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April 1, 2019, New Delhi, INDIA

### Statutory Dues are 'Operational Debt' under Insolvency and Bankruptcy Code

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The Insolvency and Bankruptcy Code, 2016 ("**Code**") is one of the most dynamic legislations in the recent times and is being interpreted by the courts to expand the ambit of the Code and also possibly provide maximum benefit to both financial and operational creditors whose dues are long outstanding. One of the recent changes was to include home buyers within the definition of 'financial creditors'. The National Company Law Appellate Tribunal ("**NCLAT**") has now upheld the view that statutory dues are included within the definition of 'operational debts' (though much to the despair of statutory authorities).

In a recent judgement passed on March 20, 2019 in the case of *Pr. Director General of Income Tax (Admn. & TPS) vs M/s. Synergies Dooray Automotive Ltd. & Ors.* (clubbed with certain other company appeals), NCLAT held that statutory dues such as income tax, sales tax, value added tax and various other taxes fall within the definition of 'operational debt' under section 5(21) of the Code and the statutory authorities claiming the aforesaid dues will be treated as operational creditors under the Code.

#### **Contentions in the Appeals**

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We herein below set forth the basic contentions of various appeals:

- [Company Appeal \(AT\) \(Insolvency\) No. 205 of 2017](#)

An appeal was preferred by Pr. Director General of Income Tax (Admn. & TPS) against the approval of the resolution plan of a corporate debtor by the National Company Law Tribunal, ("NCLT") Hyderabad wherein huge income tax concessions had been granted to the corporate debtor without making the department a party to the proceedings.

- [Company Appeal \(AT\) \(Insolvency\) No. 671 of 2018](#)

An appeal was preferred by Pr. Commissioner of Income Tax, Mumbai against the order of approval accorded by the NCLT, Mumbai to the resolution plan of a corporate debtor wherein the total income tax liability was set at one (1) per cent of the crystallised demand.

- [Company Appeal \(AT\) \(Insolvency\) No. 309 of 2018](#)

An appeal was preferred by the Maharashtra Sales Tax Department against the approval of a resolution plan by the NCLT, Mumbai on the grounds that resolution plan approved is prejudicial to the rights of the Maharashtra Sales Tax Department and 'sales tax' and 'value added tax' do not fall under 'operational debt' and Maharashtra Sales Tax Department cannot be termed as an 'operational debtor'.



- Company Appeal (AT) (Insolvency) No. 559 of 2018

An appeal was preferred by the Maharashtra Sales Tax Department against the approval of the resolution plan by the NCLT, Mumbai wherein dues against value added tax were reduced to one (1) per cent of the amount which was against the provision of the Maharashtra Value Added Tax Act, 2002.

- Company Appeal (AT) (Insolvency) No. 759 of 2018

An appeal was filed against the approval of a resolution plan by the NCLT, Mumbai on the grounds that the plan reduced the claim of the tax department to twenty (20) per cent of the amount due and tax dues and the tax department cannot be classified as an 'operational debt' and 'operational debtor', respectively under the Code.

#### **Questions before the NCLAT**

The questions raised before the Hon'ble NCLAT were:

- whether 'Income Tax', 'Value Added Tax' or other statutory dues, such as 'Municipal Tax', 'Excise Duty', etc. come within the meaning of 'Operational Debt'; and

· whether the Central Government, the State Government or the legal authority having statutory claim, come within the meaning of 'Operational Creditors'.

### **Contentions of the Statutory Authorities and Amicus Curiae**

The primary contention of various tax authorities in the company appeals was that the tax dues could not come under the definition of "operational debt" under the Code and the tax authorities would not be operational creditors for the purpose of the Code. According to the income tax department in Company Appeal (AT) (Insolvency) No. 671 of 2018, 'operational debt' under the Code would refer to claims in the respect of goods or services **or** debts in respect of repayment of dues of the Central Government, State Government or the Local Authorities and the income tax being a statutory liability under the Income Tax Act, 1961 ("**IT Act**"), is required to be paid by every person. The Income Tax Department placed further reliance on the provisions of collection and recovery under the IT Act and held that contravention of the same will deem such provisions redundant.

