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A Monthly Journal of
THE CHAMBER OF
TAX CONSULTANTS

THE CHAMBER'S JOURNAL

Your Monthly Companion on Tax & Allied Subjects

Vol. XIII | No. 2 | November 2024

INSOLVENCY & BANKRUPTCY CODE - ANALYSIS

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The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre-eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.

Unveiled by **Shri S. E. Dastur,** Senior Advocate on 30th January, 2008.

Contents

Vol. XIII | No. 2 | November 2024

From the Editor's Desk
— *Anish Thacker* **5**

From the President
— *Vijay Bhatt* **7**

Special Story — Insolvency & Bankruptcy Code - Analysis

IBC and Income Tax
— *Nikhil Tiwari & Palak Mehta* **9**

IBC and GST — *Prakasa Rao & Shraddha Sharma* **26**

Navigating Accounting, Auditing, Allied Regulations, and Resolution Professional Opportunities under IBC
— *Ashish Makhija* **33**

The Interplay between PMLA with IBC — *Aditya Ajgaonkar* **46**

Analysis of Recent Supreme Court Cases and Overcoming Challenges under IBC — *Anil Goel* **60**

Policy Initiatives: Influence on Credit Market, Group/Cross-Border Insolvency, Others — *Vikas Chandra* **70**

IBC - Impediments to its Robustness — *Sumant Batra* **77**

Making Insolvency and Bankruptcy Code more effective: A Roadmap for the Future — *Pradeep Joy & Shankey Agrawal* **86**

The Vagaries of IBC Law
— *Guru Prasad Makam* **95**

Hot Spot

Auditing Standard SA-600
— *Prashant Daftary & Vaibhav Sagvekar* **98**

Direct Taxes - Important Judgements

Supreme Court — *Keshav Bhujle* **101**

High Court — *Jitendra Singh, Radha Halbe & Harsh Shah* **105**

Tribunal — *Nikhil Mutha, Viraj Mehta & Kinjal Bhuta* **109**

International Taxation - Important Judgements

Case Law Update
— *Dr. Sunil Moti Lala* **116**

Indirect Taxes - Important Judgements

GST — *Naresh Sheth & Jinesh Shah* **124**

Service Tax — *Rajiv Luthia & Keval Shah* **130**

Corporate Laws - Important Judgements

Case Law Update — *Makarand Joshi* **137**

Other Laws

FEMA Updates & Analysis
— *Hardik Mehta & Tanvi Vora* **144**

Best of The Rest — *Rahul Hakani & Niyati Mankad* **145**

The Chamber News

— *Mehul Sheth & Neha Gada* **148**

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From the Editor's Desk

My Brothers and Sisters,

> *"Diwali is about setting goals, not accumulating gold. As Lakshmi comes from Lakshya, meaning Goal."* — **Tapan Ghosh**

As I write this editorial during the Diwali festivities, it comes to mind that Diwali ushers in a spirit of positivity, a feeling of reassurance that Good will always prevail and an atmosphere of "All Izz Well" around. It is also the perfect time to set goals for the ensuing year and thereafter, as the new Vikram Samvat Year (2081) begins. Businessmen close old accounts and begin afresh by worshipping Goddess Lakshmi requesting her to bless them with prosperity and success. And, as we set new and better goals with the positive intent of working hard to meet and better them, the mood is full of joy all around.

At the Chamber also, this feeling of positivity and an unwavering eagerness is prevalent with all the committees carrying on in fine fettle and conducting successful programs. I wish everyone of you a Happy New Year full of Joy and Success.

On the return filing front, the Government and the Central Board of Direct Taxes (CBDT) eased our pressure to complete our return filing ork by extending the due date of returns to be filed by 31st October 2024 to 15th November 2024. On behalf of you all, I take this opportunity to express gratitude to them for doing so.

As a nation, we have so much that is happening and so much to look forward to. The recent fall in the stock market prices ought not to therefore, worry the Indian diaspora, as the medium to long term outlook for economic growth remains positive and optimistic.

On the tax front, litigation and court decisions keep us on our toes always and the past month has also witnessed some decisions that have been interesting. This march of the law is what keeps tax professionals on their toes and constantly alert. The number of appeals pending at the Commissioner (Appeals) level, however, continues to grow despite efforts being taken by the Government in this direction. One hopes that somewhere, a fresh perspective to faceless assessment and dynamic jurisdiction ought to be seeding into the minds of the powers that be.

After all, we are the only nation that did experiment in this direction, and it is trite that most experiments do not always succeed initially.

Talking about bold experiments, the move by the Government in enacting and enforcing the Insolvency and Bankruptcy Code (IBC) was a much appreciated step when the process began. Time however appears to have dampened this enthusiasm, and maybe it is not only time that has led to this. This month's issue contains insightful articles on the subject and this special issue on "Insolvency and Bankruptcy Code – Analysis" will give the readers insight and perspective on the IBC's effectiveness as well as implementation issues. I sincerely thank the learned authors who have contributed their articles in this issue and compliment the Journal Committee for bringing this issue out. Special thanks to CA Sanjiv Chaudhary from Delhi and CA Sachin B from Bengaluru for their efforts in this direction.

Many of us will be participating in the state elections and of course Chartered Accountants amongst us will also be voting at the ICAI elections before the next issue is out. I would like to urge everyone of us to go and vote at the elections. In a democracy the right and the responsibility to exercise our franchise judiciously, go hand in hand and it must remain our privilege and indeed, our solemn duty to do so.

The Greek philosopher, Socrates, has said that *"An unexamined life is not worth living."* In this period of infectious positivity and setting of goals for the new year, let us include a goal to introspect and examine our lives to date, devoid of any emotion or bias whatsoever, and pledge to do our bit to make our circle of influence, more positive and happier.

Once again, I wish you all a Happy Diwali and a Prosperous New Samvat Year.

ANISH M. THACKER
Editor

From the President

Dear Members,

As we celebrate the triumph of light over darkness, I extend warm wishes to you and your loved ones for a Very Happy Diwali and a Prosperous New Vikram Samvat Year 2081!

I am sure that you all would have successfully completed the targets of filing Income Tax Returns of Audited entities by extended due date of 15th November, 2024. Now it's the time to do introspection in respect of the quality work vis-a-vis quantitative work. Take a moment to reflect on your accomplishments and strive for a balance between work and well-being.

Post-tax season, our Team Chamber is dedicated to delivering exceptional educational programs. I am excited to announce the 3rd FEMA RRC in Ahmedabad from 20th December, 2024 to 22nd December, 2024, featuring renowned experts. Details are available in our Newsletter and on the CTC Website.

The overwhelming response to our 48th Direct Tax RRC at Raipur and 13th Indirect Tax RRC at Bengaluru is a testament to our commitment to excellence. It is heartening to see that enrolment for the 48th Direct Tax RRC at Raipur had to be closed due to reaching maximum capacity four months before the event. As mentioned in my previous communication, I once again encourage the members, who have not yet enrolled for FEMA RRC & Indirect Tax RRC to enroll at the earliest, to avoid disappointment at a later stage.

We are proud to co-hosts to the much awaited 'hybrid' Half Day Seminar on "Vivad se Vishwas Scheme, 2024" - "Demystifying VSV 2.0" with IMC Chamber of Commerce and Industry (IMC) and Bombay Chartered Accountants' Society (BCAS) on 14th November, 2024 at Babubhai Chinai Hall, IMC, Mumbai which is also accessible on the virtual platform. We express our sincere thanks to Shri Raj Tandon, Principal Chief Commissioner of Income-tax, Mumbai for accepting our invitation to deliver the Keynote address in the said event. We are also thankful to Shri R. S. Syal, Vice-President, Income-tax Appellate Tribunal (Retd), Shri Ashish Kumar, Ex-IRS and all the other esteemed faculty members for their participation in the seminar for the benefit of our members.

The Law & Representation Committee has made several representations to various Regulatory Authorities on certain issues arising out of recent circulars/notifications. Like every year, this year too, the Chamber has been invited by the Ministry of Finance to attend the Pre-Budget meeting in Delhi on 11th November, 2024 and to present its suggestions. Kudos to CA Ketan Vajani, the Chairman of L & R Committee and his team for making timely representations to the authorities in spite of their busy schedule during the tax return season.

This month's Journal is on the pivotal topic "Insolvency & Bankruptcy Code – Analysis." CA Ameya Kunte, Chairman of the Journal committee and his team have selected this interesting topic for the benefit of the readers. I acknowledge the efforts of the Journal Committee team-mates, CA Sanjiv Choudhary (from Delhi) & CA Sachin B (from Bengaluru) in bringing this issue out. I thank all the authors for their knowledge sharing contributions.

After the tax & audit season, now is the time to update our knowledge by studying various Acts/Journals/Latest Judgments etc. and attending Seminars/Webinars/Study Circle meetings etc.

I wish happy learning to all the members.

Jai Hind

VIJAY BHATT
President

IBC and Income Tax

CA Nikhil Tiwari

CA Palak Mehta

Overview

In this article, CA Nikhil Tiwari alongwith CA Palak Mehta and Mr. Arpit Agrawal addresses the interplay between the provisions of the Insolvency and Bankruptcy Code, 2016 ('IBC') and Income Tax Act, 1961 ('ITA'). These two powerful legal regimes i.e. tax laws and the IBC often find themselves on a collision course. The tax laws' relentless pursuit of recovery stands in stark contrast to the IBC's ethos of providing a 'clean slate' to insolvent companies, free from past liabilities. Thus, each stage of IBC gives rise to numerous tax litigations. The major issues which arise while giving effect to the provisions of both the aforesaid statues are priority of claims, moratorium, settlement of tax dues, tax claims in liquidation, tax offences, carry forward losses etc. Even after commencement of the IBC, the approach of tax authorities pertaining to the demand and recovery of tax dues remained fairly unchanged. Tax Authorities have been often seen to initiate/continue tax proceedings despite Moratorium been declared by the NCLT. The interplay between the ITA and the IBC is complex and often requires careful navigation to ensure compliance with both laws. Although the laws may not yet align with each other fully, we hope the legislature will take proactive efforts to address the grievances for the overall betterment of economy in the long run.

Introduction

The Insolvency and Bankruptcy Code ('IBC'), enacted in India in 2016, stands as a landmark legislation designed to unify and streamline the processes for insolvency resolution and bankruptcy for individuals and corporate entities. The IBC delineates a transparent framework for the expeditious resolution of insolvency cases, aimed at optimizing asset values and mitigating the economic distress encountered by debtors by imposing a moratorium on pending demands from various creditors, initiation of suits and proceedings and their continuation. Yet, as transformative as the IBC has been, its interplay with other established laws, especially the Income-tax Act, 1961 has generated complex legal questions that challenge the very essence of this legislative framework.

The Income-tax Act, 1961 ('ITA'), a robust and far-reaching statute, is rooted in the principle of revenue maximization for the state. In contrast, the IBC seeks to provide a 'clean slate' to debt-ridden entities, often at the expense of pre-existing liabilities, including tax

dues. This divergence in objectives has led to a series of judicial interpretations, legislative amendments, and administrative challenges that continue to evolve as both laws adapt to the changing economic landscape.

However, these two powerful legal regimes i.e. tax laws and the IBC often find themselves on a collision course. The tax laws relentless pursuit of recovery stands in stark contrast to the IBC's ethos of providing a 'clean slate' to insolvent companies, free from past liabilities. This fundamental divergence creates tension, particularly in the early stages of the CIRP, where tax authorities and other stakeholders may find their interests at odds.

Vide this article, we have attempted to address the interplay between the provisions of the IBC and ITA.

Brief Overview of IBC

For better understanding of the interplay between IBC and ITA, following process of IBC would be important to keep in mind:

- Initiation of insolvency process by creditors or corporate debtor when a default occurs also in some situation insolvency process can be initiated by company on its own;
- Examination of application for existence of default and admission of application by NCLT;
- Upon admission, the NCLT declares a moratorium for prohibiting debt recovery, enforcement of security interest, sale or transfer of assets, or termination of essential contracts;
- Appointment of Interim Resolution Professional ('IRP') to take control of the debtor's assets and manage its operations;
- The IRP constitutes a Committee of Creditors ('CoC') comprising financial creditors who meet to decide on the future of the debtor.
- After constitution of CoC, Resolution Professional ('RP') is appointed by CoC. The RP invites prospective lenders, investors, and any other persons to put forward resolution plans.
- Once the CoC approves a resolution plan, it is submitted to the NCLT for final approval.
- The NCLT may either approve the plan, which is then binding on all parties, or reject it if it does not comply with the requirements.
- If no resolution plan is approved within the stipulated time frame or if the CoC decides to liquidate the company, the NCLT may allow the RP itself to continue during the liquidation proceeding or may appoint a new liquidator.

IBC Law deals with various aspects, however, we have discussed hereinafter, only those aspects which have an impact from income tax point of view.

I. Trilateral Mechanism under IBC

As we understand from the process of IBC, it is long drawn process and involves various aspects. However, only following three aspects of IBC have an impact on income tax law which are as under:

- Moratorium
- Clean Slate
- Overriding effect

1. Moratorium

Section 14 of the IBC deals with the following three restrictions:

- Restriction on institution of suits;
- Restriction on continuation of pending suits;
- Restriction on proceedings against the corporate debtor of the nature of execution of any judgment, decree or order.

Thus, the aforesaid Section mandates that from the insolvency commencement date, the Adjudicating Authority imposes a moratorium, suspending all legal proceedings, asset transfers, and enforcement of security interests against the corporate debtor.

This moratorium remains until the corporate insolvency resolution process concludes or the entity is liquidated, ensuring the debtor's operations and assets remain intact during this critical period. This judicial pause is critical in maintaining the status quo of the company's assets and operations.

The **Hon'ble Kolkata High Court**, in the case of ***Unilever Industries Private Limited & Another vs. Kwality Limited (G.A. No.942 of 2018 and C.S. No.73 of 2018 dated 30-01-2019),*** elucidated that the purpose of the moratorium as a mechanism to preserve the corporate debtor's assets during the insolvency resolution process and to ensure the entity's ongoing viability as a going concern while creditors deliberate on default resolution. The moratorium is intended to provide a "calm period" that enables a focused and peaceful resolution process, preventing individual enforcement actions that could undermine the collective insolvency resolution objectives.

Further, the **Hon'ble Supreme Court** in case of ***Alchemist Asset Reconstruction Co. Ltd. vs. Hotel Gaudavan (P.) Ltd. (CIVIL APPEAL No. 16929 OF 2017 dated 23-10-2017)*** held that even arbitration proceedings cannot be initiated after imposition of the moratorium has come into effect and it is non est in law and could not have been allowed to continue.

Implication of the moratorium period has to be examined in case of the following events under income tax law:

- Pending appeals during the mortarium period;
- Order passed and new appeals filed during the moratorium period;
- Subsequent proceedings post CIRP

a. Pending appeals during the mortarium period

If there are any income tax appeals/ proceedings pending during the moratorium period then the same are being dismissed by the courts if it is filed in the name of corporate debtor and direction has been given to file the same in the name of the Resolution Professional. In the following cases the Income Tax Department has dismissed the appeal filed by the Assessee and Revenue when the matter was pending before the insolvency Resolution professional and moratorium period was declared under Section 14 of the IBC :

- **Global Softech Ltd.(140 taxmann.com 103 (Mumbai - Trib.) dated 16-03-2022)**
- **Subhlabh Steels (P.) Ltd.(141 taxmann.com 190 (Cal HC) dated 08-06-2022)**
- **Pratibha Industries Ltd.(142 taxmann.com 295 (Mumbai - Trib.) dated 13-06-2022)**

- **Mercator Limited((ITA No. 7607/ Mum/2012) (Mumbai - Trib.) dated 5 August 2024)**

However, these proceeding will be put in abeyance till the conclusion of the insolvency proceedings. Also if the demand raised in these proceeding is not intimated to the RP, these proceedings may also be dismissed as demand cannot be enforced on the corporate debtor (we have discussed this proposition in detail in the ensuing paragraphs). Further, if from these proceedings there is substantial refund which is expected, court may allow to take these matters and may continue with the hearing even in the mortarium period.

b. ***Pending assessment proceedings***

Further with respect to assessment proceedings pending it is pertinent to note that the assessment proceedings cannot be said as recovery proceedings since they are only aimed at giving finality to the assessment and may or may not lead to recovery against the debtor, recovery is what IBC actually bars. Thus, tax authorities may undertake assessment proceedings limited to extent of finalizing assessment and not for recovering demand. It is noteworthy that NCLT in the case of **Bhuvan Madan RP for Diamond Power Infrastructure Ltd & Anr (LA No. 672 of 2019 in CP(LB) No. 137/NCLT/ AHM/2018 dated 27-05-2020)**, wherein revenue sought to proceed against a corporate debtor under moratorium due to suspicion on assessee's activities, the NCLT permitted the action solely for the purpose of conducting an assessment. Such judgement is also upheld by NCLAT (Company Appeal (AT) (Insolvency) No. 977 of 2022 dated 21-05-2024).

However, contrary view has been taken by the **Hon'ble Calcutta High Court in case of SREI Equipment Finance Ltd.(TS-389-HC-2022(CAL) dated 20-05-2022)** wherein the Hon'ble High Court sets aside assessment order passed during IBC moratorium period.

c. ***Order passed and new appeals filed during the moratorium period***

Also, as stated above, if the assessment order is passed during the moratorium, there should be no recovery of demand arising from the said assessment order since the recovery proceedings are barred during the moratorium period.

The new appeals if to be filed during the moratorium period the same should be filed in the name of Resolution Professional and will be put on hold till conclusion of insolvency proceedings. However subject to what hon'ble Calcutta high court has decided, such proceedings can be challenged in writ court to assess the income tax departments power to pass such order during moratorium period.

d. ***Subsequent proceedings post CIRP***

The question of moratorium period shall not arise in such cases, since such proceedings will take place in the hands of Successful Resolution Applicant. Ideally in such a scenario,

there should not be any demand, court cases of erstwhile entity should come on shoulders of new entity as he will take the entire company in clean slate which is dealt with in ensuing paragraphs.

2. Clean Slate

The clean slate theory is encoded in Section 31 of IBC, in terms of which an approved resolution plan is binding on all stakeholders, including the corporate debtor and its employees, members and creditors. The intent of this provision is to ensure that all stakeholders (including government authorities) abide by the terms of approved plan and refrain from making claims that are not a part of the plan.

In this regards, lets understand various claims which may arise and how the same needs to be dealt with during CIRP proceedings:

a. Claims pertaining to prior period to initiate of CIRP proceedings

When the CIRP is initiated, one of the Resolution Professional's primary duty is to notify all creditors, including statutory authorities like the Income Tax Department, to file their claims. The procedure is straightforward for tax claims that pertain to a period before the initiation of CIRP, these claims must be filed with the IRP within the prescribed timelines set out in the IBC.

Once these claims are filed, they are treated as operational debts under waterfall mechanism which is discussed in ensuing paragraphs.

Further the **Hon'ble Telangana HC** in case of **Sirpur Paper Mills [2022] 135 taxmann.com 188 (Telangana)** held that where NCLT by order had admitted resolution plan in case of corporate debtor, which provided that all assessments or other proceedings relating to period prior to completion date shall stand terminated and all consequential liabilities would stand abated.

Similar view has been adopted by the **Hon'ble Delhi High Court in case of TUF Metallurgical Pvt. Ltd. (W.P. No. 10528/2022) dated 12 December 2023**

Further there may be cases where CIRP proceedings have been initiated against the Corporate debtor and the refund has been due to the Corporate debtor from the income tax department. In this case the moot question which arises is that whether the income tax department can set off these dues against the pre CIRP income tax dues.

The Hon'ble NCLAT in the case of ***Avil Menezes (Liquidator) vs. Principal Chief Commissioner of Income Tax, Mumbai (2024- NCLAT)*** has addressed this issue and has held that while statutory authorities can determine tax dues during the moratorium, they cannot enforce recovery of these dues unilaterally. This principle extends to the liquidation process, emphasizing that the Income Tax Department does not have the jurisdiction to suo-motu adjust refunds without filing claims in accordance with the IBC procedures.

Further NCLAT, in the case of ***Mr. Devarajan Raman (Liquidator) vs. Principal Commissioner Income Tax and Ors. [Company Appeal (AT) (Insolvency) No. 977 of 2023] dated 24 May 2024*** has given similar view.

b. ***Claims Pertaining to a Period During the CIRP***

The operations and business activities of Corporate Debtor undergoes under the supervision of Resolution Professional. This continuation means that the Corporate Debtor remains subject to ongoing income tax assessments, the filing of returns, and potential scrutiny by the Income Tax Department. The Resolution Professional acting on behalf of the debtor, is obligated to respond to these notices and manage the subsequent proceedings.

Thus, Section 140 of the ITA provides that the Income Tax Return of the company undergoing insolvency proceedings would be verified by the Resolution Professional appointed by the Adjudicating Authority.

c. ***Post CIRP claims***

Once the CIRP is concluded, it exits the purview of the IBC and reverts to the normal tax assessment and compliance regime under the ITA.

Further, the Successful Resolution Applicant will get the company under clean slate with no prior claims since all such prior claims gets extinguished which is main purpose of IBC.

The **Hon'ble Supreme Court** in the case of ***Ghanshyam Mishra & Sons Pvt. Ltd. vs. Edelweiss Asset Reconstruction Co. Ltd (Civil Appeal No.8129 of 2019 dated 13-04-2021)*** the court observed that the legislative intent behind this is to freeze all the claims so that the resolution applicant starts on a clean slate and is not flung with any surprise claims.

The **Hon'ble Rajasthan High Court** in case of **Ultratech Nathdwara Cement Limited(D.B. Sales Tax Ref./rev. No. 9/2021 dated 18-04-2022)** while quashing the notices of tax authorities had held that the amount specified in the approved resolution plan is final and binding on all parties irrespective of the fact whether the claimant has been heard by the Resolution professional of Committee of Creditors.

The **Hon'ble Delhi High Court** in ***Tata Steel Ltd. vs. Deputy Commissioner of Income Tax(W.P.(C) 13188/2018 dated 31-10-2023),*** have continued to uphold the clean slate principle, reinforcing that the dues not included in the Plan are extinguished.

Further, various courts/tribunals in the following cases has held that the tax proceedings pertaining to period prior to Corporate Insolvency Resolution Process and consequent to approval of Resolution Plan by NCLT stands extinguished as the Assessee has changed hands and commenced under new ownership and management and the claims not forming part of Resolution Plan will also be extinguished:

- ***Uttam Value Steels Ltd vs. ACIT (Bom HC) (TS-658-HC-2024(BOM) / WRIT PETITION (L) NO. 9420 OF 2022 dated 09-09-2024)***
- **M Tech Developers Pvt. Ltd (Del HC) ([TS-268-HC-2024(DEL)]/ W.P.(C) 15567/2022 dated 20-04-2024)**
- **Surya Exim Limited (Guj HC) (TS-245-HC-2024(GUJ)] / R/SPECIAL**

CIVIL APPLICATION NO. 1195 of 2023 dated 15-04-2024)

- **Raj Rayon Industries Ltd (Del Trib.) (TS-723-ITAT-2022(Mum)] / I.T.A. No.830/Mum/2022 dated 16-09-2022)**

Further even for criminal proceedings same principal is followed. The **Hon'ble Madras High Court in case of Vasan Healthcare Pvt. Ltd Crl.OP. No.134 of 2024 dated 9 January 2024** quashes prosecution under Section 277 (false verification) against a company (Assessee) which was taken over by a new management under IBC by holding that the criminal liability cannot be fastened against the new management. Insofar as the criminal prosecution is concerned, the criminal liability of the corporate debtor gets completely wiped off and the new management is allowed to take over the company on a clean slate; Thus, holds that the new management does not take over the criminal liability of the Assessee but also cannot be made to undergo criminal prosecution for the offence committed by the persons who were in-charge of the Assessee during the relevant point of time. Clarifies that it is open for the Revenue to identify the persons who were in- charge of day-to-day affairs of the Assessee during AYs 2010-2011 to 2015-2016, and to continue the criminal prosecution as against such officers.

Modification and Revision of Demand under Section 156A of the ITA

A Successful Resolution Applicant ('SRA') is often concerned with the legal tussle that the SRA shall face with the Income Tax Department on account of reduction in income tax liability as payable under a Resolution Plan duly approved by the Adjudicating Authority. It is common to see that the Income Tax Department continues to challenge the reduced tax liability, and this creates an environment of uncertainty for the SRA.

Therefore, Finance Act, 2022 inserted Section 156A to provide that the Assessing Officer shall modify the demand payable in conformity with the order of the Adjudicating Authority and shall thereafter serve on the assessee a notice of demand specifying the sum payable, if any, and such notice of demand shall be deemed to be a notice under section 156 of the Income Tax Act.

Thus, this also helps the SRA acquiring company with clean slate and has nothing to do with past claims.

The **Hon'ble Chennai Tribunal** in case of **Aircel Limited (ITA Nos.811, 860, 861, 862, 863, 864, 865, 866, 870, 871 & 872/Chny/2023) dated 10 July 2024)** directs Revenue to modify demand notice as per NCLT order in accordance with Section 156A of the ITA.

3. Overriding effect

While analysing the interplay between the IBC and tax laws, the main question to ponder upon is whether IBC has an edge over any income tax laws, that is whether the provisions of IBC will have an overriding effect in case there arises any inconsistency with the income tax laws.

In this regards, it is pertinent to note that Section 238 of IBC gives overriding effect over any other contrary provisions in any other laws.

The **Hon'ble Supreme Court in case of Monnet Ispat and Energy Ltd. (SLP(C) 6483/2018 (SC) dated 10-08-2018 and Hon'ble Delhi Tribunal in case of SR Foils & Tissue Pvt. Ltd.(ITA No.540/Del/2019 dated 11-01-2023)** held that Section 238 of IBC will have the overriding effect on anything that is inconsistent in any other law including Income Tax laws as well as in case of any inconsistency with the provisions of IBC. Thus, the court has time and again given priority to IBC over any other law inconsistent with the provisions of IBC.

Further, it is pertinent to note that Section 178 of the Income Tax Act, 1961 mandates the liquidator shall not, without the leave of the Commissioner, part with any of the assets of the company or the properties in his hands until he has been notified by the Income Tax Officer about the tax liabilities due from the said company under liquidation and the liquidator is mandated to set aside an amount equal to the said tax liabilities as notified by the Income Tax Officer before the Liquidator can proceed to distribute the assets of the company under liquidation.

Hence as per Section 178 of the Income Tax Act, 1961, the Liquidator is required to first obtain a 'No Objection Certificate' (NOC) from the Income Tax Department before proceeding to distribute the assets of the companies under liquidation.

However as per Section 178(6), the provisions of Section 178 are not applicable to the companies which are undergoing liquidation under IBC, 2016.

However, in spite of the extant provisions as contained in Section 178(6) of the Income Tax Act, 1961, in practice, the liquidators in case of liquidation of the companies under IBC, 2016, practically, were obtaining the NOC from the Income Tax Department. The said practice was causing unnecessary delay in timely completion of the liquidation of the companies under IBC, 2016.

Through a Circular on November 15, 2021(IBBI/LIQ/45/2021), the Insolvency and Bankruptcy Board of India (IBBI) dispensed with the requirement of obtaining NOC from the Income Tax Department under Section 178 of the Income Tax Act, 1961.

Further, it is pertinent to note that for Section 178, the legislature has specifically provided for exclusion to companies which are undergoing liquidation under IBC, 2016.

However, no such provisions are included in the other Sections of ITA thus, the Department may argue that for overriding effect of IBC on ITA, there should be similar clauses in other Sections of ITA like is provided in Section 178 of ITA.

II. Waterfall Mechanism for settlement of debts and priority of tax dues under IBC

Section 53 of the IBC is relevant provision which has been a bone of contention for the tax authorities with the IBC. The provision provides for a waterfall mechanism ranking the relevant stakeholders and designating the priority of their claim.

The priority of claims provided under Section 53 of the IBC is as under:

- Insolvency resolution process costs and liquidation costs;
- Workmen's dues and secured creditors;
- Wages and unpaid dues owed to employees;
- Financial debts owed to unsecured creditors;

- Government dues and debts owed to secured creditors following any amount unpaid for enforcement of security interest;
- Any remaining debts and dues;
- Preference shareholders;
- Equity shareholders

In IBC, the priority of payment is given to secured creditors. The term secured creditor is defined in the Section 3(30) of the IBC which states that "Secured creditors means any creditor in favour of whom the security interest is created."

Statutory authorities considered as operational creditors or secured creditors?

Before moving further, we need to understand the major controversy which arises is whether the government authorities/statutory authorities should be considered as operational creditors or secured creditors.

Government/statutory authorities are operational creditors

As per Section 5(21) of IBC "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 it is clear from the definition of operational debt provided under IBC that the tax dues under IBC are considered as operational debts and also placed in priority below unsecured creditors unlike various tax laws wherein if any amount is due towards fulfilling of tax liabilities, the tax authorities are given first charge over unpaid tax dues.

The rationale behind keeping the right of the Central and State Governments in the distribution waterfall in liquidation at a priority below the unsecured financial creditors is stated by **The Bankruptcy Law Reforms Committee in Volume I of its report on 4 November 2015** as under:

> *"The Committee has recommended to* ***keep the right of the Central and State Government in the distribution waterfall in liquidation at a priority below the unsecured financial creditors in addition to all kinds of secured creditors*** *for promoting the availability of credit and developing a market for unsecured financing (including the development of bond markets). In the long run, this would increase the availability of finance, reduce the cost of capital, promote entrepreneurship and lead to faster economic growth. The Government also will be the beneficiary of this process as economic growth will increase revenues. Further, efficiency enhancement and consequent greater value capture through the proposed insolvency regime will bring in additional gains to both the economy and the exchequer"*

The **Hon'ble Supreme Court** in case of ***Ghanshyam Mishra & Sons Pvt. Ltd. vs. Edelweiss Asset Reconstruction Co. Ltd (supra)*** has held that even a claim in respect 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 would come within the ambit of 'operational debt'. However, this case also does not deal with waterfall mechanism.

Further, similar view has been adopted by **Hon'ble Jharkhand High Court** in case of **Electrosteel Steels Limited (W.P.(T). No. 6324 of 2019 dated 01-05-2020)**

Further, in the case of Synergies **Dooray Automotive Ltd(Company Appeal (AT) (Insolvency) No. 205 of 2017 – NCLAT Del. Dated 20-03-2019),** the revenue demanded ₹ 338 Cr from the Corporate Debtor. However, the resolution plan approved by the adjudicating authority allowed only ₹ 2.58 Cr to the revenue as a final settlement. When the revenue appealed to the NCLAT, it was determined that the revenue, as an operational creditor, is entitled to settle according to the approved resolution plan and the waterfall mechanism outlined in section 53 of the IBC, even though it may result in a significant write-off of statutory dues.

Attachment of property by government authorities

Further, the **Hon'ble Telangana and Andhra Pradesh High Court** in case of **Leo Edibles and Fats Limited (WP 8560 of 2018 dated 26-07-2018)** has held that the Income Tax **Department cannot claim any priority in payment from liquidation estate merely because it had issued attachment order much prior to initiation of liquidation proceedings under IBC and** has thus allowed the liquidation of assets of a company under the IBC despite the claim of the tax authorities that they have charge over it, by virtue of having initiated attachment proceedings under ITA.

Government/statutory authorities are secured creditors- Supreme Court ruling treating statutory dues as secured creditors

The **Hon'ble Supreme Cour**t treated government as secured creditor in case of **Rainbow Papers Ltd. (LSI-694-SC-2022(NDEL) dated 06-09-2022)** The Hon'ble Supreme Court set aside the orders of NCLAT and NCLT wherein it was observed that the government cannot claim first charge over the property or assets of the corporate debtor as the state is not a secured creditor under IBC. Thus, the said ruling disturbed the settled position emanating from the earlier decision of Supreme Court in case of ***Ghanshyam Mishra (supra)***. The Supreme Court also dismissed the review petitions filed against its decision in case of Rainbow Papers (supra). In fact the said ruling after considering the decision of Ghanshyam Mishra and Section 5(21) of the IBC has given contrary view stating that he Committee of Creditors, which might include financial institutions and other financial creditors, cannot secure their own dues at the cost of statutory dues owed to any Government or Governmental Authority or for that matter, any other dues.

Aftermath of views taken by Supreme Court in the Rainbow's case

The **Hon'ble Supreme Court** in ***Paschimanchal Vidyut Vitran Nigam Ltd. vs. Raman Ispat Pvt. Ltd (CIVIL APPEAL NOS. 7976 OF 2019 dated 17-07-2023)*** has explained the waterfall mechanism and has also distinguished **Rainbow Papers (supra)** stating that the Hon'ble Supreme Court in the said case did not notice the 'waterfall mechanism under Section 53 – the provision had not been adverted to in the judgment. Section 53, as held earlier, enacts the waterfall mechanism providing for the hierarchy or priority of claims of various classes of creditors. The careful design of Section 53 locates amounts payable to secured creditors and workmen at the second place, after the costs and expenses of the liquidator payable during the liquidation proceedings. However, the dues payable to the government are placed much below those of secured creditors and even unsecured and operational creditors. This design was either not brought to the notice of the court in Rainbow Papers (supra) or was missed altogether. In any event, the judgment has not taken note of the provisions of the IBC which

treat the dues payable to secured creditors at a higher footing than dues payable to Central or State Government.

Review petition was filed before the Supreme Court by the State Tax Officer to seek review of the judgment of Rainbow Papers (supra). In the review petition, the Supreme Court observed that the court in the impugned judgment has considered the waterfall mechanism alongwith other provisions of IBC to decide the priority for the purpose of distributing proceeds from sale as liquidation assets. The Supreme court refused to consider the observations passed by co-ordinate bench in case of **Raman Ispat Pvt. Ltd (supra)** on the basis that any passing reference made by the coordinate bench of equal strength cannot be the ground of review. Thus, the Court while rejecting the review petitions stated that a well considered judgment does not fall under the ambit of review.

Ministry of Corporate Affairs vide Discussion Paper dated 18 January 2023 proposes to amend IBC and to put operational creditors at par with unsecured creditors. It was proposed that all debts owed to Central Government and the State Government, irrespective of whether they are secured creditors pursuant to a security interest created by a mere operation of statute, shall be treated equally with other unsecured creditors. Further, it was also proposed to clarify that only where the security interest is created pursuant to a transaction of the Central Government or a State Government with Corporate Debtor, the Government in question will continue to be treated as a secured creditor in the order of priority.

Further NCLAT, in the case of ***Mr. Devarajan Raman (Liquidator) vs. Principal Commissioner Income Tax and Ors. [Company Appeal (AT) (Insolvency) No. 977 of 2023] dated 24 May 2024*** has held that in case of the Rainbow Papers (supra) the Operational Creditor was held to be a secured creditor on the basis of relevant statutory provisions of Gujarat Value Added Tax, 2003 whereas there is no such basis to claim in the case of the Appellant to be a secured Operational Creditor. Hence, the Rainbow Papers judgment does not come to the aid of the Appellant in the present case.

III. Other important issues under Income Tax vis-à-vis IBC

a. Remission or Cessation of Liabilities pursuant to Approval of Resolution Plan

Waiver of Loan

The restructuring and rehabilitation of a corporate debtor often involve the waiver of loans. The approval of Resolution Plan leads to a remission or cessation of liabilities. The same may be a remission or cessation on account of a term liability or an operational trading liability. Whilst the remission or cessation of the term liability is permitted by the Income Tax Department as a capital receipt not chargeable to income tax, the same is not permitted in the case of operational trading liability.

It is contended that such waivers are taxable under sections 41(1) [profits chargeable to tax] and 28(iv) [charging section for business income] of ITA

However, with regards to the term liability the **Hon'ble Supreme Court** judgement in the matter of the **Mahindra and Mahindra Ltd (93 taxmann.com 32 dated 24-04-2018)** has held that remission or cessation of a term liability is not liable to income tax

under Section 28(iv) of the ITA. Further, a careful interpretation of section 41(1) of ITA reveals that for income to be taxed under this provision, it must have been previously allowed as a deduction. Since loans are not deductible, they fall outside the scope of section 41(1).

The remission of any operational liability pursuant to the approval of a Resolution Plan under IBC is not treated as capital receipt and is routed as an item of profit and loss account thereby exposing it to a possibility of MAT on the same. The same is discussed in detail in the ensuing paragraphs.

Prior to the amendment by the Finance Act of 2023, section 28(iv) of ITA defined income chargeable under the head "Profits and Gains from Business and Profession" as the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession.

The Finance Act of 2023 amended this section to include the phrase “in cash or in kind or partly in cash and partly in kind”.

Thus, the landmark judgement of the **Supreme Court in case of Mahindra & Mahindra (supra)** is partly diluted post this amendment since the Finance Act has now amended and included cash benefits also under Section 28(iv) ITA.

Waiver of interest amount

Ideally the corporate debtor would have claimed deduction of interest on loan in previous years Hence, waiver of interest amount would constitute income and be taxable under section 41(1) of ITA

However, if interest amount claimed was disallowed under section 43B of ITA in earlier years, said waiver is not taxable under section 41(1) of ITA. Further, said waiver cannot be taxable under section 28(iv) of ITA.

b. MAT provisions under section 115JB of ITA

In insolvency proceedings, it is common to restructure debts and waive certain loans. Such waivers cannot be considered as revenue income in line with the decision of Hon’ble **Supreme Court** in the case of **Mahindra & Mahindra** for term liabilities and are treated as capital receipt which are not chargeable to tax. Thus, the same cannot be taxed even under Minimum Alternate Tax (MAT) provisions.

Reliance in this regard is placed on the decision of **Hon’ble Mumbai Tribunal** in case of **JSW Steel Ltd. ((82 taxmann.com 210) (Mum. Trib.) dated 13-01-2017)** which is being followed by various Tribunals in various decisions.

However, for operational liabilities the same may be considered as revenue receipt by the Department and chargeable to tax under MAT provisions. Thus, in order to mitigate with the same, the following relief has been provided by the Finance Act 2018 to Successful Resolution Applicant.

Major Relief to Successful Resolution Applicant

The Finance Act of 2018 has amended Section 115JB of ITA, allowing the aggregate of unabsorbed depreciation and brought-forward losses to be deducted from the book profits of the assessee if a Corporate Insolvency

Resolution Process ('CIRP') application is admitted by the adjudicating authority under IBC.

The said amendment in the ITA has facilitated Successful Resolution Applicant, in case book profits arise in reducing the income tax liability on account of MAT post- acquisition of companies to the Resolution Plan duly approved by the Committee of Creditors and Adjudicating Authority. Further, the word "aggregate" in the amendment has given special benefit to such companies in view of allowance of deduction of only lesser of two in other cases.

c. *TDS provisions*

Challenges arise in the context of Tax Deducted at Source (TDS) provisions during the disposal of a corporate debtor's assets. According to Section 53 of the IBC, payments to the government are to be made subsequent to other prioritized disbursements. As TDS is an interim levy of the final Income Tax, it should ideally be within the purview of section 53 of IBC i.e. TDS shouldn't be deducted when remitting the payment to a corporate debtor.

In the case of **Om Prakash Agarwal (CP 294/2018 Dated 11-06-2020),** NCLT determined that the liquidator is not responsible for remitting TDS; instead, the onus lies with the purchaser to deposit TDS with the revenue authorities. TDS is not equivalent to the pre-payment of government dues in precedence over other creditors, as it does not constitute a tax demand.

However, the decision was overturned by NCLAT (Company Appeal (AT) (Insolvency) No. 624 of 2020 dated 08-02-2021) upon appeal by Assessee (liquidator) on grounds that the revenue ought to follow waterfall mechanism as stipulated under IBC for obtaining any tax. Also, if tax is deducted, it would be an obligation on the liquidator to file return, which is not a duty of liquidator under IBC.

The bench agreed with the contentions of the Assessee and stated that Section 238 and 53 of IBC start with a non-obstante clause and would thus have an overriding effect on section 194 IA of ITA which does not have a non-obstante clause. Section 194 IA of ITA aims on recovery of advance capital gain tax which is still a part of Income Tax. Payment of it on priority basis would violate the waterfall mechanism, which cannot be allowed. Hence, revenue was directed to refund the TDS deposited to the liquidator.

Further, **the Hon'ble Delhi High Court in case of BDR Finvest Pvt. Ltd. W.P.(C) 9043/2021 & CM No.55881/2023 dated 31 October 2023** allows credit of tax deducted at source to the deductee (Assessee) which was not deposited by the deductor who is under CIRP proceedings and holds that no recovery can be made against Assessee in view of the provisions of Section 205 of the ITA. Also, highlights that since the Assessee lodged a claim with the Insolvency Resolution Professional (IRP), if it were to receive any amount, it will deposit the TDS amount with the Revenue. Also, directs the Assessee to ensure that its TDS claim is pressed before the IRP.

d. *Capital Gains*

When a company is liquidated pursuant to order of the Adjudicating

Authority and its assets are to be sold by piecemeal. In such case the moot question which arises is that "under which 'head' will the payment of capital gain tax on the sale of assets of the corporate debtor during liquidation fall into."

The moot question which arises that whether capital gain tax would be attracted on sale of such asset should be included in liquidation cost or the same should be considered as "operational debt" with other government dues as per waterfall mechanism.

This said issue was addressed in the case of ***Pooja Bahry vs. Gee Ispat Pvt Ltd.(CA-666/2019 in (IB)-250(ND)/2017 – NCLT dated 22-10-2019)*** In this case, the liquidator sold off a few properties that were given up by the secured creditors and the issue that came up was that, whether that liquidator was required to deposit "capital gains" out of the proceeds of the sold properties and whether that can be included within the "liquidation cost". The NCLT held that the tax on the gains coming from the sold properties was required to be distributed according to the "waterfall mechanism" under Section 53 of IBC.

A similar ruling was issued by the **NCLT** in the case of **LML Ltd. (CP No.(IB)55/ALD/2017 with CA No. 73/2018 dated 23-03-2018)**

e. Reassessment Notice under section 148 of ITA

Section 31 of IBC asserts that no claims can be made against a corporate debtor if they are not included in the resolution plan.

Therefore, when the CBDT initiated reassessment proceedings under section 148 of the Act following the approval of a resolution plan in the case of **Murli Industries Ltd (WP 2948/2021 dated 23-12-21),** the **Hon'ble Bombay High Court,** drawing on the precedent of **Ghanshyam Mishra (supra)**, ruled that the revenue should have been proactive in filing their claims with the Resolution Professional within the prescribed timeframe and format under IBC. Having failed to do so before the approval of the resolution plan, the revenue was left without legal recourse, and their claims were deemed extinguished. This matter is currently pending before the Hon'ble Supreme Court.

