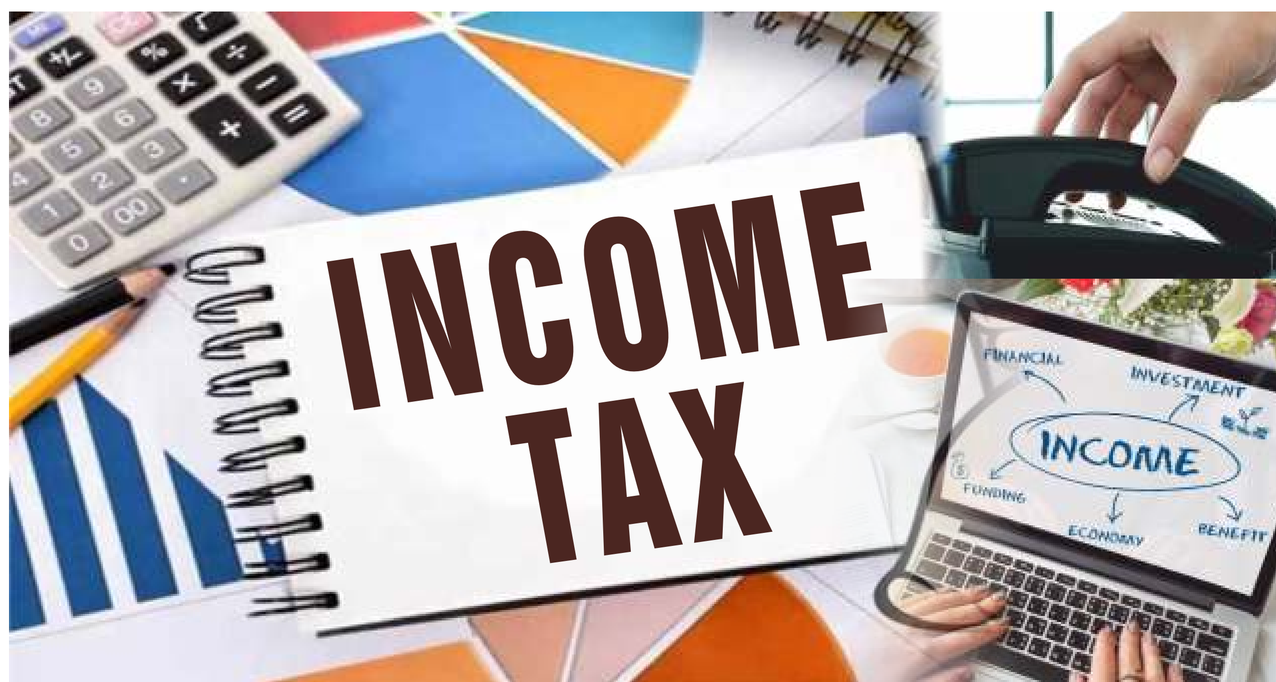
ARTICLE

Interplay between the Insolvency & Bankruptcy Code, 2016 and Income Tax Act, 1961



As per Section 17(2)(e) of the Insolvency and Bankruptcy Code, 2016 (IBC or the Code)- the IRP/RP is responsible for complying with the requirements under any law for the time being in force on behalf of the Corporate Debtor (CD). Hence it is critical for the Interim Resolution Professional (IRP)/ Resolution Professional (RP) to understand the interplay between the IBC and the other important enactments. As per Section 238 of the IBC – the provisions of IBC, 2016 shall override the provisions of other laws if they are inconsistent with its provisions.

In this article, the author has examined various provisions of the Income Tax Act, 1961 which are relevant to the provisions contained in the Code and are therefore critical in exercising the responsibilities of IRP/RP/ Liquidator. ***Read on to Know More…***

Vikram Kumar
The author is an Insolvency Professional (IP) Member of IIIPI. He can be reached at vikramau@gmail.com

1. Verification of Income Tax Return

Section 140 of the Income Tax Act, 1961 prescribes the person who is to verify the return of income. In the case of a company, the return is to be verified by the managing director or any director, if the managing director is not able to verify the return, or there is no managing director.

