Statutory Compliances during Corporate Insolvency Resolution Process

During the period of CIRP, an IP in his/her capacity as the IRP/ RP is responsible for compliance of various mandatory filings and disclosures related to the Corporate Debtor. This includes but not limited to, various compliances under The Companies Act, 2013; Income Tax Act, 1961; Goods and Services Tax Act 2017; Provident Fund Act, 1952; Employees State Insurance Act, 1948 etc. Though the Liquidator is under no specific obligation to file the Income Tax Return, the non-filing may result in denial of benefit of carry forward of losses to the successor in case the CD is sold as a going concern. In the present article, the author has analysed various compliances to be made during the CIRP and had also made recommendations to ease them. ***Read on to know more…***

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Introduction

As per Section 17(2) of the Insolvency & Bankruptcy Code, 2016 (IBC), the Interim Resolution Professional (IRP)/ Resolution Professional (RP) is vested with the management of the Corporate Debtor (CD) and shall be responsible for complying with the requirements under any law for the time being in force on behalf of the CD.

The IRP/ RP needs to ensure statutory compliances under various laws, which inter-alia include The Companies Act, 2013; Income Tax Act, 1961; Goods & Services Act 2017; Provident Fund Act, 1952; Employees State Insurance Act, 1948; etc. If a CD is having ongoing business operations and maintaining updated records, then it becomes easier for IRP / RP to ensure statutory compliances on behalf of the CD. However, in most cases, business operations have been discontinued before commencement of the Corporate Insolvency Resolution Process (CIRP). Consequently, books of account/ statutory records of the CD remains incomplete / untraceable and most/all employees who were responsible for making statutory compliances have already left the organisation. Generally, directors remain non-supportive to the RP and even if, they are willing to extend

cooperation to RP, they have their own limitations due to the prevailing situation mentioned above.

Therefore, ensuring statutory compliances often become onerous for the RP. There has been limited alignment of the Companies Act 2013, the Income Tax Act 1961, and the Central Goods & Services Tax Act 2017 (GST Act), by factoring in this new situation arising consequent to the commencement of CIRP under the IBC.

1. Impediments in compliances of Provisions of the Companies Act 2013

1.1. Annual Return

a) Section 92 of Companies Act 2013 requires filing of the Annual Return within sixty days from the day the Annual General Meeting (AGM) is held or from the last date on which such AGM should have been held, as the case may be. In the Annual Return, various details and information are required to be given which *inter alia* include details of meetings of members or a class thereof, of the Board of directors and its various committees along with attendance details, remuneration of directors and key managerial personnel etc.

b) In many companies, either secretarial records are not updated or insufficiently updated, therefore, it becomes that much more difficult to get the Annual Return certified from a practicing company secretary or obtain a secretarial audit report.

c) After commencement of CIRP, generally no Board Meeting is convened, as powers of Board of Directors is suspended. Even if, any attempt is made to convene any Board meeting, it would remain unsuccessful due to resignation or unsupportive attitude of directors. Annual Return Form, i.e. Form MGT-7, requires the number of directors present to be a figure greater than "0" and less than or equal to "99", and there is no option to show that no Board Meeting has been convened or there was no attendance at Board Meeting. As a result, e-form shows an error during pre-scrutiny stage.

"The Annual Return Form i.e., Form MGT-7 has no option to show that no Board Meeting was convened, or no member attended the meeting. As a result, it shows an error at pre-scrutiny stage."

1.2. Section 137 of the Companies Act 2013, requires filing of financial statements, duly adopted at the AGM with the Registrar within thirty days of the AGM. There are various issues in finalisation of financial statements and adoption of the same by shareholders in AGM which *inter alia* include:

a) Non availability of updated accounting data. Discontinuation of operations and desertion of employees causes difficulty in updating books of account and sometimes take considerably long time.

b) Even if books of account are updated, there may be lingering pre-CIRP legacy issues, due to non-availability of sufficient information, documents, or contravention of statutory provisions etc, resulting into qualified audit report. Since, directors and their relatives generally hold majority shareholding in the CD, therefore, adoption of financial statements with qualified audit report entirely depend upon them and shareholders may not adopt the financial statements in AGM.

c) Resignation / refusal by existing statutory auditor to audit the financial statements. Section 139(8) of the Companies Act, 2013 requires confirmation of appointment of new auditor from shareholders. Since erstwhile promoters generally hold majority shares, therefore, appointment of new statutory auditor depends largely upon the cooperation of the erstwhile promoters.

