

## No Jurisdiction for notice under section 226(3) on an escrow agent who did not hold any amount on account of the assessee

**Summary – The Delhi High Court in a recent case of AAA Portfolios (P.) Ltd., (the Assessee) held that Where Assessing Officer raised tax demand upon assessee and for recovery of said demand issued notice under section 226(3) on an escrow agent, who furnished an affidavit to effect that no amount was held by it on account of assessee, impugned notice was without jurisdiction.**

### Facts

- A charitable society was merged with another society and subsequently the same was converted into a company, namely, the assessee-company. The petitioners held shares in the assessee-company. They as sellers entered into a share purchase agreement dated 25-9-2005 for sale of their shares in the assessee-company to a purchaser. Pursuant to the share purchase agreement, the sellers and the purchaser and the respondent no. 2, a bank, entered into an escrow agreement dated 27-9-2005, which, *inter alia*, recorded the obligations of respondent no. 2 as the escrow agent. As agreed under the share purchase agreement, the purchaser was required to deposit the entire sale consideration with the escrow agent and the sellers agreed to deposit certain documents including share transfer deeds and instructions with the escrow agent in order to consummate the transaction for sale and purchase of shares of the assessee-company.
- The Assessing Officer passed assessment order for the assessment year 2001-02 on the assessee and raised a demand of Rs. 124.36 crores upon it. The said demand was disputed by the assessee. As there were disputes pending with the Income-tax department regarding the tax liability of the assessee, it was agreed between the purchaser and the petitioners that a certain sum would be held back from the sale consideration by the escrow agent and would not be released to the petitioners until the income-tax liability of the assessee was finally adjudicated.
- The Assessing Officer issued a notice under section 226(3) on the respondent no. 2 directing it to remit a sum of Rs. 94.84 crores, which was lying with it in fixed deposit, to the department. The petitioners objected the said notice contending that (i) the action under section 226(3) was in the nature of garnishee proceedings, where the revenue steps into the shoes of the assessee and recovers money directly from a third party who owed money to the assessee, and (ii) the respondent No. 2 did not either hold any money on account of the assessee or owed any money to the assessee and, therefore, the sum held by the respondent no. 2 in escrow pursuant to the escrow agreement could not be demanded by the Assessing Officer. The respondent no. 2 also furnished an affidavit unequivocally affirming that the fixed deposit of Rs. 94.84 crores was held by it in terms of the escrow agreement and that no part of the same was owed to or held on account of the assessee.
- The Assessing Officer rejected the objections and passed an order to the effect that the amount of Rs. 94.84 crores had been kept in the escrow account for meeting the income-tax demand only. Pursuant to the impugned order, he sent a notice under section 226(3) calling upon respondent no.

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2 to forthwith pay the amount held by it by way of fixed deposits pursuant to the escrow agreement. Thereafter the respondent no. 2 paid a sum of Rs. 95.84 crores to the Assessing Officer in compliance of the notice.

- On writ:

#### **Held**

- Section 226 provides for other modes of recovery of tax due from an assessee. The provisions of section 226(3) provide the machinery for enabling an Assessing Officer to recover the amount of income-tax due from an assessee by recovering sums from any person who owes any money to the assessee or holds any money on his account. Section 226(3) confers upon an Assessing Officer a special jurisdiction to proceed directly against a person, other than an assessee, for recovery of income-tax demands due from the assessee.
- The power conferred under section 226(3) is a special power that enables the Assessing Officer to reach beyond the assessee in order to appropriate amounts due to or held by third parties on account of the assessee. The proceedings under section 226(3) are in the nature of garnishee proceedings, whereby a garnishee is called upon to directly pay a debt to the creditor of a person to whom the garnishee is indebted. The Assessing Officer is similarly situated as a garnisher and is in a position to initiate action under section 226(3) to reach out to the property of the assessee which is held by a third party or to any sum which is owed by a third party to the assessee. The Assessing Officer steps into the shoes of an assessee with respect to recovering sums owed to or held by the garnishee on account of the assessee. An Assessing Officer is not conferred with any additional rights in respect of any amount due from the garnishee other than that which are available to the assessee.
- Section 226(3) neither confers jurisdiction nor provides a machinery for an Assessing Officer to adjudicate the indebtedness of a third party to the assessee and the provisions of section 226(3) must be confined to those cases where a third party admits to owing money or holding any money on account of the assessee or in cases where it is indisputable that the third party owes money to or holds money on account of the assessee. However, in cases where there are contentious issues raised by a third party who disputes his liability to pay any money to the assessee there is no mechanism provided or jurisdiction conferred upon the Assessing Officer to proceed further in the matter and take upon himself the mantle of adjudicating the said disputes.
- In the instant case, the respondent no. 2 has furnished an affidavit unequivocally affirming that no part of the amount held by it in escrow account is owed to or belongs to or is held by it on account of the assessee. In view of the affidavit furnished by the respondent no. 2, the Assessing Officer had no jurisdiction to proceed further and call upon it to make over the funds held by it as an escrow agent pursuant to the escrow agreement to the department. In this view, the impugned order and impugned notice were wholly without jurisdiction and were liable to be set aside.