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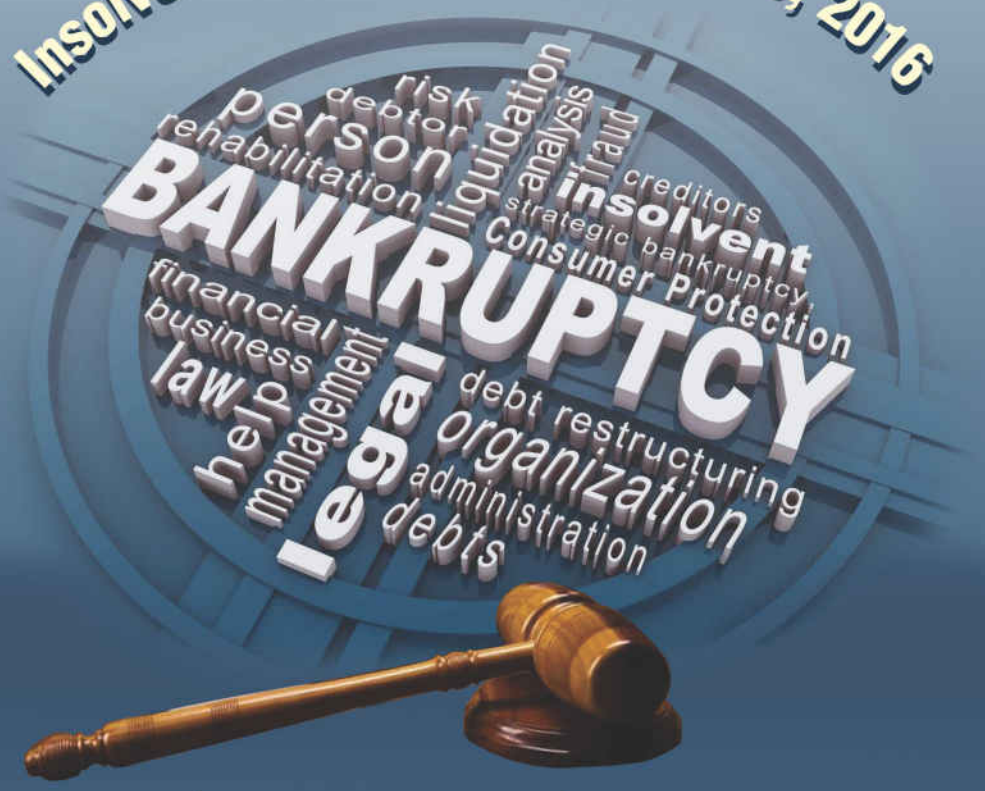
## Insolvency And Bankruptcy Code, 2016

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You must be the change you wish to see in the world.

— Mahatma Gandhi

# Editorial

The Hon'ble Prime Minister, while speaking at "Rajasva Gyan Sangam" outlined a five point charter for the tax administrators - RAPID, each alphabet stands as given below:

R - Revenue
A - Accountability
P - Probity
I - Information
D - Digitization

The proposal of the Hon'ble Prime Minister is welcome and I am optimistic that if implemented dispassionately, the results will be outstanding. As per the above, alphabet R (Revenue) – I believe that State has got all the right to collect the revenue due to it in an expeditious and seamless manner. If in any case coercive measures are to be utilised, then the same have to be employed after following the due process of law.

The next issue raised by Hon'ble Prime Minister about A (Accountability) – This is a very important issue and professional organisations like ours have been representing to the policy makers that lack of accountability leads to high pitched assessments. These assessments are usually knocked down in appellate proceedings. However, the Assessing Officer is not held responsible for raising such huge demand. Proposal of maintaining anonymity of the Assessing Officer to the assessee and of the assessee to the Assessing Officer is a good option but whether the same is workable under the present statutory provisions may have to be considered. Transparent assessment procedure which is not motivated and vindictive will help the cause of probity also. The lack of probity has created trust deficit between the tax administration and the taxpayers. The Hon'ble Prime Minister's suggestion may help bridge the same. Here it is important to note that all the aspects of RAPID can be achieved with effective digitisation. Unfortunately, the push for digitisation has not yielded desired results on the ground. However, I am optimistic that a concerted effort may improve the situation.

A doubt has been created by the glitches faced by the assessee while uploading their GST returns – whether the Government has rolled out the GST after providing for adequate IT infrastructure or not. I hope the Government will be in a position to overcome these difficulties. Though I am not a tech-savvy person, however, I wonder whether anyone has experienced such glitches while executing transactions on commercial website/web portals, be it Google, Facebook or Twitter. The amount of data and traffic that these sites are handling is quite big. One may argue that tax portals have security features, but same is not unique to them only. Websites like google/gmail/yahoo mail also have strong security checks. Have we ever seen Google site crashing or unable to handle traffic. It is the duty of Government to provide hassle free IT environment to make compliance easy.

The special story of this month's Chamber's Journal is on Bankruptcy Code, 2016. Eminent professionals have given their valuable views. This issue will come in handy to all the professionals as one may not find much literature on this topic.

I thank all the contributors to this issue of the Chamber's Journal.

**K. GOPAL**
*Editor*

# From the President

Dear Members,

Namaste

After adieu to Lord Ganesha, Government has announced the extension for filing income tax returns in cases of tax audit and extension of GST return filing, a major relief for all tax professionals as well as assessees.

However, one can clearly observe that excessive bureaucratic interference with small and medium businesses is taking a toll. Every law is being controlled by rules rather than settled principle wherein the rules are confusing, unclear and sometimes full of contradiction. Regulations need to be reined in with common sense. I feel a reasonable degree of freedom is the essential ingredient of "free" enterprise. Overregulation is ultimately the death knell of freedom, the death of the small and medium entrepreneur.

17th century Dutch philosopher Baruch Spinoza with his insight on the practical problem of overregulation once said "He who seeks to regulate everything by law is more likely to arouse vices than to reform them. It is best to grant what cannot be abolished, even though it be in itself harmful. How many evils spring from envy, avarice, drunkenness and the like, yet these are tolerated because they cannot be prevented by legal enactments."

Nevertheless, proactive role of Government in implementation of new laws is appreciated. Regulation *per se* is crucial in delivering fairness, efficiency and effectiveness in economies. However, my strong belief is that regulations need to continue to evolve; to become smarter to adapt to the realities of global commerce, and that more co-operation and dialogue between regulators and policymakers, the regulated, interest groups, and professional institutes is essential. The professionals need to support this endeavour of the Government for in cleansing the economy from corruption and black money.

Another challenge faced by the professionals is nurturing more ethical cultures and value. Encouraging stronger corporate governance and embedding ethics

and values into organisational culture is essential for growth and stability, as well as addressing issues of corporate misconduct.

First time as many as 4 States and 1 Union Territory have managed to bring down cases pending for over 10 years in subordinate courts almost to zero (excluding HC). which shows that justice delivery system have picked up pace and courts have managed to dispose of all cases pending for a decade or more.

In furtherance the Government has also put in place some technological platforms such as National Judicial Data Grid, where all cases are uploaded and status is available online. Litigants and lawyers are updated through mobile phone and text message.

For tax professional it is interesting to know that Union Ministry of Law and Justice and Hon'ble ITAT had accepted the representation made by Tax Bar for setting up of a Tribunal Bench at Surat about 2 months back. On 1st September 2017 the Surat Bench was formally inaugurated by the Hon'ble Law Minister. The move to set up the Bench in Surat would reduce time and cost of assessee as well as professional at the same time would reduce the pendency of appeals. The ITAT is called Mother of all Tribunals and it has proven to be forerunner in reducing pendency by effective management and use of technology.

The Supreme Court's nine-Judge Bench in the landmark historic judgment held unanimously that privacy is an intrinsic part of Article 21 of the Indian Constitution which governs the life and liberties of Indian Citizen. According to me the ruling will set the backdrop for changes going well beyond the issue of Aadhaar. For instance we may see the impact on data collection in the private sector. I believe that in digital world privacy is always at stake.

The effect of implementation of new laws is showing its effect particularly RERA wherein 98 complaints have been received by the State till last month. In Maharashtra State itself the first RERA order was passed where the builder was ordered to return the advance collected from the customer for a project in Virar (W). Builders are back at the drawing board to restructure realty projects and arrange finances to ensure compliance with the new regulation.

Similarly under Insolvency & Bankruptcy Code, 2016 (IBC) a group of home buyers have approached the Ministry for amendment to IBC. The representation suggested that the law should be amended to treat home buyers at par with lenders to the projects who have the first right on funds in case of liquidation. It has been suggested that home buyers' rights need greater priority than banks in terms of recovery of dues. In this context the

ruling in case of "Jaypee Infratech" will lay the foundation. The Apex Court has stayed the Insolvency resolution proceeding against Jaypee Infratech on one home buyer plea and the court have asked AG Shri K. K. Venugopal to assist in the matter.

Coming back, the Chamber had organised Jointly with local Association a half day Seminar on Tax Issues at Jalgaon which was very well attended. The Accounts and Audit Committee's programme on Tax Audit reporting and issues in ICDS and Ind AS was great success. Even the Public lecture meeting organised by Corporate Connect Committee on Recent Amendments to Companies Act was very educative and the speaker Ms. Savithri Parekh explained the issues in simple and lucid manner to the participants. I congratulate the Chairmen of the respective Committee and their team for the success.

I will also like to mention the enormous time and efforts put in by L & R committee in preparation of the writ on ICDS pending before Delhi High Court which is commendable and applaudable.

The issue of this month is on Insolvency and Bankruptcy Code, 2016 which will be of immense use to professionals. Journal has added few new features in its fleet which will prove to be interesting to readers.

Navaratri festival is nearby so are the exams of school going kids, testing time for parents to maintain the balance between both. All the best and mind your steps while you dance.

Taking your leave with a quote;

*"Always pray to have eyes that see the best in people, a heart that forgives the worst, a mind that forgets the bad and a soul that never loses faith in God."*

Thank you all

Jai Hind.

**AJAY R. SINGH**
*President*

# Chairman's Communication

Dear Readers,

Professionals as well as business community continue to struggle with filing of various returns under GST Act. The Government introduced GST on 1st July with much fanfare and boasted of its preparedness and robust IT platform. But the way things are, it is felt that GST has been introduced without adequate preparation. Hope the challenges faced are initial teething problems rather than inadequate preparation at Government's end. The year 2017 has been quite a challenging year for the professionals not only due to GST but also due to applicability of Ind AS to certain companies, applicability of ICDS, RERA etc. Extension of due date of filing of returns from 30th September to 31st October will give some respite to the professionals.

Banking Industry has been passing through one of its worst phases due to the increased proportion of stressed assets i.e. NPA which is due to multiple factors. To address the problem of NPA, the Government has enacted Insolvency and Bankruptcy Code, 2016 (the Code) which is operative from December 2016. The law is in its nascent stage and is still evolving. However there are quite a few challenges in implementing the Code. Some of them are management of affairs of the Company by an Insolvency Professional who does not have adequate knowledge of the business of an entity of which he is the Insolvency Professional, compliance of Companies Act, 2013, SEBI regulations while the Code is applicable etc. As the law evolves there would be better clarity as to how effective is the Code in addressing the problem of NPA. The Code also offers a new area of professional opportunity!

Considering its importance, this issue of the Journal is dedicated to Insolvency and Bankruptcy Code, 2016. I wish to put on record my sincere appreciation for members of the Committee CA Pankaj Majithia and Past President Paras Savla for designing this issue and also for overall co-ordination. My gratitude to all the learned authors for sparing their valuable time and sharing their knowledge.

Festival of Navratri will begin after a few days. Extension of due date of filing of Tax Audit Reports and tax returns will give us a chance to celebrate the festival with family.

Wishing you and your family Happy Navratri and Happy Dusshera !

**VIPUL K. CHOKSI**
*Chairman* – Journal Committee

THE CHAMBER OF TAX CONSULTANTS
3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai – 400 020
Phone : 2200 1787 / 2209 0423 / 2200 2455
E-Mail: office@ctconline.org • Website : http://www.ctconline.org.

# The Chamber's Journal





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|---|---|---|---|---|---|
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| | | | | | ₹ 15360 |
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| | | | | | ₹ 3186 |
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| | | | | | ₹ 7080 |
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| 9. | Journal Subscription | ₹ | 700 | 0 | ₹ 700 |

CA Dhinal A. Shah

# Role of an Insolvency Professional Agency – A Crucial Pillar of the Insolvency and Bankruptcy Code, 2016

The Government of India with a view to study the corporate bankruptcy legal framework in India and for overseeing the design and drafting of a new legal framework for resolving matters of insolvency and bankruptcy, formed Bankruptcy Law Reforms Committee.

This Committee had the mandate of comprehensive reform, covering all aspects of bankruptcy of individuals and non-financial firms, i.e., the reforms are not restricted to limited liability corporations. It evaluated the working of present arrangements in India, and the difficulties faced with these present arrangements.

The objectives of the Committee were to resolve insolvency with: (i) lesser time involved, (ii) lesser loss in recovery, and (iii) higher levels of debt financing across instruments.

The question was, what can a sound bankruptcy law achieve? A sound legal framework of bankruptcy law can achieve

- **Improved handling of conflicts between creditors and the debtor:** It can provide procedural certainty about the process of negotiation, in such a way as to reduce problems of common property and reduce information asymmetry for all economic participants.
- **Avoid destruction of value:** It can also provide flexibility for parties to arrive at the most efficient solution to maximise value during negotiations. The bankruptcy law will create a platform for negotiation between creditors and external financiers which can create the possibility of such rearrangements.
- **Drawing the line between malfeasance and business failure:** Under a weak insolvency regime, the stereotype of "rich promoters of defaulting entities" generates two strands of thinking:
  (a) The idea that all default involves malfeasance and
  (b) The idea that promoters should be held personally and financially responsible for defaults of the firms that they control.
- **Clearly allocate losses in macro-economic downturns:** With a sound bankruptcy framework, these losses are clearly allocated to some people. Loss allocation could take place through taxes, inflation, currency depreciation, expropriation, or wage or consumption suppression. These could fall upon foreign creditors, small business owners, savers, workers, owners of financial and non-financial assets, importers, exporters.

As stated by Mr. T. K. Viswanathan, Chairman, Banking Law Reforms Committee that "It was

a mission to usher in sweeping changes to the country's bankruptcy law and the new bankruptcy law was necessary for reviving economy".

The Insolvency and Bankruptcy Law has created five institutional pillars which will serve the objects and purposes of the law and ensure its effective implementation. They are as follows:

- Insolvency Professionals – To conduct the corporate insolvency resolution process and includes an interim resolution professional; The role of the IP encompasses a wide range of functions, which include adhering to procedure of the law, as well as accounting and finance related functions.
- Insolvency Professional Agencies – To enrol and regulate insolvency professionals as its members in accordance with the Insolvency and Bankruptcy Code 2016 and read with regulations.
- Information Utilities – To collect, collate and disseminate financial information to facilitate insolvency resolution.
- Insolvency and Bankruptcy Board of India – A regulator who will oversee these entities and to perform legislative, executive and quasi-judicial functions with respect to the Insolvency Professionals, Insolvency Professional Agencies and Information Utilities.
- Adjudicating Authority – The National Company Law Tribunal (NCLT), established under the Companies Act, 2013 would function as an adjudicator on insolvency matters under the Code.

One of the most important pillars as envisaged in the Insolvency and Bankruptcy Code, 2016 is the formation of the Insolvency Professional Agencies (IPAs). Insolvency Professional Agency is a body formed for the purposes of registering and regulating the Insolvency Professionals (IPs). Section 3 (20) of the Code defines an Insolvency Professional Agency as any person registered with the Board under Section 201 as an Insolvency Professional Agency.

Insolvency is a regulated profession under the Insolvency and Bankruptcy Code, 2016 and anyone who wishes to practise as an IP needs to enroll with an IPA and pass Insolvency Examination conducted by Insolvency and Bankruptcy Board of India (IBBI). As per the Code, the insolvency resolution processes are to be conducted by the Insolvency Professionals, who are required to be members of an Insolvency Professional Agency which in turn is to be registered with the Insolvency and Bankruptcy Board.

A major responsibility of the IP agencies involves the exercise of executive functions. This includes inspections, investigations, enforcement of orders and processing of complaints. The exercise of supervision and monitoring powers is fundamental to the effective enforcement of bye-laws by an authorised IP agency. It has been provided that all IPAs should have adequate governance and monitoring mechanisms and should follow a structured process for supervising the conduct of IPs at regular intervals, and enforcing their rules and standards through the bye-laws.

## Registration as an IPA

As per the Code, IPA is constituted as a Company formed with charitable object under Section 8 of the Companies Act, 2013. These agencies are required to get registered and obtain certificate of registration from IBBI. According to Regulation 3 of Insolvency and Bankruptcy Board of India (Insolvency Professional Agencies) Regulations, 2016, its sole object shall be to carry on the functions of an Insolvency Professional Agency.

## Objectives and Principles of IPA

Insolvency Professional Agency is an intermediary between IPs and IBBI. It acts as a membership body for those in insolvency practice; those engaged in insolvency related work and those with an interest in insolvency. The Code provides following guiding principles for Insolvency Professional Agencies:

- It shall promote the professional development of and regulation of insolvency professionals.
- It shall promote good professional and ethical conduct amongst insolvency professionals.
- It shall protect the interests of debtors, creditors etc.
- It shall promote the services of competent insolvency professionals to cater to the needs of debtors, creditors etc.
- It shall promote the growth of Insolvency Professional Agencies for the effective resolution of insolvency and bankruptcy processes under the Code.

## Functions of an IPA

The principal function of an IPA is to promote and maintain standards of performance and professional conduct amongst those engaged in insolvency practice. Section 204 of the Code provides that an Insolvency Professional Agency shall perform the following functions:—

(a) It shall grant membership to persons who fulfil all requirements set out in its bye-laws on payment of membership fee;

(b) It shall lay down standards of professional conduct for its members;

(c) It shall monitor the performance of its members;

(d) It shall safeguard the rights, privileges and interests of insolvency professionals who are its members;

(e) It shall suspend or cancel the membership of insolvency professionals who are its members on the grounds set out in its bye-laws;

(f) It shall redress the grievances of consumers against insolvency professionals who are its members; and

(g) It shall publish information about its functions, list of its members, performance of its members and such other information as may be specified by regulations.

The Insolvency Professional Agencies encourage wider knowledge and understanding of insolvency within and outside the insolvency profession through access to insolvency examinations, qualifications and membership and through exposure and discussion of insolvency issues which affect the profession, its stakeholders and the general public. IPAs have been entrusted to perform following key functions:-

1. Regulatory functions – IPAs draft detailed standards and codes of conduct through bye-laws that are made public and are binding on all members.
2. Executive functions – These agencies monitor, inspect and perform investigation of its members on a regular basis. They gather information about performance of its members, with the over-arching objective of preventing frivolous behaviour and malfeasance in the conduct of IP duties.
3. Quasi-judicial functions – IPAs act as quasi-judicial body for resolving the grievances of aggrieved parties, hearing complaints against members and taking suitable actions to discipline, monitor and redress the grievance of the insolvency professionals and other stakeholders.
4. Continuous Professional Development – IPA performs a leading role in the development of professional insolvency standards. All professional IP agencies must abide by the two main objectives of ensuring quality and ensuring fidelity in their members carrying out their functions as IPs under the Code. The Insolvency Professional Agency continuously works towards the professional development of the member.
5. Representation – IPAs work toward protecting the interest of its members and from time-to-time make representation to the Government and other regulatory bodies for driving beneficial changes in the Insolvency and Bankruptcy Law and procedure.

## Role of Insolvency Professionals

The Code envisages and regulates the process of insolvency and bankruptcy of all persons including corporates, partnerships, LLPs and individuals. The Code lays down a time-bound resolution process which is undertaken by Insolvency Professionals. Consequently the Code has opened up new possibilities for time bound resolution of stressed assets.

As provided in the Code, the Insolvency Professional forms a crucial pillar upon which rests the effective, timely functioning of the entire mechanism of the insolvency resolution process. An Insolvency Professional may hold the role of Interim Resolution Professional/ Resolution Professional/ Bankruptcy Trustee/ Liquidator. He has to carefully plan and manage his actions and promptly communicate with all stakeholders involved for timely discharge of his duties under different processes.

Now the Code is in the initial stage of implementation. People have started using the Code and some of the Banks have also started to use the provisions of the Code for resolution. In this direction for expeditious resolution of stressed assets in the banking system the recent **Banking Regulation (Amendment) Act, 2017** enables the Central Government to authorise the Reserve Bank of India to direct banking companies to initiate insolvency resolution process in respect of a default under the provisions of the Insolvency and Bankruptcy Code, 2016. This action of the Government will have an impact on resolution of stressed assets as the RBI is empowered to intervene in specific cases.

Thus the role of Insolvency Professionals becomes even more significant in tackling the issue of resolution of Non-Performing Assets (NPA) which is affecting the economy.

The key roles of an Interim Resolution professional/Resolution professional are:

- Issuance of public notice of the Corporate Insolvency Resolution Process
- Handling the management and affairs of the company in its best interest in order to maintain going concern status of the company
- Collation of claims received
- Constitution of the Committee of Creditors
- Conduct of the meetings of the Committee of Creditors
- Approval of best resolution plan for the company

## Key practical challenges faced by Insolvency Professionals

As the Resolution Process is on and approximately 300 cases have been admitted by National Company Law Tribunal, some of the practical challenges the Insolvency Professionals are facing are as follows:

- Lack of awareness of the law amongst stakeholders
- Preparedness of Committee of Creditors constituents to support the process
- Regulatory and legislative challenges
- Protection available to Resolution Professional
- Information challenges including for valuation of assets
- Quality of information memorandum
- Dissenting financial creditors
- Alignment with other statutes including Income-ax Act.

## Insolvency Professional Agency formed by the Institute of Chartered Accountants of India

The Indian Institute of Insolvency Professionals of ICAI (IIIPI) is a Section 8 Company formed by the Institute of Chartered Accountants of India to enroll and regulate insolvency professionals as its members in accordance with the Insolvency and Bankruptcy Code 2016 and read with regulations. ICAI formed the Insolvency Professional Agency as it is an extended arm for regulating Chartered Accountants.

ICAI IPA has been designated as the first Insolvency Agency in India and 70% of the Insolvency Professionals are enrolled with ICAI IPA. The Governing Board of IIIPI is comprised of learned professionals who are independent Directors on the Board of IIIPI

Besides, its role as a membership agency IIIPI takes initiatives for creating awareness and education of insolvency and bankruptcy law. It regularly reports the new developments in the field of insolvency and bankruptcy law and provides a brief update to its members on a regular basis. The details of case updates, news updates and related articles as well as other information is readily available on its website at the link http://iiipicai.in.

The following are some of the initiatives of IIIPI made for professional development of its members:-

- Launch of Learning Management System for the IBBI Limited Insolvency Examinations

  Indian Institute of Insolvency Professionals of ICAI has launched the Learning Management System to enable the professionals to prepare and complete the Limited Insolvency Examinations of the Insolvency and Bankruptcy Board of India. It is a platform which is available to all on a no cost basis comprises of the entire syllabus in the form of presentations and supplemented by mock tests in each component of the syllabus. A unique feature is that it enables the professionals to practice at a modular level and prepare for the examination. It contains presentations, texts and practice tests on various chapters of Insolvency and Bankruptcy Code, 2016 and related laws provided in the syllabus for Insolvency Examination.

- Frequently Asked Questions on the Insolvency and Bankruptcy Code, 2016

  IIIPI published a book on Insolvency and Bankruptcy Code, 2016 titled as "Frequently Asked Questions on the Insolvency and Bankruptcy Code, 2016". The book has been designed in a question and answer format and is comprehensive and a handy book for ready reference by the readers.

