

# Tax Issues in Insolvency Proceedings



COMPANY

LIQUIDATION

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INSOLVENCY

FINANCES

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# INTRODUCTION

## Preamble of the Code

- The Insolvency and Bankruptcy Code, 2016 ('IBC'), as stated in the preamble of the code, has been enacted as a legislation for consolidating and amending the laws relating to reorganization and insolvency resolution in a time-bound manner for maximization of value of assets , promote entrepreneurship, availability of credit including alteration in the order of priority of payment of government dues.

## Overriding effect of the Code

- The provisions of IBC have an overriding effect over other enactments in case of any inconsistency. To give teeth to the IBC, amendments have been made in several legislations including the Companies Act, Income Tax Act, The RDBFI Act, SARFAESI Act, etc.

## Interplay of IBC and Income Tax

- It is relevant to examine the interplay of IBC vis-à-vis the Income Tax Act and other taxing statutes and its impact on the latter.
- This understanding assumes significance as it impacts the interests, rights, obligations and duties not only of the taxpayer and the income tax authorities/ taxing authorities but also other stakeholders such as the creditors, resolution applicant, resolution professional, liquidator, etc.

## Stand of Revenue Authorities

- For companies going through a resolution mechanism under the IBC, the revenue authorities are insisting on having a priority in the collection of past tax dues.

# Does the IBC prevail over tax laws?

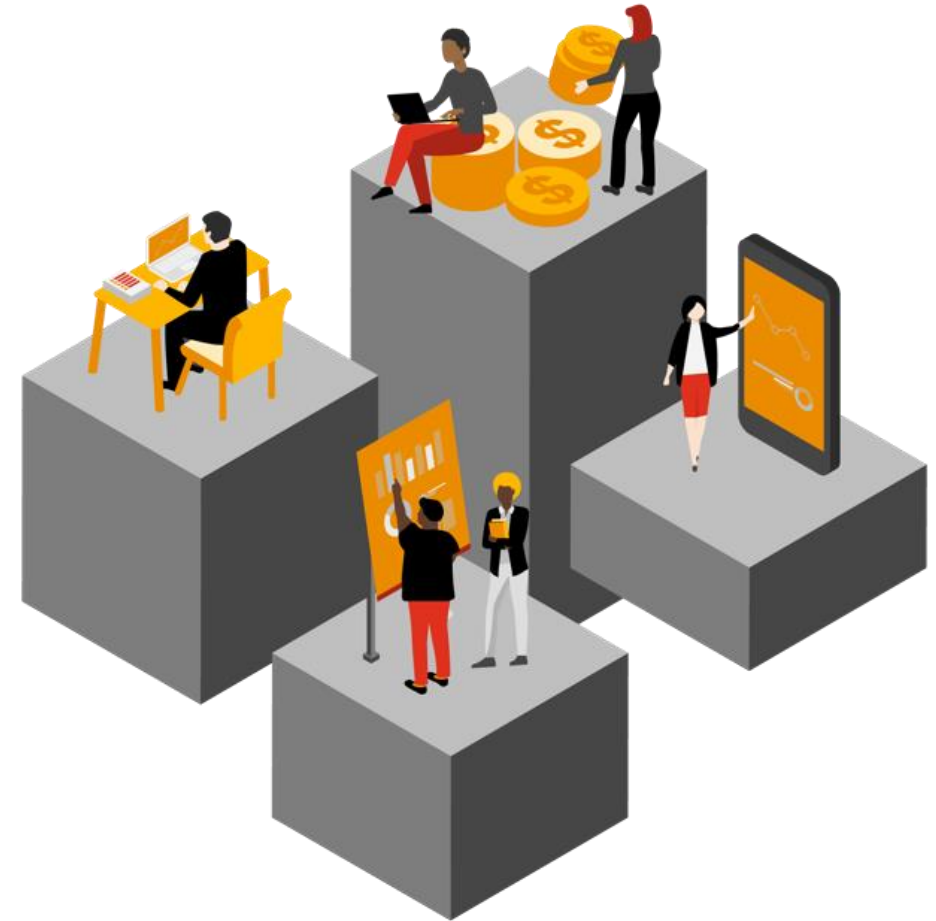
## Section 238 of the Code

The primary question-whether IBC prevails over the Income Tax Act can be analyzed in light of S. 238 of IBC which states to the effect that provision of IBC overrides all other enactments to the extent inconsistent. The provision provides as under:

