



Jharkhand High Court holds that resolution plan is not binding on government if it is not involved in the resolution

In a recent decision¹, the Hon'ble High Court of Jharkhand ('High Court') held that garnishee proceedings initiated against the corporate debtor to recover value-added tax ('VAT') dues in respect of the period prior to the approval of the resolution plan are valid even if they are initiated after the approval of the resolution plan by the National Company Law Tribunal ('NCLT') since the government was not involved in the insolvency resolution process.

Background

Electrosteel Steels Limited ('Petitioner'), having its registered office in the state of Jharkhand, filed a writ petition before the High Court challenging the Garnishee Order dated November 21, 2019, issued under section 46 of the Jharkhand Value Added Tax Act, 2005 ('Garnishee Order').

The Garnishee Order, inter alia, required the State Bank of India to deposit Rs 37.41 crores into the government treasury from the bank account of the Petitioner in respect of VAT dues for the financial years 2011-12 and 2012-13. The Petitioner had duly collected VAT from customers but had failed to deposit the same in the government treasury, utilising the same in its business operations from the financial year 2011-12 onwards.

Meanwhile, the corporate insolvency resolution process ('CIRP') had been initiated against the Petitioner on July 21, 2017 and the resolution plan filed by Vedanta Limited was approved by the NCLT on April 17, 2018, which was prior to the issuance of the Garnishee Order.

¹ Electrosteel Steels Limited v. the State of Jharkhand [LSI-277-HC-2020(JHAR)]



Contentions of the parties

Petitioner's contentions

- The claim of the VAT authorities was not admissible and was barred under section 31 of the IBC since the VAT authorities, being an 'Operational Creditor', have not made any claim in the CIRP.
- The Garnishee Order was illegal, void *ab-initio* and without jurisdiction and cannot be sustained since the resolution plan (where the VAT authorities have not made any claim) had already been approved by the NCLT and was binding upon the Petitioner and all of its creditors, including the VAT Authorities.
- The Petitioner relied upon section 238 of the IBC, pursuant to which the IBC has an overriding effect on all other laws and the decision of Hon'ble Supreme Court², wherein it was held that the IBC is an exhaustive code in itself. The Petitioner also relied on several other rulings³ wherein it was held that the dues payable to the government would come within the meaning of 'Operational Debt' under section 5(21) of the IBC, making the government an 'Operational Creditor' in terms of section 5(20) of the IBC, and also that the claims of the government would have to be adjudicated and paid solely in a manner prescribed in the resolution plan as approved by the NCLT.
- The Petitioner also relied on the Hon'ble Supreme Court's decision in the case of Essar Steel India Limited⁴ to contend that no fresh claims can be made once the resolution plan is approved.
- The Petitioner submitted that in terms of para 3.6 of the resolution plan, all claims of taxes and liabilities, whether admitted or not, due or contingent, whether or not set out in the provisional balance sheet, shall stand extinguished by virtue of NCLT order approving the resolution plan, thus, taxes even if accrued cannot be realised from the Petitioner.

Revenue's contentions

- At the outset, the VAT authorities challenged the maintainability of the writ petition since the Petitioner Company had already availed the alternative remedy before the revisional authority.
- Petitioner by not depositing the tax collected from its customers / purchasers has committed the offence of criminal breach of trust.
- Further, the IBC was enacted in the year 2016 while the right to recover tax from the Petitioner accrues during the period 2011 to 2013, and therefore the right to recover tax by the State Government cannot be said to be affected by IBC.

² Innovative Industries Limited Vs. ICICI Bank & Anr, 2018 (1) SCC 407

³ Embassy Property Developments Pvt. Ltd. Vs. State of Karnataka & Ors., reported in *Manu/SC/1661/2019*; Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors. [(2019) 4 SCC 17]; Pr. Commissioner of Income Tax Vs. Monnet Ispat & Energy Ltd. (Special Leave to Appeal (c) No.6483 of 2018)

⁴Committee of Creditors of Essar Steel India Limited, through authorized Signatory Vs. Satish Kumar Gupta & Ors., (SCC OnLine SC 1478)