- Awareness Programmes as well as Intensive three days training programmes on Insolvency and Bankruptcy Code, 2016 by ICAI

  IIIPI organises various programmes on IBC, 2016 at various places all over the country. Also, it organises three days Intensive Class Room Training for Limited Insolvency Examination of IBBI.

Insolvency Professional Agency is crucial machinery driving the process of insolvency and bankruptcy law. The objective of Indian Institute of Insolvency Professionals of ICAI is to promote the professional development of its members, exercise supervision and monitor its members and ensure effective enforcement of law balanced with greater transparency and accountability.

Indeed the Insolvency and Bankruptcy laws are stark realities of the today's business world without which policy making of doing businesses cannot be imagined. India is no exception to this phenomenon, and in fact has recently put a renewed focus on this crucial aspect of bettering the Ease of Doing Business – one of the avowed objectives of the Government. And the result has been a well-thought out 'Insolvency and Bankruptcy Code, 2016', the biggest economic reform next only to GST, which has also opened a new vista of professional opportunity.

The implementation of any system does not only depend on the law, but also on the institutions involved in administration and execution of the same. It depends on the effective functioning of all the institutions but the Insolvency Professionals Agency and Insolvency Professionals have a vital role to play in the insolvency and bankruptcy resolution process.

Hina Sadrani, *Company Secretary*

# Important Definitions in Insolvency and Bankruptcy Code, 2016

The success or otherwise of any legal system highly depends upon the skill, vision, research, sense of use of language, precise conception of the objects and knowledge of the technical interpretations of its draftsman. Clarity, conciseness and comprehensive coverage of the subject matter is the basic requirement of any statute law. Definitions are intended to avoid ambiguities by making token words represent complicated notions so that such words may be used without repeating the complication. The importance, utility and the purpose of providing definitions of most used term or concept is that all referring the Act should think, understand and interpret the term or concept in the same way and the same sense as envisaged by the law framers. With this view, some important definitions of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as "Code") are discussed below:

## 1. Charge [Section 3(4)]

"Charge" means an interest or lien created on the property or assets of any person or any of its undertakings or both, as the case may be, as security and includes a mortgage.

The Code provides the exhaustive definition of the term "charge". The term "person" and "property" used in the definition are also defined in the Code. Such interest in the property can be present or future, or vested or contingent. The definition is important for two more terms defined in the Code:

Section 3(31) – Security Interest and

Section 3(35) – Transfer of property

As distinguished from the Transfer of Property Act, 1882, the Code treats the charge at par with the mortgage and hence 'mortgage' has been included in the definition of term 'charge'. Section 100 of the Transfer of Property Act, 1882 defines a "charge" as follows:

"Where immovable property of one person is by act of parties or operation of law made security for the payment of money to another, and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property and all the provisions hereinbefore contained which apply to simple mortgage shall, so far as may be, apply to such charge."

It is apparent that as per the Transfer of Property Act, 1882, charge and mortgage are taken to be as mutually exclusive. Section 58 of the Transfer of Property Act, 1882 defines mortgage, which includes *inter alia*, "A mortgage is the transfer of an interest in specific immovable property for the purpose of securing payment….". The essence of mortgage is a transfer of an interest in the property whereas in case of charge,

there is no transfer of interest in property, but a mere obligation on property to secure a debt. Title retention is also considered as charge. The charge can be created in following ways:

1. By act/consent of parties
2. By operation of law
3. By terms of a decree

So far as the Code is concerned, the charge falling under first two categories is covered under the definition of "security interest" u/s. 3(31). Negative lien or non-disposal undertaking are not charge as they do not give a power to the creditor to cause a sale of property. The charge can be either fixed charge or a floating charge, depending upon the type of assets being charged. If the charge is created on specific property, it is a fixed charge. Floating charge implies the property by description and not by specification. It is a charge on unspecified property or an undertaking of a person. The Code does not distinguish between the two.

## 2. Claim [Section 3(6)]

"Claim" means—

(a) a right to payment, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured or unsecured;

(b) right to remedy for breach of contract under any law for the time being in force, if such breach gives rise to a right to payment, whether or not such right is reduced to judgment, fixed, matured, unmatured, disputed, undisputed, secured or unsecured.

This is the most important definition in the Code as the Code deals with the claims of creditors or claimants. 'Claim' is closely related to "debt", i.e., a claim for the creditor is the debt for a corporate debtor. The definition operates in two different domains. One is right to payment and the second is right to remedy. Some terms used in the definition are summarised as follows:

1. "Right to payment" implies any enforceable obligation of the debtor; including a restitution order. It means "right of payment" from the estate, right to distribution from the bankruptcy estate.
2. "Reduced to judgment" – A claim is reduced to judgement when a judge orders one party to pay or give property to another party.
3. "Fixed" – A fixed claim is one for a specific amount of money, as distinguished from a contingent claim.
4. "Contingent" – A contingent claim is one in which there is a triggering event for the claim to exist. All the events needed to create liability have not happened before the date the bankruptcy petition is filed.
5. "Matured" – A matured claim is for a debt that exists currently and the date of payment has come due.
6. "Unmatured" – An unmatured claim is for a debt that exists, but the payment date is in future.
7. "Disputed" – A disputed claim is one that the debtor does not agree he owes to the creditor.
8. "Undisputed" – An undisputed claim is one that the debtor agrees he owes to the creditor.
9. "Legal" – A legal claim is one which can be demanded or asserted as a matter of right, one which is legally enforceable.
10. "Equitable" – An equitable claim is a request to the court to order someone to do something, or stop or not do something, meaning to do what is fair or right.
11. "Secured" – A claim is secured when payment is backed up by a charge on the debtor's property or loan collateral.

12. "Unsecured" – Claims are unsecured if they don't have secured status.
13. "Right to remedy" – It's a claim which entitles a party to recover damages for breach of contract. Damages may be the sum ascertained by the parties or unascertained amount.

If we analyse the definition and its two parts, we will notice that the distinction "matured" or "unmatured" is not appearing in the first part of the definition i. e., for right to payment. What is the intention of the law makers for avoiding this distinction? If we read this definition with the definition of default, unless the due date, there is no onus to make payment and hence there cannot be the case of default. Hence unmatured claims (obviously) cannot give rise to insolvency proceedings.

However, if the insolvency proceeding is started for any default by the same or any other creditor to whom a debtor owes a claim / debt, then the unmatured claim will also form part of the claim for distribution out of the assets of the debtor. If a creditor has agreed to provide the moratorium period for payment or to accept the payment at a certain future date, that does not mean he has no right to claim payment in insolvency proceedings merely by virtue of the fact that the date of payment is not yet due.

The term "claim" is used in the definitions of the terms "debt", "financial debt", "operational debt", "security interest" etc.

There are many Court decisions as to when a claim arises. A claim is said to arise when the triggering event giving rise to a claim occurs or takes place. From the definition of claim, it seems that future and contingent claims are not covered under the definition of claim. However, contingent claims may be covered if such claims are in the nature of a damage for breach of a contract.

## 3. Debt [Section 3(11)]

"Debt" means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt.

We have studied the definition of a claim. The definition of "debt" includes "claim which is due from any person". To understand the meaning, please refer the Supreme Court decision in Re: Kesoram Industries and Cotton Mills Limited wherein it was held that 'A debt is a sum of money which is now payable or will become payable in future by reason of a present obligation'. The meaning of 'debt' is co-extensive with meaning of 'claim'. Unless there is a claim, there is no debt. Since claim has been defined as right in respect of a payment, debt also requires the present obligation.

For hybrid debt instruments like compulsorily convertible debentures etc. whether they fall under the definition of 'debt', will depend on and vary from case-to-case.

Debt includes a financial debt and an operational debt.

## 4. Financial Debt [Section 5(8)]

"Financial Debt" means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes—

(a) money borrowed against the payment of interest;

(b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent;

(c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;

(d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;

(e) receivables sold or discounted other than any receivables sold on non-recourse basis;

(f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing;

(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;

(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;

(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause.

The Code provides the exhaustive definition of the words "financial debt". The following things should be kept in mind while deciding whether a debt is "financial debt":

1. The time value of money is the essence of any debt to be financial debt as against claim for goods and services.

2. Borrowing is a 'money-for-money' transaction.

3. Acceptance credit facility is used for letter of credit and bill discounting facility.

4. Financial lease or hire purchase transactions regarded as capital lease / financial lease under applicable accounting standards are financial debts whereas payment obligations under operating lease are operating debts.

5. For discounting of receivables, if the underlying debt is a financial debt, only then can assignment thereof be considered as giving rise to a financial debt. The recourse that an assignee has against assignor in case of non-payment is a financial debt as it involves time value of money.

6. Forward sale and purchase agreement should be such as giving rise to financial debt and underlying asset should not be those other than the financial assets. For example, agreement to sell a particular commodity at a future date is not covered under this category.

To better understand what is financial debt and also what is not, let us analyse the recent case of *Nikhil Mehta and Sons (HUF) vs. AMR Infrastructures Ltd.1, [2017] 78 taxmann.com 302 (NCLT - New Delhi).* In the given case, the Applicants – Appellants had signed a Memorandum of Understanding with the Respondent, wherein the Appellants would purchase properties from the Respondent. In return for a substantial portion of the total money paid upfront, the Respondent promised to pay monthly "assured returns" from the time of signing of the MOU till the time the possession was delivered to the Appellants. After paying these assured returns for some time, the Respondent defaulted on its payments. Following this, the Appellants filed an application under section 7 of the IBC. The Tribunal confronted the following questions:

i. Whether the Applicant was to be considered as a Financial Creditor for the purpose of the Insolvency process as per Code?

ii. Whether the 'Assured Return' to be paid as per MOU, would qualify to be considered as the Financial Debt and its non-payment would be default for the institution of Insolvency process?

The Tribunal, *inter alia* held that "the opening words of the definition clause would indicate that a financial debt is a debt along with interest which is disbursed against the consideration for the time value of money and may include any

of the events enumerated in sub-clauses (a) to (i). Therefore the first essential requirement of financial debt has to be met viz., that the debt is disbursed against the consideration for the time value of money and which may include the events enumerated in various sub-clauses. …. In Black's Law Dictionary (9th edition) the expression 'Time Value' has been defined to mean "the price associated with the length of time that an investor must wait until an investment matures or the related income is earned". ….. A forward contract to sell product at the end of specified period is not a financial contract. It is essentially a contract for sale of specified goods. ….. When we examine the nature of transactions in the present case, we find that it is a pure and simple agreement of sale or purchase of a piece of property. Merely because some "assured amount" of return has been promised and it stands breached, such a transaction would not acquire status of a "financial debt," as the transaction does not have the consideration for the time and value of money, which is a substantive ingredient to be satisfied for fulfilling the requirements of the expression "Financial Debt".

As per Supreme Court Order dated 31st August, 2017 in *Innovative Industries Ltd. vs. ICICI Bank & Anr.,* while deciding the overriding effect of IBC, *inter alia* held, that:

1. The corporate debtor is entitled to point out that a default has not occurred in the sense that the "debt", which may also include a disputed claim, is not due. A debt may not be due if it is not payable in law or in fact.

2. In the case of a corporate debtor who commits a default of a financial debt, the adjudicating authority has merely to see the records of the information utility or other evidence produced by the financial creditor to satisfy itself that a default has occurred. It is of no matter that the debt is disputed so long as the debt is "due" i.e. payable unless interdicted by some law or has not yet become due in the sense that it is payable at some future date.

   However, in case of operational debt, the moment there is existence of such a dispute, the operational creditor gets out of the clutches of the Code.

3. When it comes to a financial creditor triggering the process, Section 7 becomes relevant. Under the Explanation to Section 7(1), a default is in respect of a financial debt owed to any financial creditor of the corporate debtor – it need not be a debt owed to the applicant financial creditor.

In *Neelkanth Township and Construction Private Limited vs. Urban Infrastructure Trustees Limited [NCLAT – Company Appeal (AT) (Insolvency) No. 44 of 2017],* NCLAT *inter alia* dealt with a peculiar question –– Whether debenture holder is a financial creditor or not and whether debenture is a financial debt.

Corporate Debtor argued as follows:

1. The time barred debt cannot be enforced by filing an application for Corporate Insolvency Resolution Process.

2. Urban Infra does not come within the meaning of financial creditor. No financial debt is owed to it. 'Debenture Certificates' forming basis of claim do not fall within the definition of 'financial debt'. A plain reading of the definition of 'financial debt' makes it apparent that it is the debt which is only if disbursed against the consideration for time value of money. Therefore, there has to be a consideration flowing from the advance of money which is at par with the time value of money. Since the 'debenture certificates' issued to the Respondent were carrying zero interest and another was carrying only one perc ent interest, the same were not issued against time value of money. The debenture certificates were purchased by Respondent only by way of an investment,

and do not come within the meaning of 'financial debt'.

NCLAT held that:

1. There is nothing on record that Limitation Act, 2013 is applicable to the Code. The Code is not an Act for recovery of money claim, it relates to initiation of Corporate Insolvency Resolution Process. If there is a debt which includes interest and there is default of debt and having continuous course of action, the argument that the claim of money by lender is barred by limitation cannot be accepted.
2. Section 5(8)(c) – Debentures come within the meaning of 'Financial Debt'. As per section 3(11), debt means ... '.....'. It is admitted that the appellant is a debenture holder. The Corporate Debtor has a liability and obligation in respect of the amount which is due to the debenture holder from the Corporate Debtor, including 'financial debt' i. e. the amount due on maturity of debentures.
3. Non-payment of amount due on maturity debt is a default.

In *Prabodh Kumar Gupta & Ars. vs. Jaypee Infratech Limited, Allahabad Bench of NCLT* did not decide whether deposit holders are financial creditors but categorised them as 'stakeholders'.

## 5. Operational Debt [Section 5(21)]

"Operational Debt" means a claim in respect of the provision of goods or services including employment or a debt in respect of the repayment 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.

From the reading of above, it is apparent that there are four categories of operational debts:

1. Debt arising out of provision of goods
2. Debt arising out of provision of services
3. Debt arising out of employment
4. Statutory dues

We can also define "operating debt" as any debt, other than financial debt. There is no concept of hybrid debt in the Code. A debt is either an "operating debt" or a "financial debt". The distinction between the two is very important in view of the fact that the Code provides different provisions for different types of debts. We can summarise the difference between the Financial Debt and Operational Debt (or financial creditor and operational creditor) as follows:

1. Financial creditors get right to vote at the meeting of the committee of creditors in proportion of the financial debt owed to such financial creditor. On the other hand, the operational creditors do not get right to vote.
2. Financial creditors can directly initiate an application for insolvency resolution process if there is a default. Operational creditors need to deliver a demand notice of unpaid invoice demanding the payment and can file application only after 10 days from the date of delivery of notice for invoice if no payment is received during that period.
3. It is mandatory for financial creditors to furnish the name of an Insolvency Resolution Professional (IRP) at the time of application. This is not the case for operational creditors. Operational creditors may or may not choose to appoint IRP.
4. So far as constitution of committee of creditors is concerned, only financial creditors can become members. Operational creditors do not form part of the committee of creditors.
5. A financial creditor shall submit financial information and information relating to assets in relation to which any security interest has been created to Information Utility. Operational creditor may submit

financial information to the information utility.

6. As discussed earlier, in the case of a corporate debtor who commits a default of a financial debt, the adjudicating authority has merely to see the records of the information utility or other evidence produced by the financial creditor to satisfy itself that a default has occurred. It is of no matter that the debt is disputed so long as the debt is "due" i.e., payable unless interdicted by some law or has not yet become due in the sense that it is payable at some future date.

While discussing the two main types of debt, we should also study the following cases:

1. *Mukesh Kumar & Anr. vs. AMR Infrastructures Limited* – The petitioners were allottees of an apartment in a commercial project and had paid advance for the same. Due to failure of the developer to deliver the possession in time, petitioners filed an application before the NCLT claiming the refund, in the capacity of operational creditors. The NCLT dismissed the application on the ground that the petitioners did not fall within the ambit of the definition of operational creditors since the claim of the petitioners could not be classified as an operational debt, which includes claim in respect of goods and services, employment dues and government dues.

2. *Nikhil Mehta & Sons (HUF) & Ors. vs. M/s. AMR Infrastructures Limited* – For the same issue as mentioned above, NCLT held that the petitioners did not fall within the definition of "financial creditors" for the debt not being a financial debt.

The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations, 2017 dated 16th August, 2017 (hereinafter referred to as "IRP Amendment Regulations") are also relevant for insertion of Regulation 9A and Form F to the schedule appended to the IRP Regulations.

The IRP Amendment Regulations came to the rescue of such creditors. The said Regulation 9A r/w Form F provides for the procedure of raising claims by creditors other than operational and financial creditors. Since the definition of 'debt' is inclusive one, it includes other types of debts also, specifically other than financial debts and operational debts. The amendment gives a legitimate status to the claims of creditors other than the ones provided for under the Code, bringing within its ambit creditors such as house buyers and allottees.

The Real Estate (Regulation and Development) Act, 2016 (RERA) should also be mentioned at this stage. As discussed earlier, the home buyers of developers are included in special category under Regulation 9A of the IRP Amendment Regulations as "creditors other than operational and financial creditors". Also, RERA is enacted, *inter alia*, to protect the interests of allottees of a project / home buyers. The home buyers of Jaypee Infratech Limited have requested UP Government to intervene in the matter and to ensure that any Jaypee resolution plan must provide for a separate escrow account as per RERA norms. Further, they have filed Public Interest Litigation with Supreme Court seeking a stay order on NCLT's insolvency proceedings. The time will tell about the applicability of RERA in such typical cases, maintainability of PIL for stay order on insolvency and ranking the priorities between IBC and RERA. As per CNBC TV News dated 4th September, 2017, the Supreme Court has ordered stay on the insolvency proceedings.

*Uttam Galva Steel Limited [NCLT Mumbai Bench] [Company Petition No. 45/I&BP/NCLT/MAH/2017]*

NCLT Mumbai Bench, while dealing with this case, interpreted the law and concluded as follows:

If we go through the definition of "financial debt", it means that a debt along with interest

is disbursed against the consideration for the time value of money and with an inclusive list specifying as to what category of debts will become financial debt. When it comes to operational debt, it is a claim made against the goods supplied or services rendered. There are two types of debts, one operational debt another financial debt, so debt has to fall either under financial debt or operational debt, there cannot be a debt other than these two types. If it is a debt against the Company, it has to invariably fall either under financial debt or operational debt. The bottom line in respect to obligation is, a man should repay the value, either in cash or kind, to what he has taken, for this. When we see the basic difference to financial debt and operational debt, it is clear that financial debt is money borrowed to repay on future date along with interest, here the money is lent for value addition to the money as agreed between the parties, whereas operational debt is normally based on an agreement to pay to goods or services, it does not mean that interest cannot be claimed in the times to come, it is a normal practice that trade payables are payments deferred for a fixed time, if the party fails to repay within the fixed time, then interest will be claimed over operational debt as well.

The difference in these two transactions is one is given to get interest over the money; second transaction happens in business operations, in both the cases money is involved, as days go by after transaction, the time value of money will be there. For that reason, it is nowhere said that the operational creditor is barred from claiming interest. On commercial side, the creditor claiming interest is quite normal and justifying, after all, business always runs keeping in mind the time value of money, transaction will be operation if payment is to goods or services, transaction is financial if money is lent on contemplation of returns in the form of interest. Therefore, goods or services supplied cannot be seen as not valued in terms of money, one is in kind another is in cash, that does not mean only cash has value of money and kind has no value of money.

## 6. Insolvency

The word "Insolvency" is not defined in the Code. So, we must take recourse of dictionary meaning. As per Black's Law Dictionary (2nd Edition), insolvency is defined as "the condition of a person who is insolvent, inability to pay one's debts, lack of means to pay one's debts or the condition of a person who is unable to pay his debts as they fall due or in the usual course of trade and business."

A company is insolvent, either, if it is unable to pay its debts as they fall due or if the value of its assets is less than the amount of its liabilities. J. B. Heaton has in its research paper (SSRN ID – 931026) has given following three tests to decide insolvency or otherwise of a person:

1. The 'Ability to Pay Solvency' Test (also known as 'cash flow solvency' or 'equitable solvency') – Whether a person reasonably can be expected to pay its debts as they come due.

2. The 'Balance Sheet Solvency' Test – Whether the fair value of a person's assets exceed the face value of its liabilities. This test can be performed on either a going concern basis or liquidation basis.

3. The 'Capital Adequacy Solvency' Test – Whether a person has adequate capital.

The US Courts have in their various decisions held that "The meaning of 'Insolvency' is not definitely fixed and it is not always used in the same sense, but its definition depends rather on the business or fact situation to which the term applies. There are various tests used to determine insolvency, none of which is generally accepted as the correct test."

Though the Code does not define the word "Insolvency", it is the default which triggers the Insolvency Proceedings. Hence, the Indian Insolvency and Bankruptcy Code is more based on "failure to pay" rather than "ability to pay". The creditors need not verify whether the default arose due to "inability to pay". However, the

key test is "inability". Default occurs because of inability and hence it should be used as indicator only and not as conclusive test.

The Code permits to import the words defined in few other Acts by virtue of Section 3(37). These Acts are:

1. The Indian Contract Act, 1872
2. The Indian Partnership Act, 1932
3. The Securities Contact (Regulation) Act, 1956
4. The Securities Exchange Board of India Act, 1992
5. The Recovery of Debts Due to Banks and Financial Institutions Act, 1993
6. The Limited Liability Partnership Act, 2008 and
7. The Companies Act, 2013

None of these Acts has defined the word "Insolvency". Section 2(8) of the Sale of Goods Act, 1930 defines an "Insolvent" as a person who has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due, whether he has committed an act of insolvency.

## 7. Bankruptcy [Section 79(4)]

"Bankruptcy" means the state of being bankrupt.

The term "Bankrupt" is defined u/s. 79(3) of the Code. "Bankrupt" means—

(a) a debtor who has been adjudged as bankrupt by a bankruptcy order under section 126;

(b) each of the partners of a firm, where a bankruptcy order under section 126 has been made against a firm; or

(c) any person adjudged as an undischarged insolvent.

Thus, even the definition of the term "Bankrupt" is using the same term. Hence, we need to refer to its dictionary meaning. The dictionary meaning of the word is "the quality or state of being bankrupt, utter failure or impoverishment; a legal process under which a borrower protects and / or liquidates assets in order to repay debts." Bankruptcy is usually a last resort for individuals. It virtually ruins a person's credit for several years, making it very difficult and expensive to borrow money.

Bankruptcy is not a synonym for Insolvency. The basic difference between the two is that while "Insolvency" is the entity's inability to pay off its debts, bankruptcy is an outcome of a legal procedure and the insolvent is declared as "bankrupt" by the court. Hence, insolvency will not necessarily lead to bankruptcy. Further, the term "undischarged insolvent" is not used elsewhere in the code. Section 79(22) defines "undischarged bankrupt" as a bankrupt who has not received a discharge order u/s. 138 of the Code.

## 8. Liquidation

The term "Liquidation" is also not defined under the Code. In common parlance, it means a process by which a juristic entity such as a company, an LLP or other body corporate is brought to an end, and the assets and property of the entity are distributed.

Though the Code does not define the word, it provides for liquidation of insolvent corporate debtors and voluntary liquidation of corporate persons. Liquidation can be triggered in following four ways in accordance with the Code:

1. By rejection of resolution plan by the adjudicator if it fails to meet the necessary conditions.
2. By failure to reach an agreement in the committee of creditors during the stipulated period.
3. By a decision of the committee of creditors during the IRP.

