

Payment of outstanding tax dues cannot be a pre-condition for implementing a scheme of arrangement holds NCLAT

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Summary

The National Company Law Appellate Tribunal (NCLAT) recently in the case of Ad2Pro Media Solutions Private Limited (transferor)¹, modified the scheme of arrangement approved by the National Company Law Tribunal (NCLT). The NCLT had earlier held that a scheme of arrangement can only be given effect to only when the transferor pays the entire income tax and service tax liability to the respective authorities.

The NCLAT held that payment of outstanding tax dues by the transferor cannot be treated as a condition precedent for implementation of the approved scheme of arrangement and such compliance shall be subject to determination of liability by the Income Tax Appellate Tribunal (ITAT).

Background

- The Bengaluru bench of NCLT in its order dated 8 March 2019, approved the scheme of arrangement between the transferor company and Ad2Pro Global Creative Solutions Private Limited (transferee), subject to imposition of certain conditions.
- One of the conditions was that the scheme of arrangement cannot be made effective until the transferor makes payment of the entire income tax and services tax liabilities to the concerned tax authorities.
- The above condition imposed by the NCLT was challenged by the both by the transferor and transferee (hereinafter collectively referred to as appellants) before the NCLAT.

Issue under consideration

Whether the NCLT can impose a pre-condition on the transferor to make payment of tax liabilities when the same was under dispute before the concerned tax authorities?

Contention of the appellants

- **Tax liability not crystallised:** The appellants contended that the demand raised by the concerned tax authorities has been challenged before the Appellate Tribunals where the adjudication is under process and hence, they contended that the tax liability has not yet crystallised.
- **NOC granted by the Income tax Department:** The appellants contended that the Income tax department had issued a No-objection certification (NOC) on the scheme of arrangement². The appellants further submitted that the NOC was subject to provision for any demands that may be raised by the income tax department in future.
- **Undertaking by the transferee company to pay off crystallised tax demands:** The transferee company had provided an undertaking to pay off the income and services tax demands to the concerned authorities, as and when the same become crystallised.

¹ Company Appeal (AT) No. 98 of 2019 and 99 of 2019

² in response to the notice served on them under section 230(5) of the Companies Act, 2013

- **Scheme provides for continuity of tax assessments/ appeals with the transferee company:** The appellants also referred to the relevant clause of the scheme which provided that post amalgamation, all tax assessment proceedings and appeals shall continue with the transferee company and all or any dues payable shall be paid by the transferee company.

NCLAT decision

- **Rights of tax department remains intact:** NCLAT noted that it is well settled that while sanctioning a scheme of arrangement, the right of the tax authorities remains intact to initiate proceeding for any tax recovery. Further, the NCLAT observed that the Scheme provided for payment of outstanding tax dues of the transferor by the transferee. Thus, it held that once the scheme is approved by the NCLT, the interest of the tax authorities is lawfully protected and their right to recover the outstanding tax dues from the transferor or the transferee remains intact.
- **Allowed the appeal in favour of the appellants:** The NCLAT held that where the transferee undertakes to make payment of all outstanding tax dues, the scheme cannot be refused. Thus, the NCLAT allowed the appeal in favor of the appellant and held that payment of tax liability by the transferor shall not be treated as a condition precedent for implementation of an approved scheme of arrangement.

Our comments

This is a welcome decision for companies having pending tax assessments/demands and intending to enter into a scheme of arrangement. Where the scheme imposes a condition for payment of outstanding tax liabilities by any of the party, tax payment cannot be taken as a pre-condition for effecting the scheme. However, facts of each case would need to be carefully analysed before taking the above position.

The decision further re-affirms the settled position that the right of the Income Tax Department to recover its dues from the transferee company is not prejudiced by the scheme.

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