Interplay Between IBC vs. Income Tax Act.

ALL INDIA CHARTERTED ACCOUNTANT SOCIETY

Mohit Gupta (Partner, PNAM & Co LLP)
FCA, Insolvency Professional
B.com (H) (SRCC), LLB, FAFD
Qualified Independent Director

TOPICS TO BE COVERED

1. **Does the IBC prevail over the Income-tax Act?**
   Section 238 - the non-obstante clause and its limits
2. **Fate of Tax appeals & assessments during the moratorium**
   Section 14 - the assessment vs. recovery divide
3. **Settlement & crystallisation under the resolution plan**
   Clean slate, extinguishment and the tax cost of a haircut
4. **Liability of directors & promoters during CIRP**
   Section 32A immunity vs. surviving personal exposure
5. **Section 28(iv) vs. 41(1) on write-off of loans & liabilities**
   Mahindra & Mahindra and the Finance Act 2023 reversal

PNAM
INSIGHTS. SOLUTIONS

Issue -1 DOES THE IBC PREVAIL OVER TAX LAWS?

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."*

Where there is a **direct conflict** between the IBC and the Income Tax Act, 1961, ***the IBC Prevails*****.**

Protects the objectives of the IBC by preventing conflicting recovery actions, ensuring time-bound resolution, value maximization of the corporate debtor, and equitable treatment of all stakeholders.

The Legislative intent is ***revival not recovery***.

LEGISLATIVE ALIGNMENT

Parliament also aligned both statutes:

S-178(6) & S-322(8) (NA) , IT Act

...independently recognises IBC's overriding effect (w.e.f. 01.11.2016)

Test for conflict: apply Sec. 238 only where a genuine inconsistency exists between the Code and the tax provision -not merely a different procedure (ED v. Axis Bank – PMLA).

Prevents parallel recovery and enforcement proceedings during CIRP

"Section 238 is the back bone of IBC"

PNAM
INSIGHTS. SOLUTIONS

The Supreme Court's Settled Position

Pr. CIT v. Monnet Ispat & Energy
SLP(C) 6487/2018 (SC)

Income-tax dues (Crown debts) do not take precedence even over private secured creditors; Section 238 overrides the Income-tax Act.

Ghanashyam Mishra v. Edelweiss ARC
(2021) 9 SCC 657 (SC)

On plan approval (Sec. 31), all claims not in the plan - including Govt statutory dues - stand extinguished. The “clean slate.”

CoC of Essar Steel v. Satish Kumar Gupta
(2019) 8 SCC 531 (SC)

A successful applicant must not face “undecided” claims. Finality is essential - no hydra heads after approval.

JSW Steel (Commercial Taxes)
SC, 2024

Pressing extinguished pre-plan tax demands after Ghanashyam Mishra was held contemptuous; the demands were quashed.

PNAM
INSIGHTS. SOLUTIONS

Issue 2 - SUSPENSION AND INSTITUTION OF APPEALS DURING MORATORIUM

THE FOUR PROHIBITIONS (SEC. 14(1) OF IBC)

(a) ***institution of suits or continuation of pending suits or proceedings*** against the CD, including execution of any judgment, decree or order - in any court, tribunal or authority.
(b) transferring, encumbering or alienating any asset of the CD.
(c) enforcing any security interest (incl. SARFAESI action).
(d) recovery of property by an owner or lessor in the CD's possession.

The moratorium period starts from the date of admission of resolution application by the Adjudicating Authority i.e. the National Company Law Tribunal (NCLT).

Moratorium suspends enforcement, not necessarily the determination of tax liability. The ***objective is to preserve the Corporate Debtor*** as a going concern while ensuring orderly resolution under the IBC.

PURPOSE

A protective "calm period," not an adversarial tool *(Swiss Ribbons; Sundaresh Bhatt).*

It preserves the estate and curbs parallel, conflicting proceedings.

Assessment and adjudication are conceptually distinct from recovery

Sec. 33(5) of IBC mirrors this in liquidation (bars fresh proceedings).

ASSESSMENT IS PERMITTED - RECOVERY IS BARRED

PERMITTED · QUANTIFICATION

- Complete assessment / re-assessment and determine the quantum of the dues.
- Finalise adjudication of demand.
- File the resulting claim with the IRP / RP as an operational creditor.

BARRED · COERCION/RECOVERY

- Issue or enforce a demand / recovery notice.
- Attach property or bank accounts.
- Sell or confiscate assets to recover.