*“The provisions of this Code 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.”*

## Overriding effect of the Code

The court has ruled in a number of cases that Sec. 238 of IBC will override anything inconsistent contained in any other enactment, including the Income Tax Act. This has significant impact on regular tax matters as can be inferred from judicial development over the period.





# Interpretation of Sec. 238 of the Code



How to read/interpret Section 238 of the Insolvency Code which is a Non – Obstante Provision?



What is the meaning of Non-Obstante Provision and what is the need for the same?



Whether due to the Non-Obstante Provision in a new law i.e. Insolvency Code, all the earlier laws would be superseded by the Code?



Whether Section 238 gives an unfettered and blanket powers to National Company Law Tribunals (NCLT) to issue orders overriding the other legal provisions and undermining the powers of the authorities/Tribunals constituted in other laws?



Whether we should apply rule of Contextual Interpretation in section 238?



Whether the wordings “inconsistent therewith” curtails/restricts the meaning of Non-Obstante Clause?



# Notable Judgments - Innoventive Industries Limited v. ICICI Bank Limited, SC)/[2017] 205 COMP CASE 57 (SC)



## Backdrop

- The question of overriding effect of IBC was first discussed by the Supreme Court in the case of Innoventive Industries .
- The moot question before the SC was whether corporate debtor enjoying the benefits/exemption from repayment under the Maharashtra Relief Undertaking (Special Provisions) Act, 1958 would be subject matter of insolvency proceedings under IBC.



## Facts

- Application was filed by ICICI as financial creditors against Innoventive Industries Ltd.
- Pursuant to relief order passed by the Government of Maharashtra under the Maharashtra Relief Undertaking (Special Provisions Act) 1958 (MRUA) the corporate debtor argued that they are not liable to pay any due to ICICI.
- NCLAT held that there is no repugnancy between MRUA and IBC as they are enactments of two diverse fields. IBC has an overriding effect over the provisions of MRUA.



## HELD

- Finally, in an appeal against NCLAT order, The Supreme Court confirmed the interpretation by holding that the non-obstante clause of IBC will prevail over the non-obstante clause in the MRUA.
- On the issue of suspension of debt on account of the relief order under the MRUA, it held that on account of the non-obstante clause in the IBC, any right of the corporate debtor under any other law cannot come in the way of the IBC.



## DDIT (Enforcement) vs. Axis Bank and Ors. (Delhi HC)



### Facts

- The PMLA tribunal had held that third parties, banks in this case, which have legitimately created rights such as a charge, lien or other encumbrances, have a superior claim over such properties and therefore, released the property attached under PMLA



### HELD

- The Delhi High Court set aside the PMLA Tribunal's order and held that the objective of PMLA being distinct from the purpose of RDBA, SARFAESI Act and IBC, the latter three legislations do not prevail over the former. It remanded the matters to the Tribunal for further consideration.
- The Delhi High Court held that the money laundering law, PMLA, prevails over the Bankruptcy Act and insolvency code when it comes to attachment of properties obtained as "proceeds of crime".
- The court said that the Prevention of Money Laundering Act (PMLA), Recovery of Debt and Bankruptcy Act (RDBA), Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act (SARFAESI Act) and Insolvency and Bankruptcy Code (IBC) must co-exist and be enforced in harmony with the PMLA.

