

INTERNATIONAL JOURNAL OF LAW
MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 4 | Issue 3

2021

© 2021 *International Journal of Law Management & Humanities*

Follow this and additional works at: <https://www.ijlmh.com/>

Under the aegis of VidhiAagaz – Inking Your Brain (<https://www.vidhiaagaz.com>)

This Article is brought to you for “free” and “open access” by the International Journal of Law Management & Humanities at VidhiAagaz. It has been accepted for inclusion in International Journal of Law Management & Humanities after due review.

In case of **any suggestion or complaint**, please contact Gyan@vidhiaagaz.com.

To submit your Manuscript for Publication at **International Journal of Law Management & Humanities**, kindly email your Manuscript at submission@ijlmh.com.

Interplay between Tax Laws and IBC

VANSHIKA KHANDELWAL¹

ABSTRACT

The Insolvency and Bankruptcy Code, was enacted with the primary objective of rehabilitation of financially distressed corporates and came into effect on 1st December 2016. The enactment of the Insolvency and Bankruptcy Code, 2016 (“Code”) has had significant ramifications on the corporate world. Over time, the Code has witnessed a manifold increase in litigation since the Code brought about a paradigm shift from the debtor-in-control method to a creditor- driven process. The provisions of IBC have an overriding effect over other enactments in case of any consistency. To give accord to the IBC, amendments have been made in a number of legislations namely the Companies Act, Income Tax Act, SARFAESI Act, etc. Now, it is pertinent to examine the interplay of tax laws with the IBC. The liquidators and the Resolution Professionals have now and then knocked on the doors of the Adjudicating Authority to ascertain the rights and the liabilities of the stakeholders. The principal question whether the IBC prevails over the Income Tax Act and the Goods and Services Act, can be analysed in view of Section 238 of the IBC, 2016 which states that the provisions of the IBC overrides all other enactments to the extent they are inconsistent with the provisions of the Code. The questions which are taken into consideration in this article are whether the statutory dues come within the meaning of operational debts or not and what is the treatment of the tax laws vis-à-vis the IBC.

I. INTRODUCTION

“Caste Section 53 of the Code provides for a waterfall mechanism which prescribes for a priority of payment to all class of creditors of the company undergoing liquidation.

Further, Under the Code, as per Section 5(21), unpaid tax dues of the Corporate Debtor like income tax, Goods and Service Tax etc. are considered to be operational debts.

In the case of *LML Ltd., In re*², the NCLT ruled that a capital gain tax has to fall under operational debt and has to be recovered in accordance with the waterfall mechanism provided under the Code.

¹ Author is a student at Vivekananda Institute of Professional Studies, GGSIPU, India.

² 2017 SCC OnLine NCLT 1685.

II. INCOME TAX LAWS

On a bare perusal of Section 178 of the Income Tax Act, 1961, it can be said that this provision casts a liability on the Liquidator to provide for payment of tax dues in priority and also creates a 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, 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 tax arrears are paid as per the waterfall mechanism prescribed under Section 53 of the Code.

In the case of *Om Prakash Agarwal Vs. Chief Commissioner Of Income Tax (TDS) & Anr. – NCLT Principal Bench* on 8 February 2021, it was held that the deduction of Tax at source under Section 194-IA of the IT Act does not mean assessment and raising demand for collection of tax by the Department. Collection of tax will arise only after passing orders under the IT Act subsequent to filing of Income Tax Return by the assessee. Thus, the deduction of TDS does not tantamount to payment of Government dues in priority to other creditors because it is not a Tax demand for realization of Tax dues. It is the duty of the purchaser to credit TDS to the Income Tax Department.

However, aggrieved by the aforesaid order, the Appellant filed an appeal before the NCLAT.

The NCLAT held that in accordance with Section 178(3) and (4), Income Tax Department has to be treated as a secured creditor but by the virtue of amendment in 178(6), the whole of Section 178 has no application to liquidation proceedings under IBC.

As per Section 194 IA of the IT Act, 1% TDS is recovered in priority to other creditors of the transferor, which is partial capital gain tax, whereas, Section 53(1)(e) of the Code in waterfall mechanism provides that the Government dues comes fifth in order of priority. Thus, in regard to recovery of the Government dues (including Income Tax) from the Company in Liquidation under the Code, there is inconsistency between Section 194IA of the IT Act and Section 53(1)(e) of the Code. As a result, by virtue of Section 238 of the Code, Section 53 (1)(e) of the Code shall have overriding effect on the provisions of the Section 194 IA of the IT Act.