d) Disagreement between the management, directors and/or auditors on the accounting treatment / disclosure in the financial statements resulting in the financial statements not being acceptable to one of the key signing parties leading to non-finalization of the accounts.

e) Sec.134(1) of the Companies Act, 2013 requires that the financial statements shall be

approved by the Board of Directors (BOD) before they are signed on behalf of the Board at least by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be Managing Director and the Chief Executive Officer, if he is a Director in the company, or the Chief Financial Officer and the Company Secretary of the company, wherever they are appointed. After the commencement of CIRP, since powers of the Board stand suspended therefore, directors, generally refuse to sign the financial statements. Resignation / non availability of the CFO and the company secretary further shifts entire responsibility about truthfulness of financial statements on to the RP, though not being privy to transactions incorporated in the said financial statements.

The decision of the Hon'ble NCLAT in the case of *Mukund Choudhary (Resolution Professional) v. Subhash Kumar Kundra*[1] that the IBC does not release the directors of the CD from their duties, but only suspends their power as directors and appoints the RP for managing the Company, and directors are under obligation to authenticate the financial statements, seldom helps in persuading directors to sign the financial statement prepared during the CIRP.

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f) Convening of AGM and adoption of financial statements at the AGM depends largely upon the cooperation from erstwhile promoter's due to having majority shareholding.

g) Non availability of requisite details and information required for preparing the Board report is also a problem. Further, the Board report is required to be signed by the Chairperson of the Company if he is so authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a Managing Director, or by the Director where there is one director. Though power of the Board of directors is vested with the RP after the commencement of CIRP but he is not designated as a director and therefore cannot act as Chairperson of the company. Therefore, the RP's signature alone on the Board Report, may not be considered as being proper and in due compliance of the Act. Further, Section 134(3)(c) requires a Director's Responsibility Statement in the Board report. The RP can neither take responsibility for any omission / commission of the erstwhile management nor can confirm any thing for which he is not privy to, by signing the Board Report.

h) A company is not allowed to file any financial statements and annual returns with the Registrar if its status on the Ministry of Corporate Affairs (MCA) portal is "ACTIVE Non-Compliant" due to non-filing of Form INC 22A. Filing of INC 22A again requires the active cooperation of directors and access to registered office.

1.3. Statutory compliance during Liquidation – an unresolved issue

The MCA vide a Circular[2] have clarified that the IRP/RP/Liquidator shall be responsible for filing all the e-forms in the MCA portal and sign the Form in the capacity of Chief Executive Officer in order to meet filing protocol in the existing Forms architecture. However, this shall in no way affect his legal status as IRP/RP/Liquidator. All the filings of e-forms including Form AOC 4 and Form MGT 7 shall be filed through e-form GNL 2 by way of attachment till the Company is under CIRP/Liquidation.

Under Section 35 of the IBC, no duty has been prescribed for Liquidator to comply with the requirement under any law for the time being enforce on behalf of corporate debtor as prescribed in section 17(2)(e) of the IBC for IRP / RP. Further, Regulation 6(3) of the IBBI (Liquidation Process) Regulations, 2016 requires the Liquidator to maintain registers and books in the forms indicated in

[1] *Company Appeal (AT) (Insolvency) No. 452 of 2021.*

[2] *Circular No. 8/2020 dated March 06, 2020.*

Schedule III, with such modifications as the Liquidator may deem fit in the facts and circumstances of the Liquidation Process. Therefore, under the IBC, Liquidator is under no specific obligation to prepare and submit audited financial statements and annual return with MCA, pursuant to section 92 and 137 of the Companies Act.

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Without prejudice to the above, preparation of financial statements during Liquidation will be a complex proposition, as underlying "concept of going concern" on the basis of which financial statements are generally prepared, cannot be used, as the CD is in Liquidation. This issue becomes that much more complex when the Liquidator is tasked to first explore selling the CD as a going concern or the business of the CD is being run as a going concern.

Further, as per Section 178 of Income Tax Act, the Liquidator is required to give a notice to the assessing officer, within thirty days of his appointment and Income-tax Officer shall inform him the amount which, in the opinion of the Income Tax Officer, would be sufficient to provide for any tax which is then, or is likely thereafter to become, payable by the company. In addition, the tax department is also requested to file its claim as required under the IBC.

