INCOME TAX : Where Assessing Officer passed an order under section 179 against assessee-director of a company to recover tax dues of said company from assessee, since despite all possible efforts made by department only a small part of tax dues could be recovered from company, and there was no other option left for department apart from recovering same from assessee director, impugned order under section 179 passed against assessee was justified

[2021] 132 taxmann.com 283 (Delhi)

HIGH COURT OF DELHI

Rajeev Behl

v.

Principal Commissioner of Income-tax*

MANMOHAN AND NAVIN CHAWLA, JJ.
W.P. (C) NO. 7869 OF 2021
CM APPLICATION NOS. 24474-475 OF 2021
SEPTEMBER 24, 2021

Section 179 of the Income-tax Act, 1961 - Company in liquidation - Liabilities of directors (Condition precedent) - Assessment years 2006-07 to 2009-10 - Whether primary condition before invoking section 179 is that tax dues could not be recovered from company before proceeding against director - Held, yes - Assessee was one of directors of a private company when he resigned - Assessing Officer finalised assessment of company and raised tax demand - However, company as well as other directors failed to pay tax - Therefore, Assessing Officer passed an order under section 179 against assessee to recover tax dues of company from him being director for such period for which tax was payable treating assessee as jointly and severally liable for payment of outstanding tax demands of company - Assessee contended that no action to recover demand from company was taken by Assessing Officer - It was noted that demand notices were served upon company but tax was not paid - Bank account of company was also attached, however, only a small part of demand was recovered - Thus, despite all possible efforts entire outstanding tax dues could not be recovered from company leaving department with no other option but to recover same from assessee director - Whether, on facts, impugned order under section 179 passed against assessee was justified - Held, yes [Paras 18, and 20 to 23] [In favour of revenue]

FACTS

- The assessee was one of the directors of a private company, namely, RGC. A memorandum of understanding (MoU) was executed according to which all the income tax liability of the company would be paid by another director of the company namely, PD. The Assessing Officer finalised assessment of company and raised tax demand. However, PD failed to pay tax liability and also the company. Thus, the Assessing Officer passed an order under section 179 against the assessee to recover tax dues of company from him being director for such period for which tax

was payable treating the assessee as jointly and severally liable for payment of outstanding tax demands.

- In instant writ petition the assessee contended that no action to recover the demand from the company was taken by the Assessing Officer. He further submitted that the revenue had failed to demonstrate that the director was guilty of any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of company. He also stated that the three directors of company had agreed amongst themselves that the tax liabilities of the company would be borne by one of the directors, namely, PD and, therefore, the recovery against the assessee was bad in law.

HELD

- Section 179 imposes a vicarious responsibility on the directors for the dues of the company. It has, therefore, to be interpreted rigidly, subject to conditions, for application under section 179. The primary condition is that the tax dues could not be recovered from company before section 179 could be invoked. The Assessing Officer has therefore to give a finding that the tax dues could not be recovered from the company before proceeding against the director. [Para 18]
- Moreover, the director of the private company can avoid his joint and several liability for payment of taxes if he proves that the non-recovery cannot be attributed to his gross neglect, misfeasance or breach of any duty on his part in relation to the affairs of a company. [Para 19]

DESPITE ISSUING NOTICES AND ATTACHMENT ORDERS THE ENTIRE OUTSTANDING TAX DUES COULD NOT BE RECOVERED FROM THE COMPANY LEAVING THE DEPARTMENT WITH NO OTHER OPTION, BUT TO RECOVER THE SAME FROM THE DIRECTORS

- The contention of the petitioner that no action to recover the demand from the RGC was taken by the Assessing Officer is not correct. It has been mentioned in the impugned order under section 179(1) that the demand notices were served upon the said companies. Thereafter, notices under section 221(1) were issued to the companies. It was only when the demand was not paid, bank accounts of the companies were attached and partial recovery was made through the said attachments. In fact, the impugned order passed under section 179(1), as well as the order passed under section 264 clearly demonstrate that only a small part of the demand was recovered despite all possible efforts by the Department including action of attachment of bank accounts of the RGC. [Para 20]
- Moreover, the tax dues against RCPL which was developing the mall was only Rs. 12.17 lakhs. The tax demand against the other companies could not be recovered from the assets of that company. Section 179 only permits recovery against a director and not against other group companies which are distinct legal entities. [Para 21]
- In fact, in the impugned order there is a specific finding that despite issuing notices and attachment orders the entire outstanding tax dues could not be recovered from the company leaving the department with no other option, but to recover the same from the directors including the petitioner. [Para 22]

