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IN THE HIGH COURT OF JUDICATURE AT MADRAS

Reserved On : 29.08.2022

Pronounced on : 01.09.2022

CORAM

THE HONOURABLE MR. JUSTICE R. MAHADEVAN
AND
THE HONOURABLE MR. JUSTICE MOHAMMED SHAFFIQ

W.A. Nos.1512 of 2021, 60, 1249 and 1385 of 2022
and
C.M.P.Nos.9630 of 2021, 6242 and 8950 of 2022

W.A. No.1512 of 2021
State Bank of India,
RACPC, OMR,
New No.4/952, 4/952A, III Floor,
Rajiv Gandhi Salai, Perungudi,
Chennai – 96,
represented by its Chief Manager. .. Appellant

Vs

1.The Tax Recovery Officer,
Income Tax Department,
TRO-1/Coimbatore.

2.The Sub Registrar,
Selaiyur,
Kanchipuram District.

3.The Sub Registrar,
Joint-I, South Chennai,
Saidapet, Chennai – 15.

4.V.Balasubramaniam

5.J.Swetha .. Respondents

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PRAYER :Writ Appeal filed under Section 15 of Letter Patent praying to set aside the order dated 27.04.2021 passed in W.P.No.5857 of 2018.

For Appellant : Mr.M.L.Ganesh

For R-1 : Mr.A.P.Srinivas

W.A. No.60 of 2022

Aditya Birla Finance Limited,
Having its registered office at
Indian Rayon Compound, Veraval,
Gujarat – 362 266 and a branch at
Sai Sadhan, Ground Floor, TS 125 (North Phase),
SIDCO Estate, Ekkaduthankal, Chennai – 600032,
Represented by its Regional Manager Legal and authorised
Officer, V.Thiyagarajan. .. Appellant

(Cause title accepted vide Court order dated 04.01.2021 made in C.M.P.No.21738 of 2021 in W.A.SR.No.115143 of 2021)

Vs

1.The Deputy Commissioner of Income Tax,
Circle 3(1) No.44, William Cantonment,
Tiruchirapalli.

2.The Assistant Commissioner of Income Tax,
Central Circle 11(1), Room No.122,
1st Floor, Investigation Wing,
46, Nungambakkam High Road,
Chennai – 600 034.

3.The Joint Sub-Registrar,
Chennai Central Joint-I,
Sub Registrar Office,
Mylapore,
Chennai – 600 004.

4.Dr.A.M.Arun (Died)
5.A.Meera

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6.A.M.Rajeshwari
7.Bala Yudhis Murugaiah
8.Tharana Arun .. Respondents

(R-6 to R-8 brought into record as LRs of the deceased 4th Respondent (Dr.A.M.Arun) vide Court order dated 09.03.2022 made in C.M.P.No.3715 of 2022 in W.A.No.60 of 2022)

PRAYER :Writ Appeal filed under Section 15 of Letter Patent praying to set aside the common order dated 31.08.2021 passed in W.P.No.25325 of 2017.

For Appellant : Mr.Vijay Narayan,
Senior Counsel
for Mr.Rahul Unnikrishnan

For Respondents : Mr.A.P.Srinivas
Senior Panel Counsel for R-1 and R-2

Mr.S.Ravikumar,
Special Government Pleader for R-3

R-4 – died
M/s.Tanya Kapoor for R-5 to R-8

W.A. No.1249 of 2022

Janata Sahakari Bank Limited,
Represented by its authorized signatory,
Bhushan Govind Kulkarni,
1444, Shukrawar Peth,
Thorale Bajirao Road, Pune 411 002. .. Appellant

Vs

Tax Recovery Officer VII,
Income Tax Department,
Company Range IV,
121, MG Road, Chennai – 600034. .. Respondent

PRAYER :Writ Appeal filed under Section 15 of Letter Patent praying to set aside the order dated 19.07.2021 passed in W.P.No.15437 of 2014.

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For Appellant : Mr.Sathish Parasaran, senior counsel,
for Mr.B.N.Suchindran

For Respondent : Mr.A.P.Srinivas

W.A. No.1385 of 2022

Tax Recovery Officer,
Income Tax Department,
Room No.35, 1st Floor,
Main Building,
63, Race Course Road,
Coimbatore – 641 018. .. Appellant

Vs

1.Union Bank of India,
Regional Office, 649/650,
Represented by Chief Manager,
Oppanakara Street,
Coimbatore – 641 001.

2.Sub Registrar,
Sub-Registrar Office No.02,
Tirupur, Tirupur District.

3.M/s.Beetle Exports No.17, SRP Nagar,
2nd Cross, Bharathi Park,
Saibaba Colony,
Coimbatore – 641 011.

4.V.Balasubramaniam
5.J.Swetha .. Respondents

PRAYER :Writ Appeal filed under Section 15 of Letter Patent praying to set aside the order of the learned Judge made in W.P.No.1251 of 2018 dated 21.04.2021.

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For Appellant : Mr.A.P.Srinivas

For Respondents : Mr.Srinath Sridevan for R-1

Mr.S.Ravikumar,
Special Government Pleader for R-2

COMMON JUDGMENT

MOHAMMED SHAFFIQ, J.

The common question that arises for consideration in the batch of writ appeals, relates to the scope and ambit of Section 281 of the Income Tax Act, 1961 (hereinafter shortly referred to as "the Income Tax Act") vis-a-vis, Section 26E of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (in short, "the SARFAESI Act") and Section 31B of the Recovery of Debts and Bankruptcy Act, 1993.

2. There are four writ appeals viz., W.A.Nos.1512 of 2021, 60 of 2022, 1249 of 2022 and 1385 of 2022, out of which, W.A.Nos. 60 of 2022, 1249 of 2022 and 1512 of 2021 are filed by the Bankers/Financial institutions challenging the orders of a learned Judge in W.P.Nos.25325 of 2017, 15437 of 2014 and 5857 of 2018, wherein it was held that the dues of the Income Tax Department would take precedence over the dues of the secured creditor, though Section 26 E of the SARFAESI Act and Section 31 B of the Recovery of Debts and Bankruptcy Act, expressly provides/grants priority in payment of debts due

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to a secured creditor over all other debts including revenues, taxes, cesses, etc. The learned Judge proceeded on the basis that tax being an attribute of sovereignty and a necessity for attaining the constitutional goals and objectives, tax dues would prevail and take precedence over the rights of the secured creditors. To arrive at the said conclusion, reliance was placed upon the "doctrine of constitutional priority".

3. On the other hand, it is the Tax Recovery Officer who has come up with W.A.No.1385 of 2022, challenging the order of another learned Judge in W.P.No.1251 of 2018, wherein, it was held that Section 281 of the Income Tax Act does not create a charge much less one preferential to the revenue overriding/prevailing over Section 26 E of the SARFAESI Act and Section 31 B of the Recovery of Debts and Bankruptcy Act. The learned Judge proceeded on the premise that the charge was created only when the property was attached by the Revenue / Income Tax Department and when a valid charge exists prior to the attachment, reliance on Section 281 of the Income Tax Act would not serve to disturb the right of the secured creditor under Section 26E of the SARFAESI Act and Section 31 B of the Recovery of Debts and Bankruptcy Act.

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4. There are conflicting views expressed by two learned Judges of this Court, while the first view being that the Revenue would have precedence over all other dues on the basis of the "Doctrine of constitutional priority", (for the sake of ease of reference, we shall refer to this order as the "first view"), the other learned Judge has taken a view, which appears to be diametrically opposite (for the sake of ease of reference, we shall refer to this order as the "second view") holding that Section 281 of the Income Tax Act by itself does not create a charge, in any view Section 26 E of the SARFAESI Act and Section 31 B of the Recovery of Debts and Bankruptcy Act, puts the issue of priority of charge beyond the pale of any doubt in favour of the secured creditors even where the competing claim is that of taxes, revenues etc. It may be relevant to note that the entitlement of the Bankers/ Financial Institutions in these four Writ Appeals to the benefit of priority in payment over other debts in terms of Section 31 B of Recovery of Debt and Bankruptcy Act and under Chapter IV A and more particularly, Section 26 E of the SARFAESI Act, remains undisputed. The only issue that has been raised for consideration is the impact of Section 281 of the Income Tax Act, 1961, vis-a-vis Section 31B of Recovery of Debt and Bankruptcy Act and Section 26 E of the SARFAESI Act.

5. Before proceeding further, we may narrate the facts and submissions made by the learned counsel appearing for all the parties, which run thus:

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5.1.1. Mr.Vijay Narayan, learned Senior counsel for the appellant in WA.No.60 of 2022 contended that the appellant, which is a non-banking financial company, had extended financial assistance to the respondents 4 and 5 on the basis of the mortgage created over the properties in their favour by executing mortgage deeds dated 23.04.2013, 18.08.2014 and 22.10.2015, but the borrowers defaulted in payment of loan amount, as a result of which, arbitration proceedings were initiated and during the course of the said proceedings, the borrowers admitted their liability and expressed their willingness to sell the mortgaged properties for realisation of the dues to the appellant. At that time, the appellant came to know about the provisional order of attachment passed by the second respondent on 03.11.2015 over the mortgaged properties for the tax dues payable by the borrowers and their group entities/companies. Due to the attachment of the mortgaged properties, the appellant being unable to recover the dues payable by the borrowers, preferred WP.No.25325 of 2017, which was dismissed by the learned Judge. Therefore, this writ appeal viz., WA.No.60 of 2022.

5.1.2. Elaborating further, the learned senior counsel appearing for the appellant submitted that Section 26E of the SARFAESI Act provides that the debts due to any secured creditor shall be paid in priority over all other debts and all revenues, taxes, cesses and other rates payable to the Central Government or

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State Government or local authority. While so, the observation of the learned Judge that at the time of mortgaging the properties by the borrowers in favour of the appellant, the assessment proceedings for the assessment years 2009-10, 2010-11 and 2011-12 were pending and therefore, the mortgages becomes null and void by virtue of section 281 of the Income Tax Act, is contrary to section 26E of the SARFAESI Act. Adding further, the learned senior counsel submitted that the learned Judge having observed that the department has a priority over the debts of the Bank, has directed the appellant to approach the competent Authority under the Income Tax Act, which is nothing but an exercise of futility/ empty formality. It is also submitted that the properties belonging to the borrowers were mortgaged with the appellant prior to the order of attachment passed by the second respondent on 03.11.2015 and hence, the said attachment is non-est / invalid. In such event, the learned Judge ought to have held that the appellant has a priority over taxes / dues under the Income Tax Act. In this context, the learned counsel placed reliance on the decision of the Andhra Pradesh High Court in ***ICICI Bank Limited v. Tax Recovery Officer and others [2019 411 ITR 518 (T&AP)]*** wherein it was held that the Income Tax Act does not provide for any primacy to income tax dues over that of the Government dues and priority of crown debts is only over unsecured debts.