In *Om Prakash Agrawal (Liquidator) of S Kumar Nationwide Limited v. Chief Commissioner of Income Tax*[3] *(TDS)*, the NCLAT held that there is inconsistency between Section 194 IA of the Income Tax Act and Section 53(1)(e) of the IBC therefore, by virtue of Section 238 of the IBC, Section 53(1)(e) of the IBC shall have overriding effect on the provisions of the Section 194 IA of the Income Tax Act. The Appellate Tribunal further observed that there is no such provision in the Income Tax Act, IBC or (Liquidation Process Regulation that the Liquidator is required to file Income Tax Return.

The Supreme Court in the case of *Principal Commissioner of Income Tax v. Monnet Ispat and Energy Limited (*2018) SCC held that Section 238 of the IBC shall have overridden effect if anything inconsistent is contained in any other enactment.

In view of the above, it may appear that the Liquidator is under no obligation to make any statutory compliance neither under Companies Act, 2013 nor under Income Tax Act, 1961. However, if liquidator proposes to sell the CD as a going concern during Liquidation, then he needs to ensure that the books of account are updated, financial statements are prepared and tax returns are also filed, as per statutory requirements, to maintain going concern status of the CD. However, there is a need to align the provisions of the Companies Act, 2013 the Income Tax, 1961 and the IBC considering practical issues arising after commencement of CIRP / Liquidation.

2. Intricacy of Provisions of Income Tax Act, 1961

2.1. Filing of Income Tax Return under Section 139 of the Income Tax Act, 1961

As per the Provisions of the Income Tax Act, all corporate assesses are required to file an income tax return latest by October 31 after obtaining tax audit report latest by September 30, of the relevant Assessment Year. An assessee may file a belated income tax return anytime on or before three months before the end of the relevant Assessment Year (AY) or before the completion of the assessment, whichever is earlier with penalty and interest. As per Section 80 of Income Tax Act, no loss from business, assessed pursuant to filing of a belated return, is allowed to carry forward and set-off.

> **"As finalisation and audit of financial statements within the stipulated time frame remains a challenge for the RP, compliance relating to timing filing of income tax return is also difficult to adhere with."**

As stated earlier, since finalisation and audit of financial statements within the stipulated time frame remains a challenge for the RP, compliance relating to timing filing of income tax return is also difficult to adhere with. The resolution professional at times, has to face the ire of a successful resolution applicant due to denial of benefit of carry forward losses on account of filing of a belated return.

Further, as stated earlier, if it is interpreted and acted upon that the Liquidator is under no obligation to file the Income Tax Return, it may result in denial of benefit of carry

[3] *Company Appeal (AT) (Insolvency) No. 624 of 2020.*

forward of losses to the successor in case the CD is sold as a going concern.

2.2. Denial of tax credit and claim for pre-CIRP unpaid TDS / TCS Amount

As per the scheme of the IBC, the Income Tax Department is required to submit its claim for all outstanding demand including for TDS / TCS, outstanding as on CIRP commencement date. Further, as per extant provisions of Income Tax Act, if any amount of TDS / TCS is deducted but remains unpaid then service provider / employees are denied credit for the same. However, on denial of any such tax credit, RP has to face hostile vendors, contractors and employees and such vendors / service providers may withhold supplies of goods & services also. Further, it may be argued that any admission of claim for the TDS / TCS amount, credit of which is denied to the recipients of income, would be enrichment of statutory authorities at the cost of other creditors, at least to extent said claim is settled through payment out of the proceeds of the resolution plan or liquidation estate, as the case may be.

Therefore, there is an urgent need for CBDT to issue clarification that no tax credit shall be denied in NCLT cases due to non-deposit of TDS/ TCS amount for the pre-CIRP period by the unit / company under CIRP and Income Tax Department shall exclude from its claim, amount for which it has already denied tax credit.

3. Intricacy of Provisions of GST Act

3.1. Requirement of new Registration number

As per Notification No. 11/20 Central Tax dated March 21, 2020, corporate debtors who are undergoing CIRP shall, with effect from the date of appointment of IRP / RP, be treated as a distinct person of the CD, and shall be liable to take a new registration within 30 days of the appointment of the IRP/RP or by June 30, 2020, whichever is later. However, corporate debtors who have not defaulted in furnishing the return under GST would not be required to obtain a separate registration.