Section 17(1)(b) of the IBC prescribes that on appointment of an IRP, the powers of the board of company shall stand suspended. To facilitate the filing of income tax returns for entities under Corporate Insolvency Resolution Process (CIRP), the Finance Act, 2018 inserted Clause (c) after the second proviso to Section 140(c), which reads – "*where in respect of a company, an application for corporate insolvency resolution process has been admitted by the AA under section 7 or section 9 or section 10 of the IBC, 2016, the return shall be verified by the Insolvency Professional appointed by such AA"*. This provision is effective from April 01, 2018.

The said amendment to the Income Tax Act, 1961 paves the path for filing of return of income by the IP appointed as an IRP/RP during the CIRP of the CD.

2. Carry Forward and Set off of Losses

Section 79 of Act provides that carry forward and set off of losses in a closely held company shall be allowed only if there is a continuity in the beneficial owner of the shares carrying not less than 51 percent of the voting power, on the last day of the year or years in which the loss was incurred.

Where a Resolution Plan is approved by the Adjudicating Authority (AA) under the IBC, the shareholding pattern of the said company would invariably change, resulting in denial of the benefit of carry forward and set off of accumulated losses. To overcome the said difficulties undermentioned amendments were made to the Income Tax Act, 1961:

"Section 79(2)(c)- nothing contained in this section shall apply to a company where a change in the shareholding takes place in a previous year pursuant to a resolution plan approved under the IBC, 2016, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner". This provision has been made effective since April 01, 2018.

The Finance Act, 2019 has further extended the benefit of carry forward and set off losses to the subsidiaries and the subsidiary of such subsidiary also. The extant provisions of Section 79(2)(d)(ii) of the Income Tax Act, 1961 says "the provision of section 79 shall not apply to those companies, and their subsidiary and the subsidiary of such subsidiary, where change in shareholding of such company, and its subsidiaries and the subsidiary of such subsidiary, has taken place in a previous year pursuant to a resolution plan approved by NCLT under section 242 of the Companies Act, 2013, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner".

> **The Finance Act, 2019 has further extended the benefit of carry forward and set off losses to the subsidiaries and the subsidiary of such subsidiary also.**

The said amendment in the Income Tax Act has facilitated the Successful Resolution Applicant (SRA) to carry forward and set off of losses of companies acquired by a SRA pursuant to the Resolution Plan duly approved by the CoC and the AA.

3. Minimum Alternate Tax (MAT) on the "Book Profits"

Section 115JB of the Act provides for levy of a minimum alternate tax (MAT) on the "book profits" of a company. In computing the book profit, it provides, *inter alia*, for a deduction in respect of the amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account. Consequently, where the loss brought forward or unabsorbed depreciation is nil, no deduction is allowed.

> **Clause (iih) to Explanation 1 Section 115 JB of Income Tax Act, has facilitated the SRAs and RP/Liquidator (in case book profits arise) in reducing the income tax liability on account of MAT after acquisition of company.**

Finance Act, 2018 inserted Clause (iih) to Explanation 1 in Section 115JB to provide that the aggregate amount of unabsorbed depreciation and loss brought forward shall be allowed to be reduced from the book profit, if a company's application for CIRP under the IBC has been admitted by the AA. This provision has been made effective from April 01, 2018.

The said amendment in the Income Tax Act has facilitated the SRAs (in case book profits arise) in reducing the income tax liability on account of MAT post-acquisition of companies pursuant to the Resolution Plan duly approved by the Committee of Creditors (CoC) and the AA. Further, the word "aggregate" has given special benefit to such companies in view of allowance of deduction of only lesser of the two (either losses or depreciation) in other cases.

4. Appearance by Authorized Representative

Section 288 of the Act provides for the persons entitled to appear before any Income-tax Authority or the Appellate Tribunal, on behalf of an assessee, as its "Authorised Representative" (RA), in connection with any proceedings under the Income Tax Act. While the IBC empowers the IP to exercise the powers of the Board of Directors of the CD, the lack of explicit reference in Section 288 of the Act for an IP to act as an AR of the CD has been raising practical difficulties.