Sundaresh Bhatt v. CBIC (SC, 2022): once moratorium is imposed, the authority has limited jurisdiction only to assess/determine - no power to recover by sale or confiscation. Kerala HC (Platino Classic Motors; Works Contract v. NCLT) is to the same effect.

APPEALS, REFUNDS AND A DIVERGENT VIEW

CD's OWN APPEALS

Proceedings for the CD's benefit are NOT barred. The moratorium is a shield, not a sword the CD's refund appeals continue, with the RP stepping in (Sec. 25).

Power Grid v. Jyoti Structures (Del. HC, 2017)

REVENUE'S APPEALS

Revenue's appeals against the CD are caught by Section 14 typically disposed or kept in abeyance, with liberty to revive after the moratorium.

Monnet Ispat (Del. HC, aff'd SC)

A DIVERGENT VIEW

Some benches hold Sec. 14 makes NO distinction between assessment, quasi-judicial and judicial proceedings all are barred.

Ravi Infrastructure v. KSS Petron (NCLT, 2022)

The Recovery of Income tax dues during the moratorium is permissible only by filing a claim as an operational creditors before the Resolution Professional; independent recovery proceedings are barred.

PNAM
INSIGHTS. SOLUTIONS

Issue 3- CLEAN SLATE CONCEPT – Crystallization of Liability

SECTION 31(1), IBC · BINDING EFFECT OF AN APPROVED PLAN *held retrospective - Ghanashyam Mishra*

"If the Adjudicating Authority is satisfied that the resolution plan … meets the requirements … it shall by order approve the resolution plan which shall be binding on the corporate debtor and its employees, members, creditors, including the Central Government, any State Government or any local authority to whom a debt … is owed … guarantors and other stakeholders involved in the resolution plan."

THE CLEAN SLATE

- Ghanashyam Mishra & Sons Pvt. Ltd. v. Edelweiss Asset Reconstruction Co. Ltd. – The Supreme Court affirmed that once a Resolution Plan is approved, ***all claims not forming part of the plan, including statutory dues, stand extinguished and cannot be enforced thereafter.***
- The Clean Slate Principle extinguishes the right to recover historical tax liabilities not recognised under the approved Resolution Plan, ensuring finality and certainty for the successful Resolution Applicant.

TAX CONSEQUENCES

- **Pre-CIRP demands not admitted** → extinguished; Sec. 148 cannot reopen settled dues (Alok Industries, Bom. HC).
- **Attachments to be lifted** - but the SRA may still need to approach the levying authority (Embassy Property).
- **Liability Crystallises** - Tax demands are typically settled at a fraction (often nil / token) as operational debt. ***The balance - tax, interest, penalty - stands extinguished; fresh notices for prior periods abate.***

PNAM
INSIGHTS. SOLUTIONS

Issue 4 - Immunity of the Corporate Debtor – Not Its Management

§ **SECTION 32A(1), IBC · LIABILITY FOR PRIOR OFFENCES**

ins. by Act 1 of 2020, w.e.f. 28.12.2019

"… the liability of a corporate debtor for an offence committed prior to … the corporate insolvency resolution process shall cease, and the corporate debtor shall not be prosecuted … from the date the resolution plan has been approved … if the resolution plan results in the change in the management or control of the corporate debtor to a person who was not - (a) a promoter or in the management or control of the corporate debtor or a related party of such a person …"

§ **SECTION 32A(1), SECOND PROVISO · PERSONAL LIABILITY PRESERVED**

"Provided further that every person who was a 'designated partner' … or an 'officer who is in default' … or was in any manner in-charge of, or responsible to the corporate debtor for the conduct of its business … and who was directly or indirectly involved in the commission of such offence … shall continue to be liable to be prosecuted and punished … notwithstanding that the corporate debtor's liability has ceased under this sub-section."

Entity immunity ≠ personal immunity. Validity upheld in Manish Kumar v. UOI (SC, 2021); the wall bars attachment of the CD's property, not prosecution of the individuals behind the offence.

