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# WITNESS

Volume 11 Issue 10 | May 2020

₹65 US \$6 UK £4

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# Sale as Going Concern & Stance on Statutory Dues IBC 2016

■ Sachin Gupta & Amir Ali Bavani

**A**n alternative to an insolvent company being dissolved under liquidation proceedings is sale of the entity as a going concern. In such a scenario, the ownership of the entity shifts hands but the operations of the business continue thereby minimizing the material changes in operation and functioning of the entity. This concept of going concern is primarily reflected in Section 20 of the Insolvency and Bankruptcy Code, 2016 ('the Code'/'IBC') where in the Corporate Insolvency Resolution Process ('CIRP'), the interim resolution professional is entrusted with the duty to protect and preserve the property of the corporate debtor and also manage the operations of the corporate debtor as a going concern. Further, the interim resolution professional is also granted authority to take certain actions as enumerated in the aforementioned provision to ensure that the corporate debtor is maintained as a going concern.

The legal provisions governing this regime under liquidation are Regulations 32 and 32A of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 ('Liquidation

Process Regulations') and Regulation 39C of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ('CIRP Regulations'). Under the process of liquidation, as per Regulation 32 of Liquidation Process Regulations, the liquidator in order to realise the assets of the corporate debtor may sell the assets on standalone basis, in a slump sale, collectively or in parcels. Otherwise, unless an asset of the corporate debtor is subject to security interest that has not been relinquished to the liquidation estate, the liquidator may either sell the corporate debtor as a going concern [Regulation 32(e)] or sell the business of the corporate debtor as a going concern [Regulation 32(f)].

The ambit of Regulation 32 was explained in the Discussion Paper on Corporate Liquidation Process along with Draft Regulations published by the Insolvency and Bankruptcy Board of India ('Discussion Paper') on 27.04.2019. It was clarified that in a transaction under Regulation 32(e), the corporate debtor will not be dissolved, instead, it will form part of the liquidation estate and will accordingly be transferred along with the business, assets and liabilities including all contracts, licenses, government approvals,



D-55, Defence Colony,  
New Delhi-110 024.  
**Tel:** 91(11) 42410000,  
**Fax:** 91 (11) 42410091  
**E:** expertspeak@dhirassociates.com

concessions, agreements, benefits, privileges, rights or interests among other things to the acquirer. Further, the consideration received from the sale will be split into share capital and liabilities based on a capital structure that the acquirer decides. Accordingly, the corporate debtor will issue shares to the extent of the share capital while the existing shares of the corporate debtor will not be transferred and will be extinguished. The existing shareholders become claimants from the liquidation proceeds under Section 53 of the Code. On the contrary, in a transaction under Regulation 32(f) only the business of the corporate debtor is liquidated and the assets and liabilities relevant for the business is transferred which implies that the corporate identity will not be retained. In this case, the existing shares are extinguished and the stakeholders are paid from the proceeds of the sale of the remaining assets as per Section 53 of the Code. The corporate debtor entity is thereby dissolved.

To elaborate, sale of the corporate debtor as a going concern implies that the corporate debtor would continue to be functional as it would have been prior to initiation of CIRP apart from restrictions imposed by the Code. While not expressly defined, 'going concern' means all such assets and liabilities which constitute an integral business or the corporate debtor must be transferred together and the consideration must be for the business or the corporate debtor. Thus, the buyer of the assets and liabilities should be able to conduct business without any disruption. Moreover, the business transferred should be running and should be transferred along with its employees and equity shareholding. The aim of such a sale is to ensure a seamless transfer of business operations.



Such mode of sale also prevents viable businesses from being liquidated due to the inadequate bidders in the market or the resolution plan being unapproved due to failure of meeting required voting share among other factors. Liquidation in such instances may result in unnecessary unemployment, risking returns for stakeholders and create significant disruption in the operation and functioning of the entity. Thus, Regulation 32 of the Liquidation Process Regulations as amended on 28.10.2018, aims to save a business from liquidation when CIRP has been deemed a failure. Regulation 32A of the Liquidation Process Regulations as implemented through an amendment dated 25.07.2019, further ascertains the role of the liquidator in executing sale as going concern as under Regulation 32.

Prior to these amendments, the scope of sale of going concern under the Code was ambiguous and uncertain.

The Hon'ble National Company Law Tribunal ('NCLT'), Kolkata bench in Gujarat NRE Coke Limited, directed the liquidator to sell the corporate debtor as a going concern, even in the absence of any express procedure following such disposal in the Code. It is widely assumed that such cases triggered the amendment of Regulation 32 and the introduction of Regulation 32A under the Liquidation Process Regulations.

Following the implementation of Regulation 32 of the Liquidation Process Regulations, NCLT, Mumbai bench, in the case of Edelweiss Asset Reconstruction Company v. Bharti Defence and Infrastructure Limited on 14.01.2019, directed the liquidator to sell the corporate debtor as a going concern as stated under Regulation 32 (e) of the Liquidation Process Regulations within a period of six months, failing which, would result in the sale of the assets of the corporate debtor to be undertaken by



the liquidator in the manner prescribed by Chapter III Part II and the relevant regulations of the Code.