Finance Act, 2020 inserted Section 288(2)(viii) to provide that any other person as may be prescribed may act as an AR. Rule 51B of the Income Tax Rules, 1962 prescribes such other category of persons as "in respect of a company

or a limited liability partnership, as the case may be, shall be the person appointed by the AA for discharging the duties and functions of an interim resolution professional, a resolution professional, or a liquidator, as the case may be, under the IBC, 2016 and the rules and regulations made thereunder".

Hence the IRP/RP/Liquidator can now act as the AR for the CD before the Income Tax Department by virtue of the amendment to Section 288 of the Income Tax Act, 1961.These provisions are also applicable w.e.f. April 01, 2020.

5. Modification and Revision of Demand Notice

A Successful Resolution Applicant (SRA) is often concerned with the legal tussle that the SRA shall face with the Income Tax Department on account of reduction in income tax liability as payable under a Resolution Plan duly approved by the AA. It is common to see that the Income Tax Department continues to challenge the reduced tax liability, and this creates an environment of uncertainty for the SRA.

Finance Act, 2022 inserted Section 156A to provide that the Assessing Officer shall modify the demand payable in conformity with the order of the AA and shall thereafter serve on the assessee a notice of demand specifying the sum payable, if any, and such notice of demand shall be deemed to be a notice under section 156 of the Income Tax Act. Hence the order passed by the AA approving a Resolution Plan shall be complied by the Assessing Officer and the revised demand notice in accordance with the resolution plan duly approved by the AA shall be issued by the Assessing Officer under Section 156 of the Income Tax Act, 1961.

> **Section 156A (1) and 156A(2) of the Income Tax Act inserted via Finance Act 2022, will assist the SRA in smooth implementation of the approved Resolution Plan and avoid unnecessary litigation on account of Income Tax.**

The extant provisions of Section 156A of the Income Tax Act, 1961 are reproduced below:

"Section 156A(1) Where any tax, interest, penalty, fine or any other sum in respect of which a notice of demand has been issued under section 156, is reduced as a result of an order of the AA as defined in clause (1) of section 5 of the IBC, 2016, the Assessing Officer shall modify the demand

payable in conformity with such order and shall thereafter serve on the assessee a notice of demand specifying the sum payable, if any, and such notice of demand shall be deemed to be a notice under section 156 and the provisions of this Act shall accordingly, apply in relation to such notice.

Section 156A(2)- Where the order referred to in sub-section (1) is modified by the National Company Law Appellate Tribunal or the Supreme Court, as the case may be, the modified notice of demand as referred to in sub-section (1), issued by the Assessing Officer shall be revised accordingly."

These amendments have been implemented w.e.f. April 01, 2022. This will assist the SRA in smooth implementation of the approved Resolution Plan and avoid unnecessary litigation on account of income tax demand being raised by the Income Tax Department post approval of the resolution plan with reduced income tax liabilities.

6. Remission or Cessation of Liabilities Pursuant to Approval of a Resolution Plan

Any remission or cessation in respect of any trading liability is taxable under Section 41(1) of the Income Tax Act, 1961, where allowance or deduction in respect of such trading liability has been obtained in computing income for any previous year.

The extant provisions of Section 41(1) of the Income Tax Act, 1961 is reproduced below:

"Section 41. Profits chargeable to tax—

(1) Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (hereinafter referred to as the first-mentioned person) and subsequently during any previous year— (a) the first-mentioned person

has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not; or (b) the successor in business has obtained, whether in cash or in any other manner whatsoever, any amount in respect of which loss or expenditure was incurred by the first-mentioned person or some benefit in respect of the trading liability referred to in clause (a) by way of remission or cessation thereof, the amount obtained by the successor in business or the value of benefit accruing to the successor in business shall be deemed to be profits and gains of the business or profession, and accordingly chargeable to income-tax as the income of that previous year."