## Duncans Industries vs. AJ Agrochem (SC), (2019) 217 Comp Cas 320 (SC)



### Facts

- Duncan Industries Ltd., the corporate debtor, owed a sum of Rs. 41,55,500/- to AJ Agrochem, an operational creditor, based on which the creditor initiated proceedings against the corporate debtor under section 9 of the Code.
- The corporate debtor opposed such action on the ground that the Central Government had not consented, as mandated by section 16G(1)(c) of the Tea Act, which lays down that the proceedings for winding up cannot be initiated without the consent of the Government if the management of the tea estate has been taken over by the Central Government
- The question before the Hon'ble Supreme Court was whether consent of the Central Government under the Tea Act is required before initiation of proceedings under section 9 of the Code.



### HELD

- The Supreme Court held that there is an overriding clause provided under section 238 of the Code. And therefore, the provisions of the Code would prevail over the Tea Act, 1953.
- The provisions of the IBC would have an overriding effect over the Tea Act, 1953 and that no prior consent of the Central Government before initiation of the proceedings under section 7 or 9 of IBC would be required.

# Notable Judgments - Narendra Singh Panwar v. Pashchimanchal Vidyut Vitran Nigam Ltd. (176 SCL 351)

## – Allahabad High Court



### Facts

- The electricity connection of the corporate debtor company had been disconnected permanently. The recovery was sought to be made by the demand notice issued in the name of both the Directors of the defaulter company.
- Copy of the demand notice had been forwarded to the District Magistrate for making recovery of dues as arrears of land revenue.
- It was urged that once the Company went into insolvency, the outstanding electricity dues towards the defaulter company being Corporate debtor could not have been recovered from its Directors. No steps could be taken for recovery of any kind of dues of the Company (Corporate debtor) by adopting any other mode under any other provision



### HELD

- Where conflict arises between one Parliamentary law and other Parliamentary law, subsequent Parliamentary law has overriding effect on earlier Parliamentary law
- Thus, IBC being a subsequent Act of Parliament, Electricity Act, 2003 cannot override any provisions of IBC





# IBC & Tax Laws: Notable Judgments

## Pr. Commissioner of Income Tax v. Monnet Ispat and Energy Ltd.



### Facts

- The National Company Law Tribunal (“NCLT”) had admitted an application under section 7 of the Code against Monnet Ispat and Energy Ltd.
- A challenge was brought forth by Principal Commissioner of Income Tax as to the applicability of the moratorium order to the proceedings of the Income Tax Appellate Tribunal (“ITAT”) against the corporate debtor. The High Court of Delhi had held that an order of moratorium is made by the NCLT under section 14 of the Code, and the same would also apply to the proceedings and orders of the Income Tax Appellate Tribunal in respect of the tax liability of the assessee.



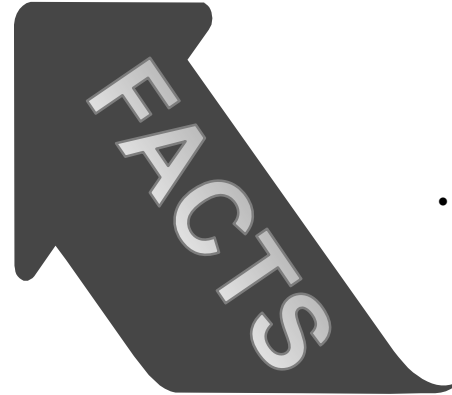
### HELD

- The Supreme Court confirmed that section 238 of the Insolvency and Bankruptcy Code, 2016 will override anything inconsistent contained in any other enactment, including the Income Tax Act.



