

Fate of Tax Demand During 'Moratorium' under IBC

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A. Brief Introduction:

Even after the commencement of the IBC, the approach of the tax authorities pertaining to the 'demand and recovery' of tax dues have remained fairly unchanged. Tax Authorities have often seen to act recklessly without at all complying the mandates of IBC. It is for this reason that we often see cases where tax authorities have been found to initiate/ continue tax proceedings despite the fact that 'Moratorium' u/s 13 read with Section 14 has been declared by the NCLT.

The concept of 'Moratorium' holds the most paramount position in the scheme of the IBC for it provides a standstill period during which creditors (whether financial or operational) cannot resort to individual enforcement action which may frustrate the object of the corporate insolvency resolution process. In this regard, recently, in the case of **Unilever Industries Private Limited & Another vs Kwaliti Limited** G.A. No.942 of 2018 (Original Side) Hon'ble Calcutta High Court had very aptly delineated the 'Purpose of Moratorium' in the following manner:

' Section 14 of IBC refers to moratorium. The Notes on Clauses in the IBC, 2015 explained the reason for this Section. In short, it is stated that the purpose of moratorium is to keep the corporate debtor's assets together during the insolvency resolution process and ensure that the company may continue as a going concern while the creditors take a view on resolution of default. It is to obviate the possibility of potentially conflicting outcome of related proceedings and also to ensure that the resolution process is a collective one. The moratorium on initiation and continuation of legal proceeding including debt enforcement action ensures a standstill period during which creditors cannot resort to individual enforcement action which may frustrate the object of the corporate insolvency resolution process. Section 14 also prescribes a period for which the moratorium will be in effect. The Viswanathan Committee (Report of the Bankruptcy Law Reforms Committee, Volume I: Rationale and Design, Chapter 5) mooted the concept of calm period to enable peaceful resolution and focussed attention for resolving the insolvency. The idea behind introduction of moratorium is to preserve the value of the corporate debtor by ensuring that it continues to work as a going concern. The aforesaid report in Clause 5.3.1 has, inter alia, stated that the motivation behind the moratorium is that it is value maximising for the entity to continue operations even as viability is being assessed during the IRP. The Insolvency Law Committee in its report of 2018 took note of the repealed [Sick Industrial Companies \(Special Provisions\) Act, 1986 \(SICA\)](#) and considered the Notes on Clauses for Section 14 of the Code in order to understand the real intention of this provision. The scope of moratorium was discussed in Clause 5.1 of the said report in which it is stated that the scope of the moratorium is broader than the moratorium in the repealed SICA in two ways - First, under SICA, the actions barred could be instituted or continued with the consent of the BIFR, and second, the language used in [Section 22](#) of SICA clarified that proceedings which affected the assets of the company or for recovery of money etc. were barred.

On a plain reading, [Section 14](#) is wider in its ambit as, firstly, any suit or proceeding cannot be instituted or continued with the consent of the NCLT and secondly, the bar on institution of suits or continuation of pending suits or proceedings against the corporate debtor is on the first blush not linked to the assets of the corporate debtor. The report in Clause 5.2 has stated -

' The notes on clauses for [section 14](#), read as follows (emphasis supplied): ' the purposes of the

*moratorium include keeping the corporate debtor's assets together during the insolvency resolution process and facilitating orderly completion of the processes envisaged during the insolvency resolution process and ensuring that the company may continue as a going concern while the creditors take a view on resolution of default' and ' **the moratorium on initiation and continuation of legal proceedings, including debt enforcement action ensures a stand-still period during which creditors cannot resort to individual enforcement action which may frustrate the object of the corporate insolvency resolution process.**' Thus, the intent does not appear to be to debar only those suits or proceedings which affect the assets of the corporate debtor, as these appear to be only one of the components that is barred.'*

Here, it must also be noted that the report of the Bankruptcy Law Reforms Committee has been relied upon even by the Hon'ble Supreme Court in **M/s Innovative Industries Limited vs. ICICI Bank & Anr** 2017 SCC OnLine SC 1025.

Further, Hon'ble Calcutta High Court also observed that:

...The purpose of moratorium is to prevent immediate collapse of the corporate debtor and with a view not to render the resolution process nugatory, Section 14 has been introduced in the Code which prohibits institution of suits or continuation of pending suits or proceedings against the corporate debtor. Section 14(1)(d) restrains a third party to initiate any proceeding for recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor. Thus, Section 14 has clearly defined the classes of persons who are restrained from proceeding against the company. The classes of creditors include both secured and unsecured creditors. **The statute insulates the corporate debtor against any debt recovery actions which are likely to endanger, diminish, dissipate or seriously affect the assets of the corporate debtor and such protection is to continue during the calm period. The emphasis is on to keep the corporate debtors' assets together during the insolvency resolution process and facilitate orderly completion of the process envisaged during the insolvency resolution process...**

B. No Tax Proceedings can be initiated once 'Moratorium' u/s 13(1)(a) read with Section 14 of IBC has been declared by NCLT

Before we discuss any further on this topic, it is indispensable to glance through following two provisions of IBC:

' Section 14: Moratorium:

(1) Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:

(a) 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;

(b) transferring, encumbering, alienating or disposing of by the corporate debtor 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 corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);

(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.