Further as per Section 28(iv), the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession is chargeable to income-tax under the head of profits and gains of business or profession.

6.1. Is remission or cessation of liabilities on account of approval of Resolution Plan liable to Income Tax?

Invariably the approval of Resolution Plan leads to a remission or cessation of liabilities. The same may be a remission or cessation on account of a term liability or an operational trading liability. Whilst the remission or cessation of the term liability is permitted by the Income Tax Department as a capital receipt not chargeable to income tax, the same is not permitted in the case of operational trading liability.

> **The remission or cessation of a term liability is not liable to income tax under Section 28(iv) of the Income Tax Act as per the Supreme Court judgement in the matter of *the Commissioner (appellant) Vs. Mahindra and Mahindra Ltd* (2018).**

The remission or cessation of a term liability is not liable to income tax under Section 28(iv) of the Income Tax Act as per the very famous judgment of the Hon'ble Supreme Court of India in the matter of *The Commissioner Vs. Mahindra and Mahindra Ltd*[1] *(2018)*, the gist of the case is stated below:

(a) Facts of the Case: The respondent entered into an agreement with Kaiser Jeep Corporation (KJC) for expanding its jeep product line. KJC agreed to sell the dies and other equipment for $6,50,000/-. KJC also provided a loan to the Respondent for the said procurement at the rate of 6% interest repayable after 10 years in installments. Later on, the American Motor Corporation (AMC) took over the KJC and agreed to waive the principal amount of loan advanced by the KJC to the respondent. In the income tax return filed by the respondent, ₹ 57,74,064/- was claimed as cessation of its liability towards AMC and not liable to income tax as it was capital receipt.

(b) Issues before the Hon'ble Supreme Court of India: Whether ₹57,74,064/- due by the Respondent to KJC which later was waived off by the lender constitute taxable income of the Respondent or not?

(c) Decision of the Hon'ble Supreme Court of India

(i) For applicability of Section 28(iv) of the Income Tax Act, any benefit or perquisite arising from the business shall be in the form of benefit or perquisite other than in the shape of money, in the present case, the amount of ₹57,74,064/- is received as cash receipt due to the waiver of loan, hence the said amount cannot be taxed under the provisions of Section 28 (iv) of the IT Act.

(ii) Section 41(1) is also not applicable as the loan from KJC was in respect of plant, machinery and tooling equipment's which are capital assets of the Respondent. The said purchase amount had not been debited to the trading account or to the profit or loss account in any of the assessment years. Section 41 (1) of the IT Act particularly deals with the remission of trading liability, whereas in the instant case, waiver of loan amounts to cessation of liability other than trading liability.

The remission of any operational liability pursuant to the approval of a Resolution Plan under IBC is not treated as capital receipt and is routed as an item of profit and loss account thereby exposing it to a possibility of MAT on the same (when carry forward loss still exists).

---

1. The Commissioner (Appellant) Vs. Mahindra and Mahindra Ltd (Respondent), Civil Appeal Nos. 6949-6950 of 2004 dated April 24, 2018.

While suitable changes may be debated under Section 41(1) of the Income Tax Act, 1961 for exempting companies from remission or cessation of operational trading liability besides the existing remission for haircuts on term liabilities sought pursuant to an approved resolution by the AA under the Provisions of IBC, 2016 in the long term, it may be pertinent for the Resolution Applicant to seek full relief of any MAT / Tax Liability that may accrue on account of implementation of the Plan *vis a vis* the write backs on account of haircuts on operational liabilities after adjustment of any permissible carry forward of losses.

This shall also be rationale to the extent that taxes on write backs to the extent that the write offs are not adjustable / mitigated by permissible carry forward of losses are not an additional burden on the Resolution Applicant.

7. Amendment Required in Section 72A of the Income Tax Act, 1961

Section 72A contains provisions pertaining to carry forward and set off of accumulated loss and unabsorbed depreciation allowance in amalgamation or demerger of companies.

