

Circular No.4 / 2011, relating to section 281, which deals with certain transfers to be void

- S.K.Tyagi

The Central Board of Direct Taxes (CBDT) has recently issued Circular No.4 / 2011, dated 19.7.2011, relating to the provisions of section 281 of the Income-Tax Act, 1961 (the Act), wherein the CBDT has laid down guidelines for the issuance of previous permission by the Assessing Officer (AO), in respect of creation of a charge on the assets of its business, by a business entity.

In view of the aforesaid Circular issued by the CBDT, a number of queries have been raised by my clients regarding the applicability of the same, in respect of the transactions of transfer of an asset or creation of a charge on an asset, for the purpose of raising loan, etc. It will, therefore, be necessary to understand the real implications of the aforesaid Circular.

In connection with the aforesaid Circular, it will be necessary to understand the nature of transactions, in relation to which the provisions of section 281 of the Act, may be applicable. Besides, it may also be necessary to understand whether the previous permission of the AO will be necessary in respect of all the transactions covered under section 281 of the Act.

In this context, it may be stated that the object of section 281 of the Act, is to safeguard the interests of the Revenue, against unscrupulous assesseees who may fraudulently part with their assets to avoid payment of taxes. *Bona fide* transactions for adequate consideration are, however, protected from the sweep of section 281 of the Act. Therefore, it will be necessary to carefully examine and understand the real intent and scope of the provisions of section 281 of the Act. In this context, the proviso to section 281(1) of the Act, is relevant, which is reproduced as follows :

“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.”*

From clause (i) of the aforesaid proviso, it may be seen that the impugned charge or transfer shall not be void if the same is made for adequate consideration and without notice of the pendency of proceedings or income-tax payable by the assessee. In other words, the impugned charge or transfer will not fall within the purview of section 281(1), if the same is made for adequate consideration or sufficient reason.

In view of the aforesaid reasons, it will be necessary to correctly understand the scope of the provisions of section 281 of the Act. In this connection, it may be stated at the outset that the previous permission of the AO, for the impugned transactions is not required in all cases, because the transactions made for adequate consideration do not require the previous permission of the AO. It may also be stated here that the aforesaid Circular No.4 / 2011, dated 19.7.2011, is relevant only in a case where the previous approval of the AO is sought by a tax-payer.

In view of the aforesaid reasons, it will be necessary to examine the relevant provisions of section 281 of the Act, another Circular No.179, dated 30.9.1975, of the CBDT and the relevant legal precedents. The same are examined as follows :

I. Relevant provisions of section 281 of the Act.

The various aspects in relation to the provisions of section 281 are as follows :

1. Brief history of section 281.

Under the 1922 Act, the only recourse available to the IT Department in a case where the assessee was found to have effected a transfer of his assets, was to file a suit under section 53 of the Transfer of Property Act, 1882, or to move a petition for insolvency adjudication of the assessee. These courses were beset with several difficulties and **the need for a specific provision to protect the interests of revenue was acutely felt.** Therefore, section 281 was introduced for the first time at the time of the enactment of the 1961 Act.

This section operates only till the service of a notice under rule 2 of the Second Schedule to the Act and once such notice is served, it has the effect of an attachment – *Inayat Hussain Vs. Union of India [1980] 122 ITR 227 (Bom.)*. ***It is, thus, clear that the provisions of section 281 are normally invoked by the IT Department in order to protect the interests of revenue, wherever the circumstances so demand.***

2. Object and scope of section 281

The object of section 281 is to safeguard the interests of the Revenue against unscrupulous assesses who may fraudulently part with their assets to avoid payment of taxes. *Bona fide* transactions for adequate consideration are, however, protected from the sweep of this section. Therefore, it will be necessary to carefully examine the real intent and scope of the provisions of section 281 of the Act.

In order to understand the correct scope of the provisions of section 281 of the Act, it may be appropriate to refer to the relevant legal precedents :

- (i) *Gangadhar Vishwanath Ranade (No.1) Vs.ITO [1989] 177 ITR 163 (Bom.)*

It was held in this case that section 281 of the Income-Tax Act, 1961 (the Act) and section 53 of the Transfer of Property Act, 1882, are *pari materia*. In both the cases, it is only the creditor or the Revenue defeated or defrauded or delayed, who can take action or

proceedings to get it declared that the transfer is fraudulent. Further, an order under section 281 means only that the Department has decided to proceed against the property, transfer being void so far as the claim of Revenue is concerned. But it does not take the character of any adjudication as to the nature of transfer. It is merely a step to recover dues from the defaulter.