Accordingly, in March, 2020 after the implementation of Regulation 32A of the Liquidation Process Regulations, the infrastructure firm IVRCL Limited was sold to Gabs Megacorp Limited as a going concern subject to the pending decision of the National Company Law Appellate Tribunal (NCLAT) with regard to orders passed by the National Company Law Tribunal (NCLT), Hyderabad.

The Insolvency Law Committee in the Report of the Insolvency Law Committee published by the Ministry of Corporate Affairs in February, 2020 agreed that the liquidator is best placed to decide whether a going concern sale should be attempted, after assessing relevant factors such as the commercial viability of the business of the corporate debtor, and consulting the relevant

stakeholders of the corporate debtor in order to ensure that it would generate a greater value than the other modes of liquidation. Further, as the fee of the liquidator is often linked to the amount distributed in liquidation, the liquidator is incentivized to choose the most value maximizing mode of liquidation, provided that such a decision is taken in consultation with the stakeholders of the corporate debtor.

At this juncture, it is pertinent to note that it is not only the assets and benefits of the corporate debtor that are transferred but also the liabilities. Any liabilities relevant to the business of the corporate debtor is transferred along with the assets. As per Regulation 39C of the CIRP Regulations, where the committee of creditors recommends sale as a going concern, they identify and group the assets and liabilities according to its commercial considerations, which are to be sold as going concern as

under Regulation 32 of the Liquidation Regulations. If the committee of creditors has not identified the assets and liabilities, then the liquidator in consultation with the consultation committee, identifies and group the assets and liabilities to be sold as a going concern under Regulation 32A of the Liquidation Regulations. Essentially, as explained in the Discussion paper, as per Regulation 32A of the Liquidation Regulations and Regulation 39C of the CIRP Regulations, the liquidator, has the ability to package a combination of the various assets and liabilities of the corporate debtor as per market practice. After receipt of bids for such packages, it is sold and the leftover liabilities from the sale proceeds are discharged in accordance to Section 53 of the Code.

In view of the treatment of liabilities, the stance of statutory dues in the sale of the corporate debtor as a going concern under the Code needs to be assessed. The statutory dues otherwise also known as government dues are mandatory payments that arise out of statutory provisions laid down by legislature, such as the tax laws that mandate payment of taxes to tax authorities and regulators on whom the entity depends upon for its ongoing operations.

Multiple petitions were being filed before the Adjudicating Authority ('AA'/ 'NCLT') by the tax departments pertaining to the treatment of their dues under the Code. It was on 20.03.2019 in the matter of Pr. Director General of Income Tax (Admn. & TPS) Vs M/s. Synergies Dooray Automotive Limited & Others, where the Hon'ble National Company Law Appellant Tribunal ('NCLAT') clarified the ambiguity regarding statutory dues and held that these dues such as the income tax, sales





tax, value added tax and other various dues fall within the ambit of operational debt as defined under Section 5(21) of the Code. The 'operational debt' is defined as, "payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority." Thus, it is clear that the Central Government, State Government or local authority to whom the debt is owed are categorized as operational creditor, as defined under Section 5(20) of the Code. The Hon'ble NCLAT further stated that the statutory dues arising out of the existing law should have a direct nexus with the operations of the corporate debtor, hence when the corporate debtor works as a going concern these statutory liabilities arise. It is necessary to consider herein the fact that the statutory dues outstanding, before the corporate debtor was put through the CIRP, should be recovered by the concerned government departments before the initiation of CIRP.

On 26.07.2018, in the matter of *Leo Edibles and Fats Limited v The Tax Recovery Officer*, the Hon'ble High Court for the state of Telangana and Andhra Pradesh clarified that the Income Tax Department does not enjoy the status of a secured creditor as it is not covered by any security interest, hence these departments cannot avail the benefits under Section 52 of the Code. Therefore, the Income Tax Department has to submit a claim for consideration and must necessarily take recourse to distribution of the liquidation assets as per Section 53 of IBC. This section provides the order of priority for distribution of assets, wherein the amount due to the Central Government and State Government comes fifth in the order of priority under clause (e) thereof.

It is interesting to observe that Section 53 of IBC does not specifically mention the term operational creditor but clearly states the position held by the government for the distribution of the assets. The scenario of statutory dues under the revival scheme to achieve a plausible resolution plan is also the same. The claims of the statutory authorities falling within the definition of operational debt are called for and are then duly verified and admitted by the Resolution Professional ('RP'). During the CIRP the fate of statutory dues are decided by the Resolution Applicant ('RA') through its Plan which is to be put before Committee of creditors and once approved would be placed before the AA. The Regulations 37, 38 and 39 of the CIRP Regulations, when read jointly reveals that, once the resolution plan provides for some measures to deal with the statutory dues, there is no further need to get any separate approval from such authorities. Accordingly, Section 31(1) of the Code was amended and notified on 16.08.2019, wherein the provision states that the Resolution Plan approved by NCLT will be binding on the Central Government, State Government or any local authority to whom statutory dues are owed by the corporate debtor.