Similar view has been expressed by **Hon'ble Telangana High Court** in case of **The Sirpur Paper Mills Limited (W.P.No.25827 of 2019 dated 18-01-2022)** and by Hon'ble Delhi High Court in case of **Rishi Ganga Power Corporation Ltd. (W.P.(C) 3167/2020 dated 31-10-2023)**

In the case of **Dishnet Wireless Ltd (WP No. 34668 of 2018 dated 17-06-2022**) of Hon'ble High Court of Madras, the reassessment notice was issued before the submission of resolution plan thus, the revenue contended that the moratorium under section 14 of the IBC did not prevent them from reopening concluded assessments under section 148 of ITA. They argued that since the income-tax authorities' claim had not yet crystallized, there was no extinguishment of any claim. It was held that no legal barrier existed to prevent the income-tax authorities from

continuing proceedings under section 148 of ITA.

The **Hon'ble High Court of Madras** determined that the resolution plan did not provide for any concessions for the income-tax department, despite the issuance of reassessment notices prior to submission of resolution plan. Furthermore, the resolution plan, as sanctioned by the NCLT, did not account for taxes due under the Act. The petitioners were expected to ensure proper notification to the CBDT. The court held that the approval of the resolution plan did not affect the rights of the income-tax department to issue orders under sections 147/148 of ITA, allowing the Income Tax proceedings to continue under a sealed cover.

This judgment overlooks the fact that the corporate debtor is not obligated to notify the CBDT specifically; a public announcement by the Interim Resolution Professional regarding the initiation of CIRP and the invitation for claims against the corporate debtor should suffice.

f. Section 178 of ITA- Company in Liquidation

Same is already covered in preceding paragraphs and thus, the same is not again discussed here for the sake of brevity.

g. Carry Forward and set off of lossses

As per Section 79 of the ITA, the benefit to carry forward unabsorbed business loss is lost in a scenario if the shareholding of a closely held company changes by more than 49% in a previous year as compared to the year in which the loss was incurred. The ITA allows companies under IBC to carry forward losses where the change in shareholding is pursuant to an approved resolution plan. But a reasonable opportunity of being heard is to be given to the jurisdictional PCIT.

As stated above, the only condition is that the jurisdictional Principal Commissioner of Income Tax (PCIT) is afforded an opportunity of being heard, understandably in the CIRP proceeding.

Some of the benches of the NCLT take this opportunity of being heard to the department as sufficient compliance under the amended second proviso of section 79 of ITA and accordingly give clear direction in the Resolution Order to allow past losses of the Corporate Debtor to be carried forward.

In ***Antanium Holdings Pte Ltd vs. Sujana Universal Industries (Company Appeal (AT) (CH) (Ins) No.07 of 2021 dated 17-05-2021),*** the NCLAT has issued several notices to PCIT to be present in the hearing, however, there was no response from PCIT ad thus, the NCLAT directed to allow past losses of the Corporate Debtor to be carried forward.

However, in many other cases, the tribunal bench gives a general observation that losses of the past years shall be carried forward as per law and the Corporate Debtor may approach the jurisdictional PCIT who will pass necessary order under section 79 to carry forward the losses.

Thus the Successful Resolution Applicant (SRA) can carry forward and set off of losses of companies acquired by a SRA pursuant to the Resolution Plan duly approved by the CoC and the Adjudicating Authority.

IV. Uncertainties and Conundrums surrounding the two statues

a. *Capital gains on Distribution of Assets by Companies in Liquidation*

As per Section 46 of the ITA - where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to income-tax under the head "Capital Gains", in respect of the money so received or the market value of the other assets on the date of distribution, as reduced by the amount assessed as dividend within the meaning of Section 2(22)(c) of ITA and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48 of ITA.

It is necessary to issue a clarification under Section 46 of the Income Tax Act, 1961, that in the case of voluntary liquidation or liquidation, if residual amounts being received in form of assets by the equity shareholders shall not require any further valuation under Section 56(2) read with rule 11UA of the Income Tax Act. Further it is also clarified that since the assets of the company are distributed in the event of the liquidation, the same shall not warrant a separate valuation under the Income Tax Act and Section 46(2) shall be given effect to by treating the consideration received as the fair value transferred.

b. *Transfer/Acquisition of shares of Corporate Debtor at Price Lesser than Fair Market Value*

Section 56(2)(x) provides for taxation in the hands of the recipient of the property (securities and shares are covered under definition of the property). Section 50CA provides for taxation arising upon transfer of unquoted shares in the hands of Transferor. Difference between the FMV and the actual consideration is charged to tax in the hand of the recipient of the property under Section 56(2) (x).

As per Section 50CA, if the shares are transferred at consideration less than FMV, FMV is deemed to be the Full Value of Consideration. These provisions of Section 50CA and Section 56(2)(x) are still applicable on IBC transactions. However, CBDT has powers to relax the same but no notification till date.

This discrepancy can deter bidders from participating in auctions, undermining the IBC's objective of facilitating smooth insolvency resolutions for corporate debtors.

However, in recent case of **Mahavir Enterprises (IT Appeal No. 1304 (Mum.) of 2023 – Mumbai ITAT dated 27-07-2023)**, when the Assessing Officer imposed the provisions of section 56(2)(x) on the assessee as it bought a property of a liquidating bank in an auction at a value less than fair market value as determined by the Assessing Officer. The Hon'ble Mumbai Income Tax Appellate Tribunal held that fair market value would be what a highest bidder is willing to pay which was the consideration paid by the Assessee and not some notional amount as arrived by the Assessing Officer.

Further, the **Hon'ble Bombay High Court in case of Abdus Samat Haji Adam Kantharia (1982) (135 ITR 177) (Bom HC)** has held that the auction price cannot be found to be tainted at all as it is most transparent price.

Further, the **Hon'ble Pune Tribunal in case of Krishi Utpa. A Bazar Samittee in ITA No. 1304/M/2023 dated 27 July 2023** wherein it was held that the public auction price was considered as the correct fair market value.

Although this case can be relied on to circumvent the wrongful imposition of the aforementioned sections in stressed situations like Insolvency, currently, there is no guidance from the CBDT on this matter.

c. ***Exception to certain void transfers under Section 281 of the IT Act***

Section 281 of ITA enables Income Tax Department to recover outstanding tax dues pending on date of transfer or arising from proceedings pending on date of transfer by treating transfer of assets (including securities) as void. Therefore, an ambiguity to a certain extent prevails with regards to the applicability of Section 281 on IBC matters.

However in light of various judicial pronouncements and effect of Section 238 of IBC, IBC should override Section 281 of the Act and therefore it is imperative that specific exemptions are brought in regarding non- applicability of Section 281 on resolutions under IBC with a view to provide more certainty on the tax position of the corporate debtor to the resolutions applicants/ bidder.

d. ***Tax treatment of Insolvency Costs***

As per section 5(13) of the IBC, the "Insolvency resolution process costs" encompass interim finance costs, resolution professional fees, business operation expenses, government-incurred costs, and other specified costs by the Board.

The deductibility of insolvency costs under Section 37 of ITA is a contentious issue among professionals. The Act does not explicitly state whether such costs are deductible, and if they are, whether the nature of the expense is capital or revenue. Although there are judicial precedents like **Akzo Nobel India Ltd ([2018] 94 taxmann 38 [Kol])** which states that the insolvency costs are to be treated as revenue expenditure and must be taxed accordingly, there is no clarification issued by the Income Tax Department or IBC in this regard.

IV. Conclusion

The interplay between IBC and ITA has been marked by a series of legal developments, judicial interpretations, and legislative amendments aimed at harmonizing their objectives and resolving conflicts. Despite these efforts, uncertainties and conundrums persist. This highlights the ongoing challenges in achieving a seamless integration of insolvency and tax laws. As India continues to evolve its legal and economic systems, it is imperative that the synergies between the IBC and the ITA are strengthened. It is through such legal and regulatory advancements that India can aspire to achieve its economic goals and maintain its position as a formidable player in the global market.

Insolvency and Bankruptcy Code and Goods and Services Tax

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Overview

The article explores the interplay between the Goods and Services Tax (GST) and the Insolvency and Bankruptcy Code (IBC) in India, two significant reforms aimed at simplifying the tax structure and streamlining insolvency processes, respectively. GST, implemented in 2017, replaced multiple indirect taxes with a unified system, enhancing compliance and ease of doing business. The IBC, enacted in 2016, provides a time-bound framework for resolving corporate insolvency, promoting entrepreneurship, and protecting creditors' interests.

The document highlights key features of both GST and IBC, such as GST's destination-based taxation and input tax credit mechanism, and IBC's Corporate Insolvency Resolution Process (CIRP) and liquidation procedures. It emphasizes the overriding effect of IBC over other laws, as demonstrated in various Supreme Court rulings, ensuring that insolvency proceedings are not hindered by other statutory claims.

Challenges in the interaction between GST and IBC include legal ambiguities, compliance burdens, and the treatment of GST liabilities during insolvency. The document underscores the need for clarity in legal provisions and effective collaboration among stakeholders to navigate these complexities, ultimately fostering a healthier business environment and sustainable economic growth.

1. Introduction

The Goods and Services Tax (GST) and the Insolvency and Bankruptcy Code (IBC) represent two transformative reforms in India's economic landscape. Implemented in July 2017, GST was introduced to simplify the complex tax structure that existed prior to its implementation, which included multiple indirect taxes such as Value Added Tax (VAT), service tax, and excise duty. GST aims to create a unified market across the country, enhance compliance, and improve the ease of doing business. Conversely, the IBC, enacted in 2016, was designed to streamline the insolvency resolution process, and provide a robust framework for the timely resolution of corporate debts. The IBC was introduced to address the challenges posed by the existing legal framework, which was often fragmented and inefficient in dealing with insolvency cases. The primary objectives of the IBC are to promote entrepreneurship, enhance the ease of doing business, and protect the interests of creditors while ensuring the timely

resolution of corporate debts. This article delves into the relationship between GST and IBC, highlighting their implications, challenges, and the way forward.

2. Understanding GST and IBC

a. *Goods and Services Tax (GST)*

The key features of GST include:

1. ***Destination-Based Taxation:*** GST is levied at the point of consumption, ensuring that tax revenue is allocated to the state where the goods or services are consumed.

2. ***Input Tax Credit (ITC):*** Businesses can claim credit for the tax paid on inputs, which can be set off against their output tax liability, thereby reducing the overall tax burden.

3. ***Unified Tax Structure:*** GST operates under a dual structure, comprising Central GST (CGST) and State GST (SGST) for intra-state transactions, and Integrated GST (IGST) for inter-state transactions.

b. *Insolvency and Bankruptcy Code (IBC)*

Key features of the IBC include:

1. ***Time-Bound Resolution:*** The IBC mandates a time-bound process for the resolution of insolvency, typically within 180 days, extendable by another 90 days under certain circumstances.

2. ***Corporate Insolvency Resolution Process (CIRP):*** The CIRP is initiated when a default occurs, allowing creditors to take control of the debtor's assets and formulate a resolution plan.

3. ***Liquidation:*** If a resolution plan is not approved, the company is liquidated, and its assets are sold to repay creditors.

3. Overriding effect of the IBC and binding nature of the Resolution Plan

a. The overriding effect of the Insolvency and Bankruptcy Code (IBC), 2016, is primarily governed by Section 238. This section contains a non-obstante clause, which means it has an overriding effect on any other law that is inconsistent with the provisions of the IBC. Section 238 of IBC is produced below:

b. 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.

This essentially means that if there is any conflict between the IBC and another law, the provisions of the IBC will prevail.

In the case of ***Sundaresh Bhatt, Liquidator of ABG Shipyard vs. Central Board of Indirect Taxes and Customs***. The Supreme Court of India ruled in favour of Sundaresh Bhatt, the Liquidator of ABG Shipyard, stating that the provisions of the Insolvency and Bankruptcy Code (IBC) would prevail over the Customs Act. The Court held that once a moratorium is imposed under Sections 14 or 33(5) of the IBC, the customs authorities have limited jurisdiction to assess and determine the quantum of customs duty and other levies, but cannot enforce the payment of these duties.

This judgment reinforces the overriding effect of the IBC, ensuring that insolvency proceedings are not hindered by claims from other statutory authorities.

In the case of ***Paschimanchal Vidyut Vitran Nigam Ltd. vs. Raman Ispat Private***

Limited & Ors (CIVIL APPEAL/7976/2019). The Supreme Court of India ruled that the provisions of the IBC would prevail over the Electricity Act, 2003. The Court held that the dues of PVVNL would be treated as operational debts and would be subject to the priority of claims mechanism under Section 53 of the IBC12. This decision reinforced the overriding effect of the IBC in insolvency proceedings, ensuring that the claims of operational creditors like PVVNL are addressed in accordance with the IBC's provisions.

Crown debts do not take precedence even over secured creditors, who are private persons. Therefore, if the departments of Central or State Governments do not file an application or participate in the resolution process, their claims automatically get extinguished and the proceedings related thereto shall stand terminated (following the judgment of the Hon'ble Supreme Court in the case of ***Ghanshyam Mishra (Ghanshyam Mishra and Sons Private Limited vs. Edelweiss Asset Reconstruction Company Limited 2021 SCC Online SC 313)); Union of India vs. Ruchi Soya Industries Ltd. 2021 (377) E.L.T. 659 (Kar.).*** It was also held in the matter of ***Ultra Tech Nathdwara Cement Limited vs. Union of India 2020 (37) G.S.T.L. 289 (Raj.)*** that since the 2019 amendment to Section 31 of IBC was clarificatory and declaratory in nature, it would have a retrospective operation. As such, if the resolution plan approved by the National Company Law Tribunal, does not comprise all the claims of the Central/State Government or the local authority, the said claim shall stand extinguished and the proceedings relating thereto shall stand terminated.

The principles of the "clean slate" doctrine are reflected in Sections 31 and 32A of the IBC.

These sections emphasize the binding nature of the resolution plan on all stakeholders and the cessation of liability for prior offences once the resolution plan is approved, provided certain conditions are met.

Section 31(1) of the Insolvency and Bankruptcy Code (IBC) makes it clear that once a resolution plan is approved by the Committee of Creditors it shall be binding on all the stakeholders, including the Government. This is for the reasons that this provision ensures that the successful resolution applicant starts running the business of the corporate debtor on a fresh slate as it were totally new. In the matter of Committee of Creditors of ***Essar Steel India Limited vs. Satish Kumar Gupta (2020) 8 SCC 531***, it was held by the Apex Court that once a Resolution Plan is approved by the CoC, it shall be binding on all stakeholders. All claims shall have to be submitted and decided by the Resolution Professional (RP) so that a prospective resolution applicant knows exactly what needs to be paid in order, it may then take over and run the business of the corporate debtor. In the matter of ***Ghanshyam Mishra and Sons Private Limited vs. Edelweiss Asset Reconstruction Company Limited 2021 SCC Online SC 313***, it has been held by the Tribunal that the Resolution Plan, as has been finalised, is binding upon the parties.

Further in the matter of the ***Garden Silk Mills vs. Commissioner of Central Excise and Customs, Surat-I (2023) 4 Centax 204 (Guj.)***, it has been held that once the resolution plan is approved and the approval order has been given under Section 31(1) of the Code, the same would have an overriding effect over all other laws in force including the Central Excise Act, 1944. Thus, it has been held on a number of occasions that IBC has an overriding effect over all other laws including laws related to revenue and a resolution plan, once approved by the Committee of Creditors, has a binding effect on all parties, including the Government.

IBC allows the submission of resolution plans by prospective resolution applicants during the insolvency resolution process. These plans outline the proposed revival or resolution of the insolvent entity. In the resolution plan, the treatment of Indirect Taxes dues can vary depending on the specifics of each case. The resolution plan may provide for the payment of GST dues either fully or partially, depending on the financial viability and feasibility of the plan.

Section 14 of the IBC clearly indicates that there is a complete/total embargo/bar to initiate and continue proceedings against the Company before any other authority including the GST authority during the pendency of proceedings before the NCLT and appeal(s) to be filed against the same, if any, when the moratorium/CIRP is in force and has not been lifted. It is also relevant to state that in ***P. Mohan Raj vs. Shah Brothers Ispat Pvt. Ltd. (2021) 6 SCC 258***, a three Judge Bench of the Apex Court has categorically held that the moratorium provision contained in Section 14 of the IBC would include proceedings under Section 138 of the Negotiable Instruments Act also and by token of the same reasoning, proceedings initiated by the respondent under the GST Act would also attract the embargo contained in Section 14 of the IBC. It was further held that appeal(s), if any, can be filed only after lifting of the moratorium and completion of the corporation insolvency resolution process. – ***Associate Decor Ltd. vs. Deputy Commissioner of Commercial Taxes, Bengaluru (2022) 1 Centax 174 (Kar.)***

4. The interplay between GST and IBC

Section 53 of the IBC outlines the distribution of assets during the liquidation process of a corporate debtor. This section is crucial as it establishes the order of priority, often referred to as the "waterfall mechanism," for distributing the proceeds from the sale of liquidation assets.

Overview of the priority order:

i. *Insolvency Resolution Process Costs and Liquidation Costs:* These are paid in full first.

ii. *Workmen's Dues and Secured Creditors:* Workmen's dues for the 24 months preceding the liquidation commencement date and debts owed to secured creditors who have relinquished their security.

iii. *Wages and Unpaid Dues to Employees:* These are for the 12 months preceding the liquidation commencement date, excluding workmen.

iv. *Financial Debts to Unsecured Creditors:* These debts are next in line.

v. *Government Dues and Secured Creditors:* Any amount due to the Central and State Governments for the two years preceding the liquidation commencement date and any unpaid debts to secured creditors after enforcing their security interest.

vi. *Remaining Debts and Dues:* Any other remaining debts and dues.

vii. *Preference Shareholders:* If any, they are next in line.

viii. *Equity Shareholders or Partners:* Finally, any remaining proceeds go to equity shareholders or partners.

a. Treatment of GST in Insolvency Proceedings

One of the critical aspects of the interplay between GST and IBC is the treatment of GST liabilities during insolvency proceedings. The Insolvency and Bankruptcy Code (IBC) does not explicitly prioritize indirect taxes, such as GST, within the category of operational debts. This lack of specific

prioritization can lead to ambiguity in how GST liabilities are treated during insolvency proceedings.

b. ***GST as an Operational Creditor***

Priority of Claims: Operational creditors, including GST authorities, have a lower priority compared to financial creditors. This means that during the distribution of assets during liquidation, GST dues are treated as part of the operational creditors' claims. However, they rank lower than secured creditors and higher than unsecured creditors in the waterfall mechanism outlined in Section 53 of the IBC as above.

c. ***Input Tax Credit (ITC) and Insolvency***

ITC Claims During CIRP: The resolution professional (RP) must ensure that the company continues to comply with GST regulations to maintain its eligibility for ITC. Failure to do so may result in the loss of ITC, impacting the financial position of the company.

d. ***GST compliance during Insolvency***

Compliance with GST regulations is essential for companies undergoing insolvency proceedings. The IBC mandates that the RP must ensure compliance with all applicable laws, including GST.

e. ***Filing of GST returns***

Penalties for Non-Compliance: Failure to file GST returns can result in penalties, which may further strain the financial resources of the insolvent company.

f. ***GST Audits and Assessments***

Impact on Resolution Plans: Any pending GST assessments or disputes may affect the viability of resolution plans, as potential liabilities could arise post-resolution.

In a recent turn of events, The Supreme Court's decision in the case of *State Tax Officers vs. Rainbow Papers Limited* established that state tax authorities can act as secured creditors under certain conditions, impacting the priority of their claims.

5. Challenges in the interplay between GST and IBC

a. ***Ambiguity in Legal Provisions***

Legal Uncertainty: The lack of clarity in the legal provisions governing the treatment of GST in insolvency proceedings creates uncertainty for creditors and debtors alike.

b. ***Impact on Resolution Plans***

Feasibility of Plans: Creditors may be hesitant to approve resolution plans that do not provide a clear strategy for addressing GST liabilities.

c. ***Compliance Burden***

Resource Allocation: The compliance burden on the RP to ensure adherence to GST regulations can be overwhelming, especially in complex insolvency cases.

6. Important Circulars & Notifications dealing with GST & IBC

a. ***Notification No. 11/2020–Central Tax:***

This was issued on March 21, 2020, outlines a special procedure for corporate debtors undergoing the Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code (IBC), 2016. This

notification mandates that corporate debtors, managed by Interim Resolution Professionals (IRP) or Resolution Professionals (RP), must obtain new GST registrations in each state or union territory where they were previously registered. This new registration must be completed within thirty days of the IRP/RP's appointment or by June 30, 2020, whichever is later.

Additionally, the notification allows these corporate debtors to avail input tax credit on invoices for goods and services received since the appointment of the IRP/RP, even if the invoices bear the GSTIN of the erstwhile registered person. This provision ensures that the corporate debtor can continue its operations smoothly during the insolvency process. The notification also clarifies that registered persons receiving supplies from these corporate debtors can avail input tax credit on invoices issued using the GSTIN of the erstwhile registered person, subject to certain conditions.

b. ***Circular No. 134/04/2020-GST (Dated 23rd March 2020)***

This circular issued by the Central Board of Indirect Taxes and Customs (CBIC) provides clarifications on various issues under GST law for companies undergoing the Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code (IBC), 2016. One of the key points is that no coercive action can be taken against the corporate debtor for GST dues related to the period before the commencement of CIRP. These dues are to be treated as operational debts, and claims for such dues should be filed before the National Company Law Tribunal (NCLT) by the proper officer.

Additionally, the circular clarifies that the GST registration of a corporate debtor should not be cancelled during the CIRP. Instead, the registration may be suspended if necessary. If the registration has already been cancelled, it can be revoked. The circular also states that the Interim Resolution Professional (IRP) or Resolution Professional (RP) is not liable to file GST returns for the pre-CIRP period. However, the corporate debtor must obtain a new GST registration within thirty days of the IRP/RP's appointment in each state or union territory where it was previously registered.

c. ***Circular No.138/08/2020-GST (Dated 06th May, 2020)***

Circular No. 138/08/2020-GST, dated 6th May 2020, was issued to address certain challenges faced by registered persons in implementing GST provisions. This circular provides clarifications on various issues, including those related to the Insolvency and Bankruptcy Code, 2016.

One key clarification is that the time limit for obtaining GST registration by an Interim Resolution Professional (IRP) or Resolution Professional (RP) has been extended. The IRP/RP must now obtain registration within thirty days of their appointment or by 30th June 2020, whichever is later. This extension aims to alleviate difficulties faced during the lockdown period.

Additionally, the circular specifies that if the corporate debtor has been compliant with GST filings (GSTR-1 or

GSTR-3B) before the appointment of the IRP, a fresh GST registration is not required. Only one GST registration is necessary, regardless of any subsequent changes in the appointment of the IRP or RP. If the IRP is replaced and the new RP needs to amend the authorized signatory details, they can do so under the existing GSTIN. If the previous IRP does not share the credentials, the new RP can approach the jurisdictional authority as the primary signatory.

d. Circular No. 187/19/2022-GST (Dated 27th December 2022)

This circular provides clarification on the treatment of statutory dues under GST law for taxpayers whose proceedings have been finalized under the Insolvency and Bankruptcy Code (IBC), 2016.

The circular clarifies that no coercive action can be taken against the corporate debtor for dues related to the period before the commencement of the Corporate Insolvency Resolution Process (CIRP). It addresses the implementation of orders from adjudicating authorities under the IBC concerning the recovery of dues against corporate debtors under the Central Goods and Services Tax (CGST) Act and other existing laws. This ensures that the treatment of statutory dues, including taxes, penalties, and interest, is consistent with the provisions of the IBC, providing clarity to both taxpayers and tax authorities.

Additionally, the circular references Section 84 of the CGST Act, which deals with the continuation and validation of certain recovery proceedings. It clarifies that any reduction in government dues as a result of IBC proceedings should be communicated to the appropriate authorities, and recovery proceedings should continue based on the reduced amount. This emphasizes that statutory dues should be handled in accordance with the resolution plan approved by the National Company Law Tribunal (NCLT), ensuring a streamlined process for the recovery of government dues post-IBC proceedings. This circular ensures that the treatment of statutory dues is consistent with the provisions of the IBC, providing clarity to both taxpayers and tax authorities.

7. Conclusion

The interplay between GST and IBC is a critical aspect of India's economic framework. While both reforms aim to enhance the ease of doing business and promote economic growth, their interaction presents challenges that need to be addressed. Clarity in legal provisions, compliance with GST regulations, and the treatment of GST liabilities in insolvency proceedings are essential for ensuring a smooth resolution process.

As India continues to evolve its economic landscape, stakeholders must navigate the complexities of GST and IBC effectively. By fostering collaboration between tax authorities, insolvency professionals, and businesses, India can create a more robust framework for addressing insolvency while ensuring compliance with GST regulations. This interplay will ultimately contribute to a healthier business environment and promote sustainable economic growth.

Navigating Accounting, Auditing, Allied Regulations, and Resolution Professional Opportunities under IBC

Dr. Ashish Makhija

Overview

The article "Navigating Accounting, Auditing, Allied Regulations, and Resolution Professional Opportunities under IBC" examines several critical issues within the Insolvency and Bankruptcy Code 2016, highlighting its transformative impact on India's financial sector. It addresses the complexities of applying Indian Accounting Standards and Accounting Standards during insolvency, emphasizing the challenges in ensuring accurate financial reporting and applying standards like AS 2 (Valuation of Inventories) and Ind AS 36 (Impairment of Assets). The role of auditors during the Corporate Insolvency Resolution Process is discussed, focusing on the need for forensic audits to detect fraudulent transactions and the difficulties auditors face in verifying information within tight timelines. The article also explores the intricate regulatory environment involving the Companies Act, SEBI regulations, and labor laws, highlighting the compliance challenges companies face during CIRP or liquidation. Additionally, it delves into the challenges of fair value measurement (Ind AS 113) and revenue recognition (Ind AS 115) when business operations are disrupted. Lastly, the article outlines the expanding opportunities for professionals, including insolvency professionals, chartered accountants, forensic auditors, and technology specialists, emphasizing the need for multi-disciplinary expertise to navigate the IBC's complex regulatory and financial landscape.

Introduction

The Insolvency and Bankruptcy Code, 2016 ("IBC") has been a transformative framework in India's economic landscape. Its primary objective is to provide a timely and structured resolution process for distressed companies, giving them a chance to revive or, if necessary, liquidate their assets in an orderly fashion. However, implementing IBC effectively requires more than just legal expertise. It also demands a thorough understanding of accounting, auditing, and a multitude of regulations across various domains such as the Companies Act, Foreign Exchange Management Act (FEMA), Securities and Exchange Board of India (SEBI) regulations, labor laws, and sector-specific regulations.

This article will delve into the intricate interplay of these regulations, focusing on how they impact the resolution process under IBC. We will explore the challenges posed

by each regulation, the role of accounting and auditing standards during the insolvency process, and the opportunities that exist for professionals like chartered accountants, company secretaries, lawyers, and other specialists.

Section 1 - Overview of the Insolvency and Bankruptcy Code (IBC)

1.1 Purpose and Objectives of the IBC

The Insolvency and Bankruptcy Code, 2016 was introduced as a comprehensive legal framework to address the growing concerns surrounding corporate insolvencies in India. Before the enactment of the IBC, India faced a fragmented legal regime for insolvency, with multiple laws governing bankruptcy and insolvency processes. These laws created confusion, delayed proceedings, and resulted in lengthy legal battles. Companies in financial distress were left without effective mechanisms to either resolve their debt or liquidate their assets in a timely manner. Creditors, on the other hand, struggled to recover their dues due to the slow pace of resolution.

The IBC was enacted to fill this void and provide a unified and robust legal framework to address insolvency and bankruptcy in a time-bound manner. Its primary objectives are to ensure the resolution of insolvency in a timely manner, maximize the value of assets, promote entrepreneurship, balance the interests of all stakeholders, shift from debtor-in-possession to creditor-in-control and time-bound processes. The IBC provides a clean slate for entrepreneurs by allowing a fresh start after the resolution process, which encourages innovation and economic growth.

1.2 Significance of IBC in India's Financial Ecosystem

The introduction of IBC has fundamentally reshaped the Indian financial and corporate landscape. Before its enactment, insolvency processes were lengthy, often taking several years to resolve, which reduced the value of distressed assets and hampered recovery efforts. The inability of creditors to recover their dues created uncertainty in the financial markets, affecting credit flow and economic growth. Banks, especially public sector banks, were burdened with rising non-performing assets (NPAs), leading to a liquidity crisis in the financial system.

The time-bound resolution process has been a game-changer in addressing the challenges such as addressing the problem of NPA's, enhancing credit discipline, facilitating the reallocation of capital, increasing the confidence of investors and creditors and development of the insolvency profession.

Section 2 - The Role of Accounting in the IBC Process

The insolvency resolution process under the Insolvency and Bankruptcy Code, 2016, involves not only legal considerations but also a deep engagement with financial reporting and accounting standards. Accurate accounting is crucial in determining the true financial position of the distressed entity, assessing its viability, and guiding

decision-making throughout the resolution process. In this section, we will explore the critical role that accounting plays in the IBC framework, particularly the application of Indian Accounting Standards (Ind AS) and Accounting Standards (AS). We will also discuss key accounting challenges that arise during the Corporate Insolvency Resolution Process (CIRP) and how they are addressed by insolvency professionals and financial experts.

2.1 The Importance of Financial Reporting

One of the most critical elements of the IBC process is the financial reporting that provides stakeholders with an accurate and clear picture of the financial health of a company. The preparation of financial statements is not merely a formality but it serves as the backbone for decision-making by the Committee of Creditors (CoC) and other stakeholders. Without accurate and reliable financial reports, it would be impossible to evaluate the company's viability, assess potential resolution plans, or determine the fair distribution of assets in the case of liquidation.

2.2 Key Accounting Standards (AS and Ind AS) Relevant to Insolvency

The preparation of financial statements is governed by specific accounting standards in India, primarily **Accounting Standards (AS)** and **Indian Accounting Standards (Ind AS)**. These standards are designed to ensure uniformity, transparency, and comparability in financial reporting across different entities. The choice between AS and Ind AS depends on the size and type of the company. Companies with a certain level of net worth or those that are listed must adhere to Ind AS, while smaller companies may follow AS.

2.2.1 *Accounting Standards (AS)*

AS applies to companies that do not fall under the criteria for adopting Ind AS. Some of the critical accounting standards that are particularly relevant include:

- **AS 2: Valuation of Inventories** - Accurate valuation of inventories is crucial, especially if the company is in the manufacturing or retail sector. Misstated inventory values can affect the overall financial position of the company.
- **AS 10: Accounting for Fixed Assets** - The proper recording and valuation of fixed assets, such as property, plant, and equipment, are important for determining the company's worth. This standard outlines the accounting treatment for fixed assets, including depreciation and impairment.
- **AS 29: Provisions, Contingent Liabilities, and Contingent Assets** - This standard is particularly relevant during insolvency, as it deals with the recognition of provisions and contingent liabilities. It is essential to assess the potential financial obligations that may arise in the future, such as lawsuits or penalties.

2.2.2 *Indian Accounting Standards (Ind AS)*

Ind AS applies to larger companies, especially those that are listed or have significant net worth. These standards are closely aligned with International

Financial Reporting Standards (IFRS) and require a more comprehensive approach to financial reporting. Some of the key Ind AS that are relevant include:

- **Ind AS 36: Impairment of Assets -** This standard requires companies to assess whether there are any indications of impairment of assets and, if so, to estimate the recoverable amount of those assets. In the case of insolvency, the likelihood of asset impairment is high, making this standard crucial for determining the company's real worth.
- **Ind AS 109: Financial Instruments** - Ind AS 109 deals with the recognition, classification, and measurement of financial instruments, including loans, receivables, and investments. Proper accounting for financial instruments is vital during insolvency, especially when assessing the value of financial assets and liabilities.
- **Ind AS 115: Revenue from Contracts with Customers** - For companies with ongoing contracts or revenue streams, recognizing revenue appropriately is essential. Ind AS 115 sets out guidelines for revenue recognition, which can be particularly challenging in cases where business operations have been disrupted due to financial distress.
- **Ind AS 113: Fair Value Measurement** - This standard provides a framework for measuring fair value, which is often required when valuing assets during insolvency. Fair value measurement is critical for assessing the value of assets that may be sold as part of the resolution process.

2.3 Accounting for Impairment of Assets

One of the significant challenges in the CIRP process is accounting for the impairment of assets. When a company is in financial distress, its assets may lose value, either because of market conditions, operational inefficiencies, or damage. The impairment of assets must be recognized in the financial statements, as failure to do so can mislead creditors and stakeholders about the actual financial health of the company.

Key Considerations in Asset Impairment:

- **Impairment Testing** - Under Ind AS 36, companies are required to assess whether there are indicators of asset impairment. These indicators could include significant declines in market value, changes in the regulatory or economic environment, or negative cash flows.
- **Estimating Recoverable Amount** - If impairment indicators are present, companies must estimate the recoverable amount of the asset, which is the higher of the asset's fair value less costs to sell and its value in use (i.e., the present value of future cash flows expected from the asset).

- **Recording Impairment Losses** - If the carrying amount of the asset exceeds its recoverable amount, the company must recognize an impairment loss in its financial statements. This loss directly affects the profitability and asset base.

- **Impact on Resolution Process** - Accurately accounting for asset impairments is crucial for the resolution process. Impaired assets may need to be written down, affecting the valuation used in the resolution plan. Overstating asset values can lead to inflated expectations among creditors, while understating them may lead to unfair recovery estimates.

2.4 Fair Value Measurement and Revenue Recognition

Fair value measurement is an essential aspect of financial reporting during insolvency. It provides a more accurate representation of the assets and liabilities, which is critical for creditors and resolution applicants evaluating the prospects of the company.

Fair Value Measurement Under Ind AS 113

- **Definition of Fair Value** - Ind AS 113 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

- **Hierarchy of Fair Value Inputs** - Ind AS 113 provides a hierarchy for fair value measurements based on the observability of inputs used in valuation. Level 1 inputs are quoted prices in active markets, Level 2 inputs are other observable inputs, and Level 3 inputs are unobservable data. During insolvency, assets may require Level 3 valuations due to limited market activity.

- **Fair Value Adjustments** - The company may need to adjust the carrying values of its assets and liabilities based on fair value estimates. For example, if a company holds real estate assets that have declined in value, the fair value adjustment would reflect the market reality.

Revenue Recognition Under Ind AS 115

Revenue recognition becomes particularly challenging during insolvency when business operations are disrupted. Ind AS 115 outlines a five-step model for revenue recognition, focusing on contract identification, performance obligations, transaction price, allocation of transaction price, and recognition when obligations are satisfied. The challenges during CIRP could be incomplete contracts, disrupted operations and revenue from discontinued operations.

Section 3 - Auditing During the Insolvency Process

Auditing plays an indispensable role in the insolvency resolution process under the Insolvency and Bankruptcy Code, 2016. It acts as the cornerstone for ensuring financial accuracy, compliance, and transparency

during the Corporate Insolvency Resolution Process (CIRP). Auditors provide an independent assessment of the financial health, verifying that financial reports reflect the true position of the company. They also ensure that the necessary regulatory and legal requirements are being followed. This section will examine the auditing responsibilities during insolvency, the challenges auditors face, and the growing importance of forensic audits in identifying fraudulent transactions.

3.1 The Role of Auditors in CIRP

During the insolvency resolution process, auditors take on critical responsibilities that extend beyond traditional statutory audits. Their primary function is to provide assurance that the financial statements of the distressed company accurately reflect its financial condition. Auditors also ensure compliance with the applicable accounting standards (AS and Ind AS) and assess whether the financial practices meet the legal and regulatory requirements.

Key Responsibilities of Auditors During CIRP

1. **Verification of Financial Statements** - Auditors are tasked with verifying the financial statements of the company, ensuring that all assets, liabilities, revenue, and expenses are accurately recorded. Their role is to detect any material misstatements that could affect the decision-making process of stakeholders.
2. **Ensuring Compliance** - Auditors ensure that the company complies with the provisions of IBC, accounting standards, and other relevant regulations, such as the Companies Act, 2013. For listed companies, compliance with SEBI regulations is also crucial.
3. **Assessment of Going Concern Assumption** - Auditors must evaluate the company's ability to continue as a going concern. If there is uncertainty about the future viability, this must be disclosed in the audit report. The going concern assumption is often questioned during insolvency, as the operations may be significantly disrupted.

Auditors, therefore, act as watchdogs during the insolvency process, ensuring that all financial information is accurate, that the company is in compliance with regulations, and that any fraudulent activities are identified and addressed.

3.2 Forensic Audits in the CIRP

Forensic audits have become increasingly important in the CIRP process due to the need to investigate and identify fraudulent transactions, misrepresentation of financials, and other irregularities that may have contributed to the company's financial distress. These audits go beyond standard financial audits by focusing on uncovering fraud, hidden transactions, and potential financial mismanagement

by the company's management or directors.

Key Aspects of Forensic Audits in CIRP

1. **Identifying Fraudulent Transactions** - One of the primary objectives of forensic audits is to detect fraudulent transactions that may have taken place before or during the insolvency process. These include transactions that were undertaken to benefit specific creditors, related parties, or shareholders at the expense of the financial health of the company.

2. **Investigating Preferential Transactions** - Forensic auditors look for preferential transactions, which occur when a company gives an unfair advantage to one creditor over others.

3. **Detecting Undervalued Transactions** - Forensic auditors also investigate undervalued transactions, where the company's assets were sold or transferred at prices significantly lower than their market value.

4. **Avoidance of Transactions** - Forensic audits are crucial in identifying transactions that should be avoided under IBC provisions, such as those that defraud creditors or are detrimental to the company's financial interests.

5. **Related Party Transactions** - Forensic auditors pay particular attention to related party transactions, as these are often used to funnel resources out of the company. Transactions with related parties are subject to greater scrutiny under IBC, and forensic auditors help ensure that such dealings were fair and did not harm the company or its creditors.

3.3 Key Challenges for Auditors During CIRP

Auditors face a variety of challenges when conducting audits during the insolvency resolution process. These challenges stem from the distressed nature of the company, the complexity of the financial transactions involved, and the need to adhere to strict timelines under the IBC. Some of the key challenges include going concern assessment, time constraints, non-availability of information and determination of fair value of assets.

Section 4: Regulatory Compliance During Insolvency

The insolvency process under the Insolvency and Bankruptcy Code, 2016, is complex and multi-dimensional, requiring adherence to various regulations beyond the core insolvency framework. Companies undergoing a Corporate Insolvency Resolution Process (CIRP) or liquidation must comply with an array of regulatory requirements that span multiple domains, including corporate law, foreign exchange management, securities regulation, labor laws, and sector-specific norms. These regulations remain applicable during insolvency, and compliance is crucial to ensuring a smooth and lawful resolution process. Failure to adhere to these regulations can result in penalties, delays, and potential legal challenges, complicating the efforts to revive or liquidate the company.

In this section, we will explore the interplay between the IBC and other regulatory frameworks, examine how these regulations impact the insolvency process, and discuss the challenges that arise from multi-regulatory compliance. We will also consider the role of insolvency professionals (IPs) in managing regulatory compliance and mitigating risks.

4.1 Companies Act, 2013 and IBC

The Companies Act, 2013, serves as the primary regulatory framework for corporate governance, financial reporting, and compliance for all companies registered in India. When a company enters into insolvency, the provisions of the Companies Act continue to apply, albeit with certain modifications and adjustments to align with the IBC framework. The key areas of overlap between the Companies Act and IBC are corporate governance requirements, annual compliance filings, the role of auditors, duties of directors and related party transactions.

4.2 SEBI Regulations for Listed Companies

The Securities and Exchange Board of India (SEBI) plays a crucial role in regulating listed companies in India. When a listed company undergoes insolvency, SEBI regulations continue to apply, ensuring that shareholders and investors are kept informed about the company's financial situation and that corporate governance standards are maintained.

Key SEBI Compliance Issues During Insolvency:

1. **Disclosure Requirements** - SEBI mandates that listed companies disclose any material events or information that could impact their stock price. The commencement of CIRP is considered a material event, and the company must inform the stock exchanges as soon as insolvency proceedings are initiated. Throughout the CIRP, the company must continue to disclose significant developments, such as the appointment of the RP, the approval of resolution plans, and any court orders that may impact the company's future.

2. **Insider Trading Regulations** - SEBI's insider trading regulations prohibit company insiders from trading on the basis of unpublished price-sensitive information (UPSI). During insolvency, the RP, directors, and management must ensure that they do not engage in any transactions based on confidential information related to the resolution process. This is especially relevant during negotiations with potential resolution applicants or when significant corporate actions, such as asset sales, are being discussed.

3. **Corporate Governance Standards** - Listed companies are required to maintain high standards of corporate governance under SEBI's listing obligations and disclosure requirements (LODR) regulations. Even during insolvency, the company must adhere to these governance norms, including ensuring that the board of directors meets regularly, that audit committees function effectively,

and that shareholders are kept informed of important decisions.

4. **Delisting and Re-Listing** - In some cases, companies undergoing insolvency may face delisting from stock exchanges if they fail to meet SEBI's listing criteria, such as maintaining a minimum share price or fulfilling compliance obligations. However, if the company is successfully revived through a resolution plan, it may be re-listed on the stock exchange. The RP must deal with SEBI's delisting and re-listing regulations during the CIRP.

5. **Treatment of Shareholders' Interests** - The priority of claims gives creditors precedence over shareholders in the distribution of assets. However, SEBI regulations require listed companies to protect shareholders' interests to the extent possible. This creates a delicate balance between satisfying creditor claims and preserving some value for equity shareholders, especially in cases where the company is being restructured rather than liquidated.

4.3 Labor Laws During Insolvency

The treatment of employees and their rights during insolvency is a critical concern, especially in companies with a significant workforce. Indian labor laws, including the Industrial Disputes Act, 1947, the Payment of Wages Act, 1936, and the Employees' Provident Fund and Miscellaneous Provisions Act, 1952, continue to apply to companies undergoing insolvency. These laws ensure that the rights of workmen and employees are protected and that their dues are prioritized in the distribution of assets.

Key Labor Law Compliance Issues During CIRP

1. Wages and Salaries - One of the primary concerns during insolvency is ensuring that employees are paid their outstanding wages and salaries. The IBC prioritizes workmen and employee dues in the waterfall mechanism under Section 53, which means that wages owed to employees are settled before payments are made to unsecured creditors.

2. **Employee Benefits and Statutory Dues** - Companies must continue to comply with statutory obligations related to employee benefits, such as provident fund contributions, gratuity payments, and employee insurance schemes. These dues are considered priority claims under the IBC and must be paid before other creditor claims are addressed.