PNAM
INSIGHTS. SOLUTIONS

DURING CIRP - WHO RUNS, WHO ANSWERS

Suspension of the board and the survival of personal exposure

Management & compliance

- Board powers stand suspended (s.17); the RP/IRP manages the CD and its statutory compliance
- Returns of an IBC company are verified by the insolvency professional - s.140(c) IT Act
- Directors owe a duty to cooperate and hand over records (s.19); non-cooperation invites NCLT directions
- TDS defaults of the CIRP period sit with the RP as the person responsible

Personal exposure survives

- s.179 IT Act: directors of a private company jointly & severally liable where tax cannot be recovered from it - moratorium shields the CD, not the directors
- s.32A IBC: post-approval immunity for the CD and its assets - expressly not for officers 'in default', who continue to be liable
- Prosecutions (e.g. s.276B TDS default; s.138 NI Act) against signatories continue - Ajay Kumar Radheyshyam Goenka (SC, 2023)

Issue 5 -Tax Treatment of Loan Waivers: 28(iv) vs 41(1)

SECTION 41(1) · REMISSION

- **Trigger:** a deduction / allowance was allowed earlier for a loss, expenditure or trading liability, and that liability is later remitted or ceases.
- **Effect:** the amount is deemed business income in the year of remission.
- **Sine qua non:** a prior deduction must have been claimed (Mahindra & Mahindra).

SECTION 28(iv) · BENEFIT

- **Trigger:** the value of any benefit or perquisite arising from business or the exercise of a profession.
- **Pre-amendment reading:** applied only to a benefit in kind - not to a benefit received as money / cash.
- **Key question:** is the benefit monetary, and did it arise from business?

The pivot: whether the loan was on capital account (asset acquisition) or revenue account (trading) drives the entire analysis under both limbs.

PNAM

INSIGHTS. SOLUTIONS

MAHINDRA & MAHINDRA - AND THE 2023 REVERSAL

2018

CIT v. Mahindra & Mahindra Ltd. (2018) 404 ITR 1 (SC)

- Loan waiver is a cash receipt → outside Sec. 28(iv) (which needs a benefit in kind).
- Waiver of principal is not cessation of a trading liability → outside Sec. 41(1) where no deduction was claimed.
- Term loan for a capital asset = capital receipt.

→

FA 2023

Sec. 28(iv) amended · w.e.f. AY 2024-25

- Now covers a benefit "in cash or in kind or partly in cash and partly in kind."
- Legislatively overrides Mahindra & Mahindra - prospectively.
- Loans written back after 01.04.2024 may be taxed as business income under Sec. 28(iv).

Loan waivers under an approved Resolution Plan may face renewed scrutiny under Section 28(iv), potentially giving rise to tax implications despite the clean slate principle.

PNAM
INSIGHTS. SOLUTIONS

PRACTICAL DECISION GRID

Scenario	Up to 31.03.2024	From 01.04.2024 (AY 2024-25)
Capital-asset loan; no deduction claimed	Not taxable (Mahindra)	Likely Sec. 28(iv) · capital-receipt debate
Trading liability / expense earlier deducted, then remitted	Sec. 41(1)	Sec. 41(1) · unchanged
Working-capital loan waiver	Capital receipt (Mahindra)	Risk under Sec. 28(iv)
Interest waived - interest earlier claimed	Sec. 41(1)	Sec. 41(1)

IBC overlay: a haircut in the plan can trigger Sec. 28(iv)/41(1) in the CD's hands; it arises on approval, so it sits outside the plan's extinguishment.

FIVE TAKEAWAYS FOR THE ENGAGEMENT FILE

- **IBC prevails (Sec. 238)** - but map statutory-charge dues (Rainbow Papers) and separate CIRP (Sec. 31) from liquidation (Sec. 53).
- **Moratorium: assess, don't recover** - let the department quantify and file its claim; the RP runs the CD's beneficial appeals.
- **The plan is a clean slate** - un-filed pre-CIRP dues are extinguished and Sec. 148 cannot reopen them.
- **Entity immunity ≠ personal immunity** - Sec. 32A frees the company, but Sec. 179 IT Act, avoidance actions and guarantees follow the promoters.
- **Write-offs can be taxed** - 41(1) needs a prior deduction; post-FA 2023, 28(iv) catches cash benefits. Watch post-approval tax and MAT.

Thank You

Questions & Discussion

CA Mohit Gupta · Partner, PNAM & Co. LLP, Chartered Accountants

Disclaimer. This presentation is for professional discussion only and reflects the position based on statutes and judicial precedents current as at the date of presentation. It is not legal or tax advice; the law in this area is evolving. Please verify the latest position and evaluate specific facts before relying on any view expressed.