



Tax Flash News



25 July 2024

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Unilateral set-off of Income-tax refund with the past dues by tax department not permissible during liquidation process under Insolvency and Bankruptcy Code

Executive summary



The Income-tax department often recovers the tax dues by way of set-off against the refunds for other years. There has been an issue whether this practice is permissible with respect to a company which has gone into liquidation under the Insolvency and Bankruptcy Code, 2016 (IBC).

The National Company Law Appellate Tribunal (NCLAT) in the case of *Avil Menezes (Liquidator)*¹ held that during the liquidation process, the tax department can continue with pending assessment proceedings and determine the quantum of tax dues.

However, it cannot unilaterally set-off such tax dues with the refund for the subsequent years. To recover the dues, the tax department should file its claim of recovery in the prescribed form with the liquidator.

¹ *Avil Menezes (Liquidator) v. PCCIT* [Company Appeal (AT) (Insolvency) No. 258 of 2024]; Source – IBC Laws

Facts of the case



The company was admitted into Corporate Insolvency Resolution Proceedings (CIRP) under the IBC and later into the liquidation process.

The company was entitled to receive an income tax refund. However, the refund was adjusted by the Income-tax department against pre-CIRP tax dues by invoking section 245 of the Income-tax Act, 1961 (the IT Act).

The issue arose whether, during the liquidation process, the tax department can set-off the refund with the past tax dues of the company and if yes, whether the tax department is required to file the prescribed claim form with the liquidator for such set-off or can the department unilaterally set-off the past dues.

Income-tax department's contentions

As required under the IT Act², a notice for set-off was issued to the company and there was no breach of the prescribed procedure for the set-off of refund.

² Section 245(1)

The income tax dues are the government dues which come under the ambit of security interest and the tax department is a secured creditor. The act of set-off by the tax department was lawful.

Liquidator's contentions



The refund amount should form part of the liquidation estate of the company and belonged to the stakeholders/ creditors. It should not be adjusted against the tax dues but should be refunded.

Once a liquidation order has been passed, no suit or other legal proceedings can be instituted by or against the company³. In the instant case, the liquidation order has already been passed and thus, recovery of income tax dues by invoking section 245 of the IT Act was illegal and improper.

The non-obstante clause of the IBC⁴ overrides the other laws including the IT Act in case of inconsistency and thus it nullifies the tax department's right to set-off the refund against the past dues.

³ Section 33(5) of the IBC

⁴ Section 238 of the IBC

The tax department was an operational creditor. It was required to file their claim with the liquidator in the prescribed form⁵ for recovery of dues and should not have unilaterally adjusted the refund against the past dues.

Merely having a right to set-off does not automatically lead to having a charge over the property. Section 245 of the IT Act provides a right to set-off but does not expressly create a charge or a security interest.

NCLAT's decision



As per the provisions of the IBC⁶, there was no prohibition on the continuation of pending suits or legal proceedings during the liquidation process. The restriction was only with respect to institution of the fresh suits or legal proceedings.

The tax department was legally entitled to continue with the tax assessment proceedings during the liquidation process and to determine the quantum of tax dues. There was no restriction placed by the IBC on the principle of set-off.

However, the department does not have the jurisdiction/power to unilaterally adjust the refund with the past tax dues.⁷ It was an operational creditor and not a secured creditor having a security interest.⁸ Section 245 of the IT Act does not create any charge or security interest in favour of the tax department.

All claimants in the liquidation process are required to file their claim in the prescribed form with the liquidator for the distribution of sales proceeds of assets of the company. Filing of claims for set-off is mandatory as per the liquidation regulations and cannot be bypassed. In the instant case, the tax department did not file the claim.

The matter was remanded back to the National Company Law Tribunal to re-assess the quantum of set-off of refund against the pre-CIRP tax dues.

