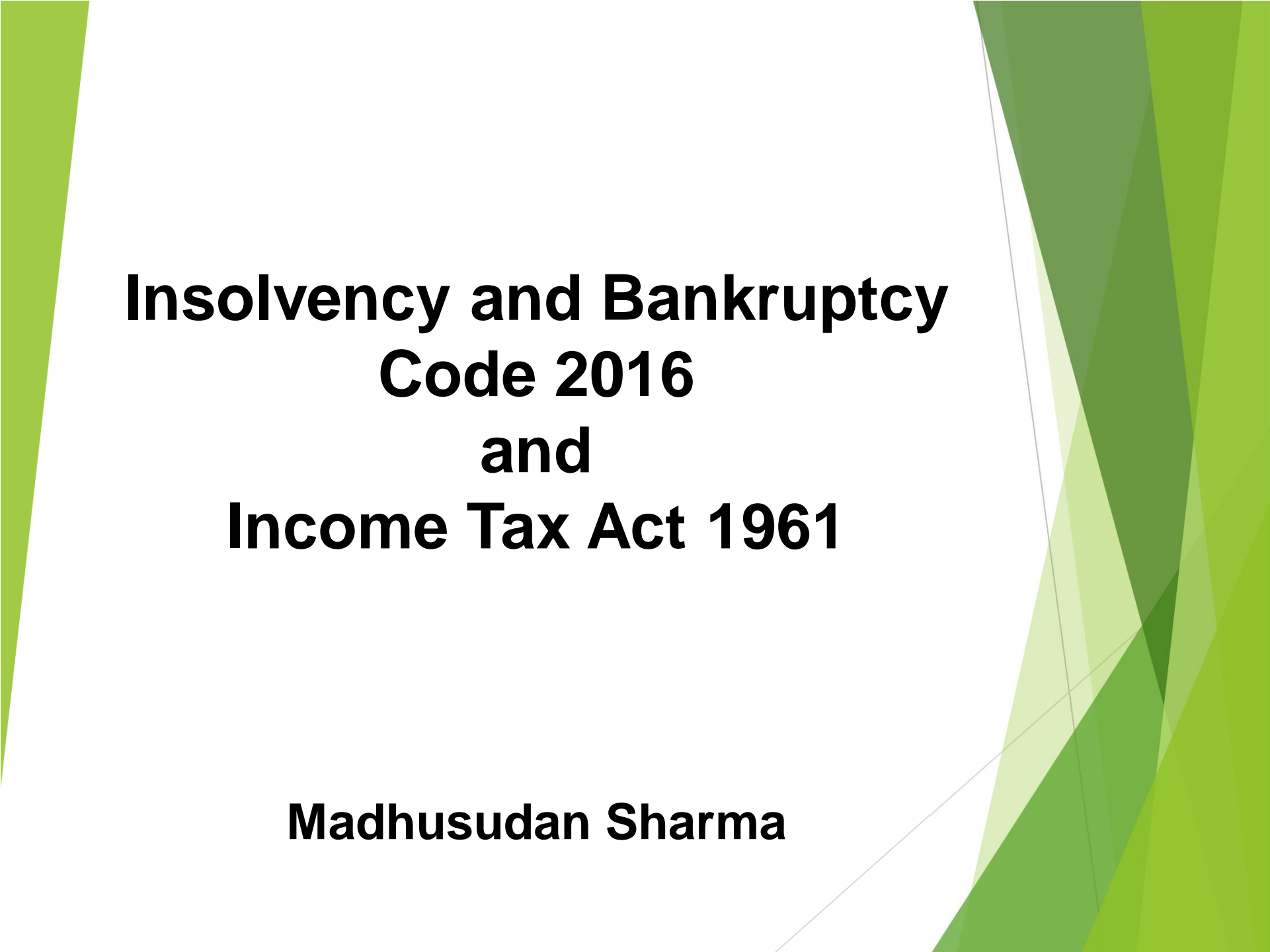




भारतीय दिवाला और शोधन अक्षमता बोर्ड
Insolvency and Bankruptcy Board of India

Workshop on Interplay of Insolvency
and Bankruptcy Code 2016
and
Income Tax Act 1961
for the officers of Income Tax
Vadodara Circle