SUBMISSION OF THE PETITIONER THAT IT IS FOR THE RESPONDENT-REVENUE TO DEMONSTRATE THAT THE PETITIONER DIRECTOR WAS GUILTY OF GROSS NEGLECT,

MISFEASANCE OR BREACH OF DUTY ON HIS PART IN RELATION TO THE AFFAIRS OF THE COMPANY IS CONTRARY TO THE EXPLICIT LANGUAGE USED IN SECTION 179

- The submission of the petitioner that it is for the revenue to demonstrate that the petitioner director was guilty of gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company is contrary to the explicit language used in section 179. The burden is on the individual director to prove that the non-recovery was not due to his gross negligence, misfeasance or breach of duty on his part. [Para 23]

PRIVATE PARTIES CANNOT APPORTION INCOME TAX LIABILITY BY PRIVATE AGREEMENT AS THE PETITIONER HAS SOUGHT TO DO IN THE INSTANT CASE. IT IS SETTLED LAW THAT WHILE RIGHTS IN PERSONAM ARE ARBITRABLE, RIGHTS IN REM ARE UNSUITED FOR PRIVATE ARBITRATION AND CAN ONLY BE ADJUDICTED BY THE COURTS OR TRIBUNALS

- The MOU, settlement deed and an arbitral award governs right *in personam* and cannot bind a statutory authority like the respondent-revenue. It is a settled law that while rights *in personam* are arbitrable, rights *in rem* are unsuited for private arbitration and can only be adjudicated by the courts or Tribunals. [Para 25]
- Consequently, private parties cannot apportion Income-tax liability by private agreement as the petitioner has sought to do in the instant case. [Para 26]

CASE REVIEW

Union of India v. *Manik Dattatreya Lotlikar* [1987] 35 Taxman 526/[1988] 172 ITR 1 (Bom.) (para 24) *followed.*

CASES REFERRED TO

Ram Prakash Singeshwar Rungtar v. *ITO* [2015] 59 taxmann.com 174/370 ITR 641 (Guj.) (para 11), *Union of India* v. *Manik Dattatreya Lotlikar* [1987] 35 Taxman 526/[1988] 172 ITR 1 (Bom.) (para 24) and *Booz Allen & Hamilton Inc.* v. *SBI Home Finance Ltd.* [2011] 5 SCC 532 (para 25).

Salil Aggarwal, Sr. Adv. and **Madhur Aggarwal**, Adv. *for the Petitioner.* **Zoheb Hossain**, Sr, SC, **Vipul Agarwal** and **Parth Semwal**, Jr. SC *for the Respondent.*

JUDGMENT

Manmohan, J. - Present writ petition has been filed challenging the orders dated 1st April, 2021 passed under section 264 of the Income-tax Act, 1961 [for short 'the Act'] and 29th January, 2018 under section 179 of the Act by respondent No. 1 and respondent No. 2 respectively. Petitioner seeks a direction to restrain the respondents from recovering the outstanding demand of Rs. 5,89,68,019/- in the case of Realtech Group from the petitioner, pertaining to the Assessment Years 2006-07 to 2009-10.

Relevant Facts

2. The relevant facts of the present case are that the petitioners along with two other promoters, namely, Sh. Pankaj Dayal and Sh. Yogesh Gupta formed and promoted the Realtech group of companies in 2005 comprising M/s. Realtech Projects (P.) Ltd., M/s Real Infrastructure (P.) Ltd., M/s. Vivid Builders (P.) Ltd. and M/s. Realtech Constructions (P.) Ltd.