(ii) *Gangadhar Vishwanath Ranade (No.2) Vs. TRO [1989] 177 ITR 176 (Bom.)*

In this case the assessee executed a mortgage of an immovable property in favour of a bank, after he received a certificate from the tax authorities under section 230A of the Act. In 1969, he executed a trust deed, which was registered in favour of his wife and daughter, in respect of the property. The assessee's wife agreed to take over the mortgage liability. On February 27, 1969, the assessee conveyed the property to his wife and daughter, by a registered deed. In October, 1972, the property was attached in recovery of assessee's tax dues and the ITO passed an order on May 9, 1974, under section 281, wherein he held that the transfer of property was void. A writ petition against the order, dated May 9, 1974, was dismissed on the ground that what was represented to be in order was no more than an internal decision of the tax authorities to proceed against the property. In September, 1981, the TRO passed an order under section 281, holding that the provisions of section 281 were applicable to the case and that the mortgage deed, the trust deed and the conveyance deed, dated February 27, 1969, were void.

It was, *inter alia*, held by the Bombay High Court that the TRO had no power under section 281 of the Act, to declare the transfers void and accordingly, the impugned order was liable to be set aside.

The aforesaid judgement of the Bombay High Court, was, later on, affirmed by the Supreme Court, in the case of *TRO Vs. Gangadhar Vishwanath Ranade (Decd.) [1998] 234 ITR 188 (SC)*.

(iii) *Twinstar Holdings Ltd. Vs. Anand Kedia, Dy. CIT [2003] 260 ITR 6 (Bom.)*

It was, *inter alia*, held in this case that clause (i) of the proviso to section 281(1) refers to a *bona fide* transfer for value, without notice of the pendency of proceedings.

It was also held that the assessee had transferred the shares under a sham dissolution as an asset. Under the block assessment orders, the shares were treated as stock-in-trade and therefore, the Assessing Officer had treated the difference between the market value of the shares as on 31.3.1999 and the book value as undisclosed business income. Under that order, the shares had to be valued at market value and not at cost. In the

circumstances, it was not open to the petitioner to contend that the transfer was for adequate consideration. Therefore, clause (i) of the proviso had no application.

From the aforesaid judgement, it may be safely concluded that clause (i) of the proviso to section 281(1) refers to a bona fide transfer for value.

(iv) *Ms.Ruchi Mehta Vs.Union of India [2007] 294 ITR 614 (Bom.)*

It was held in this case that section 281 of the Income-Tax Act, 1961, does not prescribe any adjudicatory machinery for deciding any question which may arise under it. In order to declare a transfer fraudulent under section 281, appropriate proceedings would have to be taken in accordance with law in the same manner as they are required to be taken under section 53 of the Transfer of Property Act, 1882. Principles of natural justice must be followed and opportunity to be heard must be given.

It was also held, that the action of the Tax Recovery Officer passing an order under section 281 declaring the transfer of the property in favour of the petitioners void was clearly without jurisdiction. The order also attracted civil consequences. The Tax Recovery Officer before passing any such order ought to have given opportunity to the petitioners if in law the Tax Recovery Officer could exercise the jurisdiction under section 281. That opportunity was also not given. The order, therefore, must also be set aside for violation of the principles of natural justice and fair play. The order was not valid.

(v) *Shamim Bano G.Rathi Vs.Oriental Bank of Commerce Ltd.[2008] 306 ITR 234 (Bom.)*

It was, *inter alia*, held in this case that section 281 of the Act does not prescribe any adjudicatory machinery for deciding any question which may arise under it. In order to declare a transfer fraudulent under section 281, appropriate proceedings have to be taken before the competent Civil Court. Therefore, the sale of property by agreement, dated 30.7.2002, declared to be null and void by the Department, vide order, dated 21.9.2004, was an order without jurisdiction, in the absence of a declaration by a Civil Court to that effect and consequently, the same had to be set aside.

