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The Dilemma Surrounding Payment of Dues to Statutory Authorities under IBC, 2016

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The treatment and position of statutory creditors having a statutory charge in insolvency proceedings gained

criticality at the first instance upon passing of the judgment by the Hon'ble Supreme Court in the matter of **STATE TAX OFFICER (I) VERSUS RAINBOW PAPERS LTD. 2022 SCC ONLINE SC 1162 (Rainbow Papers Case)**. The issue before the Hon'ble Supreme Court was whether in terms of Section 48 of the Gujarat Value Added Tax Act, 2003, the State Government shall be treated as a "Secured creditor" of the company undergoing insolvency proceedings. It is to be noted that Section 48 of the GVAT Act which came up for interpretation before the Hon'ble Supreme Court in the said matter provides that any amount payable to the government shall constitute a first charge on the property of such dealer (company in this case).

After considering the provisions of the Insolvency and Bankruptcy Code and GVAT Act, the Hon'ble Supreme Court held the following:

1. The State is a secured creditor under the GVAT Act. Section 3(30) of the IBC defines secured creditor to mean a creditor in favour of whom security interest is created. Such security interest could be created by operation of law. The definition of secured creditor in the IBC does not exclude any Government or Governmental Authority.

2. Section 48 of the GVAT Act is not contrary to or inconsistent with Section 53 or any other provisions of the IBC. Under Section 53(1)(b)(ii), the debts owed to a secured creditor, which would include the State government under the GVAT Act, are to rank equally with other specified debts including debts on account of workman's dues for a period of 24 months preceding the liquidation commencement date.

3. If the resolution plan excludes statutory dues payable to government or a government authority or legal authority, altogether, the NCLT is bound to reject such resolution plan.

4. The Committee of Creditors ("CoC"), which might include financial institutions and other financial creditors, cannot secure their own dues at the cost of statutory dues owed to any



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Government or Governmental Authority or for that matter, any other dues.

Therefore, as per the observations made by the Hon'ble Supreme Court in the matter of **Rainbow Papers (supra)**, the statutory authorities are to be treated at par with other secured lenders (like banks etc.) if such statutory authorities have a security interest over the assets of the company, by virtue of any statutory provision.

The judgment in the matter of **Rainbow Papers (Supra)**, was thereafter, interpreted in the following judgments:

1. The Hon'ble Supreme Court, in the matter of **Paschim Anchal Vidyut Vitran Nigam Limited versus Raman Ispat Pvt. Ltd. 2023 SCC OnLine SC 842**

held that the observations made in the matter of Rainbow Papers (supra) are to be confined to the facts of that case alone. The Hon'ble SC held that whilst the GVAT Act creates first charge in favour of the State, the separate and distinct treatment of amounts payable to secured creditor on the one hand, and dues payable to the government on the other under the waterfall mechanism in Section 53 clearly signifies Parliament's intention to treat the latter differently - and in the present case, having lower priority.

2. In the matter of **State Tax versus Ashish Chhawchharia, Resolution Professional for Jet Airways**, it was held that the judgment of Rainbow Papers (Supra) cannot be applied to the dues to Department of State Tax (GST) since the Maharashtra GST Act, 2017 provides that the first charge on the

property of taxable person (Company) is not applicable in case of initiation of Corporate Insolvency Resolution Process (CIRP) of such Company.

CONCLUSION

The analysis of Rainbow Papers Case, can thus be said to be applicable only in such cases where the statutory provision creates first charge in favour of the relevant government or statutory authority. Rainbow Papers Case does not per se be read in a manner to argue that all government dues will be secured dues under all circumstances. Basis the Supreme Court's view in Rainbow Papers Case, the classification of government dues on a broader parameter will have to be undertaken in a two-pronged manner as follows:

Step 1: Examination of the provisions



of the governing legislations (both Central and State) to ascertain whether or not a charge (Statutory in nature) is created in favour of the relevant government and statutory authority in respect of their claim. Recently, the Hon'ble Supreme Court in the matter of **Greater Noida Industrial Development Authority v Prabhjit Singh Soni & Anr, Civil Appeal No.7590-7591 of 2023, order dated 12.02.2024** recognised Greater Noida Authority as the owner of land of real estate project as a secured creditor and sent back the approved Resolution Plan for appropriate treatment of the Authority.

Step 2: Whether or not the provisions of such governing legislation are expressly made subject to IBC or have a

provision pursuant to which IBC is given primacy. If the concerned governing legislation creates a charge and is not subject to IBC (as was the case in the relevant statute which was the subject matter in Jet Airways), then such statutory authority will have to be classified as a "secured creditor" for the purposes of Section 53 and accordingly, will be eligible for distribution in terms of Section 53(1)(b) (ii) of the IBC.

The Resolution Professional, accordingly, are now required to analyse and review statutory claims and dues on a case-to-case basis to ascertain the position of such creditors in the waterfall mechanism as provided in the Code to ensure protection of stakes and rights of such statutory creditor. [W](#)



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