Vadodara 24.12.2019



**Insolvency and Bankruptcy
Code 2016
and
Income Tax Act 1961**

Madhusudan Sharma

Object of IBC

- u An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals **in a time bound manner for maximization of value of assets** of such persons, to promote entrepreneurship

Objects of IBC

to promote :

- u entrepreneurship,
- u availability of credit and
- u balance the interests of all the stakeholders including
- u **alteration in the order of priority of payment of Government dues**
- u to establish an Insolvency and Bankruptcy Board of India, and
- u for matters connected therewith or incidental thereto.

Laws Repealed

The Presidency Towns Insolvency Act, 1909

The Provincial Insolvency Act, 1920

Laws Amended

The Indian Partnership Act, 1932

The Central Excise Act, 1944

The Income-tax Act, 1961

The Customs Act, 1962

The Recovery of Debts due to Banks and Financial Institutions Act, 1993

- u The Finance Act, 1994
- u The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- u The Sick Industrial Companies (Special Provisions) Repeal Act, 2003
- u The Payment and Settlement Systems Act, 2007
- u The Limited Liability Partnership Act, 2008
- u The Companies Act, 2013

- u IBC Enacted under **Entry 9 of the List III in the 7th Schedule** of the Constitution which reads as:

“9. Bankruptcy and insolvency”

Overriding Effect

- u **Section 238** 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.**

Supreme Court in Innoventive Industries Ltd. Vs. ICICI Bank and Anr.

- u A Code is complete and that marks the distinction between a Code and an ordinary enactment, by that canon, is self-contained and complete.
- u It is settled law that a consolidating and amending act like the present Central enactment forms a code complete in itself and is exhaustive of the matters dealt with therein. (Similarly held earlier for CPC, Income Tax Act and Arbitration Act)

- u **the non-obstante clause, in the widest terms possible, is contained in Section 238 of the Code, so that any right of the CD under any other law cannot come in the way of the Code.** For all these reasons, we are of the view that the Tribunal was correct in appreciating that there would be repugnancy between the provisions of the two enactments.

- u IBC is a Parliamentary law that is an exhaustive code on the subject matter of insolvency in relation to corporate entities, and is made under **Entry 9, List III** in the 7th Schedule which reads as under: “9. Bankruptcy and insolvency”
- u *{MRU Act is enacted under **Entry 23 of List III**}*
- u “It is clear that the **later non-obstante clause of the Parliamentary enactment will also prevail** over the limited non-obstante clause contained in Section 4 of the Maharashtra Act. For these reasons, we are of the view that the Maharashtra Act cannot stand in the way of the corporate insolvency resolution process under the Code.”

Key issues in deciding Repugnancy

- u Cannot obey one without disobeying the other
- u Subject matter is relevant not the Entry in Schedule III of the Constitution

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

- u Given Section 238 of the Insolvency and Bankruptcy Code, 2016, it is obvious that the **Code will override** anything inconsistent contained in any other enactment, **including the Income-Tax Act.**
- u We may also refer in this Connection to *Dena Bank vs. Bhikhabhai Prabhudas Parekh and Co. & Ors.* (2000) 5 SCC 694 and its progeny, making it clear **that income-tax dues, being in the nature of Crown debts, do not take precedence even over secured creditors,** who are private persons.

Amendments in Income Tax Act

- u **Section 247. Amendments of Act 43 of 1961.-**
The Income Tax Act, 1961 shall be amended in the manner specified in the Third Schedule.
- u **The Third Schedule**
- u In sub-section (6) of section 178, after the words “for the time being in force”, the words and figures “**except the provisions of the Insolvency and Bankruptcy Code, 2016**” shall be inserted.
- u **Amended Section 178 (6)**
- u **Company in liquidation.** The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force **except the provisions of the Insolvency and Bankruptcy Code, 2016.**