# Clean Slate Theory - Ghanshyam Mishra & Sons. v. Edelweiss Asset Reconstruction Co. Ltd. [Civil Appeal No. 8129 of 2019]

- **Issue before Supreme Court:** Whether after approval of resolution plan by the Adjudicating Authority a creditor including the Central Government, State Government or any local authority is entitled to initiate any proceedings for recovery of any of the dues from the Corporate Debtor, which are not a part of the Resolution Plan approved by the adjudicating authority?
- The creditors in these batch matters included statutory authorities like the State commercial tax department, State mining department, income tax department etc. in respect of their respective outstanding demands against the corporate debtors.
- In each of these matters, the concerned successful resolution plan had stipulated that the claims (including statutory liabilities and contingent liabilities) to the extent not satisfied or received under the plan will be extinguished. The corporate debtor in its new avatar shall not be liable to bear the same.
- The Hon'ble Adjudicating Authority in each of these cases had approved the resolution plans exercising jurisdiction under section 31 of the IBC. On appeal, the approval of these resolution plans was upheld. However, the Hon'ble NCLAT had given the liberty to various government departments and their dues outstanding would qualify as operational debt.
- The effect of these observations was that the creditors were now filing claims/suits/recovery actions against the corporate debtor in its new avatar (under a new management). The statutory authority continued to press their demands for outstanding dues.
- The successful resolution applicants were aggrieved with these observations of the Hon'ble NCLAT and the matters were carried to the Hon'ble Supreme Court.



- Once a resolution plan is duly approved by the Adjudicating Authority under Section 31, the claims as provided in the resolution plan shall stand frozen and will be binding on the creditors (including statutory authorities, employees and guarantors)
- On the date of approval of resolution plan by the Adjudicating Authority, all such claims, which are not a part of resolution plan, shall stand extinguished and no person will be entitled to initiate or continue any proceedings in respect to a claim, which is not part of the resolution plan.
- The amendment made to section 31 of the IBC is clarificatory and declaratory in nature and therefore will be effective from the date on which I&B Code has come into effect.
- Consequently, all the dues including the statutory dues owed to the Central Government, any State Government or any local authority, if not part of the resolution plan, shall stand extinguished and no proceedings in respect of such dues for the period prior to the date on which the Adjudicating Authority grants its approval under Section 31 could be continued.

# Reassessment u/s 148 of the Income Tax Act, 1961 – The ongoing controversy

Despite judicial precedents and considering the overriding scope of IBC provisions by virtue of section 238 of IBC, the Revenue has continued to issue notices under section 148 of the IT Act to Corporate Debtor post the approval of the resolution plan.

## Murli Industries Limited v. ACIT (Bombay HC)

- Bombay HC (Nagpur Bench) quashed notice u/s 148 issued to a Corporate Debtor for an assessment year falling prior to the date of approval of Resolution Plan under the IBC.
- Assessee-Company challenged the reassessment notice issued for AY 2014-15, mainly on the ground that it was contrary to the SC ruling in Ghanashyam Mishra, by contending that the Revenue could not have issued the reassessment notice subsequent to the approval of the Resolution Plan and also averred that as the claims were not a part of the Resolution Plan, they were not maintainable
- Revenue submitted that the amount claimed through the notice could not be a part of the Resolution Plan, since the claim had not crystallized then and the notice was issued on the ground that the income chargeable to tax had escaped assessment
- Where the Assessing Officer had a reason to believe that the income chargeable to tax of the Corporate Debtor has escaped assessment within the meaning of Section 147 of the Act, it was held that once the public announcement is made under the IBC by the Resolution Professional calling upon all concerned, to raise claim, it would be expected from all the stakeholders to diligently raise their claim.
- In the present case, the Income Tax Authorities failed to do so and therefore, the claim stood extinguished. Consequently, the notices u/s 148 was quashed.

## M/s Dishnet Wireless Limited vs. ACIT (Mad HC)

- The Revenue had issued reassessment notices under section 148 of the IT Act right after the CIRP was voluntarily initiated by the CD.
- Aggrieved, the CD had filed the present writ petition, following which the Madras High Court, through an interim order asked the Revenue to continue with the proceedings in a sealed cover. The argument advanced by the Revenue was that the initiation of proceedings under section 148 of IT Act would not fall under the ambit of section 14 of the Code which restricts initiation or continuation of proceedings during the moratorium period. The Revenue further argued that since the claims were yet to be crystallized, they could not be said to be extinguished owing to the approval of resolution plan.
- The petitioners sought to quash the notices by relying on the SC ruling in *Ghanashyam Mishra*.
- The Madras High Court observed that the resolution plan has not contemplated any concessions from the income tax department; that it was incumbent on the petitioners to have ensured proper notice to the income tax department and obtained appropriate concessions in the CIRP when the notice under section 148 of the IT Act had already been issued by the Revenue right after initiation of CIRP.