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5.1.3. The learned Senior counsel appearing for the appellant further contended that the learned Judge, in his order, has invoked the "*constitutional priority doctrine"* which does not exist. According to the learned Senior counsel, invoking a non-existing doctrine to reject the claim of the appellant is not proper. In this connection, the learned Senior counsel placed reliance on the decision in ***Dena Bank v. Bhikabhai Prabhudas Parekh & Co. and others [(2000) 5 Supreme Court Cases 694]*** in which the Hon'ble Supreme Court expressly provided that the interest / priority of secured creditors would prevail over the doctrine of priority of crown debts.

5.1.4. The learned Senior counsel for the appellant also contended that secured creditors always have priority over government debts. To lend support to this submission, he placed reliance on the decision of the Full Bench of this Court in **Assistant Commissioner of Commercial Tax and others v. Indian Overseas Bank and others [2016 (6) CTC 769]** wherein it was held that in view of Section 31 B of the Recovery of Debts and Bankruptcy Act, introduced by Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, the right of the secured creditors to realise the debts by way of sale of assets will have priority over all debts and government dues including revenues, taxes, cesses and rates due to the Central Government, State Government or Local Authority. The learned Senior

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counsel further referred to another order of the Full Bench of this Court in ***UTI Bank Limited v. Deputy Commissioner of Central Excise and another [(2007) 135 CC 329 (Mad)].*** In the light of the said decisions, the order of attachment passed by the Tax Recovery Officer subsequent to the mortgage deeds executed in favour of the appellant is not a bar for the appellant to proceed with the sale of the mortgaged properties in the light of section 26E of the SARFAESI Act. Therefore, the learned senior counsel sought to allow this writ appeal by setting aside the order of the learned Judge.

5.1.5. Per contra, Mr.A.P.Srinivas, learned Standing Counsel for the respondents 1 and 2 in WA.No.60 of 2022 would contend that the question of validity of mortgage to the secured creditor will depend on whether such mortgage in favour of the secured creditor was created during the pendency of any proceeding under the Income Tax Act, 1961. Therefore, the determining factor, according to the learned counsel, is whether any proceedings were pending when the mortgage was created in favour of the secured creditor. In this context, the learned counsel placed reliance on the decision of the Honourable Supreme Court in ***Central Bank of India v. State of Kerala and others) [2009 (4) Supreme Court Cases 94]*** wherein, it was held that statutory first charge created in favour of the State under Section 26 B of the Kerala Act has primacy over the rights of the Bank to recover its dues.

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5.1.6. The learned Senior Standing Counsel for the respondents 1 and 2 submitted that as per Section 281 of the Income Tax Act, whether proceedings are pending before the Department or not, is the determinative factor in deciding the priority. The question of validity of mortgage to the secured creditor will depend on whether such mortgage in favour of the secured creditor was created during the pendency of any proceedings under the Income Tax Act or not. The learned Judge, taking note of the fact that at the time of mortgage, the income tax proceedings relating to the Assessment Years 2009 - 10, 2010 - 11 and 2011 - 12 were pending, has rightly declared the mortgage as null and void, in view of Section 281 of the Income Tax Act. Stating so, the learned Senior Standing Counsel prayed this Court for dismissal of the writ appeal.

5.1.7. Ms.Tanya Kapoor, learned counsel for the respondents 5 to 8 would submit that Section 26E of the SARFAESI Act came into force only on 24.01.2020; and there was no law before these amendments to give priority to the secured creditor over other debts. In this context, the learned counsel placed reliance on the decision of the ***Chattisgarh State Co-operative Marketing Federation Limited v. Bank of Baroda [2020 SCC ONLINE Chh 1271]*** and contended that the Central Government issued notification dated 26.12.2019 and Sections 17 to 19 of the SARFAESI Act came into effect. Therefore, there was no law before these amendments giving priority to the debts of the secured

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creditor. The learned counsel further submitted that the appellant's right to enforce the secured debt accrues only upon default by the borrowers and after realisation of the dues by the Income Tax Department. Thus, the appellant has no right to enforce the secured debt and that the Income Tax Department alone has a priority to do so. Therefore, the learned counsel prayed for dismissal of this appeal.

5.2.1. Mr.Satish Parasaran, learned senior counsel for the appellant in WA.No.1249 of 2022 submitted that the appellant had sanctioned loan to M/s.NEPC Agro Foods Ltd after executing a mortgage deed dated 11.12.1998 in respect of the property at Ambattur, in which, M/s.NEPC India Ltd (formerly known as NEPC Micon Ltd) stood as corporate guarantor. Both companies failed to repay the loan amount, which compelled the appellant to initiate the SARFAESI proceedings. After taking possession of the subject property, the appellant received a letter dated 27.12.2007 from the respondent / Tax Recovery Officer -VII that the subject property was purportedly attached by the Income Tax Department on 18.06.2003 towards the alleged outstanding tax arrears payable by M/s.NEPC Agro Foods Ltd. It is submitted by the learned senior counsel that the said attachment started reflecting on the encumbrance certificate only with effect from 31.12.2007 after the appellant took possession of the property.

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5.2.2. Continuing further, the learned senior counsel for the appellant submitted that the respondent has erroneously proceeded on the basis that the assessee in default is NEPC Agro Foods Ltd. However, from the assessment orders, it can be seen that all the proceedings under the Income Tax Act, 1961 were initiated against the corporate guarantor / NEPC India Ltd, which was earlier known as NEPC Micon Ltd. The assessment orders viz., dated 29.03.1996 for the AY 1993-94, dated 27.03.1997 for the AY 1994-95, dated 25.09.1998 for the AY 1995-96 and dated 30.03.1999 for the AY 1996-97 were all issued to NEPC Micon Ltd. The appellant bank has taken possession of the property owned by NEPC Agro Foods Ltd, which is a distinct and separate legal entity from NEPC India Ltd. In the absence of any proceedings against NEPC Agro Foods Ltd and/or claim by the respondent over its property, the order of attachment passed by the respondent asserting rights over the subject property, is illegal and unlawful and the same ought to have been set aside. However, the learned Judge erroneously dismissed the writ petition bearing No.15437 of 2014 filed by the appellant, by holding that the crown debts will have priority over the debts of the appellant, who is a secured creditor, by order dated 19.07.2021 impugned herein, which is liable to be set aside, according to the learned senior counsel.

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5.2.3. On the other hand, the learned senior standing counsel appearing for the respondent department in WA.No.1249 of 2022 submitted that all the assessment orders pertain to the NEPC Group and the properties belong to the Directors of NEPC and the Directors are same in all the entities. Hence, it is incorrect to state that in respect of the proceedings initiated against NEPC India Ltd, the properties of NEPC Agro, cannot be attached. It is also contended that the dates of mortgage and other things are factual and hence, the appellant can go before the TRO under rule 11, Second Schedule, to decide the facts, as rightly held by the learned Judge. The learned counsel further submitted that Section 281 merely declares the mortgage to be invalid and reliance placed on the decision of the Andhra Pradesh High Court in ***ICICI Bank*** case may not be proper, as it never considered the judgment of the Madras High Court in ***Abdul Jamil & Ors v. The Secretary, Income Tax [1998 (1) CTC 547]***. Therefore, according to the learned counsel, the order of the learned Judge does not require any interference at the hands of this court.

5.3.1. Mr.A.P.Srinivas, the learned standing counsel for the appellant in WA.No.1385 of 2022 submitted that the assessment notice under section 143(2) was issued on 08.08.2013; demand was raised by the department through assessment order dated 31.03.2015; after issuance of several demand notices to

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the assessee / defaulters, the subject properties were attached by the Tax Recovery Officer on 27.03.2017; and section 281 of the Income Tax Act declares as void any transfer made by the assessee during the pendency of proceedings under the Act. Therefore, the attachment of the immovable property made by the Tax Recovery Officer to secure the dues of the department is legal, lawful and not perverse. It is also submitted that the overriding powers in terms of section 35 of the SARFAESI Act, can be applied by the bank only if it has valid mortage on the properties. It is further submitted that the priority provision under the SARFAESI Act has no relevance to this case and on the other hand, the question is whether the mortage in favour of the bank during the pendency of the assessment proceedings is void as per section 281 of the Income Tax Act. Therefore, the learned counsel submitted that the order of the learned Judge in holding that in view of section 26E of the SARFAESI Act, the mortgage created in favour of the respondent bank, will not be hit by the rigour of section 281 of the Income Tax Act, warrants interference by this court.

5.3.2. Per contra, according to Mr. Srinath Sridevan, learned counsel for the respondent bank in WA.No.1385 of 2022, section 281 does not obstruct the case of the respondent bank. The learned counsel further submitted that the assessment proceedings were pending with respect to M/s. Betel Exports, whereas the mortgage was executed by the different individual assessees. In

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support of the same, reliance was placed on the decision of the Hon'ble Supreme Court in ***CIT v. A.W.Piggies Messrs & Co. and others [AIR 1953 SC 455]***, in support of the proposition that the firm and its partners are independent assessees. It is also submitted that there is no provision under the Income Tax Act, which creates charge over the property of the defaulter. Thus, the learned counsel submitted that Section 26E will save the assessee's case, as it was notified on 26.12.2019 with effect from 24.01.2020. The learned counsel also referred to the judgment in ***State Bank of India v. State of Maharastra [2020 SCC OnLine Bom 4190]***, in which, the Bombay High court, relying on the judgment of the Madras High Court in ***Assistant Commissioner of Commercial Tax & Ors v Indian Overseas Bank & Ors [(2016) 6 CTC 769]*** held that secured creditor gets priority over the tax dues. Therefore, the learned counsel prayed for dismissal of this writ appeal.

5.4.1. Mr.M.L.Ganesh, learned counsel for the appellant in WA.No.1512 of 2021 submitted that the respondents 4 and 5 viz., Balasubramaniam and Swetha had availed housing loan facility to purchase the secured property and accordingly created equitable mortgage in favour of the appellant Bank on 07.02.2016 and 28.01.2016. However, they failed to repay the loan, which compelled the appellant to issue demand notice under Section 13(2)

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of the SARFAESI Act and thereafter, possession notice under section 13(4), but the sale notice issued by the appellant bank to bring the secured property for auction, could not succeed, since the first respondent / ITO had attached the property with the office of the respondents 2 and 3 for income tax dues on 16.06.2017. Feeling aggrieved, the appellant preferred WP.No.5857 of 2018, which was dismissed by the learned Judge, by holding that the mortgage created in favour of the appellant by the respondents 4 and 5 was void in view of section 281 of the Income Tax Act. Therefore, this writ appeal.