4. By the failure of adherence to terms of a resolution plan.

Section 59 of the code enables the voluntary liquidation of the corporate debtor which has not defaulted on any debt due to any person.

## 9. Default [Section 3(12)]

"Default" means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not repaid by the debtor or the corporate debtor, as the case may be.

This is an important definition as the triggering event for insolvency is the "default". For a default, there has to be a subsisting debt. Unless the sum in the question is a debt, there is no default. Debt must be "due and payable". Even non-payment of any part or instalment of debt will amount to default. The code uses the term 'repaid' in the definition. Repayment is usually in respect of principal. Interest and operational debts are not 'repaid'. Hence the word 'repaid' should be understood as 'paid'.

Further, as discussed earlier, default means "failure to pay" and not "inability to pay". Not every default signifies that the person is in the state of insolvency. There can be a wilful default also which is unrelated to ability of the person to pay / repay its debt. It's an indication of the liquidity crisis only. However, to enable the creditors to initiate the insolvency proceedings, the Code has taken into consideration the failure to pay and not the inability.

## 10. Property [Section 3(27)]

"Property" includes money, goods, actionable claims, land and every description of property situated in India or outside India and every description of interest including present or future or vested or contingent interest arising out of, or incidental to, property.

This is an inclusive definition and does not provide the meaning of "property". The dictionary meaning of "property" is 'a thing or things belonging to someone or something that is owned by a person, business etc.' Even the Transfer of Property Act, 1882 does not define the word 'property'. Hence, we have to interpret the word so as to include every such thing as understood to be a property in common parlance. Also, any right or interest in such property is also a property. The interest can be present or future, or vested or contingent. Intangible assets are also property of a person. Thus, property will include all – movable, immovable, tangible and intangible assets / properties.

Actionable claim is defined in section 3 of Transfer of Property Act, 1882 as under:

"Actionable claim means a claim to any debt, other than a debt secured by mortgage of immovable property or by hypothecation or pledge of movable property, or to any beneficial interest in movable property not in possession, either actual or constructive, of the claimant, which the Civil Courts recognise as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, conditional or contingent."

Actionable claim, in essence, is an incorporeal right. It can be assigned for value.

## 11. Security Interest [Section 3(31)]

"Security interest" means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person:

Provided that security interest shall not include a performance guarantee.

A right, title or interest under the definition can only be covered to mean a security interest. A

title conferred in case of sale of property is not covered by above definition. Further, the use of the phrase "created in favour of or provided for" necessarily implies 'security created by act of parties' and not by operation of law.

Also, there must be a 'transaction' which is intended to secure payment or performance of an obligation. The definition of the term 'transaction' under Clause 33 of Section 3 uses the terms 'agreement or arrangement' which further leads to the conclusion that security interest must be created by act of parties (which is a broad definition). Any agreement or arrangement that fulfils all the conditions specified in the definition will be covered under the definition. We will touch upon the few types of security interest:

Mortgage – As per Section 58 of the Transfer of Property Act, 1882, "A mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or the performance of engagement which may give rise to a pecuniary liability".

Hypothecation – Every charge on movable property which is not pledge should be regarded as hypothecation. Hence, the meaning of 'hypothecation' is co-extensive with the meaning of 'charge'.

Assignment of benefits of a contract would mean assigning the assignee as the beneficiary of the contract. The assignment covered here is the 'assignment' as a mode of security, and not the one which intends to transfer a property.

## 12. Dispute [Section 5(6)]

"Dispute" includes a suit or arbitration proceedings relating to—

(a) the existence of the amount of debt;

(b) the quality of goods or service; or

(c) the breach of a representation or warranty.

The definition assigns no meaning to 'dispute'. A dispute is a disagreement on a point of law or fact, a conflict of legal views or of interests between two persons. Further, dispute need not necessarily involve suit or arbitration proceedings. The definition is inclusive one. Hence, the only option to raise dispute is not to run for suit or arbitration. Debtor may not accept the demand raised by the creditor and may dispute the same. Dispute can be raised by either party. The dispute related to existence of 'debt' itself is not covered here. The 'dispute' should be read together with 'claim' and 'debt' for its proper interpretation. A 'claim' and 'debt' must exist for a 'dispute' to exist. 'Debt' here refers to operational debt only as the existence of a 'dispute' has to be shown only in case of operational creditors making a demand and not financial creditors. In case of statutory debts, it can be disputed at appeal levels and may not have reached to the Court level. Further Courts are of the opinion that winding up / insolvency proceedings cannot be used as a device to force commercial claims.

We will discuss few Court decisions in connection with the term "dispute" and "existence of dispute".

*Annapurna Infrastructure Pvt. Ltd and Anr. vs. SORIL Infra Resources Ltd. [NCLAT – Company Appeal (AT) (Insolvency) No. 32 of 2017]*

In this case, appellants rented the premises to respondents, rent of which was payable by respondent Corporate Debtor. The Corporate Debtor failed to pay the rent and an arbitration proceeding was initiated by the appellants. The Arbitration Award was received on 9th September, 2016 in favour of the appellants. While deciding the appeal, NCLAT held as follows:

"Arbitration proceedings" used in Sec. 8(2)(a) of the I&B Code cannot be deemed to be pending because under Sec. 21 of the Arbitration Act, arbitration proceedings commenced on the date on which request for referring such a dispute

to arbitration was received by the respondent. The said proceeding came to an end in terms of Sec. 32 on the date of announcing the final award or by an order of the Arbitral Tribunal in accordance with sub-section (2) of Sec 32 of the Arbitration Act.

NCLAT dealt with the Question: Whether there is an 'existence of dispute' between the parties, when the award passed by Arbitral Tribunal is affirmed by the Court under Sec. 34 of the Arbitration Act?

NCLAT had a view that from clause (a) of sub-section (2) of Sec. 8, we find that pendency of an arbitration proceedings has been termed to be an 'existence of dispute' and not the pendency of an application under Sec. 34 or Sec. 37 of the Arbitration Act. Also, Form 5 – Format of application makes it clear that while pendency of the suit or arbitration proceeding has been termed as existence of dispute, apart from other, disputes decree and award of Tribunal has been shown as record of default. NCLAT quoted its own decision in *Kirusa Software Private Ltd. vs. Mobilox Innovations Private Limited [Company Appeal (AT) (Insolvency) 6 of 2017]* "Though one may argue that Insolvency resolution process cannot be misused for execution of a judgment and decree passed in a suit or award passed by an arbitration Tribunal, but such submission cannot be accepted in view of Form 5 of Insolvency & Bankruptcy (Application to Adjudicating Authority) Rules 2016 wherein a decree in suit and award has been shown to be a debt for the purpose of default on non-payment."

Under Sec. 36 of the Arbitration Act, an arbitral award is executable as decree but it can be enforced only after the time for filing the application under Sec 34 has expired and no application is made or such application having been made has been rejected. That means, the arbitral award reaches finality after expiry of enforceable time under Sec. 34 and/or if application under Section 34 is filed and rejected.

In International Commercial Arbitration, the general characteristics of an award are stated. In Para 1353, it is stated as follows:

"1353.—An arbitral award can be defined as a final decision by the arbitrators on all or part of the dispute submitted to them, whether it concerns the merits of the dispute, jurisdiction, or a procedural issue leading them to end the proceedings." This is subsequently elucidated through four aspects of an award, namely:

(i) an award is made by the arbitrators;

(ii) an award resolves a dispute;

(iii) an award is a binding decision; and

(iv) an award may be partial.

The arbitration result in the present case has all the elements and ingredients of an arbitration award. Accordingly, there is no pending dispute.

*Uttam Galva Steel Limited [NCLT Mumbai Bench] [Company Petition No. 45/I&BP/NCLT/MAH/2017]*

NCLT Mumbai Bench, while dealing with this case, interpreted the law and concluded as follows:

Dispute means existence of dispute. Dispute raised after receipt of notice is not the reason for denial of resolution. If reply is given denying the claim despite default occurrence is clear, it does not mean that no application can be filed by any operational creditor. If that is so, it will be virtually ousting operational creditor filing any case under Section 9. If bare denial of claim is labelled as dispute, Sections 8 and 9 of the Code would become exactly like "cobra without fangs". NCLT concluded that "dispute" is pendency of suit or arbitration.

When the matter went for appeal, NCLAT in Company Appeal (AT) (Insolvency) 39 of 2017 [Uttam Galva Steel Limited], dealt with four core issues of the Code. One of them was 'whether there is an existence of dispute, if any in the present case?'

NCLAT relied on its decision in *"Kirusa Software Pvt. Ltd. vs. Mobilox Innovations Pvt. Ltd." [Company Appeal (AT) (Insolvency) No. 6 of 2017]* and interpreted the term 'dispute' and 'existence of dispute' as follows:

1. The definition of "dispute" is "inclusive" and not "exhaustive". The same has to be given wide meaning provided it is relatable to the existence of the amount of the debt, quality of goods or service or breach of a representation or warranty.

2. Once the term "dispute" is given its natural and ordinary meaning, upon reading of the Code as a whole, the width of "dispute" should cover all disputes on debt, default etc. and not limited to only two ways of disputing a demand made by the operational creditor, i. e. either by showing a record of pending suit or by showing a record of a pending arbitration. The intent of the Legislature, as evident from the definition of the term "dispute" is that it wanted the same to be illustrative (and not exhaustive). If the intent of the Legislature was that a demand by an operational creditor can be disputed only by showing a record of suit or arbitration proceeding, the definition of dispute would have simply said dispute means a dispute pending in Arbitration or a suit.

3. Section 5(6) – "Dispute" read with Section 8(2) which uses the words 'existence of a dispute, if any, and record of the pendency of the suit or arbitration proceedings' means that 'disputes, if any' applies to all 14 kinds of disputes, in relation to debt and default. The expression used in Section 8(2) of the Code is disjunctive from the expression 'record of the pendency of the Suit or Arbitration Proceedings'.

4. Section 8(2) of the Code does not mean that a dispute must be pending between the parties prior to the notice of demand and that too in arbitration or a Civil Court. Once parties are already before any judicial forum / authority for adjudication of disputes, notice becomes irrelevant and such an interpretation renders the expression 'existence of a dispute, if any' otiose. The statutory requirement in sub-section (2) of Section 8 of the Code is that the dispute has to be brought to the notice of the operational creditor. Words 'if any' have been added to give meaningfulness to Section 8(2) of the Code.

5. The Corporate Debtor must raise a dispute with sufficient particulars. Further, the dispute must also be relatable to the three conditions provided u/s. 5(6) – (a) to (c) only. The definition of the term 'dispute' must be read together with 'operational debt' for the purpose of Section 9.

6. The term 'dispute' is capable of being discerned from any document related to it. Examples are:

   a. Notice issued under Code of Civil Procedure, 1908 by 'operational creditor' which is disputed by 'corporate debtor'.

   b. Notice u/s. 59 of the Sale of Goods Act, 1930.

   c. A labourer / employee having raised the dispute with any State Government w.r.t. existence of amount of debt or a dispute pending in any Labour Court.

   d. Any writ petition pending before any High Court.

   e. Pending liquidation proceeding before any High Court.

   f. Dispute with regard to quality of foods, if the 'Corporate Debtor' has raised a dispute and brought to the notice of the Operational Creditor to take appropriate step, prior to receipt of notice u/s. 8(1) of the Code.

7. Mere raising a dispute for the sake of dispute, unrelated or related to clauses (a) or (b) or (c) of Section 5(6), if not raised prior to application and not pending before any competent court of law or authority cannot be relied upon to hold that there is a 'dispute' raised by the Corporate Debtor. It should not be any got up or malafide dispute just to stall the Insolvency Resolution Process.

8. In a case where a suit relating to existence of amount of debt stands decided and decree is pending for execution or relating to quality of goods or services for which a suit has been filed and decreed or an award has been passed by Arbitral Panel, though petition u/s. 34 of the Arbitration and Conciliation Act, 1996 is pending, in view of Form 5 of Insolvency & Bankruptcy (Application to Adjudicating Authority) Rules, 2016, a decree in suit or an award is to be treated as a debt and not as 'pending dispute'.

## 13. Related Party [Section 5(24)]

"Related Party", in relation to a corporate debtor, means—

(a) a director or partner of the corporate debtor or a relative of a director or partner of the corporate debtor;

(b) a key managerial personnel of the corporate debtor or a relative of a key managerial personnel of the corporate debtor;

(j) any person who controls more than twenty per cent. of voting rights in the corporate debtor on account of ownership or a voting agreement;

(k) any person in whom the corporate debtor controls more than twenty per cent. of voting rights on account of ownership or a voting agreement;

(l) any person who can control the composition of the board of directors or corresponding governing body of the corporate debtor;

(m) any person who is associated with the corporate debtor on account of—

  (i) participation in policy making processes of the corporate debtor; or

  (ii) having more than two directors in common between the corporate debtor and such person; or

  (iii) interchange of managerial personnel between the corporate debtor and such person; or

  (iv) provision of essential technical information to, or from, the corporate debtor.

Prior to this code, the term related party has already been defined in the Companies Act, 2013, the SEBI (LODR) Regulations, 2015 and Accounting Standard 18 and Ind AS. The definition provided in the Code is different from the definitions under other Acts as it serves a different purpose. Section 21 of the Code prohibits a related party to whom a corporate debtor owes a financial debt from representing itself, participating or voting in a meeting of committees of creditors. As per Section 28, the Resolution Professional is not allowed to undertake any Related Party Transaction without obtaining the approval of committee of creditors.

## 14. Associate [Section 79(2)]

"Associate" of the debtor means—

(a) a person who belongs to the immediate family of the debtor;

(b) a person who is a relative of the debtor or a relative of the spouse of the debtor;

(c) a person who is in partnership with the debtor;

(d) a person who is a spouse or a relative of any person with whom the debtor is in partnership;

(e) a person who is employer of the debtor or employee of the debtor;

(f) a person who is a trustee of a trust in which the beneficiaries of the trust include a debtor, or the terms of the trust confer a power on the trustee which may be exercised for the benefit of the debtor; and

(g) a company, where the debtor or the debtor along with his associates, own more than fifty per cent of the share capital of the company or control the appointment of the board of directors of the company.

Explanation.— For the purposes of this sub-section, "relative", with reference to any person, means anyone who is related to another, if—

(i) they are members of a Hindu Undivided Family;

(ii) one person is related to the other in such manner as may be prescribed;

Section 79 (17) defines "Immediate family" of the debtor as his spouse, dependent children and dependent parents.

The Companies Act, 2013 also defines the term "associate" but it is in relation to a Company. Hence, a different definition is provided under the Code. In case of companies, the position of "associate" arises by virtue of voting power which obviously has no relation in case of natural persons or partnerships. The definition is relevant for several sections of the Code.

Section 109 – An associate of the debtor is not entitled to vote if he happens to be a creditor.

Section 135 – An associate cannot vote in respect of the resolutions in the meeting of the creditors.

Section 164 – Any transaction between a bankrupt and his associate entered into during the period of two years preceding the date of making of the application for bankruptcy shall be deemed to be an undervalued transaction.

An adjudicating authority may pass an order declaring an undervalued transaction void. Further, the law relating to insolvency and bankruptcy in section 165 and 166 is different for associates and persons other than associates.

## 15. Moratorium

The term "Moratorium" is not defined in the code. As per Black's Legal dictionary, it means delay in performing an obligation or taking an action legally authorised or simply agreed to be temporary. Moratorium is a suspension of activity or an authorized period of delay or waiting. A moratorium is sometimes agreed upon by the interested parties, or it may be authorised or imposed by operation of law. The term is also used to denote a period of time during which the law authorises a delay in payment of debts or performance of some other legal obligation.

The committee puts the rationale behind the moratorium period as follows: "Moratorium on debt recovery action:

The motivation behind the moratorium is that it is value maximising for the entity to continue operations even as viability is being assessed during the IRP. There should be no additional stress on the business after the public announcement of the IRP. The order for the moratorium during the IRP imposes a stay not just on debt recovery actions, but also on any claims or expected claims from old lawsuits, or on new lawsuits, for any manner of recovery from the entity. The moratorium will be active for the period over which the IRP is active."

Section 14 of the Code deals with moratorium. The order of moratorium prohibits continuation of or institution of suits, legal proceedings against the corporate debtor, the disposal of any assets of the corporate debtor, debt enforcement actions etc. Further, the powers of the board of directors will be suspended and the company management will report to the resolution professional. To understand the concept of moratorium properly, let us study Mumbai

NCLT order in case of *Schweitzer Systemtek India Pvt. Ltd. vs. Phoenix ARC Private Limited. NCLT* dealt with the following question:

Whether a property(ies) which is/are not 'owned' by a Corporate Debtor shall come within the ambits of the moratorium?

The NCLT analysed the provisions of Section 14 and concluded as follows:

Section 14(1) (c) is worded as follows:

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:

(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;

NCLT held that "On careful reading I have noticed that the term "its" is significant. The plain language of the Section is that on the commencement of the Insolvency process the 'moratorium' shall be declared for prohibiting any action to recover or enforce any security interest created by the Corporate Debtor in respect of "its" property. …… As result, "its" denotes the property owned by the Corporate Debtor. The property not owned by the Corporate Debtor do not fall within the ambits of the Moratorium. Even Section 10 is confined to the Books of the Account of the Corporate Debtor. The Bench has no legislative authority to expand the meaning of the term "its" even under the umbrella or *'Ejusdem generis'*. The outcome of this discussion is that the Moratorium shall prohibit the action against the properties reflected in the Balance Sheet of the Corporate Debtor. The Moratorium has no application on the properties beyond the ownership of the Corporate Debtor".

This interpretation was upheld by NCLAT [NCLAT – Company Appeal (AT) (Insolvency) No. 129 of 2017]. NCLAT further added that in this respect one may also refer to Section 60 of the Code, as per which under sub-section (2) if Corporate Insolvency Resolution Process, or liquidation proceeding of a corporate debtor is pending before the 'Adjudicating Authority', an application relating to the 'insolvency resolution' or 'bankruptcy' of a personal guarantor is required to be filed before the same Bench of Adjudicating Authority, meaning thereby, separate application for initiation of resolution process require to be filed against the guarantor before the same very Bench of the Adjudicating Authority who is hearing the corporate resolution process or liquidation proceeding against principal corporate debtor. Thus, it is settle position that the moratorium period is not applicable to the personal guarantees.

It is evident from the interpretations made by NCLT and NCLAT in various cases studied / referred above and many more not discussed, that all the definitions should be read in the context of the sections in which they have been used, particularly when the Code is at an infant stage. As rightly said by Coke "it is the most natural and genuine exposition of a statute to construe one part of the statute by another part of the same statute, for that best expresses the meaning of the makers." We will conclude this Article by a quote form Frederick J. De Sloovere's book "Contextual Interpretation of Statutes": "And the law may be resembled to a nut, which has a shell and a kernel within; the letter of the law represents the shell, and the sense of it the kernel, and as you will be no better for the nut if you make use only of the shell, so you will receive no benefit by the law, if you rely only upon the letter, and as the fruit and profit of the nut lies in the kernel, and not in the shell, so the fruit and profit of the law consists in the sense more than in the letter. *[Eyston vs. Studd, 2 Pl. Com. 459, 465 n, 75 Eng. Reprints 688 (C. B. 1574)]"*


Kumar Saurabh Singh & Ashwij Ramaiah, *Advocates*

# Heralding a New Era in Insolvency Resolution – The Insolvency and Bankruptcy Code, 2016

One of the biggest predicaments facing the banking and finance market in India in the last few years has been the alarming levels of increase in non-performing or stressed assets. While the spurt in stressed assets has largely been a result of slowdown in the economy, financial indiscipline and recalcitrant behaviour has also been incentivised by various other factors including imbalance created by the legal system between the rights of the debtors and creditors through multiplicity of laws such as the Sick Industrial Companies Act, 1985 **("SICA")**, Recovery of Debts Due to Banks and Financial Institutions Act (the **"RDDB&FI Act"**), Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (the **"SARFAESI Act"**), etc. The previous regime had several loopholes and failed to achieve time-bound resolution of stressed assets. Therefore, it was no surprise that the World Bank's Ease of Doing Business Index 2015 ranked India a dismal 137 out of 189 countries on the ease of resolving insolvencies based on various indicators such as time, costs, recovery rate for creditors, the management of a debtor's assets during the insolvency proceedings etc.[1]

To rectify this state of affairs, the Ministry of Finance constituted the Banking Law Reform Committee under the chairmanship of Mr. T. K. Vishwanathan. Based on the recommendations of this Committee, the Parliament enacted the Insolvency and Bankruptcy Code, 2016 (the **"Code"**). This Article is an endeavour to understand the impact of this law on the various stakeholders involved.

Not only is the Code unique in its own right, but also introduced sweeping changes to existing legislations in order to harmonise their provisions with the Code.

## Uniqueness of the Code

The Code has introduced several new reforms which are novel and unique in the Indian jurisprudence. They are elucidated as under

***Low Bar for triggering the Resolution Process against the Corporate Debtor***

First and the most important of these reforms is introducing a very low threshold for triggering the resolution process against a company, limited liability partnership or any other limited liability entity (**"Corporate Debtor"**). A default of INR 1,00,000 is sufficient for any creditor to initiate Corporate Insolvency Resolution Process (**"CIRP"**) against the Corporate Debtor. The Code provides that the Central Government may increase such threshold.

1 Data is available on http://www.doingbusiness.org/data/exploreeconomies/indiaa

As opposed to this, the threshold for initiation action against the Corporate Debtor was much higher under the previously existing insolvency regime in the country. Under the SICA, a creditor could take action against the Corporate Debtor only if there was a loss of more than 50% of a company's net-worth. As a result of this, by the time the creditors could even commence the process to recover their dues from the Corporate Debtor, a significant portion of its assets would have already been eroded.

Under the SARFAESI Act, a secured creditor can enforce its security interest only subsequent to a 'default.' A 'default' is said to have occurred only after the debt has been written off as a 'Non-Performing Asset' in the books of account of the secured creditor. Therefore, a secured creditor would have to wait for a minimum of 180 days to proceed against a debtor for the recovery of outstanding debts. Additionally, although the RDDB&FI Act did aim to provide for speedy recovery of debts, the Debt Recovery Tribunals (**"DRTs"**) were not empowered to restructure the loan or make the debts sustainable. The DRTs were merely able to recover debts of the creditors by selling the movable or immovable properties of the debtor, appointment of a receiver for the management of movable or immovable property or in extreme cases arrest the individual debtor or such officers in charge of the corporate debtor. The RDDB&FI Act did not envisage a situation where a debtor was genuinely not in a position to fulfil its repayment obligations.

From the above it is evident that the Code allows a creditor to take much swifter actions against the Corporate Debtors as compared to the erstwhile insolvency regime in the country.

***Creditor in 'Possession' regime***

A second reform introduced by the Code is that for the first time in the jurisprudence of Indian insolvency laws, the Creditors are vested with a significant say in the control and management of the corporate debtor if the corporate debtor defaults in its repayment obligations. On the occurrence of such a default, a financial creditor, an operational creditor or the corporate debtor itself may approach the NCLT with an application for initiation of the CIRP. The procedure for these applicants under the Code vary and are primarily as follows:

- **Financial Creditors:** In case of a financial creditor, the moment a default is triggered, the financial creditor can make an application to the NCLT for initiating the CIRP.
- **Operational Creditors:** An operational creditor may, upon the trigger of a default, serve a demand notice or invoice demanding payment on the corporate debtor. If the corporate debtor fails to make such payment within 10 days or fails to notify the operational creditor of an antecedent dispute in relation to the requested payment, the operational creditor can make an application to NCLT along with demand notice/invoice and other documents as prescribed therein.
- **Corporate Applicant:** A corporate applicant includes the corporate debtor (whose CIRP is proposed to be initiated) or its shareholder, management personnel or employees satisfying certain criteria. A corporate applicant may file an application for CIRP upon the trigger of a default and shall along with application submit its books of account and other prescribed documents to initiate the CIRP.