Section 178, which provides for

- Liquidator to notify to Assessing Officer about commencement of liquidation
- Assessing Officer to notify amount due from the Company to Liquidator
- Liquidator to take prior approval from IT Department before sale of assets
- u THESE PROVISIONS ARE NOT APPLICABLE TO COMPANIES UNDER IBC

Other Amendments in Income Tax Act

- u MAT - Clause (iih) of Explanation 1 to subsection (2) of section 115JB **book profit as reduced by** the aggregate amount of unabsorbed depreciation and loss brought forward
- u Sec 140 Returns to be verified u/s 115WD or 139
- u Sec 79(2) Carry forward and set off of losses
- u Sec 208(2) Persons entitled to claim refund

Clause (iih) of Explanation 1 to sub-section (2) of section 115JB

- u the aggregate amount of unabsorbed depreciation and loss brought forward in case of a—
- u (B) company against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under section 7 or section 9 or section 10 of the Insolvency and Bankruptcy Code, 2016 (31 of 2016).

Explanation.—For the purposes of this clause,—

- u (i) "Adjudicating Authority" shall have the meaning assigned to it in clause (1) of section 5 of the Insolvency and Bankruptcy Code, 2016 (31 of 2016);
- u (ii) "Tribunal" shall have the meaning assigned to it in clause (90) of section 2 of the Companies Act, 2013 (18 of 2013);
- u (iii) a company shall be a subsidiary of another company, if such other company holds more than half in the nominal value of equity share capital of the company;
- u (iii) "loss" shall not include depreciation;

Carry Forward and Set off of Losses

- u 79. (2) Nothing contained in sub-section (1) shall apply,—
- u (c) to a company where a change in the shareholding takes place in a previous year pursuant to a **resolution plan approved under the Insolvency and Bankruptcy Code, 2016 (31 of 2016)**, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

Section 140 (c)

- u Provided further that:
- u (c) where in respect of a company, an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under section 7 or section 9 or section 10 of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), the **return shall be verified by the insolvency professional** appointed by such Adjudicating Authority.

- u Explanation.—For the purposes of this clause the expressions "insolvency professional" and "Adjudicating Authority" shall have the respective meanings assigned to them in clause (18) of section 3 and clause (1) of section 5 of the Insolvency and Bankruptcy Code, 2016 (31 of 2016);]
- u The interim resolution professional shall have the authority to access the books of accounts, records and other relevant documents of CD **available with government authorities**, statutory auditors, accountants and such other persons as may be specified **Sec 17(2) (d). (Similar to IT Act - Section 133(6) Power to call for information)**

- u IRP/RP to file an application to NCLT and seek directions against any such person who is not co-operating with the IRP/RP – sec 19(2). Similar powers to liquidator
- u **IRP/RP** shall be responsible for complying with the **requirements under any law** for the time being in force on behalf of the CD – Sec 17(2)(e). To comply with all the provisions during CIRP e.g. TDS, TCS, payment of income-tax, filing of returns, etc.

- u IRP/RP to take control and custody of any asset over which the CD has ownership rights as recorded in the balance sheet of the CD, or with information utility or the depository of securities or any other registry that records the ownership of assets including - **assets that may or may not be in possession of the corporate debtor;**
- **Sec 18(1) (f)**

- u All the assets of CD, if attached by Govt. Authorities against tax dues would be released in favour of Resolution Professional or liquidator e.g. Bank accounts, movable or immovable properties, etc. (not if already realised and adjusted against the tax dues) Corporate Debtor to either Govt Department or third parties

Filing of Claim by Tax Authorities & their Rights in CoC During CIRP

- u Regu 7: Claim would be filed by operational Creditors in Form B of CIRP Regulations along with proofs, documents and clarifications, if any. Copies of the relevant orders would be required.
- u Claim can only be filed for amount due from the Corporate Debtor, irrespective of any appeal pending with any authority
- u Govt Authorities would also file their claims during Liquidation Process in Form C as provided in Liquidation regulations along with all the documents and evidences.
- u Right of Operational Creditors to get notice of Committee of Creditors meeting and to attend the meeting only in case

the amount of their aggregate dues are not less than 10% of total debt/claims Sec 24(3)(c)