From the aforesaid legal precedents, it may be seen that –

(i) Section 281 of the Income-Tax Act, 1961, does not prescribe any adjudicatory machinery for deciding any question which may arise under it.

- (ii) The TRO / ITO has no power under section 281 to declare a transfer void.
- (iii) In order to declare a transfer fraudulent under section 281, appropriate proceedings have to be taken before the competent Civil Court.
- (iv) Clause (i) of the proviso to section 281(1) refers to a *bona fide* transfer for value, without notice of the pendency of proceedings.
- (v) Therefore, the impugned charge or transfer will not be held to be void or in other words, the same will be saved if they are made for adequate consideration, without notice of the pendency of proceedings.
- (vi) Further, if the impugned charge or transfer is covered under clause (i) of the proviso to section 281(1), then clause (ii) of the said proviso will not come into play. In other words, previous permission of the Assessing Officer will not be required for the impugned charge or transfer, as contemplated under section 281(1) of the Act.

3. Interpretation of the provisions of section 281.

We may now examine the true intent and the purpose of the provisions of section 281. For the sake of ready reference, section 281 is reproduced as follows :

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.

From the aforesaid provisions of section 281, it may be seen that this provision is applicable in cases where the assessee creates a charge on any of his assets, or parts with the possession thereof, by way of sale, mortgage, exchange or any other mode of transfer, whatsoever. However, *bona fide* transactions for adequate consideration are protected. This is clear from clause (i) of the proviso to section 281(1). As per the aforesaid clause (i), such a charge or transfer shall not be void if it is made 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.

In this context, it will be appropriate to understand the meaning of the phrase ‘adequate consideration’, as used in clause (i) of the proviso to section 281(1) of the Act. As regards the meaning of the word ‘consideration’, a reference may be made to Advanced Law Lexicon by Shri P.R.Aiyar, 3rd Edition, 2005, Book No.1. The relevant meaning of the word ‘consideration’, as provided on page 977 of the aforesaid Book 1, may be reproduced as follows :

- (a) “A consideration in its widest sense is the reason, motive, or inducement, by which a man is moved to bind himself by an agreement. It is not for nothing that he consents to impose an obligation upon himself, or to abandon or transfer a right. It is in consideration of such and such a fact that he agrees to bear new burdens or to forgo the benefits which the law already allows him”.
- (b) “The giving of value or making of obligations by each party that is necessary to make a contract enforceable”.

From the aforesaid meaning of the word ‘consideration’, it may be seen that the same may be equated to the reason, motive or inducement for an agreement. The other meaning of the word ‘consideration’ may be giving something of value.

We may now also look at the meaning of the word ‘adequate’. As per the Concise Oxford Dictionary, 9th Edition, the word ‘adequate’ means *sufficient* or *satisfactory*.

Thus, it may be safely concluded that the meaning of the phrase ‘adequate consideration’ may be sufficient reason. Therefore, if the impugned charge or transfer is made for a sufficient reason, then the same will not fall within the purview of section 281(1) of the Act.

In this regard, it may be further stated that when a company or any other entity creates a charge on an asset for raising a loan, there is definitely a sufficient reason for such a charge or transfer.

In view of the aforesaid reasons, no permission of the AO under section 281 of the Act, is required, in case a charge is created by a tax-payer on an asset for raising a loan for the purposes of its business.

Similarly, the permission of the AO under section 281 of the Act, will not be required in case of a transfer of an asset, if the same is made for adequate consideration.

II. Relevant Circular No.179, dated 30.9.1975 of the CBDT.

In the present case, it will be appropriate to bring on record the fact that section 281, as originally enacted, was substituted by the Taxation Laws (Amendment) Act, 1975, with effect from 1.10.1975. The scope and effect of the present section 281 of the Act was explained by the CBDT, vide its Circular No.179, dated 30.9.1975 [102 ITR (St.) 19]. The aforesaid Circular is reproduced as follows :