(3) The provisions of sub-section (1) shall not apply to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.

(4) The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process:

Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under sub-section (1) of section 31 or passes an order for liquidation of corporate debtor under section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.

Section 238: Provisions of this Code to override other laws:

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.'

From the conjoint reading of Section 14 and Section 238 of the IBC it is very clear that no tax proceedings under any statute can be initiated once 'Moratorium' u/s 13(1)(a) of the IBC has been declared by the Adjudicating Authority namely NCLT till the completion of the corporate insolvency resolution process or until NCLT approves the resolution plan under sub-s. (1) of s. 31 or passes an order for liquidation of corporate debtor under s. 33, as the case may be. This view is further reinforced by the rulings/ observations taken by Tribunals/ Courts in the following cases:

i. Pr. Commissioner of Income Tax-6 vs Monnet Ispat and Energy Limited 2017 [\[TS-6514-HC-2017\(DELHI\)-O\]](#). In this case Hon'ble Delhi Court held that:

1. *The Court has heard the learned counsel for both parties. The provisions of the Insolvency and Bankruptcy Code, 2016 ('Code') and in particular, s. 14 thereof have been perused. It appears to the Court that s. 238 of the Code is categorical that the Code will apply, notwithstanding anything inconsistent therewith contained in any other law for the time being in force. Sec. 14(1)(a) of the Code states, inter alia, that on the 'insolvency commencement date', the adjudicating authority shall by order declare moratorium for prohibiting ' the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any Court of law, Tribunal, arbitration panel or other authority' .**That the Code will prevail over all other statutes inconsistent therewith has been explained in the recent decision** dt. 31st Aug., 2017 of the Supreme Court in Civil Appeal Nos. 8337-& 8338 of 2017 (**Innovative Industries Ltd vs ICICI Bank**).*

2. *In the instant case, the National Company Law Tribunal (NCLT) (which by virtue of s. 5(1) of the Code is the adjudicating authority] has by its order dt. 18th July 2017 admitted the petition under s. 7 of the Code filed by the SBI against the respondent assessee and prohibited, inter alia, ' the institution of suits or continuation of pending suits or proceedings' against the respondent. This would include the present appeal by the IT Department ('Department') against the order of the Income-tax Appellate Tribunal in respect of the tax liability of the respondent-assessee.*

3. *Mr. Asheesh Jain, learned senior standing counsel for the Revenue, points out that unlike some of the earlier insolvency statutes the Code does not envisage permission being sought from the NCLT for continuation of the pending proceedings against the respondent in other fora. In the order dt. 18th July, 2017 it is clear that the moratorium continues ' till the completion of the corporate insolvency resolution process or until this Bench approves the resolution plan under sub-s. (1) of s. 31 or passes an order for liquidation of corporate debtor under s. 33, as the case may be' . Consequently, these appeals are disposed of with liberty to the appellant-Department to revive them subject to the further orders of the NCLT.*

Above-mentioned order of the Delhi High Court was later confirmed by the Apex Court. In doing so, the Hon'ble Supreme Court, in the backdrop of Section 238 of the IBC, held that IBC will over-ride anything inconsistent contained in any other enactment including the Income Tax Act, and it was further observed by the Apex Court, while referring to the case of **Dena Bank Vs. Bhikhabhai Prabhudas Parekh and Co., reported in 2000 (5) [\[TS-5025-SC-2000-O\]](#)** that the Income Tax dues, being in the nature of Crown Debts, do not take precedence even over secured creditors, who are private persons.

ii. Dishnet Wireless Limited & Ors vs Deputy Commissioner of Income Tax & Ors

W.P.Nos.24097 and 24098 of 2018 [\[TS-7260-HC-2018\(MADRAS\)-O\]](#) . In this case Writ Petitions were filed by the Petitioner Company (therein) before Hon'ble Madras High Court under Article 226 of the Constitution of India, praying for issuance of Writs of Certiorari to call for the records of the second respondent (therein) which comprised in the impugned order and the consequential demand notice, both dated 31.03.2018 issued by the second respondent (therein) during moratorium declared under section 13(1)(a) read with Section 14 of the IBC and quash the same as being without jurisdiction, arbitrary, illegal and violative of the Constitution of India and the provisions of the Income Tax Act, 1961. Disposing the case in favour of Petitioner Company, Hon'ble Madras High Court held that:

