

[2020] 116 taxmann.com 96 (Article)

## IBC- It's a Binding Code - Tax Perspective

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Insolvency and Bankruptcy Code, 2016 (IBC) is one of the showcase legislations of the Government to consolidate and amend laws relating to reorganisation and insolvency resolution of distressed corporates in a time bound manner for maximisation of value of assets and balancing the interests of all stakeholders, including alteration in the order of priority of payment of Government dues<sup>1</sup>. The scheme of the Code marked a paradigm change from the previous regime.

A substantial issue/ question that lurks in the minds of the corporate debtor(s) and the acquiring resolution applicant(s) is the fate of statutory liabilities including income tax liabilities of the corporate debtor, relating to period prior to resolution.

To get a constructive and logical answer to the aforesaid question, one would have to understand the scheme of the Code and the intention behind the statute.

### ***Scheme of IBC at a glance:***

- The resolution process under IBC involves various parties, the primary being:
  - **Corporate Debtor** which is the corporate defaulter.
  - **Resolution Applicant(s)** being the group/ entity filing a resolution plan to acquire and revive the business of the corporate debtor.
  - **Creditors**- the financial and the operational creditors to whom debt is owed by the corporate debtor.
- Successful resolution process under the IBC involves –
  - Competitive bidding for the corporate debtor.
  - Sacrifice by the financial and operational creditors (often referred to as haircuts).
  - Takeover and subsequent continuance of the business of the corporate debtor by the successful resolution applicant/ bidder.
- Section 5(12) of the IBC defines “**insolvency commencement date**” as the date of admission of the insolvency resolution process by the Adjudicating Authority, being

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<sup>1</sup> 'Statement of Objects and Reasons' for introduction of IBC

the National Company Law Tribunal (“NCLT”).

- Section 13 mandates that NCLT shall after admission of the resolution application - declare a moratorium prohibiting institution of suits or continuation of pending suits or proceedings pending against the corporate debtor, a public announcement be made, and call for the submission of claims by various parties under section 15 of IBC.
- One of the critical steps is submissions of claims before the Resolution Professional (RP) by the financial and operational creditors as on the insolvency commencement date which are, then, verified and is followed by preparation of an estimate of the amount of claims against the corporate debtor. Under section 3(6) of the IBC, the expression “**claim**” is defined in its widest form to mean right to payment arising out of breach of contract or otherwise, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured or unsecured.

The rationale of making of public announcement inviting claims aims to call every creditor to file all possible claims, even if disputed, against the corporate debtor, in order for the same to be considered appropriately.

- IBC recognizes two types of creditors: financial creditors and operational creditors. Financial creditors are primarily parties to whom loans and interest thereon is due. Tax dues are however categorized as “operational debts” in terms of section 5(21) of IBC and the Tax Department, accordingly, falls in the category of “operational creditor”. Therefore, tax dues, despite being a sovereign debt, no longer enjoy priority over dues of the other operational creditors, which is also in line with one of the stated legislative intents set out in the preamble to the IBC, being “alteration in the order of priority of payment of Government Dues...”.
- As per section 30(2), the plan provides for repayment of debts of operational creditors such that the same shall not be less than the amount to be paid in the event of liquidation under section 53 of IBC. Simply stating, the operational creditors, including the Government, cannot, as a matter of right, claim any amount in excess of the liquidation value. Further, section 53 sets the order of priority of payment in case of liquidation. Pertinently, insolvency resolution process cost is the first item to be borne out of the insolvency proceeds and Government dues are considered after payment to the unsecured financial creditors.

### ***Binding nature of approved Resolution Plan***

- The resolution plan once approved by the committee of creditors, is placed before the NCLT for its approval. As per **section 31(1)**, once the plan is approved by NCLT, the same shall be binding on the corporate debtor, employees, members, creditors, guarantors, and other stakeholders. The provision has been amended w.e.f 16.08.2019 to specifically include that the approved Resolution Plan shall be binding on Central Government/ State Government/ statutory authority to whom a debt in respect of payment of dues arising under any law is owed.