“Certain transfers to be void – Section 281

25. *Under section 281 of the Income-Tax Act, transfers effected by an assessee during the pendency of any proceeding under the Act with the intention to defraud the revenue are regarded as 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 such proceeding. This provision is applicable in cases where the assessee created a charge on any of his assets, or parts with the possession thereof by way of sale, mortgage, exchange or any other mode of transfer whatsoever. Bona fide purchasers of value without notice are, however, protected against the operation of this section. The Amending Act has substituted a new section for the existing section 281 with a view to enlarging the scope of the provision. The main changes are as follows :*

- (i) Creation of any charge on or transfer of assets made not only during the pendency of proceedings but also after completion thereof but before the service of notice by the Income-Tax Officer under rule 2 of the Second Schedule will be void.*
- (ii) The Department would no longer be under obligation to prove that the charge or the transfer was made with the intention to defraud the revenue.*
- (iii) Assets covered by the provisions of the new section have been defined to mean land, building, machinery, plant, shares, securities and fixed deposits in banks, to the extent to which they do not form part of the stock-in-trade of the business of the assessee.*
- (iv) The charge or transfer shall not be void if made for adequate consideration and without notice of pendency of such proceedings or, as the case may be, without notice of such tax or other sum payable by the assessee. The charge or transfer shall also not be void*

if the charge is created or the transfer is made with the previous permission of the Income-Tax Officer.

(v) *The new provision will apply only if the amount of tax or other sum payable or likely to be payable exceeds Rs.5,000 and the assets charged or transferred exceed Rs.10,000 in value.*

26. *The provisions of new section 281 will apply in relation to any charge created or transfer made on or after 1 October, 1975. Charges created or transfers made before that date will continue to be governed by the earlier provision.”*

From the contents of the aforesaid Circular of the CBDT, it may be clearly noted that under section 281 of the Act, transfer effected by an assessee during the pendency of any proceeding under the Act, with the intention to **defraud the revenue**, are regarded as 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 such proceedings.

As per clause (iv) of para (25) of the aforesaid Circular, the charge or transfer shall not be void, if made for adequate consideration and without notice of pendency of such proceedings or, as the case may be, without notice of such tax or other sum payable by the assessee.

The charge or transfer shall also not be void if the charge is created or transfer is made with the previous permission of the AO.

In this connection, a reference may also be made to the initial part of the aforesaid Circular. For the sake of ready reference, the same is reproduced as follows :

“This provision is applicable in cases where the assessee created a charge on any of his assets, or parts with the possession thereof by way of sale, mortgage, exchange or any other mode of transfer whatsoever. Bona fide purchasers of value without notice are, however, protected against the operation of this section.”

It, therefore, clearly implies that the impugned charge or transfer for a sufficient reason and without notice, is protected against the operation of section 281 of the Act.

Besides, sub-para (iv) of para (25) of Circular No.179, is also relevant in this regard. For the sake of ready reference, the same is reproduced as follows :

“(iv) The charge or transfer shall not be void if made for adequate consideration and without notice of pendency of such proceedings or, as the case may be, without notice of such tax or other sum payable by the assessee. The charge or transfer shall also not be void if the charge is created or the transfer is made with the previous permission of the Income-Tax Officer.”

It may, thus, be seen that the aforesaid Circular, as a whole, supports the view that the impugned charge or transfer shall not be void, if made for adequate consideration or sufficient reason, without notice of pendency of proceedings or tax payable by the assessee.

III. Other relevant legal precedents

In this connection, we may also refer to some other relevant legal precedents. The same are discussed as follows :

- (i) *Palanpur Traders Ltd. Vs. Union of India [1991] 187 ITR 132 (Bom.)*

In this case the Hon. High Court was required to interpret the provisions of section 281 of the Act.

It was, *inter alia*, held in this case that the first proviso to sub-section (1) of section 281 of the Act provides that a transfer for adequate consideration and without notice of the pendency of such proceedings or as the case may be, without notice of such tax or other sum payable by the assessee, shall not be void.

- (ii) *Smt.Sushila Vs. Union of India [2008] 302 ITR 182 (P&H)*

In this case also, the Hon. High Court was required to interpret the provisions of section 281 of the Act.

It was, *inter alia*, held in this case that the proviso to section 281(1) of the Act provided that any such transaction as mentioned under section 281(1) shall not be void if it is made for adequate consideration and without notice of pendency of the said proceedings or, as the case may be, without notice of such tax or other sum payable by the assessee or with the previous permission of the AO.