5.4.2. According to the learned counsel for the appellant, though the demand notice was issued on 31.03.2015, the first respondent has chosen to attach the security asset only on 16.06.2017, i.e., subsequent to the purchase of the secured asset by the respondents 4 and 5 on 22.09.2015 and 23.10.2015 and hence, there is no intent on the part of the respondents 4 and 5 to defraud the revenue and there is no illegal transfer or mortgage and the said equitable mortgage in favour of the appellant bank is for valuable consideration covered under proviso to sub section (1) of section 281 of the Income Tax Act. Adding further, the learned counsel submitted that the loan was availed by the respondents 4 and 5, whereas, the assessee in question is a different entity viz., M/s. Beetle Exports in which the respondents 4 and 5 are partners. Admittedly, the property was bought out of loan and thus, the borrowers were not the owners

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of the property as on the date of attachment. Therefore, section 281, which stipulates that any mortgage or transfer is made in any manner, then all such transfers, mortgage, gift, etc, became void, does not apply to this case. Referring to the decision of the Gujarat High Court in ***TRO v. Industrial Finance Corporation of India and others [MANU/GJ/0675/2011]***, the learned counsel submitted that the appellant holds the first charge over the property in view of section 26E of the SARFAESI Act.

5.4.3. Per contra, the learned standing counsel appearing for the first respondent submitted that the mortgage in favour of the appellant in WA.No.1512 of 2021 was subsequent to notice and thus, it is covered by section 281 of the Income Tax Act. It is also submitted that the judgment of the Gujarat High Court relied on by the appellant has been dissented by a learned Judge of this court in ***D.S.Sakthivel v. Tax Recovery Officer [MANU/TN/2308/2018]*** which referred to its earlier judgments in ***Palani Gounder (Dead) & Ors v Income Tax Revenue Department [(1998) 229 ITR 59]*** and ***Abdul Jamil & Ors v. The Secretary, Income Tax [1998 (1) CTC 547]*** to hold that mortgage will be invalid when the proceeding is pending. Stating so, the learned counsel prayed for dismissal of this writ appeal.

6. In the above background, the following questions arise for consideration in these appeals:

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a) What is the nature of taxes and the right of the State to recover the same?

b) Whether fiscal/tax legislations provide for a charge in respect of the taxes/revenues that are due; and if so, what are the kind/nature of charges created in fiscal/tax legislations and its status?

c) Whether Section 281 of the Income Tax Act only contains a declaration of voidity in respect of transactions falling within its mischief or does it create a charge in respect of any sum payable under the Income Tax Act in favour of the Revenue and what is the scope of operation of Section 281 of the Income Tax Act and its input vis-a-vis Section 26 E of the SARFAESI Act and Section 31 B of the Recovery of Debts and Bankruptcy Act and whether the priority of charge created in favour of the secured creditors under the SARFAESI Act and the Recovery of Debts and Bankruptcy Act would prevail over the declaration of voidity contained in Section 281 of the Income Tax Act or any other recovery proceedings including attachment under the Income Tax Act?

7. We shall now proceed to answer the above questions in *seriatim*.

a)What is the nature of taxes and the right of the State to recover the same?

8.1. The above question has been the subject matter of consideration on numerous occasions including Constitution Benches of the Hon'ble Supreme

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Court. We do not intend to multiply case laws as the legal position insofar as the above question is well settled. It is axiomatic that power to collect tax is an inherent attribute and an incident of sovereignty. The legislature of every State will possess the power to tax under the general grant of legislative power. Importantly, but for the limitation imposed under the Articles of the Constitution, the power to tax would be unfettered. In other words, the Articles under the Constitution are not the source of power to tax, but serve as limitation on the power to tax which would otherwise be unfettered.

8.2. Taxes are collected for public good and meant for being used by the Government in discharging its constitutional obligation for public welfare and common public good and to further the directive principles enshrined under the Constitution as held in ***Srinivasa Theatre and others v. Government of Tamil Nadu and others [1992(2) SCC 643]***. In this regard, it may be relevant to refer to the following judgments to appreciate the status and purpose of tax under the Constitution. The relevance and importance of power to tax was examined by the Constitution Bench of 9 Judges in the recent case in **Jindal Stainless Ltd v. State of Haryana [(2017) 12 SCC 1]** while examining the validity of the Entry Tax and it was held as under:

*"**67.1.**…… A tax is a compulsory exaction of money for general public good and is defined as under by Thomas M.*

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Cooley in his book The Law of Taxation at p. 61 (Clark A. Nichols ed., 4th Edn. 1924) as:

"Taxes are the enforced proportional contributions from persons and property, levied by the State by virtue of its sovereignty for the support of Government and for all public needs……."

***

…….The power of taxation is said to be an incident of sovereignty, and co-extensive with that of which it is incident."

*"**112.2.** Secondly, because levy of taxes is both an attribute of sovereignty and an unavoidable necessity. No responsible Government can do without levying and collecting taxes for it is only through taxes that Governments are run and objectives of general public good achieved. Dealing with power of taxation, Cooley says:*

> *"Taxes are defined to be burdens or charges imposed by the legislative power upon persons or property, to raise money for public purposes. The power to tax rests upon necessity, and is inherent in every sovereignty. The legislature of every free State will possess it under the general grant of legislative power, whether particularly specified in the Constitution among the powers to be exercised by it or not. No constitutional government can exist without it, and no arbitrary Government without regular and steady taxation could be anything but an oppressive and vexatious despotism, since the only alternative to taxation would be a forced extortion for the needs of Government from such persons or objects as the men in power might select as victims."*

8.3. The above extract would clearly show that the power to tax is an inherent part and an attribute of sovereignty and is meant for being used for public welfare. Without taxes, the Government cannot run nor discharge its constitutional obligations set out in the form of Directive Principles of State

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Policy under Article 39 of the Constitution. In other words, taxes are collected in public interest and the taxes so collected cannot be used for any purpose other than common public good.

9.1. Having dealt with the status and purpose of tax under the Constitution, it may be relevant to examine the priority of collection of taxes.

Doctrine of priority of Crown Debts

Tax dues are normally referred to as "Crown Debt". The position insofar as priority of Crown Debt could be summarised as under:

a. The principle of priority of Government debts is founded on the rule of necessity and public policy.

b. Between an unsecured creditor and crown debt, it is the crown debt which would prevail as held by the Constitution Bench in the case of ***Builders Supply Corporation reported in AIR (1965) SC 1061***.

c. Between a secured creditor and a crown debt, the secured creditor would have priority over the crown debt in the absence of any provision which provides for priority in favour of the State's claim.

d. If the legislation provides for a charge or a priority, then, if the crown debt and the private secured creditor concurs in point of time, the crown debt would prevail. If the private secured creditor is prior in time that would prevail. If the State's charge is prior in time, then the State's charge would prevail.

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e. If a "first charge" or a "priority" is provided/granted under the provisions of the Act or if it is expressly provided to override other claims including that of secured creditors, then it appears that it would be the State which would be entitled to preference even over secured creditors.

9.2. In this regard, it may be relevant to refer to the judgment of the Hon'ble Supreme Court in ***Dena Bank Vs. Bhikhabhai Prabhudas Parekh and Co. and others [(2000) 5 SCC 694]***, wherein the Crown's preferential right to recovery of debts over other creditors was explained as under:

> "***10.****However, the Crown's preferential right to recovery of debts over other creditors is confined to ordinary or unsecured creditors. The common law of England or the principles of equity and good conscience (as applicable to India) do not accord the Crown a preferential right for recovery of its debts over a mortgagee or pledgee of goods or a secured creditor. It is only in cases where the Crown's right and that of the subject meet at one and the same time that the Crown is in general preferred. Where the right of the subject is complete and perfect before that of the King commences, the rule does not apply, for there is no point of time at which the two rights are at conflict, nor can there be a question which of the two ought to prevail in a case where one, that of the subject, has prevailed already. In Giles v. Grover [(1832) 131 ER 563 : 9 Bing 128] it has been held that the Crown has no precedence over a pledgee of goods. In Bank of Bihar v. State of Bihar [(1972) 3 SCC 196 : AIR 1971 SC 1210] the principle has been recognised by this Court holding that the rights of the pawnee who has parted with money in favour of the pawnor on the security of the goods cannot be extinguished even by lawful seizure of goods by making money available to other creditors of the pawnor without the claim of the pawnee being first fully satisfied. Rashbehary Ghose states in Law of Mortgage (TLL, 7th Edn., p. 386) — "It seems a government debt in India is not entitled to precedence over a prior secured debt." "*
>
> (emphasis supplied)

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9.3. The above position has been reiterated by the Hon'ble Supreme Court time and again and we do not intend to burden the judgment by multiplying case laws except to state that the above view has not been doubted much less a contrary view having been expressed.

b) Whether fiscal/tax legislations provide for a charge in respect of the taxes/revenues that are due and if so, what are the kind/nature of charges created in fiscal/tax legislations and its status?

10. Under common law, priority of crown debts would prevail only over unsecured creditors and would not have precedence over a secured debt. It appears that the legislature being conscious of the above limitation, while framing fiscal/taxing statutes, had incorporated provisions providing for a charge over the property of the defaulter, while also declaring that it shall have priority/preferential right for recovery through legislations, which has taken different forms. Barring a few tax legislations, the majority of fiscal/tax legislations have incorporated provisions providing for priority or creating a charge in respect of dues under the said enactment. In this regard, it may be relevant to refer to some of the provisions under the fiscal/tax laws which provide for charges in different forms. However, before that, it may be relevant to note that the provisions of the Central Excise Act, 1944 and the Customs Act, 1962 originally did not contain any provision creating a charge in respect of dues

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under the said enactments. A Full Bench of this Court in ***UTI Bank Ltd v. Deputy Commissioner Central Excise [(2006) 5 CTC 801]*** held that in the absence of any provision creating a charge, the Revenue's right to recovery, must yield to the right of a secured creditor to recover his dues. The relevant portion of the said Full Bench judgment reads as under:

> *"26.In the light of the above discussion, we conclude,*
>
> *(i)Generally, the dues to Government, i.e., tax, duties, etc., (Crown's debts) get priority over ordinary debts.*
>
> *(ii)Only when there is a specific provision in the statute claiming "first charge" over the property, the Crown's debt is entitled to have priority over the claim of others.*
>
> *(iii)Since there is no specific provision claiming "first charge" in the Central Excise Act and the Customs Act, the claim of the Central Excise Department cannot have precedence over the claim of secured creditor, viz., the petitioner Bank.*
>
> *(iv)In the absence of such specific provision in the Central Excise Act as well as in Customs Act, we hold that the claim of secured creditor will prevail over Crown's debts."*
>
> *In view of our above conclusion, the petitioner UTI Bank, being a secured creditor is entitled to have preference over the claim of the Deputy Commissioner of Central Excise, first respondent herein."*

11. At this juncture, it may be relevant to note that a specific provision creating a first charge in respect of the dues under the Central Excise Act, 1944 and the Customs Act, 1962, was inserted after the above order of the Full Bench of this Court. The said provision under the Customs Act reads as under, similar

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provision introduced under the Central Excise Act is not extracted to avoid being repetitive as the provision under the Central Excise Act is identical.

