

NATIONAL COMPANY LAW APPELLATE TRIBUNAL
PRINCIPAL BENCH, NEW DELHI
Company Appeal (AT) (Insolvency) No. 977 of 2023

Arising out of order dated 16.06.2023 passed by the Adjudicating Authority, National Company Law Tribunal, Mumbai Bench - IV in IA-117/2022 in CP (IB) No. 3269/MB-IV/2019

IN THE MATTER OF:

Mr. Devarajan Raman
Liquidator of M/s Kotak Urja Pvt Ltd
Off. No. 9, 2nd Floor, Plot No. 22,
Rajabhadur Mansion,
Mumbai Samachar Marg, Mumbai-400001

.....Appellant

Versus

1. Principal Commissioner
Income Tax, (Mumbai-1)
Aayakar Bhavan, Maharishi Karve Road,
Mumbai - 400020

2. Deputy Commissioner Income Tax,
[Mumbai-1(2) (1)] Aayakar Bhavan,
Maharishi Karve Road,
Mumbai - 400020

3. Deputy Commissioner Income Tax,
(Bangalore - 1), Income Tax Department,
Centralized Processing Centre,
1st Floor, Prestige Alpha No. 48/1, 48/2,
Beratenaagrahara Begur, House Road,
Uttarahalli Hobli, Bengaluru,
Karnataka - 560100

.....Respondents

Present:

Appellant: Ms. Anjali Sharma, Mr. Deepak Bashta and Ms. Shila Taware, Advocates.

For Respondents: Mr. Sanjay Kumar, Ms Easha and Ms. Hemlata Rawat, Advocates.

J U D G M E N T

[Per: Barun Mitra, Member (Technical)]

The present appeal filed under Section 61 of Insolvency and Bankruptcy Code 2016 (**IBC** in short) by the Appellant arises out of the Order dated 16.06.2023 (hereinafter referred to as **Impugned Order**) passed by the Adjudicating Authority, National Company Law Tribunal, Mumbai Bench-IV in IA-117/2022 in CP (IB) No. 3269/MB-IV/2019. By the impugned order, the Adjudicating Authority dismissed the application filed by the Liquidator seeking direction to the present Respondents for refund of an amount of Rs. 90,42,174/- which had been adjusted by them against outstanding tax liability of the Corporate Debtor while moratorium under Section 14 of the IBC was in effect. Aggrieved by this order, the present appeal has been preferred by the Liquidator – Appellant.

2. The chronological sequence of events of the present case which are necessary to be noticed for consideration of the matter by us is as hereunder:

- M/s Kotak Urja Pvt Ltd was admitted into Corporate Insolvency Resolution Process (**CIRP** in short) on 18.11.2019. The present Appellant was appointed as the Resolution Professional (**RP** in short).
- The RP had informed Respondent about the admission of the Corporate Debtor into CIRP following which the Respondent filed a claim with the RP for an amount of Rs.11.59 cr on 20.01.2020. The said claim was admitted by the RP.

- While moratorium was in force, on 10.02.2021, an amount of Rs.90.42 lakhs received towards tax refund was adjusted by the Respondent against outstanding tax demands.
- The Committee of Creditors ('CoC' in short) passed a resolution for liquidation of the Corporate Debtor on 04.01.2021 following which the RP filed an application before the Adjudicating Authority for this purpose on 18.05.2021.
- While the liquidation proceedings were pending before the Adjudicating Authority, the RP sent letters to the Respondent on 03.12.2021 and 07.01.2022 to refund the amount adjusted by them against outstanding income tax dues.
- The RP filed I.A. No. 117/2022 before the Adjudicating Authority praying for issue of directions to the Respondents to refund Rs.90.42 lakhs which had been adjusted against alleged tax liability of the Corporate Debtor.
- The liquidation order was passed on 03.10.2022 and the present RP was appointed as the Liquidator.
- The Respondent filed a claim of Rs.10.69 cr before the Liquidator on 01.02.2023 which was admitted by the Appellant/Liquidator.
- The Adjudicating Authority vide orders dated 16.06.2023 dismissed I.A. No. 117/2022. Aggrieved by the impugned order, the present appeal has been filed.

3. We have heard Ms. Anjali Sharma, Learned Counsel for the Appellant and Shri Sanjay Kumar, Learned Counsel appearing on behalf of the Respondents.