Upon the acceptance of the application by the NCLT and service of the application to the corporate debtor, the NCLT shall by order declare a statutory moratorium of 180 days (extendable to a maximum further period of 90 days in exceptional circumstances) during which period, there is a restriction on: (a) institution/continuation of suits against the corporate debtor; (b) transfer/disposal of assets of the corporate debtor; (c) actions against the corporate debtor or his property under any other law; (d) recovery of property

possessed by the corporate debtor but owned by third parties.

With the initiation of the CIRP, an interim resolution professional (**"Interim RP"**) is appointed whose limited role is to collect claims and manage the affairs of the corporate debtor until the formation of the committee of creditors. It is important to note that the powers of the board of directors of the corporate debtor are suspended once the Interim RP is appointed. All officers and managers of the corporate debtor are required to act on instructions of the Interim RP.

The role of the Interim RP concludes with the formation of the Committee of Creditors (**"COC"**) and the consequent appointment of the Resolution Professional (**"RP"**). The management of the company is subsequently taken over by the RP with careful oversight of the COC. The COC consists only of financial creditors with voting powers commensurate to the extent of financial debt owed to them at the meetings of the COC. The COC is vested with extensive veto powers and matters such as raising of interim finance in excess of the amounts decided by the COC, creation of security over the assets of the company, change in capital structure/ownership interest, undertaking of related party transactions, etc., requires the consent of the COC before such actions can be implemented by the corporate debtor. It is important to note that operational creditors have no voting powers and are mere observers at such meetings. All decisions of the COC are required to be approved by a majority vote of 75% of the voting shares/value of the financial creditors. All the financial creditors collectively form the COC with no distinct classes for secured and unsecured creditors.

It is also noteworthy that the 'creditor in possession' regime is a significant shift from the 'debtor in possession regime' as envisaged under the previously existing insolvency regime in the country. Under the SICA, during the inquiry and later during the preparation and sanctioning of schemes, the board of directors of the corporate debtor continued to remain in control of the corporate debtor. In fact, one of the criticisms of the SICA was that the managerial personnel of the corporate debtor often embezzled the existing assets, thereby eroding the net-worth of the corporate debtor even more. Similarly, the RDDB&FI Act at the most provides for a court-appointed receiver for the management of movable or immovable properties of the debtor. The SARFAESI Act provides for the management of a company to be wielded only by those companies which are registered under the CA 2013 as 'securitisation companies' or 'reconstruction companies'.

From the above, it becomes clear that under the Code, at the first hint of a corporate debtor's extenuating financial condition, its financial creditors begin to have a significant voice in its affairs. The wide powers given to the resolution professional and the COC during the resolution process overcomes the difficulties of the "debtor in possession" regime which placed an unfair advantage in the hands of the borrower who exploited the loopholes in the regime and used delaying tactics to thwart insolvency and recovery proceedings

***Objective criterion for liquidation and/or winding up***

The third reform introduced by the Code was that the Code lay down an objective legal position for the liquidation/winding up of the Company.

The Code provides in the event that: (i) the COC cannot agree on a workable resolution plan within the CIRP Period (i.e. 180 days extendable once by another 90 days); or (ii) the COC decides to liquidate the company; or (iii) the NCLT rejects the resolution plan; or (iv) the corporate debtor contravenes provisions of the resolution plan, the NCLT shall pass an order requiring liquidation of corporate debtor;

However, under the previously existing laws, there were no such objective conditions for the liquidation of companies. Under SICA it was observed that even when the Board for Industrial and Financial Reconstruction (**"BIFR"**)

recommended the liquidation of the corporate debtor, the High Courts were reluctant to effect the liquidation for the simple reason that liquidation of the corporate debtor would render the employees of the corporate debtor jobless. This can also be seen in the cases of *Modi Industries Ltd. vs. Nagar Palika, Modinagar (AIR 2000 All 271 (Allahabad))*, and *Narmada Aluminium Industries Ltd. vs. Appellate Authority ((2005) 3 GLR 2296 (Gujarat))* where even subsequent to the recommendation of the BIFR to liquidate a Corporate Debtor, the High Courts often stayed the proceedings which could be extended indefinitely merely on the grounds that the workers or the managers of the debtor contended during the proceedings that rehabilitation under the SICA Act was possible.

The RDDB&FI Act and the SARFAESI Act do not provide for any elaborate provisions for the winding up/ liquidation of corporate debtor.

From the above, it is evident that the Code provides for the most objective criteria for the initiation of liquidation proceedings against the corporate debtor. Additionally the Supreme Court, in its recent order in the matter of *Lokhandwala Kataria Construction Private Limited vs. Nissus Finance and Investment Managers LLP (Civil Appeal No. 9279 of 2017),* has held that the inherent powers enjoyed by the National Company Law Appellate Tribunal (the **"NCLAT"**) under Rule 11 of the National Company Law Appellate Tribunal Rules, 2016 does not apply to the provisions of the Code.

This would mean while deciding matters under the Code, the NCLT or the NCLAT have no inherent powers to make such orders beyond the express provisions of the Code as could be done by the High Courts under their inherent powers.

***Timebound Resolution***

Another novel reform introduced by the Code is a strict and rigorously time-bound resolution process at every stage of the Code. For instance, the CIRP has to be completed within a period of 180 days from the date the petition got admitted by the NCLT. This period is extendable to a maximum further period of 90 days in exceptional circumstances. The expiry of such date mandatorily triggers the liquidation process under the Code. The NCLAT has, in the matter of *J. K. Jute Mills Co. Ltd. vs. Surendra Trading Co. [CA (AT) No. 09/2017],* held that the time limit prescribed under the Code for initiating liquidation after the expiry of the moratorium period is mandatory.

Furthermore, the Code also allows for a fast track corporate insolvency resolution process which should be completed within a period of 90 days for certain kinds of corporate debtors such as unlisted companies whose total assets as reflected in books of account of the previous financial year is INR 1,00,00,000 or less, a start-up, etc.

Although the SICA did provide for time-bound thresholds, in practice they were extremely inefficient. First and foremost, it was noticed that a petition for investigating a company's financial condition by the BIFR took about a year or so just to get admitted. The BIFR itself estimated that it takes about 5 (five) to 7 years for a company to be revived under SICA.[2] These delays perversely attracted companies to the BIFR primarily because the imposition of moratorium could enable the deferral of repayment obligations.

Additionally, the failure to finalise one resolution plan is sufficient to initiate liquidation process under the Code. However, in terms of SICA, the BIFR may not only modify the sanctioned scheme but also send it for a fresh sanctioned scheme. There is no upper limit on the number of times the BIFR can either modify or send back a sanctioned scheme. Examination of cases such as *Madhu Textiles Ahmedabad Ltd. vs. Official Liquidator ((2006) BC 98)* indicate that in many instances two or more sanctioned schemes are prepared and deliberated by BIFR and the operating agency before eventually proceeding towards liquidation.

The SARFAESI Act does prescribe time-limits on when an appeal can be filed before various appellate authorities. However, it does not

2 www.bifr.nic.in/geninfo.htm>

prescribe any time limit within which the security interest can be enforced. Further the RDDB&FI Act also lays down that the DRT shall endeavour to dispose of the application of the creditor within 180 but the language of the statute itself makes it clear that it is a directory and not a mandatory provision.

In light of the above, strict time-bound procedures which have to be complied with at every stage of the process under the Code are the most unique and also the most important features of the Code.

***Inclusive nature of the legislation***

Lastly, this Code is unique for being an all-encompassing and inclusive piece of legislation. The Code is a comprehensive piece of legislation addressing insolvency/ bankruptcy issues pertaining not just to companies, LLPs (and other limited liability entities) but also to individuals and partnerships. It attempts to streamline the multifarious legislations which were in operation in India in this area and bring all relevant provisions under one common umbrella. However, this was not the scenario in the previous insolvency regime. Only secured creditors could seek refuge under the provisions of the SARFAESI Act. Only banks and financial institutions could proceed against the Corporate Debtor under the RDDB&FI Act and the SICA was applicable only if the Corporate Debtor was in a 'scheduled industry' i.e., any of the industries specified in the First Schedule to the Industries (Development and Regulation) Act, 1951.

From the above-mentioned features, it is evident that the Code has introduced a plethora of sweeping changes which has made it expeditious and efficacious for a creditor to ensure that its interests are protected. The innumerable petitions and appeals entertained before the NCLT and the NCLAT, respectively, and the overbearingly creditor-friendly manner in which the provisions of the Code have been interpreted, are heartening indicators that the Code has indeed rectified the issues and filled the lacunae that existed under the earlier insolvency regime.

## Impact of the Code on other legislations

It is evident from the above that that the sweeping changes introduced by the Code has some far-reaching implications. Aimed at harmonising the existing laws with the new insolvency regime in the country, the Code contains several provisions amending several legislations. Section 245 to Section 255 read with Schedules 1 to 11 elaborately list down various legislations which have been amended by the Code. The CA 2013, the RDDB&FI Act, the Sick Industrial Companies (Special Provisions) Repeal act, 2003 (the **"SICA Repeal Act"**) are just some of the legislations which have been substantially amended by the Code. The detailed analysis of all the legislations which have been amended by the Code are as under:

***SICA Repeal Act***

As has been mentioned above, the SICA was one of the many legislations governing the insolvency regime in India prior to the enactment of the Code. And it was sought to be repealed by way of the SICA Repeal Act long before the enactment of the Code. However, the SICA Repeal Act was never notified and never came into effect until after the Code came into existence. Under Section 3 of the SICA Repeal Act, the BIFR constituted under Section 4 of the SICA and the Appellate Authority for Industrial and Financial Reconstruction (**"AAIFR"**) constituted under Section 5 of SICA became functus officio. Section 4(b) of SICA Repeal Act held that any inquiry of proceedings still pending before BIFR and AAIFR would stand abated. The Code vide Section 252 read with the Eighth Schedule amended this provision. Subsequent to this amendment, when a corporate debtor in respect of which such appeal or reference or inquiry stands abated may make a reference to the NCLT under the provisions of the Code within a period of 180 days of the commencement of the Code. This extends to debts arising out of personal guarantees as was enunciated by the NCLAT in *Schweitzer Systemtek India Private Limited vs. Phoenix Arc Private Limited (Company Appeal (AT) (Insolvency) No. 129 of 2017).* However, if BIFR or AAIFR has already issued an order, then that order is saved under Section 5 of the SICA Repeal Act.

***CA 2013***

The CA 2013 has been amended quite substantially to bring it in symmetry with the Code. These amendments have been made under Section 255 read with the Eleventh Schedule of the Code. Some of the important amendments are listed as under

- Section 2(94a) has been inserted into the CA 2013 to lay down that the term 'winding-up' has an inclusive definition to include not just winding up under the CA 2013 but also liquidation under the Code.
- The entire Chapter XIX containing Sections 253 to 269 and pertaining to revival and rehabilitation of sick companies has been omitted.
- Section 271(a) allowed a creditor to file a petition to wind-up a company for its inability to pay its debts. While, Section 272(b) listed creditors in the list of entities empowered to initiate winding up petitions against the Company. Subsequent to the Code, both these provisions have been omitted. The conclusion of such omissions is that if a Corporate Debtor has defaulted in its repayment obligations, the creditors' recourse is to initiate CIRP under the Code and not to file a petition for winding up the Corporate Debtor as was allowed under prior to the enactment of the Code.
- Section 275 provided that the provisional liquidator or the company liquidator shall be appointed from a panel maintained by the Central Government consisting of chartered accountants, company secretaries, advocates, etc. However, this provision has been amended by the Code. Post this amendment, the liquidators shall be appointed by the NCLT from amongst the panel of resolution professionals registered with the Insolvency and Bankruptcy Board of India (**"IBBI"**) under the provisions of the Code.
- The powers of the NCLT on application of stay of winding-up, as provided under Section 289, has also been omitted
- Additionally, the whole of Part II of Chapter XX (from Sections 304 to 323), dealing with voluntary winding up, has been omitted.
- Section 327 dealing with 'preferential payments' provides for the order of priority in which the debts are discharged. This provision is no longer applicable when liquidation process has been initiated under Chapter III of Part 1 of the Code. The order of priority shall instead be governed under Section 53 of the Code.
- Section 434(d) provides for the abatement of proceedings initiated before BIFR or AAIFR under the SICA. This provision has been omitted, too.
- Along similar lines, the Code has made substantial amendments to provisions in the CA 2013 regarding the transfer of proceedings by effecting amendments to the Companies (Transfer of Pending Proceedings) Rules, 2016 read with Companies (Removal of Difficulties) Fourth Order, 2016. Some of the important developments are as follows
  - All winding-up petitions on the ground of "inability to pay debt" pending before the High Court, where, such petition has not been served on the corporate debtor as per the Company Rules, 1959, shall be transferred to the NCLT and such petitions shall be treated as an application under Sections 7, 8 and 9 of the Code, as the case may be, including details of the proposed insolvency professional.
  - All other winding up petitions filed on any other basis and wherein such petition has not been served upon the corporate debtor as per Rule 26 of the Company Rules, 1959 shall be transferred to NCLT exercising territorial jurisdiction and such

petition shall be treated as petition under the relevant provisions of the CA 2013.

***Central Excise Act, 1944***

- Section 246 of the Code read with the Second Schedule amends the provisions of the Central Excise Act. Section 11E of the Central Excise Act dealt with "first charge over any liability under the Act." Under this section, the first charge over the debtor's liability under the Central Excise Act will be subject to the provisions of Section 529A of CA 2013, RDDB&FI Act and SARFAESI Act. Subsequent to the amendment introduced by the Code, the first charge is also subject to the provisions of the Code.

***Customs Act, 1962***

- Similar to the amendment of the Central Excise Act discussed above, Section 248 of the Code read with the Fourth Schedule amends provisions of the Customs Act, 1962. Section 142A of the Customs Act, 1962 also dealt with "first charge over any liability under the Act" Under this section, the first charge over the debtor's liability under the Central Excise Act will be subject to the provisions of Section 529A of CA 2013, RDDB&FI Act and SARFAESI Act. Subsequent to the amendment introduced by the Code, the first charge is also subject to the provisions of the Code.

***Finance Act, 1994***

- Section 250 of the Code read with the Sixth Schedule amends provisions of the Finance Act, 1994. Section 88 of the Finance Act deals with "first charge over any liability under the Act" Under this section, the first charge over the debtor's liability under the Central Excise Act will be subject to the provisions of Section 529A of CA 2013, RDDB&FI Act and SARFAESI Act. Subsequent to the amendment introduced by the Code, the first charge is also subject to the provisions of the Code.

***Income-tax Act, 1961***

- Section 247 of the Code read with the Third Schedule amends the provisions of the Income-tax Act, 1961. Under Section 178 of the Income-tax Act dealing with "company in liquidation" – the procedure to be followed under Section 178, by a liquidator / receiver of a company being wound up, has now been made subject to the provisions of the Code.

***Limited Liability Partnership Act, 2008***

- Section 254 of the Code read with the Tenth Schedule amends certain provisions of the Limited Liability Partnership Act, 2008. Along the lines of Section 271(a) of the CA 2013, the provisions pertaining to winding up of LLPs for its inability to meet its repayment obligations as provided under Section 64 of the Act has been deleted.

***SARFAESI Act***

- Section 251 of the Code read with the Seventh Schedule amends provisions of the SARFAESI Act. Section 13(9) of the SARFAESI Act provided for enforcement of security interest, where there are multiple secured creditors. Now the applicability of this provision has been made subject to the provisions of the Code, as per Section 251 of the Code.

***Payment and Settlements Act, 2007***

- Section 253 of the Code read with the Ninth Schedule 9 amends certain provisions of the Payment and Settlements Act, 2007. Section 23 of the Act said the Payment and Settlements Act provides for the procedures pertaining to Settlement and netting procedures. Clause 4 of Section 23 provided for non-obstante clause when a system participant has been declared insolvent under the Banking Regulation Act, 1949, CA 2013, etc. Subsequent to the amendment, the Code has been specifically added to the list.

- Section 23A provided for a similar non-obstante clause while dealing with provisions pertaining to protection of funds collected from customers". The Code has been specifically added to the list of provisions included in the non-obstante clause.

In addition to the above-mentioned amendments, the Code has also introduced significant amendments to the RDDB&FI Act and the Indian Partnership Act, 1932. However, it is pertinent to note that these amendments have not been notified yet.

***RDDB&FI Act***

- Section 249 of the Code read with the Fifth Schedule has introduced several amendments to the RDDB&FI Act.
- Section 3(1A) has been inserted to the RDDB&FI Act which empowers the Central Government to establish DRTs and its benches as it may consider necessary to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under the Code. This provision also makes it expressly clear that the DRTs shall act as the Adjudication Authority for the purposes of the RDDB&FI Act.
- Section 17(1A) has been inserted to the RDDB&FI Act which specifically provides that the DRTs shall exercise its jurisdiction, powers and authority to entertain and decide applications pertaining to insolvency of individuals as stipulated in Part III of the Code. Furthermore, Section 17(2A) has also been added to stipulate that the appeals from the DRT pertaining to insolvency of individuals would be entertained and heard by the Appellate Tribunal established under the RDDB&FI Act.

***Indian Partnership Act, 1932***

- Section 245 of the Code read with the First Schedule has introduced amendments to the Indian Partnership Act, 1932.
- Section 41 of the Indian Partnership Act provided for the compulsory dissolution of partnership firm in case all but one of the partners of the firm are declared insolvent. This provision has been omitted.

In addition to effecting amendments in the existing statutes, the Code has also repealed The Provincial Insolvency Act, 1920 and the Presidency Towns Insolvency Act, 1903. These legislations governed the law pertaining to the insolvency of individuals. While the latter was applicable in the cities of Mumbai, Kolkata and Chennai, the former was applicable to the rest of the country. However, both these laws are largely in pari materia with each other. Section 243 of the Code expressly provides that both the above-mentioned statutes stand repealed. However, it is again pertinent to note that this section has not been notified as the provisions of the Code under Part III pertaining to the insolvency of individuals have not been notified yet.

It was evident from the first chapter of this article, that the insolvency regime in the country that existed prior to the Code was a melange of multiple legislations governing different kinds of stakeholders, and providing different kinds of remedies. However, subsequent to the amendments by the Code discussed above, it appears that there is symmetry and harmony between all legislations pertaining to the recovery of outstanding debts. An effective legislation providing for speedy resolution, existing in the milieu of harmonised enabling statutes, is what any economy needs for the smooth and efficacious recovery of outstanding debts by creditors.

CA Udayraj Patwardhan

# Role of Institutional Mechanism of Various Agencies

The Insolvency and Bankruptcy Code, 2016 (Code) is considered as the biggest economic reform as it is a unified and comprehensive piece of legislation for the resolution of insolvency in respect of corporate persons, limited liability partnerships, partnership firms and individuals. The Code was introduced with the primary objective of increasing lender's confidence and facilitating expansion of the credit market in India and balancing the interests of all stakeholders. It offers a market determined, time bound mechanism for orderly resolution of insolvency, wherever possible, and orderly exit, wherever required. It envisages an ecosystem comprising National Company Law Appellate Tribunal (NCLAT), National Company Law Tribunal (NCLT), Debt Recovery Appellate Tribunal (DRAT), Debt Recovery Tribunal (DRT), Insolvency and Bankruptcy Board of India (Board), Information Utilities (IUs), Insolvency Professionals (IPs), Insolvency Professional Agencies (IPAs) and Insolvency Professional Entities (IPEs) for implementation of the Code.

## Role of Insolvency and Bankruptcy Advisor

IPs are licensed professionals registered with Insolvency Professional Agencies who would act as resolution professional/ liquidator/bankruptcy trustee in an insolvency resolution process The IPs are regulated by the Board. They have a critical role in transactions under the Code. The Code and regulations made thereunder provide for strengthening their capacity on a continuous basis. IP's are appointed to sort out situation of financial crisis and in some cases; their main task is to try to rescue a business. The complexity of many insolvency proceedings makes it highly desirable that the insolvency practitioners be appropriately qualified with knowledge of the law. The knowledge should not only be of insolvency law, but also relevant commercial, finance and business law. The absence of participation of insolvency professionals possessing appropriate knowledge and skills can impact the quality and efficiency of the entire process of law makers. Insolvency affects the interests and rights of broad groups – creditors, employees, shareholders and debtors themselves. In the centre of this stands the practitioner who has wide powers, duties, responsibilities and functions.

The provisions of the code of Conduct, qualification, registration with the board etc. are governed by Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016. These Regulations shall come into force on 29th November, 2016.

If IP is not a citizen of India, he cannot render services as an insolvency professional unless he

becomes a partner or director of an insolvency professional entity recognised by the Board under Regulation 13, Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016.

The Code clearly specifies functions and obligations of the Insolvency Professionals. Where any Insolvency Resolution Process, Fresh start, Liquidation, Voluntary Liquidation or Bankruptcy process has been initiated, it shall be the function of Insolvency Professionals to take such actions as may be necessary in the manner provided in the Code.

A recent press release issued by Insolvency and Bankruptcy Board of India (IBBI) has made it imperative that Insolvency Process has to be run by an Insolvency Professional (an individual) and not by an Insolvency Professional entity (IPE).

## Corporate Insolvency Resolution Process/Fast Track Corporate Insolvency Resolution Process

In the corporate insolvency resolution process and Fast track corporate insolvency resolution process, Insolvency Professional plays three roles one as an **Interim Resolution Professional** (**IRP**) and other as **Resolution Professional** (**RP**) and as **Liquidator**, if order to that effect has been passed. IRP is appointed by Adjudicating Authority, if no disciplinary proceedings are pending against him. The committee of creditors may at its first meeting with a majority vote of not less than 75% of the voting share of the financial creditor either resolve to appoint the IRP as an RP or to replace the IRP by another RP. In case where Adjudicating Authority passes a liquidation order, Resolution professional of corporate debtor shall act as the liquidator unless replaced by Adjudicating Authority by another Insolvency Professional.

**IRP shall perform following functions**

- Collect all information relating to the assets, finances, and operations of the corporate debtor for determining the financial position of the corporate debtor.
- IRP shall within maximum 3 days from his appointment, make a public announcement and call for submission of proof of claim
- Receive and collate all the claims submitted by creditors to him pursuant to the public announcement
- Constitute a committee of creditors
- Monitor the assets of the corporate debtor and manage its operations until a resolution professional is appointed by the committee
- File information collected with the information utility
- Take control and custody of any assets over which the corporate debtor has ownership rights as recorded in the balance sheet of the corporate debtor or with information utility or the depository of securities or any other registry that records the ownership of assets

**RP shall perform following functions**

- Preserve and protect the assets of the corporate debtor and continued business operations of the corporate debtor
- Represent and act on the behalf of the corporate debtor with third parties, exercise rights for the benefits of the corporate debtor in judicial, quasi-judicial or arbitration proceedings
- Raise interim finances subject to the approval of the committee of the creditors.
- Appoint accountants, legal or other professionals in the manner as specified
- Maintain an updated list of claims
- Convene and attend all meetings of the committee of the creditors
- Prepare the information memorandum
- Invite prospective lenders, investors and any other persons to put forward resolution plans

- Present all resolution plans at the meetings of the committee of creditors
- File application for avoidance of transactions

**Liquidator shall perform following functions**

- The IP may act as the liquidator and exercise all powers of the BoD
- The liquidator must try to maximise the value of the assets in the most efficient manner of disposal and create a liquidation trust for distribution
- The primary responsibilities of the liquidator are:
  - o to verify claims of all the creditors
  - o to take into his custody or control all the assets, properties, effects and actionable claims of the corporate debtor (CD)
- prepare end file reports with Adjudicating Authority as prescribed
- to take such measures to protect and preserve the assets and properties of the CD
- to carry on the business of the corporate debtor as he considers necessary
- to sell the immovable and movable property and actionable claims by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels in such manner as may be specified
- Institute or defend any suit, prosecution or other legal proceedings, civil or criminal, in the name of on behalf of the corporate debtor
- to investigate the financial affairs of the corporate debtor to determine undervalued or preferential transactions
- The liquidator shall form an estate of the assets, and consolidate, verify, admit and determine value of Creditor's claims
- Distribute the proceeds of liquidation to all the stakeholders
- Apply for dissolution of corporate debtor

## Voluntary Liquidation of Corporate Persons

A corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings. The resolution is to be passed under Regulation 3(2)(c) of Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017 requiring corporate person to be liquidated and appointing **Insolvency Professional to act as a Liquidator.**

## Insolvency Resolution Process

Under Chapter III of Insolvency and Bankruptcy Code, 2016, a debtor who commits a default may apply, either personally or through a **resolution professional,** to the Adjudicating Authority for initiating the insolvency resolution process, by submitting an application. If the application is filed through a resolution professional, the Adjudicating Authority shall direct the Board to confirm that there are no disciplinary proceedings pending against resolution professional and upon confirmation Insolvency Professional shall be appointed as Resolution professional by Adjudicating Authority.