> *"142A. Liability under Act to be first charge.—Notwithstanding anything to the contrary contained in any Central Act or State Act, any amount of duty, penalty, interest or any other sum payable by an assessee or any other person under this Act, shall, save as otherwise provided in section 529A of the Companies Act, 1956 (1 of 1956), the Recovery of Debts Due to Banks and the Financial Institutions Act, 1993 (51 of 1993) and 2 [the Securitisation and Reconstruction of Financial Assets and the Enforcement of Security Interest Act, 2002 (54 of 2002) and the Insolvency and Bankruptcy Code, 2016 (31 of 2016).]*

12.1. It may also be relevant to take note of some of the other tax legislations, wherein, a statutory charge has been created in respect of the tax dues under the respective enactment, which are as follows:

> ***Madhya Pradesh General Sales Tax Act, 1958:***
>
> *"33-C. Tax to be first charge.— Notwithstanding anything to the contrary contained in any law for the time being in force, any amount of tax and/or penalty, if any, payable by a dealer or other person under this Act shall be a first charge on the property of the dealer or such person."*

> ***Section 11-AAAA was introduced in the Rajasthan Sales Tax Act, 1954 by way of an amendment in 1989 and the same reads thus:***
>
> *"11-AAAA. Liability under this Act to be the first charge.— Notwithstanding anything to the contrary contained in any law for the time being in force, any amount of tax, penalty, interest and any other sum, if any, payable by a dealer or any other person under this Act, shall be the first charge on the property of the dealer, or such person."*

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Section 42 of TNVAT Act creates a charge subject to exceptions, reads as follows:

42. Payment and recovery of tax, penalty, etc.-

(1) Save as otherwise provided for in Section 21, the tax assessed or has become payable under this Act from a dealer or person and any other amount due from him under this Act shall be paid in such manner and in such instalments, if any, and within such time as may be specified in the notice of assessment, not being less than thirty days from the date of service of the notice. The tax under Section 21 shall be paid without any notice of demand. In default of such payment, the whole of the amount outstanding on the date of the default shall become immediately due and shall be a charge on the properties of the person or persons liable to pay the tax or penalty or interest under this Act.

(2) Any tax assessed on or has become payable by, or any other amount due under this Act from a dealer or person and any fee due from him under this Act, shall, subject to the claim of the Government in respect of land revenue and the claim of the Agriculture and Rural Development Bank in regard to the property mortgaged to it under sub-section (2) of Section 28 of the Tamil Nadu Co-operative Societies Act, 1983 (Tamil Nadu Act 30 of 1983), have priority over all other claims against the property of the said dealer or person and the same may without prejudice to any other mode of collection be recovered,-

(a) as land revenue, or

(b) on application to any Magistrate, by such Magistrate as if it were a fine imposed by him:

12.2. We may note that while the Madhya Pradesh and Rajasthan Sales Tax Acts provide for "first charge" in favour of the tax dues, the TNVAT Act, while providing for a "charge", does not create a first charge rather makes it subject to

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certain claims. Now, a first charge has been held to prevail even over existing charges/mortgages, which would apply to the Madhya Pradesh and Rajasthan enactments, but not to the TNVAT Act as it merely creates a charge, which, as stated above, is subject to other claims mentioned therein. In this regard, it may be relevant to refer to the judgment of the Hon'ble Supreme Court in ***State Bank of Bikaner and Jaipur v National Iron and Steel Rolling Corporation***, reported in ***(1995) 2 SCC 19***, wherein, the scope of 1st charge was explained as under:

> *"10. The section creates first charge on the property, thus clearly a statutory charge mortgage. created by The giving priority to the property statutory including first a charge over all other charges submission, therefore, on that the section 11AAAA the Rajasthan of Sales Tax Act operate only over the equity of redemption, cannot can be accepted. The charge operates on the entire property of the dealer including the interest of the mortgage therein."*

12.3. Thus, it is evident that the legislature has provided provisions for creating charge over the property of the defaulter in tax enactments, some of which has been extracted above, with a view to enable recovery of the tax dues. The above legislative device/practice also reflects legislative recognition of the fact that in the absence of provision providing for statutory charge, the recovery mechanism may suffer from inadequacy/deficiency, when pitted against secured creditors.

13. We find that the recovery mechanism under the Income Tax Act suffers from the above deficiency, in the absence of a provision creating a charge

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in respect of the property of the defaulter to enable recovery of their dues arising out of the above enactment. We say so, for in contrast to other tax enactments referred to above, we do not find any provision under the Income Tax Act, which creates a charge in respect of tax or any sums that may become payable under the same. This aspect ought to be borne in mind for we find that both the learned Judges have proceeded on the basis that they had to decide the "priority of charge" under the Income Tax Act vis-a-vis SARFAESI Act and Recovery of Debts and Bankruptcy Act, while the first view proceeds on the basis that priority must be granted to recovery of Government dues on the basis of "doctrine of constitutional priority", the second view proceeds on the basis that attachment results in creation of charge and if the same is subsequent to mortgage, the right of the existing mortgagee would prevail.

14. Insofar as the first view is concerned, the law relating to the Government's right to recover dues commonly known as "Crown debt" stands resolved by a series of decisions, wherein, it has been consistently held that Crown/State would have preferential right to recover only over ordinary unsecured creditors but would not be entitled to precedence over a secured debt unless express provisions are incorporated. Therefore, reliance on "doctrine of constitutional priority" for which we do not find any basis, is in any view unsustainable as it is contrary to the settled legal position.

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15. Coming to the second view, it has been held that a charge gets created only when the attachment is made. This view is again unsustainable since attachment would not constitute a charge. In this regard, it may be relevant to refer to the decision of the Hon'ble Supreme Court in ***Kerala State Financial Enterprises Ltd. v. Official Liquidator [(2006) 10 SCC 709]*****,** which reads as under:

> ***"9....****An attachment itself does not create any charge in the property.*
>
> ***10****. The expression `attachment' has no definite connotation. An order of attachment is passed for achieving a limited purpose. It is subject to further orders as also provisions of other statute.*
>
> ***11****. The word `attachment' would only mean `taking into the custody of the law the person or property of one already before the court, or of one whom it is sought to bring before it. It is used for two purposes : (i) to compel the appearance of a defendant; and (ii) to seize and hold his property for the payment of the debt. It may also mean prohibition of transfer, conversion, disposition or movement of property by an order issued by the court."*

16.1. While, on the correctness of the divergent views expressed by the learned judges, to appreciate as to what would constitute "charge", we may have to look to the Transfer of Property Act, 1882, in particular, Section 100 of the same, which reads as under:

> "*100. Charges.—*
>
> *Where immoveable property of one person is by act of parties or operation of law made security for the payment of money to another,*

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and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property; and all the provisions hereinbefore contained [which apply to a simple mortgage shall, so far as may be, apply to such charge]. Nothing in this section applies to the charge of a trustee on the trust-property for expenses properly incurred in the execution of his trust, 2[and, save as otherwise expressly provided by any law for the time being in force, no charge shall be enforced against any property in the hands of a person to whom such property has been transferred for consideration and without notice of the charge].

The charges that have been dealt with in the above section are:

(1) Charges created by act of parties.

(2) Charges arising by operation of law.

16.2. The above provision has come up for consideration before the Hon'ble Supreme Court in ***JK (Bombay) Private Ltd v. New Kaiser-I-Hind Spinning and Weaving Co. Ltd [1970 AIR 1041]*** and the expression "charge" has been explained as under:

"While in the case of a charge, there is no transfer of interest of property or any interest therein, but only the creation of a right of payment out of the specified property, a mortgage effectuates transfer of property or an interest therein. No particular form of words is necessary to create a charge and all that is necessary is that there must be a clear intention to make a security for payment of money in presenti."

16.3. The broad distinction between a mortgage and a charge is that a charge only gives a right to payment out of a particular fund or particular property without transferring that fund or property, whereas a mortgage is in

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essence a transfer of an interest in specific immovable property. A mortgage is a *jus in rem,* a charge is a *jus ad rem* and the practical distinction is that mortgage is good against subsequent transferees and a charge is only good against subsequent transferees with notice. A charge does not amount to a mortgage. In every mortgage, there is a charge, but every charge is not a mortgage.

17. Having examined the scope of "charge", it may be relevant to note that the second view holding that an attachment creates a charge is unsustainable as 'attachment' and 'charge' are distinct and attachment does not by itself create a charge as stated supra. In any view, we find that the Income Tax Act does not create a charge towards recovery of dues. Section 281 only declares certain transactions to be void and cannot be understood as creating a charge in favour of the Income Tax Department in respect of dues arising under the same.

c)Whether Section 281 of the Income Tax Act only contains declaration of voidity in respect of transactions falling within its mischief or does it create a charge in respect of any sum payable under the Income Tax Act in favour of the Revenue and what is the scope of operation of Section 281 of the Income Tax Act vis-a-vis Section 26 E of the SARFAESI Act and Section 31 B of the Recovery of Debts and Bankruptcy Act and whether the priority of charge created in favour of the secured creditors under the SARFAESI Act and

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Recovery of Debts and Bankruptcy Act would prevail over the declaration of voidity contained in Section 281 of the Income Tax Act or any other recovery proceedings including attachment under the Income Tax Act?

