
[2019] 101 taxmann.com 27 (Article)/[2019] 43 CPT 899 (Article)

[2019] 101 taxmann.com 27 (Article)

Date of Publishing: December 20, 2018

Is revenue at par with secured creditors for IBC?

HC denies any priority in payment to tax dept. even if it issued attachment order before initiating IBC proceedings



SURABHI AGARWAL

Director S.S. Kothari Mehta & Co.



ROHIT BAJAJ

Manager, S.S. Kothari Mehta & Co.

Introduction

1. As per the provisions of Section 53 of the Insolvency and Bankruptcy Code, 2016, the payment to secured creditors has been listed on priority *vis-à-vis* payment of tax dues.

Section 3(30) of the IBC defines secured creditors. "secured creditors" means a creditor in favour of whom security interest is created.

Further, "Security Interest" has been defined to mean "right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person"

Few questions that may arise out of the above proposition, in law, are as follows:

- ◆ If the property is attached by revenue authorities against tax dues, can they then fall in the category of "Secured Creditors"?
- ◆ What if the tax proceeding had been initiated prior to the order of revival/liquidation by NCLT? Whether the reference to amendment to section 178(6) of the Income-tax Act would be of any help?

In a landmark ruling the Hon'ble High Court of Andhra Pradesh and Telangana (the Court) held that Income tax authorities (Department) are not at par with 'secured creditors' under Insolvency and Bankruptcy Code (IBC). The Court in the case of *Leo Edibles and Fats Ltd. v. Tax Recovery Officer (Central)*

[2018] 99 taxmann.com 226 (AP.) ruled that Department, not being a secured creditor, cannot claim the priority in respect of its claim and must take recourse in accordance with Section 53 of the IBC. Section 53 of the IBC provides the waterfall mechanism for distribution of assets and sets out the priority of payment of debts. According to this mechanism, government dues secure fifth position after liquidation cost, workmen's due/debts owed by secured creditors who have relinquished their security interest, employee dues and unsecured creditors.

2. Relevant facts of the case

- ◆ Pursuant to the order passed against VNR Infrastructure Limited (Corporate Debtor) by the Hyderabad bench of the NCLT in accordance with provision of the IBC, a liquidator was appointed to liquidate the aforesaid company. Liquidator pooled the assets of the Corporate Debtor to form a liquidated estate and all such assets were to be sold by e-auctions.
- ◆ Leo Edibles and Fats Limited (petitioner) also participated in such auction and was declared the highest bidder for the commercial/residential building along with land. The petitioner duly complied with the direction of liquidator and made payment of 25% of the bid amount. Subsequent to deposit of 25% Petitioner came to know about existence of attachment against such property by department. Petitioner claims that on enquiry with registrar's office, it came to know that registrar would not entertain any registration request in view of attachment by the department.
- ◆ The petitioner then filed a writ petition before the court seeking:
 - an interim order directing department to recall the attachment and directing registrar to register sale of property in its name, and
 - a direction to the liquidator not to insist upon the petitioner for paying the balance sale consideration till registration of sale deed in its favour.
- ◆ During initial hearing The Court passed an interim order denying petitioner's request of not depositing the balance amount till sale deed registration and asked to meet the direction of the liquidator. Court, however, directed the liquidator not to disburse any amount paid by petitioner pending further order from the Court.
- ◆ The petitioner argued that section 33 of the IBC imposed a moratorium on initiation and continuation of legal proceeding by or against corporate debtor from the date of appointment of liquidator. The department opposed the argument stating that since the tax proceeding had been initiated prior to the liquidation proceeding under the order of the NCLT. Accordingly, neither provisions of IBC nor amended section 178(6) of the Income-tax Act would be applicable in the instant case.

2.1 Court's observations and judgment

- ◆ Section 178 of the Income-tax Act provides for a priority in appropriation of the amount set aside by the liquidator for clearance of the tax dues. However, where the company is under liquidation in accordance with provisions of the IBC, section 178 stands inapplicable by virtue of amendment.
- ◆ The Court observed that department does not enjoy the status of secured creditor on par with "secured creditors by a mortgage or other security interest", who can avail of the provision of section 52 of the IBC.
- ◆ Further, the Court referred to the case of *Anant Mills Ltd. (in liquidation) v. City Deputy Collector* [1972] 42 Comp. Cas 476 (Guj.) wherein the Hon'ble Gujarat High Court observed that the purpose of attachment appeared to be to prevent the private alienations of the property by the

company. The Court also considered the effect of attachment prior to commencement of winding up proceedings and drew final conclusion that attachment of property would be of no consequence against the liquidator if department had not taken any action post-attachment until winding up order of the Court. The liquidator was free to dispose off the property wholly ignoring the attachment order.

- ◆ The court made reference to *Prem Lal Dhar v. Official Assignee* [1897] ILR 25 Cal. 179 (P.C), wherein the Privy Council had opined that attachment in this country merely prohibits private alienation by the person(s) whose property is attached but creates no interest, lien, charge or confers a title in the property in favour of attaching-creditor.

On the basis of above analysis, the Hon'ble Court clearly distinguished secured creditor from tax dues and held that the department could not claim any priority merely because of the fact that the order of attachment had been issued earlier than initiation of liquidation proceeding under the provision of the IBC. The department necessarily had to submit its claim to the liquidator for consideration in accordance with the priorities stipulated in terms of section 53(1) of the IBC.

Concluding remarks

3. The intent of the IBC, 2016 is to ensure revival of the financially stressed company. Where the Company is under liquidation as per IBC, it appears that the Code provides to protect the interest of the buyers/bidders to acquire the property from liquidator free of all encumbrances. The aforesaid decision of the Hon'ble Andhra Pradesh High Court will help in providing certainty to the acquirer of property on liquidation of a company as per IBC, 2016. The acquirer can register the property without any additional cost due to attachment of such property under Income-tax Act. The view of the Hon'ble High Court also finds support from a subsequent decision of the Hon'ble Supreme Court in the case of *Monnet Ispat and Energy Limited* wherein the Hon'ble Supreme Court has held that "Given Section 238 of the Insolvency and Bankruptcy Code, 2016, it is obvious that the Code will override anything inconsistent contained in any other enactment, including the Income-tax Act."

It appears from various decisions of the Hon'ble Courts that the provisions of the IBC, 2016 should be given supremacy over all other enactments to ensure acquisition of encumbrance free property by the acquirer. We still look upon clarifications from CBDT regarding the on-going tax litigations and uncrystallised liabilities in the hands of acquirer.

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