- u Operational Creditors will not have any right to vote in Committee of Creditors
- u In Liquidation Govt. Authorities have been given one seat on the Stakeholders' Consultation Committee out of the maximum 11 seats, if there are claims filed by Govt. Authorities.
- u The SCC members do not have any power except to observe the process of sale of assets and understand Liquidation Value. Can direct Liquidator to do some act or not

Moratorium u/s 14

Effects of Moratorium

1) Prohibiting all of the following:

(a) The institution of suits or continuation of pending suits or proceedings against the CD including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority;

(b) Transferring, encumbering, alienating or disposing off by the CD any of its assets or any legal right or beneficial interest therein;

(c) Any action to foreclose, recover or enforce any security interest created by the CD in respect of its property including any action under the SARFAESI Act;

(d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

(2) The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.

Regu 32: The essential goods and services referred to in section 14(2) shall mean-

(a) electricity; (b) water; (c) telecommunication services; and (d) information technology services,

To the extent these are not a direct input to the output produced or supplied by the corporate debtor.

Punishment for contravention of Moratorium - Sec 74

- By the Corporate Debtor or any Officer of the CD – imprisonment 3-5 years and/or Fine Rs. 1 to 3 Lakh
- Any Creditor Financial or Operational – imprisonment 1-5 years and/or fine Rs. 1 lakh to 1 Crore

CASE LAWS



30

High Court, Hyderabad

- u **Leo Edibles & Fats Limited Vs. The Tax Recovery Officer (Central), Income Tax Department, Hyderabad, and others, Writ Petition No.8560 OF 2018** Registration of IT attached property:
- u Income-tax Department, which claimed a charge over the immovable property that was purchased by the petitioner company in the liquidation proceedings.
- u The Court held that due to the amendment to section 178 (6) of the IT act which was brought about by section 247 of the IBC, the IT department stood excluded as a secured creditor.

- u Thus, it has to take recourse to distribution of the liquidation assets as per Section 53 of the IBC where it stood at fifth position
- u As per Section 36(3)(b) of the Code, the liquidation estate assets may or may not be in possession of the corporate debtor, including but not limited to encumbered assets.
- u Therefore, the said order of attachment cannot be taken to be a bar for completion of the sale effected by the liquidator under the provisions of the Code.

- u Registry directed to register the property sold in liquidation though the property had been attached by Income Tax Department under recovery proceedings.
- u Property, even if encumbered, will still be part of the liquidation estate subject to the waterfall under IBC.

HC Delhi in Power Grid Corporation v. Jyoti Structure Ltd

- u Petition pending u/s 34 (i.e. objections to the award) of Arbitration and Conciliation Act, 1996 for setting aside arbitral award in favour of the respondent. During pendency application u/s 7 of IBC filed by a financial creditor for CIRP against the respondent. NCLT admitted such application and declared a moratorium u/s 14 of the Code.
- u Held: Proceeding u/s 34 would not be hit by the embargo of Section 14(1)(a) viz.,
- u proceedings do not mean all proceedings;

- u moratorium under section 14(1)(a) of the code is intended to prohibit debt recovery actions against the assets of corporate debtor;
- u continuation of proceedings u/s 34 which do not result in endangering, diminishing, dissipating or adversely impacting the assets of corporate debtor are not prohibited under section 14(1)(a);
- u term including is clarificatory of the scope and ambit of the term proceedings;
- u the term proceeding would be restricted to the nature of action that follows it i.e. debt recovery action against assets of the corporate debtor;

- u the use of narrower term "against the corporate debtor" in sec 14(1)(a) as opposed to the wider phrase "by or against the corporate debtor" used in sec 33(5) further makes it evident that section 14(1)(a) is intended to have restrictive meaning and applicability
- u Arbitration Act draws a distinction between proceedings under sections 34 and 36 (i.e. the enforceability and execution of the award). Proceedings under section 34 are a step prior to the execution of an award. Only after determination of objections under section 34, the party may move to execute such award if they are settled against CD