3. During the year 2010-11, allegedly disputes arose amongst the promoters and to settle the said inter se disputes a Memorandum of Understanding (MOU) was executed on 02nd June, 2011. In terms of the

MOU, the petitioner allegedly resigned as Director from M/s Vivid Builders (P.) Ltd., M/s. Realtech Construction (P.) Ltd. as well as some other group companies of Realtech group and stopped participating in the management of the Realtech group. It was also allegedly agreed in the MOU that all the income tax liabilities in respect of Realtech Construction (P.) Ltd., Realtech Projects (P.) Ltd., Vivid Builders (P.) Ltd. and Realtech Infrastructure will be borne and paid by Mr. Pankaj Dayal (one of the Directors). Mr. Pankaj Dayal was allegedly separately allocated 17000 sq. ft. in City Emporia Mall, Chandigarh to meet the tax liabilities of Realtech group of companies.

4. Subsequent to the MOU, an alleged Settlement Deed dated 16th December, 2015, was also entered into between Mr. Rajeev Behl and Mr. Pankaj Dayal, in which the MOU dated 2nd June, 2011 was given assent to and it was reiterated that Mr. Pankaj Dayal will bear the income tax liabilities of the Realtech group.

5. In order to implement the MOU, an arbitration proceeding was started under the aegis of Hon'ble Justice Sh. S.B. Sinha (Retired), who *vide* Arbitration Award dated 28th January, 2018 upheld the terms of the aforesaid MOU.

6. The Arbitration Award was challenged by Mr. Pankaj Dayal before this Court by way of O.M.P (COMM) No. 449 of 2018, wherein, a learned Single Judge of this Court upheld the Award *vide* order dated 29th October, 2018.

7. In the meantime, the petitioner was called upon by the income tax authorities to provide details of arrangement for discharge of income tax liability of Realtech group of companies. In response thereto, the petitioner *vide* its letters dated 10th March, 2015 and 18th March, 2015 addressed to CCIT gave details of assets of Realtech group, which were sufficient to discharge the income tax liability and requested the authorities to take appropriate steps as early as possible for recovery of income tax.

8. The petitioner was served with the impugned order dated 29th January, 2018 under section 179 of the Act wherein it was held that tax dues of a private limited company that cannot be recovered from the company can be recovered from a Director of the said company as the Director is jointly and severely liable for payment of outstanding tax demands of the company. Petitioner's revision petition under section 246 of the Act was also dismissed *vide* order dated 01st April, 2021.

Arguments on behalf of the Petitioner

9. Learned senior counsel for the petitioner stated that no action to recover the demand from the Realtech Group of Companies had been taken by the Assessing Officer. He emphasised that the Respondent No. 1 had failed to appreciate that there are more than adequate assets available with Realtech group to pay the tax demand and in the absence of any steps taken to recover the demand from their assets, it could not be alleged much less validly held that demand could not be recovered from Realtech group.

10. He further submitted that the Revenue had failed to demonstrate that the Petitioner Director was guilty of any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of company. According to him this was an essential pre-requisite before any recovery under section 179 could be effected against the petitioner Director.

11. He also stated that the three Directors of Realtech group of companies had agreed amongst themselves that the tax liabilities of the Realtech Group would be borne by one of the directors, namely, Mr. Pankaj Dayal and therefore the recovery against the petitioner was bad in law. In support of his contention, learned senior counsel for the petitioner relied upon the MOU by which the tax liabilities of the Realtech Group of Companies were assumed by one of the Directors by way of a private arrangement between the Directors of the company of the various companies of Realtech Group and

later affirmed by an Arbitral Award which was subsequently upheld by this Court. In support of his submission, learned senior counsel for petitioner relied upon the judgment of Gujarat High Court in *Ram Prakash Singeshwar Rungta* v. *ITO* [2015] 59 taxmann.com 174/370 ITR 641, wherein it has been held as under:-