## Bankruptcy Order for Individuals and Partnership Firms

Where an application for bankruptcy of a debtor is made, by a creditor individually or jointly with other creditors or by a debtor, to the Adjudicating Authority under Chapter IV of Insolvency and Bankruptcy Code, 2016, an **Insolvency Professional shall be appointed as Bankruptcy Trustee** by the Adjudicating Authority upon confirmation received Board that there are no disciplinary proceedings pending against such professional. Where a bankruptcy trustee is not proposed by the debtor or creditor, Adjudicating Authority shall direct the Board within seven

days of receiving the application to nominate a bankruptcy trustee for the bankruptcy process.

**The following shall be the duty and functions of Bankruptcy Trustee:-**

- The estate of the bankrupt shall vest with the bankruptcy trustee;
- Register the claims received from creditors and prepare a list of creditors of the bankrupt;
- Call meeting of creditors and shall be convener of the meeting of the creditors
- Conduct the administration and distribution of the estate of the bankrupt

## Role of Insolvency Professional Entity

The term **"Insolvency Professional Entity"** has no mention in the Insolvency and Bankruptcy Code, 2016. Though Insolvency Process has to be run by an Insolvency Professional (an individual) and not by an Insolvency Professional entity (IPE), keeping in mind that the assignment as an Interim Resolution Professional/Resolution Professional would require huge infrastructural support, which may go beyond the capabilities of an individual IP, the provision of IPE are recognised by the Board through Regulation 12, of the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016. The IPs have been enabled to engage other professionals as may be necessary and ***to use organisational resources of an Insolvency Professional Entity*** of which he is a partner or whole time director, as the case may be, for servicing the transactions.

According to Sub-Regulation (1) of Regulation 12, a limited liability partnership, a registered partnership firm or a company may be recognized as an insolvency professional entity if-

(a) a majority of the partners of the limited liability partnership or registered partnership firm are registered as insolvency professionals; or

(b) a majority of the whole-time directors of the company are registered as insolvency professionals, as the case may be.

Thereafter sub-regulation (2) talks about application for recognition, "a person eligible under sub-regulation (1) may make an application for recognition as an insolvency professional entity to the Board in Form C of the Second Schedule to these Regulations. If the Board is satisfied, after such inspection or inquiry as it deems necessary that the applicant is eligible under these Regulations, it may grant a certificate of recognition as an insolvency professional entity in Form D of the Second Schedule to these Regulations.

**An IPE is jointly and severally liable for all acts or omissions of its partners or directors as IPs committed during such partnership or directorship.**

## Role of Information Utility

The Insolvency and Bankruptcy Board of India has notified the Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017 effective 1st April, 2017. The object of regulation is to provide for a framework for registration and regulation of information utilities.

The role of an Information Utility (IU) is to store financial information that helps to establish defaults as well as verify claims expeditiously and thereby facilitate completion of transactions under the Insolvency and Bankruptcy Code, 2016 in a time bound manner. It constitutes a key pillar of the insolvency and bankruptcy ecosystem, the other three being the Adjudicating Authority (National Company Law Tribunal and Debt Recovery Tribunal), the IBBI and Insolvency Professionals.

## Provision of services

As per Regulation 17 of Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017

1. An information utility shall provide-
   (a) **core services;***
   (b) other services under these Regulations; in accordance with the Code.
2. An information utility may provide services incidental to the services under sub-regulation (1), with the permission of the Board.
3. An information utility shall comply with the applicable Technical Standards, while providing services.

**As per section 3, sub-section 9 of Insolvency and Bankruptcy Code, 2016 "core services" means services rendered by an information utility for—*

*a) accepting electronic submission of financial information in such form and manner as may be specified;*

*b) safe and accurate recording of financial information;*

*c) authenticating and verifying the financial information submitted by a person; and*

*d) providing access to information stored with the information utility to persons as may be specified;*

## Registration of Users

As per Regulation 17 of Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017,

1. A person shall register itself with an information utility for-
   (a) submitting information to; or
   (b) accessing information stored with any of the information utilities.
2. The information utility shall verify the identity of the person under sub-regulation (1) and grant registration.
3. Upon registration of a person under sub-regulation (2), the information utility shall intimate it of its **unique identifier**.
4. A person registered once with an information utility shall not register itself with any information utility again.
5. An information utility shall provide a registered user a functionality to enable its authorised representatives to carry on the activities in sub-regulation (1) on its behalf.
6. An information utility shall-
   (a) maintain a list of the
      (i) registered users;
      (ii) the unique identifiers of the registered users; and
      (iii) the unique identifiers assigned to the debts under Regulation 20.
   (b) make the list under clause (a) available to all IU and the Board.

## Use of different information utilities

As per Regulation 19 of Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017,

1. A registered user may submit information to any information utility.
2. Different parties to the same transaction may use different information utilities to submit, or access information in respect of the same transaction.
3. A user may access information stored with an information utility through any information utility.

## Information of default

As per Regulation 19 of Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017,

1. On receipt of information of default, an information utility shall expeditiously undertake the processes of authentication and verification of the information.
2. On completion of the processes of authentication and verification under sub-regulation (1), the information utility shall communicate the information of default, and the status of authentication to registered users who are-
   (a) creditors of the debtor who has defaulted;
   (b) parties and sureties, if any, to the debt in respect of which the information of default has been received.

## Access to Information

An information utility shall allow the following persons to access information stored with it-

- the user which has submitted the information;
- all the parties to the debt and the host bank, if any, if the information is of the categories in section 3 (13) (a), (c) and (d);
- the corporate person and its auditor, if the information is of the categories in section 3 (13) (b) and (e);
- the insolvency professional, to the extent provided in the Code; the Adjudicating Authority; the Board;
- any person authorised to access the information under any other law; and
- any other person who the persons referred to in (a), (b) or (c) have consented to share the information with.

An information utility shall in all cases enable the user to view-

- the date the information was last updated;
- the status of authentication; and
- the status of verification while providing access to the information.

**An information utility shall provide information to the Adjudicating Authority and Board free of charge.**

## Technical Standards

The regulations enable the IBBI to lay down Technical Standards, through guidelines for the performance of core services and other services by IUs. Technical Standards shall inter-alia provide for matters relating to -

- authentication and verification of information to be stored with the IU,
- registration of users,
- data integrity and security,
- porting of information,
- inter-operability among information utilities etc.

**In order to safeguard the interests of the user, the regulations require-**

- Information Utility to have a grievance redressal policy as well as an exit management plan;
- to have a compliance officer who shall ensure compliance with the provisions of the Code and shall, immediately and independently, report to the IBBI any non-compliance of any provision of the Code observed by him.
- An information utility may constitute a Regulatory Committee from amongst the independent directors.
- The Regulatory Committee, if constituted, shall oversee the information utility's compliance with the Code.
- The compliance officer shall report to the Regulatory Committee, wherever constituted.


CA S. R. Jariwala & Ami Jain, *Advocate*

# Initiation of Corporate Insolvency Resolution Process and application before NCLT

The advent of the Insolvency and Bankruptcy Code (IBC), 2016, for initiation of insolvency proceedings in respect of corporates (limited liability entities such as companies incorporated under the Companies Act and Limited Liability Partnerships, has, at its core, the innovative concept of resolution of debts of a corporate debtor. The Code is largely financial creditor-driven and is a time-bound process of tackling insolvency, culminating either in the approval of a resolution plan for the debtor for discharging all its debts or its liquidation. By empowering insolvents and/or their creditors to initiate a corporate insolvency resolution process (CIRP) in the event of a default, the Code aims to prune the time taken in various Court proceedings either for the resolution / recovery of debts of such a company or its liquidation to *inter alia* ensure quick deployment of funds.

IBC consolidates various laws relating to corporate insolvency that were hitherto spread across various legislations / Courts / jurisdictions such as the Sick Industrial Companies (Special Provisions) Act (SICA), 1985; Companies Act 1956 / 2013; the Recovery of Debts Due to Banks and Financial Institutions Act, 1993; the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, etc.

## Object of IBC vs. SICA

The object of IBC is distinct from that of its predecessor – SICA, 1985. While IBC focuses on the resolution of a corporate debtor's debts in the event of a default of ₹ 1 lakh or more, SICA was concerned with the expeditious revival / rehabilitation of sick industrial companies whose net worth was completely eroded by its accumulated losses at the end of a financial year. Resolution of debts in a time-bound manner under IBC has given a massive fillip to creditors who were heretofore required to wait indefinitely for the recovery of their dues. But it is devoid of the heart and soul of SICA in the form of revival measures which were available to sick companies in the form of reliefs and concessions from various statutory and other governmental agencies to aid its rehabilitation. The inclusion of such measures under IBC would have allowed the Code to provide a holistic solution to corporates that need to be resuscitated as well while tackling their financial obligations.

## Application to adjudicating authority

Under IBC, any financial or operational creditor who has to recover a debt of ₹ 1 lakh or more [Section 4(1)], which is due and payable by a corporate and in default, may file an application with the concerned National Company Law

Tribunal (Adjudicating Authority), in the prescribed format along with the specified fee. Alternatively, the corporate debtor can itself file an application if it is in default of an amount of ₹ 1 lakh or more to its creditor. The minimum threshold amount of default of ₹ 1 lakh must be proved by such a creditor / corporate applicant and should be within the limitation period (as observed in various judgments) to be eligible for admission. The chart below explains in a tabular format the persons eligible to file an application under IBC for the initiation of the CIRP, which may be read with *The Insolvency and Bankruptcy (Application to Adjudicating Authority Rules), 2016:*

| Sr. No. | Creditor | Section | Rule | Form | Fee (In ₹) |
|---|---|---|---|---|---|
| 1. | Financial Creditor (whether solely or jointly) | 7 | 4 | 1 | 25000.00 |
| 2. | Operational Creditor | | | | |
| | Must first deliver | | | | |
| | - Demand Notice | 8 | 5 | 3 | NIL |
| | OR | | | | |
| | - Invoice attached to notice | 8 | 5 | 4 | NIL |
| | If the amount is not disputed or settlement amount is not received from corporate debtor in 10 days, Operational Creditor may file an application | 9 | 6 | 5 | 2000.00 |
| 3. | Corporate Debtor | 10 | 7 | 6 | 25000.00 |

An application by the persons mentioned above may be made to NCLT along with other documents / information, as may be specified, which must be admitted (unless rejected) by NCLT within 14 days to enable the CIRP to be concluded in a time-bound manner, i.e., 180 days or the maximum extended time of 270 days from the date of admission of the application. Withdrawal of an application is permitted only before admission of the application by NCLT and not thereafter, as the Code is silent on the same. This aspect is repeatedly coming to the fore and may necessitate an amendment, especially in cases where the corporate debtor settles the amount due and payable to its concerned creditor post-admission and wishes to seek discharge from the purview of the Code. NCLT and its appellate body, the National Company Law Appellate Tribunal (NCLAT), have expressed the lack of any inherent power in this regard. The Hon'ble Supreme Court has, however, utilised its power under Article 142 of the Constitution recently to take on record consent terms entered into between the creditor and the corporate debtor [order dated 24-7-2017 in Civil Appeal No. 9279 of 2017 in re: Lokhandwala Kataria Construction Pvt. Ltd., Appellant(s) vs. Nisus Finance and Investment Managers LLP, Respondent] and also to dispose of the pending proceeding before NCLT on acceptance of the settlement [order dated 28-7-2017 in Civil Appeal No. 9286 of 2017 In re: Mothers Pride Dairy India Pvt Ltd, Appellant(s) vs. Portrait Advertising and Marketing Pvt Ltd, Respondent(s)].

## Application by Financial Creditor [Section 7]

In terms of Section 5(7) of IBC, a 'financial creditor' means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to. 'Financial debt', in turn, means a debt along with interest, if any, which is disbursed against the consideration for the time value of money [Section 5(8)]. In terms of Section 7 of IBC, a financial creditor either by itself or jointly with other financial creditors may file an application for initiating CIRP against a corporate debtor in the event of a default before the NCLT having territorial jurisdiction over the place where the registered office of the corporate debtor is located.

An application by a financial creditor must be complete in all respects for it to be admitted by NCLT and must be accompanied by (a) a record of the default recorded with the information utility or such other record or evidence of default as may be specified; (b) provide the name of the resolution professional (RP) proposed to act as an interim resolution professional (IRP); and (c) any other information as may be specified by the Insolvency and Bankruptcy Board of India (IBBI), the regulatory body that is *inter alia* responsible for implementing the Code and regulating insolvency professionals. On receipt of an application by a financial creditor, the NCLT must, within 14 days, ascertain the existence of a default from the records of an information utility or evidence provided by the financial creditor. If the NCLT is satisfied that a default has occurred and the application is complete, and there is no disciplinary proceedings pending against the proposed resolution professional, it may, by an order, admit such application. Alternatively, if it is satisfied that a default has not occurred or the application is incomplete or any disciplinary proceeding is pending against the proposed resolution professional, it may reject such an application after giving a notice to the applicant to rectify the defect in the application within seven days.

## Application by Operational Creditor [Sections 8 & 9]

An 'operational creditor', [Section 5(20)], means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred. An 'operation debt' [Section 5(21)], means a claim in respect of the provision of goods or services including employment or a statutory debt in respect of the repayment of dues arising under any law for the time being in force. A different process is proposed for an application by an operational creditor under IBC, in that, such a creditor has to first deliver a demand notice of unpaid debt on the corporate debtor or attach an invoice with a notice demanding payment. On receipt of either notice, a corporate debtor is required to bring the following to the notice of the operational creditor, within a period of 10 days:

(a) existence of a dispute, if any, and pendency of any suit or arbitration proceedings filed before the receipt of such notice or invoice in relation to such dispute; or

(b) the repayment of unpaid operational debt by sending proof of such repayment by the corporate debtor.

After the expiry of the said period of ten days, if the operational creditor does not receive either the payment from the corporate debtor or notice of dispute, it may file an application before NCLT for initiating the CIRP. The application form shall be accompanied by (a) a copy of the demand notice or invoice attached with the notice demanding payment; (b) an affidavit that the operational creditor has not received any notice of a dispute for the unpaid debt; (c) a certificate from the bank / institutions with which the operational creditor maintains its accounts, confirming that there is no payment of the debt; and (d) any other information as may be specified. The operational creditor, unlike a financial creditor and the corporate debtor, may or may not propose the name of a RP to act as an IRP. NCLT must, within 14 days of the receipt of the application, either admit the application if it is complete; there is no repayment of the unpaid operational debt; the invoice or notice for payment has been delivered to the corporate debtor; no notice of dispute has been received by the operational creditor; and if there is no disciplinary proceeding pending against any resolution professional proposed. Alternatively, NCLT may reject the said application if such an application is incomplete; repayment of the debt has been made; the creditor has not delivered the invoice or notice for payment to the corporate debtor; there is a dispute and notice has been received by the operational creditor or if any disciplinary proceeding is pending against any proposed RP. Once again the NCLT is required to give notice to the applicant to rectify its

application within seven days before rejecting the same.

Instances of conflicting judgments by different benches of NCLT have arisen with respect to the interpretation of the term 'dispute' as corporate debtors were prone to raising frivolous disputes on receipt of a demand notice u/s. 8 of IBC to stave off proceedings under the said Code. The Hon'ble NCLAT's judgment in the matter of *Kirusa Software Pvt Ltd vs. Mobilox Innovations Pvt. Ltd. [Company Appeal (AT) (Insolvency) 6 of 2017]* appears to have settled the issue by holding that the scope of existence of a dispute includes any dispute raised prior to Section 8 in relation to clause (a) or (b) or (c) of Section 5(6). Such a dispute must be raised in a court of law or authority and proposed to be moved before the court of law or authority and should not be any malafide dispute just to stall the insolvency resolution process.

## Application by Corporate Applicant [Section 10]

A corporate debtor can itself file an application in the event of a default of a debt due of ₹ 1 lakh or more under Section 10 of IBC. The corporate applicant shall provide information relating to its books of account, other relevant information and propose the name of the RP to be appointed as an IRP. The NCLT shall thereafter, within 14 days of the receipt of the application, either admit the application, if it is complete; or reject the same if it is incomplete, after giving an opportunity to the applicant to rectify the defects within seven days.

A recent judgment of the Hon'ble NCLAT (dated 11-8-2017) in the matter of *Neelkanth Township & Construction Pvt. Ltd. vs. Urban Infrastructure Trustees Ltd. [Company Appeal (AT) (Insolvency) No.44 of 2017]* has come to the rescue of numerous creditors with time-barred debts. The Hon'ble NCLAT has categorically held that there in nothing on record that the Limitation Act is applicable to IBC as the Code relates to the initiation of CIRP and is not an Act for recovery of money claim/s.

## Companies registered with BIFR

With the repeal of SICA, 1985, proceedings of companies that were formerly registered with the Board for Industrial & Financial Reconstruction (BIFR) and the appellate body –AAIFR – stood abated w.e.f. 1st December, 2016. An amendment was carried out by Section 252 of IBC to Section 4(b) of the SICA Repeal Act, 2003, (as given in the Eighth Schedule of IBC) which gave an option to such companies to file a reference to NCLT under the provisions of IBC within 180 days, i.e. up to 29-5-2017, without the payment of any fee. The said provision, however, appears to have been carried out without true application of mind, given that the provisions of SICA and IBC are distinct and different.

## Corporate Insolvency Resolution Process

The fulcrum of IBC is the insolvency resolution process for the corporate debtor which commences [Section 5(12)] on the date of admission of the application by NCLT. Simultaneous with the admission of the application, NCLT approves the appointment of an Insolvency Professional to act as an IRP, who is vested with the powers of the Board of Directors of the corporate debtor following suspension of the powers of the Board of Directors. The CIRP under IBC envisages handing over the entire control and command of the corporate debtor to the IRP for the first 30 days, followed by the RP, both of whom are entrusted with the task of running the company as a going concern [Section 20(1)]. IRPs / RPs are professionals such as chartered accountants, cost accountants, company secretaries, advocates, etc. who are registered with IBBI through an Insolvency Professional Agency and appointed to conduct the CIRP [Sec 5(27)]. The entire course of CIRP is insulated by a moratorium [Section 14] that prohibits the institution and / or continuation of suits and legal proceedings against the corporate debtor on and from the date of the commencement of CIRP, including

action for foreclosure, recovery or enforcement of security interest against the corporate debtor under the laws available in the country and also SARFAESI, while restricting the corporate debtor from selling its assets. It is pertinent to state that the said moratorium on suits / proceedings is only with respect to the corporate debtor and not its guarantors, as held by the Hon'ble NCLT, Mumbai, in the matter of *Schweitzer Systemtek India Pvt. Ltd. [TCP No.1059/2017].* It may be stated that under SICA guarantees, too, enjoyed legal immunity. The IRP / RP is guided by the *Insolvency and Bankruptcy Board of India {Insolvency Resolution Process for Corporate Persons) Regulations, 2016.* The Code also envisages a fast-track insolvency resolution process for certain companies which is to be concluded within a period of 90 days for which the method is set out in the *Insolvency and Bankruptcy Board of India (Fast Track Process for Corporate Persons) Regulations, 2017.*

The Code also allows an investigation / inquiry by the RP or liquidator into the transactions undertaken by the corporate debtor for the previous two years / one year to identify preferential transactions; undervalued transactions; transactions defrauding creditors; extortionate transactions, etc. [Sections 43 to 51] and provides for harsh penalties for any such offences [Sections 68 to 77].

The CIRP envisages that the RP invite potential investors, applicants to present a resolution plan for the resolution of debts of a corporate debtor by providing such applicants with an information memorandum, as discussed below.

## Responsibilities of IRP

The IRP shall *inter alia* have the responsibility of making a public announcement regarding the initiation / commencement of the insolvency resolution process for a corporate debtor in two newspapers and call for claims of all financial and operational creditors, including workers, in the prescribed format within 14 days. Such an announcement is also published on the websites of the corporate debtor and IBBI. He is further assigned with the task of taking into his custody the books of accounts of a corporate debtor; ascertaining the assets and liabilities of the corporate debtor; verifying and determining the claims received from the financial and operational creditors of the corporate debtor; verifying the payments made by the corporate debtor to its financial and operational creditors, among others, in the previous two years; constituting the Committee of Creditors (CoC) comprising of financial creditors or of operational creditors in the absence of financial creditors; appointing registered valuers for ascertaining the liquidation value of the corporate debtor; preparing the information memorandum with respect to the corporate debtor for the CoC and prospective resolution applicants to enable them to present a resolution plan, etc. The IRP is also required to report the constitution of CoC to NCLT within 30 days from his appointment and hold the first meeting of CoC within seven days thereof. On 16th August, 2017, IBBI amended the regulations by inserting Regulation 9A to the insolvency resolution regulations to facilitate submission of claims by creditors other than financial and operational creditors.

The tenure of the IRP is for a period of 30 days [Section 16(5)], whereafter he is either to be appointed as the RP or to be replaced by another RP by the CoC at their first meeting [Section 22(2)]. On appointment, the RP is required to continue the entire CIRP and manage the operations of the corporate debtor while exercising the same powers and performing the same duties as the IRP [Section 23].

## Resolution Plan

With the spotlight on resolution of debts under IBC, the RP is vested with the authority to invite potential resolution applicants to prepare and submit resolution plans for a corporate debtor. On receipt of such resolution plan/s, the RP is required to verify the same to ensure that it conforms with the provisions of Section 30(2)

of IBC read with Regulation 37 of insolvency resolution regulations before submitting such plans to the CoC for its approval by a minimum of 75% of the financial creditors in value / voting share and thereafter to NCLT for its approval. Once the NCLT is satisfied that the resolution plan meets the pre-requisites set out in Section 30(2), it shall by order approve the resolution plan [Section 31(1)] which shall be binding on all concerned. The approval of a resolution also ends the moratorium order passed u/s. 14. Strict provisions have been made in the Code for wilfull violation of the moratorium and resolution plan by any party [Section 74].