18.1. To answer the above question, it may be relevant to extract Section 281 of the Income Tax Act, which reads as under:

> ***Certain transfers to be void.***
>
> *281. (1) Where, during the pendency of any proceeding under this Act or after the completion thereof, but before the service of notice under rule 2 of the Second Schedule, any assessee creates a charge on, or parts with the possession (by way of sale, mortgage, gift, exchange or any other mode of transfer whatsoever) of, any of his assets in favour of any other person, such charge or transfer shall be void as against any claim in respect of any tax or any other sum payable by the assessee as a result of the completion of the said proceeding or otherwise :*
>
> *Provided that such charge or transfer shall not be void if it is made-*
>
> > *(i) for adequate consideration and without notice of the pendency of such proceeding or, as the case may be, without notice of such tax or other sum payable by the assessee; or*
> >
> > *(ii) with the previous permission of the Assessing Officer.*
>
> *(2) This section applies to cases where the amount of tax or other sum payable or likely to be payable exceeds five thousand rupees and the assets charged or transferred exceed ten thousand rupees in value.*
>
> *Explanation.—In this section, "assets" means land, building, machinery, plant, shares, securities and fixed deposits in banks, to the extent to which any of the assets aforesaid does not form part of the stock-in-trade of the business of the assessee.*

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18.2. On a reading of section 281 of the Income Tax Act, the following

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position emerges:

a) The provision is intended to operate during the pendency of any proceeding or after the completion thereof and before the service of notice under Rule 2 of the Second Schedule to the Income Tax Act.

b) Any charge/transfer that is created during the pendency of any proceeding or after its completion under the Act and before service of notice under Rule 2 of the Second Schedule shall be *"void to the extent of any sum payable as a result of completion of the said proceedings"*.

c) The provision is a statutory declaration of any charge/transfer created by an assessee during the pendency of any proceeding or after its completion under the Act and before service of notice under Rule 2 of the Second Schedule, being void in respect of the tax or any sum payable as a result of completion of the said proceeding or otherwise.

d) The voidity though is with reference to and governs transfers during the pendency of any proceeding or after its completion under the Act and before service of notice under Rule 2 of the Second Schedule, but appears to become operational only on completion of the proceeding consequent to which sums become payable under the Act. This is apparently for the reason that there could be instances where on completion of the proceeding, there may be no liability for the voidity to operate. However, once sum becomes payable on completion of

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proceeding, the declaration of voidity would relate back and cover any transfer made prior to the completion of any proceeding under the Act.

e) Section 281 of the Income Tax Act does not create a charge. It is a negative declaration in the sense that certain transactions, viz., any charge or transfer made during the pendency of the proceeding and on completion thereof and before issuance of notice under Rule 2 of the Second Schedule are declared void to the extent of sums payable on completion of such proceeding.

f) The declaration of voidity under Section 281 of the Income Tax Act, is not absolute, but comes with exceptions, viz., that the charge/transfer though made during the pendency of proceedings under this Act or after completion but before issuance of notice, the charge/transfer, may still not be void if the same is made for adequate consideration and without notice of pendency of such proceedings or notice of such tax or sum being payable by the assessee or if the transfer is made with the previous permission of the Assessing Officer.

g) The declaration of voidity under Section 281 of the Income Tax Act, is not absolute but only in respect of any tax or sum payable by the assessee as a result of completion of proceedings under the Income Tax Act.

h) It may be relevant to note that Section 281 of Income Tax Act as it originally stood provided that charge/transfers would be void only if the same "is with an intent to defraud revenue". In other words, unless the intent behind the

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charge or the transfer was to defraud the revenue, the same would not be covered by Section 281 of the Income Tax Act, as it then stood. While examining Section 281 of the Income Tax Act, as it then stood, it was held by the Hon'ble Supreme Court in ***TRO v. Gangadhar Vishwanath Ranade [1998 (234) ITR 188 (SC)]***, as under:

> *"If the Department desires to have the transaction of transfer declared void under Section 281, the Department being in the position of a creditor, will have to file a suit for a declaration that the transaction of transfer is void under Section 281 of the Income Tax Act.*
>
> .....
>
> *14. However, the right of the Department to have the transfer declared as void under Section 281 of the Income Tax Act, as it stood at the relevant time, is not thereby taken away. We are informed that the property continues to be under attachment by virtue of interim orders passed in this appeal. The Department may, if it so desires, take appropriate proceedings in accordance with the law for having the transfer declared as void under Section 281 of the Income Tax Act."*

18.3. Section 281 of the Income Tax Act has since been amended whereby, the expressions "intent to defraud revenue" was omitted. Consequently, any transfer during the pendency of any proceeding under the Act or after completion thereof before service of notice under Rule 2 of the Second Schedule shall be void against any claim in respect of any tax or any other sum payable by the assessee as a result of completion of the said proceeding. In other words, the

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need to examine/enquire the intent of such transfer, viz., whether the charge/transfer is to defraud revenue is done away with.

19.1. There is yet another aspect which may have to be borne in mind. As stated above, the operation of Section 281 of the Income Tax Act is during the pendency of the proceeding and on completion thereof and before issuance of notice under Rule 2 of the Second Schedule, if any sum becomes payable as a result of completion of the said proceeding. This is in view of the fact that once a notice is issued under Rule 2, the Rules of the Second Schedule kicks in and governs the recovery mechanism.

19.2. To appreciate the compartmentalization of the recovery mechanism between Section 281 and the Rules of the Second Schedule of the Income Tax Act, it may be useful to refer to the decision of the High Court of Andhra Pradesh, in ***ICICI Bank Limited v. Tax Recovery Officer and others*** [***(2019) 411 ITR 518]***, wherein, while dealing with the scope of Section 281 and the Rules under the Second Schedule of the Income Tax Act, it was held as under:

> ***"24.*** *If we keep in mind the sequence of steps to be taken first by the Assessing Officer and then by the Tax Recovery Officer in terms of Section 222(1) read with Rules 2, 4, 16 and 48, it will be clear that they are compartmentalized into 3 sections, (i) the first, up to the issue of a certificate of recovery (ii) the second, from the issue of a certificate of recovery upto the attachment of the property for non compliance with the demand made under Rule 2 and (iii) the third, the voidity of all transfers from the date of the order of attachment.*

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25.*Section 281(1) operates from the stage of commencement of proceedings under the Act upto the stage of service of a notice of demand under Rule 2. Rule 16(1) operates from the stage of service of a demand under Rule 2 upto the stage of attachment. Rule 16(2) takes over from the stage of attachment. Among these 3 provisions namely Section 281(1), Rule 16(1) read with Rule 2 and Rule 16(2), only the first (Section 281) and the third (rule 16[2)) talk about voidity. Rule 16(1) merely talks about prohibition of alienation.*

26. *Therefore the only way Section 281(1) can be reconciled with sub-rules (1) and (2) of Rule 16 is to hold that up to the stage of issue of an attachment in terms of Rule 48, the transfers made by the assessee in default can be declared void only if an exercise is carried out by someone (be it the Tax Recovery Officer or a Civil Court). But after an attachment is made, the declaration of voidity under Section 281(1) becomes automatic without any further effort on the part of any one. This is in view of sub-rule (2) of Rule 16.*

27. *The conclusion that we have reached as above, is also fortified by the provisions of Rule 11 of the Second Schedule. Rule 11 empowers the Tax Recovery Officer to investigate into all claims and objections made to the attachment or sale in execution of a certificate of recovery. A detailed procedure is prescribed in sub-rules (3) and (4) of Rule 11 as to how the investigation is to be carried out. Sub-rule (5) of Rule 11 empowers the Tax Recovery Officer to disallow any claim or objection to the attachment or sale, if he is satisfied after investigation that the property was in possession of the defaulter as his own property or that the property was in possession of some other person in trust for the defaulter or that the property was in occupation of a tenant paying rent to the defaulter. If an order rejecting the claim or objection is passed by the Tax Recovery Officer under Rule 11(6), the party against whom such an order is made, may move the Civil Court to establish his right, in terms of Rule 11(6).*

28. *The procedure prescribed in Rule 11 for the investigation of claims and objections to the attachment or sale of a property, is relatable to the proviso to sub-section (1) of Section 281. It may be seen from the main part of sub-section (1) of Section 281 that the same declares all transfers and creation of charges to be void. But the proviso to sub-section (1) carves out an exception, in cases where*

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the creation of the charge or the transfer was for adequate consideration and without notice of the pendency of any proceeding under the Act. What is important to note from the proviso (i) is that the exception carved out therein may be available only up to the stage of issue of an order of attachment. The proviso (i) to sub-section (1) of Section 281 uses the words "without notice of the pendency of such proceeding". Therefore, an assessee or a transferee or a mortgagee can claim the benefit of proviso (i) only if the transfer has been made or charge created before the issue of an order of attachment, but during the pendency of the proceedings under the Act. Once an order of attachment is to be issued, then Rule 16(2) will come into play and the benefit of the proviso to sub-section (1) of Section 281 may not be available.

29. *Therefore, it is clear that the proviso (i) to sub-section (1) of Section 281 provides an escape route for innocent third parties, to whom the property of the assessee is transferred during the pendency of the proceedings, but before an attachment is ordered. This compartmentalization is very important to be noted, in view of the fact that during the pendency of the proceedings for assessment, an assessee does not become an assessee in default. Section 281(1) cannot be interpreted to mean that every assessee is likely to become an assessee in default and therefore, all transfers effected by him even before he becomes a defaulter are null and void.*

30*. Keeping in mind the fundamental premise on which the scheme of Section 281 read with Section 222 and the Second Schedule to the Act operates, let us now come back to the facts of the case. The timeline of events Part-II, which we have furnished elsewhere, shows that the 3rd respondent herein filed a return of income on 31-07-2009. His case was selected for scrutiny through CASS. Notices under Section 143(2) were issued in September 2010 and February 2011. A notice under Section 142(1) was issued on 23-02-2011. The order of assessment itself was passed only on 27-12-2011 under Section 143(3). Consequently, the demand notice under Section 156 was issued only on 27-12-2011, giving the Managing Partner of the 3rd respondent thirty days time. Even if the period of thirty days is counted from the date of the notice namely 27-12-2011, the notice period would expire on 26-01-2012. Therefore, the Managing Partner of the 3rd respondent became an assessee in default in terms*

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of Section 220(4), only on 26-01-2012. It is only thereafter that a notice ought to have been issued under Rule 2. We do not know the date on which the notice under Rule 2 was issued."

19.3. The High Court of Andhra Pradesh as a matter of fact found that the return of income for the relevant period was filed on 31.07.2009 and notices under Section 143(2) were issued on September 2010 and February 2011, the order of assessment was passed on 27.12.2011 and the demand notice under Section 156 was also issued on 27.12.2011. The assessee therein would have become an assessee in default on 26.01.2012. It was only thereafter that notice could have been issued under Rule 2. The Tax Recovery Certificate was issued on 09.01.2014 and the order of attachment was on 14.03.2018. Importantly, the mortgage has been created on 11.07.2011 much before the order of assessment. It was thus held that the rights of the mortgagee would prevail. The relevant portion of the judgment reads as under:

"31.But the mortgage was created by the third respondent in favour of the petitioner-bank on July 11, 2011, much before the order af assessment was passed under section 143(3) on December 27, 2011. In other words, the assessee was nowhere near the point of being declared as an assessee-in default on the date of creation of the mortgage. Hence, the creation of the mortgage cannot be said to have automatically become void in terms of section 281(1) merely because of the pendency of the proceedings under Sections 143 and 142. It required something more to be done, but the same was not done in this case. As a matter of fact even an investigation, under rule 11 was not carried out in this case. Therefore, the order of attachment is clearly illegal. On the date on which the order of attachment was

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passed, the property had already been sold by the petitioner-bank, in exercise of the power conferred upon the bank under the Securitisation Act, 2002.