The Maharashtra Sales Tax, Department, in Company Appeal (AT) (Insolvency) No. 559 of 2018, had taken a similar plea and referred to section 37 of the Maharashtra Value Added Tax Act, 2002 which states that liability under the aforesaid act shall be a first charge on the property of the dealer.

The amici curiae appointed by the Hon'ble NCLAT to assist the Tribunal on the question of law forwarded the proposition that various statutory dues such as income tax, value added tax were not required for the operation of the corporate debtor and therefore should not be included within the meaning of 'operational debt'. It was further contended by the amici curiae that the word 'or' used in the definition of 'operational debt' may be interpreted as 'and' in this circumstance since its use as a disjunctive could not have been intended by the legislature and in this regard placed reliance on the decision of the Hon'ble Supreme Court in *Life Insurance Corporation of India vs D. J. Bahadur & Ors.*[(1981) 1 SCC 315].

### **Findings of NCLAT**

The NCLAT took into consideration the proposition forwarded by the amici curiae and analysed the definition of 'operational debt' under the Code. The Tribunal observed that the word 'or' had been used by the legislature in three places in the definition of 'operational debt' and what was required to be considered was whether such use was disjunctive or should be given the meaning of 'and' in this circumstance.

Reliance was placed by the Tribunal in the case of *Life Insurance Corporation of India*, where the Hon'ble Supreme Court while discussing the interpretation of 'or' and 'and' has observed that "*It is no doubt true that the word "or" may be interpreted as "and" in certain extraordinary circumstances such as in a situation where its use as a disjunctive could obviously not have been intended (see Mazagaon Dock Ltd. v. Commissioner of Income Tax and Excess Profits Tax [AIR 1958 SC 861 : 1959 SCR 848] ). Where no compelling reason for the adoption of such a course is, however, available, the word "or" must be given its ordinary meaning, that is, as a disjunctive*".

The Tribunal also referred to the recent case of the Supreme Court in the matter of *Swiss Ribbons Pvt. Ltd. & Anr. vs. Union of India & Ors. [Writ Petition (Civil) No. 99 of 2018]*, wherein it was *inter alia* observed that "*an 'operational debt' would include a claim in respect of the provision of goods or services, including employment, or a debt in respect of payment of goods or services, including employment, or a debt in respect of payment of dues arising under any law and payable to the Government or any local authority*".

Upon taking into consideration definition of 'operational debt' under the Code and the principles laid down by the Supreme Court with regard to the interpretation of 'or' and 'and', the Tribunal held that there was no ambiguity in the definition of 'operational debt' and the legislature had consciously used the word 'or' instead of 'and' before '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, and State Government or any local authority'.

The Tribunal further elucidated on the concept of 'Operational Debt' and observed that such debts arise out of operation of the company/corporate debtor and the goods and services are essential for the company/corporate debtor as a going concern. Statutory dues such as income tax, value added tax and other statutory dues arising out of law will arise only if the company/corporate debtor is operational and, therefore, such dues have a direct nexus with the company.

Consequently, the NCLAT held that statutory dues such as income tax, value added tax etc. fall within the ambit of 'operational debt' under the Code and the statutory authorities claiming the aforesaid dues will be treated as operational creditors under the Code.

**Conclusion:**

With operational creditors not being very high on the priority order either under the resolution plan or for distribution of assets under the Code and such debtors generally receive only a fraction of their outstanding dues, the judgement of the NCLAT is a serious blow to the tax authorities which may lead to severe revenue loss. With far stringent penalty and prosecution provisions available under various statutory enactments, it is doubtful that this judgement will appease the government departments and will most likely end up before the Supreme Court of India for final adjudication.

**Feedback**

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