> "12 …….. However, such liability can be avoided if it proves that the non-recovery cannot be attributed to the three factors mentioned in the said order. Thus, the responsibility to establish such facts is on the director. However, once the director places before the authority his reasons why it should be held that non-recovery cannot be attributed to any of the above three factors, the authority would have to examine such grounds and come to a conclusion in this respect. The court observed that the lack of gross-negligence, misfeasance or breach of duty on the part of the directors is to be viewed in the context of non-recovery of the tax dues of the company. In other words, as long as the director establishes that the non-recovery of the tax cannot be attributed to his gross neglect, etc. his liability under section 179(1) of the Act would not arise. Here again the legislature advisedly used the word gross neglect and not a mere neglect on his part. The court observed that the entire focus and discussion of the Assistant Commissioner in the order impugned therein was with respect to the said petitioner's neglect in functioning of the company, when the company was functional. Nothing came to be stated by him regarding the gross-negligence on the part of the petitioner due to which the tax dues from the company could not be recovered. The court held that in the absence of any such consideration, the Assistant Commissioner could not have been ordered recovery of dues of the company from the director.
>
> 13. Examining the facts of the present case in the light of the principles propounded in the above decision, a perusal of the notice under section 179 of the Act reveals that the same is totally silent as regards the satisfaction of the condition precedent for taking action under section 179 of the Act, namely, that the tax dues cannot be recovered from the Company. In the notice under section 179 of the Act also there is no reference to any steps having been taken for recovery of the outstanding amount from the company. Even in the impugned order, except for a statement to the effect that in-spite of all efforts, demand could not be recovered from the Company since it has closed down its activities since 1999, nothing has been stated as regards the steps that had been taken for recovery of the outstanding amount from the Company. The affidavit-in-reply filed by the respondent is also totally silent in this regard. Therefore, the necessary prerequisite for resorting to the provisions of section 179 of the Act itself against the directors is not satisfied in the present case."

12. Learned senior counsel for petitioner lastly stated that the impugned orders were bad in law as the petitioner had not been given a fair and reasonable opportunity to present his case.

Arguments on behalf of the respondent-revenue

13. *Per contra* learned counsel for the respondents submitted that the present petition was an abuse of process of law as the petitioner was seeking to settle his private scores with different parties through the income tax department, which is evident from the fact that neither Mr. Pankaj Dayal nor the Realtech Group of companies had been impleaded as party-respondents to the writ petition. According to him, on this ground alone, the petition deserves to be dismissed with costs.

14. He further stated that petitioner's argument that no opportunity was granted to him of being heard before passing an order under section 179(1) of the Act is not correct. *Vide* notice F.No. ACIT/CC-14/Recovery/2017-18/1045 dated 19th September, 2017, the petitioner was given an opportunity to file his reply and was required to *show cause* as to why action against him should not be taken under section 179(1) of the Act. By the said notice, it was categorically informed to the petitioner that in case of non-compliance, it would be construed that he has nothing to say. An annexure was also enclosed with

the said notice mentioning the outstanding demands of various companies in which the petitioner was a Director. Petitioner was requested to submit his reply on or before 25th September, 2017. Notice dated 19th September, 2017 was sent *vide* dispatch number 1045 and was dispatched through speed post *vide* ED064360602IN. However, no reply was submitted by the petitioner till the scheduled date. Even otherwise, no reply was submitted till the passing of the impugned order 29th January, 2018.

15. He also pointed out that notices to the three Directors were issued on the same date *i.e.* 19th September, 2017. One of the Directors Mr. Yogesh Gupta has filed his reply *vide* letter dated 25th September, 2017. He further stated that orders under section 179(1) had been passed in the case of other directors as below:—

Sl. No.	*Name of the Directors*	*Date of the order passed under section 179(1)*
1	Sh. Pankaj Dayal	29-1-2018
2	Sh. Yogesh Gupta	29-1-2018

16. He stated that the order under section 179(1) of the Act dated 29th January, 2018 was dispatched through speed post on the same address on which the notice dated 29th September, 2017 was issued and was delivered to the petitioner. Consequently, according to him principles of natural justice had been fully complied with in the present case.

COURT'S REASONING

SCOPE OF SECTION 179(1) OF THE ACT

17. Having heard learned counsel for the parties, this Court is of the view that it is essential to first analyse the scope of section 179(1) of the Act as well as its necessary ingredients. Section 179(1) of the Act reads as under:-

> "179. *Liability of directors of private company in liquidation*.
>
> (1) Notwithstanding anything contained in the Companies Act, 1956 (1 of 1956), where any tax due from a private company in respect of any income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company."