32. It is important to note one more aspect. Section 281(1), by its very nature operates only up to the stage of service of notice under rule 2 of the Second Schedule. Therefore, section 281(1) obviously deals with a situation, which can be compared to fraudulent preferences dealt with by the insolvency laws. Therefore, what is applied to an assessee (or an insolvent under the Insolvency laws) cannot be applied to a secured creditor like the bank.

33. There appears to be no provision in the Income-tax Act. by which a first charge is created automatically on the properties of the assessees. There is no provision in the Income-tax Act, similar to section 16C of the Andhra Pradesh General Sales tax Act, 1957."

20. It may also be relevant to refer to the judgment of the Hon'ble Supreme Court in ***Connectwell Industries (P) Ltd. v. Union of India, [(2020) 5 SCC 373 : (2020) 3 SCC (Civ) 314]***, wherein, while dealing with the scope of Rule 16 of the Second Schedule to the Income Tax Act sustained the mortgage created, on finding that the mortgage was earlier in point before the restriction under Rule 16 got triggered. The relevant portion of the judgment reads as under:

"9. *It is trite law that, unless there is preference given to the Crown debt by a statute, the dues of a secured creditor have preference over Crown debts. [See : Dena Bank v. Bhikhabhai Prabhudas Parekh & Co. [Dena Bank v. Bhikhabhai Prabhudas Parekh & Co., (2000) 5 SCC 694], Union of India v. Sicom Ltd. [Union of India v. Sicom Ltd., (2009) 2 SCC 121], Bombay Stock Exchange v. V.S. Kandalgaonkar [Bombay Stock Exchange v. V.S. Kandalgaonkar, (2015) 2 SCC 1 : (2015) 1 SCC (Civ) 694], CIT v. Monnet Ispat & Energy Ltd. [CIT v. Monnet Ispat & Energy Ltd., (2018) 18 SCC 786*

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: (2019) 3 SCC (Civ) 252]]

10. *Rule 2 of Schedule II to the Act provides for a notice to be issued to the defaulter requiring him to pay the amount specified in the certificate, in default of which steps would be taken to realise them. The crucial provision for adjudication of the dispute in this case is Rule 16. According to Rule 16(1), a defaulter or his representative cannot mortgage, charge, lease or otherwise deal with any property which is subject-matter of a notice under Rule 2. Rule 16(1) also stipulates that no civil court can issue any process against such property in execution of a decree for the payment of money. However, the property can be transferred with the permission of the Tax Recovery Officer. <u>According to Rule 16(2), if an attachment has been made under Schedule II to the Act, any private transfer or delivery of the property shall be void as against all claims enforceable under the attachment.</u>*

11. *There is no dispute regarding the facts of this case. The property in dispute was mortgaged by BPIL to Union Bank of India in 2000 and DRT passed an order of recovery against BPIL in 2002. The recovery certificate was issued immediately, pursuant to which an attachment order was passed prior to the date on which notice was issued by the Tax Recovery Officer, Respondent 4 under Rule 2 of Schedule II to the Act. It is true that the sale was conducted after the issuance of the notice as well as the attachment order passed by Respondent 4 in 2003, but the fact remains that a charge over the property was created much prior to the notice issued by Respondent 4 on 16-11-2003. The High Court held that Rule 16(2) is applicable to this case on the ground that the actual sale took place after the order of attachment was passed by Respondent 4. The High Court failed to take into account the fact that the sale of the property was pursuant to the order passed by DRT with regard to the property over which a charge was already created prior to the issuance of notice on 11-2-2003. <u>As the charge over the property was created much prior to the issuance of notice under Rule 2 of Schedule II to the Act by Respondent 4, we find force in the submissions made on behalf of the appellant."</u>*

21. Thus, the judgment of the Andhra Pradesh High Court in the case of

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ICICI Bank Limited **(supra)** looked to the fact of declaration of the assessee as an assessee in default vis-a-vis the date on which the mortgage was created and the Hon'ble Supreme Court looked to issuance of notice under Rule 2 of the Second Schedule to the Income Tax Act vis-a-vis the date of creation of mortgage to resolve the question of priority. In other words, both the Andhra Pradesh High Court and the Hon'ble Supreme Court held that the secured creditor has priority since the mortgages were found as a matter of fact to have been created prior to the assessee being treated as an assessee in default or notice having been issued under Rule 2 of the Second Schedule to the Income Tax Act.

Impact of Section 281 of the Income Tax Act vis-a-vis Section 26 E of the SARFAESI Act and Section 31 B of the Recovery of Debts and Bankruptcy Act:

22.1. To understand the impact of Section 281 of the Income Tax Act vis-a-vis section 26E of the SARFAESI Act and Section 31B of the Recovery of Debts and Bankruptcy Act, it may be necessary to extract the said provisions, which reads as under:

Section 26E: Priority to secured creditors.

***26E**. Notwithstanding anything contained in any other law for the time being in force, after the registration of security interest, the debts due to any secured creditor shall be paid in priority over all other debts and all revenues, taxes, cesses and other rates payable to the Central Government or State Government or local authority.*

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Explanation.—For the purposes of this section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code.]

31B. Priority to secured creditors.—

Notwithstanding anything contained in any other law for the time being in force, the rights of secured creditors to realise secured debts due and payable to them by sale of assets over which security interest is created, shall have priority and shall be paid in priority over all other debts and Government dues including revenues, taxes, cesses and rates due to the Central Government, State Government or local authority.

Explanation.—For the purposes of this section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code.

22.2. The most important aspect of the above provisions and one which would help to resolve the controversy, viz., the impact of Section 281 of the Income Tax Act vis-a-vis Section 26E of the SARFAESI Act and Section 31B of the Recovery of Debts and Bankruptcy Act, is the effect and extent of the non-obstante clause contained in Section 26E and 31B of the SARFAESI Act and the Recovery of Debts and Bankruptcy Act, respectively. This is not the first time that the SARFAESI Act had employed non-obstante clause with a view to override other laws, even prior to Section 26E of the SARFAESI Act and Section

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31B of the Recovery of Debts and Bankruptcy Act, there were Sections 35 and section 34 of the SARFAESI Act and the Recovery of Debts and Bankruptcy Act which provided for provisions with non-obstante clauses intended to override other laws.

23.1. Before we proceed to examine the manner in which the non obstante clauses contained in the SARFAESI Act and the Recovery of Debts and Bankruptcy Act has been understood judicially, it may be relevant to set out broadly the scope of non obstante clause in general. In this regard, it may be relevant to refer to the following judgments:

Woodward Governor India P. Ltd Vs. Commissioner of Income Tax and others reported in ***(2002) 253 ITR 745***:

"A clause beginning with "notwithstanding anything" is sometimes appended to a section in the beginning with a view to give the enacting part of the section in case of conflict an overriding effect over the provision of Act mentioned in the non obstante clause (see Orient Paper and Industries Ltd. v. State of Orissa, 1991 Supp (1) SCC 81 : AIR 1991 SC 672). A non obstante clause may be used as a legislative device, to modify the ambit of the provision of law mentioned in the non obstante clause, or to override it in specified circumstances, (see T.R. Thandur v. Union of India, (1996) 3 SCC 690 : AIR 1996 SC 1643). The true effect of the non obstante clause is that in spite of the provision or Act mentioned in the non obstante clause, the enactment following it will have its full operation or that the provisions embraced in the non obstante clause will not be an impediment for the operation of the enactment (see Smt. Parayankandiyal Eravath Kanapravan Kalliani Amma v. K. Devi, (1996) 4 SCC 76 : AIR 1996 SC 1963)."

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and another reported in ***AIR 2006 SC 3252:***

In ICICI Bank Ltd. v. Sidco Leathers Ltd. and Others (2006) Scw 2361) 5 SCALE 27] the law is stated in Para 38) the following terms: "The non obstante nature of a provision although may be of wide amplitude, the interpretative process thereof must be kept confined to the legislative policy. Only because the dues of the workmen and the debt due to the secured creditors are treated pari passu with each other, the same by itself, in our considered view, would not lead to the conclusion that the concept of inter se priorities amongst the secured creditors had thereby been intended to be given a total go-by.
A non obstante clause must be given effect to, to the extent the Parliament intended and not beyond the same."

23.2. It thus appears that non-obstante clause is a legislative device intended to give an overriding effect and ensure that the provisions have its full operation. As stated above, prior to introduction of Sections 26E and 31B of the SARFAESI Act and the Recovery of Debts and Bankruptcy Act, Section 35 of the SARFAESI Act and Section 34 of the Recovery of Debts and Bankruptcy Act provided that the provisions of these Acts would override other laws. For a better appreciation of the width of the non- obstante clause in Section 26E of the SARFAESI Act and section 31 B of the Recovery of Debts and Bankruptcy Act, it may be relevant to contrast the same with Section 35 of the SARFAESI Act and Section 34 of the Recovery of Debts and Bankruptcy Act. The following table is relevant:

Section 26 E of SARFAESI Act and	**Section 35 of SARFAESI Act and**

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Section 31 B of Recovery of Debts and Bankruptcy Act	**Section 34 of** Recovery of Debts and Bankruptcy Act
SARFAESI Act **Section 26E: Priority to secured creditors.** ***26E**. Notwithstanding anything contained in any other law for the time being in force, after the registration of security interest, the debts due to any secured creditor shall be paid in priority over all other debts and all revenues, taxes, cesses and other rates payable to the Central Government or State Government or local authority.* *Explanation.—For the purposes of this section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code.]*	**Recovery of Debts and Bankruptcy Act** **Section 35. Provisions of this Act to override other laws.** *35. The provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.* **Section 37. Application of other law not barred** *37. The provisions of this Act or the rules made thereunder shall be in addition to, and not in derogation of, the Companies Act, 1956 (1 of 1956), the Securities Contracts (Regulation) Act, 1956 (42 of 1956), the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) or any other law for the time being in force."*
Recovery of Debts and Bankruptcy Act: *31B. Priority to secured creditors.—* *Notwithstanding anything contained in any other law for the time being in force, the rights of secured creditors to realise*	***Recovery of Debts and Bankruptcy Act:*** *34. Act to have overriding effect.* *(1) Save as provided under sub-section (2), the provisions of this Act shall have effect notwithstanding anything*