# Conflicting Views on the Operation of IBC vis a vis Tax laws by the SC

The established legal position which has been affirmed time and again by Indian courts is that government departments like customs authorities and income tax officials among others, cannot be treated like secured creditors and are consequently ineligible to claim priority during the payment of dues. The ruling in Rainbow Papers completely deviates from these precedents and revives a legal question that was, otherwise, well-settled.

## State Tax Officer v. Rainbow Papers Ltd. (SC)

- The appeal was filed against the NCLAT order dismissing the company appeal filed by the State Tax Authorities against the order of NCLT rejecting the state tax application and holding that the Government cannot claim first charge over the Corporate Debtor's property.
- Section 48 of the Gujarat Value Added Tax (GVAT), provides for first charge on the property of a dealer in respect of any amount payable by the dealer on account of tax, interest, penalty etc. under the GVAT Act, cannot prevail over Section 53 of the IBC.

### HELD

- Section 48 of GVAT Act is not contrary to or inconsistent with section 53 or any other provisions of IBC.
- State is a secured creditor under GVAT Act
- definition of 'secured creditor' in IBC does not exclude any Government or Governmental Authority
- Resolution Plan was set aside with a direction to consider a fresh resolution plan in the light of the observations made by the SC.

## \_Sundaresh Bhatt v. Central Board of Indirect Taxes and Customs)

- ABG Shipyard, corporate debtor ran the shipbuilding business. Its business involved importing of raw materials for ship building purpose and exporting of the finally completed ships to various other countries. Imported raw material for the same was stored in Custom Bonded warehouse.
- The Interim Resolution Professional ("Appellant"), on 21.08.2017, sought for the custody of the warehoused goods from the Central Board of Indirect Taxes and Customs ("Respondent"), and requested them not to dispose of or auction the same. The Respondent issued five different demand notices to the Corporate Debtor raising a total demand of around Rs. 15,80,00,000.
- The NCLAT allowed the appeal thereby directing that the warehoused goods can be "released or disposed of as per Applicable Provisions of Customs Act by the Proper Officer".

### HELD

The Supreme Court has observed that the Customs Act, 1962, and the IBC act in their own spheres. In case of any conflict Insolvency and Bankruptcy Code overrides the Customs Act. The Customs Act and the Code can be read in a harmonious manner wherein customs authorities have limited jurisdiction to determine the quantum of operational debt. The Code would prevail over the Customs Act. to the extent that a moratorium is imposed in terms of sections 14 or 33(5) of the Code.



# Suspension of tax proceedings

## Section 14



- The IBC provides for a period of moratorium from the date of admission of resolution application by the Adjudicating Authority. The moratorium is declared u/s 14 of IBC which prohibits the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority.
- The tax proceedings including litigation before appellate forums would need to be kept in abeyance during the moratorium period.

## Point to note

- However, such proceedings cannot culminate in enforcing recovery of outstanding taxes during the moratorium period which can only be claimed in the manner prescribed for operational creditors.

# Judicial Precedents

## Pr. Commissioner of Income Tax Vs. Monnet Ispat and Energy Ltd

The moratorium also applies to tax proceedings, appeals and litigations (pending or new) during the period.

## Deputy Commissioner of Income Tax Vs. Bhuvan Madan RP for Diamond Power Infrastructure Ltd. & Anr,

Considering the necessity of the assessment arising out of search proceedings and findings of irregularities by the Corporate Debtor (which may have led to huge tax demand), the prayer of the tax authorities was accepted to the extent of only conducting assessment.