- The VAT authorities also contended that they were never afforded an opportunity to make a claim since they were not aware of the initiation of the CIRP proceedings. Section 13 of the IBC requires the making of a public announcement of the initiation of the CIRP and the inviting of claims from the creditors. This announcement, which should have been made in Jharkhand where the registered office of the Petitioner is situated, was never published in Jharkhand but was published solely in Kolkata. As such, the VAT authorities never became aware of the CIRP proceedings.
- The VAT authorities further contended that under section 31 of the IBC, an approved resolution plan can be binding on the stakeholders only if they are involved in the resolution plan. However, due to non-publication of the public notice, the VAT authorities were never made aware of the CIRP proceedings and could not file a claim and hence the resolution plan should not be binding on them.

The ruling of the High Court

Whether the VAT dues could be classified as 'Operational Debt'?

- The High Court held that tax dues would typically fall within the definition of 'Operational Debt' for the purpose of the IBC. However, with respect to VAT dues in the present case, the High Court has expressed a doubt if the same would be covered within the definition of 'Operational Debt'.
- This was on the basis that the act of collecting taxes from customers and not depositing the same with the government, utilised the same for its business purposes, amounted to criminal misappropriation of government money and therefore, would not bring such amount under the ambit of 'Operational Debt' under IBC.
- The High Court has further observed that since in the present case VAT had already been realised by the Petitioner from its customers on behalf of the state government, it was not a direct debt of the Petitioner owed to the government. The Court went on to hold that the decisions cited by the Petitioner were in the context of income-tax dues which were the direct debt of the Petitioner owed to the government, unlike the VAT dues in the facts of the present case.

Whether the resolution plan was binding on the VAT authorities?

- Basis the IBC provisions, the Court observed that public announcement of CIRP was required to be made in Jharkhand. Further, the Court also expressed that since the resolution plan was approved by the NCLT and not interfered even with by the Supreme Court, they were not required to look into the legality or otherwise of the resolution process, but due to the non-publication of the public notice in Jharkhand, the VAT authorities had no opportunity to make their claim in the CIRP and thus it was not binding on them in terms of section 31 of the IBC.
- Further, it was observed that the amendment in section 31(1) of the IBC to make the approved resolution plan binding on the government authorities in relation to statutory dues was made effective on August 16, 2019, whereas the resolution plan in the present case was approved prior to that date. The High Court held that amendment to section 31(1) of the IBC cannot held to be applicable retrospectively.



- Accordingly, it was held that the resolution plan shall not be binding upon the VAT authorities since they were not involved in the resolution process.

Dhruva comments

The substantive reason for dismissing the writ petition by the Hon'ble High Court appears to be the fact that the initiation of CIRP proceedings against the Petitioner was never brought to the knowledge of the VAT authorities. Furthermore, due to the non-publication of notice in the state of Jharkhand, no opportunity could be afforded to the VAT authorities to file their claim. Accordingly, the High Court held the resolution plan to be not binding on the VAT authorities.

Interestingly, in rendering the above decision, the Court also held that amendment to section 31(1) of the IBC, making the resolution plan binding on the government and statutory authorities, is only applicable in respect of resolution plans approved after August 16, 2019. With due respect to the decision of the Hon'ble High Court, the amendment appears to be only a clarificatory amendment and therefore should have been held to be retrospective and applicable even to resolution plans approved prior to the said date.

Furthermore, the Hon'ble High Court has also tried to distinguish the nature of the VAT dues from that of the income-tax dues and has expressed a doubt if the same could be regarded as 'Operational Debt'. With due respect to the decision of the Hon'ble High Court, the doubt expressed appears to be contrary to the provisions and the intent of the IBC, as well as the recent decision of the Hon'ble High Court of Rajasthan in the case of Ultratech Nathdwara Cement Limited⁵.

It is important to note that reasoning adopted by the High Court in doubting the status of VAT dues as 'Operational Debt' could also be applied to taxes deducted at source ('TDS') under the Income-tax Act, 1961. Given the difference of opinion amongst the High Courts, one will need to wait for a ruling of the Supreme Court to resolve the issue of status of tax dues under the IBC.

⁵ Ultratech Nathdwara Cement Ltd v Union of India (Civil Writ Petition No. 9480/2019)



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