- (iii) *Twinstar Holdings Ltd. Vs. Anand Kedia, Dy. CIT [2003] 260 ITR 6 (Bom.)*

In this case also, the Hon. High Court was required to refer to the provisions of section 281 of the Act.

On page 31 of the Report, the Hon. High Court has laid down that section 281(1) has a proviso under which transfers are saved, if they are made with adequate consideration and if such transfers are made without notice of pendency or proceedings or if made without notice of tax payable by the assessee.

It was also held in this case that clause (i) of the proviso to section 281(1) refers to a *bona fide* transfer for value, without notice of pendency of proceedings.

From the aforesaid legal precedents, it is clearly established that clause (i) of the proviso to section 281(1) lays down that the impugned transfer or charge will be saved if they are made for adequate

consideration and without notice of pendency of proceedings or made without notice of tax payable by the assessee.

From the aforesaid discussion, it may be seen that the provisions of section 281 are not applicable, in respect of a transaction if the conditions under clause (i) **or** clause (ii) of the proviso to section 281(1) are satisfied. In other words, the provisions of section 281(1) will not apply, if the conditions laid down under either of the aforesaid two clauses of the proviso to section 281(1) are satisfied.

Therefore, if the conditions laid down under the aforesaid clause (i) are satisfied, then it is not necessary to satisfy the conditions laid down under the aforesaid clause (ii) of the said proviso to section 281(1) of the Act.

IV. Relevance of Circular No.4 / 2011, dated 19.7.2011

We may now deal with the relevance of the aforesaid Circular No.4 / 2011, dated 19.7.2011, issued by the CBDT.

As already pointed out, in the preceding paras, the previous permission of the AO will not be required if the impugned charge or transfer is made for adequate consideration or sufficient reason.

However, if under certain circumstances, it is necessary for a tax-payer to obtain the previous permission of the AO, as contemplated under clause (ii) of the proviso to section 281(1) of the Act, then the conditions laid down for the grant of such permission by the AO, in the aforesaid Circular No.4 / 2011, dated 19.7.2011, will apply.

The conditions laid down in the aforesaid Circular are self-explanatory and they require no further explanation on my part.

V. Conclusion

In the light of the discussion in the preceding paragraphs, it may be safely concluded that –

1. Section 281 is normally invoked by the IT Department, in order to protect the interests of Revenue, wherever the circumstances so demand.
2. Section 281 of the Income-Tax Act, 1961, does not prescribe any adjudicatory machinery for deciding any question which may arise under it.
3. The TRO / ITO has no power under section 281 to declare a transfer void.
4. In order to declare a transfer fraudulent under section 281, appropriate proceedings have to be taken by the IT Department before the competent Civil Court.

5. Clause (i) of the proviso to section 281(1) refers to a *bona fide* transfer for value, without notice of pendency of proceedings.

In other words, the provisions of section 281 will not apply in a case where the impugned charge or transfer is made for adequate consideration or sufficient reason, without notice of the pendency of proceedings.

6. In view of the proviso to section 281(1), if the impugned charge or transfer is covered under clause (i) of the proviso, then clause (ii) of the said proviso will not come into play.

In other words, previous permission of the Assessing Officer will not be required for the impugned charge or transfer, as contemplated under section 281(1) of the Act.

7. Creation of a charge on an asset for raising a loan for the purposes of business of the assessee, is definitely an adequate consideration or sufficient reason for such charge.

8. The previous permission of the Assessing Officer will not be required in a case where the impugned charge is created for raising a loan for the purposes of the business of the assessee.

Similarly, the previous permission of the Assessing Officer will not be required in a case where the impugned transfer is made for adequate consideration.

9. The aforesaid Circular No.4 / 2011, dated 19.7.2011, will, therefore, apply only in a case where the previous permission of the Assessing Officer is sought by the assessee and not otherwise.

In view of the aforesaid reasons, the aforesaid Circular will not apply in cases –

- (i) where the transfer of an asset is made for adequate consideration, or
(ii) a charge is created on an asset for raising a loan for the purposes of the business of the assessee.

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