The continuation of proceedings was considered necessary to protect the interest of the exchequer. The NCLT however directed that tax authorities may file their claim as operational creditor with the resolution professional for examining the claim in accordance with the provisions of the code.

# Amendments in Income Tax Act vis a vis IBC

- Section 140 of the Income Tax Act, 1961 provides that in case of company the return is required to be verified by the managing director (MD) thereof. In case of a company in whose case application for insolvency resolution process has been admitted by the Adjudicating Authority (AA) under the Insolvency and Bankruptcy Code, 2016 (IBC), the return has to be verified by the insolvency professional appointed by such AA.
- Section 79 of Act provides that carry forward and set off of losses in a closely held company shall be allowed only if there is a continuity in the beneficial owner of the shares carrying not less than 51 percent. of the voting power, on the last day of the year or years in which the loss was incurred. A proviso to sec. 79 inserted by the Finance Act, 2018 to allow carry forward and set off of losses even if there is change in voting power or shareholding due to pursuant to a Resolution Plan approved by NCLT.
- Budget, 2019 has proposed to allow carry forward and set off of losses to its subsidiaries and the subsidiary of such subsidiary also. Now, even if change in shareholding is more than 49% due to Resolution Plan approved by NCLT, losses of holding company and its subsidiaries and the subsidiary of such subsidiary was being allowed to be carry forward and set off.



- Clause (iih) to explanation 1 in section 115JB inserted by Finance Act, 2018 to provide that the aggregate amount of unabsorbed depreciation and loss brought forward (excluding unabsorbed depreciation) shall be allowed to be reduced from the book profit, if a company's application for corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016 has been admitted by the Adjudicating Authority.
- Section 170A of the IT Act was inserted vide Finance Act, 2022 in order to make provisions for giving effect to the order of business reorganization issued by tribunal or court or an Adjudicating Authority under the Insolvency and Bankruptcy Code, 2016. The section provides that in case of business reorganization, where a return of income has been filed by the successor under section 139 of the Act, such successor shall furnish a modified return within six months from the end of the month in which such order of business reorganization was issued, in accordance with and limited to the said order.
- Section 156A allows for the modification of demand orders in accordance with the directions of the Court, Tribunal, or Adjudicating Authority, in order to ensure the future viability of sick entities that have been acquired in business reorganization. The Assessing Officer (AO) is required to modify the demand payable in conformity with the order of the Adjudicating Authority and serve the assessee with a notice of demand specifying the sum payable, if any.



# Liabilities of Directors

## GST

- Section 88(3) of the CGST Act, it emerges that the directors of private companies can be held liable for payment of GST dues (along with interest and penalty) which remain unrecovered, whether the same were accrued prior to liquidation or during the liquidation or after the liquidation.
- GST authorities can invoke the provisions of Section 88(3) of the CGST Act to catch hold of directors of private companies in cases where the tax dues remain unrecovered.
- CGST Act is a later law than IBC and legislature has conspicuously decided not to make Section 88(3) of the CGST Act subject to the provisions of IBC
- When it comes to liquidation under IBC, the directors of private companies can still be held liable for unrecovered tax dues



## Income Tax

- The provisions related to company in liquidation and liability of directors of private companies are contained in Section 178 and 179 Income Tax Act, 1961 (“Income Tax Act”) respectively.
- Section 178 of the Income Tax Act casts a liability on the Liquidator to provide for payment of tax dues in priority and also creates restriction on parting of assets unless tax dues are paid. Section 178 also has a non-obstante clause which gives it an overriding effect over all other laws.
- However, it is noteworthy that at the time of enactment of IBC, the legislature has conspicuously amended sub-clause 6 of Section 178 to make this non-obstante clause subject to the provisions of the IBC. This implies that where liquidation is done under IBC, Section 178 is not applicable and income tax authorities will get their arrears as per the waterfall prescribed under IBC.



Thank you