4. Making her submissions, the Learned Counsel for the Appellant contended that the Adjudicating Authority had failed to appreciate the statutory provisions of IBC in the right perspective by not taking notice of the fact that the provisions of IBC do not permit the Corporate Debtor to make any adjustment/set off to pay outstanding dues to creditors when CIRP proceedings are continuing and moratorium is in effect. It was submitted that Section 14(4) of the IBC provides that the order of moratorium takes effect from the date of such order and subsists till the completion of the CIRP. In the present case, though CIRP period had come to an end on 21.12.2020, the CIRP process kept continuing until the liquidation order was passed on 03.10.2022. Since CIRP was continuing, moratorium also continued and, hence, the Respondent during this period was not entitled to adjust the tax refund received by the Corporate Debtor against outstanding tax dues of different assessment year. It was vehemently contended that during the interregnum period between the end of CIRP period and passing of liquidation order, the assets of the Corporate Debtor cannot be appropriated by any creditor as it would tantamount to frittering away of the liquidation estate.

5. It was also asserted that the Adjudicating Authority had misinterpreted the statutory provisions of IBC in holding that the adjustment of tax refund against tax dues was an exercise of the right to realize security interests by a

secured creditor. It was pointed out that in terms of Section 52 of the IBC, the option to realize security interest becomes available to a secured creditor only after liquidation proceedings have commenced. In the present case while the liquidation order was passed on 03.10.2022, the purported realization of security interest by way of adjustment of tax refund took place on 10.02.2021 which clearly preceded the commencement of liquidation and hence impermissible.

6. Contention was raised that the procedure prescribed in Section 52 of the IBC was also not followed by the Respondent while adjusting tax refund against tax dues in that they had not filed Form D of Schedule II under Regulation 21A of the IBBI (Liquidation Process) Regulations, 2016. It was submitted that any secured creditor intending to realise security interests is first required to inform the Liquidator after identifying the assets subjected to such security interests and only after the Liquidator verifies the security interests and gives permission that they can proceed to realise the same.

7. Advancing their arguments further, the Learned Counsel for the Appellant submitted that the Respondent representing the Income Tax Department cannot be treated as a secured creditor. It was pointed out that there is no provision in the Income Tax Act which vests on them a statutory charge in respect of the tax liability. It was also pointed out that this Tribunal has held that there is no basis for treating the Income Tax Department as a secured creditor in ***Income Tax Department Vs. G. Madhusudhan Rao in CA(AT)(Ins) No. 1302 of 2023.***

8. Rebutting the arguments of the Appellant, the Learned Counsel for the Respondent submitted that asserted that it is settled law that when no resolution plan is received until expiry of maximum period permitted for completion of CIRP, the Corporate Debtor is mandatorily put into liquidation. It was further submitted that in the present facts of the case, notwithstanding that formal liquidation orders were passed on 03.10.2022, the CIRP period had already expired on 21.12.2020. In such circumstances, the exercise of the right of set off by the Respondent on 10.02.2021 which date was well after the expiry of the maximum CIRP period did not suffer from any infirmity. It was contended that in the intervening period between the attainment of the maximum period within which CIRP was to be completed and the passing of the liquidation order, the right to set off can be exercised.

9. It has also been stated that in terms of Section 52, a secured creditor is allowed realization of security interest in liquidation proceedings. It has also been contended that the Income Tax Department being a Government authority is a secured creditor and in support this contention, reliance has been placed on the ***Rainbow Papers judgment*** of the Hon'ble Supreme Court as well as the judgment of this Tribunal in ***Principal Commissioner of Income Tax Vs Assam Company India Ltd in CA(AT)(Ins) No. 241 of 2022.***

10. We have duly considered the arguments advanced by the Learned Counsel for the parties and perused the records carefully.

11. The limited point coming up for our consideration is whether set-off exercised by the Respondent, during the intervening period when the CIRP timeline period had expired and the liquidation order was passed, amounted to violation of the provisions of moratorium contained under Section 14 of the IBC and, if so, whether the Respondent is liable to refund the amount which had been set off.

12. For a proper appreciation of the issue at hand, we may begin by first perusing the provisions contained in Section 14 of IBC which is as extracted hereunder:

“14. Moratorium - (1) *Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:-*

(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority;

(b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;

(c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);

(d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

Explanation.--For the purposes of this sub-section, it is hereby clarified that notwithstanding anything contained in any other law for the time being in force, a license, permit, registration, quota, concession, clearances or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law for the time being in force, shall not be suspended or terminated on the grounds of insolvency, subject to the condition that there is no default in payment of current dues arising for the use or continuation of the license, permit,

registration, quota, concession, clearances or a similar grant or right during the moratorium period.