As per Section 72A, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was affected, however the benefit of Section 72A, shall be denied under the circumstances as laid down under Section 72A(2)(a) & (b). For e.g., one of the conditions is that the amalgamated company continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation. Such conditions are restrictive in nature and go against the spirit of resolution as laid down under IBC, 2016.

> **An exemption needs to be carved out under Section 72A for companies whose Resolution Plan is approved under the provisions of IBC, 2016.**

An exemption needs to be carved out under Section 72A for companies whose Resolution Plan is approved under the provisions of IBC, 2016.

8. Section 178- Company in Liquidation

Section 178 of the Income Tax Act, 1961 mandates the liquidator shall not, without the leave of the Commissioner, part with any of the assets of the company or the properties in his hands until he has been notified by the Income Tax Officer about the tax liabilities due from the said company under liquidation and the liquidator is mandated to set aside an amount equal to the said tax liabilities as notified by the Income Tax Officer before the Liquidator can proceed to distribute the assets of the company under liquidation.

Hence as per Section 178 of the Income Tax Act, 1961, the Liquidator is required to first obtain a 'No Objection Certificate' (NOC) from the Income Tax Department before proceeding to distribute the assets of the companies under liquidation. However as per Section 178(6), the provisions of Section 178 are not applicable to the companies which are undergoing liquidation under IBC, 2016. The extant provision of Section 178(6) of the Income Tax Act, 1961 says – "*Section 178(6)- The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force, except the provisions of the IBC, 2016.*"

> **IBBI vide a circulation on November 15, 2021, dispensed with the requirement of obtaining NOC from the Income Tax Department under Section 178 of the Income Tax Act, 1961.**

However, in spite of the extant provisions as contained in Section 178(6) of the Income Tax Act, 1961, in practice, the liquidators in case of voluntary liquidation of the companies under IBC, 2016 were obtaining the NOC from the Income Tax Department. The said practice was causing unnecessary delay in timely completion of the voluntary liquidation of the companies under IBC, 2016.

Through a Circular[2] on November 15, 2021, the Insolvency and Bankruptcy Board of India (IBBI) dispensed with the requirement of obtaining NOC from the Income Tax Department under Section 178 of the Income Tax Act, 1961. IBBI has clarified vide above mentioned circular that "*The process of applying and obtaining of such NOC/NDC from the Income Tax Department consumes substantial time and thus militates against the express provisions of the Code, and also defeats the objective of time-bound completion of process under the Code. Therefore, it is hereby clarified that as*

[2] Circular, IBBI/LIQ/45/2021 dated November 15, 2021.

per the provisions of the Code and the Regulations read with Section 178 of the Income Tax Act, 1961, an IP handling voluntary liquidation process is not required to seek any NOC/NDC from the Income Tax Department as part of compliance in the said process".

9. Section 46-Capital Gains on Distribution of Assets by Companies in Liquidation

As per Section 46 of the Income Tax Act- where a shareholder on the liquidation of a company receives any money or other assets from the company, he shall be chargeable to income-tax under the head "Capital Gains", in respect of the money so received or the market value of the other assets on the date of distribution, as reduced by the amount assessed as dividend within the meaning of Section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

It is necessary to issue a clarification under Section 46 of the Income Tax Act, 1961, that in the case of voluntary liquidation or liquidation, if residual amounts being received in form of assets by the equity shareholders shall not require any further valuation under Section 56(2) read with rule 11UA of the Income Tax Act. Further it is also clarified that since the assets of the company are distributed in the event of the liquidation, the same shall not warrant a separate valuation under the Income Tax Act and Section 46(2) shall be given effect to by treating the consideration received as the fair value transferred.

It is also to be clarified that since the assets of the company are distributed in the event of liquidation, the same shall not warrant a separate valuation under the Income Tax Act.

Thus, the interplay between the provisions of the Income Tax Act, 1961 and the IBC, 2016 is critical to understand for every IP for effectively discharging his duties as an IRP/RP/Liquidator and this plays a significant role in decision making of the prospective resolution applicant while deciding to buy/not to buy a certain company.