3. **Rights of Workers During Liquidation** - In cases where the company moves to liquidation, employees may face termination of their employment. Labor laws ensure that workers are entitled to severance pay, gratuity, and other benefits in accordance with the law. The liquidator must ensure that these obligations are met during the liquidation process.

4. **Handling Employee Claims:** Employees are entitled to file claims during the CIRP, just like other creditors. The RP is responsible for verifying these claims and ensuring that they are included in the resolution process. The timely settlement of employee claims is essential to maintaining workforce morale and ensuring smooth operations during the CIRP.

4.4 Interplay of Regulations

The IBC does not operate in isolation; it intersects with a wide range of regulations, including corporate law, foreign exchange management, securities regulation, labor laws, and sector-specific rules. This creates a complex regulatory environment that requires careful navigation by insolvency professionals. Managing the interplay of these regulations is essential to ensuring a successful resolution process and avoiding legal challenges or delays.

4.6 Role of Insolvency Professionals in Regulatory Compliance

Insolvency professionals (IPs) play a critical role in ensuring that companies undergoing CIRP or liquidation comply with all relevant regulations. The IP is responsible for managing the company's operations during insolvency, verifying creditor claims, and facilitating the resolution process. A key part of this role is ensuring that the company remains compliant with corporate, financial, labor, and sector-specific regulations throughout the process.

5.1 Accounting and Legal Conflicts

One of the most significant challenges in the CIRP process is the potential conflict between accounting standards and legal requirements. Accounting standards such as Indian Accounting Standards (Ind AS) and Accounting Standards (AS) provide the framework for financial reporting, but the requirements of the IBC may impose different obligations on how assets, liabilities, and financial transactions are treated.

Key Areas of Conflict Between Accounting Standards and Legal Requirements

1. **Valuation of Assets and Liabilities** - Ind AS requires companies to value assets and liabilities at fair value, but the IBC focuses on maximizing asset recovery for creditors. This can create conflicts when the valuation under Ind AS differs from what creditors or the Committee of Creditors (CoC) deem acceptable for the resolution process. For example, impaired assets may need to be written down in financial statements under Ind AS, but the CoC may push for higher valuations to increase the recovery potential in the resolution plan.

2. **Revenue Recognition** - Ind AS 115 provides detailed guidelines on revenue recognition, which can become difficult to apply in insolvency scenarios where contracts have been disrupted, performance obligations are incomplete, or revenue-generating

activities are on hold. Meanwhile, the IBC may require immediate recognition of revenue or other income streams for the purpose of resolution plans, irrespective of the company's ability to generate consistent revenue.

3. **Provisioning for Contingent Liabilities** - Under Ind AS 37, companies must recognize provisions for contingent liabilities based on probable outflows of resources. However, under the IBC, contingent liabilities often become a critical part of creditor claims, and how these claims are treated can affect the resolution process. The difficulty lies in balancing the legal recognition of claims with the accounting provisions for liabilities that may or may not materialize.

4. **Treatment of Write-Downs** - During insolvency, assets and receivables often require significant write-downs due to the deteriorated financial condition of the company. The legal framework under IBC, however, may require that these write-downs be carefully managed to avoid adversely affecting creditor recoveries. This creates a conflict between adhering to accounting principles and protecting creditor interests under the IBC.

5. **Going Concern Assumption** - Auditors and accountants often struggle with the going concern assumption in the context of insolvency. Ind AS requires the disclosure of uncertainties related to the company's ability to continue as a going concern, while the IBC mandates that the company continue operating during CIRP to maximize value for creditors. This creates tension between presenting an accurate financial picture and maintaining operations during the resolution process.

Section 6 - Opportunities for Professionals in the IBC Ecosystem

The Insolvency and Bankruptcy Code, 2016, has transformed the landscape of corporate insolvency resolution in India, creating a wealth of opportunities for professionals with expertise in finance, law, accounting, auditing, and corporate governance. The complex, multi-disciplinary nature of the insolvency process requires a wide range of skills and knowledge, and the demand for qualified professionals has grown significantly since the implementation of the IBC.

This section explores the various professional roles within the IBC ecosystem, highlighting the opportunities available for insolvency professionals, chartered accountants (CAs), forensic auditors, corporate finance advisors, and other specialists. We will also discuss the increasing need for technology-driven roles, such as data analysts and compliance automation experts, and the emerging opportunities for professionals in training, advisory, and research roles related to insolvency and bankruptcy law.

6.1 Insolvency Professionals (IPs)

The role of the Insolvency Professional (IP) is central to the IBC ecosystem. IPs are the cornerstone of the insolvency resolution process, responsible for

managing the entire CIRP, liquidating assets when necessary, and ensuring compliance with the legal framework. The demand for qualified and experienced IPs has skyrocketed since the introduction of the IBC, and the profession has become one of the most sought-after roles in the corporate finance and legal sectors. The key responsibilities of the IPs include managing CIRP, facilitating resolution plans, verifying claims of the creditors, and ensuring compliance.

6.2 Chartered Accountants (CAs)

Chartered Accountants (CAs) play a critical role in the insolvency process, particularly in the areas of financial analysis, asset valuation, forensic accounting, and regulatory compliance. CAs are often called upon to assist in the preparation and verification of financial statements, conduct due diligence on the corporate debtor's assets and liabilities, and advise on tax and accounting matters during the resolution process.

Key Roles for CAs in the IBC Ecosystem

1. **Financial Reporting and Analysis** - CAs are responsible for ensuring that the financial statements of the insolvent company accurately reflect its financial position. This includes verifying asset valuations, revenue recognition, impairment of assets, and provisioning for liabilities.

2. **Asset Valuation** - Accurate valuation of assets is essential for both the resolution and liquidation processes. Cas, who are registered valuers, use their expertise to assess the fair market value of the corporate debtor's assets, which is critical for determining the recovery potential for creditors.

3. **Forensic Audits** - CAs with expertise in forensic accounting are in high demand for conducting forensic audits during insolvency. These audits help identify fraudulent transactions, preferential payments, undervalued asset transfers, and other irregularities that may have contributed to the company's financial distress.

4. **Advising on Resolution Plans** - CAs play a key role in advising resolution applicants and the CoC on the financial aspects of resolution plans, including cash flow projections, financial restructuring, and the feasibility of proposed resolutions.

5. **Tax Advisory and Compliance** - Insolvency cases often involve complex tax issues, such as the treatment of accumulated losses, set-offs, and indirect tax liabilities. CAs provide valuable tax advisory services to ensure that the resolution plan complies with tax laws and maximizes the tax benefits available to the corporate debtor.

6.3 Forensic Auditors and Financial Investigators

Forensic auditors and financial investigators play a pivotal role in uncovering fraudulent transactions,

misappropriation of funds, and financial irregularities during the insolvency process. Their expertise is essential in identifying and reversing transactions that have harmed the corporate debtor and its creditors.

6.4 Corporate Finance Advisors

Corporate finance advisors play a vital role in insolvency cases by providing financial restructuring advice, evaluating resolution plans, and helping companies maximize value during the resolution process. Their expertise is particularly valuable in cases where the corporate debtor requires significant financial restructuring to remain viable.

6.5 Compliance and Regulatory Advisors

Compliance and regulatory advisors are essential in ensuring that companies undergoing insolvency comply with the myriad of legal and regulatory requirements imposed by the IBC, Companies Act, SEBI regulations, labor laws, and sector-specific regulations. Their expertise helps mitigate legal risks and ensures that the insolvency process adheres to all relevant laws.

6.7 Technology and Automation Experts

The increasing use of technology and automation in the insolvency process has created new opportunities for professionals with expertise in data analysis, compliance automation, and digital tools. As the insolvency landscape evolves, the need for technology-driven solutions has become more pronounced, particularly in areas such as creditor management, compliance tracking, and data analysis.

6.8 Training, Advisory, and Research Roles

The growing importance of the IBC has created new opportunities for professionals in training, advisory, and research roles. These professionals play a critical role in educating stakeholders about the IBC, advising companies on insolvency-related matters, and conducting research on insolvency trends and best practices.

Conclusion

The IBC ecosystem presents a wide range of opportunities for professionals across multiple disciplines, including insolvency professionals, chartered accountants, lawyers, forensic auditors, corporate finance advisors, compliance experts, and technology specialists. As the insolvency landscape continues to evolve, the demand for qualified professionals with expertise in managing complex insolvency cases will continue to grow.

Professionals who specialize in insolvency-related services have the opportunity to build rewarding careers, work on high-profile cases, and contribute to the success of companies facing financial distress. The IBC has created a dynamic and expanding ecosystem that offers significant career growth opportunities for professionals who are equipped with the skills, knowledge, and expertise needed to navigate the complexities of the insolvency process.

Through ongoing education, specialization, and collaboration, professionals can position themselves as leaders in the IBC ecosystem and play a critical role in shaping the future of corporate insolvency resolution in India.

The Interplay between Prevention of Money Laundering Act with Insolvency and Bankruptcy Code

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Overview

The interplay between various special legislations is a theme that has been the subject matter of any discussions. The interplay between PMLA and the IBC is a crucial topic of interest for commercial lawyers. Chapter III of the PMLA deals with the attachment, adjudication and ultimate confiscation of proceeds of crime. These so called proceeds of crime can in many cases be the assets of a Corporate Debtor that is in the process of being 'resolved' through the resolution process (CIRP) before the Adjudicating Authority (NCLT). The vesting of these properties with the Central Government would lead to the erosion of the value of the corporate debtor and be a hinderance in the successful resolution of the Corporate Debtor.

Though at first blush, it would appeal that Chapter III of the PMLA would be in conflict with certain provisions of the IBC (especially Section 14 and 32A) this would not necessarily be true. The Courts have interpreted the two acts harmoniously with due consideration given to the chronology of the enactments and their amendments as well as their intended purposes. While there are decisions of various High Courts on certain burning issues, the matter shall perhaps be laid to rest only by an authoritative decision of the Supreme Court.

Prologue

We live in interesting times to be students of commercial laws. Over the last two decades, we have seen a raft of special legislations that have been enacted by the parliament to fulfil specific objectives. These are in addition to the general legislations that are already in place. It is quite a different matter that even certain general legislations have been overhauled in recent times. This has for better or worse given prominence to that subject which a lot of students did not enjoy in law school i.e. the subject of conflict of laws.

Introduction

While special laws are made with specific objectives in mind, a multitude of such laws results in an inevitable conflict of laws as classically alleged or an interplay between laws as contemporarily discussed. With the wide array of laws jostling for space to govern certain transactions, some conflict or rather interplay is but natural. Many a legal 'pundit' (as the term is now defined in many English dictionaries – may invariably find a place in the Black's legal dictionary before long) has tried to hazard an interpretation of what the

interplay between two different laws may be. Invariably, one may only speculate based on precedent before an authoritative ruling on the matter comes from a court of competent jurisdiction. While I have been enlisted the noble cause of hazarding the interplay between the Prevention of Money Laundering Act, 2002 (**PMLA**) and the Indian Bankruptcy Code 2016 (**IBC**), my analysis comes with a caveat - there is currently no judgment of the Supreme Court that directly deals with the issue. Such a judgment, if and when it comes, shall be the most authoritative pronouncement on the issue and shall be able to accurately give certainty to what is certainly a complex and contested relationship.

Before we delve deeper into discussing the interplay between these two special statutes, we must as they say start at the start. The PMLA is currently the talk of the town. The jurisprudence is fast evolving as various courts deal with the complex and often vexatious issues that are thrown up. As the law sees greater enforcement by the agency aptly called the Directorate of Enforcement (**ED**), entities and individuals that were hitherto not exposed to its provisions have started to stand up and take notice of the same. The PMLA is not merely a criminal law, as the 'P' in the PMLA suggests, one of its avowed objectives is to prevent the activity of money laundering. This was succinctly laid down by the Supreme Court in the case of **Vijay Madanlal Chaudhary 2022 SCC OnLine 929**. The consequences of PMLA and proceedings are not singular in nature. For the sake of simplicity, they can be divided into three distinct parts - compliance, confiscation and prosecution. For our discussion, we shall be looking primarily into confiscation proceedings that often start with a provisional attachment of property and culminate into the confiscation of the property upon orders of the Special Court designated under PMLA to try the offense of money laundering.

A Tale of Two Acts

The PMLA is an Act to prevent money laundering. Beyond the prosecution sections, it contains in Chapter III a process to attach and confiscate proceeds of crime. The process comprises of attachment and ultimate confiscation. Being a special law the PMLA has an overriding effect on other legislations.

Section 71 of the PMLA states:

> *71. Act to have overriding effect.-- The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.*

The IBC was enacted more than a decade after the PMLA came into force. The IBC is *"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 maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto."*

Similar to Section 71 of the PMLA, this special law also has an overriding effect on other laws.

Section 238 of the Code which states:

> *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.*

Given that both the Acts purport to have an overriding effect, it is clear that they would prevail over other laws. However, a reading of each of the Sections make it clear that they would have an overriding effect *'notwithstanding anything inconsistent therewith contained in any other law for the time being in force'.* The IBC was not in force when the PMLA came into force. Therefore, a hypothesis can be drawn that the IBC shall prevail over the PMLA, if there is a conflict between the two. It is trite law that in the normal course, a special law with a non-obstante clause shall override general legislation, but when two special laws both have non-obstante clauses, it is the latter Act that shall prevail. A Three judge Bench of the Supreme Court in the case of ***Solidaire India Ltd. vs. Fairgrowth Financial Services Ltd., (2001) 3 SCC 71*** held that in such an event it is the later Act which must prevail. The Supreme Court in turn relied on its previous judgments in ***Maharashtra Tubes Ltd. vs. State Industrial & Investment Corpn. of Maharashtra Ltd. (1993) 2 SCC 144, Sarwan Singh vs. Kasturi Lal (1977) 1 SCC 750, Allahabad Bank vs. Canara Bank (2000) 4 SCC 406 and Ram Narain vs. Simla Banking & Industrial Co. Ltd. AIR 1956 SC 614*** in support of this observation.

This comes with an obvious caveat. If harmonious interpretation can be made, then one of them need not prevail over the other. The Courts have often interpreted Acts in a manner to avoid conflict between the provisions. In ***Nitin Jain Liquidator PSL vs. Enforcement Directorate 2021 SCC OnLine Del 5281*** the Delhi High Court observed that *"The discussion on the issue of the overriding effect of the two competing statutes as urged by respective parties, must be prefaced with the acknowledgment of the fact that both the PMLA as well as IBC employ non obstante clauses by virtue of Sections 71 and 238 respectively. Both statutes, admittedly, are legislations promulgated by Parliament in 2005 and 2016. Both enactments have undergone recent amendments with PMLA seeing the passing of Finance (No. 2) Act, 2019 and the IBC which was amended by virtue of Act 1 of 2020 pursuant to which Section 32A came to be included in the statute book. It, therefore, cannot possibly be presumed that the legislature was oblivious of the reach and ambit of the two enactments. The submissions canvassed by respective sides on this score must be evaluated firstly on the well settled precept of the Court identifying the core and fundamental purport and object of the statutes. This principle obliges the Court to examine and decipher the intent and objective of the statute, the essential subject of legislation and the field of activities that it seeks to regulate. While discharging that burden, especially when dealing with two statutes which may independently employ a legislative command for their provisions to have effect notwithstanding anything to the contrary contained in any other law, the first question that must be answered is whether there is in fact an element of irreconcilability and incompatibility in the operation of the two statutes which cannot be harmonized. The issue of incompatibility in the operation of two statutes should not be answered on a mere perceived or facial examination of their provisions, but on a deeper and meticulous scrutiny and evaluation of the operation of the competing provisions and the subject that is sought to be regulated."*

The Case of Two Monkeys and a Cat

Most of us are very well acquainted with the case of the two monkeys and the cat. It is a story of how when two monkeys were fighting over a slice of cake, it was the cat who benefited. A strict interpretation of the PMLA would lead to the central government being the cat in the case of financial crimes. Chapter III of the PMLA that leads to the ultimate confiscation of the proceeds of crime under Section 8 contemplates the confiscation of the proceeds of crime. Section 8(5) of the PMLA contemplates that where on conclusion of a trial of an offense under the PMLA, the special court finds that the offence of money laundering has been committed, it shall order that such property involved in money laundering or that has been used for the Commission of the offense of money laundering shall stand confiscated to the central government.

Many of the current prosecutions under the PMLA deal with public money. Many borrowers that have cheated banks, financial institutions or also private individuals are arraigned for the offense of money laundering and their properties are sought to be attached. While banks try to recover their money lent from those borrowers that have unscrupulously played a fraud upon them, these monies can be characterized as the proceeds of crime would vest upon the final conviction of the accused with the Central Government and not with the bank or the lender or any other person so defrauded. This then would give rise to a situation where it would not be in the best interest of the Complainant to ensure the ultimate conviction of the person or entity accused of money laundering. This would be to avoid the transaction becoming a case of two monkeys and the cat.

The above mentioned scenario is particularly relevant with respect to the IBC as the vesting of the proceeds of crime of these cheating and fraudulent defaulters with the central government would actually go against the very grain and object of the IBC. This is the biggest flash point between the two legislations, which otherwise operate in their own independent domains. If proceeds of crime in the case of a loan fraud are to be confiscated by the central government, the chances of a successful resolution of a corporate debtor accused of such loan fraud would be doomed. Though the example of a loan fraud would be perhaps the most common occurrence with regard to IBC, a variation of this example would apply to most financial and operational creditors for other transactions. Banks and other financial creditors find themselves as party to many litigations under Chapter III of the PMLA especially as very often, mortgaged assets also find themselves considered proceeds of crime by the Directorate of Enforcement.

When it comes to IBC and PMLA, two of the most important aspects that we will consider today is the effect of Section 14 and 32A of the former Code with the latter Act. This is because the interplay of these two sections with the PMLA has a direct bearing on the resolution/liquidation process itself as well as the assets that are available for the successful resolution of a company.

While it is clear that proceedings under the PMLA and IBC fall in completely different domains, there is an interplay when it comes to the two flash points. The provisional attachment may happen either before IBC proceedings or may be sought to be done during the moratorium under section 14 of the IBC. There are inherent challenges that the liquidator is often made a party to proceedings under the PMLA and that though he is not

accused, nor his personal property is sought to be attached, he is usually hamstrung by a lack of prior knowledge of the transactions and often a lack of staff and data to put up an effective defence before the adjudicating authority. As held by the Delhi High Court in ***Rajiv Chakraborty Resolution Professional of EIEL vs. Directorate of Enforcement 2022 SCC OnLine Del 3703*** an order of attachment when made under the Act does not result in the corporate debtor or the Resolution Professional facing a fait accompli. The statutes provide adequate means and avenues for redressal of claims and grievances. It could be open to a Resolution Professional to approach the competent authorities under the Act for such reliefs in respect of tainted properties as may be legally permissible. A Provisional Attachment Order made by the Enforcement Directorate under the Act does not invest in that authority a superior or overriding right in property. Ultimately the claims of parties over the property that may be attached and the question of distribution and priorities would have to be settled independently and in accordance with law.

Interplay with Section 14 of the IBC

Section 14 of the IBC provides for a moratorium to be declared by the adjudicating authority (NCLT) for prohibiting the institution of suits, continuation of pending suits or proceedings against the corporate debtor, execution of any judgment, decree or order in any court of law, tribunal, arbitration panel order the authority. It prohibits transferring, encumbering, alienating or disposing of by the corporate debtor any office assets or legal rights or beneficial interest therein. It also prohibits any action to foreclose or recover or enforce any security interest created by the corporate debtor in respect of its property, including any action under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Act, 2002 (SARFESI) And also the recovery of any property by an owner or lessor where such property is occupied by or in possession of the corporate debtor.

While it could be argued that proceedings under Chapter III of the PMLA could constitute proceedings against the corporate debtor, this would not stricto sensu be true.

The Appellate Tribunal under PMLA in ***Siddhi Vinayak Logistic Ltd vs. The Joint Director Directorate of Enforcement, Mumbai, FPA-PMLA-1970/MUM/2017; FPA-PMLA-2107/MUM/2017, FPA-PMLA-2137-39/MUM/2017*** had held that the IBC has an overriding effect over the PMLA as the latter is a statue which came into effect much prior to the coming into force of the former. The Tribunal observed that the aim and object of both the statutes are different and they operate in their respective fields. The legislature while framing the IBC is quite aware of the existence of PMLA and other statutes. The Tribunal relied upon Section 238 of the IBC to support its decision. The Tribunal further observed that the intention of the Legislature is clearer in this regard if the provisions of Section 238 are read with Section 14(1)(a) of the Code. Section 14(1)(a) of the Code states "14. Moratorium. - (1) Subject to provisions of sub-section (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare a moratorium for prohibiting all of the following, namely. The institution of suits or continuation of pending suits or proceedings against the corporate debtor, including the execution of any judgments decree or order in any court of law, tribunal, arbitration panel or other authority.

However, In ***Rajiv Chakraborty Resolution Professional of EIEL vs. Directorate of Enforcement 2022 SCC OnLine Del 3703***

the Delhi High Court has held that the Moratorium under Section 14 of the IBC does not affect the powers of Directorate of Enforcement to attach properties under the PMLA. The Court held that while both the IBC and the PMLA are special statutes in the generic sense, they both seek to sub-serve independent and separate legislative objectives. The subject matter and focus of the two legislations are clearly distinct. When faced with a situation where both the special legislations incorporate non obstante clauses, it becomes the duty of the Court to discern the true intent and scope of the two legislations. Even though the IBC and Section 238 thereof constitute the later enactment when viewed against the PMLA, which came to be enforced in 2005, the Court was of the opinion that the extent to which the latter was intended to capitulate to the IBC is an issue which must be answered on the basis of Section 32A of the IBC. The Court came to the conclusion that the power to attach under the PMLA would not fall within the ken of Section 14(1)(a) of the IBC. Through Section 32A of the IBC, the Legislature has authoritatively spoken of the terminal point whereafter the powers under the Act would not be exercisable. The events that trigger its application when reached would lead to the erection of an impregnable wall that cannot be breached by invocation of the provisions of the Act. The non obstante clause finding place in the IBC thus can neither be interpreted nor countenanced to have an impact far greater than that envisaged in Section 32A of the IBC.

The Court further observed that the provisions of the PMLA are not subservient to the provisions of Section 14 of the IBC and held that the moratorium would not prevent the authorities under the PMLA from exercising powers conferred by Section 5 and Section 8 of the PMLA, notwithstanding the pendency of the Corporate Insolvency Resolution Process.

In ***Varrasana Ispat ltd. vs. DDE 2019 SCC OnLine NCLAT 236*** the National Company Appellate Tribunal held that *"it is clear that the 'Prevention of Money-Laundering Act, 2002' relates to 'proceeds of crime' and the offence relates to 'money-laundering' resulting confiscation of property derived from, or involved in, money-laundering and for matters connected therewith or incidental thereto. Thus, as the 'Prevention of Money Laundering Act, 2002' or provisions therein relates to 'proceeds of crime', we hold that Section 14 of the 'I&B Code' is not applicable to such proceeding… .. 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'."*

Interplay with Section 32A of the IBC

Section 32A of the IBC has been inserted with the very specific purpose in mind at a later point of time when the code came into force. It was introduced by the insolvency and Bankruptcy Code Amendment Act, 2020 and came into force with effect from 28/12/2019. Section 32A of the IBC reads as follows:

> ***32A. Liability for prior offences, etc.-***
>
> *(1) Notwithstanding anything to the contrary contained in this Code or any other law for the time being in force, the liability of a corporate debtor for an offence committed prior to the commencement of the corporate insolvency resolution process shall cease, and the corporate debtor shall not be prosecuted for such an offence from the date the resolution plan has been approved by the Adjudicating Authority under Section 31, 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; or

(b) a person with regard to whom the relevant investigating authority has, on the basis of material in its possession, reason to believe that he had abetted or conspired for the commission of the offence, and has submitted or filed a report or a complaint to the relevant statutory authority or Court:

***Provided** that if a prosecution had been instituted during the corporate insolvency resolution process against such corporate debtor, it shall stand discharged from the date of approval of the resolution plan subject to requirements of this sub-Section having been fulfilled:*

***Provided further** that every person who was a "designated partner" as defined in clause (j) of Section 2 of the Limited Liability Partnership Act, 2008 (6 of 2009), or an "officer who is in default", as defined in clause (60) of Section 2 of the Companies Act, 2013 (18 of 2013), or was in any manner in-charge of, or responsible to the corporate debtor for the conduct of its business or associated with the corporate debtor in any manner and who was directly or indirectly involved in the commission of such offence as per the report submitted or complaint filed by the investigating authority, shall continue to be liable to be prosecuted and punished for such an offence committed by the corporate debtor notwithstanding that the corporate debtor's liability has ceased under this sub-Section.*

(2) No action shall be taken against the property of the corporate debtor in relation to an offence committed prior to the commencement of the corporate insolvency resolution process of the corporate debtor, where such property is covered under a resolution plan approved by the Adjudicating Authority under Section 31, which results in the change in control of the corporate debtor to a person, or sale of liquidation assets under the provisions of Chapter III of Part II of this Code to a person, who was not—

(i) a promoter or in the management or control of the corporate debtor or a related party of such a person; or

(ii) a person with regard to whom the relevant investigating authority has, on the basis of material in its possession reason to believe that he had abetted or conspired for the commission of the offence, and has submitted or filed a report or a complaint to the relevant statutory authority or Court.

Explanation.-- For the purposes of this sub-Section, it is hereby clarified that,--

(i) an action against the property of the corporate debtor in relation to an offence shall include the attachment, seizure, retention or confiscation of such property under such law as may be applicable to the corporate debtor;

(ii) nothing in this sub-Section shall be construed to bar an action against the property of any person, other than the corporate debtor or a person who has acquired such property through corporate insolvency resolution process or liquidation process under this Code and fulfils the requirements specified in this Section, against whom such an action may be taken under such law as may be applicable.

(3) Subject to the provisions contained in sub-Sections (1) and (2), and notwithstanding the immunity given in this Section, the corporate debtor and any person who may be required to provide assistance under such law as may be applicable to such corporate debtor or person, shall extend all assistance and co-operation to any authority investigating an offence committed prior to the commencement of the corporate insolvency resolution process.

Section 32A therefore is critical in making the resolution process effective when there are criminal proceedings and a corresponding liability against the Corporate Debtor. It seeks to remove the 'taint' that such criminal proceedings may impart to the assets of the Corporate Debtor as well as the Corporate Debtor itself. This would also extend to the proceedings under the PMLA. However, it would not be a 'get out of jail free card' for the erstwhile management of the Corporate Debtor. It confers protection upon the purchaser of the assets or the new management of the Corporate Debtor through the CIRP process does not need to fear prosecution and proceedings for past actions.

The Supreme Court in ***Ghanashyam Mishra & Sons (P) Ltd. vs. Edelweiss Asset Reconstruction Co. Ltd., (2021) 9 SCC 657*** reproduced the text of the speech of the Hon'ble Finance Minister in the Rajya Sabha on 29/07/2019 which is quite instructive

> *"IBC has actually an overriding effect. For instance, you asked whether IBC will override SEBI. Section 238 provides that IBC will prevail in case of inconsistency between two laws. Actually, Indian courts will have to decide, in specific cases, depending upon the material before them, but largely, yes, it is IBC.*
>
> *There is also this question about indemnity for successful resolution applicant. The amendment now is clearly making it binding on the Government. It is one of the ways in which we are providing that. The Government will not raise any further claim. The Government will not make any further claim after resolution plan is approved. So, that is going to be a major, major sense of assurance for the people who are using the resolution plan. Criminal matters*

alone would be proceeded against individuals and not company. There will be no criminal proceedings against successful resolution applicant. There will be no criminal proceedings against successful resolution applicant for fraud by previous promoters. So, I hope that is absolutely clear. I would want all the Hon'ble Members to recognise this message and communicate further that this Code, therefore, gives that comfort to all new bidders. So now, they need not be scared that the taxman will come after them for the faults of the earlier promoters. No. Once the resolution plan is accepted, the earlier promoters will be dealt with as individuals for their criminality but not the new bidder who is trying to restore the company. So, that is very clear."

Therefore, Section 32A of the IBC is of special significance. It was brought out that the Section was inserted in the code to give comfort to all new bidders that the taxman will not come after them for the faults of earlier promoters. One can just presume that the term 'taxman' is used loosely as it does not find itself featured in the words of the section itself which gives a broader immunity to the successful bidders.

How binding is the speech one may ask? It is not binding for the purposes of interpretation as held by the Supreme Court, but it can be referred to for the purpose of identifying the mischief that 'to build purports to address' as held by the Supreme Court in the case of in ***K.P. Varghese vs. ITO, (1981) 4 SCC 173***.

The constitutional validity of Section 32A of the IBC was challenged before the Supreme Court. In ***Manish Kumar vs. Union of India, (2021) 5 SCC 1*** the Supreme Court upheld the constitutional validity of this section stating:

"Section 32-A has been divided into three parts consisting of sub-sections (1) to (3). Under sub-section (1), notwithstanding anything contained, either in the Code or in any other law, liability of a corporate debtor, for an offence committed prior to the commencement of the CIRP, shall cease. Further, the corporate debtor shall not be liable to be prosecuted for such an offence. The change in the management or control of the corporate debtor must not be in favour of a person, with regard to whom the relevant investigating authority has material which leads it to entertain the reason to believe that he had abetted or conspired for the commission of the offence and has submitted or filed a report before the relevant authority or the Court. The person, who comes to acquire the management and control of the corporate person, must not be a person who has abetted or conspired for the commission of the offence committed by the corporate debtor prior to the commencement of the CIRP. Therefore, abetting or conspiracy by the person, who acquires management and control of the corporate debtor, under a resolution plan, which is approved under Section 31 of the Code and the filing of the report, would remove the protective umbrella or immunity erected by Section 32-A in regard to an offence committed by the corporate debtor before the commencement of the CIRP. To make it even more clear, if either of the conditions, namely, abetting or conspiring followed by the report, which have been mentioned as aforesaid, are present, then, the liability of the corporate debtor, for an offence committed prior to the commencement of the CIRP, will remain unaffected.

> *Reading sub-section (1) and sub-section (2) of Section 32-A together, two results emerge:*
>
> *Subject to the requirements embedded in sub-section (1) of Section 32-A, the liability of the corporate debtor for the offence committed under the CIRP, will cease.*
>
> *The property of the corporate debtor is protected from any legal action again subject to the safeguards, which we have indicated.*
>
> *The bar against action against the property, is available, not only to the corporate debtor but also to any person who acquires property of the corporate debtor under the CIRP or the liquidation process. The bar against action against the property of the corporate debtor is also available in the case of a person subject to the same limitation as prescribed in sub-section (1) and also in sub-section (2), if he has purchased the property of the corporate debtor in the proceedings for the liquidation of the corporate debtor."*

It also observed that *"The corporate debtor and its property in the context of the scheme of the Code constitute a distinct subject-matter justifying the special treatment accorded to them. Creation of a criminal offence as also abolishing criminal liability must ordinarily be left to the judgment of the legislature. Erecting a bar against action against the property of the corporate debtor when viewed in the larger context of the objectives sought to be achieved at the forefront of which is maximisation of the value of the assets which again is to be achieved at the earliest point of time cannot become the subject of judicial veto on the ground of violation of Article 14. We would be remiss if we did not remind ourselves that attaining public welfare very often needs delicate balancing of conflicting interests. As to what priority must be accorded to which interest must remain a legislative value judgment and if seemingly the legislature in its pursuit of the greater good appears to jettison the interests of some, it cannot unless it strikingly ill squares with some constitutional mandate, suffer invalidation."*

In fact, in ***Manish Kumar vs. Union of India, (2021) 5 SCC 1*** the Supreme Court held that provisions of Section 32A of the IBC are not manifestly arbitrary and also considered the interplay with the PMLA which also clarifies the stand of the Union of India in this matter:

> *"The contentions of the petitioners appear to be that this provision is constitutionally anathema as it confers an undeserved immunity for the property which would be acquired with the proceeds of a crime. The provisions of the Prevention of Money-Laundering Act, 2002 (for short "the PMLA") are pressed before us. It is contended that the prohibition against proceeding against the property, affects the interest of stakeholders like the petitioners who may be allottees or other creditors. In short, it appears to be their contention that the provisions cannot stand the scrutiny of the Court when tested on the anvil of Article 14 of the Constitution of India. The provision is projected as being manifestly arbitrary. To screen valuable properties from being proceeded against, result in the gravest prejudice to the homebuyers and other creditors. The stand of the Union of India is clear. The provision is born out of experience. The Code was enacted in the year 2016. In the course of its working, the experience it has produced, is that, resolution applicants are reticent in*

> *putting up a resolution plan, and even if it is forthcoming, it is not fair to the interest of the corporate debtor and the other stakeholders."*

In ***Nitin Jain Liquidator PSL vs. Enforcement Directorate 2021 SCC OnLine Del 5281***, the Delhi High Court held that *"Section 32A in unambiguous terms specifies the approval of the resolution plan in accordance with the procedure laid down in Chapter II as the seminal event for the bar created therein coming into effect. Drawing sustenance from the same, this Court comes to the conclusion that the approval of the measure to be implemented in the liquidation process by the Adjudicating Authority must be held to constitute the trigger event for the statutory bar enshrined in Section 32A coming into effect. It must consequently be held that the power to attach as conferred by Section 5 of the PMLA would cease to be exercisable once any one of the measures specified in Regulation 32 of the Liquidation Regulations 2016 comes to be adopted and approved by the Adjudicating Authority. The expression "sale of liquidation assets" must be construed accordingly. The power otherwise vested in the respondent under the PMLA to provisionally attach or move against the properties of the corporate debtor would stand foreclosed once the Adjudicating Authority comes to approve the mode selected in the course of liquidation. To this extent and upon the Adjudicating Authority approving the particular measure to be implemented, the PMLA must yield."*

The Gujarat High Court in ***Vimal Oil and Foods Ltd. vs. State of Gujarat 2022 SCC OnLine Guj 1123*** held that the proceedings under the IBC are designed to ensure maximization of value, that requires transfer of the corporate debtor to *bona fide* persons, where position is safeguarded by ring-fencing them from prosecution and liabilities under offences committed by erstwhile promoter etc. When *bona fide* persons, takes over the management of the corporate debtor, they should not be penalized for the action of erstwhile management of the corporate debtor.

Very recently the Bombay High Court in the case of ***Shiv Charan vs. Adjudication Authority 2024 SCC OnLine Bom 701*** held that the NCLT has the power to apply the provisions of Section 32A of the IBC to declare that the attachment of property comes to an end while in ***Kiran Shah vs. ED, KOL, 2022 SCC OnLine NCLAT 2,*** the NCLAT held that the NCLT in its role as the adjudicating authority under IBC is not empowered to deal with matters falling under the purview of another authority under PMLA. The Court also made observations as to the role of quasi-judicial authorities such as the ED. The findings of the Court are reproduced as below:

i. *The NCLT was well within its jurisdiction in declaring, both in the Approval Order (dated 17th February, 2023) under Section 31 of the IBC, 2016 and in the April 2023 Order (under Section 60(5) of the IBC, 2016), that the corporate debtor would stand discharged from the offences alleged to have been committed prior to the CIRP and that the Attached Properties as identified in the Approval Order became free of attachment from the time of approval of the resolution plan eligible for benefit of Section 32A. On facts, it is evident that the NCLT was accurate in the valid exercise of its explicit jurisdiction;*

ii. *The jurisdiction of Section 32A of the IBC, 2016 would be attracted from the point at which a qualifying resolution plan is approved under Section 31 of the IBC, 2016. The protections afforded by Section 32A would become available only*

when the resolution plan is so approved, and such resolution plan meets the other necessary ingredients to qualify for the immunity, namely, that there is a clean break with a change in ownership of, and control over, the corporate debtor;

iii. *IA 383 could be regarded as having become infructuous since the Approval Order had already, and rightly, protected the corporate debtor and the Attached Properties from continued prosecution of the scheduled offenses and the offense of alleged money laundering under the PMLA, 2002. However, the April 2023 Order that disposed of IA 383 was founded on applying the provisions of Section 32A to the facts of the case;*

iv. *There is one other facet that makes the scheme and import of Section 32A of the IBC, 2016 clear, logical and reasonable. The attachment under Section 5 of the PMLA, 2002 is but a measure in aid of eventual potential confiscation under Section 8(5) of the PMLA, 2002. Confiscation of the property of the corporate debtor can only be effected upon conviction of the corporate debtor for an offence of money laundering. Where Section 32A(1) of the IBC, 2016 confers immunity to the corporate debtor from prosecution, there can be no conviction that can follow. Consequently, it is but logical that the property of the corporate debtor would have protection from any continued attachment by reason of Section 32A(2). Therefore, when there is no potential in law for an eventual confiscation, the attachment, which is only an interim measure in aid of the final measure of confiscation must necessarily abate and come to an end, since it cannot continue in a vacuum.*

v. *We are not opining on the implications of Section 14 of the IBC, 2016 for continuation of a prior attachment during the course of a CIRP. In the facts at hand, the jurisdiction of Section 14 came to an end, and the jurisdiction of Section 32A commenced, on 17th February, 2023. Therefore, dealing with a conflict between the provisions of the PMLA, 2002 and Section 14 of the IBC, 2016 was rendered irrelevant with effect from 17th February, 2023;*

vi. *As a consequence of Section 32A of the IBC, 2016, the ED must now necessarily release the attachment on the Attached Properties, without being bogged down by the question of how to interpret the continuation of attachment after the commencement of the CIRP and before the Approval Order, and the implications for the same under Section 14 of the IBC, 2016. We are not opining on this facet of the law as it is wholly unnecessary to dispose of the case at hand. It is trite law that no court should rule on questions of law in a vacuum;*

vii. *The Approval Order, which interpreted questions of fact and answered the question of law on implications of Section 32A for the corporate debtor, has not been challenged by the ED – neither in an appeal from the Approval Order nor in WP 29111 filed before us. The ED's challenge is to the April 2023 Order that allowed IA 383 on the strength of Section 32A. The April 2023 Order does contain remarks about the interplay between Section 14 and the attachment but that is not the ratio of the April 2023 Order, which explicitly relies on Section 32A of the IBC, 2016 to direct the release of the Attached Properties. Even if purely for the sake of argument, the April 2023*

Order were to be set aside, the Approval Order would hold the field and that order correctly requires the ED to release the Attached Properties owing to the operation of Section 32A of the IBC, 2016;

viii. *The NCLT in its capacity as the Adjudicating Authority under the IBC, 2016 has only interpreted the provisions of Section 32A and applied them to the facts at hand, to declare that the attachment of the Attached Properties by the ED must come to an end. It is possible that in a given case, the application of Section 32A of the IBC, 2016 may have an effect on existing and intended attachments and prosecution by enforcement agencies operating under laws such as the PMLA, 2002. However, since both Section 32A and Section 60(5) are non-obstante provisions, they would prevail, with no room for concern, real or imagined, about any conflict between legislations. We, therefore, hold that the interpretation by the NCLT in both, the Approval Order, and the April 2023 Order, did not at all render nugatory, the provisions of the PMLA, 2002 or its legislative objectives. The NCLT has merely given effect to the provisions of Section 32A of the IBC, 2016 in its terms and that is an accurate decision, as explained by us above; and*

ix. *Finally, quasi-judicial authorities wielding powers of a civil court in relation to the functioning of a State agency such as the ED, have a role that is distinct and separate from the executive authorities in the same agency. The former are inherently a statutory check and balance on the latter. As quasi-judicial authorities exercising the powers of civil courts and functioning within the territory of India, the law declared by the Hon'ble Supreme Court would bind the quasi-judicial authorities. As required under Article 141 of the Constitution of India, such quasi-judicial authorities must act consistent with the law declared by the Hon'ble Supreme Court rather than disobey the rule of law to give rise to avoidable litigation.*

Can Section 14 and 32A be used to aid in interpreting each other?

The Supreme Court in ***P. Mohanraj vs. Shah Bros. Ispat (P) Ltd., (2021) 6 SCC 258*** held that "Section 32-A cannot possibly be said to throw any light on the true interpretation of Section 14(1)(a) as the reason for introducing Section 32-A had nothing whatsoever to do with any moratorium provision. At the heart of the section is the extinguishment of criminal liability of the corporate debtor, from the date the resolution plan has been approved by the adjudicating authority, so that the new management may make a clean break with the past and start on a clean slate. A moratorium provision, on the other hand, does not extinguish any liability, civil or criminal, but only casts a shadow on proceedings already initiated and on proceedings to be initiated, which shadow is lifted when the moratorium period comes to an end. Also, Section 32-A(1) operates only after the moratorium comes to an end. At the heart of Section 32-A is the IBC's goal of value maximisation and the need to obviate lower recoveries to creditors as a result of the corporate debtor continuing to be exposed to criminal liability.

Unfortunately, Section 32A of the IBC is inelegantly drafted. The second proviso to Section 32A(1) of the IBC speaks of persons who are in any manner in charge of, or responsible to the corporate debtor for the conduct of its business or associated with

the corporate debtor and who are, directly or indirectly, involved in the commission of "such offence" i.e. the offence referred to in sub-section (1), "as per the report submitted or complaint filed by the investigating authority ...". The report submitted here refers to a police report under Section 173 CrPC, and complaints filed by investigating authorities under special Acts, as opposed to private complaints. If the language of the second proviso is taken to interpret the language of Section 32A(1) of the IBC in that the "offence committed" under Section 32A(1) would not include offences based upon complaints under Section 2(d) CrPC, the width of the language would be cut down and the object of Section 32A(1) would not be achieved as all prosecutions emanating from private complaints would be excluded. Obviously, Section 32A(1) cannot be read in this fashion and clearly incudes the liability of the corporate debtor for all offences committed prior to the commencement of the corporate insolvency resolution process. Doubtless, a Section 138 proceeding would be included, and would, after the moratorium period comes to an end with a resolution plan by a new management being approved by the adjudicating authority, cease to be an offence qua the corporate debtor." This Judgement has later been followed by the Supreme Court again in ***Ghanashyam Mishra & Sons (P) Ltd. vs. Edelweiss Asset Reconstruction Co. Ltd., (2021) 9 SCC 657*** and ***Narinder Garg & Ors. vs. Kotak Mahindra Bank 2022 SCC OnLine SC 516.***

Conclusions

While it would seem prima facie that there would be a conflict between the two enactments, the PMLA and the IBC can both be interpreted harmoniously. In the general sense, section 14 of the IBC would not necessarily affect the attachment proceedings under the PMLA while section 32A of the IBC ensures that resolution of a company and the realization of its value does not suffer in order to avoid the story of the two monkeys and the cat as already mentioned. What is more important though is that both these enactments were watershed moments in their respective field and that they can operate in tandem. After all, the avowed objective of the PMLA was to ensure that in addition to punishing those accused of the offense of money laundering, they should not be allowed to take advantage of their ill-gotten gains in the form of proceeds of crime. It is not and was never the intent of the PMLA to punish those *bona fide* parties who came into possession of those assets that could once be called proceeds of crime.

