Interplay Between IBC Proceedings & Income Tax Dept.'s Right to Re-Open Assessment

Jul 12, 2022

Abhinav Ashwin
Partner, AZB & Partners

The inter-play of the rights of the tax authorities vis-à-vis the Corporate Insolvency Resolution Process (**"CIRP"**) has been a subject matter of litigation for some time.

Section 14 of the Insolvency and Bankruptcy Code, 2016 (**'IBC'**) provides that on the insolvency commencement date, the Adjudicating Authority, shall by an order declare a moratorium on, inter alia, 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. This moratorium would continue to be in effect till the date the Adjudicating Authority approves the resolution plan under section 31(1) of the IBC.

Section 31(1) of the IBC deals with the approval of the resolution plan by the Adjudicating Authority. It originally provided that upon approval of the resolution plan by the Adjudicating Authority, the same "*shall be binding upon the corporate debtor and its employees, members, creditors*…." However, in 2019, the above-referred section was amended to expressly provide that upon approval of the resolution plan by the Adjudicating Authority, the same "shall be binding upon the corporate debtor and its employees, members, creditors, *including the Central Government, any State Government or any local authority to whom a debt in respect of payment of dues arising under any law for the time being in force, such as authorities to whom statutory dues are owed*…"

A three judge bench of the Apex Court [LSI-216-SC-2021(NDEL)], while interpreting the provisions of section 31 of the IBC, including the rationale and need for the 2019 amendment, observed as under:

"……

77. It is clear, that the mischief, which was noticed prior to amendment of Section 31 of I&B Code was, that though the legislative intent was to extinguish all such debts owed to the Central Government, any State Government or any local authority, including the tax authorities once an approval was granted to the resolution plan by NCLT; on account of there being some ambiguity, the State/Central Government authorities continued with the proceedings in respect of the debts owed to them. In order to remedy the said mischief, the legislature thought it appropriate to clarify the position, that once such a resolution plan was approved by the Adjudicating Authority, all such claims/dues owed to the State/Central Government or any local authority including tax authorities, which were not part of the resolution plan shall stand extinguished….."

In light of the above-referred provisions, read with section 238 of the IBC, which provides that the provisions of the IBC shall override the provisions of any other law, notwithstanding anything inconsistent contained under such other laws, the Courts, have categorically held that once a resolution plan is duly approved by the Adjudicating Authority under section 31(1) of the IBC, the treatment of the claims, as provided in the resolution plan, shall stand frozen and will be binding on the corporate debtor and its employees, members, creditors, including the Central Government, any State Government or any local authority, guarantors and other stakeholders. Further, all 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 of a claim, which is not part of the resolution plan.

However, despite the above legal position, it is not uncommon to witness litigation by the tax authorities, including attempts by them to initiate assessment/ re-assessment proceedings against the corporate debtor post initiation of the CIRP process. A case on the point is the recent judgment by the Madras High Court in the matter of ***Dishnet Wireless Limited v. Assistance Commissioner of Income-tax (OSD)*** [TS-505-HC-2022(MAD)]

In this case, the income-tax authorities had initiated reassessment proceedings against the corporate debtor for AY 2011-12 and AY 2012-13, post admission of the CIRP application filed by the corporate debtor under section 10 of the IBC. The petitioner filed writ petitions against such reassessment notices. The High Court passed interim orders in the matter, allowing the income-tax authorities to proceed with the reassessment but directing them to keep the assessment in a sealed envelope, till the conclusion of the CIRP. Subsequently, the NCLT approved the resolution plan in June 2020, while granting the dispensation that any inquiries, investigations, proceedings, suits, claims, disputes against the corporate debtor in relation to the period prior to the approval date shall stand extinguished and barred.

The petitioner argued that the income-tax authorities, being "operational creditors", were not entitled to proceed further in the matter in light of the definition of "claim" under section 3(6) of the IBC. Further, since the resolution plan had been approved by the NCLT, all claims pre-existing and/ or relating to the period prior to the initiation of CIRP, stood extinguished in terms of section 31 of the IBC.

The income-tax authorities, on the other hand, argued that the moratorium under section 14 of the IBC did not preclude them from re-opening of concluded assessments under section 148 of the Income-tax Act, 1961 (**"IT Act"**). Further, since the claim of the income-tax authorities had not crystalized till date, the question of extinguishment of any claim did not arise. They argued that there was no bar in law to restrict the power of the income-tax authorities to continue with proceedings under section 148 of the IT Act. Further, even if the petitioner had any grievances arising from the order passed in such re-assessment proceedings, it had an alternate remedy under the IT Act against such order.

The Madras High Court, while dismissing the writ petitions, noted that the resolution plan in the instant case did not contemplate any concession from the income-tax department even though reassessment notices had already been issued. Further, the resolution plan, as approved by the NCLT did not contemplate taxes due under the IT Act. In any event, at that stage, the reassessment proceedings had not crystallized into a claim or a demand. Importantly, what seems to have significantly influenced the Court in dismissing the writ petitions was the fact that this was a case of CIRP having been initiated by the petitioners i.e. the company itself, and given the fact that the proceedings under the IBC were initiated few days prior to the initiation of the reassessment proceedings, petitioners ought to have ensure proper notice to the income-tax department and also obtained/carved out relevant concessions in the resolution plan. Accordingly, the Madras High Court held that since the claims of the income-tax department were not considered by the NCLT, while approving the resolution plan, the question of abatement of such rights cannot arise. The Court held that the fact that the resolution plan has been approved could not impinge upon the rights of the income-tax department to pass any orders under section 147/ 148 of the IT Act.

The High Court, it appears, has failed to appreciate that unlike in the case of mergers/ demergers under the Companies Act, 2013, where there is a specific positive obligation on the applicant companies to give a notice of the proceedings to, amongst others, the income-tax authorities[1], there is no analogous provision under the IBC. Under the provisions of the IBC, the Interim Resolution Professional (**"IRP"**) is merely required to make a public announcement of the initiation of the CIRP and inviting claims against the corporate debtor. In fact, recognizing and seeking to address precisely the risk of their claims getting extinguished in a CIRP, in the absence of a specific notice, the Central Board of Indirect-taxes and Customs (**"CBIC"**) have recently issued a detailed Standard Operating Procedure (**"SOP"**).

Courts, including the Supreme Court, have time and again, reiterated the proposition that once a resolution plan has been approved; it is binding on all the stakeholders, including governmental agencies. The idea behind this is to freeze all the claims, thereby enabling the resolution applicant to start on a clean slate. Permitting the exercise of a right to reassess by the income-tax authorities, especially, when

such right cannot be enforced in light of the specific mandate of the IBC and Supreme Court decisions, seems to be an academic exercise.

It could, therefore, be argued that the aforesaid judgment does not represent the current position of law and is *per in curium*. It is expected that this order may be challenged before the Supreme Court, and it will be interesting to see the position taken by the Apex Court on the matter. Having said that, this judgment, nevertheless, is likely to create possibilities for the income-tax department to initiate or continue tax proceedings against the corporate debtor, during the pendency of the moratorium under section 14 of the IBC, of after approval of the resolution plan under section 31 of the IBC; thereby leading to unnecessary litigation, which strikes against the spirit of the IBC.

*****

[1] Section 230(5) of the Companies Act, 2013.