

Supreme Court holds that a resolution plan that altogether ignores statutory demands payable to any state government or legal authority is bound to be rejected

In a recent judgment of *State Tax Officer (1) v. Rainbow Papers Limited*,¹ a 2 (two) judges' bench of the Hon'ble Supreme Court of India ("Supreme Court") observed that if a resolution plan altogether ignores the statutory demands payable to any state government or legal authority, it is bound to be rejected by the adjudicating authority (here, National Company Law Tribunal ("NCLT")). The Supreme Court went on to observe that: (a) if there is no resolution plan providing for payment of the corporate debtor's statutory dues in a phased manner, it would necessarily have to be liquidated in terms of the Insolvency and Bankruptcy Code, 2016 ("Code"); and (b) delay in filing of claim before the resolution professional ("RP") cannot be the sole ground for rejection of such claim.

Brief Facts

The statutory debt: Rainbow Papers Ltd. ("Corporate Debtor") owed the appellant certain sums towards value added tax ("VAT") and central sales tax ("CST") payable under the Gujarat Value Added Tax, 2003 ("GVAT Act"). Pertinently, under Section 48 of the GVAT Act, the tax payable thereunder by a dealer or a person constitutes the first charge on the property of such dealer or person.²

Filing and rejection of appellant's claim: The Corporate Debtor was admitted into insolvency by order of the NCLT Ahmedabad. It was only after the committee of creditors ("COC") had been constituted and the last date for submission of claims had passed that the appellant filed its claim before the RP. After not receiving any update for nearly a year, the appellant called upon the RP to confirm its claim, who informed that the entirety of the appellant's claim had been waived off. In the meantime, a resolution plan had also been submitted.

Challenge before the NCLT: The appellant objected to the resolution plan by way of an application before the NCLT Ahmedabad, contending that statutory dues cannot be waived off. The appellant prayed for payment of the entire sum claimed by it. However, noting that the resolution plan had already been approved by the COC, the NCLT found that the appellant's objections were not maintainable.

Appeal before the NCLAT: The NCLT Ahmedabad's decision was upheld by the NCLAT on appeal. In December 2019, the NCLAT found that: (a) the appellant's claim could not be entertained as it was filed at a belated stage; and (b) the appellant did not occupy the position of a 'secured creditor' since Section 48 of the GVAT Act does not prevail over Section 53 of the Code.³

¹ Judgment dated September 6, 2022 in Civil Appeal No. 1661 of 2020.

² "48. Tax to be first charge on property — Notwithstanding anything to the contrary contained in any law for the time being in force, any amount payable by a dealer or any other person on account of tax, interest or penalty for which he is liable to pay to the Government shall be a first charge on the property of such dealer, or as the case maybe, such person."

³ Section 53 of the Code provides for the mode and manner of distribution of the proceeds from sale of a corporate debtor's assets in liquidation.

Thereafter, the appellant approached the Supreme Court against the decision of the NCLAT under Section 62 of the Code.

Issues

The Supreme Court's assessment revolved around the determination of whether the NCLAT was correct in dismissing the appellant's appeal and claim. In doing so, it examined and answered the following issues:

1. Whether the appellant's claim could be rejected simply because it was filed beyond the timelines prescribed under the Code?
2. Whether Section 48 of the GVAT Act does not prevail over Section 53 of the Code?

Findings of the Supreme Court

Re: Issue (1)

At the outset, the Supreme Court observed that the timelines prescribed under the Code, even for the completion of proceedings, were directory and not mandatory.⁴ Similarly, the time period prescribed for submission of a claim under Regulation 12 Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("**CIRP Regulations**") was also reiterated as only being directory.⁵ This, the Supreme Court stated, was obvious from Regulation 14(2) of the CIRP Regulations, that enabled the RP to revise the amounts of admitted claims as and when additional information was received.⁶ Therefore, the Supreme Court held that "*delay in filing a claim cannot be the sole ground for rejecting the claim*"⁷ and concluded that the NCLT as well as the NCLAT erred in rejecting the appellant's claim.