Epilogue

On the issue of Section 32A of the IBC even the Calcutta High Court has issued notice in ***Ramsarup Industries Limited and Others vs. UOI 2022 SCC OnLine Cal 2571***. It is of great importance that the interplay between the IBC and the PMLA is crystallized by the courts at the earliest as the successful resolution of any corporate debtor rest primarily on the certainty in the law that can be afforded to a resolution applicant. These matters of course may once again travel to the Supreme Court and an authoritative judgment shall no doubt be rendered in order to put matters at rest.

Analysis of Recent Supreme Court Cases and Overcoming Challenges under IBC

CA Anil Goel

Overview

The article provides an analysis of recent Supreme Court rulings under the Insolvency and Bankruptcy Code, 2016 (IBC) and their impact on tax and accounting practices. The focus is on avoidance transactions, including preferential, undervalued, fraudulent, and extortionate transactions (PUFE). Key judgments discussed include State Tax Officer vs. Rainbow Papers Ltd., *which elevated government dues to secured debt status, and* Paschimanchal Vidyut Vitran Nigam Ltd. vs. Raman Ispat Pvt. Ltd., *which clarified the lower priority of government dues in the liquidation hierarchy and then analysis of the review petition on Rainbow Papers creating an unresolved situation.*

The article also examines the implications of decisions such as Anuj Jain vs. Axis Bank Ltd., *emphasizing the need for scrutiny of preferential and undervalued transactions. Additionally, the rulings on fraudulent trading under Section 66 of the IBC are explored, with a focus on liability for third parties, as seen in* Gluckrich Capital Pvt. Ltd. vs. State of West Bengal.

The article highlights the need for tax and accounting professionals to stay vigilant in the insolvency process, as these rulings have profound implications for asset distribution, compliance, and creditor protection under the IBC.

1. Introduction

The Insolvency and Bankruptcy Code, 2016 (IBC) has fundamentally transformed corporate insolvency resolution in India. With its robust framework for addressing distressed assets, the IBC has significantly impacted legal, financial and tax systems. The Hon'ble Supreme Court of India has played a crucial role in shaping the interpretation of the IBC, particularly concerning avoidance transactions, such as preferential, undervalued, fraudulent, and extortionate (PUFE) transactions.

This article delves into recent Supreme Court rulings on key issues under the IBC, with a focus on PUFE transactions. It also explores the impact of these rulings on tax and accounting professionals involved in insolvency proceedings and highlights the challenges faced during insolvency resolutions.

2. Analysis of Recent Supreme Court Judgments: Tax and Accounting-Related Rulings under the IBC

A. State Tax Officer vs. Rainbow Papers Ltd.[1] (September 06, 2022)

In this landmark case, the Honourable Supreme Court addressed whether dues owed to the State under the Gujarat VAT Act should be treated as secured debt under the IBC. Overturning the rulings of the NCLT and NCLAT, the Court held that the statutory charge created under Section 48 of the Gujarat VAT Act, giving the State a first charge on a dealer's property for unpaid VAT, created a security interest. This allowed the State to be considered a secured operational creditor under Section 3(31) of the IBC.

Implications for Taxation: This ruling is critical as it elevates the State's tax dues to the same level as secured creditors in the liquidation hierarchy. This reshapes how statutory dues are treated in the IBC framework, particularly impacting financial creditors who may now face higher haircuts in resolution plans.

B. Paschimanchal Vidyut Vitran Nigam Ltd.(PVVNL) vs. Raman Ispat Pvt. Ltd.[2] (July 17, 2023)

Although, this judgement of Supreme Court was on a slightly different issue, but it also, while distinguishing the judgement of ***Rainbow Papers (Supra)***, observed as under:-

> *"Rainbow Papers judgment did not notice the 'waterfall mechanism' under Section 53 – the provision had not been adverted to or extracted in the judgment. The dues payable to the government are placed much below those of secured creditors and even unsecured and operational creditors. This design was either not brought to the notice of the court in Rainbow Papers (supra) or was missed altogether. In any event, the judgment has not taken note of the provisions of the IBC which treat the dues payable to secured creditors at a higher footing than dues payable to Central or State Government."*

The expression "government dues" is not defined in the IBC - it finds place only in the preamble. The repeated reference of lowering of priority of debts to the government, on account of statutory tax, or other dues payable to the Central Government or State Government, or amounts payable into the Consolidated Fund on account of either government, in the various reports which preceded the enactment of the IBC, as well as its Preamble, means that these dues are distinct and have to be treated as separate from those owed to secured creditors.

1. *State Tax Officer vs. Rainbow Papers Ltd. (2022) ibclaw.in 107 SC*
2. *Paschimanchal Vidyut Vitran Nigam Ltd. vs. Raman Ispat Pvt. Ltd. & Ors. (2023) ibclaw.in 81 SC*

The specific mention of other class of creditors whose dues are statutory, such as dues payable to workmen or employees, "the provident fund, the pension fund, the gratuity fund" under Section 36(4), which excludes these enumerated amounts from the liquidation, especially clarifies that not all dues owed under statute are treated as 'government' dues.

Dues payable to statutory corporations which do not fall within the description "amounts due to the central or state government" such as for instance amounts payable to corporations created by statutes which have distinct juristic entity but whose dues do not constitute government dues payable or those payable into the respective Consolidated Funds stand on a different footing.

Therefore, in ***Paschimanchal Vidyut Vitran Nigam Ltd. vs. Raman Ispat Pvt. Ltd.,*** the Supreme Court held that PVVNL's unpaid electricity dues, which were secured by a charge on the corporate debtor's assets under an agreement, should be treated as secured debt under the IBC based on the agreement and provisions of the Electricity Act, 2003.

On the issue of registration of charge under section 77 of the Companies Act, 2013, the Hon'ble Court observed as under:-

> Section 78 enacts, that when a company whose property is subject to charge, fails to register it, the charge holder (or the person entitled to the charge over the company's assets) can seek its registration. Section 3(31) of the IBC defines "security interest" in the widest terms.

In view of these factual developments, this Court does not consider it appropriate to rule on the submissions of the liquidator vis-a-vis the fact of non-registration of charges under Section 77 of the Companies Act, 2013 and the claim of PVVNL was considered as secured creditor even without the registration of charge under the Companies Act, 2013.

C. *Multiple Review Petitions Filed in the Rainbow Papers Judgment[3] (October 31, 2023)*

In the review petition, the Supreme Court was asked to reconsider its original ruling, which treated statutory VAT dues under the Gujarat VAT Act as secured debt. The petitioners argued that the decision did not properly apply the waterfall mechanism under Section 53 of the IBC, which prioritizes secured creditors over operational creditors, including statutory dues. They contended that statutory dues should be classified as operational debts, ranking lower in liquidation

3. *Sanjay Kumar Agarwal vs. State Tax Officer (1) & Anr. Review Petition (Civil) No. 1620 Of 2023 In Civil Appeal No. 1661 Of 2020*

distribution. Even the ***Paschimanchal Vidyut Vitran Nigam Ltd. vs. Raman Ispat Pvt. Ltd (Supra)*** was also referred by the petitioners.

The Supreme Court, however, dismissed the review petitions, affirming its earlier judgment. The Court held that Section 48 of the Gujarat VAT Act, which creates a statutory charge over the corporate debtor's assets, is not inconsistent with the IBC's provisions. As a result, it ruled that statutory dues can be treated as secured debt, provided a legal charge exists, as in this case. This decision reinforces the notion that statutory authorities with statutory charges may claim secured creditor status in insolvency proceedings under the IBC.

Impact of dismissal of review of the Rainbow Papers Judgment

The Rainbow Papers judgment has effectively made the payment of secured government dues a mandatory requirement for approval of a resolution plan. Given this, financial creditors are required to take a higher haircut which will impact the overall recovery for financial creditors under the IBC.

Additionally, given the dismissal of the Review Petitions, the ambiguity in the treatment of statutory dues continue to persist with the PVVNL Judgment and the Rainbow Papers Judgment providing for different treatments to statutory dues. A reference to a larger bench of the Supreme Court is required to clear the ambiguity created by the different rulings on this crucial question of law.

It is clear that one of the stated legislative intents behind IBC is to accord a lower priority to Government dues as against dues owed to secured lenders/banks/financial institutions. The said intent is manifest not only in the Preamble to the IBC but also from other provisions of the IBC and the regulations framed thereunder. The various reports of expert committees including the Bankruptcy Law Reforms Committee and the Insolvency Law Committee also bear out the same. The fact that Rainbow Papers did not notice the 'waterfall mechanism' under Section 53 – the provision had not been adverted to or extracted in the judgment may lead to a conclusion that the Rainbow Papers Judgment will not be applicable in cases where the underlying provision for creation of security interest are not complied with.

D. Sundaresh Bhatt vs. Central Board of Indirect Taxes and Customs[4] (August 26, 2022)

The Supreme Court in this case ruled that once a moratorium under Section 14 of the IBC is imposed, customs authorities cannot enforce recovery or auction assets of a corporate debtor, even for unpaid customs duties. The

4. *Sundaresh Bhatt, Liquidator of ABG Shipyard vs. Central Board of Indirect Taxes and Customs (2022) ibclaw.in 103 SC*

Court reaffirmed that the IBC overrides the Customs Act, 1962, and that the customs authorities can only assess the duties but cannot initiate recovery during the moratorium or liquidation process under Section 53 of the IBC.

The judgment directly affects how customs duties and other government dues are treated in insolvency proceedings. Customs authorities, as operational creditors, must file their claims within the resolution process and are subject to the IBC's priority waterfall mechanism under Section 53, where tax claims do not have precedence over secured creditors and unsecured financial creditors.

E. New Okhla Industrial Development Authority (NOIDA) vs. Anand Sonbhadra[5] (May 17, 2022)

The Hon'ble Supreme Court observed as under in this judgement:-

— In the lease in question, there has been no disbursement of any debt (loan) or any sums by the appellant to the lessee. The appellant would, therefore, not be a financial creditor within the ambit of Section 5(8).

— The subject matter of Section 5(8)(d) is a lease or a hire-purchase contract. The matter does not end there. In other words, it is not any lease or a hire-purchase contract, which would entitle the lessor to be treated as the financial creditor.

— Accounting Standard- IndAS-116 is applicable and should be seen by the Court to 'deem' a lease as a finance lease. It provides that a lease may be classified as a financial lease, if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. The converse position applies to an operating lease and a lease is to be classified as an operating lease, if the lease does not substantially transfer all the risks and the rewards incidental to the ownership of the underlying asset.

— That the lease in question does not fall within the ambit of Section 5(8)(f). The mere permission or facility of moratorium, followed by staggered payment in easy instalments, cannot lead to the conclusion that any amount has been raised, under the lease, from the appellant, which is the most important consideration.

The Supreme Court finally held that NOIDA, as a lessor, cannot be treated as financial creditor under the IBC. The ruling clarifies that merely having a lease arrangement does not automatically entitle the lessor to financial creditor status unless it meets the criteria of a financial lease under Indian Accounting Standards. NOIDA was held as operational creditor.

5. *New Okhla Industrial Development Authority vs. Anand Sonbhadra, Civil Appeal No. 2222 Of 2021*

3. Rulings on PUFE (Preferential, Undervalued, Fraudulent, Extortionate) Transactions under the IBC.

A. *Anuj Jain (RP) for Jaypee Infratech Ltd. vs. Axis Bank Ltd.[6] (February 26, 2020)*

In this case, the Supreme Court examined a series of mortgage transactions where Jaypee Infratech Limited (JIL) had mortgaged its properties to secure loans taken by its holding company, Jaiprakash Associates Limited (JAL). The Court upheld the National Company Law Tribunal's findings that these transactions were preferential and undervalued under Sections 43 and 45 of the IBC. The transactions placed JAL in a more favorable position than other creditors, which violated the equitable distribution principle outlined in Section 53 of the IBC.

Practical Implications:

- ***Preferential Transactions:*** The case emphasizes the need to scrutinize transactions that may give an undue advantage to certain creditors over others during the look-back period. In this instance, the Court identified the following parameters for determining whether a transfer qualifies as preferential:

  a. Whether the transaction benefits a specific creditor or guarantor?

  b. Whether the transfer puts the creditor in a better position than others?

  c. Whether the transfer settles a pre-existing debt?

  d. Whether the transfer occurred within the look-back period (two years for related parties, one year for unrelated parties)?

  e. Whether the transaction was outside the debtor's regular business or financial activities?

  f. Whether the creditor received an undue advantage over others?

- ***Undervalued Transactions:*** The decision also highlighted the risk of undervalued transactions, under Section 45 of the IBC. Here's a breakdown of the requirements established by the Supreme Court:

  a. The corporate debtor must have transferred assets to another party.

  b. The transfer must have been made without receiving adequate or fair consideration, meaning the value received by the corporate debtor is significantly less than the market value.

6. *Anuj Jain Interim Resolution Professional for Jaypee Infratech Limited vs. Axis Bank Limited Etc., Civil Appeal Nos. 8512-8527 Of 2019*

c. The transaction must not have occurred in the ordinary course of the debtor's business or financial affairs.

d. The transaction must have taken place within the relevant look-back period of two years before the insolvency commencement date if involving related parties.

e. The transaction must result in reducing the value of the debtor's assets, which would otherwise be available for distribution to creditors.

B. Dyna Rasayan Udyog Pvt. Ltd. vs. Pooja Bahry[7] (July 14, 2023)

In this case, the Supreme Court upheld the NCLAT[8] ruling and held that the payments made to GVR Consulting Services Pvt. Ltd. and GVR Electronics Pvt. Ltd., which were repayments of unsecured loans during the look-back period constituted preferential transactions under Section 43 of the IBC. These payments discharged antecedent liabilities and provided certain creditors with an undue advantage over others, thereby violating the principle of equitable distribution of assets in insolvency.

Practical Implications:

- ***Recovery of Preferential Payments:*** The ruling highlights the importance of ensuring that all payments made during the look-back period are scrutinized to ensure they do not favour certain creditors over others. Preferential transactions can be reversed, and amounts refunded to the corporate debtor's estate for equitable distribution.
- ***Antecedent Liabilities:*** The decision reinforces that payments made for antecedent liabilities within the look-back period may be deemed preferential, even if they were made in the ordinary course of business.

C. Kushal Traders Proprietorship Firm vs. T.V. Balasubramanian[9] (January 31, 2022)

In this case, the Supreme Court upheld the NCLAT[10] ruling, which classified the transfer of land by Sholingur Textiles Ltd. to M/s. Kushal Traders as a preferential transaction under Section 43 of the IBC.

The facts of the case involved the Corporate Debtor transferring a piece of land through a sale deed on July 4, 2018, to settle an outstanding

7. *Dyna Rasayan Udyog Pvt. Ltd. vs. Pooja Bahry and Anr., CA 4125/2023*
8. *GVR Consulting Services Pvt. Ltd. and Anr. vs. Pooja Bahry and Ors. CA (AT) (I) 405/2022*
9. *Kushal Traders Proprietorship Firm vs. T.V. Balasubramanian, Civil Appeal No. 149 of 2022*
10. *Kushal Traders vs. T.V. Balasubramanian (RP for Sholingur Textiles Ltd.), CA (AT) (I) 189/2021*

operational debt owed to Kushal Traders, prior to its admission into insolvency on February 4, 2019. The Resolution Professional challenged this transaction, arguing that it favoured Kushal Traders over other creditors.

The NCLAT determined that the transaction, being within the look-back period of one year for non-related parties, gave preferential treatment to Kushal Traders and violated the equitable distribution principle under Section 53 of the IBC. Consequently, the sale deed was declared void.

The Supreme Court, in its decision dated January 31, 2022, reinforced the NCLAT's findings, emphasizing that transactions providing preferential treatment within the prescribed look-back period can be set aside. This case highlights the importance of scrutinizing transactions that give undue advantage to certain creditors and violate the equitable treatment of all creditors during insolvency.

D. Gluckrich Capital Pvt. Ltd. vs. State of West Bengal[11] (2023)

In this case, the Supreme Court addressed the issue of whether Section 66 of the IBC, which deals with fraudulent trading, could be invoked against third parties who were not directly involved in the management of the corporate debtor. The Court ruled that Section 66 applies only to individuals who were directly responsible for the fraudulent trading of the corporate debtor, not third parties.

Practical Implications:

- ***Fraudulent Transactions and Liability:*** The ruling limits the application of Section 66 to those directly involved in the corporate debtor's fraudulent activities. This provides clarity for Resolution Professionals and stakeholders on who can be held accountable for fraudulent transactions during insolvency proceedings.
- ***Third-Party Transactions:*** While third-party transactions may still be scrutinized under other provisions, they are not automatically subject to avoidance under Section 66, unless there is a clear involvement in fraudulent activities.

Apparently, in the above judgement the case was built on section 66(2) and section 66(1) was not considered

It may, however, be noted that in the matter of ***M/s Tenny Jones & Ors vs. Mr. Prathap Pillai***[12], the NCLAT addressed the liability of third parties involved in fraudulent trading under Section 66(1) of the IBC. The Tribunal emphasized that any company or entity knowingly involved in or benefiting from fraudulent business practices

11. *Gluckrich Capital Pvt. Ltd. vs. The State of West Bengal & Ors., (CRL.) NO. OF 2023 (DIARY NO. 6732 OF 2023)*
12. *M/s Tenny Jones & Ors vs. Mr. Prathap Pillai Company Appeal (AT) (CH) (INS.) No. 95 / 2023*

could be held liable for "fraudulent trading." This includes any third party that assists in or benefits from the offending business in a dishonest manner.

In such cases, the law recognizes that third parties, if they participate knowingly in carrying on the business fraudulently, can be made parties to the proceedings and held accountable. This highlights the wide scope of liability under Section 66, which not only applies to the directors of the corporate debtor but also extends to any external entities involved in the fraudulent activity.

E. *Venus Recruiters Pvt. Ltd. vs. Union of India*[13] *(January 13, 2023)*

In this case before the Hon'ble Delhi High court, The Single Judge vide its order dated 26.11.2022[14], initially ruled that once a resolution plan is approved by the NCLT and the new management takes control of the company, the role of the RP ends, and they become functus officio, meaning their authority expires. The Court held that the RP cannot continue with avoidance applications post-CIRP. This decision was based on the principle that the purpose of avoidance transactions is to benefit the creditors before the resolution, not after. Therefore, the Court ruled that avoidance applications should not survive the approval of the resolution plan.

Review by Division Bench

Upon appeal, the Division Bench of the Delhi High Court reviewed the Single Bench's ruling and addressed whether avoidance applications can continue beyond the CIRP. The Bench noted that avoidance applications, which deal with recovering assets lost due to preferential, undervalued, or fraudulent transactions, serve to maximize the value of the corporate debtor's estate. It held that such applications could indeed continue post-CIRP. The Court clarified that avoidance applications serve the purpose of benefiting the corporate debtor's estate and not just the creditors during the CIRP. Thus, these applications do not necessarily lapse upon the conclusion of CIRP, and they can still be adjudicated by the NCLT after the resolution plan is approved.

F. *Smt. Sudipa Nath vs. Union of India*[15]*: Constitutionality of Section 66(1) of the IBC (October 4, 2023)*

In this case, the Tripura High Court upheld the constitutionality of Section 66(1) of the IBC, which deals with fraudulent and wrongful trading. The petitioner challenged this section, arguing that it was arbitrary and

13. *Venus Recruiters Pvt. Ltd. vs. Union of India, LPA 37/2021 and C.M. Nos. 2664/2021, 2665/2021 & 2666/2021*
14. *Venus Recruiters Pvt. Ltd. vs. Union of India & Ors., W.P.(C) No. 8705 of 2019*
15. *Smt. Sudipa Nath vs. Union of India WP(C) (PIL) 04 of 2023*

violated Article 14 of the Constitution of India by restricting the right to file applications under this provision solely to the RP.

The Court, however, affirmed that Section 66(1) is necessary to hold individuals personally accountable for conducting the corporate debtor's business with fraudulent intent or to defraud creditors. It allows the NCLT to order such individuals to contribute to the corporate debtor's assets during the insolvency process. The provision applies during both the CIRP and liquidation phases.

Furthermore, the Court emphasized that the exclusive right of the RP to file applications under Section 66(1) ensures proper regulation and prevents misuse of this provision by other stakeholders. The petition was dismissed, with the Court reaffirming the importance of Section 66(1) in preventing fraudulent activities during insolvency.

4. Conclusion

These landmark Supreme Court rulings have brought significant clarity to the treatment of preferential transactions, undervalued transfers, and fraudulent trading under the IBC. For tax consultants, accountants, and insolvency professionals, understanding these rulings is essential to ensuring compliance and safeguarding creditors' interests. The IBC continues to evolve, and these judgments emphasize the importance of proactive due diligence, strategic planning, and thorough financial scrutiny during insolvency proceedings.

"The greatest truths are the simplest things in the world, simple as your own existence."

— *Swami Vivekananda*

"There is nothing that wastes the body like worry, and one who has any faith in God should be ashamed to worry about anything whatsoever. "

— *Mahatma Gandhi*

Policy Initiatives: Influence on Credit Market, Group/Cross-Border Insolvency, Others

Mr. Vikas Chandra

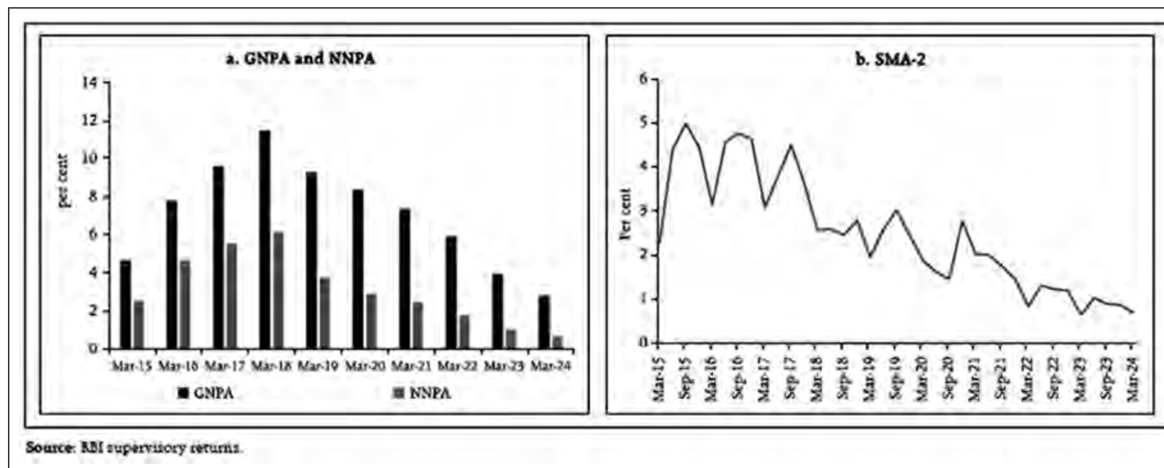
Overview

IBC in 2016 was a watershed legislation by India to provide a framework, for timely resolution of corporate insolvency for all stakeholders, especially with the aim to free capital of Banks locked in NPAs for improving credit flow to the economy. IBC has undergone periodical amendments to incorporate learnings for improving its effectiveness from a timeline & value realization perspective. The net effect of all such policy level interventions are clearly reflected in the decline in the NPA levels of the SCBs and growth in Bank credit. However, the ecosystem continues to be besieged with numerous challenges, which IBBI is seized with and actively working on addressing them with fresh enactments and process level changes. Legal pronouncements on the intricacies faced in resolving insolvency cases involving cluster of companies of Large Corporates both in India and abroad has established the grounds for specific amendments required in IBC, taking cues from UNCITRAL Model. In terms of innovations, taking inspiration from the success in other countries, a novel scheme of Pre-Packaged Insolvency Process (PPIRP) was introduced in 2021 for MSMEs. Similar innovation in legislation is being examined for an out of Court negotiated process through a Creditor Led Resolution Process (CLRP) mechanism. IBC has come a long way since inception but has to cover lot of ground before it can achieve status of a Model Code.

The Insolvency and Bankruptcy Code 2016 (IBC) was legislated with the objective of streamlining the resolution process for the NPAs besieging the Indian Banking System back then. Upon analysing the progress of the code since implementation, while the general view is that IBC has significantly transformed the debt recovery landscape in India, the creditors on the other hand harbour a grudge that they are often shortchanged in the process due to both procedural infirmities and inflated security values in the financial statements vis-à-vis ultimately realized amounts from them. IBC's overall impact must be appreciated in the context of the policy focus on addressing the economy-wide problem of bad loans of the lenders and positively impacting credit growth in the economy. Towards this end, let us first look at the economic data released by the regulator, which would validate the impact of IBC on the movement of NPAs in the Indian banking system.

Reserve Bank of India (RBI) Financial Stability Report of June 2024 highlights the positive

impact of IBC in terms of tremendous improvement in the asset quality of the SCBs over the years (March 2015 to March 2024). and the overall stress in the banking system, as reflected in the declining SMA-2 pool of assets in SCBs.

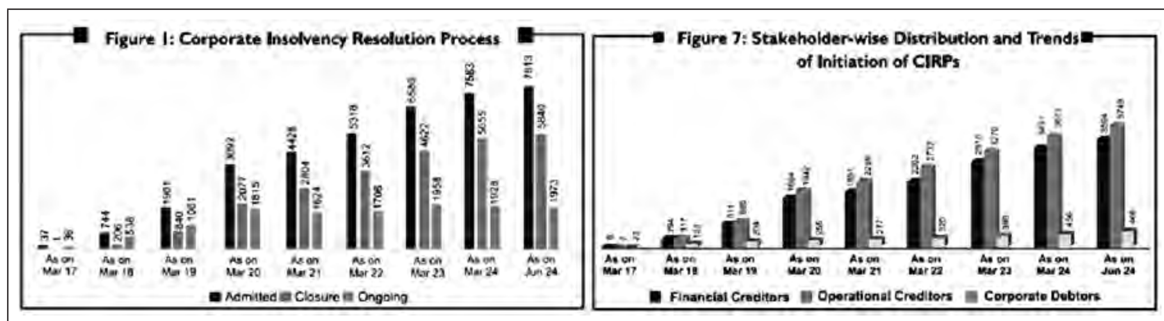


Source: RBI supervisory returns.

The GNPA ratio of SCBs moderated to a 12 year low of 2.80 in March 2024 and the corresponding figure of NNPA ratio was at the record low of 0.58 as at March 2024. Similarly, in the category of accounts with early warning signals, the ratio in SMA-2 category came down to a historically low level of less than 1% of aggregate advances of SCBs. While some improvement can be attributed to the accelerated write off by the lenders, but the RBI data clearly shows that the amount of write offs (on standalone basis) by the lenders have been declining substantially. In terms of value, investment grade advances (rated BBB & above) have increased to 91.30% of total externally rated funded advances to large borrowers (exposures ₹ 5.00 Cr & above). Bank credit has been showing robust growth q-o-q and has outpaced deposit growth during FY 2024.

Such data from the regulator's point of view reflects positive change in tangible terms, but there have been intangible benefits as well in the credit ecosystem. IBC outcomes have instilled a sense of discipline in the promoters/ management, for they now fear losing control of their companies in case of default. With NCLT admitting and adjudicating all cases, the fear of witch-hunting amongst the loan executives at the Banks (especially PSBs) has abated and is encouraging them to take reasoned decisions.

Coming to the statistics on cases resolved & recoveries under IBC, the Insolvency and Bankruptcy Board of India (IBBI), which monitors & regulates the progress of the resolutions under IBC/related ecosystem, in its latest newsletter (June 2024) has released the progress of IBC cases as given the table(s) below:



Since enactment, IBC has rescued 3293 CDs (1005 through resolution plans, 1096 by way of withdrawals and 1192 through settlements/appeal/review) and 2547 cases were taken into liquidation. As is evident, a very large number of CIRP cases (almost 44%) had to be taken into liquidation, which perhaps was due to preponderance of legacy cases/very old NPAs where asset values had eroded over an extended period. The resolved cases resulted in realization of ~32% of the admitted claims and more than 161% of the liquidation value. Of late, most of the resolutions were in the real estate projects due to measures introduced from time to time and conventions established by NCLT/NCLAT/SC judgements. Out of 1400 RE cases admitted into CIRP so far, 645 were resolved and 261 liquidated. The ratio of resolution vs liquidation in RE sector was 2.5, when compared to the ratio of 1.2 for overall CIRP cases so far. IBBI has dedicated its June quarter report to the successful resolution of RE assets, perhaps rightly so. In terms of initiation of CIRP, operational creditors (OC) have been the most active stakeholder group consistently since enactment. In a lighter vein, IBC has ended up providing OCs a negotiation tool to bring pressure on the management to settle their dues and not as much to initiate insolvency proceedings against the Corporate Debtor. IBBI's conclusion is that resolution plans on an average are yielding ~85% of the fair value of the CDs. This figure is, however, disputed by the creditor group in the light of high preponderance of PUFE transactions coming to light and with no effective provisions/mechanism for their voidance, the fair value computation of a CD itself is debatable as it is at present majorly dependent on tangible assets available. Even here, working capital lenders sulk that current assets (inventory & receivables) financed by them have virtually vanished and no proper mechanism exists for their retrieval.

Overall, it can be said from the policy planner's perspective that the objectives of the IBC have been by and large on anticipated lines. However, the variety & nature of issues that are brought up for legal intervention by the CDs, Operational Creditors, RP, Lenders (inter-se) and even statutory bodies; all contribute to delay of the process and effective value realization in the process. Frequent adjournments by NCLT benches also contribute to the overall delay. While addressing of such issues have been a work in progress since introduction of IBC, still a plethora of issues remain to be effectively addressed to prevent unnecessary litigation and smoothen the process. Listing a few of them for better appreciation:

a) CD disputing the debt and default at the admission stage & during early stages of CIRP, despite filing of valid documents and Information Utility (NeSL) issuing "Record of Default".

b) Lack of clarity on the interpretation of inter-se priority during distribution, where secured creditors are holding different level of charges.

c) Unattended issue of large operational creditors (capital goods & services) posing themselves as financial creditors (FCs) and staking claim and litigating up to SC stage.

d) Continued ambiguity on treatment of security interest created in favour of Central/State Govt./Statutory Bodies by a mere operation of statute needs to be addressed.

e) IBBI/IBC should further clarify on collection and collations of claims by RPs in the interest of fairness and attended litigations.

f) Requirement of re-initiation of CIRP by FCs, when FC's parallel CIRP application becomes infructuous, after CD settles against OC's CIRP application, which causes avoidable delay.

g) Manner of dealing with the intermingled assets of the CD and PG needs to be conjoined rather than being dealt with separately.

h) Clearer guidelines on identification & dealing with avoidance (PUFE) transactions at RP & NCLT levels and dealing with ED attachment orders & disposal of CD assets.

i) Increasing number of NCLT Benches/ Members further, in view of large backlog of cases.

j) Suitable amendments on group insolvency and cross border insolvency can effectively address the present state of prevailing confusion & delays/value loss.

An early policy level interventions by GoI, will result in faster resolution of cases for the lenders as they will develop faith in the capability of IBC for its effectiveness. With gradual reduction in timelines for resolution, the lenders stand to benefit in terms of lower capital engagement for provisioning requirements. This would have a net positive impact on growing the credit market in India. For the lenders, it would benefit them in the form of lower borrowing cost as in the revised scenario the risk premiums will fall, as in case of developed economies.

Many companies in India are part of a single promoter group, as result of which they are interconnected in terms of organizational, financial & operational matters. An analysis of IBC cases over the years, highlights that in certain industries like Real Estate & Infrastructure, these usually operate through project specific SPVs to contain risk at the project level only. Similarly, large corporate houses operate through a network of group companies for different business lines. However, borrowings are usually raised at the parent/holding company level and even if raised at the SPV level, lenders insist on collateralization by way of Group/ Holding parent guarantee or share pledge. This structure often leads to transmission of risk both ways between the parent/ holding company and the SPV/subsidiaries.

Such interlinkages often lead to most of the companies in the group being dragged into CIRP and that too on individual level with different RPs, making coordination a nightmare and in the process enormous loss in value for the stakeholders of all the companies involved. The situation becomes highly complex in the case of involvement of overseas subsidiaries of Indian companies. This issue became prominent in the Jet Airways Ltd. (JA) insolvency proceedings in India, when parallel insolvency proceedings were initiated by European creditors of JA in a Dutch Court seeking seizure of one of the JA Boeing 777 aircraft parked in Schiphol Airport in Amsterdam. The Dutch Bankruptcy Administrator petitioned NCLT for recognizing the insolvency proceedings in Netherland, which was later approved at the NCLAT level for a "Joint CIRP" under IBC. IBC framework is designed on the principle of dealing with the CIRP of a single economic entity on a "standalone basis" and lacks specific provisions for "Group Insolvency".

In the domestic scenario, currently the challenges are being resolved through rulings given by different Courts on clubbing of cases, a single RP for different group companies, monetary contribution by parent company etc. In the landmark case of Videocon group, NCLT had ordered for consolidation of almost all the group companies and in a way laid down the foundation and established the need for amendments to IBC for group insolvencies for companies incorporated in India. Once formally enacted, the mechanism will enable joint CIRP applications, synergy in information sharing, single Adjudicating Authority, single RP, creation of group creditors committee & coordination meetings; all of which will lead to faster resolution of cases.

IBC only offers two provisions that assist in cross-border insolvency disputes; that it empowers the Central Government to enter into bilateral agreements with other countries for purposes of enforcing the Code and empowers the adjudicating authority under the Code to issue a letter of request to a Court in a country with which an agreement has been entered into, to deal with assets situated in that country in a specified manner. The main difficulties foreseen in implementing any Cross Border Insolvency laws are: (i) Judicial Cooperation between Bankruptcy Courts of different jurisdictions and (ii) Determination of Centre of Main Interests (COMI). To overcome such hurdles, United Nations Commission on International Trade Law (UNCITRAL) in 1997 introduced a model law which provides legislative guidance for countries on cross-border insolvency. The four principles governing the model law are: (i) recognition (ii) access (iii) cooperation & (iv) coordination. The intent of the UNCITRAL was to come up with a broad framework to enable countries to mould their own insolvency laws in a modern, harmonized and fair framework for addressing the complex issue of cross border insolvency.

IBBI in 2018 constituted a "Working Group" (WG) for examining the model law and submit its recommendations for a comprehensive framework for dealing with group insolvency. The Working Group in its recommendations considered three key elements – framework for procedural coordination, substantive consolidation mechanism and rules for perverse behaviour of companies in a corporate group. It also submitted recommendations on the key aspect of identification of a group, extent of grouping etc. and suggested implementation in a phased manner.

With enormous growth in the average number of overseas corporate entities by Indian corporates it is imperative that a suitable framework is put in place urgently. However, the framework would require extensive discussions/negotiations on complex issues like: extent of applicability (giving precedence to domestic proceedings), legislative reciprocity (recognition/cooperation), national interest (access should not lead to abuse of law) & determination of COMI etc.; before it is introduced as law.

Various judgements on handling of domestic group insolvency cases have clearly established the necessity for expediting necessary amendments to IBC for dealing with domestic group insolvency cases under CIRP, which policy changes need to be expedited immediately; without waiting for closure of bilateral negotiations required for cross border action, and then undertake comprehensive amendment to IBC.

IBC in India is structured on the principle of "Creditor in Control" (CIC) as opposed to the alternative approach of "Debtor in Possession" (DIP). CIC approach is generally the norm in developed countries also, with the exception of USA, where the DIP approach is followed. During the IBC journey so far, a noticeable observation was that the CIC approach hands over the control of a CD to the RP, who are largely ill-equipped/lack competence to run a company, especially in cases involving complexities. It is the general impression that this lack of competence observed at the RP level is also in a large way responsible for inordinate delays and poor value realizations. A faction in the ecosystem strongly supports a DIP approach arguing that the existing management is in the best position to run the operations during the period of CIRP. Besides, in case of MSMEs, the shifting of control to RP often drags the company into closure with attendant loss in value of the CD assets. However, this proposition is vehemently opposed by the lenders group, due to their inherent lack of trust in the existing set of promoters/management's competencies/intentions after they being at the helm of affairs when the account turned NPA.

Drawing inspiration from US Bankruptcy Laws (Chapter 11 proceedings), IBC was amended in April 2021 to introduce CD initiated Pre-Packaged Insolvency Resolution Process (PPIRP) on the DIP concept for MSMEs, as an alternative to CIRP. Unlike the lengthy and financially draining processes involved in CIRP or bilaterally negotiated settlements lacking statutory backing & legal certainty; PPIRP was structured as a hybrid solution. Although it was hailed as a pathbreaking approach, PPIRP failed to generate desired results with only 5 cases having been decided so far with average recovery of 25% only, even worse than realization under CIRP. The resolution also exceeded more than 2 years in most of the cases with procedural flaws, lack of transparency, mistrust between CD & FC (Financial Creditor), questionable corporate governance standards, lender's hesitancy on haircuts etc. In essence, PPIRP has proven to be unattractive due to embedded hair cut expectation in the resolution approach, lack of decision-making framework at the lender's front, regulatory guidelines/forbearance on resolution approach, borrower's hesitancy in certifying that there is no avoidance transaction etc. Given the fact that MSMEs in India lack proper corporate governance standards and are invariably promoter/family driven businesses, together with questionable value of assets represented by financial

statements; PPIRP looks like a concept ahead of its times for the moment.

It was in the above backdrop that, IBBI floated discussion on the proposed mechanism of Creditor Led Resolution Process (CLRP), however, with a twist. CLRP envisages lender-initiated process but with CD in possession approach; objective being to have a formal out of Court negotiated process for addressing inordinate delays, both at the initiation & resolution plan stages. From what is coming out in public domain, lenders prefer a predominantly CIC approach (with suitable flexibility on exceptions for going in for DIP) and clear guidelines for examining and taking decisions on haircuts under the resolution plans. Unless all ambiguities are addressed prior to code amendment, its fate may end in line with that of PPIRP. Most important amongst them would be circulation of a comprehensive regulatory framework, for dealing with such cases by the lenders, to avoid allegations of impropriety at a later stage.

Overall, IBC has made its mark on the envisaged lines, by introducing proper mechanism for dealing with corporate insolvency measures and continues to evolve. The journey so far has highlighted procedural hiccups and need for legislative amendments and active discussions to usher in suitable changes for expediting resolution timelines and value maximisation for the lenders. With promoters realizing that the threat of losing control over their companies is very real under IBC, there would be more seriousness on their part to improve governance and work on building better trust with the lender group. While requirement for improvements in Indian IBC law, by benchmarking the provisions to laws of other developed economies, would be a forever process; the present IBC laws have heralded the right beginning and concern for continuous upgradation. Someday, India will, surely, be able to finetune the framework, when IBC may be quoted as a Model; very much how our UPI framework is currently admired world over. Till such time, the ecosystem needs to evolve, improve and ultimately resolve.

> "Hindu religion does not consist in struggles and attempts to believe a certain doctrine or dogma, but in realising — not in believing, but in being and becoming."
>
> — *Swami Vivekananda*

Insolvency and Bankruptcy Code 2016 - Impediments to its Robustness

Mr. Sumant Batra

Overview

On 15 August 2022, as the nation marked 75 years since independence from British rule, the Prime Minister Narendra Modi pledged, from the ramparts of the Red Fort, to turn India into a developed country in the next quarter-century. Reforms and policy initiatives in multiple areas are needed to achieve this grand target. Amongst these, India needs a robust insolvency system that ranks amongst the best in the world. In 2016, India introduced the Insolvency and Bankruptcy Code (IBC) paving way for a much-needed modern framework to deal with the insolvency and bankruptcy of corporate entities in India. The IBC moved forward in leaps and bounds in early years of implementation; many green shoots have already emerged in a very short span of time. While the speed with which the government has acted to enact and implement IBC is applaudable, many impediments continue to drag down IBC. Delays in particular have starting taking some sheen off an otherwise shining piece of legislation. No degree of substantive law improvement will make IBC robust without effective enforcement with speed and unless the essence and fundamental principles of insolvency are preserved by courts and the regulator. This paper highlights some key impediments which continue to impede the success of IBC.

In 1991, India stepped out of the shadows of socialism to step into the new world of capitalism. A number of changes were initiated aimed at supporting a free market economy. However, it took over 20 years to reform the exit laws, a critical component of a competitive market. In 2016, the Insolvency and Bankruptcy Code (IBC) was introduced as a much-needed reform in this area. The IBC enables the creditors and corporate debtor to trigger CIRP of a corporate debtor for resolution of stress when it has committed a threshold amount of default of ten million rupees and more. If an order of commencement of insolvency is passed by Adjudicating Authority (NCLT), corporate debtor (CD) moves from '*debtor-in-possession*' to '*creditor-in-control*' status. Its management and assets vest with an insolvency professional, who serves as resolution professional (RP), and runs CD as a going concern and conducts its CIRP. A committee of creditors (CoC) comprising of financial creditors[1] of CD is constituted

1. IBC, S5(7). "financial creditor" means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to.

   IBC, S5(8). "financial debt" means a debt alongwith interest , if any, which is disbursed against the consideration for the time value of money and includes money borrowed against the payment of interest, amount raised as under any acceptance credit facility, purchase facility, etc.

to evaluate options for its resolution and value maximization. The voting shares are then assigned to members of CoC based on the amount of debt owed to them. An alternate provision provides that CoC is formed with operational creditors[2] when CD has no financial debt or when all its financial creditors are related parties. The CoC has a statutory role; IBC entrusts it with the responsibility of unlocking valuable assets for their more productive use in the economy. Commercial decisions are left to the collective wisdom of CoC. It decides the fate of CD by approving a plan for resolution of its insolvency (resolution plan) or opting for its liquidation. The RP invites feasible and viable resolution plans from eligible and credible resolution applicants for resolution of CD's insolvency. If CoC approves a resolution plan within the stipulated time with a 66% majority in value, CD continues as a going concern. Distribution to be made to the creditors under a resolution plan is also decided by CoC taking into consideration the relevant provisions of IBC. This has been critical in establishing IBC as a credible bankruptcy resolution process[3]. All this is required to be done within a period of 180 days, with two extensions of up to 90 and 60 days each, to be sought by RP from NCLT, if decided by CoC. There are two other resolution processes for corporate entities which are available under IBC: Fast-track Corporate Insolvency Resolution Process[4], and Pre-packaged Insolvency Resolution Process (PPIRP)[5]. However, CIRP represents the primary formal procedure under IBC[6].