- Furthermore, **section 238** provides that the provisions of IBC shall have effect notwithstanding anything inconsistent contained in any other law including Income-tax Act, 1961 ('IT Act').
- The approved resolution plan provides the quantum of amount to be paid to the financial and operational creditors against their respective claims/ dues, which is **binding on the creditors who are bound to accept the amount stated in the plan to be paid against their dues.**
- Certain relevant judicial precedents affirming the supremacy of the approved resolution plan and the IBC are highlighted hereinbelow:
  - **Innoventive Industries Limited**<sup>2</sup> (SC), the Court elaborately explained that the provisions of the IBC overrides any other law inconsistent therewith.
  - In **Monnet Ispat**<sup>3</sup>, the apex Court held that the provisions of IBC would override anything inconsistent contained in the IT Act.
  - In the case of **V. Ventaka Sivakumar**<sup>4</sup> the NCLT directed the withdrawal/ vacation of attachment under section 178 of the Act treating it to be inconsistent with IBC.
  - In the case of **Leo Edibles**<sup>5</sup>, the Court held that the tax Department cannot claim any priority in payment from liquidation assets merely because the IT Department has issued attachment order prior to initiation of liquidation proceedings.
  - In **Synergies Dooray Automotive**<sup>6</sup> case, it was held that the statutory dues such as income-tax, sales tax, VAT and other taxes fall within the definition of 'operational debt'. Settlement @ 1% of crystalized demands/ claims of taxes was upheld.
  - In the decision of **Star Agro Marine Exports**<sup>7</sup>, the Appellate Tribunal laid down certain important legal principles- (i) In a situation where assets of corporate debtor are not enough to meet out the liability of the operational creditors in the event of liquidation, then, no provision could be made in the resolution plan for payment to such creditors; (ii) The operational creditors/ statutory authorities may not be getting anything for satisfaction of their claims under the valid resolution plan; and (iii) The pending proceedings, suits, claims, disputes in connection with the corporate debtor pending or threatened, present or future in relation to any period prior to the plan approval date or arising on account of implementation of the resolution plan shall stand withdrawn.

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<sup>2</sup> of Innoventive Industries Limited Vs. ICICI Bank in Civil Appeal Nos. 8337-8338 of 2017 (SC) dated 31.08.2017

<sup>3</sup> PCIT vs. Monnet Ispat and Synergy Limited SLP (C) No.6483/2018 (SC)

<sup>4</sup> V. Ventaka Sivakumar (Liquidator) (Rathna Stores Pvt. Ltd.) v. Velavan Stores in M.A./875/2019 (NCLAT Del)

<sup>5</sup> Leo Edibles and Fats Limited vs. TRO: [2018] 259 Taxman 387 (AP HC)

<sup>6</sup> Pr. DGIT vs. Synergies Dooray Automotive Ltd.: Company Appeal (AT) (Insolvency) No. 205 of 2017 (NCLAT Del)

<sup>7</sup> Union Bank of India Ltd. v. Star Agro Marine Exports Pvt. Ltd: MA/520/ 2018 in CP/668/IB/2017 (NCLAT Chn)

- The aforesaid discussion clearly **shows the supremacy and the binding effect of the approved resolution plan under the provisions of the IBC, overriding the other applicable provisions.**

Having noticed the fundamental/ salient features of the IBC, there is substantial ongoing debate particularly with regard to the fate of various statutory dues/ claims as a consequence of approval of the resolution plan.

For the sake of convenience, the said claims may broadly fall in either of the following categories:

I. Dues/ claims **relating to period upto the insolvency commencement date**, which may include:

- (i) Crystallized claims, whether disputed or not, pending payment;
- (ii) Proceedings initiated prior to insolvency commencement date, but completed subsequently resulting in crystallization of claims, which may or may not be disputed;
- (iii) Proceedings initiated after the insolvency commencement date but relating to the period upto that date, resulting in subsequent crystallization of claims, which may or may not be disputed;

II. Dues/ claims relating to period from insolvency commencement date to the effective date, i.e., date of approval of the resolution plan;

III. Dues/ claims relating to period after the effective date.

**Re (I): Claims relating to period prior to insolvency commencement date:**

Having regard to the scheme of resolution process, tax authorities are expected to file complete claim in respect of the categories referred in para (I)(i) and should ordinarily also refer to pendency of proceedings in respect of categories referred in para (I)(ii) which may result in crystallization of further claims on a later date. Insofar as categories referred in para (I)(iii) is concerned, since the proceedings itself are initiated after the insolvency commencement date, it would obviously not be possible for the creditor to make/ lodge claim in prescribed Form.