(2) The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.

(2A) Where the interim resolution professional or resolution professional, as the case may be, considers the supply of goods or services critical to protect and preserve the value of the corporate debtor and manage the operations of such corporate debtor as a going concern, then the supply of such goods or services shall not be terminated, suspended or interrupted during the period of moratorium, except where such corporate debtor has not paid dues arising from such supply during the moratorium period or in such circumstances as may be specified;

(3) The provisions of sub-section (1) shall not apply to--

(a) such transactions, agreements or other arrangements as may be notified by the Central Government in consultation with any financial sector regulator or any other authority;

(b) a surety in a contract of guarantee to a corporate debtor.

(4) The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process:

Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under sub-section (1) of section 31 or passes an order for liquidation of corporate debtor under section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.”

13. From a bare reading of Section 14(1)(a), (b) and (c) of the IBC, the legislative intent seems to be quite clear that during the period of moratorium qua the Corporate Debtor, there shall be a stay on the commencement and continuation of all legal proceedings against the Corporate Debtor and prohibition of action whatsoever of foreclosure, recovery or enforcement of any 'security interest' which has been created by the corporate debtor vis-a-vis its property. Further, there shall be no transfer,

encumbrance, alienation or disposal of the assets or any legal right or beneficial interests by the corporate debtor during the moratorium. The logical corollary that follows is that any adjustment of any tax refund amount during moratorium period is not permitted in terms of the above provisions.

14. The fundamental principle underlying insolvency law as codified in IBC is that insolvency proceedings are collective proceedings addressing the interests of all the stakeholders including the creditors, which seeks to protect, preserve and maximise the value of the assets of the distressed Corporate Debtor while simultaneously providing breathing space to organise its affairs and work out a reorganisation plan. Towards furthering this objective, the moratorium under the IBC operates in a manner so as to protect the assets of the Corporate Debtor from dissipation and diminution and prevents any individual creditor from commencing actions to enforce their rights at the expense of others.

15. Coming to the facts of the present case at hand, we notice that the Corporate Debtor was admitted into CIRP on 18.11.2019 and moratorium under Section 14 of the IBC was declared in respect of the Corporate Debtor. This fact has not been controverted by the Respondent. Therefore, it is clear that Respondent was well aware of the imposition of moratorium. It is also an undisputed fact that during the CIRP, the Respondent had filed their claim with the RP for an amount of Rs.11.59 cr on 20.01.2020.

16. Now coming to where the bone of contention lies between the Appellant and Respondent, we notice that the same arises with regard to adjustment of an income tax refund order amounting Rs 90 lakhs. On the one hand, the

said amount has been claimed by the Respondent to have been credited to the Corporate Debtor, on the other hand, it has been contended by the Appellant that the said amount was not received in the bank account of the Corporate Debtor but had been adjusted against outstanding tax demands of the Corporate Debtor. It is the case of the Appellant that this action of adjustment/set off during moratorium is not permitted in terms of the statutory provisions of IBC and tantamount to preferential payment to the Respondent. Per contra, it has been contended that the Respondent was entitled to exercise the right of set-off as the permitted CIRP period had already expired on 21.12.2020 after considering 90 days extension and Covid exclusion. It is their case that in the intervening period between the completion of maximum period within which CIRP was to be completed and the passing of the liquidation order, the right to set-off can be exercised. Thus, when the CIRP period had come to an end, there is no scope for moratorium to subsist and hence the question of infringement of moratorium does not arise.

17. This therefore brings us to the question of how long does moratorium in IBC remain in place in terms of Section 14 of IBC. This position is made amply clear by Section 14(4) of IBC in that it stipulates that the order of moratorium shall take effect from the date of order of the commencement of CIRP and continue till the completion of the CIRP. The proviso to the said clause further amplifies that moratorium shall cease to have effect once the Adjudicating Authority confirms the resolution plan as approved by the CoC or until the Adjudicating Authority passes a liquidation order requiring the

assets of the Corporate Debtor to be gathered and distributed among its creditors.