Implementation

It is increasingly recognised that in law-making a gap opens up between law on the books and law in action. The success of any law, therefore, depends on its implementation. Largely a sound piece of legislation, IBC had its own share of flaws at the time of its enactment[7]. It was expected to sail through rough currents created by implementation issues. India defied its past track record and surpassed all expectations in implementation of IBC. The year after year witnessed further consolidation of the new insolvency and bankruptcy regime. Initial revisions in IBC and its regulations were prompted by the snags experienced in the insolvency of the

2. IBC, S5 (20), An "operational creditor" is defined as any person to whom an operational debt is owed, including any person to whom such debt has been legally assigned or transferred". IBC, S5 (21) defines operational debt is a claim for the provision of goods or services, including employment, or a debt for the repayment of dues arising under any law for the time being in force and payable to the Central Government, any State Government, or a local authority.
3. See, 1. *Committee of Creditors of Essar Steel India Limited vs. Satish Kumar Gupta, (2020) 8 SCC 5311*.
   2. *Maharashtra Seamless Limited vs. Padmanabhan Venkatesh & Ors., (2020) 11 SCC 467*
   3. *Jaypee Kensington Boulevard Apartments Welfare Association & Ors. vs. NBCC (India) Ltd. & Ors., (2021) 5 SCC 12.*
4. See, IBC, Part II Chapter IV, S. 55 to 58.
5. See, IBC Part II Chapter III-A S.54A to 54P.
6. See, Framework Report on Creditor Led Resolution Approach in Fast-track Corporate Insolvency Resolution Process under the Insolvency and Bankruptcy Code, 2016, IBBI Expert Committee, May 2023. https://ibbi.gov.in/uploads/resources/ede9252b24c28166ea95602ca3c214b1.pdf.
7. Sumant Batra, Corporate Insolvency: Law and Practice (2017), Eastern Book Company.

twelve largest defaulter accounts[8]. The IBC witnessed 6 legislative interventions in the first 4 years since its enactment to strengthen the processes and further its objectives, in sync with the emerging market realities. Each of the amendments is a milestone on the road of insolvency reforms, reinforcing the primary objective of IBC, namely, rescuing the lives of companies. The IBBI has also made 102 amendments to its 18 regulations under IBC, out of which 22 amendments have been made from April 2022 to March 2023 alone[9]. The IBC has undoubtedly emerged to be one of the most dynamic economic legislations of recent times.

It has been nearly eight years since IBC came into effect in December 2016. We have enough data in hand to assess the impact, effectiveness and shortcomings of IBC. The outcomes have been encouraging. The IBC has triggered a cultural shift in the dynamics between lenders and borrowers, and promoters and creditors by shifting the balance of power from the borrower to the creditor. This metamorphosis is attributable not solely to the statutory framework, but also IBC's proficient execution[10]. It has instilled a significantly increased sense of fiscal and credit discipline to better preserve economic value[11]. Simplification of regulatory frameworks through reforms such as IBC has enhanced the ease of doing business[12]. The defaulter's paradise is lost.

Impediments in effectiveness

IBC has been hailed as one of the most important economic legislations in recent times, having reformed the much-needed revival as well as an exit mechanism for corporate entities. Yet, many impediments continue to hold back the effectiveness of an otherwise robust insolvency regime ushered in by IBC. Some of these are discussed below.

Delays in initiation, admission, and approval of resolution plan

Time taken by financial creditors for initiation of CIRP, and by Adjudicating Authority for admission of insolvency petition, and procedural delays in completion of CIRP and liquidation processes, continue to impact the outcomes under IBC and impede its objectives. A *bonafide* CD, seeking a genuine resolution of stress in business and financial situations, would be keen for an early resolution of the problem, with the cooperation of its creditors and other stakeholders. For making use of IBC, CD must wait for the default to occur before it can initiate CIRP. As IBC entitles the stakeholders to initiate CIRP only in the event

8. See, Sumant Batra, Jaypee Infra Insolvency Saga (2024), Om Books International.
9. Insolvency and Bankruptcy Board of India, Annual Report 2022-23 (New Delhi: Insolvency and Bankruptcy Board of India, 2023), https://ibbi.gov.in/uploads/publication/78358f458f7d24e182b28fa2fef55d9a.pdf.
10. See, Framework Report on Creditor Led Resolution Approach in Fast-track Corporate Insolvency Resolution Process under the Insolvency and Bankruptcy Code, 2016, IBBI Expert Committee, May 2023. https://ibbi.gov.in/uploads/resources/ede9252b24c28166ea95602ca3c214b1.pdf.
11. Understanding the IBC, Key Jurisprudence and Practical Considerations, A Handbook, International Finance Corporation, and Insolvency and Bankruptcy Board of India.
12. Insolvency and Bankruptcy Code (IBC): Whose Loss, Whose Gain? A Critical Analysis of Performance of Two Years of IBC. New Delhi: Centre for Financial Accountability, May 2019. https://cenfa.org/wp-content/uploads/2019/07/IBC-Report-Final.pdf.

of default in payment of debt[13]. Although a financial creditor has right to initiate a proceeding under IBC after a default of the threshold amount has been committed, it is not obliged to do so at the first available opportunity. It may defer the initiation of proceeding indefinitely[14]. Delay in initiating insolvency allows ballooning of default to unresolvable proportions[15]. There is merit in allowing trigger of CIRP on the likelihood of default, that is when insolvency of a corporate debtor is imminent, without waiting for default to occur, as is the law and practice in many advanced insolvency systems.

Where petitioned for initiation, admission of application by NCLT may take time due to procedures to be followed, and the state of NCLT's institutional capacity at the given time[16]. It can take over a year for admission of insolvency petition to commence the CIRP in certain instances[17]. The delays for CIRP closure are higher compared to liquidation across various categories of stakeholders[18]. The delays associated with the CIRP and liquidation have adversely affected the outcome of resolution and liquidation process, resulting in value depletion and diminished stakeholder confidence in the system[19]. When the company is not in the pink of its health, prolonged uncertainty about its ownership and control may make the possibility of resolution remote, impinging on economic growth.

Liquidation as a last resort?

A sound insolvency system must promote ease of exit, wherever required. It should enable optimum utilisation of resources, all the time, either by ensuring efficient resource use within the company through resolution of insolvency; or releasing unutilised or under-utilised resources for efficient uses through closure of the company[20]. Therefore, it should allow the creditors to liquidate the enterprises at the earliest if its resolution is not feasible.

13. S. 7 of IBC allows a financial creditor to initiate, by himself or jointly with other financial creditors corporate insolvency resolution process against corporate debtor, where there is default in payment of financial debt; ‘financial debt' has an inclusive definition given under S. 5(8), which defines it as a debt along with interest, if any, which is disbursed against the consideration for the time value of money. S. 3(12) of IBC defines default as “non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not repaid by the debtor or the corporate debtor, as the case may be”.
14. See, Report of the Working Group on Tracking Outcomes under the Insolvency and Bankruptcy Code, 2016, IBBI, November, 10, 2021.
15. See, Report of the Working Group on Tracking Outcomes under the Insolvency and Bankruptcy Code, 2016, IBBI, November 10, 2021.
16. Until recently, Adjudicating Authority has rarely functioned at its full capacity due to time taken in filling the vacancies of judicial and technical and members.
17. Insolvency and Bankruptcy Board of India. "Framework Report on Creditor-Led Resolution Approach in Fast-track Corporate Insolvency Resolution Process by the Expert Committee." May 2023. https://ibclaw.in/framework-report-on-creditor-led-resolution-approach-in-fast-track-corporate-insolvency-resolution-process-by-the-expert-committee-may-2023/?print=pdf.
18. RBI's dirty dozen list: Legal wrangle at NCLT cost banks Rs. 25,000 crore, says report - Business Today -June 18, 2018. https://www.businesstoday.in/current/economy-politics/rbi-dirty-dozen-list-legalwrangle-nclt-cost-banks-rs-25000-crore/story/279266.html.
19. Insolvency and Bankruptcy Board of India. “Corporate Insolvency Resolution Processes Yielding Resolution Plans: as on 31st December, 2023.” Last modified December 31, 2023. https://ibbi.gov.in/en/claims/cd-summary.
20. See, Report of the Working Group on Tracking Outcomes under the Insolvency and Bankruptcy Code, 2016, IBBI, November, 10, 2021.

The IBC permits financial creditors of corporate debtor to take this decision at any stage of insolvency process[21]. However, the Supreme Court has interpreted IBC objectives as that of resolution; liquidation being the last resort, and all efforts to resolve the corporate debtor's insolvency should be explored before the debtor is put to corporate death[22]. Due to this view taken by Supreme Court, insolvency process for a corporate debtor under IBC proceeds in two phases—in the first phase, an attempt is made to resolve corporate debtor's default through a CIRP; only if no resolution is reached, the corporate debtor is liquidated in the second phase. As a result, even in cases where it is apparent to RP and CoC that liquidation is the only inevitable fate of corporate debtor to maximise the value of assets, they often run the entire resolution process including process of inviting plans before the liquidation of corporate debtor eventually starts. This kicking of the can of decision down the lane, erodes the value of the corporate debtor further, particularly when corporate debtor is not a going concern. It incurs avoidable costs during an unproductive CIRP. For a market economy to function efficiently, the process of creative destruction should drive out failing, unviable companies at the earliest. An early exit should be available for companies destined to be liquidated from the '*chakravyuha*[23]' of unsustainable business or with idle assets and no business. Where an enterprise is not viable, the main thrust of the law should be swift and efficient liquidation to maximize recoveries for the benefit of creditors. Liquidations can include the preservation and sale of the business, as distinct from the legal entity. On the other hand, where an enterprise is viable, meaning that it can be rehabilitated, its assets are often more valuable if retained in a rehabilitated business than if sold in a liquidation[24].

Short-changing operational creditors

The IBC has faced criticism for being lopsided in favour of financial creditors and ignoring the interest of operational creditors (OC). An OC can file a petition for insolvency against a CD, and has a right to file its claim with RP during the process; however, does not have the right to be on the CoC as it comprises of financial creditors only. OC gets representation in meetings of CoC (through a representative), only if the total dues of OC are 10% or more of the total aggregate debt of corporate debtor. A resolution applicant is legally bound to pay to OC only liquidation

21. See, IBC, S. 33(2) allows the committee of creditors to, at any time during the corporate insolvency resolution process, but before confirmation of resolution plan, to decide, by not less than sixty-six per cent. of the voting share, to liquidate the corporate debtor, and inform the Adjudicating Authority which shall pass a liquidation order.

22. *Swiss Ribbons Pvt. Ltd. vs Union of India, 2019 (4) SCC 17.*

23. Chakravyūha (Sanskrit: चक्रव्यूह) is a military formation used to surround enemies, depicted in the Hindu epic Mahabharata. It resembles a labyrinth of multiple defensive walls. knowledge of how to penetrate it was limited to only a handful of warriors on the Pandavas' side, namely: Abhimanyu, Arjuna, Krishna and Pradyumna, of whom only Abhimanyu was present when the Kauravas used it on the battlefield.

24. Hybrid Insolvency Resolution Process. Insolvency Law Academy, 2024. [https://insolvencylawacademy.com/wp-content/uploads/2024/08/hybrid-insolvency-resolution-process-v3.pdf] [https://insolvencylawacademy.com/wp-content/uploads/2024/08/hybrid-insolveny-resolution-process-v3.pdf].

value of debt[25]. Unsecured OC gets paid only a fraction of its debt, sometimes not even that. In US, trade creditors are treated as unsecured creditors. Unlike under IBC, they have the right to participate in a bankruptcy case through official committees of unsecured creditors, which represent the interests of all unsecured creditors. One of the original concepts of insolvency law was that a debtor needed to pay certain vendors who were the "sole source" of a key good or service[26]. If the payment were not made, such a vendor, if it were sufficiently dependent on the debtor, might go out of business. If the vendor is an MSME, it only aggravates the problem for such vendor. Indian MSMEs contribute more than 29 per cent to country's GDP. They are responsible for 50 per cent of country's total exports. They employ more than 11 crore (110 million) people[27]. The sector contributes significantly to the economic and social development of the country by fostering entrepreneurship and generating large employment opportunities at comparatively lower capital costs, next only to agriculture. Their distress can cause a cascading effect on economy.

Disruption in priority rules

The distribution of assets is the penultimate and the most awaited event for the stakeholders[28] of CD. An orderly distribution is necessary to provide certainty to the creditors regarding their rights created in the commercial arrangements. The UNCITRAL Legislative Guide on Secured Transactions[29] states that the concept of priority is at the core of every successful secured transaction regime. Clear priority rules are critical in providing predictable outcomes in any competition between claimants to the encumbered assets. The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes[30] also emphasize the importance of recognizing the priorities held by creditors in

25. IBC, S. 30(2).
26. *In re CoServ, LLC, 273 B.R. 487, 498-501 (Bankr. N.D. Tex. 2002)* (analyzing various arguments for the payment of prepetition claims of certain vendors, including that certain vendors would be unable to continue business absent payment and other vendors were sole source suppliers).
27. See, Annual Report 2022-2023, Ministry of MSME.
28. Sumant Batra, Corporate Insolvency Law and Practice, Chapter 30 Distribution page 517.
29 UNCITRAL Legislative Guide on Secured Transactions, United Nations Publication Sales No. E.09.V.12 ISBN 978-92-1-133675-7 para 1, page 185.
30. The World Bank Principles were originally developed in 2001 in response to a request from the international community in the wake of the financial crisis of the late 1990s. At that time, the principles constituted the first internationally recognized benchmarks to evaluate the effectiveness of domestic creditor/debtor rights and insolvency systems. Based on the practical experience gained from using of the principles, and following extensive consultations, the principles have been revised in 2005, 2011 and 2015. While the 2005 revisions grouped the principles under relevant headings to provide a streamlined approach, the 2011 revisions incorporated the updates made to the UNCITRAL Legislative Guide on Insolvency Law. In this regard, two new Principles (C16 and C17) were added to reflect best international practice in the regulation of the insolvency of enterprise groups. In 2015, changes were made to the World Bank Principles, which highlight the relationship between the cost and flow of credit (including secured credit) and the laws and institutions that recognize and enforce credit agreements. In this regard, World Bank Principles dealing with Registries and Enforcement mechanisms got addressed in a more detailed manner in the 2015 draft.

their security interest[31]. The IBC recognizes the inter-se priority of payments, including inter-se priorities amongst the creditors in the same class (secured creditors) in the matter of distribution under S. 53(1) (waterfall mechanism) and sub-section (4) of S. 30. However, certain court decisions have caused disruption in the understanding of established priority rules, even though in Committee of Creditors of ***Essar Steel Limited vs. Satish Kumar Gupta 2019 SCC Online SC 1478,*** the Supreme Court had clarified the position of law aligned with global standards. Noting the ratio of the judgment in ***Essar Steel Limited (Supra)***, IBBI summarized on its website that equitable treatment is to be accorded to each creditor depending upon the class to which it belongs: secured or unsecured, financial or operational. However, the decision of Supreme Court in ***State Tax Officer vs. Rainbow Papers Limited 2022 SCC Online SC 1162***, holding that GST Authority is a secured creditor under the GVAT Act and security interest can be created by operation of law shook the foundation of IBC. While enacting IBC, the policymakers had made a clear choice to subordinate government dues to debt of financial creditors; the judgment reversed the policy without holding it being bad in law. Later, in ***India Resurgence ARC Private Limited vs. M/s. Amit Metaliks Limited & Anr. (2021) 6 SCC 458***, while deciding the entitlement of dissenting financial creditors, the Supreme Court held that the intent of the legislature is to provide liquidation value of debt held by such creditor and not the value of security interest. This matter is now referred to a larger bench of the Supreme Court causing further anxiety in already troubled CIRP processes. In countries where court-ordered foreclosure is costly and inefficient, often creditors are reluctant to grant secured credit because they realize that the market value of the collateral will have depreciated dramatically during the long period it takes to get the collateral sold pursuant to a court order. Investment in emerging markets is discouraged by the lack of well-defined and predictable risk allocation rules and by the inconsistent application of written laws. The inability to predict downside risk can cripple markets. This effect can impinge on other risks in the country, causing lender reluctance even toward untroubled borrowers.

31. A7. Enforcement of Rights over Immovable Assets

§ Enforcement systems should provide efficient, cost-effective, transparent and reliable methods (including both judicial and non-judicial) for enforcing a security right over immovable asset.

§ Enforcement proceedings should provide for prompt realization of the rights obtained in secured assets, designed to enable recovery in a commercially reasonable manner.

§ The proceeds should be distributed according to the priority rules of the applicable substantive law.

A8. Enforcement of Security Rights over Movable Assets

§ There should be efficient, cost-effective, transparent and reliable methods (including both judicial and non-judicial) for enforcing security rights over movable assets.

§ Enforcement proceedings should provide for recovery of possession of the encumbered asset, the possibility of proposing the acquisition of the asset by the secured creditor in total or partial satisfaction of the secured debt, and the prompt realization of the value of the encumbered asset, in good faith and in a commercially reasonable manner.

§ The proceeds should be distributed according to the priority rules of the applicable substantive law.

An unrealistic pre-pack process

The PPIRP[32] has failed to catch the imagination of the Indian market. Specifically tailored for MSMEs, PPIRP is led by CD and involves the formulation of a base resolution plan in an informal setting, with which external bidders can compete subsequently, through a Swiss challenge. There are many reasons for lack of traction by PPIRP. PPIRP is available only to MSMEs incorporated as companies or limited liability partnerships. In India, by definition, MSME is small in size and scale. It mainly operates informally. For a variety of reasons, promoters of MSMEs forgo formal incorporation or registration of their enterprise and operate without limited liability, a practice particularly common in developing economies. The mass of MSMEs thus, do not have access to PPRIP. Although touted as a hybrid procedure, it is not a combination of an out-of-court resolution and a formal process, but nearly a formal process micromanaged by rules and regulations, throughout[33]. The key elements of prepacks, that is, cost and time efficiency, are lost in the rigors of the procedure required to be followed for initiation of the process and approval of plan in PPIRP. The PPIRP has ended up being a court-driven process exposing it to procedural delays similar to CIRP. Adjudicating Authority is involved at each step[34], causing unnecessary delay and interference, defeating the purpose of introducing PPIRP as an alternative to CIRP. The current status of the pending PPIRP cases highlights the difficulty in meeting the prescribed timeline[35].

Unscrupulous promoters versus bonafide entrepreneurs

IBC has served as a credible threat of taking away control from the hands of current promoters/management in the event of default. It has instilled a significantly increased sense of fiscal and credit discipline to better preserve economic value[36]. Unfortunately, IBC does not create any distinction between a *bonafide* debtor who may have defaulted for reasons beyond its control, and a dishonest promoter who may have pushed the debtor into insolvency and has no intention to pay its creditors despite the ability to pay. Both would suffer the same legal consequences in the event of default. Inability to pay debt invites the same consequence as the unwillingness to pay. It is time to take benefit of this behavioural change and make hybrid resolution process, based on a 'debtor in possession', but 'creditor in control' model available for *bonafide* debtors who have not lost the confidence of the creditors, or where the trust deficit between the debtor and creditors can be bridged by debtor taking corrective measures. This building on the behavioural changes experienced in the last

32. See, IBC Part II Chapter III-A S.54A to 54P.
33. Insolvency and Bankruptcy Board of India (Pre-packaged Insolvency Resolution Process) Regulations, 2021. New Delhi: Insolvency and Bankruptcy Board of India, 2021. https://ibbi.gov.in/uploads/legalframwork/2965a9ffb18b4b626c81734a189882da.pdf.
    Insolvency and Bankruptcy (Pre-packaged Insolvency Resolution Process) Rules, 2021. New Delhi: Ministry of Corporate Affairs, 2021. https://ibclaw.in/insolvency-and-bankruptcy-pre-packaged-insolvency-resolution-process-rules-2021/.
34. IBC, S. 54A-54L
35. Ibid
36. Understanding the IBC: Key Jurisprudence and Practical Considerations, A Handbook. New Delhi: International Finance Corporation and Insolvency and Bankruptcy Board of India, 2023. https://ibbi.gov.in/uploads/whatsnew/e42fddce80e99d28b683a7e21c81110e.pdf.

nearly eight years will be a formidable sign of a maturing free market economy.

Adversarial Proceedings

Insolvency resolution under IBC is not an adversarial process, yet implementation-wise, it has become litigious in India. This is primarily due to multiple contentious issues brought before NCLT for resolution by parties such as the CD, creditors, including financial creditors and OC alike, members of CoC, and at times, the appointed RP for the conduct of CIRP. Third parties filing applications under S. 60(5) of IBC also contribute to the proliferation of litigation during CIRP. Thus, this creates several systemic bottlenecks and leads to cascading delays in the resolution process and increasing pendency. In terms of efficient systems and the delivery of robust outcomes in insolvency cases, other jurisdictions have benefited from the adoption of alternate dispute resolution mechanisms under their respective insolvency laws[37]. Noticeably, the introduction of a non-adversarial approach helps in maintaining cordiality in business relationships and saves CD from the stigma of insolvency while resolving conflicting interests through amicable settlement. Mediation can be widely used in pre-insolvency and out-of-court insolvency processes particularly, including in hybrid procedures that have developed in recent times. This will add to the efficiency of resolution under the proposed hybrid procedure.

Endnote

The enactment of IBC was a watershed moment for recovery of distressed business enterprises in India. Over the past nearly eight years, IBC has continued to support the *'ease of doing business'* in India and its stated strengths of facilitating easy exit with time-bound resolutions for corporations have aided the financial system absorb external spillovers, tightening global financial conditions and high volatility in financial markets[38]. Progressively, the law and practice of IBC in India have matured to focus on entire value chains. It has sought to address enterprise sickness and facilitate insolvency resolution through 'creditor-in-control' model and collective deliberation process within statutory timelines. However, despite significant improvement in insolvency resolution outcomes over seven years of its implementation[39], IBC processes are still time-consuming, adversarial, and resource-intensive. India aspires to become the third-largest economy in the world by 2027, and a 'developed country' by 2047. To become a developed nation, reforms are required in various areas which have long been hamstringing India. Futuristic and visionary policies will have to be formulated at multiple levels. To support these goals, India needs a robust insolvency system that ranks amongst the best in the world. The impediments standing in the way of IBC's robustness need to be addressed by institutional reforms.

37. This Report in Chapter IV and Annexure III briefly discusses select jurisdictions where mediation forms part of respective insolvency regimes, as noted and discussed by the Committee.
38. The Economic Survey of India 2022-2023. New Delhi: Ministry of Finance, 2023. https://www.indiabudget.gov.in/economicsurvey/doc/echapter.pdf. Last accessed November 11, 2023.
39. Para 4.30, The Economic Survey: "As per the RBI data, in FY 22, the total amount recovered by SCBs under IBC has been the highest compared to other channels such as Lok Adalat's, SARFAESI Act and DRTs in this period."

Making Insolvency and Bankruptcy Code more effective: A Roadmap for the Future

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Overview

This article intends to examine the efficacy of the Insolvency and Bankruptcy Code and its journey over the years. This piece further explores the intent of the code and how it has ventured into an arena of revival of stressed businesses, recovery for lenders, and maximising value for stakeholders while laying down a formalised framework for liquidation proceedings. This article further aims to analyse the challenges and loopholes in the code and provides suggestions that can be implemented to make the legislation more progressive and well-rounded. The article seeks to comprehensively balance the law and its realities in the Indian marketplace.

Introduction

Bankruptcy laws can be seen as crucial enactments as they help in revival along with speedy and successful resolution for businesses in financial distress. A law of this nature serves as an initiative-taking legislation, especially in India, a developing economy poised for growth. The main goal of enacting the insolvency law was to precipitate confidence and trust in the enforcement of contracts in our country, which directly enhanced the 'ease of doing business'. The law also establishes a framework to curb and limit debt burden, maximising the asset value, rehabilitating stressed businesses, and efficiently repaying stakeholders by balancing their interests. With these objectives in mind, the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as '**the Code/IBC**') was enacted, marking a notable change to the philosophy of debt restructuring and recovery process in India. After eight years of implementation of IBC, it is now time to mull over its' progress, analyse the learnings and lay down a high-level road map for improvements in the code. In this article, the authors aim to explore the specific shortcomings of IBC and, consequently, provide solutions to counteract them in order to attain impactful improvements. Here, it may be worthwhile to underscore that IBC is a work-in-progress legislation, and public input and engagement are vital for its continuous improvement.

Implementation of IBC and its journey

As noted above, the IBC was enacted to reform the insolvency mechanism and resolve the challenges arising from the existing laws. A progressive, business-oriented solution is engraved as one of the primary ethos of the Code. IBC, in an undoubtful manner,

consolidated the laws in relation to insolvency, which was crippling with impediments such as multiplicity of laws and counterproductive proceedings. The Code, to a large extent, aided in reviving distressed businesses by providing an opportunity for rehabilitation in a timely manner and ensuring that liquidation is seen as a last resort measure. Ergo, the introduction of IBC has created a sense of trust in the banking and financial ecosystem and has elevated the tribunals and courts into a new pedestal of maturity[1].

In a short span of eight years, IBC has brought about various positive developments in the economy. A recent press release by the Insolvency and Bankruptcy Board of India (hereinafter referred to as **'IBBI'**) shows that the Gross Non-Performing Assets have reached a 12-year low of 2.8% with Net Non-Performing Assets at only 0.6%. Moreover, as per a recent press release published by the Ministry of Corporate Affairs, it has been noted that post successful resolution, the average total assets of the revived companies saw a significant increase of 50%. Further, a 130% increase in capital expenditure has also been noted, thereby portraying a healthy state of the economy. Significantly, in the fiscal year 2022-23, 271 cases were successfully resolved through the IBC ecosystem[2].

However, although the IBC functioned as a significant reform in the country, it still had its fair share of controversies. RBI Governor Shaktikanta Das and the Parliament's Standing Committee on Finance have also flagged these concerns, emphasizing the need to reform the IBC to enhance its effectiveness[3]. The Standing Committee report on the implementation of IBC points to delayed processes, with 71.3% of the cases taking more than 180 days to be resolved[1]. The intent of the IBC was to provide a fast-track mechanism for insolvency resolution through a streamlined and timebound process; however, in practice, inordinate delays often creep in. The Standing Committee report also sheds light on the haircuts to the creditors, some as high as 95%. Further, in a 2023 report published by the IBBI, only 20% of the resolved firms could retain their key management personnel, and over 40% of these firms could obtain favourable terms from creditors[5]. It is perhaps worth questioning whether IBC has guaranteed the success it initially sought to achieve and what further steps could enable IBC to attain its objectives effectively.

Major challenges for IBCs

It is amply clear through various research studies that despite the remarkable attempt to compile the insolvency resolution mechanisms,

1. 'IBC: Idea, Impressions and Implementation 2022' by Insolvency and Bankruptcy Board of India of 2022.
2. Press Release by PIB Delhi, Ministry of Corporate Affairs dated 02 Oct 2024. https://pib.gov.in/PressReleasePage.aspx?PRID=2060974#:~:text=Citing%20the%20Reserve%20Bank%20of,IBC%20on%20the%20Indian%20economy
3. 'Delays in IBC erode value of assets, says RBI governor Shaktikanta Das' by Business Standard dated 11 Jan 2024. https://www.business-standard.com/economy/news/delays-in-ibc-erodes-value-of-assets-says-rbi-governor-shaktikanta-das-124011100928_1.html
4. Thirty Second Report- Standing Committee on Finance dated August 2021.
5. 'Report Study on Effectiveness of the Resolution Process: Firm Outcomes in the Post-IBC Period' by Indian Institute of Management Ahmedabad dated August 2023.

a gap exists between how legislation may function theoretically and how it applies to complex practical circumstances. Legislations are often imperfect, and, in these instances, it becomes imperative for drafting committees to take cognizance of the challenges in the law along with the law laid down by the Apex Court and aim to rectify any discomforts as soon as possible. Like several other laws in the country, the Code has posed unmissable hurdles in its effective implementation. It would be reasonable to assume that IBC, being in the first decade of its enactment, may need to undergo various amendments and additions for it to be an infallible framework.

Concerns in the effective implementation of IBC

- ***Has IBC evolved as a complete Code?:*** The primary distinction between an act and a code is the specificity that it aims to achieve. A code is seen as a broad legislation that imbibes principles and codifies existing legislations, whereas an act is narrower in nature dealing with a specific area of law. IBC, being a code, comprises various principles for insolvency resolution due to the comprehensive character of the Code. However, in many situations, it is seen that other laws are relied upon by stakeholders for their individual interests and that has reduced the effectiveness of the Code. The case of ***Rainbow Papers***[6] is one such example, wherein the court has classified government dues to have priority which is against the laid principle in the preamble of IBC. Moreover, the courts have ventured into complex issues such as employer-employee differences[7], social welfare legislations viz. provident fund[8], gratuity issues, contractual issues etc, by ignoring the principle that all such issues ought to have been decided based on the concept that IBC is a complete Code in itself[9]. There should be a constant endeavour to only rely on a process under IBC itself instead of relying on secondary laws. This would in turn provide the utmost clarity and certainty on the interpretation of the Code.

- ***Significant delays in the recovery mechanism:*** Approaching final resolution in many Corporate Insolvency Resolution Processes (hereinafter referred to as **'CIRP'**) has become increasingly difficult for corporate debtors. The delays are attributable to non-adherence of the prescribed timelines under the Code. In a defined process in which time is of the essence for salvaging the value of a financially distressed entity, inordinate delays caused by several technical or practical difficulties could impede the effectiveness of the entire process and, in particular, the value

6. Civil Appeal No. 1661 of 2020.
7. *SBI v. Moser Bear Karamchari Union, 2023 SCC OnLine SC 140.*
8. *Anuj Bajpai v. EPFO, 2024 SCC Online NCLAT 886.*
9. *Narendra Singh Panwar v. Pashchimanchal Vidyut Vitran Nigam Limited and Others, Writ – C No. 26355 of 2022.*

that can be protected. The variety of reasons include procedural delays, disputes amongst the participants in the Committee of Creditors (hereinafter referred to as **'CoC'**) and a clear stream of judicial oversight by way of poorly numbered NCLT benches under the IBC framework. Further, overburdening Tribunals and Appellate Tribunals through litigations by promoters, unsuccessful resolution applicants, erstwhile management or promoters of the company, employees and other third parties have increased these delays. Therefore, the primary cause of delay in most cases is identified as frivolous, ill-motivated and often irresponsible litigations initiated at the behest of various stakeholders with vested interests and even third parties, which are often ghost litigants. These unwarranted and repetitive litigations put an unnecessary burden on the National Company Law Tribunals (hereinafter referred to as **'NCLT'**) and National Company Law Appellate Tribunals (hereinafter referred to as **'NCLAT'**) during the pendency of which, in most cases, the resolution process comes to a complete halt which may make the commercial viability of any resolution plan entirely obsolete. These delays further lead to significant value erosion and asset stripping[10].

- ***Efficacy of the Pre-Pack mechanism:*** In 2021, the Pre-Packaged Insolvency Resolution Process (hereinafter referred to as the **'PPIRP'**) was launched, which intended to revive the Micro, Small and Medium Enterprises (hereinafter referred to as **'MSME'**) sector[11]. This amendment intended to aid and empower the MSME sector in order to promote insolvency resolution processes and consequently, help them enter a phase of rehabilitation. The amendment was aligned with the objective of boosting entrepreneurship. However, the promoters of MSME insolvent companies are hesitant to opt for PPIRP due to the fear of immense scrutiny and its inherent lack of viability[12]. Statistically, since the initiation of the PPIRP mechanism, the resolutions have been tepid, with only five approved cases, which can be termed as only 25% realisation of the admitted claims[13]. These setbacks have made PPIRP commercially unsustainable and, therefore, needs a re-look to make it workable.

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10. 'Anything that can go wrong may have gone wrong with IBC' by Fortune India dated 15 Feb 2024. https://www.fortuneindia.com/opinion/anything-that-can-go-wrong-may-have-gone-wrong-with-ibc/115807
11. The Insolvency and Bankruptcy Code (Amendment) Act, 2021.
12. 'MSME pre-pack process sees limited effectiveness, says IBBI report; suggests steps to enhance adoption' by Financial Express dated 7 Oct 2024. https://www.financialexpress.com/business/sme/msme-pre-pack-process-sees-limited-effectiveness-says-ibbi-report-suggests-steps-to-enhance-adoption-among-msmes/3633100/
13. 'Strengthening IBC: Extend prepack to big companies, says industry' by Business Standard dated 26 Jul 2024. https://www.business-standard.com/economy/news/demands-to-strengthen-ibc-pre-pack-for-large-firms-124072501333_1.html

- ***Are haircuts a concern?:*** The introduction of IBC has been a welcome step for all market participants in the commercial ecosystem as it promised better recovery for creditors and promoted entrepreneurship through successful insolvency resolution of debt-ridden companies. However, in reality, there are huge haircuts in recoveries even under the IBC ecosystem wherein the same has reached over 73% as of the fiscal year 2024[14]. The direct impact is that the creditors receive only a fraction of what they are owed through the resolution process. However, considering the predecessor statutes, where successful resolution processes were rarely undertaken, and value erosion was 100%, IBC still holds hope. Despite the haircuts, IBC promises higher resolutions of distressed businesses and recouping of available value for productive purposes in the best possible manner, and the same is worth an applause.

- ***Lack of manpower and infrastructure:*** Currently, the NCLT only has fifteen benches, whereas certain benches, like Chandigarh and Guwahati, have a territorial nexus of multiple states. The judge strength for NCLTs currently is thirty-nine, whereas the sanctioned limit for judges is sixty-three[15]. Most NCLT benches are often burdened with adjudicating across multiple benches. With the increasing number of insolvency cases, it can be asserted that the NCLT is not fully equipped with the required manpower to handle the bulk load of cases, extending proceedings beyond the mandated timeline. A similar scenario is seen before the appellate authority as well. The delay in adjudication of appeals due to insufficient resources either causes an entire halt in the CIRP and liquidation process or makes the appeals infructuous when they come up for hearing.

- ***Overlapping legislation and jurisdictional issues:*** Despite the express mandate for the primacy of provisions under the Code, in practice, several issues show up during the CIRP and liquidation processes, leading to overlapping legislative and jurisdictional issues. Pursuant to the same, multiple disputes may arise under distinct legislative mechanisms, thereby increasing the financial burden manifold. These conflicts arise under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (2002) (hereinafter referred to as **'SARFAESI'**), the Prevention of Money Laundering

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14. 'Creditors' haircuts in bankruptcy cases jump to 73 pc in FY24, resolutions taking longer: Report' by The Economic Times dated 17 May 2024. https://economictimes.indiatimes.com/industry/banking/finance/creditors-haircuts-in-bankruptcy-cases-jump-to-73-pc-in-fy24-resolutions-taking-longer-report/articleshow/110210505.cms?from=mdr
15. '15 new judicial and technical members appointed for NCLT benches' by Business Standard. https://www.business-standard.com/article/economy-policy/govt-increases-capacity-of-nclt-appoints-15-new-members-at-tribunal-122110901320_1.html

Act (2002), the Income Tax Act (1961), employee welfare legislation and contract law issues. A similar issue had come up for consideration in the case of ***Sundaresh Bhatt vs. Central Board of Indirect Taxes & Customs***[16] wherein an overlap of the IBC and Customs Act was discussed. Moreover, other statutory and governmental bodies also raise technicalities regarding the conflict of the respective laws, which generally lead to unwarranted delays. This further leads to insolvency resolutions being overburdened by the multiplicity of litigations, discouraging resolution applicants from entering into a value-maximised resolution plan.

- ***Insolvency resolution for non-corporates:*** It is also pertinent to note that the insolvency resolution process for limited liability partnerships, sole proprietorships, individuals, trusts and societies is yet to be notified. In terms of the present provisions of the Code, the Debt Recovery Tribunal (hereinafter referred to as **'DRT'**) has jurisdiction upon being notified of the same. Due to excessive litigation pending before DRTs, the system is clogged. As can be seen from the scheme of the IBC, it envisages a systematic approach towards individual insolvencies, which, upon notification, can be merged with the pre-existing NCLT mechanism. It is essential to incorporate partnerships in this scheme and imbibe processes regarding technological advancements from the learning in NCLT. It can even be considered that the jurisdiction of DRT can be entirely conferred to NCLT. This is a critical need considering the fact that the notification in the matter is delayed even after eight years of the Code. For the NCLT to perform the function of DRT, a coordinated arrangement will be needed between the Ministry of Corporate Affairs and the Ministry of Finance as the two forums operate under separate ministries.

- ***Procedural defects in the code:*** Insolvency resolution and liquidation must be business-oriented and commercially driven. Various cases are often raised before the NCLT, which touches upon each aspect of the CIRP, leading to extensive delays in adjudication. The overarching implication of this is the inevitable delay in the insolvency proceedings. Such proceedings, if relevant, should be adjudicated through an appropriate alternative dispute resolution mechanism to ensure compliance with timelines under the Code.

Next generation of reforms in IBC

IBC is undoubtedly an effective tool in bankruptcy mechanisms. However, reaching to a holistic pedestal of effectiveness, would only be possible if certain glaring challenges faced by the Code are met with fruitful solutions. The last eight years of IBC show that amendments were frequent in the beginning to redress the concerns, but of late, such initiatives have turned silent. One such amendment was introduced in 2021, which

16. Civil Appeal No. 7667 Of 2021.

introduced the PPIRP[17]. Though helpful to a large extent, these amendments have not fully curbed all the loopholes within the Code. There is a significant potential for issues within IBC to be eliminated through amendments and clarifications, which can further enhance the effectiveness of the Code. It is imperative to list specific viable solutions that can be imbibed within IBC to ensure enhanced success in terms of bankruptcy mechanisms.

Key steps that can be undertaken to make IBC more impactful

- ***Need for technological advancements:*** In India, technological advancements have been on the rise, especially with new developments such as the introduction of Artificial Intelligence. These advancements are not limited to software changes but have also seen light in Indian laws such as the Income Tax Act,1961. The Faceless Assessment mechanism under the income tax laws is one such landmark innovation. A similar mechanism can be introduced under the Code to streamline the process and minimise value diminution along with other changes, such as a simplified e-filing mechanism.

- ***Multi-layer resolution process:*** A manner in which the institutional framework under IBC can be solidified is the introduction of a tier-based resolution mechanism. In essence, layers can be created to adjudicate disputes at distinct stages of the resolution process. This, in turn, would reduce the burden on NCLT benches and would divide the cases across different levels. To ensure that a certain amount of workload is shifted from the NCLT, a private institutional framework can be envisaged. This mechanism would work through vigilance from the State Level Coordination Committee constituted by RBI and IBBI. A framework such as this can act as an aid to resolve issues and stalemate arising in IBC proceedings. Fee payments can further be introduced within this tier-based approach wherein applicants can be allowed to pay fees for the timely resolution of disputes or to fast pace the process. Moreover, to ensure that intervening litigants do not hamper the adjudicating process, a lofty fee for intervention could be imposed. The concept of security deposits could also be imbibed within the IBC as can be seen in the framework of Debt Recovery Appellate Tribunals in SARFAESI matters, pre-deposits in Goods and Services Tax matters, court fees in civil suits and arbitrator's fees in arbitral proceedings.

- ***Guidance mechanisms:*** The Security Exchange Board of India has introduced an informal guidance mechanism focussing on investor protection. This mechanism protects investors from risky investments and provides them with the relevant legal knowledge. The highlight of these guidance mechanisms is that the aggrieved party can pay a fee and raise queries before the relevant authority, the nature of which is not binding. A similar mechanism can be incorporated within IBC, under which

17. The Insolvency and Bankruptcy Code (Amendment) Act, 2021.

technical guidance on the questions arising during the CIRP can be given to the applicants to ensure that they have a holistic understanding of the law along with their rights and obligations. Introducing informal guidance mechanisms can provide an authentic direction to the parties that seek clarity of law and procedure and aim at fast-paced decision making. This would substantially reduce misinterpretation of the Code and any cases of unnecessary litigations leading to inordinate delays. Furthermore, a fruitful addition to such a mechanism would include clarificatory circulars, as seen under the Goods and Services Tax regime. Consequently, Central Board of Direct Taxes issues circulars on a recurrent basis wherein clarifications and explanations for sections under the direct taxation regime are provided. Admittedly, the IBBI has issued several circulars in the recent past clarifying certain aspects of the Code. The issuance of these circulars on a recurrent basis would ensure that the law is not misinterpreted in any manner and appropriate guidance is given to the market participants. Lastly, a concept of master circular and master directions, as issued by the Reserve Bank of India, could also be incorporated.

- ***Modifications in the PPIRP:*** The pre-pack insolvency mechanism is initially proposed for the MSME sector. The PPIRP can be modified so that companies bigger than MSMEs can also be included, and other entities such as partnerships and sole proprietorships, trusts, societies and individuals can be embraced. PPIRP needs to be re-looked at to ensure that it protects the business ecosystem rather than discouraging it.

- ***Introduction of Alternate Dispute Resolution Mechanisms:*** The Code provides for a timely resolution process; however, excessive litigation has overtaken and is failing the objectives of IBC. Various alternate dispute settlement mechanisms can be implemented to avoid such a tendency and impart discipline aimed at providing a distinct commercial approach. An arbitrational and mediated approach would provide a relatively hassle-free dispute resolution mechanism during insolvency proceedings.

- ***Focus on fast-track CIRPs:*** Another way to tackle delays in the resolution process is to prefer adopting the fast-track CIRP process. Section 56 of the Code provides for a fast-track insolvency mechanism wherein the same has to be completed within 90 days with a one-time extension of up to 45 additional days. However, a corporate debtor can only apply for a fast-track insolvency process if their assets, turnovers, capital borrowings, and other financial indices are below a certain threshold. The specific nature of this section disallows various companies from initiating a fast-track CIRP mechanism. Adopting a more liberal and relaxed process would significantly aid the objective of IBC, which aims at concluding liquidation processes in a time-bound manner.

- ***Insolvency Resolution- a commercial affair:*** With the growing economy and expansion of businesses, a significant need has been created within the marketplace for insolvency proceedings to become more private and commercial affairs. A set of guidelines in this regard could be introduced, which

may be kept as a guidance mechanism for the parties intending to enter into an insolvency resolution process by adopting arbitrational and mediational processes. Needless to say, such guidelines could imbibe a mechanism wherein the principle of transparency is not breached while ensuring that the confidentiality of the proceeding is kept at the forefront.