⁵ Regulation 18 of Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 (Liquidation Regulations)

⁶ Section 33(5) of IBC

⁷ *Sundaresh Bhatt, Liquidator of ABG Shipyard v. Central Board of Indirect Taxes and Customs* (Civil Appeal No. 7667/2021) (SC)

⁸ *Paschimanchal Vidyut Vitran Nigam Ltd. v. Raman Ispat Pvt. Ltd. & Ors.* (C.A. No. 7976 of 2019) (SC)

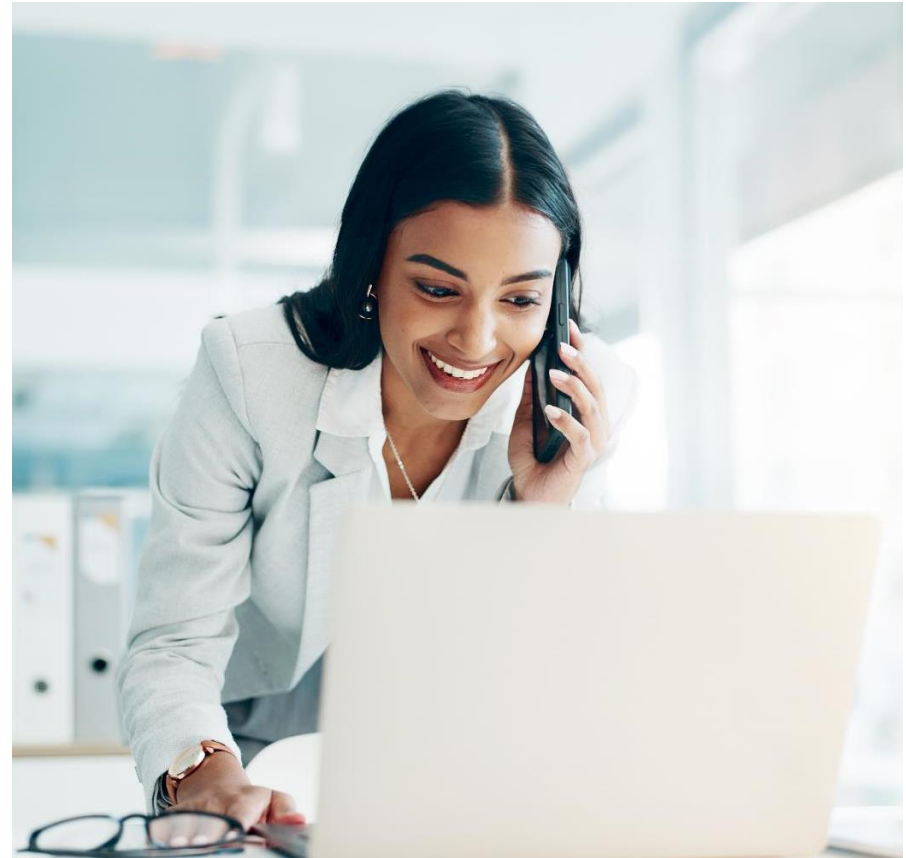
Our comments



The decision highlighted that the right to set-off and the creation of a charge/ security interest are separate and distinct concept. Section 245 of the IT Act merely permits the Income-tax department to set-off the refund against the past dues. It does not create any charge or security interest in favour of the tax department.

Accordingly, the decision underscored the necessity of filing claims with the liquidator instead of *suo moto* adjustment by the tax department.

Recently, the Mumbai bench of the Income-tax Appellate Tribunal (ITAT) in the case of *Doshion Veolia Water Solution (P) Ltd.*⁹ observed that there is no legal impediment in deciding the appeal before the ITAT. However, as the provisions of IBC prevail over the IT Act, the Income-tax department will have limited powers to determine quantum of tax dues and would not have authority to recover such dues during the liquidation process. The department is to be treated like other creditors and should file its claim before the liquidator as per the procedure prescribed under the IBC.



⁹ *ACIT v. Doshion Veolia Water Solution P. Ltd.* (ITA No. 78/MUM/2018) (Mum)

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