A resolution plan may contain various provisions for its implementation while containing certain mandatory requirements such as identification of the source of funds for the payment of (a) the insolvency resolution process costs in priority to any other creditor; (b) liquidation value due to operational creditors and its payment in priority to any financial creditor before the expiry of 30 days of the approval of the resolution plan by NCLT; and (c) liquidation value to the dissenting financial creditors before any recoveries are made by the financial creditors who voted in favour of the resolution plan. Further, the RP must ensure that a resolution plan provides for the term of the plan and its implementation schedule; the management and control of the business of the corporate debtor; and adequate means for supervising its implementation [Regulation 38]. Under IBC, a resolution plan is beneficial in cases where the liabilities exceed the assets and can provide for restructuring of creditors' dues other than the dues of financial creditors based on the liquidation value. Further, the process of approving a resolution plan has been made less cumbersome by doing away with the consent of all operational creditors, shareholders, workers, etc. The liquidation value, which is arrived on the basis of the valuation report of two registered valuers, is expected to help creditors ascertain the amount they can expect under a resolution plan. An endeavour must also be made by a resolution applicant to submit the resolution plan one month before the conclusion of the CIRP period to facilitate discussions on the same within the overall time frame.

However, the Code lacks the holistic approach of a revival scheme under SICA which provided for reliefs and concessions from various parties, including government authorities, which genuinely enabled the rehabilitation of a sick company. Mere resolution of debts may not always help a corporate debtor sustain itself on a long-term basis as it also needs additional relief, either fiscal or non-fiscal, for restoration of its financial viability. The first resolution plan approved by the Hon'ble Hyderabad NCLT by its order dated 2-8-2017 in the matter of *Synergies-Dooray Automotive Ltd.* [CP(B) No. 01/HDB/2017] provides for a host of reliefs and concessions from various statutory authorities which, in the opinion of the authors, may not be sustained in law. One may take a stand that as the Code contains a *non-obstante* clause under Section 238, the provisions shall prevail over other laws and therefore such reliefs and concessions can be granted without the consent of the statutory authorities. The authors are unable to agree with this view as a *non-obstante* clause can only operate if there is a genuine inconsistency between IBC and a prevailing law operating in the same field. One cannot be allowed to create an inconsistency when none exists. Only time may answer when the said decision is judged on the touchstone of sustainability in a competent court of law.

The Hon'ble Supreme Court's judgment dated 31-8-2017 in the matter of *Innoventive Industries Ltd vs. ICICI Bank & Anr [Civil Appeal Nos. 8337-8338 of 2017]* may throw some light on the issue as the aforementioned order of Synergies-Dooray is likely to be challenged before the Hon'ble NCLAT, according to news reports..

## Liquidation of Corporate Debtor

In the event no resolution plan is received or such a plan is rejected by NCLT or if the CoC decides to liquidate a corporate debtor even prior to the completion of the insolvency resolution process

period, the NCLT must pass an order to liquidate such a company [Section 33] and ultimately order its dissolution. The violation of such a resolution plan can also be a ground to seek a corporate debtor's liquidation. Such an order will serve as a notice of discharge to the officers, workers and employees of the corporate debtor and the RP is appointed as the liquidator to dispose of the assets of the company for maximum recovery in a time-bound manner before such a corporate debtor is finally dissolved [Section 54].

### Committee of Creditors

The CoC holds the reins of the corporate debtor in its hands post-admission as every significant decision regarding the CIRP / liquidation is taken by a majority of not less than 75% of the voting share of the said committee [Section 21(8)]. Under IBC, wide powers have been conferred on the CoC, most of which are set out in Section 28. The CoC shall comprise financial creditors – both secured and unsecured (barring related parties) and, in the case of a company having no financial creditors, the 18 largest operational creditors. As mentioned above, the CoC approves the resolution plan with requisite majority, which is then placed before NCLT for its approval. The submission of a resolution plan is open to all parties and is not restricted to the corporate debtor alone. Any resolution plan must at least provide for payments to the creditors in consonance with what they would receive in the event the corporate debtor were to be wound up, i.e. as per the liquidation value, a new concept that will render it easier to resolve debts. An interesting feature of IBC is the subordination of the debts of the statutory authorities to the debts of unsecured financial creditors.

## AUTHORS' VIEWPOINT

### Code's Weaknesses

- The provisions of the Code appear to be harsh on the corporate debtor and its management with its control being handed over to an insolvency professional, even though temporarily. Such an exercise can, in certain cases, debilitate a company's performance as the time provided to the incoming IRP / RP to familiarise himself with the management and operations is very brief. Further, the lack of adequate experience may dent the corporate debtor's credibility in the market and have an adverse impact on its sustainability on commencement of insolvency proceedings. The erstwhile SICA offered a better alternative through the appointment of a Special Director to the board, without requiring the suspension of powers of all the existing directors.
- The ratio of number of insolvency professionals to the number of limited liability entities is extremely low at this juncture and could have a negative impact in future as well given that the Code has opened a new arena for all kinds of creditors. The Hon'ble Hyderabad NCLT's recent observation in the matter of Lanco Infratech Ltd, observing that an insolvency professional should handle no more than two matters may severely hamper the implementation of the Code.
- While the Code is open to financial and operational creditors, the balance of convenience is in favour of financial creditors, secured or unsecured, who are the biggest beneficiaries in insolvency proceedings as every significant decision, including the approval of a resolution plan, requires only their vote.
- Another lacuna that comes to the fore is the lack of a provision under the Code for the modification of a resolution plan once approved, making it absolutely rigid. It is trite to state that no one can possibly foresee the future and any change in any party's circumstances may make it difficult for the corporate debtor to implement the resolution plan in toto or in its original form. Modification of such a

plan and provision for reliefs and concessions can help make the Code more effective.

- The Code casts an onerous responsibility on the corporate debtor who has more obligations than privileges. Further, the Code does not provide an exit option to a corporate debtor post-admission even if an applicant's / creditors' debt is settled and paid by it before a resolution plan.

- Another hitch in the Code is the burden of expenses that are to be borne and paid by the applicant during the first 30-day process post-admission. It must be appreciated that a creditor, who is already reeling from the lack of recovery of his money, is made to bear the brunt of not only filing the application fee but also costs of the IRP and other related costs in the first month until and if the CoC decides to ratify it at the first meeting, in which case it will be termed as the 'insolvency resolution process cost' (Regulation 31) and will be given foremost priority under a resolution plan or in the distribution of liquidation proceeds. The expenses on the public announcement shall not form part of insolvency resolution process costs. Such expenses are indeed uneconomical for a creditor, especially operational creditors, who are being subjected to said cost for being proactive while benefiting an indolent financial creditor who will receive the monies in priority under a resolution plan / liquidation of such a corporate debtor. Further, if the CoC decides not to ratify the expenses, such an expense is a complete loss for the creditor-applicant. It would have been prudent to split the expenses pro-rata amongst all creditors instead of burdening the creditor-applicant. A peculiar situation arises when the corporate debtor itself is the applicant and the expenses are not ratified by the CoC. It is difficult to fathom the generation of revenue for meeting the expenses by the applicant is such cases.

- The duration of 180 days (or when extended to 270 days) is extremely short for resolution of debts of a corporate debtor given the complexities involved in terms of different agencies and multifarious laws, especially when out of the said period, 30 days get consumed even before the CoC's first meeting is convened and the resolution plan which is prepared in accordance with the Code and the regulations is required to be submitted to RP 30 days before expiry of the maximum period permitted u/s. 12 for the completion of CIRP. A longer period may help ease the pressure on insolvency professionals, creditors and also NCLTs.

- The Code further ought to have provided for an automatic extension of the IRP as RP under Section 22(2) in the event the CoC fails to either confirm his appointment or his replacement by another RP by 75% of the voting share. An automatic extension must also be put in place until the NCLT receives confirmation from IBBI regarding the appointment of a new RP. The Hon'ble NCLT, Mumbai, has had to intervene in a few matters (CP No.1042/(MAH)/2017 in P&S Jewellery Ltd and CP No. 31/I&BP/2017 In re: *Bank of India vs Gupta Coal India Pvt Ltd)* and direct the IRP to continue as an RP until receipt of confirmation from IBBI. The authors feel that the need to send the new RP's name to IBBI ought to be done away with in order to save on time.

The above are just some observations of the authors based on practical difficulties that have arisen thus far. The success or otherwise of the law will be known over a period of time, as it evolves through judicial interpretation and practice.


CA Paras K. Savla & CA Priti P. Savla

# Liquidation of Corporate Person

*"Oh how wrong we were to think immortality meant never dying"*

*— Gerard Way*

The objective of the Insolvency and Bankruptcy Code is to handle revival, reorganization and insolvency resolution of the business ventures, which failed, rapidly and swiftly. The code provides resolution in a time bound manner and first step for such business is to revive. But, if revival is not possible in a time bound manner, the code provides for the corporate death i.e. liquidation. Thus, the entrepreneurs and lenders will be able to move on, instead of being bogged down with decisions taken in the past. Further, it was also felt that the winding up provisions of the Companies Act, 1956 have neither been able to aid recovery for lenders nor aid restructuring of firms. It is said that capitalism without bankruptcy is like Christianity without hell.

Liquidation process of Corporate Debtor (CD) is contained in Chapter III of Part II of the Code (Sections 33 to 54) and Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2017. Relevant sections and regulations were notified on 15-12-2016.

## Liquidation order

It is provided that Adjudicating Authority (AA) i.e. National Company Law Tribunal (NCLT) shall pass order for liquidation of CD if –

- Resolution plan is not received within the permitted period/extended period of corporate insolvency resolution process (CIRP) or fast track CIRP
- Resolution plan is not accepted by NCLT
- Resolution professional intimates NCLT that the Committee of Creditors (COC) has decided to liquidate CD
- Approved Resolution plan is contravened by the CD

NCLT shall reject resolution plan if resolution plan as approved by the COC is not as per the provisions of section 30(2). Section 30(2) provides that resolution plan –

- provide for payment of insolvency resolution process cost
- provide for the debts of operational creditors
- provide for management of the affairs of CD
- provide for implementation and supervision of the resolution plan
- is not in contravention of provision of law
- confirms requirements as specified by Insolvency & Bankruptcy Board of India (IBBI)

Recently NCLT has passed order for liquidation in case of couple of companies after the borrowers and lenders failed to come up with a plan to revive operations.

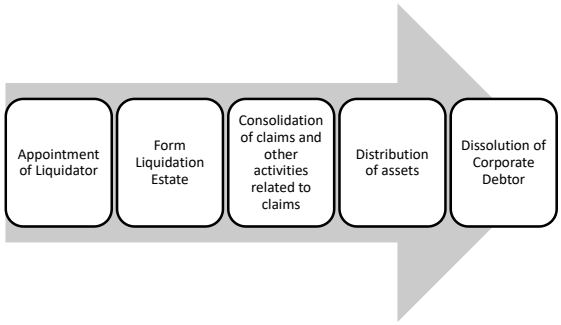
## Impact of liquidation order

On passing of liquidation order

- No suit or other liquidation proceeding shall be instituted by or against the CD. However, liquidator can institute suit or other legal proceedings on behalf of CD with prior permission from NCLT.
- Liquidation order shall be deemed to be notice of discharge to the officers, employees and workmen of the CD, except when business of CD is continued during the liquidation process by liquidator.

## Liquidation process

Liquidation of corporate debtor would involve following steps:




## 1 Liquidator

### 1.1 Appointment

On passing the order of liquidation, resolution professional appointed during CIRP shall act as liquidator unless replaced by Adjudicating Authority. Adjudicating Authority shall replace resolution professional if resolution plan submitted by the resolution professional was rejected since it was not as per the law or Insolvency and Bankruptcy Board of India (IBBI) recommends for the replacement for reasons to be recorded in writing. The liquidator on his appointment needs to give the public announcement in a specified form. The liquidator is required to be an independent to CD. He is said to be independent if he is entitled to appointed as an independent director of the company or not related to CD or not an employee or proprietor or a partner of firm of auditors / Company Secretary / Cost auditors of the CD in last 3 years or not an employee or proprietor or a partner of firm of legal or a consulting firm, that has or had any transaction with the CD contributing 10% or more of the gross turnover of such firm in last three years. The liquidator shall disclose his pecuniary or personal relationship with the CD to IBBI as soon as he becomes aware of it. Further Insolvency Professional shall not continue as a liquidator if the Insolvency Professional Entity (IPE) of which he is a director or partner, or any other partner or director of such IPE represents any other stakeholder in the same liquidation process. It is not clarified whether auditors would mean statutory auditors only or would also cover internal auditor or tax auditors.

The liquidator shall assume the power of the board of directors or partners of CD and key managerial person and they shall cease to have any effect. Personnel of the CD shall extend all assistant to the Liquidator. Liquidators fees shall form part of liquidation cost. His fees are fixed by the IBBI and it is as a percentage to amount realise / distributor and shall be paid over the period of time.

### 1.2 Powers, duties and functions

Section 35 of the code lays down various powers and duties of the liquidator. The liquidator shall be required to complete books of account of CD in case they are incomplete on the liquidation date. He shall be required to maintain specified books of account and registers and same shall be preserved for 8 years after the dissolution of CD. Regulations also provide for the form of books and registers that are required to be maintained. The liquidator shall also appoint

various professional who can assist him in the discharging of his duties, obligations and functions. However such professional should not be a relative of the liquidator or related to CD or has served as auditors in 5 years preceding the liquidation commencement date. The liquidator shall also be entitled to carry consultation with various stakeholders. However, consultation shall not be binding on liquidator. Details of the consultation shall be maintained in a prescribed form and shall be made available to all stakeholders. The liquidator shall also have a power to access information, which is maintained with information utility, credit information system, any Government agencies, etc. Liquidator is required to prepare and submit various reports viz. preliminary report, asset memorandum, progress report, sales report, final reports etc. at regular intervals. Regulations prescribe contents of these reports.

## 2. Liquidation estate

2.1 Liquidator for the purpose of liquidation shall form estate of liquidation and he shall hold estate in a fiduciary capacity for the benefit of creditors. Liquidation estate shall comprise of following –

(a) any assets over which the corporate debtor has ownership rights, including all rights and interests therein as evidenced in the balance sheet of the corporate debtor or an information utility or records in the registry or any depository recording securities of the corporate debtor or by any other means as may be specified by the Board, including shares held in any subsidiary of the corporate debtor;

(b) assets that may or may not be in possession of the corporate debtor including but not limited to encumbered assets;

(c) tangible assets, whether movable or immovable;

(d) intangible assets including but not limited to intellectual property, securities (including shares held in a subsidiary of the corporate debtor) and financial instruments, insurance policies, contractual rights;

(e) assets subject to the determination of ownership by the court or authority;

(f) any assets or their value recovered through proceedings for avoidance of transactions in accordance with this Chapter;

(g) any asset of the corporate debtor in respect of which a secured creditor has relinquished security interest;

(h) any other property belonging to or vested in the corporate debtor at the insolvency commencement date; and

(i) all proceeds of liquidation as and when they are realised.

2.2 However following assets shall not form part of the liquidation estate:

(a) assets owned by a third party which are in possession of the corporate debtor, including—

  (i) assets held in trust for any third party;

  (ii) bailment contracts;

  (iii) all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund;

  (iv) other contractual arrangements which do not stipulate transfer of title but only use of the assets; and

  (v) such other assets as may be notified by the Central Government in consultation with any financial sector regulator;

(b) assets in security collateral held by financial services providers and are subject to netting and set-off in multilateral trading or clearing transactions;

(c) personal assets of any shareholder or partner of a corporate debtor as the case may be provided such assets are not held on account of avoidance transactions that may be avoided under this Chapter;

(d) assets of any Indian or foreign subsidiary of the corporate debtor; or

(e) any other assets as may be specified by the Board, including assets which could be subject to set-off on account of mutual dealings between the corporate debtor and any creditor.

## 3. Claims

3.1 Liquidator on its appointment, shall receive and collect claims from creditors in proscribed form along with necessary proof, within a period of 30 days from the date of the commencement of the liquidation process. Creditors have been classified into various categories viz.

a. Financial creditors

b. Operational creditors

c. Workmen and employees

d. Others

Secured creditors shall prove his security interest on the basis of the information available in the information utility, certificate of registration of charge with Registrar of Companies or Central Registry of Securitisation Assets Reconstruction and Security in Interest of India.

The liquidator may call for such information as he may deem fit from a claimant for substantiating the whole or part of the claim. Liquidator after verification may admit or reject the claim. On rejection, claimant can file an appeal before Adjudicating Authority within 14 days of receipt of such decision. Cost of proving claims shall be borne by the claimant and the cost borne by the liquidator for verification and determination of a claim shall be part of liquidation cost. In case liquidator finds that false claim has been made by the claimant, he shall recover the cost of verification and determination from the claimant. However, creditor is allowed withdraw his claim.

### 3.2 Quantification of claims

Quantification of claims shall be made on the basis of nature of claims

- Contingent claims : Best judgment
- Foreign Currency debts : Claims in Foreign currency shall be translated into Indian currency at the RBI rate of exchange as on date of the liquidation commencement date.
- Periodical payments: In the case of rent, interest and such other payments of a periodical nature, a person may claim only for any amount due and unpaid up to the date of liquidation commencement.
- Debts due in future: Debt which is not yet due on the liquidation commencement date shall be recorded at discounted rate. Government securities yield rate shall be used for the purpose of discounting.
- Mutual credits and set-off: Where there are mutual dealings between the CD and other party, the sums due from one party shall be sett off against the sums due from the other to arrive at the net amount payable to the CD or to other party

The liquidator shall prepare a list of stakeholders, category-wise on the basis of proof submitted and accepted under the regulation. Said list shall be filed before Adjudicating Authority within 45 days from the last date of receipt of claims and filing of a list shall be announced to the public. However, the said list

can be modified either on receipt of additional information warranting such modification.

**3.3 Preferential transactions**

Specific anti-abuse provision has been incorporated in case CD has at relevant time given a preference in transaction. CD shall be deemed to have given preference if

a. there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor; and

b. the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a beneficial position then it would have been in the event of a distribution of assets being made in accordance with section 53

c. such transaction has been entered with related party during the period of two years preceding the insolvency commencement date and other than a related party during the period of one year preceding the insolvency commencement date.

Preference shall not include following transfers-

i. such security interest secures new value and was given at the time of or after the signing of a security agreement that contains a description of such property as security interest, and was used by corporate debtor to acquire such property; and

ii. such transfer was registered with an information utility on or before thirty days after the corporate debtor receives possession of such property

The Adjudicating Authority, may, on an application made by the resolution professional or liquidator can pass protective order. No order can be passed in case interest in the property is acquired in good faith. However, it shall be presumed that interest was not acquired in good faith in case interest in property is acquired from person other than CD or who has received a benefit from the preference or such another person to whom the CD gave preference

i. had sufficient information of initiation or commencement of CIRP.

ii. person is a related party

**3.4 Undervalued transaction**

Another anti-abuse provisions are pertaining to undervalued transactions. Transaction shall be considered as undervalued where CD –

a. makes a gift to a person; or

b. enters into a transaction with a person which involves the transfer of one or more assets by the corporate debtor for a consideration the value of which is significantly less than the value of the consideration provided by the corporate debtor.

and such transaction has not taken place in the ordinary course of business of the corporate debtor

If the liquidator or the resolution professional, as the case may be, on an examination of the transactions of the corporate debtor determines that certain transactions were made during the relevant period, which was undervalued, he shall make an application to the Adjudicating Authority to declare such transactions as void and reverse the effect of such transaction.

**3.5 Extortionate credit transaction**

The third category of the anti-abuse transaction is Extortionate Credit transactions. If

Adjudicating Authority is satisfied that terms of a credit transaction required exorbitant payments to be made by CD, it shall by an order set-aside whole or part of the debt or modify terms, or **person who is party to such transaction may be** asked to repay any amount etc.

However, any debt extended by any person providing financial services which are in compliance with any law for the time being in force in relation to such debt shall not be considered as an extortionate credit transaction.

### 3.6 Secured creditors in liquidation proceedings

A secured creditor in the liquidation proceedings may

a. relinquish its security interest to the liquidation estate and receive proceeds from the sale of assets by the liquidator in the specified manner

b. realise its security interest. In such event he shall inform the liquidator of such security interest and identify the asset subject to such security interest to be realised.

A secured creditor may enforce, realise, settle, compromise or deal with the secured assets in accordance with such law as applicable to the security interest being realised and to the secured creditor and apply the proceeds to recover the debts due to it. In case secured creditor has difficulties in enforcing his security interest, he shall make application to Adjudicating Authority. Adjudicating Authority pass order to facilitate the secured creditor to realise such security interest in accordance with law for the time being in force.

The amount of insolvency resolution process costs, due from secured creditors who realise their security interests as above, shall be deducted from the proceeds of any realisation by such secured creditors, and they shall transfer such amounts to the liquidator to be included in the liquidation estate.

Where the proceeds of the realisation of the secured assets are not adequate to repay debts owed to the secured creditor, the unpaid debts of such secured creditor shall be paid by the liquidator as per the provisions of the code.

## 4. Distribution of assets

### 4.1 Realisation of assets by liquidator

The liquidator may sell asset either on a standalone basis or in slump sale or set of assets collectively or the assets in the parcel. The regulations also provide the mode of sale of assets. It states that assets of the corporate debtor ordinarily be sold through auction as specified in Schedule I of the regulation.

Assets can also be sold in private sale if –

i. the asset is perishable or

ii. the asset is likely to deteriorate in value significantly if not sold immediately or

iii. the asset is sold at a price higher than the reserve price of a failed auction; or

iv. the prior permission of the Adjudicating Authority has been obtained for such sale.

Any private sale of assets to a related party of the corporate debtor or to the liquidator's related party or to any professional appointed by liquidator, shall be done only with prior permission from Adjudicating Authority. The liquidator shall not proceed with the sale of an asset if he has reason to believe that there is any collusion between the buyers, or the corporate debtor's related parties and buyers, or the creditors and the buyer, and shall submit a report to the Adjudicating Authority in this

regard, seeking appropriate orders against the colluding parties.

An asset that cannot be readily or advantageously sold, due to its peculiar nature or other special circumstances, may be distributed amongst the stakeholders with the permission of the Adjudicating Authority. It shall be the liquidator's endeavour to recover and realise all assets of and dues to the corporate debtor in a time-bound manner for maximisation of value for the stakeholders.

**4.2 Valuation of assets**

The liquidator shall appoint at least two registered valuers to value the assets of the CD. The registered valuers shall independently submit to the liquidator the estimates of the realisable value of the asset(s) computed in accordance with internationally accepted valuation standards, after physical verification of the assets of the corporate debtor. The average of the estimates received shall be considered the value of the assets.

**4.3 Liquidation proceeds**

For the receipt of all amounts of moneys due to the corporate debtor, the liquidator shall open a bank account in the name of the corporate debtor followed by the words 'in liquidation', in a scheduled bank. Wherein all sums of moneys, including cheques and demand drafts received by him as the liquidator of the corporate debtor, and the realizations of each day shall be deposited into the said bank account without any deduction but not later than the next working day. All payments from the account above ₹ 5,000/- shall be made by cheques drawn or online banking transactions against the bank account. The liquidator is allowed maintain a cash of ₹ 1 lakh or such higher amount as may be permitted by the Adjudicating Authority to meet liquidation costs.

**4.4 Distribution of sale proceeds of assets**

The liquidator shall not commence distribution before the list of stakeholders and the asset memorandum has been filed with the Adjudicating Authority. The liquidator shall distribute the proceeds from realisation within six months from the receipt of the amount to the stakeholders. The insolvency resolution process costs if any, and the liquidation costs shall be deducted before such distribution is made. "Insolvency resolution process costs" means —

i. the amount of any interim finance and the costs incurred in raising such finance;

ii. the fees payable to any person acting as a resolution professional;

iii. any costs incurred by the resolution professional in running the business of the corporate debtor as a going concern;

iv. any costs incurred at the expense of the Government to facilitate the insolvency resolution process; and

v. any other costs as may be specified by the Board;

Section 53 states that notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority.

a. the insolvency resolution process costs and the liquidation costs paid in full.

b. the following debts which shall rank equally between and among the following

   i. workmen's dues for the period of twenty-four months preceding the liquidation commencement date; and

   ii. debts owed to a secured creditor in the event such secured creditor has

relinquished security as discussed in para 3.5 above;

c. wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;

d. financial debts owed to unsecured creditors;

e. the following dues shall rank equally between and among the following:

   i. any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date;

   ii. debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;

f. any remaining debts and dues

g. preference shareholders, if any; and

h. equity shareholders or partners, as the case may be.