18. Applying the provisions contained in Section 14 of IBC to the factual matrix of the present case, we have no reasons to disagree with the Respondent that at the time when the tax set-off was carried out, the maximum time period for CIRP stood already crossed. Be that as it may, we also notice that at that point of time when the set-off exercise was carried out, neither was the resolution plan approved nor the liquidation order passed. Thus at the best, we may agree that in the present matter, CIRP period had come to an end on 21.12.2020, however, the CIRP process kept continuing until the liquidation order was passed on 03.10.2022. To say that merely on completion of permissible CIRP time-period, the CIRP process is completed and the effect of moratorium automatically ceases to exist, irrespective of whether the resolution plan is approved or liquidation order is passed, does not commend us. Accepting any such proposition would defeat the very legislative intent behind inserting the provision of moratorium under the IBC which is not only to protect the assets of the Corporate Debtor from dissipation and diminution but also to avert the anomalous situation where merely on expiry of CIRP period, the creditors start frittering away the liquidation estate. Thus, to answer the first part of the question, we are of the considered opinion that even if the CIRP period is over with no resolution plan on the anvil and Adjudicating Authority was yet to pass the liquidation order, the creditor of the Corporate Debtor cannot avail of the benefit of set-off during this interregnum by claiming that moratorium had ceased to exist.

19. This brings us to the next part of the question as to whether the Respondent in the given factual matrix is liable to refund the amount which has been set off against income tax dues. It is the case of the Respondent that a secured creditor is allowed realization of security interest in liquidation proceedings in terms of Section 52 of IBC and the Income Tax Department being a Government authority was entitled to do so as it enjoyed the status of a secured creditor. The rival contention is that the option to exercise security interest realisation arises only after commencement of liquidation proceedings which event clearly arose on 03.10.2022. However, in this case, the set-off exercise undertaken by the Respondent preceded the liquidation orders, hence could not have been allowed by the Adjudicating Authority. It is also strenuously contended that the Income Tax Department cannot claim the status of a secured creditor.

20. At this juncture, we may refer to the judgement of the Hon'ble Apex Court in ***Bharti Airtel Ltd vs Vijaykumar V. Iyer in C.A. Nos. 3088-3089 of 2020*** wherein after explaining the contours and different meanings that can be ascribed to the term 'set-off', it was held that set-off done at the behest of any entity against a company while undergoing CIRP is violative of the basic principles and provisions of IBC. The relevant excerpt of the said judgment is as under:

"5. At least five different meanings can be ascribed to the term 'set-off', namely, (a) statutory or legal set-off; (b) common law set-off; (c) equitable set-off; (d) contractual set-off; and (e) insolvency set-off. It is observed that the streams of common law and equity on the right of set-off have flown together and have so combined as to be in the modern era indistinguishable from one another. It is necessary to

briefly explain the contours of contractual set-off, statutory/legal set-off, equitable set-off and insolvency set-off.

12. At the outset we should record, that there is a difference between the Corporate Insolvency Resolution Process and the liquidation process of the IBC. The Corporate Insolvency Resolution Process focuses on and fosters rehabilitation, revival and resolution of the corporate debtor, whereas the liquidation process focuses on the constellation of assets of the company in liquidation, and distribution and payment to the creditors from the liquidation estate in terms of the order of preference set out in the insolvency statute.

13. Unlike the provisions of the Companies Act, 1956 or the Companies Act, 2013, IBC in the case of Corporate Insolvency Resolution Process does not give the indebted creditors the right to set-off against the corporate debtor. The earlier enactments – the Companies Act, 1956 vide Section 529, and the Companies Act, 2013 vide Section 325 (now omitted) – did permit set-off per the Provincial Insolvency Act, 1920, which enactment is now repealed. Accordingly, under the Companies Acts, in terms of the provisions of Section 46 of the Provincial Insolvency Act, 1920, indebted creditors’ right to set-off against the corporate debtor was statutorily recognised subject to satisfaction of certain conditions. Significantly, in the case of partnerships and individual bankruptcies, Section 173 of the IBC permits set-off. Regulation 29 of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 provides for mutual credits and setoff and reads:

“29. Mutual credits and set-off. - Where there are mutual dealings between the corporate debtor and another party, the sums due from one party shall be set off against the sums due from the other to arrive at the net amount payable to the corporate debtor or to the other party.”

The title of the Liquidation Regulations states that they shall apply to the process under Chapter III Part II of the IBC. In other words, the Liquidation Regulations are not applicable to Chapter II Part II of the IBC, which relates to the Corporate Insolvency Resolution Process.