Re: Issue (2)

The Supreme Court held that Section 48 of the GVAT Act was neither contrary to nor inconsistent with Section 53 (or any other provision) of the Code.⁸ It found that:

1. 'Security interest' under the Code could be created by operation of law, and the definition of a 'secured creditor' did not exclude any government or authority.⁹ As such, the statutory charge created by virtue of Section 48 of the GVAT Act squarely fell within the definition of 'security interest' under Section 3(31) of the Code, thereby making the appellant a 'secured creditor' in terms of Section 3(30) of the Code.
2. Consequently, debts owed to the appellant – a secured creditor – would rank equally with other debts (such as workmen dues) specified in the waterfall mechanism under Section 53(1)(b) of the Code.

With the above findings, the Supreme Court resolved the purported conflict between the Code and the GVAT Act. Interestingly, the Supreme Court went several steps further in assessing the maintainability of the appellant's claim and made sundry other key observations:

3. It was reiterated that under Section 31 of the Code, a COC-approved resolution plan might be approved by the NCLT only if it was satisfied that the said plan met the requirements under Section 30(2) of the Code. In other words, satisfaction of the requirements under Section 30(2) of the Code was a condition precedent for approval of the resolution plan.¹⁰
4. A resolution plan that does not meet the requirements of Section 30(2) of the Code would be invalid and not binding on any government, authority or creditor "*to whom a debt in respect of dues arising under any law for the time being in force is owed*".¹¹

⁴ Para 23, *supra* note 1.

⁵ Para 39, *supra* note 1.

⁶ Para 24, *supra* note 1.

⁷ Para 58, *supra* note 1.

⁸ Para 56, *supra* note 1.

⁹ Para 57, *supra* note 1.

¹⁰ Paras 41, 43, 45 and 46, *supra* note 1.

¹¹ Para 48, *supra* note 1. The underlying rationale – though not stated in the decision – appears to be that non-provision of a debt arising under a provision of law for the time being in force makes the resolution plan liable to be rejected in terms of Section 30(2)(e) of the Code.

5. If the resolution plan altogether ignores the statutory dues payable to any government or authority, the NCLT is bound to reject the resolution plan.¹²
6. If there is no provision in resolution plan providing for payment of the Corporate Debtor's statutory dues in a phased manner, it would necessarily have to be liquidated, and its assets sold and distributed, in terms of Section 53 of the Code.¹³

JSA Comment

The judgment of the Supreme Court confounds the existing position of law with respect to treatment of statutory dues under the Code. Strangely, the judgment copiously quotes another 3 (three)-judges' bench decision in *Ghanashyam Mishra v. Edelweiss Asset Reconstruction Company Ltd.*,¹⁴ which laid down the law in the completely opposite direction. It held that dues payable to any government or authority come within the ambit of 'operational debt'¹⁵ and if not provided in the approved resolution plan, they stand extinguished.¹⁶ The NCLTs too have allowed waiver of statutory dues while approving the resolution plan in several cases.¹⁷

In this backdrop, the Supreme Court's judgment may have far-reaching consequences, as it may be read to mean that every resolution plan must provide for payment of statutory dues/ dues owed to any government or authority in their entirety. Such an interpretation flies in the face of established precedent and is likely to have a deleterious impact on the regime contemplated under the Code. Potential resolution applicants suddenly faced with the prospect of paying pending or potential governmental and statutory demands are likely to be deterred. As a result, there would be fewer resolution applicants, lower valuations, and larger haircuts for creditors.

Therefore, even though the observations of the Supreme Court are binding on all lower courts and tribunals, including the NCLT, the only word of caution here can be that the observations of the Supreme Court at paras 52 – 54 should not be taken out of context.

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¹² Para 52, *supra* note 1.

¹³ Para 53, *supra* note 1.

¹⁴ (2021) 9 SCC 657.

¹⁵ *Ibid* at para 98.

¹⁶ *Ibid* at paras 77, 95 and 130.

¹⁷ *Reliance Commercial Finance v. Ved Cellulose Ltd.*, CP(IB) 156/PB/2017; *SREI Infrastructure Finance v. Assam Company India Ltd.*, CP(IB) 20/GB/2017; *State Bank of India v. MOR Farms Pvt. Ltd.*, CP(IB) 51/CHD/HRY/2017.

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