

NCLAT classifies income tax, VAT and other statutory dues as ‘operational debts’ under IBC

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Summary

The National Company Law Appellate Tribunal (NCLAT) has in a recent decision¹ held that all statutory dues, including income tax, value added tax (VAT), etc., are ‘operational debts’ under the Insolvency and Bankruptcy Code, 2016 (IBC). The NCLAT also held that the Income Tax Department of the Central Government and the Sales Tax Department of the state government/local authority which are entitled to dues under any existing law shall fall within the meaning of ‘operational creditor’ under IBC.

Facts of the case

- The NCLAT was considering a batch of appeals filed by the Income Tax Department and the Sales Tax Department, Maharashtra, against adverse orders passed by the National Company Law Tribunal (NCLT)
- The common issues for consideration before the NCLAT were as under:
 - Whether income tax, VAT or other statutory dues such as municipal tax, excise duty, etc., would fall within the meaning of ‘operation debt’ under² IBC
 - Whether the Central Government, the state government or the legal authority having a statutory claim come within the meaning of ‘operational creditors’ under³ IBC

¹ Principal Director General of Income-tax v Synergies Dooray Automotive Ltd.

² Under section 5(21) of IBC

³ Under section 5(20) of IBC

Arguments before the NCLAT

By the Income Tax Department

- Income tax dues are the statutory liability of every person; therefore, failure to discharge such liability would render the provisions⁴ of the Income-tax Act, 1961 redundant.
- The Income Tax Department argued that on the basis of the definition of 'operational debts', it only covers claims in respect of 'goods' or 'services' or a debt in respect of re-payment of dues of the Central Government, state government or local authorities. As such, income tax shall not form part of 'operational debts'.

By the Sales Tax Department

- As per the provisions under the VAT laws⁵, liability under the said laws would be the first charge on the property of the taxpayer.

By amicus curiae

- The Counsel stated that since both income tax and VAT are not required for the operation of the debtor, they should not fall within the meaning of 'operational debt'.

The NCLAT's decision

- The tribunal noted that 'operational debt' in the normal course means a debt arising during the operations of a company. As dues towards income tax, VAT and other statutory levies arise when a company is operational, it has a direct nexus with the operations of a company and would therefore be considered as operational debts.
- As all statutory dues including income tax and VAT fall within the meaning of 'operational debt' and consequently, the Income Tax Department and Sales Tax Department, etc., shall qualify as 'operational creditor' under IBC.

⁴ Chapter XVII (Collection and Recovery of Tax) of the Income-tax Act, 1961

⁵ Section 37 of the 'Maharashtra Value Added Tax, 2002'

Our comments

The ruling might prove to be a blessing in disguise for the Tax Department, as the classification of tax dues as 'operational' should give it the ability to initiate insolvency as an operational creditor. However, it can also be inferred from this ruling that tax dues do not have priority over secured creditors or even the unsecured financial creditors as prescribed under IBC⁶. On the subject of tax dues under IBC, it would be helpful if the authorities also clarify the treatment of unpaid TDS (for deductee) or unpaid GST (for payer customers) in case of insolvent companies.

⁶ Under section 53 of IBC

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