14. Section 36(4) in Chapter III Part II of the IBC deals with the exclusion of assets that do not form part of the liquidation estate. Section 36(4) permits the Insolvency and Bankruptcy Board of India to specify assets which could be subject to set-off on account of mutual dealings between the corporate debtor and the creditor. When an asset is excluded from the liquidation estate, it is not available for distribution in the liquidation process. It follows that if a creditor exercises and is

allowed set-off, then in terms of Section 36(4) of the IBC this creditor is given a preferred status over others, including the secured creditors, to the extent of the set-off value.”

The Hon’ble Apex Court in this judgement also referred to Section 238 of the IBC to come to the conclusion that in view of the specific legislative mandate as incorporated and reflected in Chapter II Part II of the IBC, the provisions of the IBC relating to CIRP do not recognise the principle of insolvency set-off, nor can insolvency set-off which is contemplated in Regulation 29 of the IBBI (Liquidation Process) Regulations, 2016 (**‘Liquidation Regulations’** in short) be applied to CIRP.

21. When it is settled law that Regulation 29 of the Liquidation Regulations does not apply to Part II of the IBC, we have no hesitation in holding that Regulation 29 comes into play only after the liquidation order is passed by the Adjudicating Authority and not at any moment earlier than that. Given this position, we hold that the Adjudicating Authority committed grave error to hold that moratorium had come to a halt during the period of vacuum from the expiry of the permitted CIRP period till passing of the liquidation order and that the Respondent was entitled to conduct the set-off exercise to realise security interest in terms of Section 52 of the IBC. Furthermore, the option to realise security interests becomes available to a secured creditor only after liquidation proceedings commences in terms of Section 33 of IBC with the passing of liquidation order. It is interesting to note that the definition clause under Section 3(31) the IBC provides that a security interest shall include an interest that has been created for a secured creditor by way of a transaction that secured performance of an obligation. We find that the Respondent has

relied on the judgment of the Hon'ble Supreme Court in ***State Tax Officer vs. Rainbow Papers Limited- Civil Appeal No. 1661 of 2020*** to claim that the Income Tax Department being a Government authority is a secured creditor and entitled to realise security interest. We may add here that in a subsequent judgment of the Hon'ble Supreme Court in ***Paschimanchal Vidyut Vitran Nigam Ltd. v. Raman Ispat Pvt. Ltd. & Ors. in C.A. No. 7976 of 2019***, it has been held that the ratio of the ***Rainbow Papers*** has to be confined to the facts of that case. In that case the Operational Creditor was held to be a secured creditor on the basis of relevant statutory provisions of Gujarat Value Added Tax, 2003 whereas there is no such basis to claim in the case of the Appellant to be a secured Operational Creditor. Hence, the ***Rainbow Papers judgment*** does not come to the aid of the Appellant in the present case.

22. Admittedly, the Respondent had exercised the set-off by adjusting the tax refunds payable to the Corporate Debtor. This set-off clearly reduced the total kitty of funds available to the other creditors awaiting distribution as per the provisions of the IBC. The assets therefore available for distribution amongst the general body of creditors would thus stand reduced to the extent of the set-off while it would put the Respondent in a more beneficial position. Such action of the Respondent-Income Tax Department is clearly unwarranted because the Department did not have the right to adjust the past income tax demands with the money belonging to the liquidation estate. The refund from the Income Tax fell under the asset of the Corporate Debtor and would require to be added to the liquidation assets. In such

circumstances, the adjustment of the said amount of Rs 90 lakhs towards tax demands prior to liquidation amounted to a sort of recovery by the Respondent in violation of the moratorium and hence the Respondent is liable to return or pay the adjusted amount to the Corporate Debtor. Hence, this bench is of the considered view that there is a need to refund the amount in question to the Corporate Debtor.

23. In view of the foregoing discussions, we direct the Respondent to refund the sum of Rs. 90,42,174/- which had been set-off against outstanding tax dues of the Corporate Debtor to the Liquidator within two weeks from the date of this order. The Respondent shall have the liberty to file their claim with the Liquidator for recovery of their dues in terms of the IBBI (Liquidation Process) Regulations, 2016. The Appeal is allowed in above terms and disposed of accordingly. The impugned order is set aside. No costs.

[Justice Ashok Bhushan]
Chairperson

[Barun Mitra]
Member (Technical)

[Arun Baroka]
Member (Technical)

Place: New Delhi

Date: 24.05.2024

Ashok Kumar/ Harleen