- ***Cross-border insolvency:*** There is a higher level of confidence in Indian businesses, which is reflected in capital markets and the private investment climate. Indian businesses have also expanded overseas businesses to acquire global footprints. While considering the hurdles faced in domestic insolvency process, a framework for cross-border insolvency remains a pipedream. Having said that a friendly mechanism must be developed to promote ultimate holding companies to be located in India. To be at par with the global standard and to invite investors from across the globe to select India, a mature insolvency regime is needed as one of the critical factors. Thus, after the implementation of next set of reforms, the Government may look at Cross-border insolvency mechanism. In this regard, adoption of the United Nations Commission on International Trade Law (Model Law) on Cross-Border Insolvency in a manner suitable for the country may be considered.

Conclusion

The Insolvency and Bankruptcy Code has undoubtedly been an extremely proactive and reformative enactment. It has achieved feats such as giving lifelines to Bhushan Power, Binani Cements, Essar Steel, Dewan Housing Finance and many other corporate giants as well as several MSME entities. The main attractive feature of the Code is that insolvency of the corporate debtor is considered a last resort, and revival of the company during CIRP is given prime importance. Such a rehabilitation emphasised mechanism is necessary for a growing economy like India. However, for a well-rounded insolvency resolution mechanism, certain challenges and roadblocks must be catered to in order to make IBC even more effective. Furthermore, ensuring that gaps are closed would exponentially help in the holistic advancement of the Code.

"Karma means law, and it applies everywhere. Everything is bound by Karma."

— *Swami Vivekananda*

The Vagaries of IBC Law

CA Guru Prasad Makam

Overview

Any new law to implement is difficult and it takes time to mature and become a well established principle. This is an article which covers certain basic elements of the law which could change soon. These elements do not require a legal mindframe, or any notifications, these are mostly procedural pointers. The reader should exercise his judgement if the article appears critical or realistic. The views expressed are purely that of Guru Prasad Makam as an independent view and not of the firm.

Process – Some minor changes can make the Law Beautiful

The Insolvency and Bankruptcy Code (IBC) of India, enacted in 2016, aims to streamline and strengthen the insolvency and bankruptcy resolution process for companies, partnerships, and individuals. The reduced resolution time, the enhanced recovery from creditors, reduction of NPA, strengthened the rights of the creditors, evolution of a robust insolvency ecosystem and improvement of credit discipline has been an amazing achievement of the IBC code. It is indeed a landmark milestone for India that IBC has reached such maturity in a shorter period, yet there is enough to be done. There are some instances which makes it intriguing and amusing as to how such an advanced legal thought process gets struck in old legacy and many redundant processes.

It is a process which requires large streamline. The faceless assessment in tax, the process of GST reconciliation, the success of the Flash in the MCA could be examples for IBBI. This article brings out some actions which, if started, could make the IBC process seamless. These could be minor items, no huge jurisprudence, but operationally it could be a boon. Some instances are articulated in the ensuing paragraphs.

There could be light shed on the question "Why is the IP required to file multiple forms". Many times, excel spread sheets, google links from gmail ids, keep invading the inbox, on ad-hoc basis and arbitrary basis. The purpose of these data assimilation nor the frequency is rarely understood. IBBI asked an IP a spreadsheet, a google sheet, and relative same or diametrically opposite data request floods from IPAs of the ICAI, ICSI and ICMAI. These have separate set of reporting mechanism i.e., monthly utility. In both instances, there are technical issues which crop up time and again. Even a slight delay also is not taken with a lenient view.

This is an evolving process, and the regulators would at the proper time stabilise this data seeking process, make it more automated, seamless and data could be shared between the IBBI and the IPA. The only hope is this process does hasten faster rather than – the idiom "Make haste slowly" could be the order of the day. Further there would be a flood of reminder emails, which would flock our inboxes, with a disclaimer "Ignore if already filed". Sending reminders is good but sending the same email on too frequent basis, does not service the purpose.

In some cases, the velocity of action of the regulator seems extremely fast. The same direction of action – a character which could change the ecosystem to a large positive extent is welcome. Sometimes results are born before action. Suspension of AFA precedes the show cause notice also. This could be rare, but law does not work on exceptions, even a single instance is not natural, when it comes to principles of natural justice.

Continual learning is the key to continual living. CPE process has been so beautifully developed. It is laudable to understand the regulator has inspired the profession through CPE. This is the making of a mature environment of IBC. Learning is the life blood of the profession. Kudos to the IBBI and IPA. Even after decades in the profession, it gives a beautiful feeling to see the screen smile back at you and say "glad you completed 2 hours of CPE credit". Yet, mysteriously the 2 hours, becomes 1 hour, and it is a unilateral decision. May be better technology could help these. Moog of the IIM's or the exceptional ICAI learning portals could be an example.

The world is moving faster than ever before. Corporate houses are in great acceleration and time is the essence of recovery. The IBC processes are time-bound but due to numerous factors, most of the time, the delay in admitting an application defeats the purpose of the law. Even though the company appears insolvent in good faith, the hearings does not seem to have any semblance of time boundedness. If admission of the application is itself a victory, the purpose of the law itself stands diminished.

IBC proceedings also get adversely affected due to too much of emphasis on technicalities like Date of Default, what is a debt, nature of debt, etc., whereby the bench does not concentrate on the core aspect i.e., the financial substratum of the Corporate Debtor. The absence of documents such as Form D i.e., NeSL related forms is given more importance rather than emphasizing on the intent of the Code i.e., Insolvency Resolution and Maximization of assets of the Corporate Debtor.

The Code has so beautifully defined PUFE. Identifying PuFE transactions ensures that the debtor's estate is not unfairly depleted, promoting fairness and maximising asset recovery for all creditors involved in the insolvency process. 43,45, 50 and 66 are not the marks of an average students, these sections are the fulcrum of fairness to the creditors. These sections protect the process. Every of these beautiful sections and substance of law gets punctuations when Interlocutory Application is filed and the same run for a long time before. However, there is no explicit manner prescribed as to how the PuFE transactions are to be dealt with and how they can be reversed.

Greed is a bottomless pit which exhausts the person in an endless effort to satisfy the need without ever reaching satisfaction. Sometimes the Committee of Creditors feel that the RP has a magic wand. A global financial institution could not even imagine that the borrower is going down the sink, the same financial institution now expects an IP to wield a magic wand. Many a times COC loses the plot by trying to salvage everything

from the empty coffers, but a more strategic view is what is required. This strategy needs a recommended process of law.

Few times, COC does not exercise patience nor strategy in dealing with the issues faced by genuine Corporate Debtor, in some cases, COC only takes care of its own concerns and jeopardizes concerns and interests of the other creditors or any other stakeholders. Every corporate debtor need not be viewed with a lens of negativity.

A single focus that assets run business and not the potential, customer base, technology, market conditions, competitor analysis is seldom seen. Only the generic meaning i.e., assets are not sufficient to pay the debts of the company is considered for the same. What all aspects contribute to Insolvency is not addressed thereof. A broader view of what all business can expand, grow, or recover needs to be the moot point. There could be business houses which could function with restructure, realignment of the liabilities and a broader view of the future business potential. Distress funds like Oaktree Capital turning around Matalan UK based retailer is not in the history, it happened during the current times. Blackstone Group turned around Hilton World wide and it went public in 2013 and today one of the top brand of hotels. Cerberus turned around Chrysler. KKR turned around Toys R US to a global giant helped Toys “R” Us adapt to changing market conditions for several years.

These distressed funds typically leverage their ability in restructuring and operational optimisation to revitalise struggling companies. Although not every turnaround is successful, these funds have demonstrated the ability to stabilise businesses, improve financial performance, and, in some cases, lead them to new growth phases or successful exits. A strategic approach could go a long way in helping the eco system,

Failing in business is not a sin, if it is coupled with honesty, it is a virtue too. Personal insolvency is not properly addressed under IBC. The resolution of personal insolvency cases has been poor, with only 4 cases concluding in a resolution plan and an abysmal recovery rate of around 2%.

A few other thoughts regarding the IBC, can the progressive Board think on the matters of stepping up the current IBC process. It is important to consider the need of Alternate Dispute Resolution (ADR) in IBC proceedings which could minimize the delays is mechanisms laid down under IBC. Secondly, IBBI not working towards direction of streamlining the processes instead levying additional processes on the IPs, making the processes difficult. It is so easy for the IBC to create enough of tools to gather claims, making a dashboard for the progress of the the IBC process, another dash board for the Resolution Plan and bidding. Everything could be tech enabled like the MCA. Further granting of multiple extensions for processes also is hindering the process and thus faster resolution, as desired for, is not happening, in any manner whatsoever.

Though the digital hearing, judgement based on artificial intelligence, data analysis and the computer reading the submissions could make the life of the board members to focus on more crucial directional and judgement matters. The concept of Pre-scrutiny of all applications for admissions can itself be a tech enabled, and so can be the issue of notices and hearing dates.

A few of the above thoughts could appear critical in language, but not the intention. The reader could understand the above examination as a process improvement opportunity and not a fault finding exercise.

CA Prashant Daftary CA Vaibhav Sagvekar

HOT SPOT

Auditing Standard SA-600

Is there need for Re-Audit of component by group auditor?

An unmodified opinion of the auditor in the audit report on the financial statements of the Company gives comfort to the users/ stakeholders/shareholders that the said financial statements gives true and fair view of the financial position of the Company and are free from material misstatements. Great value and trust are placed upon the work done by the auditors and auditors reports, however, few corporate frauds which have come to light in recent times has resulted in a significant trust deficit and questions are being raised on the work done by the fraternity as a whole. This issue was particularly highlighted during the NFRA review of the audits of Coffee Day Global Limited.

One such matter which is being debated is quality of group audit and the responsibility of the auditor of the holding company (or group auditor) and how much reliance can be placed on the work done by the component auditors. Standard on Auditing 600 deals with audit of group consolidated financial statements by the auditors of holding Company.

The subsequent contents of this article summarises the current auditing standard, rights & obligations under the Companies Act and the changes which are proposed by NFRA and its potential impact/implications.

Rights and obligations of auditor of the holding company under the Companies Act

Section 143 of the Companies Act, 2013 mentions that the auditor of the holding company shall have access to the records of all the subsidiaries and associates in so far as it relates to the consolidation of its financial statements with that of its subsidiaries. This right itself brings lot of responsibility on the shoulders of the auditor of the holding company as far as consolidated financial statements are concerned.

SA 600 – Using the work of another auditor

This auditing standard is effective from 1st April 2002 and provides clear guidelines as regards the procedure to be followed by the group auditor. These guidelines include the following.

- Materiality of the portion of the financial information which is audited by the principal auditor.
- Obtaining sufficient and appropriate audit evidence as regards the work performed by the component auditors.

- Emphasis on the communication between the auditors including informing the component auditors as regards the critical audit areas and specific audit procedures (if any). Generally, there is a practice to issue group audit instructions which include specific questions to determine the appropriateness of work done by the component auditors.
- Observations/findings of the component auditors are required to be considered while forming an opinion on the consolidated financial statements.

Standard states that the principal auditor would not be responsible for the work done by the component auditor except in circumstances which should have aroused suspicion as regards reliability of work done. Also, the group auditor is required to clearly state as regards his reliance on the work done by component auditors.

Over the last 2 decades the procedures and implementation of this standard has come a long way and in general has given good results except for a few cases of fraud which have been reported in last few years.

Proposed changes by NFRA

The proposed draft of SA 600 by NFRA is replica/adoption of ISA 600 (revised) which is effective from 15th December 2023.

These changes are proposed to be made applicable to public interest entities which are covered under NFRA except for Public Sector Enterprises, Public Sector Insurance Companies, Public Sector Banks, and their respective branches.

Key highlights of ISA 600 (revised) - Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors) which contains 59 paras, 182 explanatory paras and corresponding changes in existing ISAs related to audit reports, quality management, audit documentation, etc.

- Auditor's report on the group financial statements shall not refer to a component auditor, unless required by law or regulation. Even if the reference is made that does not diminish the group engagement partner's or the group engagement partner's firm's responsibility for the group audit opinion.
- Although component auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings or conclusions, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.
- ISA 600 additionally requires a group auditor to establish an overall group audit strategy and group audit plan including components at which audit will be performed. In doing so, the group auditor shall evaluate whether they will be able to be sufficiently and appropriately involved in the work of the component auditor.
- Group engagement partner is required to sufficiently be involved throughout the group audit and in the work of the component auditor.

Accordingly, there would be additional responsibility on group auditor for identifying, assessing, and responding to risk of material misstatement at group level reporting, evaluating the component auditor's communication and adequacy of their work, evaluating sufficiency and appropriateness of

audit evidence obtained and documentation thereof.

The above change upgrades the current auditing standard to the internationally accepted practices and should be welcome by the stakeholders in general.

Potential challenges/issues from India perspective

- In India auditing practice is carried out by large number of firms which are scattered and many of them are not very large. Large corporation would prefer only a single auditor across the group to reduce the additional time & efforts. This may lead to concentration of audits with few large firms.
- There could be substantial increase in audit fees on account of increased responsibilities which would require additional audit procedures, documentation and overall increase in time cost.
- Adherence to timelines could also be a challenge as principal auditor may reperform some of the audit procedures
- Two different auditing standards – one for public interest entities and one for entities not covered by the new standard.

The auditing fraternity should review the standard in detail and provide their feedback before the due date for public comments and government (NFRA) should give due weightage to the public comments/suggestions and concerns before the final roll out. Some carveouts and exceptions to suit the Indian environment should be considered.

The intent and the rationale of the proposed change is well understood however whether it would be result into improved perception about audit quality needs to be seen. Also, whether these changes address the root cause or lead to additional documentation.

It should also be considered whether mandatory joint audits for public interest entities could be a better way forward.

"Work for work's sake. There are some who are really the salt of the earth in every country and who work for work's sake, who do not care for name, or fame, or even to go to heaven."

— *Swami Vivekananda*

DIRECT TAXES
Supreme Court

Keshav B. Bhujle
Advocate

1 ***ITO vs. Tia Enterprises Pvt. Ltd.; [2024] 468 ITR 10 (SC): Dated 13/09/2024***

Reassessment — Notice — Approval of specified authority — To be furnished to assessee with reasons for notice — Failure to furnish — Notice and order disposing of assessee's objections set aside — Supreme Court dismissed special leave petition filed by the Revenue: Ss. 147, 148 and 151 of ITA 1961: A. Y. 2011-12

The assessee filed a writ petition challenging the notice issued u/s. 148 of the Income-tax Act, 1961, and the order disposing of the assessee's objections on the ground that the reassessment proceedings were commenced without the approval of the specified authority.

The Delhi High Court allowed the writ petition and held as under:

"i) The approval granted by the statutory authorities for reassessment proceedings u/s. 147 of the Income-tax Act, 1961, as required under the provisions of the Act, has to be furnished to an assessee along with the reasons to believe that income has escaped assessment. The statutory scheme encapsulated in the Act provides that reassessment proceedings cannot be initiated till the Assessing Officer has reasons to believe that income, which is otherwise chargeable to tax, has escaped assessment and reasons recorded by him are placed before the specified authority for grant of approval to commence the process of reassessment.

ii) There was nothing contained in the order disposing of the objections raised by the assessee which would answer the poser raised by the assessee that there was no application of mind by the Principal Commissioner for initiation of reassessment proceedings u/s. 147 for the A. Y. 2011-12. The only assertion made by the Revenue was that the Principal Commissioner had conveyed her approval u/s. 151 to the Assessing Officer by way of a letter but had not produced the letter despite the assessee's raising a specific objection that the Principal Commissioner had not applied his mind while granting approval for the commencement of reassessment proceedings. The condition requiring the Assessing Officer to obtain prior approval of the specified authority was not fulfilled, as otherwise, there was no good reason not to furnish it to the assessee along with the document which contained the Assessing Officer's reasons recorded for the belief that income otherwise chargeable to tax had escaped assessment. The notice issued

u/s. 148 and the order disposing of the objections raised by the assessee were unsustainable and hence set aside."

(See ***Tia Enterprises Pvt. Ltd. vs. ITO; [2024] 468 ITR 5 (Delhi)***)

The Supreme Court dismissed the special leave petition filed by the Revenue and held as under:

> "In view of the categorical finding recorded in the judgment and in the facts of the case, no case for interference was made out under Article 136 of the Constitution. The special leave petition is accordingly dismissed."

2 ***Principal Chief CIT vs. Nitin Nema; [2024] 468 ITR 105 (SC): Dated 17/09/2024***

Reassessment — Notice after three years — Validity — New procedure — Income chargeable to tax — Gross receipt of sale consideration not income chargeable to tax — Notice issued treating gross receipt on the export transaction as an asset which had escaped assessment — Not sustainable— Supreme Court dismissed special leave petition filed by the Revenue: Ss. 147, 148, 148A(b) and 148A(d) of ITA 1961: A. Y. 2016-17

On a writ petition challenging the order passed u/s. 148A(d) of the Income Tax Act, 1961 for issuance of notice u/s. 148 for reopening of the assessment u/s. 147 on the ground that the assessee has not filed a return of income for the A. Y. 2016-17, the amount of ₹ 72,05,084 received by the assessee as a result of an export transaction was an asset that had escaped assessment by the Madhya Pradesh High Court, allowing the writ petition held as under:

"i) The expression "income chargeable to tax" is not defined in the Income-tax Act, 1961. However, the provisions with respect to computation of business income make clear that the definitions of the expressions "income" and "income chargeable to tax" are at variance with each other. The expression "income" is inclusively defined u/s. 2(24) whereas "income chargeable to tax" denotes an amount which is less than "income". The "income chargeable to tax" is arrived at after deducting from "income" the permissible deductions under the Act. Therefore, the quantum of "income" is invariably more than "income chargeable to tax".

ii) The Department had failed to understand the fundamental difference between sale consideration and income chargeable to tax. It had relied upon sections 2(24), 14, 28 and 44AD to semphasise the expression "income". Neither the notice u/s. 148A(b) nor the order u/s. 148A(d), nor the consequential notice u/s. 148 stated that the income alleged to have escaped assessment included land or buildings or, shares or equities or loans or advances.

ii) The assessee had filed a reply to the notice u/s. 148A(b) wherein it had submitted that the amount of ₹ 72,05,084 was the gross receipt of sale consideration of 16 scooters, which meant that the amount of ₹ 72,05,084 was the total sale consideration receipt of the transaction in question, and not income chargeable to tax which would obviously be less than such amount. With the reply the assessee had also furnished the details of items sold and payment receipts, computation of total income and the computation of tax on total income and had submitted these to the Assessing Officer before the passing of the order u/s. 148A(b). There

was nothing stated in the provisions of section 148, 148A or 149 which could prevent the assessee from taking advantage of these provisions merely because of his failure to file the return of income.

iii) The impugned order dated March 25, 2023 u/s. 148A(d) and The notice dated March 25, 2023 u/s. 148 of the Income-tax Act are quashed.

iv) However, the Department was at liberty to invoke the provisions of section 148A in accordance with law."

(See ***Nitin Nema vs. Pr. Chief CIT; [2023] 458 ITR 690 (MP)***)

The Supreme Court dismissed the special leave petition filed by the Revenue and held as under:

> "We are not inclined to interfere with the impugned orders and hence, the special leave petitions are dismissed."

3 *CIT (International Taxation) vs. Gracemac Corporation Golf View Corporate; [2024] 468 ITR 1 (SC): Dated 13/09/2024*

Royalty — Computer software — Payments for licensing of software products in the territory of India not taxable in India as royalty — Supreme Court dismissed special leave petition filed by the Revenue: Ss. 9(1)(vi) and 12 of ITA 1961: A. Y. 2005-06 and 2007-08

The Delhi High Court dismissed the appeal filed by the Revenue and held as under:

"i) The Tribunal had not erred in holding that licensing of software products of M in the territory of India by the assessee was not taxable in India as royalty u/s. 9(1)(vi) of the Income Tax Act, 1961 read with Article 12 of the Double Taxation Avoidance Agreement between India and the United States of America. Since the issue of law raised had been conclusively decided in favour of the assessee by the Supreme Court, no substantial question of law arose. ***Engineering Analysis Centre of Excellence Pvt. Ltd. vs. CIT [2021] 432 ITR 471 (SC)*** followed.

ii) The dispute in question had been decided in favour of the assessee by the Tribunal in earlier years."

(See ***CIT (International Taxation) vs. Gracemac Corporation; [2023] 456 ITR 124 (Delhi)***)

The Supreme Court dismissed the special leave petition and held as under:

> "We are not inclined to interfere with the impugned judgment and order passed by the High Court. The special leave petition is, accordingly, dismissed."

4 *Joint CIT vs. Vinoda B. Jain; [2024] 468 ITR 4 (SC): Dated 10/09/2024*

Search and seizure — Retention of seized asset — Cash seized in July 1996 — Order of Tribunal attaining finality on 25/09/2014 and Principal Commissioner passing order on 31/12/2019 u/s. 132B — Cash not returned even after a petition was filed by the assessee — High handedness of Officers of Department — Inordinate delay in returning seized cash — Assessee held entitled to interest at 12 per cent per annum for the post-assessment period until payment — Supreme Court dismissed special leave petition filed by the Revenue: S. 132B of ITA 1961: A. Y. 1991-92

During the period relevant to the A. Y. 1991-92, the Central Excise Department apprehended one late Bharat Kumar Jain,

whose legal heir is the petitioner and seized gold items weighing 1545.200 gms. and cash of ₹ 2,60,000. The gold and cash seized were taken over by the Income-tax Department u/s. 132A of the Income-tax Act, 1961, and order u/s. 132(5) of the Act was passed on July 9, 1996, retaining the said assets. Subsequently, the case was scrutinised u/s. 143(3) of the Act, and an assessment order came to be passed. By an order dated September 24, 2014, the Income-tax Appellate Tribunal decided the issue in favour of the assessee. No further appeal u/s. 260A of the Act was filed by the Department. Therefore, the order dated September 24, 2014, of the Income-tax Appellate Tribunal attained finality. By an order dated December 31, 2019, passed under section 132B of the Act, the Principal Commissioner of Income-tax directed as under:

> "On the basis of the report submitted by the Assessing Officer, the Joint Commissioner of Income-tax, Range-20(3), Mumbai, the above-mentioned seized gold items weighing 1545.200 gms. and cash of ₹ 2,60,000 is hereby released to the Smt. Vinoda B. Jain, legal heir of Late Shri Bharat Jethmal Jain."

Thereafter, since there was no action taken by the Department to return the cash, the petitioner filed a writ petition. The Bombay High Court allowed the writ petition and held as under:

"i) The petitioner has approached this court due to the inaction of the Revenue in not even obeying and complying with the orders and directions passed by the Income-tax Appellate Tribunal as well as the Principal Commissioner of Income-tax.

ii) The Income-tax Act, 1961 recognises the principle that a person should only be taxed in accordance with law and hence, where excess amounts of tax are collected from an assessee or any amounts are wrongfully withheld from an assessee without the authority of law, the Revenue must compensate the assessee.

iii) The order of the Tribunal which attained finality on September 25, 2014, the Revenue did not consider it fit to return the cash of ₹ 2,60,000 that was seized on or about July 9, 1996. Moreover, even after the Principal Commissioner passed the order on December 31, 2019, under section 132B of the Act, the Revenue did not consider it fit to process and refund the amount. Even after the petition was filed and served and the lawyer appeared for the Revenue, the Revenue still did not consider it fit to return the money.

iv) Therefore, there had been an inordinate delay, and this was nothing but a clear case of high-handedness on the part of the officers of the Revenue. The assessee would be entitled to interest at 12 percent per annum for the post-assessment period, i. e., from September 25, 2014, until payment/realisation."

(See ***Vinoda B. Jain vs. Jt. CIT; [2024] 462 ITR 58 (Bom)***).

The Supreme Court dismissed the special leave petition filed by the Revenue and held as under:

> "We are not inclined to interfere with the impugned order passed by the High Court. The special leave petition is, accordingly, dismissed."

DIRECT TAXES
High Court

Jitendra Singh
Advocate

Radha Halbe
Advocate

Harsh Shah
Advocate

1 ***Ashok Kumar Rungta vs. ITO [2024] 167 taxmann.com 429 (Bombay)***

Unexplained Expenditure – section 69C of the Income Tax Act 1961 - ad hoc disallowance made by AO by treating the purchases as bogus – Tribunal upholding the ad hoc disallowance even after holding that the AO's finding was not backed by any cogent and convincing evidence – Order passed by Tribunal is void ab initio.

Facts

The Assessing Officer while finalizing the assessment of the assessee for relevant assessment years 2009-10 to 2011-12, disallowed 100 per cent of the purchases made from 12 entities by treating the same as bogus/non genuine. The assessee being aggrieved by the assessment order preferred an appeal before the first appellate authority. The Ld. CIT(A) after considering the documentary evidences furnished by the assessee such as sales tax returns and VAT audit report apart from other documents, which established the genuineness of the transaction of sale, restricted the addition to 10% of the total purchases in question. The assessee as well as department filed cross appeals before the Tribunal challenging the findings rendered by the Ld. CIT(A). However, the Tribunal upheld the order of the Commissioner (Appeals).

The assessee being aggrieved by the order passed by the Tribunal filed an appeal before the Hon'ble Bombay High Court challenging the ad hoc addition of 10% out of purchases made during the relevant assessment years.

Ruling of the High Court

Hon'ble Bombay High Court was pleased to allow the appeal of the assessee by observing that the onus of bringing the purchases by the assessee under cloud was on the revenue, which has not been discharged in the first place. Apart from the inputs being received from the investigation wing, there is nothing concrete in the material on record that was used to confront the assessee. If the counterparties in these purchases could not be produced years later, simply adopting a 10 per cent margin for disallowance, without any cogent or convincing evidence, would be unreasonable and arbitrary. It is unjust for the Tribunal to uphold such an addition of 10 per cent of the allegedly bogus purchases, despite returning a firm finding that the Assessing Officer's order was untenable not being backed by cogent and convincing evidence.

Hon'ble Bombay High Court also observed that once there is a quasi-judicial finding that there is no cogent and convincing evidence at all on the part of the Revenue in levelling an allegation, it would be wrong to expect that the Assessee would still have to prove its innocence. The Tribunal ought to have gone into this facet of the matter and dealt with why the 10% disallowance was plausible, reasonable and necessary in the context of the facts of the case. Such an analysis is totally absent in the Impugned Order passed by Tribunal.

2 *Kusharaj Madhav Bhandary vs. ITO [Writ Petition No. 4748 OF 2022 (Bom HC)]*

Penalty for under-reporting and misreporting of income – section 270A of the Income Tax Act 1961 – penalty levied without giving credit for TDS in the assessment order – Rectification order passed rectifying the assessment order by allowing the credit for TDS – penalty levied is bad in law.

Facts

The assessee received salary on which tax was deducted at source. Form No. 16 was issued by the employer accordingly showing the deducted amount of TDS, and the same was also reflected in the Form No. 26AS. Reassessment proceedings were initiated in the assessee's case. During the course of reassessment proceedings, the assessee filed various submissions justifying the salary income declared in the return. The AO finalised the assessment order accepting the returned income. However, while computing the tax liability, the AO did not give credit of the TDS deducted and charged interest for alleged non-payment of taxes and also initiated penalty proceedings for the same. The assessee filed an application under Section 154 of the Act to rectify the mistake apparent from record in not allowing the credit for TDS.

Pending the rectification application, the AO proceeded with the penalty proceedings. During the course of the penalty proceedings, the assessee contended that assessment order suffers from mistake apparent on the face of record as the credit for TDS amount was not given and therefore, the penalty proceedings are totally unwarranted. However, the AO disregarding the fact that assessee's rectification application is pending for adjudication, passed the penalty order under section 270A of the Act holding the assessee guilty of under reporting and mis reporting of his income.

The assessee being aggrieved by the penalty order passed by the AO challenged the same by way of writ petition before the Hon'ble Bombay High Court.

Ruling of High Court

Hon'ble High Court was pleased to allow the writ petition filed by the assessee and also quashed the penalty order by observing that on one hand, the rectification application was not being disposed of and on the other hand, the AO proceeded with the penalty proceedings. In pursuance of earlier order passed by the Hon'ble High Court, the AO disposed of the rectification application allowing credit of the TDS. Thus, the case of any under reporting or misreporting as initially being asserted on behalf of the department has certainly proved to be incorrect, in view of the rectification order passed. In this view of the matter, the penalty proceedings would also be rendered inconsequential as the very foundation of such penalty proceedings stood

extinguished in view of rectification order being passed.

Hon'ble High Court further observed that once the order of assessment merges into the rectification order passed under section 154 of the Act, penalty proceedings initiated on the basis of the said assessment order as originally passed would be rendered inconsequential in view of the rectification order. No penalty proceedings or any other proceedings can be initiated under the assessment order which stand merged in the rectification order.

3 ***T.K.S. Builders (P) Ltd. vs. ITO [2024] 167 taxmann.com 759 (Delhi)***

Faceless assessment of income escaping assessment – section 151A of the Income Tax Act – section 144B merely prescribes manner for completing the assessment in a faceless manner and does not completely deprive of the power of the jurisdictional AO to issue notice under section 148 of the Act.

Facts

In the present case, the jurisdictional Assessing Officer issued notice under section 148 of the Act on 22.07.2022 for the AY 2014-15. On 29.03.2022 the CBDT notifies the Faceless Assessment Scheme 2022 which provides that the notice under section 148 of the Act shall be through automated allocation, in accordance with risk management strategy formulated by the Board as referred to in section 148 of the Act for issuance of notice, and in a faceless manner, to the extent provided in section 144B of the Act.

The Assessee, therefore, challenged the legality of the notice issued under section 148 of the Act by the jurisdictional Assessing Officer by way of a Writ Petition before the Hon'ble Delhi High Court.

Ruling of the Hon'ble High Court

Hon'ble Delhi High Court dismissed the writ petition filed by the assessee by observing that the distribution of functions between the JAO and NFAC is complimentary and concurrent as contemplated under the various schemes and the statutory provisions. This balanced distribution underscores the legislative intent to create a seamless integration of traditional and faceless assessment mechanisms within a unified statutory framework. Hence, section 144B cannot be viewed as the exclusive basis for all assessment and reassessment procedures and JAO cannot be completely deprived of power to assess or reassess merely because Section 144B and Faceless Reassessment Scheme 2022 have been introduced.

"Be not Afraid of anything. You will do Marvelous work. it is Fearlessness that brings Heaven even in a moment."

— *Swami Vivekananda*

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Tribunal

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Advocate

1 ***Monica Parmanand Mirchandani vs. ITO 23(3)(3) [ITA No. 1081-1083/MUM/2024 dated 23.09.2024] [AY: 2012-13, 2015-16 & 2016-17]***

Section 2(24) – Compensation received from the developer was to be considered as a capital receipt or revenue receipt – compensation received in instalments - amount received by the appellant was as per the agreement signed by both the parties and to be allowed.

Facts

The appellant was an individual, a tuition teacher, who filed her Income Tax Return declaring income under the head of "Income from other sources". Her case was reopened u/s. 148 of the Act on 29.03.2019. The appellant had received approximately ₹ 71 lakhs as compensation from the Developer. The Ld. AO added the entire amount considering it as a revenue receipt. The appellant filed an appeal before the first appellate authority, which upheld the AO's addition stating that the appellant failed to prove the source of the receipt. The appellant thus filed an appeal before the Hon'ble ITAT against the order of the Commissioner of Income Tax (Appeals).

Held

The AR for the appellant contended that under the re-development agreement, the Developer would rebuild the existing apartments after the members vacated their units. The AR explained that, as per the agreement, the Developer was to pay hardship compensation to all society residents, which included the first instalment received by the appellant in the AY: 2012-13. Due to delays in the project, the agreement was modified, allowing the remaining compensation to be paid in seven instalments. AR relied upon several jurisdictional ITAT decisions and the Hon'ble Bombay HC decision in the case of ***Sarafaraz S. Furniturewalla (166 taxmann.com 425).*** Whereas the DR disputed the claim that the hardship compensation should be viewed as a one-time payment. DR pointed out that the compensation was received over three years and in different instalments and that this receipt qualified as a revenue receipt and supported the decisions of the lower authorities.

The Hon'ble ITAT observed that the moot question was whether the amount received by the appellant from the developer was in the nature of hardship compensation and if so whether the same was a 'capital receipt' or 'revenue receipt'. Upon reviewing the documents, it was clear that the developer was

obligated to pay the hardship compensation in instalments at various stages, starting from the execution of the Memorandum of Understanding (MOU), through the handover of vacant possession, and into the commencement of construction. The Ld. AO had only contested the classification of the receipt as a "revenue receipt" and had not provided any evidence to indicate that the amounts received by the appellant from the builder were anything other than hardship compensation. The CIT (A) argued that the hardship compensation should not have been received for two consecutive years for the same residential property, claiming the appellant failed to disclose the source of the receipt. However, the Hon'ble ITAT disagreed with both the Ld. AO and the CIT(A) on this matter. The appellant had clearly established the source of the receipt as coming from the builder backed by both the development agreement and the deed of modification. Further the Hon'ble ITAT relying on the Jurisdictional HC held that hardship allowance, referred to as "transit rent," received by the appellant as compensation for displacement due to redevelopment, constitutes a capital receipt, not a revenue receipt. There was no doubt that just because the appellant received the amount from the Developer, it did not automatically classify as income u/s. 2(24) of the Act unless it qualified as a revenue receipt. An established legal precedent confirmed that hardship compensation was to be considered a 'capital receipt'. The appeal of the appellant was allowed.

2 *ACIT vs. Amal Corporation (ITA No. 674/Mum/2024 dt. 14.10.2024) (AY 2012-13)*

Section 68 – Unsecured Loan taken from 4 entities – Information received from Investigation Wing that loan parties are managed by Bhanwarlal Jain Group – All details submitted – 133(6) notices also complied with –Identity, creditworthiness, genuineness proved – No link of assessee found in the search conducted in case of Bhanwarlal Jain Group – Addition deleted

Facts

The assessee is engaged in the business of investment in shares/securities/properties etc, and also in the business of contractors/ designers/developers. During the year under consideration, the assessee availed unsecured loans of ₹ 1,50,00,000/- from 2 entities. The Ld. AO noted the parties who have extended loans are listed by the Investigating Wing as fake parties basis the search conducted in Bhanwarlal Jain Group. During the assessment proceedings, the assessee in response to the show-cause notice, gave all the relevant documents and explanations to prove the genuineness and creditworthiness. The Ld. AO rejected the submissions, including the statements and the documents submitted by these parties in response to notice u/s. 133(6) solely based on the outcome/ findings of the Investigation Wing in the Bhanwarlal Jain group & accordingly made addition u/s 68 of ₹ 1,50,00,000/-. On further appeal, the (Ld. CIT(A) allowed the assessee's appeal and deleted the addition mainly on the reason that the Ld. AO did not point out any specific instances or any infirmity in the statement recorded by the Investigation Wing in the case of Bhanwarlal Jain group, which reveals the alleged involvement of the assessee in taking accommodation entries. Further, once the assessee has filed all the documents and the Ld. AO himself carried out the enquiry, then no addition can be called for. Being aggrieved with the order, an appeal is filed by the department before the Hon'ble ITAT.

Held

The Hon'ble ITAT held that the assessee has furnished copy of ledger account, bank statement of the creditors reflecting the loan transaction, income tax returns and their audited financial statements wherein the assessee has shown the source of giving the loans and lenders are regularly assessed the tax. Not only that, the Ld. AO himself carried out his own enquiry and issued notice u/s. 133(6) and in response these parties had given the entire details as required by the Ld. AO. Once these parties have confirmed the source of their loan, which is out of their own funds from the balance sheet, then the creditworthiness stands proved and the Ld. AO has not further brought anything on record that such source of funds are fictitious. Then again, when the Ld. AO summoned all the three parties, two of them personally appeared before him and have given their statement on oath and they have categorically admitted of giving of loan; have explained their operation of the business, the extent of their turnover and the funds in the balance sheet. Thus, the onus upon the assessee was duly discharged at the assessment stage. The entire premise of the Ld. AO is based on Investigation report in the case of Bhanwarlal Jain and nothing has been brought on record that any particular information or material was found relating to the assessee that assessee was beneficiary of accommodation entry of loan or advance from any of the group concerns of Bhanwarlal Jain. Once the Ld. AO himself has carried out his enquiry and nothing adverse has been found, then simply relying upon the investigation report cannot justify the addition. On the above basis, the appeal filed by the department was dismissed and therefore additions were confirmed to be deleted.

3 ***The ACIT vs. Bennett Coleman & Co. Ltd. [ITA No.1387/Mum/2023 dated 01.10.2024] [AY 2018-19]***

Section 143(3) - Validity of assessment order without digital signature

Facts

The assessee filed its return of income for AY 2018-19, which was subsequently scrutinized by the learned Assessing Officer, Faceless ('the Ld FAO'). The Ld FAO issued assessment order dated 28/09/2021 under section 143(3) r.w.s 144B of the Act, but the digital signature was affixed only 1/10/2021 i.e., beyond the statutory deadline (being 30/09/2021). The assessee contended that this delay rendered the assessment order invalid as it was barred by limitation u/s. 153 of the Act. The Ld CIT(A) upheld the validity of the assessment order. The assessee appealed to the Hon'ble ITAT, interalia, challenging the validity of the order besides the merits of the case.

In the course of proceedings before the Hon'ble ITAT, the Department's representative relied upon a detailed report submitted by the Jurisdictional Assessing Officer after seeking response from the Ld FAO. In this report, various evidences of the Order having been passed on 28/09/2021 and the evidence made by the Ld FAO to get the technical glitch resolved were submitted. The Department also relied on the fact that the DIN cited on the order and the computation sheet was generated on 28/09/2021. It was thus contended by the Department that it was only owing to technical glitches that the Order was not signed on or before the due date but based on the said evidences, the assessment order should be considered to have been completed based on the generation of the order i.e., 28/09/2021 which is before the deadline.

Held

The Hon'ble ITAT after considering various evidences brought out by the Department on record, as a matter of fact, observed that the assessment order was not digitally signed till 01/10/2021 and the assessment order made on 28/09/2021 was unsigned. The Hon'ble ITAT thereafter referred to the Hon'ble SC decisions in the case of ***Kalyankumar Ray vs. CIT (634 ITR 191), M.M. Rubber Co (1991) (55) ELT 289, Smt Kilasho Devi Burman (219 ITR 214)*** and the Hon'ble Delhi HC decision in the case of ***Suman Jeet Agarwal (449 ITR 517)***. Basis the same, the Hon'ble ITAT concluded that it is of a considered view that the signing of the assessment order is an integral part of order generation in e-assessment and the assessment proceedings conclude only after the order is digitally signed, therefore, signing of the assessment order should not be brushed aside lightly. Therefore, the signing of the assessment order is a mandatory requirement and not a procedural formality unless the order is signed assessment does not complete. The Hon'ble ITAT relying upon the aforesaid decisions held that the Order was passed beyond the period of limitation and, therefore, invalid.

4

The DCIT vs. PME Power Projects India Ltd. [ITA Nos.242 & 249/Del/2024 dated 16.10.2024] [AY 2013-14]

Section 144 - Assessment under Section 144 warranted for defective returns as per the CBDT Instructions

Facts

The assessee, PME Power Projects India Ltd filed its return of income under Section 139 for AY 2013-14. Due to financial difficulties, the Assessee failed to remit self-assessment tax. An intimation under section 143(1) was issued seeking payment of self-assessment tax. The case was selected for scrutiny under section 143(3) of the Act. Due to failure to deposit self-assessment tax, the Ld. AO treated the return of income filed as invalid u/s 139(9) of the Act. The Ld. AO passed assessment order u/s 143(3) of the Act, making certain additions. The CIT(A) dismissed the appeal as not maintainable on the ground that the assessee has not paid the tax due on the returned income till date. The assessee thereafter a big gap of 2423 days filed an appeal before the Hon'ble ITAT seeking condonation of delay filed an appeal against the first order of CIT(A). The Hon'ble ITAT in the facts and circumstances described in detail in the order condoned the delay.

Held

The Hon'ble ITAT observed that for non-payment of self-assessment tax, the Ld. AO treated the return filed by the assessee as an invalid return. The Ld. AO having treated the return filed by the assessee as non-est and invalid, proceeded to look into the very same return and made disallowance of various expenses and addition towards sundry creditors. Once the return is treated as defective and invalid in terms of section 139(9) of the Act, the only recourse legally available to the Ld. AO is to frame the assessment u/s 144 of the Act. Whereas, in the instant case, the Ld. AO had framed the assessment u/s 143(3) of the Act by starting the computation of income from the income returned by the assessee.

The Hon'ble ITAT further observed that one of the conditions prescribed in Explanation (aa) of section 139(9) of the Act for treating the return as defective is non –payment of self-assessment tax as per the law prevailing at the relevant point in time and applicable for the year under consideration. Hence, the

Hon'ble ITAT held that the learned AO was duly justified in treating the return filed by the assessee as invalid and defective. Having done so, he ought to have ignored the said return completely and ought not to have started the computation of income with the income returned by the assessee. The Hon'ble ITAT relied upon the CBDT Instruction dated 12.12.2017 providing guidelines for framing of assessment in respect of defective returns. Merely because the assessee co-operated in the assessment proceedings by furnishing the requisite details called for by the Ld. AO, it would not give way for the Ld. AO to frame the assessment u/s 143(3) of the Act. Accordingly, the Hon'ble ITAT held that the Ld. AO should have framed the assessment only u/s 144 of the Act and hence, the order quashed the assessment proceedings u/s 143(3) of the Act.

5

Go Fashion (India) Ltd. vs. PCIT (ITA No. 939/Chennai/2024 dt. 30.09.2024) (AY 2018-19)

Section 263 – CCPS issued during the year – difference between issue price and FMV was 0.65% - within the permissible 10% limit as per Rule 11UA – no scope of addition u/s 56(2)(viib) – one of the twin condition that order was prejudicial to the interest of revenue not being satisfied – 263 does not hold good and order u/s 263 to be quashed (Sec. 56(2)(viib)/Rule 11UA)

Facts

The assessee-company had issued compulsory convertible preference shares raising ₹ 100 crs under a private equity investment made by ICICI Venture through India Advantage Fund S4-I. The shares were issued for ₹ 416.69 per share, while the Fair Market Value (FMV) of the shares was determined to be ₹ 414 per share. During the assessment process, Ld. AO accepted the valuation of shares and made no addition under Section 56(2)(viib) for the difference in issue price and FMV of the shares. The Principal Commissioner of Income Tax (PCIT) found that Ld. AO did not make any additions regarding the differences and issued a revision order u/s. 263 of the Act, contending that the Ld. AO's order was erroneous and prejudicial to the interest of the revenue because of insufficient inquiry into the valuation difference. Being aggrieved with the same, an appeal is filed before the Hon'ble ITAT challenging the revision order.