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secured debts due and payable to them by sale of assets over which security interest is created, shall have priority and shall be paid in priority over all other debts and Government dues including revenues, taxes, cesses and rates due to the Central Government, State Government or local authority. *Explanation.—For the purposes of this section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code.*	*inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act.* *(2) The provisions of this Act or the rules made thereunder shall be in addition to, and not in derogation of the Industrial Finance Corporation Act, 1948 (15 of 1948), the State Financial Corporations Act, 1951 (63 of 1951), the Unit Trust of India Act, 1963 (52 of 1963), the Industrial Reconstruction Bank of India Act, 1984 (62 of 1984), the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) and the Small Industries Development Bank of India Act, 1989 (39 of 1989).”*

23.3. A question arose before the Hon’ble Supreme Court in ***Central Bank of India v. State of Kerala and others*** [***(2009) 4 SCC 94]*** as to whether Sections 34 and 35 of the Recovery of Debts and Bankruptcy Act and SARFAESI Act which give overriding effect to the provisions of those Acts against other laws, would prevail over Section 38-C of the Bombay Act and Section 26-B of the Kerala Act, which provided for non obstante clause and created a first charge in favour of the State with regard to the dues arising under those enactments. The

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Hon'ble Supreme Court held that the non obstante clause contained in Sections 34 and 35 would get attracted only in the event of conflict in the light of the language employed therein which provided that the provisions of the said enactments will prevail in the event of any inconsistency. In other words, non-obstante clause contained in Sections 34 and 35 would not come into play unless inconsistency is demonstrated between the provisions of the SARFAESI Act and Recovery of Debts and Bankruptcy Act and other enactments. It was found that there was nothing inconsistent between SARFAESI Act or Recovery of Debts and Bankruptcy Act vis-a-vis Bombay Act and Kerala Act and therefore, it was held that despite the non-obstante clause in Sections 34 and 35, the First charge under the Bombay Act and the Kerala Act would prevail. In this regard, it may be relevant to refer to the judgment of the Supreme Court which reads as under:

> *"111. However, what is most significant to be noted is that there is no provision in either of these enactments by which first charge has been created in favour of banks, financial institutions or secured creditors qua the property of the borrower.*
>
> *112. Under Section 13(1) of the Securitisation Act, limited primacy has been given to the right of a secured creditor to enforce security interest vis-à-vis Section 69 or Section 69-A of the Transfer of Property Act. In terms of that sub-section, a secured creditor can enforce security interest without intervention of the court or tribunal and if the borrower has created any mortgage of the secured asset, the mortgagee or any person acting on his behalf cannot sell the mortgaged property or appoint a Receiver of the income of the mortgaged property or any part thereof in a manner which may defeat the right of the secured creditor to enforce security interest. This provision was enacted in the backdrop of Chapter VIII of the*

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Narasimham Committee's Second Report in which specific reference was made to the provisions relating to mortgages under the Transfer of Property Act.

113. In an apparent bid to overcome the likely difficulty faced by the secured creditor which may include a bank or a financial institution, Parliament incorporated the non obstante clause in Section 13 and gave primacy to the right of secured creditor vis-à-vis other mortgagees who could exercise rights under Sections 69 or 69-A of the Transfer of Property Act. However, this primacy has not been extended to other provisions like Section 38-C of the Bombay Act and Section 26-B of the Kerala Act by which first charge has been created in favour of the State over the property of the dealer or any person liable to pay the dues of sales tax, etc. Sub-section (7) of Section 13 which envisages application of the money received by the secured creditor by adopting any of the measures specified under sub-section (4) merely regulates distribution of money received by the secured creditor. It does not create first charge in favour of the secured creditor.

....116. The non obstante clauses contained in Section 34(1) of the DRT Act and Section 35 of the Securitisation Act give overriding effect to the provisions of those Acts only if there is anything inconsistent contained in any other law or instrument having effect by virtue of any other law. In other words, if there is no provision in the other enactments which are inconsistent with the DRT Act or the Securitisation Act, the provisions contained in those Acts cannot override other legislations. Section 38-C of the Bombay Act and Section 26-B of the Kerala Act also contain non obstante clauses and give statutory recognition to the priority of the State's charge over other debts which was recognised by Indian High Courts even before 1950. In other words, these sections and similar provisions contained in other State legislations not only create first charge on the property of the dealer or any other person liable to pay sales tax, etc. but also give them overriding effect over other laws.

....126. While enacting the DRT Act and the Securitisation Act, Parliament was aware of the law laid down by this Court wherein priority of the State dues was recognised. If Parliament intended to create first charge in favour of banks, financial institutions or other secured creditors on the property of the borrower, then it would have

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incorporated a provision like Section 529-A of the Companies Act or Section 11(2) of the EPF Act and ensured that notwithstanding series of judicial pronouncements, dues of banks, financial institutions and other secured creditors should have priority over the State's statutory first charge in the matter of recovery of the dues of sales tax, etc. However, the fact of the matter is that no such provision has been incorporated in either of these enactments despite conferment of extraordinary power upon the secured creditors to take possession and dispose of the secured assets without the intervention of the court or Tribunal. The reason for this omission appears to be that the new legal regime envisages transfer of secured assets to private companies.

...128. If the provisions of the DRT Act and the Securitisation Act are interpreted keeping in view the background and context in which these legislations were enacted and the purpose sought to be achieved by their enactment, it becomes clear that the two legislations, are intended to create a new dispensation for expeditious recovery of dues of banks, financial institutions and secured creditors and adjudication of the grievance made by any aggrieved person qua the procedure adopted by the banks, financial institutions and other secured creditors, but the provisions contained therein cannot be read as creating first charge in favour of banks, etc."

23.4. The above judgment proceeds on the basis that though there is a non-obstante clause, the same would become operational and get triggered only in the event of inconsistency with provisions of other enactment. In other words, the non-obstante clause was found to be inadequate and may not operate unless there is inconsistency with any other law. With a view to get over the deficiency in the non-obstante clause which was contained in Sections 34 and 35, Sections 26E and 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act has been introduced. If one contrasts the non-obstante clauses contained in Sections

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26E and 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act vis-a-vis Sections 34 and 35, it would be evident that the non-obstante clause in Section 26E and Section 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act is not limited in its operation only in the event of inconsistency, but is intended to give primacy to the rights of secured creditors to recover over all other debts and expressly includes revenues, taxes, cesses or other rates payable to Central Government or State Government or local authority. Parliament intended to give primacy to Sections 26E and 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act, as evident from the non-obstante clause contained therein which is couched in very wide terms as to its scope and operation. Section 281 of the Income Tax Act declares certain transactions to be void, now can it be understood that the declaration of voidity would prevail despite Sections 26E and 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act conferring primacy in very wide terms. There is no doubt that Parliament's intention was to give priority to secured creditors which is to prevail over revenue, taxes, cesses, etc, in view of the express provisions contained in Sections 26E and 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act. This is further reinforced by the Statement of Objects and Reasons (SOR) appended to the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016 which

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introduced sections 26E of the SARFAESI Act and 31B of the Recovery of Debts and Bankruptcy Act. According to the SOR, priority was accorded to secured creditors in repayment of debts in order to augment economic growth and ease of doing business. This gives a glimpse of the position earlier and what the amendment sought to remedy.

24. Keeping the above background in mind, it does not seem that section 281 of the Income Tax Act and sections 26E of the SARFAESI Act and 31B of the Recovery of Debts and Bankruptcy Act can operate simultaneously without conflict. In other words, the conflict is inevitable. Application of section 281 could result in two possible outcome:

(i)the transfer / charge can either be saved under the proviso (or)

(ii)transfer / charge could come under the mischief of section 281 and its declaration of voidity.

In the first case, if the transfer / charge falls under the proviso, Section 281 of the Income Tax Act would not get attracted and the secured creditor will be entitled to enforce in view of its priority. If the transfer / charge falls within the mischief of Section 281 of the Income Tax Act as discussed supra, it would suffer from the declaration of voidity. 'Void' as explained by the Hon'ble Supreme Court in ***Kalawati v. Bisheshwar [AIR 1968 SC 261] and State of Kerala v.***

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M.K.Kunhikannan Nambiar Manjeri Manikoth [(1996) 1 SCC 435 : AIR 1996 SC 906], would mean 'non-existent from its very inception' and 'nullity'. Sections 26E and 31B presuppose an existence of a valid charge / mortgage and if the declaration of voidity in section 281 of the Income Tax Act destroys the very foundation on which sections 26E and 31B exists, it appears doubtful that a banker or a financial institution can take advantage of the priority provided therein. In this regard, it may be necessary to bear in mind the Maxim *sublato fundamento, cadit opus,* meaning, "if the foundation is removed, the superstructure falls" ***[See: Kalabharati Advertising v. Hemant Vimalnath Narichania and others, (2010) 9 SCC 437 : 2010 SCC Online SC 970 at page 447]***.

25. Thus, once the security interest is declared a nullity, it will be non-est and there is no question of applying SARFAESI or Recovery of Debts and Bankruptcy Act and consequentially, no question of priority. This would essentially lead to a conflict, as in the present case, primacy to section 281 will render the priority accorded to secured creditors nugatory. We must thus examine, whether section 281 of the Income Tax Act or sections 26E and 31B of the SARFAESI and Recovery of Debts and Bankruptcy Act would prevail. It appears that the non-obstante clause in Sections 26E and 31B of the SARFAESI Act and

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Recovery of Debts and Bankruptcy Act would prevail over the declaration of voidity contained in Section 281 of the Income Tax Act, for unless it is nullified, the primacy contained in the provisions of Sections 26E and 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act would stand nullified, thereby defeating the object of Sections 26E and 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act.

26. While interpreting the scope of the non-obstante clause contained in Sections 26E and 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act, we may take guidance from the Heydon's Rule, commonly known as "Purposive Construction", which provides that when the material words are capable of bearing two or more constructions, the most firmly established rule for construction of such words of all statutes in general (be they penal or beneficial, restrictive or enlarging of the common law) is the rule laid down in Heydon's case which has now attained the status of a "classic"[1]. The rule which is also known as "purposive construction" or "mischief rule" enables consideration of four matters in construing an Act: (i) What was the law before the making of the Act, (ii) What was the mischief or defect for which the law did not provide, (iii) What is the remedy that the Act has provided, and (iv) What is the reason of the remedy. The rule then directs that the courts must adopt that construction which "shall suppress the mischief and advance the remedy". Four

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things are to be discerned and considered:

Firstly, what was the common law before the making of the Act,

[1]Secondly, what was the mischief and defect for which the common law did not provide,

Thirdly, what remedy the Parliament hath resolved and appointed to cure the disease of the commonwealth, and

Fourthly, the true reason of the remedy,

Then to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and *pro priuate commodo,* and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, *pro bone publico*.