Recently on 07.04.2020 the Hon'ble Rajasthan High Court in the matter of *Ultra Tech Nathdwara Cement Limited vs. Union of India and others*, was apprised with the legislative intent behind the amendment in Section 31(1) of the Code and a reference was made to the judgment pronounced by the Hon'ble Supreme Court in the matter of *Essar Steel India Ltd.* Thereafter the Hon'ble High Court stated that ".....it is trite to note that as per the amended Section 31 of the IBC referred to supra, the Central Government, State Government or any

other local authority to whom, a debt in respect of payment of dues arising under any law for the time being in force are owed, have been brought under the umbrella of the resolution plan approved by the adjudicating officer which has been made binding on such governments and local authorities...." The Hon'ble Court affirmed that "...Once the offer of the resolution applicant is accepted and the resolution plan is approved by the appropriate authority, the same is binding on all concerned to whom the industry concern may be having statutory dues. No right of audience is given in the resolution proceedings to the operational creditors viz. the Central Government or the State Governments the case may be...". Further, the Hon'ble Court concluded that "...the authorities should have adopted a pragmatic approach and immediately withdrawn the demands rather than indulging in totally frivolous litigation, thereby unnecessarily adding to the overflowing dockets of cases in the courts."

It is relevant to refer the matter of *State Bank of India vs. MOR Farms Private Limited* wherein no claims were received by the government department. Hence, a resolution plan seeking waiver of past statutory dues was granted on 15.06.2019 by Hon'ble NCLT, Chandigarh Bench. Therefore, making it clear that government dues are like any other operational debt and they have to follow the procedure of the operational creditor as prescribed by IBC.

Furthermore, in the matter of *Kiran Global Chem Limited* a Miscellaneous Application was filed, wherein the Hon'ble NCLT Chennai, Division Bench on 05.12.2019 has stated that once the corporate debtor has gone into CIRP and if it is to run as a going concern, it can

be obligated to pay taxes from the date of initiation of CIRP. The Hon'ble NCLT has held that "since law is clear that Tax authorities fall within the ambit of the Operational Creditor, as to the pre-admission claims are concerned, they are at liberty to make their claims before the Resolution Professional instead of insisting upon the Resolution Professional to pay the pre-admission dues before accepting the tax liabilities arising during the CIRP period."

Therefore, it can be stated that the statutory dues are categorized as operational debt, which at the time of Company's revival according to the Resolution Plan are treated at par with other operational debts, whereas, during the distribution of assets, under liquidation, these dues are ranked first amongst the other operational creditors in the priority list, as per the waterfall mechanism. As of now, it is evident that the government authorities have to make in effort to claim its statutory dues as these dues do not fall under the class of those liabilities of the corporate debtor that are transferred as a part of going concern sale. But as the Code is still evolving many questions are expected to be raised for clarification under this particular part of the Code. Looking at the revival strategy of the Code, no Resolution Applicant would risk his money into a corporate debtor which carries on with itself the burden of prior undecided debts. In affirmation with the above statement the Hon'ble Supreme Court in the matter of Committee of Creditors of Essar Steel India Ltd. through Authorised Signatory Vs Satish Kumar Gupta & Ors. has laid down that "A successful resolution applicant cannot suddenly be faced with "undecided" claims after the resolution plan submitted by him has

been accepted as this would amount to a hydra head popping up which would throw into uncertainty amounts payable by a prospective resolution applicant who successfully take over the business of the corporate debtor. All claims must be submitted to and decided by the resolution professional so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the corporate debtor". Hence, section 31(1) of IBC ensures that the successful RA starts running the business of the corporate debtor on a fresh slate as the provision clearly states that once a resolution plan is approved by the AA, it shall be binding on all stakeholders including the government authorities. Therefore, the RA is absolved of all the past dues and is not obligated to pay for such dues.

Ultimately, it is explicit that the Code stipulates Governmental bodies to fall in line and get their dues cleared either from the proceeds of CIRP by making a claim before the RP or from the proceeds of liquidation estate via waterfall mechanism under Section 53. Hence, neither the RA nor the transferee of the corporate debtor under going concern sale bears the liability of past statutory dues if not recovered as per the provisions of IBC. Furthermore, it can also be affirmed that the sale of a corporate debtor as a going concern is a feasible option in view of the benefits when compared to other modes of disposal under liquidation, especially with regard to the recent amendments providing for procedure on the same. Thus, if viable, considering sale of corporate debtor as going concern under liquidation for the upcoming cases is strongly recommended. [W](#)



**Sachin Gupta** heads the Litigation Practice of the Firm as a Senior Partner, with prime focus on complex civil & commercial litigation and arbitration matters. He handles matters in the Supreme Court of India, High Courts and various Tribunals, other quasijudicial and alternate dispute resolution forums.



**Amir Bavani** is a Principal Associate in the firm. His core expertise lies in Dispute Resolution especially involving Insolvency & Bankruptcy Code 2016, Banking Laws and General Corporate. He regularly appears before various judicial/quasi-judicial authorities including High Court, Debt Recovery Tribunal and National Company Law Tribunal.