18. In the opinion of this Court, section 179 of the Act imposes a vicarious responsibility on the Directors for the dues of the company. It has, therefore, to be interpreted rigidly, subject to conditions, for application under section 179. The primary condition is that the tax dues could not be recovered from the company before section 179 could be invoked. The Assessing Officer has therefore to give a finding that the tax dues could not be recovered from the company before proceeding against the director. [See: *Sampath Iyengar's Law of Income Tax*, Vol.8, 12th Edition].

19. Moreover, the director of the private company can avoid his joint and several liability for payment of taxes if he proves that the non-recovery cannot be attributed to his gross neglect, misfeasance or breach of any duty on his part in relation to the affairs of a company.

DESPITE ISSUING NOTICES AND ATTACHMENT ORDERS THE ENTIRE OUTSTANDING TAX DUES COULD NOT BE RECOVERED FROM THE REALTECH GROUP OF COMPANIES LEAVING THE DEPARTMENT WITH NO OTHER OPTION, BUT TO RECOVER THE SAME FROM THE DIRECTORS

20. The contention of the petitioner that no action to recover the demand from the Realtech Group of Companies was taken by the Assessing Officer is not correct. It has been mentioned in the impugned order dated 29th January, 2018 under section 179(1) that the demand notices were served upon the said companies on 29th March, 2014. Thereafter, notices under section 221(1) of the Act were issued to the companies on 14th November, 2014. It was only when the demand was not paid, bank accounts of the companies were attached and partial recovery was made through the said attachments. In fact, the impugned order passed under section 179(1) of the Act dated 29th January, 2018, as well as the Order passed under section 264 dated 1st April, 2021 clearly demonstrate that only a small part of the demand was recovered despite all possible efforts by the Department including action of attachment of bank accounts of the Realtech Group of companies.

21. Moreover, the tax dues against Realtech Construction (P.) Ltd. which was developing The City Emporio Mall was only Rs. 12.17 lakhs. The tax demand against the other companies could not be recovered from the assets of that company. Section 179 only permits recovery against a director and not against other group companies which are distinct legal entities.

22. In fact, in the impugned order dated 1st April, 2021 there is a specific finding that despite issuing notices and attachment orders the entire outstanding tax dues could not be recovered from the Realtech Group of companies leaving the Department with no other option, but to recover the same from the Directors including the petitioner. The relevant portion of the said order dated 29th January, 2018 is reproduced hereinbelow:—

> *" ……The Companies, M/s Realtech Projects (P.) Ltd., M/s Real Infrastructure (P.) Ltd., M/s Realtech Constructions (P.) Ltd. and M/s Vivid Builders (P.) Ltd. were issued demand notices dated 29-3-2014 u/s 156 for A.Ys. 2006-07 & 2009-10 which were sent to the address of the aforesaid companies i.e.* D-22, Defence Colony, New Delhi - 110024. However, the demand was not paid within specified time. Therefore, the aforesaid companies were issued notice u/s 221(1) of the I.T. Act, dated 14-11-2014 to pay the demand alongwith interest chargeable u/s 220(2) and submit the proof of payment made if already deposited. No reply in respect of the said notice was submitted by the companies.
>
> *As the demand was not paid, therefore, the bank accounts of companies available in the records were attached. Till date, recovery of Rs. 10,38,373/- in the case of M/s Realtech Infrastructure (P.) Ltd. and Rs. 62,00,000/- in the case of M/s Vivid Builders (P.) Ltd. has been made through attachment of bank accounts.*
>
> *As per the provisions of section 179(1) of the Income-tax Act, 1961, if the tax due from a private company cannot be recovered, then every person who was director of such company at any time during the previous year shall be jointly and severally liable for the payment of such outstanding tax.*
>
> As per information available with this office, you were a director in all three companies mentioned above. Notice u/s. 179(1) dated was issued to you to show cause as to why proceedings of recovery of above demand should not be initiated against you. You were required to submit your reply by 25-9-2017. However, you have not submitted any reply to this office till date. Therefore, you are held liable for non payment of tax dues as discussed above in the case of the said companies for the period during which you were director of company...."