Held

The Hon'ble ITAT held that assessee has issued compulsory convertible preference shares at a price of ₹ 416.69 per share as against the fair market value of 414 determined as per Rule 11UA. There is a difference of only 0.65% in the issue price and FMV. The Ld. AO during the course of assessment proceedings, has issued notice u/s. 142(1) of the Act and has asked for a detailed note on the determination of the fair market value of the issued share as per section 56(2)(viib) and the assessee has submitted the details after which the Ld. AO has not made any addition. Relying on the Hon'ble ITAT Delhi Bench case of Sakshi Fincap Ltd (ITA No. 8389/Delhi/2019. dated 16.04.2024) it was held that the amendment brought in Rule 11UA was introduced to mitigate the hardship faced by taxpayers by the unintended invocation of section 56(2)(viib) r/w Rule 11UA and therefore, the same is a curative amendment. The difference in the fair market value and the issue price of compulsory convertible preference shares is only 0.65%. Therefore, as per Rule 11UA, the issue price is deemed to be fair market value, and hence, no scope for addition is made u/s. 56(2)(viib) of the Act. In order to invoke section 263 of the Act, the twin conditions of erroneous and

prejudicial to the interest of Revenue are to be satisfied. In the present case, the second condition that the order is prejudicial to the interest of revenue is not being satisfied. Hon'ble ITAT, thereby, quashed the order passed u/s 263 and deleted the proposed addition.

6

Vmobi Solutions Pvt. Ltd. vs. PCIT (ITA No. 2173/Mum/2024 dt. 10.10.2024) (AY 2017-18)

Section 263 – Expenditure incurred wrt. increase in authorised share capital – assessee claimed as revenue expenditure – AO allowed the said claim in original assessment – Issue examined by the AO - Revision u/s 263 not permissible – order quashed (Sec 37)

Facts

The assessee had filed its return declaring nil income on 30.10.2017 and the assessment was completed u/s 143(3) of the Act. Subsequently, PCIT issued an order u/s 263 of the Act on the ground that the order of the Ld. AO was erroneous and prejudicial to the interest of the revenue as an amount of ₹ 22,10,336/- claimed as a filing fee in respect of the increase in share capital was wrongly allowed as revenue expenditure. During the 263 proceedings, the assessee submitted that ₹ 22,10,336/- is the filing fee incurred in relation to an increase in the authorised share capital during the year. The authorised capital was raised to meet the working capital requirement of the business, and the same is revenue in nature. Hence, allowable as a revenue expenditure. However, PCIT proceeded to pass an order u/s 263 of the Act setting aside the assessment order passed by the Ld. AO u/s 143(3) of the Act. Being aggrieved with the same, the appeal is being filed.

Held

The Hon'ble ITAT held that during the course of assessment proceedings, the Ld. AO vide notice dated 21.08.2018 u/s 143(2) of the Act has intimated to the assessee that the case had been selected for limited scrutiny on the issue "share capital/capital"- Filling fee of ₹ 22,10,336/- had been shown under "the head operation and other expenses in the profit and loss account". During the course of 263 proceedings before the PCIT, the assessee explained that the issue had been examined by the AO and, therefore, it cannot be said that the order was erroneous and prejudicial to the revenue. In support of the contention that expenditure incurred in raising share capital is revenue in nature, the assessee has placed reliance, inter alia, on the decision of the co-ordinate bench in the case of ***Navi Mumbai SEZ Private Ltd. vs. Assistant Commissioner of Income-tax, Range-7(1), Mumbai (2015) (54 taxmann.com 259)***. Hon'ble ITAT held that the expenditure of the filing fee of ₹ 22,07,836/- was allowed by the AO after conducting the requisite examination and, therefore, it cannot be said that the order of the Ld. AO was erroneous and/or prejudicial to the interest of the revenue. Thereby, on the above basis the order u/s 263 of the Act was quashed.

7

St. Peter's School vs. ITO Ward-2(1), Kolkata [ITA No. 820/KOL/2024 dated 08.10.2024] [AY 2018-19]

Section 270 – Penalty charged u/s. 270A (9) on misreporting of income by a charitable trust claiming depreciation on assets which are already claimed as the application in earlier returns – *Bonafide* error cannot be considered as misreporting of income.

Facts

The appellant is a charitable institution engaged in providing education and filed a nil Income Tax Return for AY:2018-19. The institution was operating u/s. 10(23C)(vi) of the Income Tax Act, 1961 (the Act) and had a valid tax exemption from Income tax until AY:2026-27. During the assessment, the AO noticed that the assessee claimed depreciation on assets already treated as an application of income in previous years. The Assessing Officer disallowed this depreciation u/s. 11(6) of the Act, holding that the institution had under reported its income. Consequently, the Assessing Officer initiated penalty proceedings u/s. 270A of the Act, for misreporting the income and imposed a penalty, which was 200% of the tax on the under reported income. The appellant filed an appeal before the Ld. CIT(A). However, the appeal was dismissed. Against this imposition of penalty, the appellant filed an appeal before the Hon'ble ITAT.

Held

In the appeal before Hon'ble ITAT, it was contended by the assessee that the depreciation claim was a *bonafide* mistake and it was an inadvertent error and cannot be considered as an attempt to evade tax. The AR emphasized that there was no intention to misreport income and once it was pointed out, the error was corrected during the assessment process with no revenue loss since the assessee was exempt from tax. Further, the AR relied on the Supreme Court rulings of ***CIT vs. Reliance Petro Products Pvt. Ltd. (322 ITR 158)*** and ***Price Water House Corporation P. Ltd. vs. CIT (348 ITR 306)***, wherein it was held that an incorrect claim doesn't amount to furnishing of inaccurate particulars of income.

The DR argued that the appellant misreported its income by claiming depreciation that was disallowed u/s. 11(6) of the Act. He further mentioned that the rules were straightforward and that the charitable institution should have known it couldn't claim such depreciation. Therefore, he asserted that this was not just a clerical error, but an actual misreporting, which justified the penalty u/s. 270A of the Act. The DR supported the lower authority orders.

The Hon'ble ITAT observed that assessee a charitable institution enjoys tax exemption u/s. 10(23C)(vi) of the Act, and this is the first instance of such an error in the return of income. The assessee has consistently followed its accounting method and the depreciation claim appears to have been made due to a clerical mistake. The assessee accepted the issue during the scrutiny proceeding and cooperated with the AO. Further, it was also observed that assessee has not derived any personal benefit or tax advantage from an incorrect claim of depreciation, as its income would still remain exempt u/s. 10(23C)(vi) after disallowance. Relying on the two Supreme Court decisions (supra), it was held by the Hon'ble ITAT that Section 270A(9) of the Act provides for the imposition of penalty for misreporting of income. However, the provisions are applicable only in the cases where there is deliberate misreporting, such as misrepresentation of facts or making false entries in the books of account. In the present case, the assessee's error in claiming depreciation was neither intentional nor deliberate and, therefore, the imposition of penalty u/s. 270A(9) of the Act is not justified. Accordingly, the appeal of the appellant was allowed.

INTERNATIONAL TAXATION
Case Law Update

Dr. CA Sunil Moti Lala
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A. SUPREME COURT

1 ***Johnson Matthey Public Ltd. Company vs. CIT (International Taxation) - [2024] 167 taxmann.com 395 (SC)***

The Hon'ble SC dismissed assessee's SLP against High Court ruling that where the assessee, a non-resident company, provided guarantee to various banks to extend credit facilities to its Indian subsidiaries, such guarantee fee would not fall within expression "interest" in article 12 of India UK DTAA, since guarantee charges were not received by assessee in respect of any debt owed to it by its Indian subsidiary.

2 ***CIT (International Taxation) vs. Gracemac Corporation - [2024] 166 taxmann.com 659 (SC)***

The Hon'ble SC dismissed Revenue's SLP against impugned order of HC ruling that where payments were made by an Indian company to a non-resident company which was a computer software manufacturer/supplier for resale/use of computer software through distribution agreements, said payments did not amount to royalty for use of copyright in computer software, and consequently, the same did not give rise to any income taxable in India.

B. HIGH COURT

3 ***Hyatt International Southwest Asia Ltd. vs. ADIT - [2024] 166 taxmann.com 466 (Delhi)***

The Full Bench of the Hon'ble HC held that where assessee had a PE in India, it would be liable to pay tax on income attributable to that PE notwithstanding that assessee had suffered a loss at an entity level.

Facts

i. The assessee, a company incorporated in UAE, filed its return of income declaring nil income.

ii. The assessee had filed appeal before Division Bench of High Court contending that assessee's case was squarely covered by ***CIT (International Taxation) vs. Nokia Solutions and Networks OY [2023] 147 taxmann.com 165/455 ITR 157 (Delhi)*** wherein it was held that in case an enterprise at an entity level had suffered a loss in relevant assessment year, no profit or income attribution would be warranted insofar as PE in India was concerned.

iii. The Division bench of High Court doubted the correctness of the view expressed in ***Nokia Solutions (supra)***

and made a reference before the Full Bench of High Court.

Decision

i. The Hon'ble Full Bench of the HC held that the concept of a PE is based upon the undertaking of economic activity in a particular State irrespective of the residence of an enterprise. Any entrepreneurial activity which gives rise to income or profit thus becomes liable to be taxed at source irrespective of the ultimate recipient or owner of that income. Source here would mean the location which gives rise to the accrual of profits or income or which is the location where the same arises. The PE principle thus enables the assignment of tax to the State which constitutes the source. Once the DTAA confers an independent identity upon the PE, it would be wholly erroneous to answer the question of taxability basis either the activities or profitability of the parent or the entity which seeds and sustains the PE.

ii. The Contracting State in which this imagined entity is domiciled and undertakes business thus becomes identified as an independent profit or revenue earning center which is liable to be taxed. Once such an entity is found to exist in one of the Contracting States, it is viewed as a unit which contributes to the economic life of that State and is thus be liable to tax. It is these basic precepts which debunk the theory of taxation in the source State being dependent upon a global profit or taxation being subject to income or profit having been earned at an entity level.

iii. Article 7 of the DTAA postulates that the profits of an enterprise shall be taxable only in that State. It thus, and as a matter of first principle, restricts the taxation of profits of an enterprise only to and in the State of which it may be a resident. However, it then proceeds to expand the scope of taxability by taking into consideration the activities that may be undertaken by such an enterprise in the other Contracting State through a PE situate therein. This is further explained with article 7(1) prescribing that if the enterprise were carrying on business through a PE situate in the other Contracting State, its profits would become liable to be taxed in the other State, restricted however, to the extent that those profits are attributable to that PE.

iv. As article 7 is read, it becomes evident that paragraph (1) clearly envisages the profits of a PE being liable to be independently taxed notwithstanding that PE being a constituent of a larger enterprise which may be domiciled in the other Contracting State. Article 7(1) thus in clear and unequivocal terms constructs a dichotomy between the profits that may be earned by an enterprise on a global scale and those which are attributable to a PE situated in the Contracting State. This becomes further evident from a reading of paragraph (2) of article 7 which stipulates that where an enterprise carries on business through a PE in the other Contracting State, profits would be liable to be attributed to that PE as if it were a distinct and separate enterprise engaged in similar activities and independent of the enterprise of which it may be a part.

v. This aspect is further amplified when article 7(2) employing the phrase "dealing wholly independently with the enterprise of which it is a permanent establishment". Article 7(2) thus clearly bids to view the PE as a distinct and separate entity engaged in undertaking business activity in its own right in a Contracting State. It would consequently and on a fundamental plane be incorrect to fuse the incomes generated by an enterprise as a whole with the income that may be earned by a PE in one of the Contracting States.

vi. It would also be incorrect to interpret article 7 as requiring to ignore the income that may be generated pursuant to activities undertaken by a PE in one of the Contracting States and making the exercise of attribution dependent upon the profits or the income that the enterprise may otherwise earn at an entity level. In fact, article 7(1) itself excludes the profits of an enterprise from being subjected to tax till such time as such an entity carries on no business in the other Contracting State through a PE. Consequently, even though a PE may be merely a part of the larger entity, the profits generated from its activities undertaken in the other State becomes subject to taxation. The view taken above also finds support from the OECD Commentary on article 7. The source State is ultimately concerned with the income or profit which arises or accrues within its territorial boundaries and the activities undertaken therein. As those commentaries pertinently observe, the profits attributable to a PE are not liable to be ignored on the basis of the performance of the entity as a whole.

vii. Global income, as a fundamental precept, has always been invoked in respect of residents of a Contracting State. Most Nations have ultimately reverted to the source rule for purposes of taxation. Thus, one is called upon to deal with a regimen which concerns itself with the source from which income accrues or arises. This precept also stands mirrored in section 5 and which jettisons the principle of territoriality only in respect of income earned by a resident. Thus, taxation based on worldwide income stands confined to natural residents. However, no Nation avows or waives its right to tax capital or transactions which are anchored to its own territory. It is this basic precept of source which continues to bind.

viii. If the submission of the assessee were to be accepted, the revenue would be recognised to have the power to tax even in a situation where although the entity be profitable, the PE may have incurred a loss. If the aforesaid logic were to be applied, in a converse situation, the Contracting State would be countenanced to have the right to tax only if the assessee at a global level were found to have earned profit. That is clearly not the import of article 7 of the DTAA. In fact, article 7 itself restricts the taxability of the enterprise to the extent of income or profit attributable to the PE. Thus, the argument of global income or profit being relevant or determinative is totally unmerited and misconceived. The submission is clearly contrary to the weight of authority which has been noticed hereinabove.

ix. Regard must also be had to the fact that article 7 does not expand its gaze or reach to the overall operations or profitability of a transnational enterprise. It is concerned solely with the profits or income attributable to the PE. The taxability of income earned by a PE existing in a Contracting State is not even remotely linked or coupled to the overall operations of the enterprise of which it may be a part. The argument of world-wide income is thus rendered wholly untenable.

x. The Division Bench in these appeals rightly doubted the correctness of taxation being dependent upon profits or income being earned at the "entity level". Article 7 cannot possibly be viewed as restricting the right of the source State to allocate or attribute income to the PE based on the global income or loss that may have been earned or incurred by a cross border entity. Thus, the reference was answered by holding that the tentative view expressed by the Division Bench in these set of appeals as well as the doubt expressed with respect to the findings rendered in Nokia Solutions was well founded and correct.

4 *PCIT vs. Sony India (P.) Ltd.- [2024] 167 taxmann.com 549 (Delhi)*

Where assessee, engaged in import and distribution of various products, outsourced manufacturing activities to OEMs and paid royalty to its AEs for use of licensed patents, know-how and trademarks which was disallowed by the TPO on ground that since goods were manufactured by OEMs the same did not justify any payment of royalty by assessee to its AE, the Hon'ble HC upheld the order of the Tribunal deleting the said disallowance on the ground that the assessee was also entitled to get products manufactured through sub-contractors. It was further held that TPO is not required to examine the efficacy of commercial transactions and his role is confined to determining the price or value of the transactions on an arm's length basis.

Facts

i. Assessee was engaged in import and distribution of various products under the brand name 'Sony' and there were certain categories of products where manufacturing activities were outsourced to OEMs (original equipment manufacturers).

ii. Assessee had obtained license for manufacturing and selling of various products and paid royalty to its Associated Enterprises (AEs) for use of licensed patents, know-how and trademarks.

iii. TPO proposed that royalty was to be bench-marked at nil on the ground that as goods were manufactured by OEMs, the same did not justify any payment of royalty by assessee to its AE's.

iv. The DRP upheld the TPO's order.

v. However, the Hon'ble Tribunal set aside the aforesaid TP adjustment w.r.t royalty paid in respect of Sony products manufactured by (Moser Bear India Ltd. (hereafter MBIL) and Competition Team Technology [India] Pvt. Ltd. (hereafter CTTL) as original equipment manufacturers (OEMs).

vi. Aggrieved, the Revenue filed appeal before the Hon'ble HC.

Decision

i. The Hon'ble HC noted that the assessee had furnished the agreements with the concerned parties and that Sony Corporation, Japan had not licensed any technology to MBIL and CTTL but had only set out terms and conditions, which would govern the transactions between Sony Corporation or any of its subsidiaries with MBIL and/or CTTL. The assessee had also set out the commercial arrangement between the assessee and the AEs, which required payment of royalty.

ii. The Tribunal referred to the decision of this Court in ***CIT-I vs. M/s Cushman and Wakefield (India) Pvt. Ltd., Neutral Citation No. 2014: DHC:2764-DB*** and faulted the learned TPO for ignoring the commercial expediency and benchmarking the payment of royalty at Nil. It also accepted that Sony Corporation or any of its subsidiaries had invested significant amount for intangible properties, which the assessee had the license to use on payment of royalty @ 2% on net sales.

iii. The Tribunal concluded that MBIL and CTTL were manufacturing sub-contractors and the assessee had been granted the license for use of the license patents, license know-how, and license trademarks. The assessee was also entitled to get the products manufactured through sub-contractors. The Tribunal also observed that it was not the Revenue's case that MBIL and CTTL had paid royalty to Sony Corporation, Japan for manufacturing their products and using the licensed patents, know-how and trademarks.

iv. The Hon'ble HC noted that the aforesaid finding of fact was not controverted. It further held that the learned TPO is not required to examine the efficacy of commercial transactions and its role is confined to determining the price or value of the transactions on an arm's length basis. Accordingly, the Hon'ble HC upheld the conclusion of the Tribunal and dismissed the Revenue's appeal.

5 ***Alcatel Lucent India Ltd. vs. DCIT [2024] 167 taxmann.com 595 (Delhi)***

a) Where assessee-company rendered software development services, the Hon'ble HC held that a company which derived its revenue from both software development services and sale of software products, could not be selected as comparable.

b) Where the business model followed by selected company was largely outsourcing its activities and sub-contracting services and yet however the Hon'ble Tribunal held that the selected company was a comparable entity as it did not fail employee cost filter as per annual report, the Hon'ble HC directed exclusion of the said company from the comparables list.

c) Where assessee-company contested certain comparables and submitted detailed contentions against each of such companies and yet however, the Hon'ble Tribunal inadvertently did not adjudicate upon inclusion/exclusion of said companies in the final set of comparable, the Hon'ble HC remanded

back the matter to the Tribunal for deciding afresh assessee's objections.

C. TRIBUNAL

6 ***Ashok Kumar Pandey vs. ACIT [2024] 167 taxmann.com 286 (Mumbai-Trib)***

Where assessee, an Indian citizen, claimed himself to be a resident of USA as his family was US national holding US passport and he was overseas citizen of India, the Hon'ble Tribunal held that the assessee was a resident of India in terms of article 4(2)(a) of Indo-US - DTAA and all his income derived in USA, was chargeable to tax in India by virtue of provisions of section 5 since;

a) **He had an active involvement in a running of business of a private limited company in India which he had set up along with his wife.**

b) **He did not have any active involvement in USA for earning wages, remuneration, profit therefrom.**

Facts

i. The assessee, an individual deriving income from capital gains, dividend, interest income and income from house property filed his return of income for assessment year 2013-14.

ii. The assessee claimed that he was a resident but not ordinarily resident for assessment year 2009-10 and a resident since assessment year 2010-11. For the relevant year, the assessee had claimed that he was resident in India as well as in the United States of America and thus, the residential status of the assessee was required to be determined in accordance with the provisions of Double Tax Avoidance Agreement (DTAA) between India and USA.

iii. The assessee had also stated that he had a permanent home in India as well as in the USA and, therefore, his residential status would depend upon his personal and economic relation and its closeness (centre of vital interest) which according to the assessee lay in the USA and, therefore, in terms of article 4(2)(a) he was a resident of the USA.

iv. The AO in view of his findings, given below held, that the assessee's centre of Vital Interest, i.e., personal and economic interest, were closer to India and, therefore, the claim of the assessee that he was a resident of the United States of America for tax purposes was rejected. The AO found that;

a. The stay of the assessee in India was more than 183 day and that he was staying with his wife and children in India,

b. The assessee was a Managing Director with shareholding of more than 50 per cent in an Indian company in whose affairs he was actively participating.

c. The assessee had made investments in mutual funds and also shares in India deriving dividend and capital gains therefrom.

d. Income derived by the assessee from the US such as interest, dividend, house property, and capital gain were passive income for which active involvement was not required.

e. The assessee was residing in India for a major part of the year (and was married to an Indian, also living in India along with his spouse and one child, while the other child was in the US for study purposes only).

v. Thus, according to the AO, as per clause-2 of article 10 of DTAA, the assessee was liable to offer the entire amount as income where he was resident and then avail DTA benefit. Since no taxes had been withheld in the USA w.r.t the entire dividend income, the same was considered as income of the assessee by applying a conversion rate of ₹ 53.98 per $ and ₹ 40,39,358 was added back.

vi. Further, the assessee had earned taxable interest income of $ 5695 and since the assessee had not paid any tax in the US as it was less than the minimum income chargeable to tax, applying article 11(2), the AO made addition of the said income.

vii. On appeal, the CIT (A) held that as per section 5, if an individual was residing for more than 183 days in India, he would be considered as a Resident in India and his entire global income would be taxable in India, though he would be allowed credit of tax paid in the United States in Indian tax returns. As the assessee had not paid any tax in the USA, the computation of total income made by the Assessing Officer was upheld.

viii. Aggrieved, the assessee filed appeal before the Hon'ble Tribunal.

Decision

i. The Hon'ble Tribunal noted that the assessee was staying in India with his wife, son and daughter for more than 183 days in the current year and therefore according to the domestic law, he was to be considered a resident of India. His other daughter was staying in USA for the purpose of study. The stay of his extended family including parents in USA was not so much relevant to decide whether his personal relationship was close to USA or not, because, though his parents were USA National, but his brother and his sisters were also staying there. He had a home in India and though he also had a home in USA, purchased by mortgage loan, the same was let out on rent.

ii. Regarding the assessee's economic interest, the Hon'ble Tribunal noted that he had come back to India for carrying on business in a private limited company which was set up by him and his wife in 2009 for distribution of films and which had a work in progress of approximately ₹ 69,152,085/– and long-term unsecured borrowing from the directors of ₹ 81,256,726/–. Further, he held 50 per cent of the shares and the balance 50 per cent of the shares were held by assessee's wife. The loan amount of ₹ 81,256,726/– invested in the above company which was mostly tied up in the work in progress as well as the bank balance, was also financed by the assessee. Assessee had attended along with his wife five Board meetings of the above company. Therefore, the assessee had an active involvement in running of this company in India. In India he also had operative bank

accounts with Union Bank of India and ICICI bank. (He also had investment in mutual funds. However, the Hon'ble Tribunal clarified that operating a bank account and having an investment in mutual funds may not have any vitality of economic relationship because these are passive investments and may flow to any country irrespective of the residence if the other laws permit, based on rate of return.)

iii. It further noted that, from USA, assessee was deriving rental income where his house property was rented out, he had investments in bank accounts as well as alternative investments. He had also other investments where dividend income accrued along with the increase in market price of the investment. Thus, he did not have any active involvement in the USA for earning wages, remuneration, profit.

iv. The Hon'ble Tribunal therefore concluded that on comprehensive appraisal, the personal relationship and economic relationship of the assessee, tilt more in favour of being close to India then the US. Consequently the assessee was a resident of India in terms of article 4(2)(a) of the Indo-US – DTAA and all his income derived in the USA, was chargeable to tax in India by virtue of the provisions of section 5 of the Act. Further, since the income tax return of assessee filed by him in USA, did not show that he had paid any tax there, no credit was available against tax payable by the assessee in India.

v. Accordingly, appeal filed by the assessee was dismissed.

7 *Transkor Global Pte Ltd. [TS-742-ITAT-2024 (Del)]*

The Hon'ble Tribunal held that income derived by a Singapore based company (assessee) on account of services rendered towards technical non-invasive inspection and integrity assessment/scanning of off-shore pipelines under the sea or surface through Magnetic Tomography Method (MTM) technology to Indian Companies did not constitute FTS under Article 12(4)(b) of India-Singapore DTAA, since it did not satisfy the 'make available' clause. Further, the said income could also not be taxed as business income under Article 7 of the said DTAA in the absence of PE. It also rejected Revenue's reliance on Section 90(i)(b) introduced with effect from April 01, 2021 alleging that assessee was engaged in treaty shopping arrangement holding that the said allegation was not made before the CIT(A) and that the Revenue could not improve its case by stating new facts or allegation. It further held that Section 90(i)(b) is applicable only from AY 2021-22 and could not be made applicable for the relevant AY i.e. 2019-20.

8 *GKN Driveline (India) Ltd. vs. ACIT (OSD) [2024] 167 taxmann.com 124 (Delhi-Trib)*

The Hon'ble Tribunal held that where assessee's margin was much higher than comparables' margin, no TP adjustment could be made on account of interest on outstanding receivables from AEs.

■●■

CA Naresh Sheth CA Jinesh Shah

INDIRECT TAXES
GST

A. WRIT PETITIONS

1 *K T Saidalavi vs. State Tax Officer [2024-TIOL-1760-HC-Kerala-GST] – Kerala High Court*

Facts and issues involved

Proper officer under the CGST Act initiated enquiry regarding non-payment of GST and directed the appellant to produce certain records. This was followed by a summons issued under Section 70 of the CGST Act leading to the recording of certain statements. Certain records were also produced before the Central Authority.

While matters stood thus, the State Authority initiated proceedings u/s 74 r.w. Section 122(1) of the CGST Act against the appellant.

Petitioner preferred the present writ to challenge the duality of proceedings initiated by Centre as well as State GST authorities.

Petitioner's submissions

Petitioner contended that the proceedings initiated by the State Authority u/s 74 of the CGST Act, which culminated into an order, were unsustainable in law as per provisions of Section 6 of the CGST Act. Petitioner claimed that as per Section 6 of the CGST Act, 2017, where proceedings have been initiated by one authority, such proceedings shall be continued and culminated by that authority.

In other words, since proceedings had already been initiated by the Central Authority, the State Authority could not have served any notices under Section 74 on the applicant. The petitioner relied on several case laws in support of his contention.

Discussions by and Observations of High Court

On perusal of Section 6 of the CGST Act, 2017, it is found that Section 6(2) of the CGST Act, 2017 mandates that where a proper officer under the CGST Act (Central Authority) has issued an order under the said Act, he shall also issue an order under the respective State GST Act or the UTGST Act. The Section further provides that where a proper officer under the State GST Act or the UTGST Act has initiated any proceedings on a subject matter, no proceedings shall be initiated by the proper officer under the CGST Act on the same subject matter.

The term 'initiation of any proceedings' is no doubt a reference to the issuance of a notice under the provisions of the CGST/SGST Acts and the initiation of an enquiry or the issuance of summons under Section 70 of the CGST/SGST Acts cannot be deemed to be initiation of proceedings for the purpose of Section 6(2)(b) of the CGST/SGST Acts.

All case laws cited by the petitioner were found to be unrelated to the current case and hence the analogy from the same could not be drawn in the favor of the petitioner.

Decision of High Court

Writ petition was dismissed. All questions, including the question as to whether the proceedings should have been initiated and continued under Section 74 of the CGST/SGST Acts are left open and it is open to the petitioner to raise objections to the proceedings on that ground also before the authorities.

Since the writ petition was pending since 2020, it was directed that the petitioner file appeal against the impugned orders within two weeks from the date of receipt of this judgment.

2 *Bajaj Herbals Pvt Ltd vs. Deputy Commissioner of Customs and Ors [2024-TIOL-1789-HC-AHM-GST] – Gujarat High Court*

Facts and issues involved

Petitioner has exported goods but inadvertently did not include the IGST amount of ₹ 19,44,122/- paid by the petitioner in Form GSTR-1 of the relevant month. However, the same was correctly included in the petitioner's Form GSTR-3B and Form GSTR-9.

The petitioner made an inquiry when it did not receive the refund and subsequently learnt about error made by it. Petitioner tried to amend Form GSTR-1 but the same was not allowed. Thereafter, the petitioner vide various communications requested the GST Authorities to sanction the refund of IGST paid on the Zero-Rated Supplies. The petitioner also filed the CA certificate and undertaking pursuant to the Circular No. 12 of 2018-Cus dated 29.05.2018 issued by CBIC prescribing the procedure for sanction of pending IGST refund claims where the records have not been transmitted from GSTN to DG systems.

The petitioner received letter dated 27.08.2021 from the Office of the Principal Commissioner of Customs informing the petitioner that there is no office process mechanism or office interface to amend the errors made by petitioner in filing Form GSTR-1 data. The petitioner, therefore, being aggrieved has filed the writ petition.

Discussions by and Observations of High Court

Petitioner cannot be deprived of the refund which is otherwise legitimately payable to the petitioner as per Section 16 of the IGST Act, read with Section 54 of the CGST Act read with Rule 96 of the Rules.

GST Authorities should act immediately and manually process the refund of the petitioner within 12 weeks from receiving the order. Since the error was committed by the petitioner, the petitioner was not entitled to interest on the delayed refund.

Decision of High Court

Writ Petition was accordingly disposed of.

3 *Amir Malik vs. Commissioner of GST [2024-TIOL-1802-HC-DEL-GST] – Delhi High Court*

Facts and issues involved

Petitioner is aggrieved by the cancellation of its registration vide impugned order dated 04.07.2023. The said order was preceded by SCN dated 16.06.2023.

Neither the SCN nor the final order issued to the petitioner assigned or recorded any reason in support of the conclusion that the petitioner has violated the provisions of the CGST Act, 2017.

Discussions by and observations of High Court

SCN is gloriously silent with respect to the provisions of the GST Act which are alleged to have been violated or infringed. The aforesaid position remained unaltered in the final order which too fails to provide any clue with respect to the provision of the statute which may have been violated or infringed. It is unable to sustain such impugned order.

Decision of High Court

Writ petition is allowed; SCN as well as Order of cancellation of registration is quashed.

4 *Veremax Technologie Services Ltd vs. Assistant Commissioner of Central Tax [2024-TIOL-1835-HC-KAR-GST] – Karnataka High Court*

Facts and issues involved

Petitioner has challenged impugned SCN dated 03.05.2024 issued by GST authorities for the tax periods 2017-18, 2018-19, 2019-20 and 2020-21 on the ground that they are flawed due to the improper consolidation of multiple tax periods into a single show cause notice.

Petitioner's submissions

Petitioner's primary argument is that the authorities cannot issue a common show cause notice by grouping the tax periods from 2017-18 to 2020-21. The petitioner asserts that u/s 73 of the CGST Act a specific action must be completed within the relevant year, and the limitation period of three years applies separately to each assessment year. Consequently, the petitioner contends that clubbing multiple tax periods in a single notice is impermissible, and separate notices should have been issued for each assessment year u/s 73(1) of CGST Act.

Petitioner relied on judgment of the Hon'ble Madras High Court in the case of ***M/s. Titan Company Ltd. vs. Joint Commissioner of GST [2024-TIOL-131-HC-MAD-GST].*** The Madras High Court, while addressing a similar issue, relied on the Hon'ble Supreme Court's decision in ***State of Jammu and Kashmir and Others vs. Caltex (India) Ltd. [AIR 1966 SC 1350]*** wherein it was held that where an assessment encompasses different assessment years, each assessment order can be distinctly separated and must be treated independently.

Discussion by and observations of High Court

Court reviewed the judgment of the Madras High Court and the scope of inquiry under Section 73 of the CGST Act. Based on the established legal principles and the precedent set by the Hon'ble Apex Court, authorities have erred in issuing a consolidated show cause notice for multiple assessment years, spanning from 2017-18 to 2020-21.

Section 73(10) of the CGST Act mandates a specific time limit from the due date for furnishing the annual return for the financial year to which the tax due relates. The law stipulates that particular actions must be completed within a designated year, and such actions should be executed in accordance with the law's provisions.

The principles enunciated in the judgment cited by the Hon'ble Supreme Court are directly applicable to the present case.

For the reasons aforementioned, show cause notices issued by the authorities are fundamentally flawed. The practice of issuing a single, consolidated show cause notice for multiple assessment years contravenes the provisions of the CGST Act and established legal precedents.

Decision of High Court

Writ petition is allowed. Impugned SCN dated 03.05.2024 issued by the respondent for the

tax periods 2017-18, 2018-19, 2019-20 and 2020- 21 are hereby quashed. This, however, does not preclude the authorities from issuing separate SCN for each assessment year in compliance with Section 73 of the CGST Act, 2017.

5 *Tikona Infinet Pvt Ltd vs. Union of India And Others [2024-TIOL-1777-HC-MUM-GST] – Bombay High Court*

Facts and issues involved

Petitioner is engaged in providing internet services across India from various States, including the State of Maharashtra. On 17.08.2017, Petitioner entered into a Business Transfer Agreement (BTA) with Tikona Digital Networks (TDN) in which the TDN business was transferred to the Petitioner as a going concern.

On 22.09.2017, TDN filed a letter with the jurisdictional authority informing them about the non-availability of Form ITC-02 functionality on the department's common portal. Since Form ITC-02 was not yet available on the GSTIN portal, TDN requested the jurisdictional authority to guide them on transferring credit from TDN to the Petitioner.

As there was no response from jurisdictional authority, petitioner submitted letter dated 12.02.2018 informing the jurisdictional authority about the transfer of ITC from TDN to the Petitioner through Form GSTR-3B.

After about 5 to 6 years, jurisdictional authority issued an Audit Notice and thereafter an SCN to the Petitioner proposing to recover and demand the ITC of ₹ 18,30,58,995/- with interest and penalty on the alleged ground of wrongful availment of ITC. Petitioner, thus, preferred the present writ petition.

Discussions by and observations of High Court

Section 18(3) of the CGST Act provides that where there is a change in the constitution of a registered person on account of sale, merger, demerger, amalgamation, lease or transfer of the business with the specific provisions for transfer of liabilities, the said registered person shall be allowed to transfer the input tax credit which remains unutilsed in his electronic credit ledger. Rule 41 of the CGST Rules provides for manner of transfer of credit on the sale, merger, amalgamation, lease or transfer of a business.

Pertinently, the only allegation in the impugned show cause notice is that the Petitioner, before availing of and utilizing the credit of ₹ 18,30,58,995/- did not ensure that the prescribed Form GST ITC-02 was filed "electronically on the common portal" along with a request for transfer of unutilsed input tax credit lying its electronic credit ledger to the transferee. The allegation might have had some substance had it been the case that its common portal was fully functional and TDN or the Petitioners could file Form GST ITC-02 electronically on the common portal. However, it was conceded that the GST portal was nascent during the relevant time, and GST ITC-02 was not available for filing electronically. Thus, neither the Petitioner nor TDN could be faulted for not filing Form GST ITC-02 electronically on the department's common portal. The record establishes, and in any event, it was not disputed, that TDN or the Petitioner couldn't file Form GST ITC-02 on the department's common portal during the relevant period because of the functionality issues relating to such a common portal.

The issuance of the impugned show cause notice, given the admitted facts and circumstances, is an exercise in arbitrariness, and GST authorities certainly lacks jurisdiction to act arbitrarily and seek to fault the Petitioner for matters entirely beyond the

control of the Petitioner or reasons attributable to GST authorities themselves.

Decision of High Court

Impugned SCN is quashed and set aside. GST authorities is directed to consider the manually filed forms by the TDN as expeditiously as possible. If, upon due consideration of the same, the GST authorities still find that the ITC of ₹ 18,30,58,995/- was not due or was wrongly availed of and utilized by the Petitioner, the concerned authorities is free to make an appropriate order in that regard.

B. RULINGS BY ADVANCE RULING AUTHORITY

1 ***Green Infra Wind Farm Assets Limited [Ruling No. RAJ/AAR/2024-25/10] – Rajasthan AAR***

Facts and Issues involved

Applicant is engaged in business of development and operation of renewable power projects and allied activities.

As a part of shareholder's activities, overseas group companies provide corporate guarantees to banks financial institutions for loans obtained by applicant. The said corporate guarantee remains in effect till final settlement date of loan contract i.e. there is no specific requirement of periodic renewal. It is valid for specific time period.

Applicant sought an advance ruling on following questions:

1. Whether GST under RCM on issuance of corporate guarantee is payable one time or on periodic basis considering that guarantee is issued only once and valid for specified period without periodic renewal?
2. If GST under RCM is to be paid on periodical basis, then to ascertain value of supply:
   a. Whether value of loan for which guarantee is given needs to be divided equally amongst the relevant years of guarantee and GST under RCM is to be paid considering 1% of such divided value each year?
   b. Whether GST under RCM is to be paid on 1% of total value in first year and on 1% of only remaining outstanding value of loan at beginning of each such subsequent year?

Applicant's submissions

Corporate guarantee received from foreign group companies is a one-time guarantee and not a continuing guarantee. Hence, the same is not a continuous supply of service in terms of Section 2(33) of CGST Act. Continuous supply of service is defined u/s 2(33) of CGST Act as supply of services which is provided continuously or on recurrent basis under a contract for a period exceeding 3 months with periodic payment obligations.

In the present case, transaction of providing corporate guarantee by the foreign group company for repayment of term loan will qualify to be one time supply of corporate guarantee since there is no renewal of the subject guarantee on an annual basis/periodical basis, but the guarantee provided once at the time of execution of deed of guarantee continues over a period of time.

The date of execution of the deed of guarantee would be deemed to be the date of provision of corporate guarantee as per amended provision of Rule 28(2) of the CGST Rules and deemed value @ 1% of such guarantee offered would be deemed consideration from

the date of the said amendment, where there is no consideration such guarantee. Reliance is placed on the FAQs issued by the CBIC on Banking, Insurance and Stock-Brokers Sector wherein time of supply of life insurance service has been clarified that for a new policy, the time of supply would be the time of issuance of the policy.

Without prejudice to the above, Rule 28(2) does not specify the methodology of how GST under RCM is to be paid if GST is payable periodically. It just states that the "value of supply" of providing corporate guarantee "shall be deemed to be one per cent of the amount of such guarantee offered.....". From the wordings of the said Rule, the intention of the legislature is to ensure that the value of the supply is not more than one percent of the guarantee offered. If GST is paid on a periodic basis over the course of time when the deed of guarantee is in force, the total "value of supply" on which GST under RCM would be payable would be significantly higher than 1% of the guaranteed value unless GST under RCM is paid cumulatively only on 1% of the value of supply over the period of the guarantee. Paying GST under RCM on a periodical basis wherein "value of supply" is more than 1% of the amount of guarantee would be highly exorbitant and against the intent of Rule 28(2) of the CGST Rules. If periodic payments are required, the value of the loan should be divided equally over the years of the guarantee and GST should be paid annually on 1% of the divided value.

Discussions by and observations of AAR

In the instant case, as no consideration has been charged by the Associated Enterprises from the applicant and where the supplier of service is located outside India, the time of supply in accordance with Section 13(3) of CGST Act shall be the date of entry in the books of account of the recipient of supply i.e. Indian subsidiary and the GST liability is to paid by the Applicant at one time basis at the time of supply.

The next question raised by the applicant is if the GST under RCM is to be paid on periodical basis, then in order to determine the value of supply, whether the value of loan is to be at divided equally amongst the relevant years of guarantee and GST is to be paid considering 1% of such divided deemed value each year or 1% of only remaining outstanding value of loan the beginning of each subsequent year in term of Rule 28(2) of the CGST Rules 2017. In this context, it is pertinent to mention here that it has already been explained above that GST is required to paid at one time for Import of Service, there is no question of payment of GST periodically.

With regard to value of supply,

1. If the guarantor executes the contract of guarantee without consideration, in the GST regime prior to 26.10.2023, for the benefit of a related party, GST would be payable on the basis of the valuation mechanisms as per Rule 28(1) of RGST/CGST rules 2017 at the time of execution of the contract.

2. GST under RCM is payable on 1% of deemed total value of loan after guarantees executed after 26.10.2023 as per rule 28(2) of RGST/CGST rules 2017 on one time basis at the time of execution of the contract.

Ruling of AAR

GST under RCM is required to be paid at one time and not periodically considering that the guarantee has been issued only once and is valid for specified period of time without requirement of any periodical renewal.

CA Rajiv Luthia CA Keval Shah

INDIRECT TAXES
Service Tax

CA Rajiv Luthia
CA Keval Shah

1 *GIDC vs. CCE, Ahmedabad II 2024-(9)-TMI-1359-CESTAT-Ahmedabad*

Backgrounds and facts of the case

- The appellant established under the Gujarat Industrial Development Act, 1962, facilitates industrial development in Gujarat by allocating land and providing infrastructure in industrial areas. GIDC also maintains and upgrades infrastructure like roads, water supply, and drainage, funded through the Infrastructure Maintenance and Upgradation Funds.
- GIDC collects rent from lessees and pays service tax on the amount retained for infrastructure up-gradation fund.
- A circular dated 17.07.2010 outlined quarterly payments of 40% of the collected amount to industrial associations. An audit by the Central Excise Commissionerate raised objections about GIDC's failure to pay service tax on share of 40% allocated to industrial associations.
- It was further observed that the appellant failed to pay service tax on the following charges collected from the leaseholders as follows:

a) *Non-Utilization (NU) Penalty*: According to GIDC norms, every leaseholder is required to complete a minimum level of construction for the utilization of plots, sheds, and other properties. In cases where this condition is not met, the appellant collects a Non-Utilization (NU) Penalty from the leaseholders. It appears that the amount collected falls under the category of "declared service" asper Section 66B, and the appellant is therefore liable for the service tax on this amount.

b) *Water Supply Charges:* The appellant has been collecting "water charges" from business entities operating from plots allotted to them in the GIDC area for the supply of water. This activity is considered taxable under the category of "support services of business or commerce" or "business support services".

c) *Miscellaneous Receipts:* The appellant collects various fees/ charges such as sub-letting fees, subdivision charges, amalgamation fees, collateral fees, etc., from leaseholders operating businesses in the GIDC area. These charges represent additional consideration

and were in relation to "renting of immovable property," and are liable for service tax.

d) *Transfer Charges:* The appellant collects "transfer fees" from leaseholders as additional consideration during the transfer of property from one leaseholder to another. These transfer fees are deemed additional consideration related to the renting of immovable property and are subject to service tax.

- Accordingly, SCN dated 19.04.2017 was issued for the period Oct,2011 to March,2016 for recovery of service tax in all ₹ 2,44,32,267/-.
- The Ld. Commissioner during adjudication dropped the demand of ₹ 1,41,13,393/- considering that

  (i) Service Tax amounting to ₹ 36,75,995/-as NU Penalty which pertained to the period 01.07.2012 onwards was collected as a statutory levy and not against provisions of any kind of taxable service;

  (ii) Service Tax amounting to ₹ 13,08,905/- on water charges for the entire period covered under SCN, was also dropped as the water charges are not earned by the appellant by providing any services and same are considered as sale proceeds of essential commodity and also it is covered under Twelfth Schedule under Article 243W of the Constitution;

  (iii) Service Tax amounting to ₹ 91,28,492/-, on the amount recovered as Infrastructure Upgradation fund and Transfer Fees for the period from 01-07-2012 to March, 2016, as it is covered under Twelfth Schedule under Article 243W of the Constitution.