10. A perusal of the above provisions clearly tells us that once an order of moratorium is granted by the NCLT, the legal fiction under Section 14 of the IBC will come to the rescue of the corporate debtor. Therefore, taking into consideration all the abovesaid provisions of law and also the ratio laid down by the Apex Court in the abovesaid case, as also the Delhi High Court holding that when once the Moratorium is granted by the NCLT, it will continue till the completion of Corporate Insolvency Resolution Process or until it approves the resolution plan under Section 31(1) of the IBC or passes an order of liquidation of corporate debtor under Section 33 of the IBC, as the case may be, the present Writ Petitions shall stand disposed of, directing the respondents to keep the impugned orders in respect of both the petitioners, in abeyance, till the disposal of the proceedings pending before the NCLT, Mumbai and also the further appeal(s), if any that may be filed by any of the parties to these Writ Petitions. No costs. Consequently, W.M.Ps. are closed.

iii. **Sujana Towers Ltd. vs Commissioner of Central Excise Customs and Service Tax** . In this case, Appellants had sought adjournment of the matter pending before the CESTAT, Hyderabad on the ground that they had filed petition before the National Company Law Tribunal (NCLT) and the same was admitted vide the order dt. 03.06.2019 and in terms of the said order NCLT had specifically prohibited for institution of fresh suits or continuation of pending suits or proceedings in the judicial forum including the Tribunal. Adjourning the matter sine die, the Hyderabad Tribunal held that:

3. In view of the fact that the petition filed by the petitioner, the appellants herein, was admitted by the Ld. NCLT, we are of the considered opinion that the present appeals filed by the appellants cannot be proceeded further till final decision on the issue is rendered by Ld. NCLT. Accordingly, the matter is adjourned sine die. However, the appellants are at liberty to apprise this Bench about the development of the petition filed by them before the Ld. NCLT and thereafter, further course of action will be decided by this Bench accordingly.

iv. NCLT Kolkata Bench vide its order 02.03.2017 dated in **Nicco Corporation Limited C.P. No.03/2017** took note of the act Assistant Commissioner of Income Tax of issuing notice under section 226(3) of the Income Tax Act, 1962 on 21.02.2017 during the subsistence of moratorium declared by the Kolkata Bench vide its order dated 18.01.2017 and issued Show Cause Notice to the Income Tax Authority asking as to how their proceedings u/s 226(3) of the Income Tax Act was issued when moratorium order was passed against Nicco Corporation Limited. Further, the Tribunal also passed direction to the Income Tax Authority to issue necessary instructions to the Corporate Debtor's banks to un-fridge accounts so that resolution process could be carried out.

C. Understanding the correct way that Tax Authorities should proceed:

From the above discussion, it is beyond any pale of doubt that all legal proceedings including tax proceedings which are '**likely to endanger, diminish, dissipate or seriously affect the assets of the corporate debtor**' cannot be initiated or continued from the date of declaration of moratorium by the NCLT. Thus, the moment the application under Section 7, 9 or 10 of the IBC is admitted by the NCLT and appoints Interim Resolution Professional (for brevity 'IRP') u/s 16, tax authorities should stake its claim before IRP pursuant to public announcement issued by IRP u/s 13 read with Section 15, failing which, (if resolution plan is approved by NCLT) tax authorities will run the risk of losing tax dues once and forever.

At this juncture, it would be worthwhile to mention that tax dues are in the nature of '**operational debts**' and therefore tax authorities would be treated as '**operational creditors**' under the scheme of IBC. Being '**operational creditor**', it is incumbent on the part of tax authorities to stake their claim before IRP pursuant to public announcement issued by IRP u/s 13 read with Section 15. For the sake of convenience,

definitions of the 'operational debts' and 'operational creditors' as stipulated in the IBC have been reproduced below:

'Section 5 (20)- 'operational creditor' means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred;

*Section 5 (21)- 'operational debt' means a claim in respect of the provision of goods or services including employment or a debt in respect of the **payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority;***

Thus, from the conjoint perusal of above-mentioned Section 5(20) & (21) of IBC it is clear that Government dues (whether Central or State) is an operational debt which makes the Government 'Operational Creditor' in the scheme of IBC. Here, it must be borne in mind that the view that Revenue Department is 'Operational Creditor' as stipulated under section 5(20) of the IBC is no more res- integra as different High Courts/ Tribunals have already clarified the same in affirmative. In this regard, attention can be adverted to rulings/germane observations given by Hon'ble Supreme Court/ High Courts in the following cases:

i. Embassy Property Developments Pvt. Ltd. Vs. State of Karnataka & Ors., reported in Manu/SC/1661/2019 (refer Para 36)

ii. Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors., reported in (2019) 4 SCC 17 (refer Para 42)

iii. Electrosteel Steels Limited vs The State Of Jharkhand W.P.(C) No. 4850 of 2018 (refer Para 21)