TAX AUTHORITIES LEFT HIGH & DRY IN IBC CASES

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Editor's Note: *Moratorium u/s 14 of IBC applies to all recovery proceedings against the corporate debtor. However, can its impact be stretched to tax assessment proceedings? The Supreme Court upheld a Delhi High Court ruling imposing bar on Income Tax Department in making appeals against the orders of the Income Tax Appellate Tribunal. This piece is a brief critique on the precedent.*

In insolvency, there is a dilemma between preserving the insolvent debtor's business and protecting the rights of creditors. This is taken care of by imposing stay on any adversarial proceedings against the debtor, and simultaneously allowing the creditors to file their claims before the insolvency practitioner for due consideration in reorganisation plans. Given the basis, the law and the judiciary shall ensure that the protection of the debtor shall be balanced against rights of the creditors and *vice-versa*.

In recent case of Pr. Commissioner Of Income Tax v. *Monnet Ispat And Energy Ltd.*, the Supreme Court (SC) upheld the decision of the Delhi High Court (Delhi HC) which ruled that the moratorium under section 14 of the Insolvency and Bankruptcy Code, 2016 (IBC) will also apply to *appeals being made by the Income Tax Department against the orders of Income Tax Appellate Tribunal,in respect of tax liability of a debtor* under corporate insolvency resolution process (CIRP).

The Delhi HC had noted (but, not SC) that the moratorium continues till the completion of CIRP or until NCLT approves the resolution plan or passes an order for liquidation of the debtor, whichever is earlier. As such, the Delhi HC had disposed of the appeals by the Income Tax Department *with liberty to revive them subject to the further orders of NCLT*. This stand of Delhi HC was held to be "correct in law" by SC.

With due respect to the observations of the judiciary, it may be noted that there is a natural difference between assessment and recovery proceedings. There may be a scenario where the tax authority might be left with no opportunity to "revive" the appeals.

> ***"The Delhi HC in Power Grid Corporation of India Ltd. Jyoti Structures Ltd. ruled that the moratorium provisions would apply to "debt recovery actions" against the corporate debtor"***

Assessment *versus* recovery proceedings

Income tax liability is first determined by the assessing officer. The appellate machinery consists of commissioners, Income Tax Appellate Tribunals, High Courts and then the Supreme Court. Appeal to High Courts and the Supreme Court can be made only where the case involves questions of law.

Whether such appeals are restrained by section 14 of the IBC, would need a two-fold consideration -- *first*, the sweep of the moratorium under section 14; and, *secondly*, the nature of the appellate proceedings and whether as such, these proceedings come within the ambit of section 14.

The moratorium is intended to restrain proceedings which are in the nature of debt-recovery, and cannot be extended to merely assessment proceedings which have no adverse impact on the assets of the debtor during CIRP. The Delhi HC itself, in *Power Grid Corporation of India Ltd. v. Jyoti Structures Ltd.*ruled that the moratorium provisions would apply to "debt recovery actions" against the corporate debtor.

The assessment proceedings are only aimed at giving finality to the assessment, which *per se*, is a preliminary step, and may or may not lead to a recovery against the debtor, which is what IBC actually bars.

Once the assessment proceedings conclude, the determined tax liability shall stand subjected to the resolution plan under IBC. It is obvious that unless there is an assessment, a creditor's right to file a claim cannot be served. The tax-authorities can only become a creditor when the assessment is made and not before. As such, where the assessment itself is in dispute, there is no impending recovery against the debtor. At the outset, even disputed claims are to be considered in the resolution plan.

A widely known provision comparable to section 14 of IBC was section 22 of the Sick Industrial Companies Act (SICA), where the courts have held that the provision would not extend to proceedings not eroding into the assets or paid up capital of the company. Similarly, in the context of section 446 of the Companies Act, 1956, it had been held that a company, even in liquidation, remains an assessee and income-tax proceedings upto the stage of assessment do not fall in the scope of the words "legal proceedings".

"Revival" of appeal proceedings – a misnomer?

The moratorium remains operational until the expiry of the CIRP period or until NCLT passes an order approving resolution plan or an order for liquidation, whichever is earlier. While the Delhi HC gave *liberty* to revive the appeals subject to further orders of the NCLT, it is doubtful whether the liberty can be exercised at all.

During CIRP, the resolution plan, if drawn up, may not consider the tax liability at all, which was the subject-matter of the purported appeal, being decided by ITAT. Given this, an interesting question which would arise is whether the tax authorities can proceed to make an appeal against the acquirer coming under the resolution plan.

Alternatively, if the debtor goes into liquidation, the moratorium would still continue under section 33. As such, it would not be possible to revive the appeals.

No way ahead?

The stand taken by judiciary might actually lead to a permanent prohibition on the tax authorities to make the appeals. While the spirit of section 14 has to be protected in all conditions, it should not serve as a dead-end to creditors seeking remedy for determination of their dues.

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In the matter of *Pr. Director General of Income Tax v. Synergies Dooray Automotive Limited & Ors*, the Hon'ble NCLAT, held that 'Income Tax Department of the Central Government' and the 'Sales Tax Department(s) of the State Government' and 'local authority', who are entitled for dues arising out of the existing law are 'Operational Creditor' within the meaning of Section 5(20) of the 'I&B Code**.**