- However, the demand of service tax amounting to ₹ 34,83,749/-for the Misc receipts for the whole period, ₹ 4,60,369/- on IUF for the period Oct. 11 to June 2012 & ₹ 63,74,756/- on transfer fees for the period Oct. 11 to June 2012 was upheld.
- Hence the present appeal.

Arguments by Appellant Assessee

- The term 'gross amount charged' should not be construed as any amount billed by the service provider but rather the amount directly related to the service provided. Since the Appellant did not provide any services directly to the allottees, the amount collected on behalf of Industrial Associations is not liable for service tax. The Circular dated 17.07.2010 specifies that ₹ 3 per sq. Mtr. is retained by the Appellant, while ₹ 2 per sq. Mtr. is paid to the Industrial Associations. The Appellant’s records show the amount transferred to the Industrial Associations as a liability, proving that the disputed amount was not retained.
- By using the words 'for such service provided" the Act has provided for a nexus between the amount charged and the service provided. In absence of such nexus, the consideration received by the assessee cannot form part of the total taxable value in terms of Section 67 of the Act.
- That the income received under various heads like transfer fees and Misc receipts comprising various fees/charges such as sub-letting fees, subdivision

charges, amalgamation fees, collateral fees, etc., from leaseholders operating businesses in the GIDC area is the income of the State of Gujarat. As the Appellant is an undertaking of the State Government of Gujarat, this income is immune from Union taxation, and therefore, no service tax is payable.

- The Hon'ble CESTAT Delhi, in ***Central GST Delhi vs. Delhi International Airport Ltd. - 2023 (5) TMI 867***, held that fees collected for sovereign/public functions, even if termed differently, are not subject to service tax. The fees collected by the Appellant, such as Infrastructure Upgradation Fund, Transfer Fee, and other Miscellaneous Fees, are mandated by statutory provisions and pertain to land development and maintenance.

- The Hon'ble CESTAT Ahmedabad, in ***Gujarat Industrial Development Corporation vs. CCE & ST, Ahmedabad-III - 2018 (11) TMI 363 – CESTAT AHMEDABAD*** ruled that maintenance charges collected by a State Industrial Development Corporation are not taxable.

Arguments by Department

- The appellant has failed to account for the misc. receipts and prove that same pertain to exempted services and further though GIDC qualifies as a 'governmental authority' and is thus eligible for exemption from Service Tax under Item No. 39 of Notification No. 25/2012- ST, dated 20-06-2012, concerning functions listed under Article 243W of the Constitution.

- GIDC collects 'Development Charges' for converting land to non-agricultural use, which is covered under functions like 'Regulation of land use and construction of buildings,' 'Roads and bridges,' and 'Planning for economic and social development,' per the Twelfth Schedule and the development charges collected for these services are exempt from Service Tax.

- However, income earned by M/s. GIDC from 01-10-2011 to 30-06- 2012, before the notification came into effect, is not eligible for exemption and is liable for Service Tax. These charges, categorized as 'Transfer Fees' and 'Infrastructure Upgradation Fund,' relate to the service of 'Renting of Immovable Property,' which attracts Service Tax.

Decision of the Hon'ble Tribunal

- That as per circular dated 18th December 2006 bearing No.89/7/2006 it is stated that - *"The Board is of the view that the activity performed by the sovereign/public authorities under the provision of the law are in the nature of statuary obligations which are to be fulfilled in accordance with the law. The fee collected by them for performing such activates is in the nature of compulsory levy as per the provisions of the relevant statute, and it is deposited into the Government Treasury. Such activity is purely in the public interest and it is undertaken as mandatory and statutory function. These are not in the nature of service to any particular individual for any consideration. Therefore, such activity performed by a sovereign/public authority under the provisions of law does not constitute provision of taxable service to a person and, therefore, no service tax is leviable on such activities.*

- It has been accepted in the impugned order that the "Infrastructural up-gradation fund" and "transfer fees" were covered under article 243W which is a

statutory function and GIDC is a state undertaking which is performing these functions in the state for development of industry in the state. Once it is accepted that these are the statutory functions of the state, the same cannot be exigible to tax under the period prior to 01.07.2012 also.

- Further misc. receipts which are stated to be in respect of as sub- letting fees, subdivision charges, amalgamation fees, collateral fees are nothing but necessary for orderly regulation of industrial estate and are for of the infrastructural development activity only. It is an avowed statutory duty of the state to develop industry in the state and any charges collected for such making such development cannot be subjected to tax.

- Hon'ble Bombay High Court in the matter of ***CCE, Nashik vs. Maharashtra Industrial Development Corporation-2018 (2) TMI 1498*** has held that the demand is in respect of service charges collected. We find that even in the Order-in-Original, there is no finding of fact recorded that the service rendered for which service tax was sought to be levied was not in the nature of statutory obligation.

- The above case law is squarely applicable to the facts of the case as any development authority vested with the obligation and powers to develop an industrial estate need to collect fees/ charges as the State Act constituted for the purpose and so long as these fees/charges are as per the Act and not discretionary, the same are considered to be statutory levies.

- We further hold that no service tax could be charged on the share of "IUF" which was collected from the leaseholders on behalf of the Industrial Associations and reimbursed to them as those does not qualify as consideration for any service provided by GIDC as discussed in the preceding paras.

- Resultantly the services as that of construction provided to Government/ local authority/Governmental authority remain exempted from entire service tax liability irrespective the date of contract for the purpose is post 01.03.2015.

- In the present case, the Service in question has been rendered to government/local authority (PWD). Hence, though the contract is 19.08.2015 i.e. post-1.04.2015, the condition of contract to be executed prior 1.03.2015 is held to have wrongly being relied upon/invoked by the adjudicating authority.

- The appellant had explained that exemption being arising from notification 25/2012 has been the reason to not to file the returns. The said contention of appellant is acceptable and hence there is no act of suppression being committed by the appellant.

2 ***Raj Kumar vs. CCE, Ujjain 2024-(9)-TMI-1358-CESTAT-New Delhi***

Backgrounds and facts of the case

- The appellant is registered with the Service Tax department for rendering Works Contract Services.

- The department observed that the appellant had received a total sum of ₹ 2,03,37,152/- for rendering W.C.S to Public Works Departments (P.W.D) Khandwa, Nagar Palika, Nigam Khandwa and Nagar Panchayat Bhikangaon by way of constructing a girl's hostel

and drainage respectively. It was also observed to have received an amount of ₹ 28,50,000/- against providing private labour works. Resultantly vide Show Cause Notice (SCN) dated 30.12.2020, for the period April,2015 to June,2017, an amount of ₹ 64,83,146/- of Service Tax was Proposed to be recovered along with the proportionate interest and the appropriate penalty.

- The part of the service tax demand was dropped by adjudicating authority. However, part of the liability towards construction activity of girl's hostel was upheld even by CCE(Appeals). It was held that the construction of hostel is not construction of residential complex as hostel is a one building. Individual room of hostel building cannot be equated to a residential house or a flat.
- Hence the present appeal.

Arguments by Appellant Assessee

- That no Service Tax is Payable on the Works Contract Service as the same is an exempted Service in view of notification no 25/2012-ST dated 20.06.2012 entry no 12A(a). This notification exempts the Works Contract Service when provided to the government authorities, local authorities or to the governmental authorities. The W.C.S for construction of drainage is also mentioned to have been exempted under the definition of Construction Services itself.
- Further, as regards the construction of hostel, being a single residential unit, is exempted from Service Tax Liability is exempted under entry 14(b) of Mega exemption notification.
- They also relied upon the decision in the case of ***Quest Engineer and Consultant Pvt. Ltd. vs. CCE Allahabad reported as 2022 (58) GSTL 345 Tri***, where it is impressed upon that the ST-3 Returns were not required to be filed as services rendered were not taxable. The extended period of limitation is therefore wrongly invoked while issuing the impugned show cause notice.

Arguments by Department

- That though Girls Hostel is not covered under definition of 'Residential Complex', but the exemption under entry no. 12A (a) of notification 25/2012 is available to such constructions services for which the contract had been entered prior to 01.03.2015 and on which appropriate stamp duty, where applicable, had been paid prior to that date. Since in the instant case, the contract has been entered on 19.08.2015 hence exemption under S. no. 12A(a) of Notification No. 25/2012 is not available to the appellant.

Decision of the Hon'ble Tribunal

- We observe that Sr. No. 12 of Mega Exemption Notification No. 25/2012-ST dated 20.06.2012 as amended vide Notification No. 6/2015 dated 01.03.2015 is reported below vide which the entry at serial no. (c) "A residential complex predominantly meant for use self-use or the use of their employees or other persons specified in the Explanation I to clause (44) of section 65 B of the said Act.", was omitted vide notification no. 6/2015-ST dated 01.03.2015 with effect from 01.04.2015.

- This perusal is sufficient to hold that for the period in dispute, the condition that contracts for rendering construction/ WCS services to be executed prior to 01.03.2015 was no more in existence as it was omitted with effect from 1.04.2015.
- Resultantly the services that of construction provided to Government/ local authority/Governmental authority remain exempted from entire service tax liability irrespective the date of contract for the purpose is post 01.03.2015.
- In the present case, the Service in question has been rendered to government/local authority (PWD). Hence, though the contract is 19.08.2015 i.e. post-1.04.2015, the condition of contract to be executed prior 1.03.2015 is held to have wrongly being relied upon/invoked by the adjudicating authority.
- The appellant had explained that exemption being arising from notification 25/2012 has been the reason to not to file the returns. The said contention of appellant is acceptable and hence there is no act of suppression being committed by the appellant.

3 *CCE, Kutch vs. KEPCO Plant Service & Engineering Company Ltd 2024-(9)- TMI- 1077-CESTAT-Ahmedabad*

Backgrounds and facts of the case

- The respondent is engaged in the business of operation and maintenance of third-party boiler plant namely Akimota Thermal Power Station situated at Nanichher, Kutch for generation of electricity owned by M/s. GMDC Limited, a government of Gujarat enterprise.
- As per the terms of contract, whenever Progressive Plant Available Factor (PAF for short) is below 75%, the monthly O&M Fees for service contract shall be correspondingly lowered using a certain formula. Accordingly, in cases where the PAF is below 75%, the fee for O&M service was lowered as per the formula for which the respondent has raised credit notes to M/s. GMDC Limited.
- The case of the department is that the penalty which is imposed on account of lowering O&M fees due to PAF below 75%, the amount by which the fixed contract price is reduced by way of credit notes is includible in the gross value of service.
- Another issue raised in the show cause notice is that during the course of provision of service of operation and maintenance of the power generation plant, the appellant has also supplied spares and consumables and the value of the same was not included in the value of service.
- Department's contention is that since Notification No. 12/2003-ST was non-existent during the disputed period i.e. from January 2013 to September 2014 as the said notification was repealed vide Notification No. 34/2012-ST dated 20.06.2012, the value of such spares and consumables liable to be included in the gross value of the service and to that extent, the Adjudicating Authority has wrongly dropped the demand of ₹ 3,25,16,268/-.

Arguments by the Respondent assessee

- That as regards the credit note on account of PAF less than 75%, since the

amount reduced from the fixed O&M fees, the same is not part of transaction value hence the same cannot be treated as part of the gross value.

- As regards the spares and consumables supplied for service for operation and maintenance of power plant, it is his submission that for this part there is separate contract and consideration for the same is also separate from the service charges. Therefore, there are two part of the contract, one is service and another is sale of spares and consumables.

Decision of the Hon'ble Tribunal

- It is clear that when there is low performance i.e. PAF is less than 75%, the service is not as per the contract and for lower performance of service the amount was deducted by way of credit notes. It is also the fact that the amount of credit notes stand reduced from the contract price as mentioned in the contract therefore, the reduced amount of fees is the actual amount which is charged by the respondent to M/s. GMDC Limited.

- Therefore, it is the reduced amount of service charge as gross value which is strictly in terms of Section 67 of the Finance Act, 1994 therefore, no further notional addition can be done for charging service tax.

- As regard the demand of service tax on the value of spares and consumables, we find that the contract is for two transactions one is for service simpliciter i.e. maintenance and operation of power plant and the service charge for the same is fixed only for service and the second limb of contract is for supply of spares and consumables which is nothing but sale of goods. In this fact, the value of spares and consumables cannot be included in the service of operation and maintenance of power plant.

- That there is no suppression of facts with intention to evade the payment of tax established in this case. The appellant has paid service tax under the category of "consulting engineering service" instead of "intellectual property service" as claimed by the Department. If service tax is paid under a different category, it is only a procedural lapse, for which no penalty can be imposed.

- As regards the invocation of extended period, we observe that no cogent evidence has been adduced for invocation of the extended period or establish suppression of facts with an intent to evade tax. Therefore, the demand for extended period, and the penalties are set aside. However, the liability to interest will be recalculated as per the demand to be recalculated by the adjudicating authority.

CORPORATE LAWS
Case Law Update

CS Makarand Joshi

IBC – CASE – 1

In the matter of *Times Innovative Media Limited (Appellant) vs. Pawan Kumar Aggarwal (Liquidator/Respondent no.1) and Anr.,* at National Company Law Appellate Tribunal (NCLAT) New Delhi dated 19 September 2024

Facts of the Case

- An application was filed u/S 9 of the Insolvency and Bankruptcy Code, 2016 (IBC) for initiating the Corporate Insolvency Resolution Process (CIRP) against Brand Connect Communications (India) Private Limited (CD). The CIRP commenced with an order dated 27 March, 2018.
- In the CIRP of the CD, the claim of Times Innovative Media Limited - the Appellant was admitted as an Operational Debt and the claim of ex-director respondent no. 2 was admitted as an Unsecured Financial Debt.
- By an order dated 28 January 2019, the National Company Law Tribunal (NCLT) directed for liquidation of the CD.
- In the stakeholders' consultation meeting, the liquidator informed that as per section 53 of the IBC, respondent no. 2 of the CD would get priority over the appellant in the distribution of the liquidation estate.
- An objection was raised by the appellant claiming priority in payment of its operational debt over the payment to ex-director- respondent no. 2 who was an unsecured financial creditor. The objection of the appellant was that in the distribution u/s 53 of IBC priority should not be given to a related party.
- The objection of the appellant was rejected by the liquidator vide its communication dated 3 September 2021.
- The NCLT vide order dated 24 April 2024, held that the appellant who is an operational creditor cannot be given any preference over the debt of the unsecured financial creditor. It was also held that Section 53 of the IBC does not envisage any difference between unsecured financial creditors and related party unsecured financial creditor.
- Aggrieved by this order an appeal was filed at National Company Law Appellate Tribunal (NCLAT).

Arguments of the Appellant

- The ex-director- respondent no. 2 of the CD, being a related party cannot be given priority in the distribution of

proceeds of liquidation assets of the CD, ahead of the appellant/operational creditor.

- The ex-director - respondent no. 2 of the CD had to be treated as an equity shareholder and a related party of the CD, and therefore, he was not entitled to a priority in the waterfall mechanism under section 53 of the IBC, as he wears was a promoter/director/equity shareholder and a financial creditor. Therefore, he ought to be considered under the head of an equity shareholder.

- Reliance was placed on ***J.R. Agro Industries P. Limited vs. Swadisht Oils P. Ltd.***- and the judgment of the Hon'ble Supreme Court in ***Arun Kumar Jagatramka vs. Jindal Steel and Power Limited & Anr.*** as well as the judgment of the Hon'ble Supreme Court in ***M.K. Rajgopalan vs. Dr. Periasamy Palani Gounder & Anr.*** where in it is submitted that a related unsecured debtor has to be treated differently in the waterfall mechanism from the unrelated unsecured creditors and the operational creditor. Operational Creditor debt has to be given priority over debt of related party unsecured creditor.

Arguments of the Respondent 1 (Liquidator)

- The inclusion of the ex-director -respondent no. 2 of the CD as an unsecured financial creditor in the list of stakeholders was never challenged. The objection was raised only after the stakeholders' consultation meeting.

- The ex-director-respondent no. 2 of the CD had advanced the loan on 2 February, 2011 and thereafter, he resigned as a director on 1 October, 2013 thus, the ex-director-respondent no. 2/of the CD would not fall within the ambit of a related party of the CD.

- Section 53 of the IBC does not envisage any difference between an unsecured financial creditor, i.e., the appellant/ operational creditor and a related party unsecured financial creditor, i.e., the ex-director/respondent no. 2/of the CD.

- Section 53(1) of the IBC provides that liquidation assets shall be distributed in the order of priority as enumerated therein. In the order of priority, financial debts owed to unsecured creditors are at Clause (d). Clause (f) deals with any remaining debts and dues. The operational debt of the appellant falls under clause (f). Thus, on a plain reading of section 53(1), it is clear that financial debts owed to unsecured creditors ranked higher than the debt of operational creditors.

- The Hon'ble Supreme Court in ***Swiss Ribbons Private Limited and Anr. vs. Union of India and Ors.*** had occasion to consider section 53 of the IBC. The Hon'ble Supreme Court held that there is an intelligible differentia between the financial debts and operational debts. The reason for differentiating between financial debt and operational debt was noticed and differentiation was upheld. The Bankruptcy Law Reforms Committee Report also highlighted the importance of financial debt and dues of unsecured financial creditors were kept higher than the remaining debts within which operational debt now formed.

- The definition of 'financial debt' as contained in Section 5(8) of IBC does not indicate any exclusion of financial debt which is reflected by any transaction with the CD by the related party.

- When a financial debt is extended by the related party the consequence for such creditor is captured in section 21 of IBC. As per section 21(2) of IBC, a financial creditor if it is a related party of the CD shall not have any right of representation, participation or voting in a meeting of the CoC. Further, by virtue of Section 29A, related party may incur any of the disqualifications under Section 29A. With respect to filing of the claim as per Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations 2016, the claim by the financial creditors can be filed as per regulation 18 **Scheme of regulations 2016 does not indicate that the related party is excluded from filing a claim.**

Arguments of the Respondent No. 2 (supporting the case of the liquidator)

- The loan was advanced by the ex-director -respondent no. 2 of the CD in 2011 to 2012, which loan had been partly repaid by the CD.
- The financial debt of the ex-director-respondent No. 2 of the CD was admitted and he was treated as an unsecured financial creditor, which was never challenged.

Held

- Financial debts owed to unsecured creditors rank higher than debts of operational creditors. The appellant/ operational creditor cannot claim any priority in the distribution of the assets of the CD as compared to the unsecured financial creditor, who was the appellant/ex-director in the present case.
- The Operational Creditor which is the appellant in this case cannot claim any priority in the distribution of assets of the CD as compared to unsecured financial creditor and the appeal was dismissed.

Companies Act — Case 2

In the matter of *HT Media Ltd And Anr vs. Regional Director & Ors,* NCLAT principle bench New Delhi, order dated 12 March, 2024

Facts of the Case

- A composite scheme of amalgamation was proposed for the merger of Digicontent Ltd., Next Mediaworks Ltd (NMW) and HT Mobile Solutions Ltd (HTMS) transferor companies, with HT Media Ltd (Transferee company/ Appellant).
- Scheme of a merger of these companies was provided in the scheme in different parts: Part D of the composite scheme dealt with the amalgamation of the HTMS with HT Media (Transferee company), Part B dealt with the amalgamation of Digicontent with the Transferee Company and Part C dealt with the amalgamation of NMW with the Transferee Company.
- The said scheme was presented before the Hon'ble National Company Law Tribunal ['NCLT'] Delhi and Mumbai for its approval and through its first motion order, ordered Digicontent Ltd, NMW, HTMS and Transferee company ['Amalgamating companies'] to call meetings of their respective shareholders and creditors. Accordingly, the Amalgamating companies called the requisite meetings and notified other authorities like the Regional Director and Income Tax authority etc. about the proposed scheme.

- The scheme stood approved qua HTMS and Transferee company with requisite majority shareholders and creditors. However, the scheme was not approved by the requisite majority of public shareholders of Digicontent Ltd as well as the requisite majority of public shareholders of NMW.
- Thereafter, the Transferee company moved the second motion under sections 230 to 232 seeking sanction of the scheme with respect to HTMS and Transferee company, that is sanction of part D of the scheme.
- However, the Hon'ble NCLT, New Delhi dismissed the application of the second motion on the ground that the other two parties viz. Digicontent Ltd. and NMW had rejected the proposed scheme, and it was difficult to comprehend how the approval can be granted to the scheme which involves all the three companies.
- Therefore, the appellants are before NCLAT for obtaining approval for a specific part of the composite scheme.

Contentions of Transferee company

The schemes were separable as per provisions of the composite scheme of the amalgamation filed viz Annexure-2, annexed with the appeal.

Reliance is placed on Clause No. 1.2.2 of the scheme and further, Clause 23.1 of the scheme, as under:

"*1.2.2. Notwithstanding, anything contained in this Scheme, if for any reason any Part of this Scheme being Part B or Part C or Part D of the Scheme is found to be unviable or unworkable qua the relevant Transferor Company or cannot be effected together with other Parts of the Scheme in a consolidated manner including on account of non-approval of the Scheme by the Appropriate Authority or by requisite majority of the shareholders of the relevant Transferor Companies, the same shall not, unless decided otherwise by the Boards of the Transferee Company and other Transferor Companies, affect the validity or implementation of the other Parts of this Scheme. For the avoidance of doubt, it is hereby clarified that each part of this Scheme being Part B or Part C, or Part D, are severable and can be made effective independently along with the applicable clauses of this Scheme as contained in Part A, Part E and Part F of this Scheme, subject to Clause 22 of this Scheme. It is further clarified that for the purpose of Part A, Part E and Part F of this Scheme, the term Transferor Company or the Transferor Companies shall be construed accordingly. 23.1. In the event any of the sanctions and approvals as referred to in Clause 22 of the Scheme is not obtained or complied with or satisfied, or, if for any other reason, any Part of this Scheme cannot be implemented, such Part of this Scheme shall automatically stand revoked, cancelled and be of no effect, save and except in respect of any act or deed done prior thereto as is contemplated hereunder, or as to any rights and liabilities which might have arisen or accrued pursuant thereto, and which shall be governed and be preserved or worked out as is specifically provided in the Scheme or as may otherwise arise in law. It is hereby clarified that the non-receipt of approvals, as mentioned above, shall not, unless decided otherwise by the Boards of the relevant Transferor Companies and Transferee Company, affect the validity or implementation of the other Parts of this Scheme*".

Ld. Sr. Counsel for the Appellant submitted that the scheme was structured in a manner the shares of HTMS held by the shareholders will be swapped with those of the transferee Company based on a pre-determined ratio, except for the shares of the transferor company held by the transferee company which shares are intended to be cancelled. It is pertinent to note the share swap ratio as determined by the registered valuer for the respective Parts B, C and D are completely distinct and independent of one another.

Respondent's contentions: The income Tax Department and Regional Director gave no objections for the partial acceptance of the scheme.

Held

- We have gone through the order of Hon'ble NCLT Mumbai and Delhi, and it doesn't discuss if the scheme of amalgamation was separable as pointed out in clauses no. 1.2.2 and 23.1 (supra). The impugned order is completely silent on these clauses.
- Section 231(1) (b) of the Companies Act 2013 duly empowers the Hon'ble NCLT to exercise discretion to "give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement". The Hon'able NCLT was thus duly vested with sufficient powers under the Companies Act, 2013 to even partly sanction the scheme.
- Reliance was also placed on '***Rama Investment Company Pvt. Ltd. vs. Ankit Mittal'*** wherein vide order dated 07.09.2022 in Civil Appeal Nos. 2022-2023/2022 the Hon'ble Supreme Court was pleased to set aside the order of this Tribunal and confirm the scheme of amalgamation in part as approved by the Ld. NCLT.
- In the aforesaid circumstances, while setting aside the impugned order dated 23.02.2023 we direct the Hon'able NCLT, New Delhi Bench to revisit the application of the second motion in the light of the observations made by this Hon'able Tribunal above and after considering the observations/ clarifications of Regional Director, may dispose of the petition in accordance with law within six weeks from the date of communication of this order.
- Appeal and pending applications stand disposed of.

SEBI — Case 3

The Securities Appellate Tribunal ('SAT') Order in the Matter of Remsons Industries Limited

Facts of The Order

1. The Remsons Industries Limited ('Appellant') is a Company registered under the Companies Act, 1956. The Appellant is engaged in the manufacturing of auto products like control cables, gear shifters etc.
2. The National Stock Exchange ('NSE') vide email dated January 11, 2022, had called upon the Appellant to clarify with regard to the disclosure of Related Party Transactions as required under Regulation 23(9) of the Securities Exchange Board of India (Listing Obligation and Disclosure Requirement) Regulations ('SEBI LODR Regulation') for the quarter ended September 30, 2021.
3. In reply, *vide* email dated January 11, 2022, the Appellant sought to clarify that Regulation 23 of the SEBI LODR Regulations is not applicable to the

Appellant as the Appellant is exempted under Regulation 15(2) of the LODR Regulations.

4. The reason of said exemption as mentioned was that, the paid-up equity share capital of the Appellant was ₹ 5.71 crores and Company's net worth was ₹ 31.36 crores and as per Regulation 15 of SEBI LODR Regulations, a listed entity having paid-up equity share capital not exceeding ₹ 10 crores **and** net worth not exceeding ₹ 25 crores, **is exempt from compliance of corporate governance provisions under various Regulations including Regulations 23 of SEBI LODR**.

5. Further the learned Advocate on behalf of Appellant submitted that the Appellant had paid the penalty amount of ₹ 12,04,200 under protest and had sought for a direction for a refund of the same as the Appellants paid up share capital is less than ₹ 10 crore hence Appellant is entitled for exemption under Regulation 15 of the SEBI LODR.

6. The respondents in the present matter are NSE, SEBI and the Bombay Stock Exchange ('BSE').

Charges Levied

Issue involved in this appeal is the applicability of provisions of related party transactions (i.e. Regulation 23 of SEBI (LODR) Regulations to Appellant Company?

Submissions on Behlaf of The Appellant

1. <u>The appellant is entitled for exemption under Regulation 15 of the SEBI LODR Regulation:</u>

   On behalf of the Appellant, it was submitted that the Appellant is a listed entity having net worth of ₹ 31.36 crore as on March 31, 2021. Further, it was submitted that the Appellant had paid-up share capital less than ₹ 10 crore. Further, it was submitted that Regulation 15 of the SEBI LODR Regulation it was submitted that a listed entity having paid-up equity share capital not exceeding ₹ 10 crores and net worth not exceeding ₹ 25 crores, is exempt from compliance of corporate governance provisions under various Regulations including Regulations 23 of SEBI LODR Regulation. Hence the submission of the Appellant was that since the Appellants paid up capital is less than ₹ 10 crores they are entitled for exemption under Regulation 15 of SEBI LODR Regulations.

<u>Contentions on behalf of the Respondents</u>

1. <u>The appellant is entitled for exemption under Regulation 15 of the SEBI LODR Regulation:</u>

   Advocate for the Respondent contended that compliance with the corporate governance provisions must be strictly construed because they shall have far-reaching consequences in the securities market. It was further submitted that on a plain reading of Regulation 15(2)(a) of SEBI LODR Regulation it was clear that in order to seek exemption from compliance with corporate governance a listed entity has to satisfy both the conditions (viz. the share capital must not exceed ₹ 10 crores and the net worth should not exceed ₹ 25 crores.)

   The paid-up share capital of the Appellant company as of March 31, 2021 was ₹ 5.71 crores and the net worth of the company was ₹ 31.36 crores as certified by the independent Chartered Accountant.

   Advocate for the Respondent further submitted that in ***'Durrani Abdullah***

Khan vs. State of Maharashtra ['(2017), 4 AIR Bom R 300 decided on May 5, 2017'] it was held that if the use of word 'and' conjunctively unintelligible result, the court has the power to read the word 'or' as 'and; and vice versa to give effect to the intension of the legislature.

Further, it was contended that it is settled that words of a statute are to be understood in their natural and ordinary sense and according to their grammatical meaning. The learned Senior Advocate for the Respondent hence contended that one of the two conditions namely net worth of the Appellant admittedly exceeds ₹ 25 crores therefore Appellant is not entitled for any exemption.

Held

Hon'ble SAT held that plain reading of the second proviso to sub-regulation (2) of regulation 15 states as follows:

"*15(2) The compliance with the corporate governance provisions as specified in regulations 17, [17A,] 18, 19, 20, 21,22, 23, 24, [24A,] 25, 26, 27 and clauses (b) to (i) and (t)] of sub-regulation (2) of regulation 46 and para C, D and E of Schedule V shall not apply, in respect of –*

(a) [a] listed entity having paid up equity share capital not exceeding rupees ten crore and net worth not exceeding rupees twenty five crore, as on the last day of the previous financial year:

Provided *that where the provisions of regulations 17 to 27, clauses (b) to (i) and (t) of sub-regulation (2) of regulation 46 and para C, D and E of Schedule V become applicable to a listed entity at a later date, it shall ensure compliance with the same within six months from such date:*'

Provided further *that once the above regulations become applicable to a listed entity, they shall continue to remain applicable till such time the equity share capital or the net worth of such entity reduces and remains below the specified threshold for a period of three consecutive financial years"*

On reading the second proviso to sub-regulation (2) of regulation 15 it is clear that the exemption shall continue to remain applicable till the equity share capital or the net worth of the entity reduces below the specified threshold. This means when the corporate governance provisions become applicable to a listed entity, they shall continue to remain applicable till either the equity share capital falls below ₹ 10 Crores or net worth reduces to less than ₹ 25 Crores. Thus, by reading the proviso, the intent of the legislature becomes clear that the Regulations shall be applicable upon happening of both contingencies and remain as such, till one of the conditions reduces below the specified threshold. Hence it was held that since the paid-up equity share capital is less than ₹ 10 crores, the corporate governance provisions do not apply to the Appellant.

Order

Appeal allowed holding that the corporate governance provisions are not applicable to the Appellant as the paid-up equity capital is less than ₹ 10 Crores.

OTHER LAWS

FEMA – Updates and Analysis

CA Hardik Mehta CA Tanvi Vora

In this article, we have discussed recent amendments made in FEMA through Notifications, Circulars, Master Directions, Press Notes & Press Releases.

A. Update through Circulars

1. Due diligence in relation to non-resident guarantees availed by persons resident in India

RBI has come across instances of guarantees (including Standby Letters of Credit [SBLCs] and/or performance guarantees) issued by persons resident outside India, favouring persons resident in India, which are not permitted under the extant FEMA regulations. Therefore, the RBI has instructed AD banks to ensure that guarantee contracts advised by them to, or on behalf of, their resident constituents are in accordance with the FEMA regulations.

A.P. (DIR Series) Circular No. 18, dated 4th October 2024

(Comment: While there is no amendment effected through the circular, RBI has merely issued the same as a reminder to the AD banks to allow only those guarantee transactions that are permitted under FEMA. The circular deals with cases of instances of guarantees issued by PROIs in favour of PRIIs.

Regrettably, the circular does not further reference the instances/examples of non-permitted guarantees nor does it reference the Rules, Regulations or Notification under which the permitted guarantees are provided. In our understanding, FEMA 8/2000-RB dated 3rd May 2000 viz. Foreign Exchange Management (Guarantees) Regulations, 2000 provides a list of permitted PROI to PRII guarantees (including Standby Letters of Credit [SBLCs] and/or performance guarantees). Accordingly, any guarantee transactions should be reviewed for permissibility by AD banks and in case of non-permitted transactions that are already undertaken, advice the PRII to close the guarantee and approach the RBI for compounding.)

Best of The Rest

Rahul Hakani
Advocate

Niyati Mankad
Advocate

LENIN KUMAR RAY VERSUS M/s. EXPRESS PUBLICATIONS (MADURAI) LTD. – JUDGMENT DT 21/10/2024 [2024 INSC 802]

Section 2(s) of the Industrial Disputes Act, 1947 ("ID Act") - To qualify as a "workman" - the determinative factor is the principal duties and functions performed by an employee in the establishment and not merely the designation of his post. Further, the onus of proving the nature of employment rests on the person claiming to be a "workman" within the definition of section 2(s) of the I.D. Act.

Facts

Lenin Kumar Ray, the employee, initially joined Express Publications (Madurai) Ltd. as a Junior Engineer in 1997 and was later promoted to Assistant Engineer. In October 2003, his employment was terminated with one month's salary in lieu of notice. Ray challenged this termination, claiming he was a "workman" under Section 2(s) of the ID Act and argued that his termination violated legal protections under the Act. The Labour Court ordered his reinstatement with compensation in lieu of back wages, a decision partially overturned by the Orissa High Court. Both parties subsequently appealed to the Supreme Court. Ray contended his supervisory duties were insufficient to exclude him from "workman" status, while the employer argued his salary and duties positioned him outside this definition. The court also examined the applicable wage limits under the ID Act's amended and pre-amended provisions.

Issues Involved

(1) whether Ray qualified as a "workman" under Section 2(s) of the ID Act, considering his supervisory role and salary exceeding ₹ 1,600 at the time of termination?

(2) whether his termination adhered to procedural requirements under the ID Act?

Held

The Supreme Court concluded that Ray did not qualify as a "workman" under the ID Act, applying the pre-2010 amendment wage limit of ₹ 1,600 for supervisory employees, which was less than Ray's salary at termination. The Court emphasized the determinative factor was the nature of duties, not designation, citing ***S.K. Maini vs. Carona Sahu Co. Ltd. [(1994) 3 SCC 510]*** and ***Ananda Bazar Patrika (P) Ltd vs. Workmen [(1970) 3 SCC 248].*** It held that without clear evidence of non-supervisory duties, the Labour Court's order of reinstatement could not be upheld. Since, Ray

did not qualify as workman, protections under the ID Act, including Section 25F (relating to conditions for retrenchment), did not apply. The Court clarified that wrongful termination claims for employees outside the “workman” definition must be resolved contractually rather than under the ID Act. The Court allowed the employer's appeal and dismissed Ray’s appeal, confirming no procedural violations occurred in his termination.

CENTRAL WAREHOUSING CORPORATION & ANR. VERSUS M/S SIDHARTHA TILES & SANITARY PVT. LTD – JUDGMENT DT 21/10/2024 [2024 INSC 805]

Sections 11 and 16 of the Arbitration and Conciliation Act, 1996 (“the A&C Act”); Public Premises (Eviction of Unauthorised Occupants) Act, 1971 (“the PP Act”) - The presence of an arbitration clause in a lease agreement - The PP Act neither bars nor overlaps with the scope and ambit of proceedings that were initiated under the A&C Act. The court’s role at the Section 11 of A&C stage is limited to confirming the existence of the arbitration clause without examining the merits of the dispute (*SBI General Insurance Co. Ltd. vs. Krish Spinning* applied).

Facts

Central Warehousing Corporation (CWC) leased warehouse space to M/s Sidhartha Tiles & Sanitary Pvt. Ltd. (respondent) under a three-year agreement starting on 12th September 2012, with a provision for mutual renewal. During the lease, CWC unilaterally increased storage charges, which led to disputes. The respondent, seeking renewal and contesting the rate hike, did not vacate when the lease expired on 11th September 2015. CWC initiated proceedings under the Public Premises (Eviction of Unauthorized Occupants) Act, 1971 (Public Premises Act), and the respondent vacated the premises on 13th November 2015. Subsequently, the respondent sought arbitration per the arbitration clause in the lease agreement. The appellant argued that the Public Premises Act precluded arbitration, as eviction matters should fall under it. The respondent argued that the dispute regarding renewal rights and revised charges, which arose during the lease period, should be settled through arbitration as per the agreement.

Issues Involved

The primary issues were:

(1) whether the Public Premises Act overrides the Arbitration and Conciliation Act, 1996 (Arbitration Act) in such disputes? and

(2) whether the High Court erred in appointing an arbitrator under Section 11 of the Arbitration Act?

Held

The Supreme Court upheld the High Court’s decision to refer the dispute to arbitration, ruling that the PP Act did not override the A&C Act, since, the lease issues arose within the contractual term. ***Citing SBI General Insurance Co. Ltd. vs. Krish Spinning [2024 SCC OnLine SC 1754]***, the Court clarified that the referral court's role under Section 11 is limited to confirming the existence of an arbitration clause. As the arbitration clause explicitly covered disputes about rates and renewals, the case was suitable for arbitration. The Court dismissed the appeal, ordered arbitration to proceed, and imposed costs of ₹ 50,000 on the appellant for unnecessary litigation.

RATILAL JHAVERBHAI PARMAR AND ORS. VERSUS STATE OF GUJARAT AND ORS. - JUDGMENT DT 21/10/2024 [2024 INSC 80]

Articles 141 and 227 of the Constitution of India; Order XX of the Code of Civil Procedure, 1908 - A judge's oral pronouncement dismissing a petition without stating "reasons to follow" makes the court functus officio, barring a delayed detailed order. Judicial propriety requires that reasons for a judgment be documented promptly after an oral ruling to allow timely appeal. The issuance of reasons over a year later violates procedural norms, demanding reversal for lack of transparency and due process.

Facts

Ratilal Jhaverbhai Parmar and others, the appellants, filed a Special Civil Application before the Gujarat High Court under Article 227 of the Constitution, challenging an order by the Deputy Collector, which confirmed an earlier decision by the Mamlatdar regarding their land rights. Following a brief hearing on March 1, 2023, the High Court Judge orally dismissed the petition, but no written order was made available until April 2024. The appellants alleged that the judge issued a backdated, detailed order, signed over a year after the oral pronouncement, raising concerns about judicial propriety. The appellants argued that the delayed reasoning prevented them from timely appeal, undermining their right to legal recourse. Additionally, the court considered whether the delay contravened established standards requiring timely, written judgments.

Issues Involved

(1) whether a judge can issue a detailed, backdated order after orally dismissing a petition without stating that "reasons would follow"? and

(2) whether this practice violates principles of justice and judicial propriety?

Held

The Supreme Court found that the High Court Judge's conduct breached judicial protocol by issuing reasons over a year after the oral dismissal without an indication that reasons would follow. Referring to ***Vinod Kumar Singh vs. Banaras Hindu University [(1988) 1 SCC 80]*** and ***Anil Rai vs. State of Bihar [(2001) 7 SCC 318]***, the Court emphasized that reasons should be promptly documented if an order is orally pronounced. The Court set aside the High Court's order, restored the appellants' petition for a fresh hearing, and stressed the need for high judicial standards, noting that judgments should ideally be reasoned within a few days of oral pronouncements.

"Dare to be free, dare to go as far as your thought leads, and dare to carry that out in your life."

— *Swami Vivekananda*

CA Mehul Sheth
Hon. Jt. Secretary

CA Neha Gada
Hon. Jt. Secretary

THE CHAMBER NEWS

Important events and happenings that took place online/physical between **October 1, 2024 to October 31, 2024** are being reported as under:

I. ADMISSION OF NEW MEMBERS

The details of new members who were admitted in the Managing Council Meeting held on October 16, 2024 are as under:

Type of Membership	No. of Members
Life Member	22
Ordinary Member	16
Student Member	31
Associate	0
Total	**69**

II. PAST PROGRAMMES

Sr. No.	*Date*	*Topics*	*Speakers*
COMMERCIAL & ALLIED LAWS			
1	Seminar on NPO Conclave jointly with BCAS		
1	9.10.2024	Keynote Speech	Mr. Rajiv Mehta (Ratna Nidhi Charitable Trust, Trustee) in conversation with CA Shariq Contractor
2		Corporate Social Responsibility – A practical guide	Ms. Savitri Parekh (Reliance industries Ltd, Company Secretary)

Sr. No.	*Date*	*Topics*	*Speakers*
3		Panel 1: Sharing Best Practises	***Panelist***: EDG Chetan Desal (Rotary District 3141, Governor) Mr. F. N. Subedar (TATA Trusts) Mr. Rajiv Mehta (Ratna Nidhi Charitable Trust, Trustee) ***Moderator:*** CA Naushad Panjwani
4		Compliances for NGOs under myriad laws	CA Dr. Gautam Shah
5		Practical Challenges affecting our FCRA Registrations	CA Anjani Sharma (Bhawani Sharma & Co, Partner)
		Panel 2: The Change in Laws and how Internal Audit can step in to meet up with the compliances	***Panelist:*** Mr. Noshir Dadrawala (Centre of Advancement Philanthropy, Trustee), Mr. Anil Nair (St. Jude India Child Care Centres, CEO and Executive Director), CA Ashuthosh Pednekar ***Moderator:*** CA Nandita Parekh
		Critical Issues relating to Income Tax Laws affecting NGOs	CA Anil Sathe
2	26.10.2024	Study Circle on Directors Responsibilities & Liabilities	CS Anoop Deshpande
SELF AWARENESS SERIES			
1	9.10.2024	From Doing to Being	Mr. Girish Agrawal (Accountant Member, ITAT)
DIRECT TAXES			
1	11.10.2024	Fall out of Apex Court Decision on TOLA and Reopening	Mr. Dharan Gandhi, Advocate

Sr. No.	*Date*	*Topics*	*Speakers*
2	16.10.2024	ISG - Recent Important Decisions Under Direct Tax	Mr. Fenil Bhatt, Advocate
3	23.10.2024	Intricacies of Income Tax Refunds	CA M Gopichand
INDIRECT TAXES			
1	11.10.2024	Analysis of Hon'ble Supreme Court's Landmark Decision in the case of Safari Retreats	Adv. Vipin Jain
BENGALURU STUDY CIRCLE			
1	17.10.2024	Delhi High Court in Tiger Global – some learnings	CA Vishnu Bagri
INTERNATIONAL TAXATION			
1	18.10.2024	Study Circle - TDS u/s 195 on Foreign Remittances – Fees for Technical Services	CA Yashika Sangani
2	25.10.2024	International taxation issues for Domestic and Foreign Companies in their Return of Income	***Speaker:*** CA Jimit Devani ***Chairman**:* CA Anish Thacker
PUNE STUDY GROUP			
1	19.10.2024	Practical Difficulties of Reporting u/s 45(5A)	CA Vardhman Jain
STUDENT			
E-Certificate course on Practical Income Tax & Litigation – *contd*.			
1a	8.10.2024	Income from Capital Gains (continued)	Mr. Dharan Gandhi, Advocate
1b	15.10.2024	Taxation of Charitable institutions – Section 12	CA Ashok Mehta
2	23.10.2024	Udaan – Episode 8 ~ Learning Today Leading Tomorrow	***Esteemed Guest*** Justice R.V. Easwar (Former Judge, Delhi High Court) ***Host*** Mr. Aditya Ajgaonkar Advocate

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