The related issue that would arise is whether the said categories of claims can be enforced subsequently by the creditor against the corporate debtor.

As noticed above, the contents of the resolution plan are binding on all the stakeholders including the Governments. Being so, if all the dues related to period prior to insolvency commencement date, whether crystallized, contingent, raised, disputed, pending, etc., of any creditor including Revenue Department are settled for a particular amount, the said settlement is binding on the parties including the revenue authorities.

What is required is that the resolution plan must ensure that the payment to operational creditor(s) should not be less than the liquidation value. There is no doubt that in case the

corporate debtor were to be forced into liquidation, the Income-tax department could, irrespective of the quantum of its claim (whether known or unknown, crystallized or not, pending or concluded, etc.), at the most recover the liquidation value and nothing more.

It is thus, clear that the essence and spirit of the IBC is to attempt insolvency resolution of a corporate debtor whereunder every stakeholder is expected to make a sacrifice to revive the business of corporate debtor. There can be no further subsequent claims on the corporate debtor for that period after the approval of the resolution plan.

In this context, it may be pertinent to mention, that the amendments made in the IBC in the year 2019 were subject matter of substantial debate in Rajya Sabha, on 29<sup>th</sup> July, 2019, wherein various questions/ issues were raised, which were duly addressed by the Hon'ble Finance Minister<sup>8</sup>. From the said debate, the intent of the statute appears to be clear that the successful resolution applicant is given a clean slate to revive the corporate debtor, with the Government not raising any further claim after the approval of the plan.

Attention is also invited to the decision in the case of **Essar Steel India Limited**<sup>9</sup> wherein the Apex Court while recognising the supremacy/ binding nature of the Resolution Plan and Scheme of IBC held, “.....A successful resolution applicant cannot suddenly be faced with “undecided” claims after the resolution plan submitted by him has been accepted as this would amount to a hydra head popping up which would throw into uncertainty amounts payable by a prospective resolution applicant who successfully take over the business of the corporate debtor. All claims must be submitted to and decided by the resolution professional so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the corporate debtor. This the successful resolution applicant does on a fresh slate, as has been pointed out by us hereinabove.”

Recently, the **Rajasthan High Court** in the case of **Ultra Tech Nathdwara Cement**<sup>10</sup>, considering the aforesaid intent and the legal position, has been pleased to allow the writ petition of the Company quashing/ setting aside the action of the Revenue Authorities in seeking to recover GST demands for period prior to Insolvency Commencement Date. The Hon'ble Court held that once the liabilities have been settled in terms of approved resolution plan which is binding on all stakeholders including the Governments, no further demand was recoverable in respect of outstanding dues which stands settled under the resolution plan.

### **Re (II) & (III): Claims relating to period post insolvency commencement date:**

Settlement of claims in categories II and III are, however, not recovered by the resolution plan and thus are not settled thereunder. In relation to period post insolvency commencement date, till the approval/ implementation of the plan, the management of the corporate debtor is ousted, and the company is run by the RP. The claims relating to such period are fully enforceable against the corporate debtor run by the RP. Further, claims

<sup>8</sup> <https://rajyasabha.nic.in/http://164.100.47.5/newsite/debatenew/newshow.aspx>

<sup>9</sup> COC of Essar Steel India Limited v. Satish Kumar Gupta & Ors.: Civil Appeal No. 8766-67 OF 2019 dated 15.11.2019

<sup>10</sup> Ultra Tech Nathdwara Cement Ltd., (formerly known as Binani Cements Ltd.) v. UOI and Ors: D.B. Civil Writ Petition No. 9480/2019 dated 7.4.2020

relating to period post effective date, when the successful resolution applicant takes over the corporate debtor for revival, the claims for that period are fully enforceable against the company and the same is not governed by the provisions of IBC.

### **Conclusion**

To conclude, the liabilities of the corporate debtor relating to the period prior to insolvency commencement date stands settled in terms of the binding approved resolution plan and no further amounts, other than the amount provided in the scheme, can be recovered from the resolution applicant subsequently. Undoubtedly, the same would result in a huge impact/ hit to the Revenues, but the Department must recognise that the very genesis of the IBC law is to give a fresh slate to the new investor to revive the corporate debtor, which would ultimately result in betterment of the economy, saving of employment and also generation of tax revenues in long term. What is therefore lost in short run, shall get recouped by the huge benefits that shall come with a revived corporate debtor.