It is provided that any contractual arrangements between recipients with equal ranking if disrupting the order of priority as specified shall be disregarded by the liquidator. Further, at each stage of the distribution of proceeds in respect of a class of recipients that rank equally, each of the debts will either be paid in full or will be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full.

A stakeholder is also mandated to return any monies received by him in distribution, which he was not entitled to at the time of distribution, or subsequently became not entitled to.

### 4.5 Unclaimed proceeds of liquidation or undistributed assets

Before the order of dissolution is passed, the liquidator shall apply to the Adjudicating Authority for an order to pay into the Companies Liquidation Account in the Public Account of India any unclaimed proceeds of liquidation or undistributed assets or any other balance payable to the stakeholders in his hands on the date of the order of dissolution. A person claiming to be entitled to any money paid into the Companies Liquidation Account may apply to the Board for an order for payment of the money claimed; which may, if satisfied that such person is entitled to the whole or any part of the money claimed, make an order for the payment to that person of the sum due to him, after taking such security from him as it may think fit. Any money paid into the Companies Liquidation Account in pursuance of this Regulation, which remains unclaimed thereafter for a period of fifteen years, shall be transferred to the general revenue account of the Central Government.

Any liquidator who retains any money, which should have been paid by him into the Companies Liquidation Account under this Regulation, shall pay interest on the amount retained at the rate of twelve per cent per annum, and also pay such penalty as may be determined by the Board.

### 4.6 Completion of liquidation

The liquidator shall liquidate the corporate debtor within a period of two years. If he is unable to complete liquidation within the said period of two years, he shall make an application to the Adjudicating Authority to continue such liquidation, along with a report explaining why liquidation has not been completed and specifying the additional time that shall be required for liquidation.

## 5. Dissolution of corporate debtor

When the corporate debtor is liquidated, the liquidator shall make an account of the liquidation, showing how it has been conducted and how the corporate debtor's assets have been liquidated. If the liquidation cost exceeds the estimated liquidation cost provided in the Preliminary Report, the liquidator shall explain the reasons for the same. The final report shall form part of the application for the dissolution of the corporate debtor to the Adjudicating Authority.

The Adjudicating Authority shall on application filed by the liquidator, order dissolution of the CD from the date of the order. A copy of an order within 7 days from the date of the order shall be forwarded to the Registrar of Companies.

## Applicability of other laws

### The Companies Act, 2013

Pursuant to the IBC, various sections pertaining to winding up under the Companies Act, 2013 has been amended/ incorporated viz. winding-up to include liquidation under IBC, liquidator under Companies Act shall include liquidator appointed under IBC, priority payments to include workmen's due and payment to secured creditors, deletion of provisions of voluntarily winding-up etc.

### Income-tax Act, 1961

Section 178 requires liquidator give notice of his appointment to the Assessing Officer who is entitled to assess the income of the company. Liquidator is personally liable for the payment of the tax which the company would be liable to pay, if fails to give notice.

The Assessing Officer shall, after making such inquiries or calling for such information as he may deem fit, notify to the liquidator within three months from the date on which he receives notice of the appointment of the liquidator the amount which, in his opinion, would be sufficient to provide for any tax which is then, or is likely thereafter to become, payable by the company.

The liquidator shall not, without the leave of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, part with any of the assets of the company or the properties in his hands until he has been notified by the Assessing Officer and on being so notified, shall set aside such amount. Before such set aside he, shall not part with any of the assets of the company or the properties in his hands. However, he is not debarred from parting with such assets or properties for the purpose of the payment of the tax payable by the company or for making any payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government on the date of liquidation or for meeting such costs and expenses of the winding up of the company as are in the opinion of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner reasonable.

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 Insolvency and Bankruptcy Code, 2016.

## Conclusion

There can be no doubt, that the Code is an exhaustive code on the subject matter of revival, reorganization and insolvency in relation to corporate entities. The Code is swift change as compared to other laws in India and also have overriding effect over other laws. Judiciary has interpreted (NCLT, NCLAT, HC, SC) law considering the intent, object and spirit of it. They have not gone into technicalities. Supreme Court while dealing in one of the matter has even exercised exceptional powers under Article 142 of the Constitution. Introduction of this Code is one of the steps for improving ease of doing business in India and it in in continuation of Start-up India, Make in India etc.


CA Sundaresh Bhat & CA Rajesh Thakkar

# Voluntary Liquidation of Corporate Person

## 1. Background

The Insolvency & Bankruptcy Code, 2016 ('IBC') is a new law to regulate winding up process by creditors and members. IBC has been notified with effect from May 28, 2016 however, the relevant provisions for voluntary liquidation were notified later on March 30, 2017. Further, the Insolvency and Bankruptcy Board of India (Voluntary Liquidation) Regulations, 2017 have been notified on March 31, 2017. In effect, the provisions relating to voluntary liquidation by a corporate person have been made applicable from April 1, 2017.

Prior to their notification, voluntary liquidation was governed under the provisions of the Companies Act, 1956. The relevant provisions under the Companies Act, 2013 were never notified pending introduction of IBC.

## 2. Applicability

Corporate person shall mean:

a) A company;

b) A limited liability partnership; or

c) Any body corporate with limited liability.

## 3. Commencement of Voluntary Liquidation

A corporate person may initiate voluntary liquidation if majority of the directors or designated partners or person responsible for exercising its corporate powers make a declaration to the effect that

a) the corporate person has no debt or it will be able to pay its debts in full, from the proceeds of the assets to be sold under the proposed liquidation, and

b) the corporate person is not being liquidated to defraud any person.

The aforesaid **declaration** has to be accompanied by certain financial data as (audited financial statements, valuation report, etc.) as specified in the regulations.

Within 4 weeks of the declaration, a resolution is required to be passed by special majority of the contributories; i.e., members/designated partners/person liable to contribute towards the assets of the corporate person, approving the voluntary liquidation and appointing an insolvency professional to act as liquidator.

If the liquidator (i.e., insolvency professional) is of the opinion that the corporate person will not be able to pay its debts in full from proceeds of assets to be sold or the voluntary liquidation is being done to defraud a person, he shall make an application to the adjudicating authority to pass such orders as it deems fit.

Where the corporate person owes any debt at the time of passing the resolution for liquidation, creditors representing two-thirds in value of the debt shall approve, the resolution passed by the contributories, within seven days.

The corporate person shall notify the Registrar of Companies and the Insolvency and Bankruptcy Board of India about the resolution under sub-section (3) to liquidate the company within seven days of such resolution or the subsequent approval by the creditors, as the case may be.

The voluntary liquidation of a corporate person shall be deemed to have commenced from the date of passing of above resolution.

## 4. Eligibility for appointment as liquidator

An insolvency professional shall be eligible to be appointed as a liquidator if he, and every partner or director of the insolvency professional entity of which he is a partner or director is independent of the corporate person.

A person shall be considered independent of the corporate person if he:

a) Is eligible to be appointed as an independent director on board of a company under Section 149 of the Companies Act, 2013;

b) Is not a related party of the corporate person; or

c) Has not been an employee or proprietor or a partner:

   i. Of a firm of auditors or company secretaries or cost auditors of the corporate person; or

   ii. Of a legal or consulting firm that has or had an transaction with the corporate person, contributing 10% or more of the gross turnover of such firm,

in the last three financial years.

## 5. Powers and functions of a liquidator

The liquidator is required to prepare and submit the status report and final report prior to dissolution in the manner specified. The liquidator is required to preserve a physical copy as well as an electronic copy for a period of eight years after dissolution of the corporate person.

In addition, the liquidator is also required to preserve prescribed registers and books of account for a period of eight years after the dissolution. The liquidator shall keep an account of the expenses incurred by him to preserve the records.

A liquidator may also appoint professionals to assist him in discharge of his duties, obligations and functions. The cost of these professionals is to be borne by the liquidator. Here again, the liquidator cannot appoint any professional who is not independent of the corporate person.

The liquidator shall make a public announcement within 5 days of his appointment. The public announcement shall call upon stakeholders to submit their claims as on the liquidation commencement date and provide the last date for submission of claim, which shall be 30 days from the liquidation commencement date.

## 6. Claims of stakeholders

Pursuant to the public announcement by the liquidator, various stakeholders are required to furnish their claim in prescribed forms as follows:

| Nature of creditor | Form |
|---|---|
| Operational Creditor | Form B |
| Financial Creditor | Form C |
| Workmen & Employees (refer note below) | Form D |
| Other stakeholders | Form F |

Where there are dues to several workmen or employees, an authorised representative may submit one proof of claim for all such dues on their behalf in Form E.

The liquidator may call for such evidence to satisfy himself about the claim of the stakeholders. The claimant shall bear the cost of proving the claim while the liquidator will bear the cost for verification of claim.

Where the amount of claim of any stakeholder is not determinate due to any reason, the liquidator shall make a best estimate of the claim amount based on the information available.

A person may also prove a claim which is not due on the liquidation commencement date but payable at a later date due to some contractual obligation.

The liquidator is required to verify the claim within 30 days from the last date of receipt of claims and may either admit or reject a claim. An aggrieved creditor has a right to appeal before the adjudicating authority against the decision of the liquidator.

After verification of all claims, the liquidator is required to prepare a list of stakeholders with various information about the claims and the claimants, within 45 days from the last date for receipt of claims. This information is available for inspection by claimants, members, partners, directors and guarantors of the corporate person. In addition, this data is also displayed on the website, if any, of the corporate person.

## 7. Realisation of assets & distribution of proceeds

The liquidator shall endeavour to dispose off/ realise all the properties/assets of the corporate person, in the manner approved by the latter. In case of any uncalled capital, the liquidator shall realise the said money from the contributors.

The liquidator is required to open a separate bank account where all money realized will be deposited and payments will be made. The liquidator shall distribute the proceeds within 6 months from the receipt of amounts, to the stakeholders. Where any asset cannot be realised, the liquidator may, with the approval of the corporate person, distribute the said asset to any stakeholder.

## 8. Realisation of assets & distribution of proceeds

The liquidator shall endeavour to wind up the affairs of the corporate person with 12 months from the liquidation commencement date.

In the event, the liquidation extending beyond 12 months, the liquidator shall:

a) Call a meeting of the contributories of the corporate person within 15 days from the end of the year in which he is appointed; and

b) Present a status report indicating the progress of liquidation.

The status report shall enclose audited accounts showing the receipts and payments pertaining to liquidation.

## 9. Final report prior to dissolution

Once the affairs of the corporate person have been completely wound up, the liquidator shall submit a final report consisting of comprehensive details about realisation of assets, settlement of liabilities, etc. the final report is submitted by the liquidator to:

a) Contributories of the corporate person;

b) The Registrar; and

c) The Insolvency and Bankruptcy Board of India.

The liquidator shall submit the final report to the National Company Law Tribunal (NCLT) along with an application under Section 59(7) of the IBC.

## 10. Liquidation of corporate person

The NCLT may pass such order as it may deem fit. Prior to passing the order, the liquidator shall deposit the unutilised proceeds or undistributed assets, into a Companies Liquidation Account in the Public Account in India. A person entitled to any money paid into the Companies Liquidation Account may apply to the Insolvency and Bankruptcy Board of India for an order for payment of the money claimed. Any unclained money lying into the Companies Liquidation Account for a period after 15 years shall be transferred to the general reserve account of the Central Government.

CA Tejas Parikh

# Fresh-start-up for Individuals and Firms – Is it really workable?

## Fresh Start Process – Summary

Presently, individual insolvency process is governed by two enactments, Presidency Towns Insolvency Act, 1909 and Provisional Insolvency Act, 1920. These laws do not provide for pre-bankruptcy resolution process or an opportunity for fresh start by an order of discharge. Also present legal framework has resulted in undue losses to creditors and recovery of loans was remote and difficult. The enactment of Insolvency and Bankruptcy Code (IBC), 2016 hopes to provide sound bankruptcy and insolvency framework by 1) providing mechanism whereby both debtor and creditor can participate and negotiate settlement without active involvement of the Court and 2) provide for fair and orderly process for dealing with financial affairs of insolvent individuals. The IBC provides two distinct processes for individual bankruptcy. The first is Fresh Start order (dealt with in this article) and the second is the Insolvency Resolution Process which is process of negotiation between debtors and creditors supervised by a Resolution Professional (RP).

Fresh Start Order is a new concept introduced by IBC whereby debtor who is unable to pay its debt and fulfills certain conditions, shall be entitled to make an application to Court on its own, for discharge of its qualifying debt. As a result their debts will be written off and thereby giving a debtor "fresh start to life".

Fresh Start Process (FSP) is provided under Chapter II of Part III of the IBC Code dealing with Insolvency Resolution and Bankruptcy for Individuals and Partnerships. Sections 80 to 93 of IBC deals with FSP. These sections are yet to be notified.

## Eligibility Criteria for FSP

A debtor may apply for a fresh start to the Adjudicating Authority if

a. the gross annual income of the debtor does not exceed **sixty** thousand rupees

b. the aggregate value of the assets of the debtor does not exceed **twenty** thousand rupees

c. the aggregate value of the qualifying debts does not exceed **thirty five** thousand rupees

d. he is not an undischarged bankrupt

e. **he does not own a dwelling unit,** irrespective of whether it is encumbered or not;

f. a fresh start process, insolvency resolution process or bankruptcy process is not subsisting against him and

g. no previous fresh start order has been made in relation to him in the preceding twelve months of the date of the application for fresh start

From the above, *prima facie* it appears that thresholds limits are very low and may render majority section of insolvent individuals ineligible to make application under FSP. However the report of the Bankruptcy Law Reforms Committee provides that the proposed thresholds in the Code have been provided taking into account the relevant data and the Central Government shall have power to revise the relevant assets and income test from time-to-time. The report also suggests that these should ideally be increased at regular intervals in line with inflation measured by the Consumer Price Index.

The above FSP application can only be made by debtor fulfilling above criteria and cannot be made jointly along with spouse.

## Format of Application for FSP

The application shall contain the following information supported by an affidavit containing the following information:

a) a list of all debts owed by the debtor as on the date of the said application along with details relating to the amount of each debt, interest payable thereon and the names of the creditors to whom each debt is owed;

b) the interest payable on the debts and the rate thereof stipulated in the contract;

c) a list of security held in respect of any of the debts;

d) the financial information of the debtor and his immediate family (spouse, dependent children and dependent parents) up to two years prior to the date of the application

e) the particulars of the debtor's personal details, as may be prescribed;

f) the reasons for making the application;

g) the particulars of any legal proceedings which, to the debtor's knowledge has been commenced against him;

h) the confirmation that no previous fresh start order has been made in respect of the qualifying debts of the debtor in the preceding twelve months of the date of the application.

## Concept and Meaning of Qualifying Debt

FSP gives discharge of only qualifying debts of the debtor.

A Qualifying Debt is an amount due, which includes

- interest or
- any other sum due in respect of the amounts owed under any contract, by the debtor for a liquidated sum
- either immediately or at certain future time and does not include
  - a) an **excluded** #debt;
  - b) a debt to the extent it is secured; and
  - c) any debt which has been incurred three months prior to the date of application for fresh start process

*# Excluded debt means Court fines, maintenance payments, damage claims (statutory, contractual or legal) and student loans. There is provision for further addition to excluded debt.*

## Appointment and Role of Resolution Professional

FSP application can be done by debtor personally or through RP. The Adjudicating Authority for Fresh Start Process is Debt Recovery Tribunal.

Where the debtor files the application, the Adjudicating Authority (AA) shall direct to Insolvency and Bankruptcy Board of India (IBBI) to nominate a RP within seven days of application and the IBBI shall nominate RP within ten days of receiving the direction issued by AA. RP so appointed shall be provided a copy of the application.

When the RP files the application, AA shall seek confirmation from IBBI within seven days of receipt of application that there are no disciplinary proceedings against RP and accordingly RP is appointed.

The resolution professional shall examine the application made within ten days of his appointment, and submit a report to the Adjudicating Authority, either recommending acceptance or rejection of the application. The resolution professional shall record the reasons for recommending the acceptance or rejection of the application in the report to the AA and shall give a copy of the report to the debtor.

The report by RP shall contain details of amount of

(a) qualifying debts; and

(b) liabilities eligible for discharge

The debtor or creditor aggrieved by decision of resolution professional may make application to AA for challenging any decision on the ground that adequate opportunity was not given for representation, resolution professional has colluded with third party or not complied with any requirements. The resolution professional can also be replaced on application made by debtor or creditor on application to AA. The resolution professional has to perform his functions and duties in compliance with code of conduct.

The resolution professional may also apply to AA if debtor does not comply with duties and restrictions as detailed in this article or which there are no specific provisions.

## Effect of admission of application

When application for FSP is filed by debtor, an interim-moratorium shall commence on the date of filing application in relation to all the debts and shall have cease to have effect on the date of admission or rejection of application as the case may be.

When application is filed through RP, the morato-rium period shall commence in respect of all the debts on the date of admission of the application by AA.

During the moratorium or interim-moratorium period

a) any pending legal action or legal proceeding in respect of any debt shall deemed to have been stayed; and

b) the creditors shall not initiate any legal action or proceedings in respect of any debt.

The moratorium ceases to have effect at the end of the period of one hundred and eighty days beginning with the date of admission unless the order admitting the application is revoked.

## Duties of Debtor and Restrictions on Debtor

The debtor shall

a) Make available to the resolution professional all information relating to

his affairs, attend meetings and comply with the requests of the resolution professional in relation to the fresh start process.

b) Inform the resolution professional

i. any material error or omission in relation to the information or document supplied to the resolution professional; or

ii. any change in financial circumstances after the date of application, where such change has an impact on the fresh start process

During the moratorium period, the debtor shall

a) not act as a director of any company, or directly or indirectly take part in or be concerned in the promotion, formation or management of a company

b) not dispose of or alienate any of his assets;

c) inform his business partners that he is undergoing a fresh start process;

d) be required to inform prior to entering into any financial or commercial transaction of such value as may be notified by the Central Government, either individually or jointly that he is undergoing a fresh start process;

e) disclose the name under which he enters into business transactions, if it is different from the name in the application admitted;

f) not travel outside India except with the permission of the Adjudicating Authority

## Role of Creditors

Any creditor within a period of ten days from the date of receipt of the order can object on the following grounds, namely

(a) inclusion of a debt as a qualifying debt

(b) incorrectness of the details of the qualifying debt

A creditor may file an objection by way of an application to the resolution professional. The resolution professional shall examine the objections and either accept or reject the objections, within ten days of the date of the application

## Role of Adjudicating Authority and Discharge Order

The AA may within fourteen days from the date of submission of the report by the RP pass an order either admitting or rejecting the application. The order shall state the amount which has been accepted as qualifying debts by the RP and other amounts eligible for discharge for the purposes of the fresh start order.

A copy of the order passed by the AA along with a copy of the application shall be provided to the creditors mentioned in the application within seven days of the passing of the order.

The resolution professional shall prepare a final list of qualifying debts and submit such list to the AA at least seven days before the moratorium period comes to an end.

The AA shall pass a discharge order at the end of the moratorium period for discharge of the debtor from the qualifying debts mentioned in the list.

The AA shall discharge the debtor from the following liabilities, namely

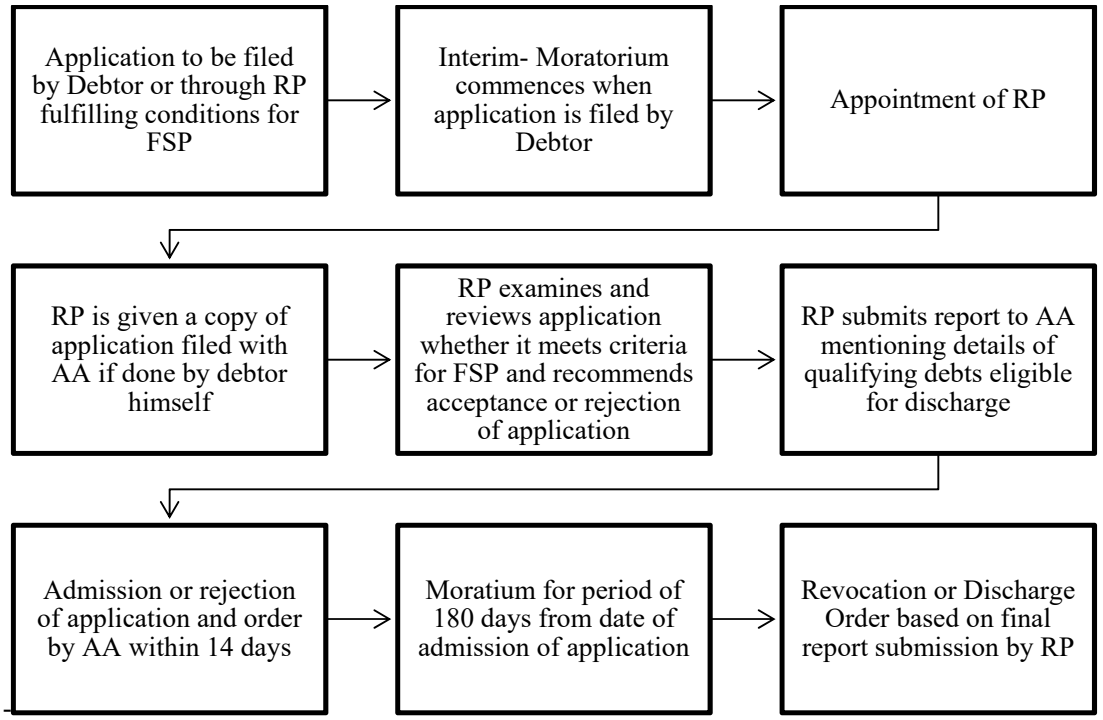
a) penalties in respect of the qualifying debts from the date of application till the date of the discharge order.

b) interest including penal interest in respect of the qualifying debts from the date of application till the date of the discharge order.

c) any other sums owed under any contract in respect of the qualifying debts from the date of application till the date of the discharge order.

## Conclusion

Summarised Process flow for FSP




Fresh Start Process is a welcome step by Government to provide relief and release from financial liabilities and obligations to insolvent individuals. However thresholds limits related to assets, income and qualifying debts appears to be very low, which may require revision or rethinking. Even if such individuals fulfil conditions, the insolvency process costs may outweigh the benefits of effective and timely resolution available through this institutional framework.

The success of FSP is dependent largely on three pillars namely,

- Adequate benches of Debt Recovery Tribunals (AA)
- Information utilities infrastructure, and
- Resolution professionals

However this is good beginning and hope law will develop over a period of time to adapt itself to changing economic environment.

*Sources:*

*Insolvency and Bankruptcy Code, 2016*
*The Report of the Bankruptcy Law Reforms Committee, November 2015*

CA Hemant Mehta

# Insolvency Resolution of Individual and Partnership Firm

What was common between Michael Jackson, Mike Tyson, Francis Ford Coppola and Nicolas Cage? Yes, all High Profile people, who managed to lose their Fortunes by declaring themselves Bankrupt under Personal Bankruptcy Laws in their respective countries. Some of them could be fortunate to get them back again.

Now, let us examine the situation, what would have happened to all the above personalities, if they were to be declared Bankrupt under Indian Laws prevailing prior to introduction of Insolvency and Bankruptcy Code, 2016?

## Scenario so far...

Let us examine the Law prevailing prior to May 2016 in India.