Hence, in conclusion it can be said that the deduction of tax at source means raising demand for collection of tax by the Department. TDS under Section 194 IA is an advance capital gain tax, recovered through transferee on priority with other creditors of the company. Hence, it is inconsistent with the provision of Section 53(1)(e) of the Code and by virtue of Section 238 of

the Code, the provision of Section 53(1)(e) shall have overriding effect.

The Hon'ble Supreme Court in ***Commissioner of Income-Tax V. KTC Tyres (India)***³ rejected the contention that the capital gains tax payable by a corporate debtor to the Union of India must be treated as liquidation expenses and, therefore, must be paid first, even before the dues of secured creditors and workmen are discharged. It was hence summarized that the Code does not treat the revenue taxes as liquidation expenses.

Also, in ***Pr. Director General of Income Tax (Admn. & TPS) Vs. M/s. Synergies Dooray Automotive Ltd. & Ors***⁴, it was held that 'Operational Debt' in normal course means a debt arising during the operation of the Company ('Corporate Debtor'). The 'goods' and 'services' including employment are required to keep the Company ('Corporate Debtor') operational as a going concern. If the Company ('Corporate Debtor') is operational and remains a going concern, only in such case, the statutory liability, such as payment of Income Tax, Value Added Tax etc., will arise. As the 'Income Tax', 'Value Added Tax' and other statutory dues arising out of the existing law, arises when the Company is operational, we hold such statutory dues has direct nexus with operation of the Company. For the said reason also, we hold that all statutory dues including 'Income Tax', 'Value Added Tax' etc. come within the meaning of 'Operational Debt'.

In the above mentioned case, it was therefore held that 'Income Tax Department of the Central Government' and the 'Sales Tax Department(s) of the State Government' and 'local authority', who are entitled for dues arising out of the existing law are 'Operational Creditor' within the meaning of Section 5(20) of the 'I&B Code'.

In ***Leo Edibles & Fats Ltd. V. The Tax Recovery Officer (Central) Income Tax Department, Hyderabad and others***⁵, while deciding upon the nature of security interest of Government dues, the High Court of Telangana and Andhra Pradesh made it clear that the Government dues like income-tax dues are unsecured creditors and do not enjoy the status of a secured creditor. The tax dues, being an input to the Consolidated Fund of India and of the States, clearly come within the ambit of section 53(1)(e) of the Code.

Ordinarily, the Government is an operational creditor. However, the Government or any of its agencies could come within the ambit of a financial creditor, if the nature of debt is such.

³ [2014] 185 CompCas17(SC)

⁴ Company Appeal (AT) (Insolvency) No. 205 of 2017

⁵ WP No. 8560 of 2018

III. GST LAWS

Under Section 88 of the Central Goods and Services Act, 2017, when any company is being wound up or liquidated, the “liquidator” appointed shall give intimation of his appointment to the Commissioner and the Commissioner in return shall notify the liquidator within three months from the date on which he receives the intimation of his appointment, any amount which is payable by the company.

Sections 88(3) of CGST Act, 2017 incorporated the principle of vicarious liability of the directors of the debtor company. It provides that when any private company is liquidated and any tax, interest or penalty determined under this Act remains unrecovered, then the directors of such debtor company shall be jointly and severally liable for the payment of such tax, interest or penalty.

IV. CONCLUSION

The treatment of statutory dues shall be as per resolution plan approved by the Committee of Creditors. Once, the resolution plan, as approved by the Committee of Creditors, is approved by the Adjudicating Authority the same shall be binding on all stakeholders involved in the resolution plan including government authorities to whom statutory dues are payable. Therefore, the fate of statutory dues payable to government authorities will be initially decided by the Committee of Creditors and thereafter by the Adjudicating Authority when it considers the resolution plan.

Even if statutory dues are given a priority in contradiction with Section 53 of the Code, it would oust the whole hierarchy of repayment of dues and would be highly detrimental to the rights of the secured creditors whose preferential treatment is the cornerstone of the Code.

In conclusion, it can be said that tax dues do not have a priority over secured creditors or even unsecured financial creditors. One thing is certain that the breadth of the tax laws and the traditional priority of the claims under it have taken a backseat post the enactment of the Insolvency and Bankruptcy Code.