27. Applying the mischief or Heydons Rule to Sections 26E and 31B of the SARFAESI and Recovery of Debts and Bankruptcy Act, we can infer the following:

The Mischief - Inadequacy of the non-obstante clause in Section 34 and 35 of the Recovery of Debts and Bankruptcy Act and SARFAESI Act, which was found to be limited in operation to grant to primacy only in case of inconsistency with other laws.

The remedy - To get over the above mischief of Section 26E and 31B of the SARFAESI and Recovery of Debts and Bankruptcy Act, containing non-obstante clause was introduced. The said non-obstante clause is very wide in scope and operation and grants primacy against any other law, which is not confined to circumstances, wherein, there is inconsistency between the SARFAESI Act and Recovery of Debts and Bankruptcy Act.

Thus, applying the Heydon's Rule or Purposive construction, the non-obstante

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clause contained in Sections 26E and 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act, which was introduced to give primacy to the secured creditors and expressly provides that it would prevail over all taxes, cesses etc., ought to be construed/interpreted in a manner that would promote and not defeat the object of the Parliament to protect and safeguard the interest of the secured creditors, intended in larger public interest and as a matter of policy.

28. One more rule of construction is that when two competing Acts construed to further the purposes behind them produce a conflict; the court may resolve the conflict by taking into consideration as to which Act represents "the superior purpose", as held in the case of ***Allahabad Bank v. Canara Bank [(2000) 4 SCC 406],*** which reads as under:

> ***"34.*** *While it is true that the principle of purposive interpretation has been applied by the Supreme Court in favour of jurisdiction and powers of the Company Court in Sudarsan Chits (I) Ltd. case [(1984) 4 SCC 657], and other cases, the said principle, in our view, cannot be invoked in the present case against the Debts Recovery Tribunal in view of the superior purpose of the RDB Act and the special provisions contained therein. In our opinion, the very same principle mentioned above equally applies to the Tribunal/Recovery Officer under the RDB Act, 1993 because the purpose of the said Act is something more important than the purpose of Sections 442, 446 and 537 of the Companies Act. It was intended that there should be a speedy and summary remedy for recovery of thousands of crores which were due to the banks and to financial institutions, so that the delays occurring in winding-up proceedings could be avoided."*

If the above rule is applied, then there is no room for doubt that Section 26 E of

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the SARFAESI Act and Section 31 B of the Recovery of Debts and Bankruptcy Act which was introduced with a specific purpose to override and grant priority to recovery of debts due to secured creditors over all other debts, taxes, cesses etc., must be understood as prevailing over Section 281 of the Income Tax Act, in the event of conflict of priority. This is also in view of the fact that the Parliament must be understood to have given priority to the secured creditors under Section 26E of the SARFAESI Act and Section 31B of the Recovery of Debts and Bankruptcy Act, fully aware and conscious of the status and importance that taxes enjoy under the Constitution. Therefore, with regard to operation of section 281 of the Income Tax Act vis-a-vis the operation of sections 26E and 31B of the SARFAESI Act and Recovery of Debts and Bankruptcy Act, sections 26E and 31B according priority to secured creditors shall prevail and thus, the attachment by the Tax Recovery Officer is impermissible in the facts and circumstances of the case.

29. Now coming to the question of whether the amendments by way of Section 26E of the SARFAESI Act and Section 31B of the Recovery of Debts and Bankruptcy Act, would be applicable to the Bankers in the present case in view of the fact that Section 31B was inserted with effect from 01.09.2016, while Section 26 E was inserted and notified to come into force on 24.01.2020. The above question need not detain us long for the following reasons:

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a) Firstly, the Full Bench of this Court in W.P.No.2675 of 2011 etc. batch, dated 10.11.2016 has held that it would govern the rights of the parties even in respect of a pending *lis*. The relevant portion of the same reads as under:

> *"3. There is, thus, no doubt that the rights of a secured creditor to realise secured debts due and payable by sale of assets over which security interest is created, would have priority over all debts and Government dues including revenues, taxes, cesses and rates due to the Central Government, State Government or Local Authority. This section introduced in the Central Act is with "notwithstanding" clause and has come into force from 01.09.2016.*
>
> *The law having now come into force, naturally it would govern the rights of the parties in respect of even a lis pending."*

The Special Leave Petition is stated to be pending before the Apex Court and there is an order of "Status Quo" in SLP (Civil) No.20471 of 2021 dated 16.03.2018. In view thereof, the Full Bench Order of this Court would continue to bind/govern.

b) Secondly, we would think the examination of the above question may be academic, in view of the fact that even if the recovery proceeding is set-aside for any reason, the same may not serve any purpose. The claim of the Bankers/ Financial Institutions is admittedly still outstanding, hence it is open for the Bankers/ Financial Institutions on proceeding being set-aside to invoke Section 26 E of the SARFAESI Act and Section 31 B of the Recovery of Debts and Bankruptcy Act as it is applicable presently in any view. In similar circumstances, the Hon'ble Supreme Court in the case of

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Dena Bank v. Bhikhabhai Prabhudas Parekh and Co. [(2000) 5 SCC 694] while examining the question whether the State would have precedence to recover the tax dues over that of secured creditors after clarifying the position on the above issue, proceeded to examine the further contention that the petitioners therein who were partners of a firm that Section 15(2-A) of the Karnataka Sales Tax Act, which provided that where any firm is liable, the firm and each of the partners would be jointly and severally liable was introduced only with effect from 18.11.1983, however the taxes that were sought to be recovered related to periods prior to 1964-65 i.e., prior to the insertion of the above provision. The Apex Court after holding that it would be prospective, however proceeded to hold that even if the recovery proceedings were to be set aside, it may not serve any purpose since it was open for the State to resort to the amended Section 15(2-A) of the Karnataka Sales Tax Act which would prevail over the right of the appellant Bank. The following portion is relevant and thus extracted:

> *"21.....Even if we were to set aside the sale held by the State, it will merely revive the arrears outstanding on account of sales tax to which further interest and penalty shall have to be added. The amended Section 15(2-A) of the Karnataka Sales Tax Act shall apply. The State shall have a preferential right to recover its dues over the rights of the appellant Bank and the property of the partners shall also be liable to be proceeded against. No useful purpose would, therefore, be served by allowing the appeal which*

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will only further complicate the controversy. "

The position here is no different. Apart from the fact that the Full Bench has while considering the applicability of Section 31 B of the Recovery of Debts and Bankruptcy Act has held that it would apply even to lis pending, which would be the position in respect of Section 26E of the SARFAESI Act as well. Even if this Court were to set aside the recovery proceedings for any reason, the Bankers/ Financial Institutions right to claim priority in terms of Section 31 B of the Recovery of Debts and Bankruptcy Act and Section 26 E of the SARFAESI Act would be available and the right to recover under the Income Tax Act, 1961 must yield to the provisions under the SARFAESI Act and the Recovery of Debts and Bankruptcy Act and thus, the above exercise may not serve any useful purpose. Therefore, the above issue appears to be a mere academic exercise and we do not intend to examine the question any further.

30.1. In view of the legal position explained above and applying the same to the facts of the present case, we arrive at the following conclusion:

(i)In WA.No.60 of 2022, the appellant is a secured creditor, who offered credit facilities to the Respondents 4 and 5, for which, mortgages were created in favour of appellant on 23.04.2013 vide document No.453 of 2013, on 18.08.2014 vide document No.2467 of 2014 and on 22.10.2015 vide document No.3168 of 2015. However, the Income Tax Department passed the order of attachment on 03.11.2015, for recovery of the tax dues, in respect of the properties over which

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mortgages were already created.

(ii)In W.A.No.1249 of 2022, the appellant sought to quash the communication of the Respondent dated 27.12.2007 with respect to recovery of income tax arrears of M/s.NEPC Agro Foods Limited and its Directors, on the premise that mortgage in respect of the property, was executed in favour of the Bank on 31.03.1999 itself, i.e., prior to the recovery proceedings.

(iii)In WA.No.1385 of 2022, the writ petitioner / Bank challenged the attachment notice dated 27.03.2017 issued by the Income Tax Department, in respect of the properties which were offered to them as security by way of mortgage by deposit of title deeds for securing loans on 10.02.2014. The learned Judge allowed the writ petition on the ground that the mortgage preceded the attachment.

(iv)In WA.No.1512 of 2021, the appellant / Bank sought a direction to the first respondent – Tax Recovery Officer, Income Tax Department to remove the attachment made on 16.06.2017 and 23.07.2017 in respect of the properties, which were already mortgaged on 28.01.2016 and 07.02.2016, by the fourth and fifth Respondents to raise loan.

30.2. In all these cases, the orders of attachment passed by the Tax Recovery Officer / Income Tax Department were subsequent to the mortgage created in favour of the secured creditors and hence, the same will have no legs

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to stand, in view of the principles laid above by this court. Therefore, the orders impugned in the writ appeals viz., WA Nos.1512/2021, 60/2022 and 1249/2022 and in the writ petitions, are quashed. Regarding WA No.1385 of 2022 filed by the Revenue, there is no necessity to interfere with the order passed by the learned Judge.

31. Accordingly, all the Writ Appeals are disposed of. There shall be no order as to costs. Consequently, connected miscellaneous petitions are closed.

[R.M.D., J.] [M.S.Q., J.]
01.09.2022

Index : Yes/No
Speaking/Non-Speaking Order
Lm

To
1.The Tax Recovery Officer,
Income Tax Department,
TRO-1/Coimbatore.

2.The Sub Registrar,
Selaiyur, Kanchipuram District.

3.The Sub Registrar,
Joint-I, South Chennai,
Saidapet, Chennai – 15.

4.Tax Recovery Officer VII,
Income Tax Department,
Company Range IV,

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121, MG Road, Chennai – 600034.

5.The Deputy Commissioner of Income Tax,
Circle 3(1) No.44, William Cantonment,
Tiruchirapalli.

6.The Assistant Commissioner of Income Tax,
Central Circle 11(1), Room No.122,
1st Floor, Investigation Wing,
46, Nungambakkam High Road,
Chennai – 600 034.

7.The Joint Sub-Registrar,
Chennai Central Joint-I,
Sub Registrar Office,
Mylapore, Chennai – 600 004.

8.Union Bank of India,
Regional Office, 649/650,
Represented by Chief Manager,
Oppanakara Street,
Coimbatore – 641 001.

9.Sub Registrar,
Sub-Registrar Office No.02,
Tirupur, Tirupur District.

R. MAHADEVAN, J.
and
MOHAMMED SHAFFIQ, J.

Lm/rk

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Pre-delivery Judgement in
W.A. Nos.1512 of 2021, 60, 1249 and 1385 of 2022

01.09.2022

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