

Taxman to defer to banks in IBC rescue

Changes on way in bankruptcy law to redefine secured creditor

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The taxman will defer to secured creditors such as banks while sharing the proceeds of a bankruptcy rescue, two people aware of the government's plans said.

The Centre will amend the Insolvency and Bankruptcy Code (IBC) to unambiguously state that tax authorities will be below secured creditors having a charge on the assets of a corporate borrower in hierarchy while distributing the proceeds, the people cited above said on condition of anonymity.

This is a key proposal in the amendments to the IBC that the ministry of corporate affairs has prepared in consultation with the sector's rule maker Insolvency and Bankruptcy Board of India (IBBI). The amendments will be presented in the Parliament after the national polls in the April-May period, one of the two persons quoted above said.

Emails sent to the ministry of corporate affairs and IBBI on Monday seeking comments for the story remained unanswered at the time of publishing.

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CREDIT NOTES

The idea is to amend the definition of secured creditors in the IBC to specifically exclude dues to government including tax dues.

GOVT TO amend IBC after the national elections in the April-May period

GOVT DUES not to be counted as secured debt merely by operation of tax laws

SPECIFIC TRANSACTIONS will give govt dues secured debt status

SUPREME COURT had given apparently conflicting views on status of govt dues

KEEPING GOVT below secured creditors will help investments into distressed assets

IBC LOWERED status of government dues below secured creditors in 2016

tion of secured creditors in the IBC to specifically exclude dues to government including tax dues. "The proposals are under inter-ministerial consultation," said the person.

The IBC says workmen's dues and secured debtors must be paid first in a bankruptcy rescue, followed by wages of other employees, unsecured debtors and government dues, in that order. However, conflicting judicial pronouncements have sowed confusion in the minds

of stakeholders.

In the Gujarat state tax officer vs Rainbow Papers Ltd case, the Supreme Court ruled in September 2022 that lenders cannot secure their dues at the expense of statutory dues owed to government or a government authority, effectively upsetting the hierarchy of creditors in the bankruptcy code.

In another case last July, the apex

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court said the way the code distinctly treats dues to secured creditors and the government shows Parliament's intention to treat the latter separately.

"Law makers' intention to treat government dues separate from that of secured creditors is also evident from the preamble to IBC that speaks about balancing the interests of all the stakeholders by altering the order of priority of payment of government dues," said the second person quoted above.

Introduced in 2016, the IBC had brought down the priority of sovereign debt below that of secured creditors. "It was a conscious decision," said the first person. "The original intention of the law will be made specific. But let us say, if a government entity is creating security interest using an instrument just like a bank, that would of course be treated at par with secured creditors," said the person.

Treating government dues lower in the hierarchy was aimed at encouraging invest-



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ments into distressed assets and to maximize the chances of reviving a company in financial trouble.

Giving state dues higher priority could reduce the resources available for turning around a business and save jobs. The Supreme Court recently rejected

review petitions against the Rainbow Paper ruling and, as it stands today, the decision

on the Rainbow Papers continues to be applicable in corporate insolvency resolution,

explained Vishwas Panjari, Partner at business advisory firm Nangia Andersen LLP.

"Given the prevalence and significance attached to the issue of appropriate

classification of government dues and ultimately in the success of IBC process, a

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clarity in this regard is an urgent need of the hour. Therefore, in line with the object of IBC, the government should expressly clarify that all debts owed to central government and the state government shall be treated equally with other unsecured creditors unless in cases where specific 'security interest' is created pursuant to a 'transaction,' said Panjari. "Clarity will go a long way in minimizing disputes and streamline the resolution process," said Panjari.

Recognizing government as a secured creditor only on the basis of transaction as per definition of security interest, and not on the basis of statutory charge, will benefit the corporate rescue and liquidation process under IBC and would be in furtherance of the preamble of IBC, said Anoop Rawat, partner (insolvency and bankruptcy) at law firm Shardul Amarchand Mangaldas & Co. "It is important to note that even in security enforcement legislation such as SARFAESI Act, crown debt is subordinated to secured debt," said Rawat.