Central Board of Indirect Taxes and Customs (CBIC) has further clarified that though IRP/RP are not under an obligation to file returns of pre-CIRP period, but they will be liable to furnish returns, make payment of tax and comply with all the provisions of the GST law during the CIRP period.

> **CBIC has clarified that though IRP/RP are not under an obligation to file returns of pre-CIRP period, they will be liable to furnish returns, pay taxes and comply with all the provisions of the GST during the CIRP.**

The threshold of aggregate turnover in a financial year for obtaining a GST registration is ₹20.00 lacs and therefore, legally IRP / RP can dispense with the requirement of taking new GST registration number, if the CD has no operations. However, in the author's view, IRP / RP should take new GST registration number, even if sale turnover during CIRP period is likely to be below threshold limit of ₹20.00 lacs, if turnover is likely to exceed threshold limit post approval of resolution plan, as resolution applicant can continue with the said number and take benefit of eligible input credit on CIRP cost.

3.2. Denial of input credit and claim for pre-CIRP GST liability

As per scheme of the IBC, the GST Department is required to submit its claim for all demands, outstanding as on CIRP commencement date. CBIC by Instruction No 1083/04/2022 dated May 23, 2022, has circulated Standard Operating System (SOP) to all principal chief commissioners, relating to NCLT cases. As per SOP, concerned office/ Commissionerate which has arrears pending against the unit /company shall file its claims timely for safeguarding and realisation of the government dues and inform the fact of having filed its claim to the Nodal Officer through the ADC/ JC in the Chief Commissioner's Office (CCO).

However, as per GST Act, input credit is allowed only on deposit of GST by suppliers of goods & services which means customers are denied input credit even if GST is paid by customers but remains undeposited with GST Department. As per strict legal interpretation, claim of unpaid GST amount is not admissible if GST Department has denied input credit as it has already recouped its losses by denying such input credit. If claim for unpaid GST amount is admitted during CIRP and thereafter, said claim is settled through payment out of Resolution Plan settlement amount, then it may be argued that this would be enrichment of statutory authorities at the cost of other creditors. On the contrary, the RP has to face hostile customers who have been denied credit input of GST due to non-deposit of the same, resulting into withholding of

payments by customers to recoup their losses, stress in cash flow and disruption in going concern status of the CD. Therefore, there is an urgent need for CBIC to issue clarification that no input credit for GST shall be denied in NCLT cases due to non-deposit of GST amount for the pre-CIRP period by the unit / company under CIRP and GST department shall exclude from its claim, amount for which it has denied input credit.

> **RP has to face hostile customers who have been denied credit of GST due to non-deposit of the same, resulting into withholding of payments by them to recoup their losses, stress in cash flow and disruption in going concern status of the CD.**

3.3. Can liability relating to pre CIRP period be paid during CIRP Period

RP cannot pay any liability including deposit of TDS / TCS, GST amount, electricity bill, salary & wages etc., relating to pre-CIRP period as same may be termed as transferring or disposing off assets by the CD, an activity prohibited u/s 14(1)(b) of the IBC. However, to maintain continued business operations, certain essential payments may need to be made, even if pertaining to pre CIRP period. For instance, if the CIRP period commences on October 20, then business expediency requires that all pending electricity bills outstanding or accruing up to October 20, GST / TDS amount collected from customers till October 20 and workers / staff salary becoming due up to October 20, should be paid on respective due date (s) to avoid any business disruption. Presently, only available option is to seek the permission of the Adjudicating Authority to make such payments which at times, take untoward long time. Therefore, there is an urgent need for IBBI to amend CIRP Regulations to authorise IRP / RP to make few payments relating to pre- CIRP which inter-alia includes gas, electricity, water, TDS / TCS, GST, PF, ESI, and salary & wages which became due within 30 days prior to commencement of CIRP wherever, CD is having on going business operations.

4. Conclusion

Section 238 of the IBC gives an overriding effect to its provisions over any other law, in case of any inconsistency between the two. However, provisions of other law shall prevail if there is no inconstancy or if the IBC is silent on the same. As regards statutory compliances, the IBC is silent except making IRP/RP responsible for complying with the requirements under any law for the time being in force on behalf of the CD. Therefore, there is a need to harmonise various provisions of the Companies Act, Income Tax Act and GST Act with the IBC to ensure better compliance by resolution professionals and liquidators.