NCLAT
Rotomac Global Private Limited,
Vs. Dy Director,
Directorate of Enforcement
02.07.2019

- u In so far as penalty is concerned, offence of money laundering is punishable with rigorous imprisonment which is not less than three years and has nothing to do with the 'Corporate Debtor'. It will be applicable to the individual which may include the Ex-Directors and Shareholders of the 'Corporate Debtor' and they cannot be given protection from the
- u Prevention of Money Laundering Act, 2002' and such individual cannot take any advantage of Section 14 of the 'I&B Code'. This apart, we find that the attachments were made by the Deputy Director of Directorate of Enforcement much prior to initiation of the 'Corporate Insolvency Resolution Process', therefore, the 'Resolution Professional' cannot derive any advantage out of Section 14.

- u As the 'Prevention of Money Laundering Act, 2002' relates to different fields of penal action of 'proceeds of crime', it invokes simultaneously with the 'I&B Code', having no overriding effect of one Act over the other including the 'I&B Code'.

**SREI Infrastructure Finance
Limited v/s Sterling SEZ and
Infrastructure Ltd. NCLT
Mumbai, 12.02.2019. Sec 14**

- u The purpose and object of Insolvency and Bankruptcy Code, 2016 (Code) is for resolution of the Corporate Debtor by maximizing the value that can be received by the Creditors and stake holders.
- u The Code provides for timelines within which the resolution has to be arrived at. The PMLA's object is also to recover the property from wrong doers and compensate the affected parties. Here the beneficiaries are the creditors of the Corporate Debtor

- u The criminal proceedings before PMLA takes a longer time and by the time there can be erosion in the value of assets.
- u Due to the overriding provisions of Section 238 of Code which is the later legislation than PMLA, the provisions of Code will prevail.
- u Further, the quantum of amount locked in the assets of the Corporate Debtor can be released at the earliest when resolution is found through Code instead of taking a long route under PMLA. This is the economic aspect of the case.

- u Further, as per the provisions of Section 14(1)(a) of Code, where moratorium is imposed by the AA under Code, all other proceedings are kept at hold.
- u Since, the attachment order passed by the PMLA court is hit by the provisions of Section 14 of the Code and considering the overriding effect of Code under Section 238 of the Code, it was held that the attachment order under PMLA Act is a nullity in law.
- u Further, section 63 of the Code provides that no Civil Court or Authority shall have jurisdiction to entertain any proceeding in respect of any matter on which NCLT or NCLAT has jurisdiction under this Code.

- u Hence, the Adjudicating Authority under PMLA does not have jurisdiction to attach the properties of the Corporate Debtor undergoing CIRP. Considering these factors, application was allowed granting orders against the DOE to release the attachment on the assets of the Corporate Debtor.

Amendments in Income Tax Act,1961 for facilitation of CIRP under IBC

- u Company in Liquidation Sec 178(1)
- u Verification of Returns Sec 140
- u Provision for MAT Sec 115JB (2) (iih)
- u Carry forward and set off of losses
- u Sec 79(2)

Critical Tax Issues Arising Out of Interplay between Income Tax Act and IBC to be Resolved

- u Tax Implication on debt waivers/haircuts against loans and other liability:
- u Transaction Structuring – Impact on accumulated tax losses and Valuation Perspective
- u Validity of proceeding during moratorium period
- u Proceedings post liquidation

- u Liability of directors
- u No Objection Certificate from Income-tax Department
- u Deductibility of insolvency resolution process costs
- u Right of Income tax department to claim preferential treatment in the event of liquidation
- u Applicability of GAAR
- u Applicability of Capital Gain Tax and liability of payment of tax thereupon on sale of fixed assets of CD by liquidator

- u Refunds of TDS deducted by payee in case of capital gain on sale assets during liquidation
- u Return of Income Tax during liquidation period

जय हिन्द Jai Hind

धन्यवाद Thanks

Madhusudan Sharma

Advocate, Insolvency Professional, FCS, FCMA

madhusudan.ip@outlook.com 9868872918

Website: www.madhusudansharma.in