(*Emphasis supplied*)

SUBMISSION OF THE PETITIONER THAT IT IS FOR THE RESPONDENT-REVENUE TO DEMONSTRATE THAT THE PETITIONER DIRECTOR WAS GUILTY OF GROSS

NEGLECT, MISFEASANCE OR BREACH OF DUTY ON HIS PART IN RELATION TO THE AFFAIRS OF THE COMPANY IS CONTRARY TO THE EXPLICIT LANGUAGE USED IN SECTION 179

23. The submission of the learned senior counsel for the petitioner that it is for the respondent-Revenue to demonstrate that the petitioner Director was guilty of gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company is contrary to the explicit language used in section 179. The burden is on the individual Director to prove that the non-recovery was not due to his gross negligence, misfeasance or breach of duty on his part.

24. In fact, the Division Bench of Bombay High Court in the case of *Union of India* v. *Manik Dattatreya Lotlikar* [1987] 35 Taxman 526/[1988] 172 ITR 1 has so held. The relevant portion of said judgment reads as under:—

> "9. Finally, *Shri Patil submitted that the liability of the director under section 179 is not absolute and the director would be liable only if the non-recovery can be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the Company*. The learned counsel urged that the respondent was a former director and was more busy in performing social work and in that connection was involved in several legal battles and therefore was not guilty of gross neglect to attend to the affairs of the company. It was also contended that the director should not be held liable as the company had no assets whatsoever for any of the assessment years subsequent to the year 1964-1965 and the assessment was 'nil'. We fail to appreciate any merit in this submission. *In the first instance, sub-section (1) of section 179 cast burden upon the director to prove that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part. The burden being on the director, the respondent ought to have established the requirements of the sub-section to escape the liability, and the respondent has failed to do so. The question as to whether the respondent discharged the burden is a pure question of fact and could not have been entertained in writ petition filed under Article 226 of the Constitution of India when the finding was recorded by the Commissioner of Income-tax against the respondent on this count*. Apart from this consideration, it is clear that the non-recovery can well be attributed to the breach of duty on the part of the respondent. The respondent loved to continue as a director of a defunct private company and while holding the office of director it was the bounden duty of the respondent to ensure that the tax amount is paid. The respondent having failed in his duty, cannot escape the liability prescribed under section 179 of the Act. The contention that the company had no income and suffered losses does not impress us as the assessments for the relevant years were complete and final and it is not open for the director to challenge those assessments in a proceeding under section 179 of the Act. In our judgment, the respondent was not entitled to any relief in the writ petition and the impugned judgment of the learned single Judge cannot be sustained.
>
> 10. Accordingly, appeal is allowed and the impugned judgment dated January 11, 1983 in Miscellaneous Petition No. 1432 of 1978 is *set aside* and the petition is dismissed. The respondent shall pay costs of the Revenue throughout."

(*Emphasis supplied*)

PRIVATE PARTIES CANNOT APPORTION INCOME TAX LIABILITY BY PRIVATE AGREEMENT AS THE PETITIONER HAS SOUGHT TO DO IN THE PRESENT CASE. IT IS SETTLED LAW THAT WHILE RIGHTS IN PERSONAM ARE ARBITRABLE, RIGHTS IN REM ARE UNSUITED FOR PRIVATE ARBITRATION AND CAN ONLY BE ADJUDICTED BY THE COURTS OR TRIBUNALS.

25. This Court is further of the opinion that the MOU, Settlement Deed and an Arbitral Award govern

rights in personam and cannot bind a statutory authority like the respondent-Revenue. It is a settled law that while rights in personam are arbitrable, rights in rem are unsuited for private arbitration and can only be adjudicated by the Courts or Tribunals. (See: *Booz Allen & Hamilton Inc.* v. *SBI Home Finance Ltd.* [2011] 5 SCC 532).

26. Consequently, this Court is of the opinion that private parties cannot apportion Income-tax liability by private agreement as the petitioner has sought to do in the present case.

27. Accordingly, the present writ petition being bereft of merits is dismissed, but with no order as to costs.

Tanvi

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*In favour of revenue.