There were two statutes dealing with Personal Insolvency (including proprietorship and Partnership). One was Presidency Towns Insolvency Act, 1909, which was applicable to erstwhile prudency towns of Bombay, Calcutta and Madras. The other was Provincial Insolvency Act, 1920, which was applicable to rest of India. Both laws were more than a century old and were considered inadequate and outdated, used to take decades in legal process to be completed.

Criminal proceedings could also be initiated against the insolvent. At times, it worked as punishment for a genuine entrepreneur who came up with a novel idea of business, and he failed due to external circumstances beyond his control.

CIBIL score of any person can get affected in a situation where default occurs in repayment of any of the following loans:

1) Business Loan,
2) Personal Loan,
3) Housing Loan,
4) Education Loan,
5) Marriage Loan,
6) Festival Loan,
7) Credit Card payments.

On any of the above loans, he will be barred for indefinite period for taking any further loan.

***Reform in the Bankruptcy and Insolvency Regime***

Recognising that reforms in the bankruptcy and insolvency regime are critical for improving the business environment and alleviating distressed credit markets, the Government announced the Insolvency and Bankruptcy Code Bill in November 2015, drafted by a specially constituted 'Bankruptcy Law Reforms Committee' (BLRC) under the Ministry of Finance. After a public consultation process and recommendations from a joint committee of Parliament, both houses of Parliament have passed the Insolvency and Bankruptcy Code, 2016 (Code).

The Bankruptcy Law Reforms Committee report (2015) intended the infrastructure of the adjudication authorities dealing with individual insolvency to be more widespread across the country to facilitate access to justice for every citizen. It said that it would help in creating economies of scale if the same judicial institutions adjudicated resolution processes for firms and individuals.

## Rationale to introduce Bankruptcy Code

1) To introduce concept of Pardoning rather than punishing :

   A genuine entrepreneur who came up with novel idea of business, may fail, due to circumstances which were beyond his control, should be pardoned than punishing him for a life time.

   Which will in turn encourage entrepreneur skills in the country for a speedy restart.

2) Speedy and better utilisation of resources which have become idle due to years long old bankruptcy laws, which took more than 5-6 years to complete insolvency proceedings by the court.

3) Encouragement of Foreign Investment:

If the law of the county enables the recovery ratio to be high and speedy for foreign investors, they will bring more investment for economic growth.

## What is the difference between Insolvency and Bankruptcy for an Individual or a Firm?

Let us try to understand difference between Insolvency and Bankruptcy. An individual can be insolvent, but may not be bankrupt. This is the main reason for provision of Resolution Plan in the code. If Resolution plan work then it may be a fresh "restart" for an individual or firm. If resolution plan doesn't work, then only it may lead to bankruptcy i.e. Liquidation process.

## Insolvency and Bankruptcy as an individual or Partnership

**These provisions are not yet notified and not in force (Till 15-8-2017)** and are likely to be notified soon.

If an individual, (or partnership firm) is in a situation where his liabilities are too high as compared to his assets, filing for bankruptcy will act as a restart button. It will give an honest and burden-free start to his fresh life as he will be relieved from all the debts which he could not pay before filing insolvency.

Keeping above objective in mind, the newly established regulator, the Insolvency and Bankruptcy Board of India (IBBI), is working on drafting the guidelines for individuals who want to declare bankruptcy.

The IBBI is the nodal agency for implementing the new bankruptcy law under The Insolvency and Bankruptcy Code, 2016, which consolidated and amended laws relating to

insolvency of companies, partnership firms and also individuals in a time bound manner. Laws providing for individual declaration of bankruptcy are currently state-specific, but have been seldom used because of the tedious process associated with it.

"Individual bankruptcy is our next immediate priority. Any citizen will be able to use it. Unlike Companies, which have homogeneous legal structure, individuals are not that homogeneous. We really need to think through.

It's difficult to give a guideline for Individual Bankruptcy" said Mr.Sahoo, the Chairperson of IBBI.

## Advantages of filing for individual bankruptcy

Getting bankrupt is in no way a desirable state, but it is not the end of the road either. You may lose your self-confidence and sense of direction, but you can make a comeback with careful planning. There are a few advantages that come along with filing for bankruptcy:

## Mental peace

Financial stress often pushes debtors to the wrong direction. Numerous cases of suicide and murder related to individuals' debt situation are reported commonly nowadays. By filing for bankruptcy, a debtor can avoid stress and harassment at the same time.

## Opportunity to restart

Before filing for bankruptcy, debtors do not get enough time for planning their future since the focus remains on creditors. **Remember, even with all your assets gone, you still possess your skills and intelligence. You can concentrate on your future plans once your debts are written off** post-bankruptcy.

## Disadvantages of filing for bankruptcy

Financial distress caused by bankruptcy can disrupt your plans - both for the present and the future.

Following are few discussed disadvantages of bankruptcy:

## All your assets are going to be lost

All your assets are liquidated in case of bankruptcy. The amount obtained is simply drained out in settling creditors' claims. You are left empty-handed which makes a restart highly difficult.

## Credibility goes for a toss

Once you file a suit for bankrupt status, the message is loud and clear that you are a defaulter. You lose credibility in the eyes of creditors. Lack of credibility makes it impossible for you to secure debt in the future.

## Cost of filing bankruptcy

Filing for bankruptcy, a costly affair indeed, is the final nail in the coffin as you have to pay for fighting your case. It simply fuels the pain one is already going through.

## How to avoid bankruptcy?

As it's quite evident that bankruptcy may adversely affect your future life, it is wise to avoid such a situation. Here are a few options which can be used as lifelines.

## Consult a financial advisor

Financial advisor can help you manage your situation better. An advisor can not only identify hidden sources of fund but can also help in disposing off some liabilities. This two-fold improvement might motivate you to defer your decision to declare bankruptcy.

## Negotiate with your creditor

If you feel that buying little time might improve your situation a bit, negotiate with your creditor. Under normal circumstances, a creditor would not like you to file for bankruptcy and if you are able to convince him regarding your future cash flows, he will definitely listen to you.

## Offer to sell your skills against debt

If you possess a saleable set of skills, you can offer the same to your creditors against the debt you owe. A creditor is likely to accept your offer if you have a skill that may be of use to your creditor. We may consider example of Legendary Amitabh Bacchan who did use his acting and modelling skill to repay his past debt as reported in some newspapers.

## Background of new Code

Part III of Insolvency and Bankruptcy Code, 2016 (Insolvency Code, 2016) – (Section 79 to 187) deals with provisions relating to Bankruptcy relating to individual and partnership firms. Firm here means a body of individuals carrying on business in partnership, whether registered under Indian Partnership Act or not. Limited Liability Partnership (LLP) are covered else in Corporate Insolvency Resolution Process.

**As stated earlier these provisions are not yet notified and not in force (till 15-8-2017).** However, when the provisions are notified in future by the authorities, it is expected to create a revolutionary change in Indian economy for individuals and firms.

## Time Limits

The Code specifies time limit for every action. If action could not be completed within the time by Debt Recovery Tribunal (DRT) or Debt Recovery Appellate Tribunal (DRAT), extension up to 10 days can be granted by Chairperson of DRAT.

## Overview of the Provisions

**Adjudicating Authority**

Debt Recovery Tribunal (DRT), which is the adjudicating authority for individual and partnership insolvency has a wider presence across the country.

The DRT which is having territorial jurisdiction over the place where individual debtors or Firm actually and voluntarily resides or carries on business or personally work for gain.

However, the shift from district courts to DRTs for all personal partnership and insolvency cases above ₹ 1, 000 value has been drastic. At present, there are 33 DRTs in the country spread across 23 cities as against District Courts in 673 districts under various High Courts.

The regime was premised on the Central Government's assurance to the BLRC that additional DRT benches will be set up. Also, there have been recent amendments empowering other Tribunals and their judicial officers to take additional charge of DRTs, which could help reduce the additional burden.

DRAT (Debt Recovery Appellate Tribunal) will be appellate authority for Individuals and Firms.

Civil Court or any authority will not have any jurisdiction, an appeal from an order of DRAT can be filed before Supreme Court within 45 days only on the question of law.

## What is proposed to be excluded from assets of an individual under the Code?

There are some class of assets which are not subject to be treated as a part of assets under the Code which includes:

(a) Unencumbered tools, books, vehicles and other equipment as are necessary to the debtor or bankrupt for his personal use or for the purpose of his employment, business or vocation;

(b) Unencumbered furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his immediate family;

(c) Any unencumbered personal ornaments of such value, as may be prescribed, of the debtor or his immediate family which cannot be parted with, in accordance with religious usage;

(d) Any unencumbered life insurance policy or pension plan taken in the name of debtor or his immediate family; and

(e) An unencumbered single dwelling unit owned by the debtor of such value as may be prescribed;

Relevance – Section 155 (2) state that estate of Bankrupt shall not include excluded assets along with other assets specified therein.

## What types of debts are not subject to Resolution Plan under the Code?

Section 94 (3) states that for following kind of debts debtors cannot apply for any relief. Further, Section 139 (d) where the order does not discharge the bankrupt from excluded debt which are as under:

(a) Liability to pay fine imposed by a Court or Tribunal;

(b) Liability to pay damages for negligence, nuisance or breach of a statutory, contractual or other legal obligation;

(c) Liability to pay maintenance to any person under any law for the time being in force;

(d) Liability in relation to a student loan; and

(e) Any other debt as may be prescribed.

## Is a single partner liable for the debt of a firm?

"Partnership debt" means a debt for which all the partners in a firm are jointly liable. Application under the Code may be made by any of its partner.

## What is a qualifying debt under the Code?

"Qualifying Debt" means amount due, which includes interest or any other sum due in respect of the amounts owed under any contract, by the debtor for a liquidated sum either immediately or at certain future time and does not include —

(a) An excluded debt;

(b) A debt to the extent it is secured; and

(c) Any debt which has been incurred three months prior to the date of the application for fresh start process.

## Threshold Limit

The threshold for applicability of the code to individuals and partnership firms has been set at a minimum of ₹ 1,000. However, the Central government may increase the threshold to a value not exceeding ₹ 1 lakh.

## Two distinct processes in brief

The current laws for individual bankruptcy have two distinct processes not available

earlier. A fresh start order (FSO) and an insolvency resolution process (IRP).

Individuals can declare insolvency through a FSO, which is a process where individuals with assets and income lower than certain specified amounts will be eligible for a discharge from their debts. The qualifying debts will be written off, providing a fresh start to the debtor while the default will be mentioned in the credit history of the individual. For an individual or partnership to apply for FSO, one should full fill three criteria:

1) Have gross annual income of less than ₹ 60,000, with

2) Assets of a value not exceeding ₹ 20,000, and

3) The aggregate value of the qualifying debt not exceeding ₹ 35,000.

The amount is so meagre that there will be very few individuals who will be eligible and in fact, for them, even this process is beyond their means. Details of FSO are discussed in a separate article.

In case of other individuals and firms, the process is similar to that applicable to corporate persons. Period of moratorium to be excluded for the purpose of limitation like to corporates.

A claim here means a right to payment, whether such rights are reduced to judgement, fixed, disputed, undisputed, secured or unsecured.

## Role of Resolution Professional

The process will be handled by 'Resolution Professional' (RP) under supervision of DRT.

## Insolvency Resolution Process

The Code also defines an Insolvency Resolution Process — a process of negotiation between debtors and creditors supervised by a Resolution Professional (RP), who is registered with the insolvency board.

If the negotiation succeeds, it will lead to a 'repayment plan' which the RP will execute. The Discharged order will be given by DRT.

In case the negotiations fail, the matter will proceed to bankruptcy resolution process led by a Bankruptcy Trustee who is appointed by the Adjudicating Authority. Bankruptcy Trustee will take over the estate of the Bankrupt will sell or dispose it off and satisfy repayments of creditors to the extent possible and discharge order will be given. The discharge order will be registered with the Board (IBBI) in the register maintained under section 196 of IBC.

## Impact on personal Bank Guarantees

Once provisions are implemented, all types of personal guarantees granted by individuals for bank loan and various other purposes are covered under the provision of this Code.

## Notification Awaited

Actual impact of the said provisions relating to individuals and firms can be known only after actual implementation of the Code. Let us wait till the date when provisions of individual and firm get notified.

It is expected that many individuals and firms, who, otherwise, suffered for number of years in long court processes, are expected to get a time bound solution and opportunity to "Restart".

Strength does not come from physical capacity. It comes from an indomitable will.

*— Mahatma Gandhi*

CA Pravin Navandar

# Administration & Distribution of the Estate of Bankrupt

**(Part III of IBC – Insolvency and Bankruptcy for Individual and Partnership Firms)**

## 1. What is Bankruptcy?

Bankruptcy is a legal life line for people drowning in debt. Consumers and businesses petition courts to release them from liability for their debts. In a majority of cases, the request is granted. Bankruptcy is a court proceeding in which a judge and Bankruptcy Trustee (BT) examine the assets and liabilities of individuals and businesses who can't pay their bills and decide whether to discharge those debts so they are no longer legally required to pay them.

Bankruptcy laws are written to give people whose finances collapsed a chance to start over. Whether it was bad decision-making or bad luck, lawmakers could see that in a capitalistic economy, consumers and businesses who failed, need a second chance. Bankruptcy carries some significant long-term penalties because it will remain on credit report for 7-10 years, but there is a great mental and emotional lift when given a fresh start and all debts are eliminated. Filing a bankruptcy case will immediately stop ("stay") most of the creditors from taking collection action. In most cases, the filing will end collection calls, letters, lawsuits, garnishments and other collection practices until there is a final ruling. If a discharge in bankruptcy is granted, the affected creditors will be prohibited from taking any further collection action against the debtor.

Since the present legal framework does not aid lenders in effective and timely recovery from non-performing assets (NPA) the cumulative NPAs are causing strain on the Indian credit system. The Government has, therefore, come out with a consolidated code viz. Insolvency and Bankruptcy Code, 2016 (IBC) for dealing with individual and corporate bankruptcy/ insolvency. A person or an entity is Bankrupt when the total value of his or its debts and liabilities is greater than the total value of its assets. A bankrupt estate's administration is often a very daunting prospect for the executors or administrators. The task of administering such an estate is challenging and often fraught with pitfalls.

Presently, the individual insolvency is governed by century old laws, The Presidency Town Insolvency Act, 1909 & The Provincial Insolvency Act, 1920. The procedure was quite complex and used to take number of year's even decades.

Part – III of the IBC titled "Insolvency Resolution and Bankruptcy for individual and Partnership Firms" is divided into Chapters I to VII containing provisions applicable to individuals. The Adjudicating Authority (AA) will be Debt Recovery Tribunal (DRT) under old law it was District Courts. Insolvency Professional (IP)

would be playing a major role in the entire process. As collection of dues is collective process an individual can discharge all his dues in a systematic well defined controlled manner, as per the procedure laid down in the Code. Separate recovery proceeding from different creditors in different courts will thus be avoided. Harassment would be reduced to a large extent. Process would be fast and equitable.

The law is not yet been notified. It said that initially, it will be notified for one who does business. Around 97% of SMEs in India are proprietorship or partnership firms, and not limited liability partnerships or companies; so they are outside the ambit of the extant corporate insolvency regulations under the IBC. According to noted insolvency lawyer Sumant Batra. "Our society is quite unforgiving to defaulters, unlike the US where even courts have propagated the concept that society should be willing to forgive an unfortunate debtor– somebody who has failed to service his debt for reasons beyond his control and is not a fraudster. "He said there are many things that are outside the control of a debtor who has invested in a company. "So the debtor is also taking risks and he may fail at times. If we call every debtor a thief, it will strike at the very root of entrepreneurship."

If the Resolution Process (as per sections 94-120) fails, the individual concerned can be taken to bankruptcy if the creditor so wishes or even the debtor himself can apply to DRT for bankruptcy.

## 2. Definitions

Being a new subject, let us start with few important definitions.

**a.** **"Bankrupt"** means —

A debtor who has been adjudged as bankrupt by a bankruptcy Order; each of the partners of a firm, where a bankruptcy order has been made against a firm; or any person adjudged as an undischarged insolvent;

**b.** **"Bankruptcy commencement date"** means the date on which a bankruptcy order is passed;

**c.** **"Bankruptcy Trustee"** (BT) means the insolvency professional (IP) appointed as a trustee for the estate of the bankrupt;

**d.** **"Discharge order"**

An order passed by the DRT discharging the debtor. Discharged, meaning the individual will no longer legally required to pay the debt. The primary objective of filing a bankruptcy petition is to obtain a discharge order. A discharge order is given on an application by the BT, on expiry of one year from the bankruptcy commencement date though an earlier discharge is also possible where the committee of creditors (COC) approves the report of the BT.Even after discharge order the bankruptcy proceeding may continue and the discharged bankrupt will be required to co-operate with the various authorities including BT to conclude the process. A discharge order shall release the bankrupt from all the bankruptcy debt except debt incurred by means of fraud or breach of trust and excluded debts. Discharge order shall not affect the functions of the BT.

**e.** **"Undischarged bankrupt"** a bankrupt who has not received a discharge order.

**f.** **"Immediate family"** of the debtor means his spouse, dependent children and dependent parents; (important as some of the assets of immediate family members are excluded from estate)

While provisions of Corporate Insolvency and Liquidation relates only to corporates debtor here is a natural person, the Insolvency laws exclude certain assets "Excluded Assets" from the estate as these are necessary for the debtor to earn a living and personal and house hold assets.

The minimum assets required to preserve personal rights of the person and to allow an insolvent to live a productive life are excluded from attachment.

**g. "Excluded Assets"**

(i) Unencumbered tools, books, vehicles and other equipment as are necessary to the debtor or bankrupt for his personal use or for the purpose of his employment, business or vocation, No limit on value of assets.

(ii) Unencumbered furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt and his immediate family; No limit on value of assets. In USA even refrigerator, radio, television, cookware, tableware, sewing machine, books and pets too are excluded.

(iii) Any unencumbered personal ornaments of such value, as may be prescribed, of the debtor or his immediate family which cannot be parted with, in accordance with religious usage. Maximum value will be prescribed by regulation, above which ornaments will not be excluded. In USA watch, jewellery and object of Art with cap on value is excluded.

(iv) Any unencumbered life insurance policy or pension plan taken in the name of debtor or his immediate family. There is no cap as to amount and number of policies.

(v) Any unencumbered single dwelling unit owned by the debtor of such value as may be prescribed. Hope, for metro cities the prescribed value is appropriate.

(vi) In USA a motor vehicle, up to $ 4,425 in market value over any financed amount owed on the vehicle is excluded. For example vehicle with market value of $ 10,000 would be excluded asset if the loan on the same exceeds $ 5,675 and the bankrupt accepts to repay the loan with interest thereon.

It is said in USA most of bankruptcy cases (number wise) there is nothing beyond the excluded assets and thus the bankruptcy process becomes very simple as there remains nothing to manage and to distribute.

## 3. Bankruptcy Order

**a. Effect of Bankruptcy order**

Bankruptcy commences from the date on which a bankruptcy order is passed. On passing of the bankruptcy order, the estate of the bankrupt shall vest in the BT, which shall be divided among his creditors. Creditors are debarred from initiating any action against the bankrupt for their debts or commence any suit except with the leave of DRT. For bankruptcy order against firm it shall operate as if it were made against each of the individual partners. BT will have to perform the functions efficiently, diligently and professionally.

**b. Statement of Financial Position**

Where a bankruptcy order is passed on application by creditor, the bankrupt shall submit his statement of financial position to the bankruptcy trustee within 7 days from Bankruptcy commencement date.

**c. Standard of Conduct / Code of Conduct for BT**

The bankruptcy trustee shall perform his functions and duties in compliance with the code of conduct provided. *[refer*

*IBBI (Insolvency Professionals) Regulation, 2016 and Code of Conduct for Insolvency Professionals. (Refer IBBI http://www.ibbi.gov.in/law.php)]*

**d. Fees of BT**

Often the question is asked what the fee structure would be – The BT shall charge such fees as may be specified in proportion to the value of the estate of the bankrupt and shall be paid from the distribution of the estate.

**e. Release of BT**

When the role as BT is over – Bankruptcy trustee who has completed the administration of the bankruptcy process shall be released of his duties with effect from the date on which the committee of creditors approves his report.

## 4. Administration and Distribution of the Estate of the Bankrupt

**a.** BT plays an important role in the bankruptcy process. The trustee acts as the "agent of the adjudicator". In effective and efficient implementation of Insolvency law, with powers over the estate of debtor, debtor and his debts. Taking all necessary steps to protect and preserve the assets of bankrupt and his business, including preventing unauthorised disposal of those assets; realising the assets of insolvency estate; distributing the proceeds of realisation in liquidation and closing the estate promptly, in best interest of various constituencies. To ensure that the insolvency law is applied effectively and impartially.

**b. There are three Broad Functions of BT**

(i) Investigate the affairs;

(ii) Realise the estate; and

(iii) Distribute the estate.

**c. Duties of bankrupt towards BT**

The bankrupt shall assist the BT by:

(i) Giving to the BT the information of his affairs,

(ii) Attending on the BT at such times as may be required,

(iii) Giving notice within seven days, to the BT of any of the following events which have occurred after the bankruptcy commencement date,—

- acquisition of any property by the bankrupt;
- devolution of any property upon the bankrupt
- increase in the income of the bankrupt;

(iv) Doing all other things as may be prescribed.

The bankrupt shall continue to discharge the duties as above other than the duties under clause (iii) above, even after the discharge.

**d. "Rights of BT" :**

For the purpose of performing his functions, the BT may, by his official name—

(i) Hold property of every description;

(ii) Make contracts;

(iii) Sue and be sued;

(iv) Enter into engagements in respect of the estate of the bankrupt;

(v) Employ persons to assist him;

(vi) Execute any power of attorney, deed or other instrument; and

(vii) Do any other act which is necessary or expedient for the purposes of or

in connection with the exercise of his rights.

The BT steps into the shoes of the bankrupt, able to exercise rights which the bankrupt could have exercised had he not been adjudged bankrupt. BT has to undertake it in his official name, for example, *"the trustee of the estate of Mr ABC, a bankrupt". The rights have been given for the purpose of performing the functions entrusted to the BT.*

**e.** **"General Powers of BT"** which are exercisable without any sanction / approval by DRT or Committee of Creditors (COC) –

(i) Sell any part of the estate of the bankrupt;

(ii) Give receipts for any money received;

(iii) Prove, rank, claim and draw a dividend in respect of such debts due to the bankrupt;

(iv) Where any property is held by any person by way of pledge or hypothecation, exercise the right of redemption in respect of any such property;

(v) Where any part of the estate consists of securities in a company or any other property which is transferable in the books of a person, exercise the right to transfer the property to the same extent as the bankrupt might have exercised; and

(vi) Deal with any property comprised in the estate of the bankrupt to which the bankrupt is beneficially entitled in the same manner as he might have dealt with it.

**f.** **Additional powers exercisable by BT with the prior sanction of the COC**

(i) Carry on any business of the bankrupt as far as may be necessary for winding it up beneficially; On Insolvency adjudication, the bankrupt's business ceases and therefore, the business cannot be carried any further, however, the trustee has been empowered to carry on the business of the bankrupt only to the extent required for beneficial winding up. For example, selling of stock in hand.

(ii) Bring, institute or defend any legal action or proceedings;

(iii) Accept as consideration for the sale of any property a sum of money due at a future time subject to certain stipulations such as security;

(iv) Mortgage or pledge any property for the purpose of raising money for the payment of the debts of the bankrupt;

(v) Where any right, option or other power forms part of the estate of the bankrupt, make payments or incur liabilities with a view to obtaining, for the benefit of the creditors, any property which is the subject of such right, option or power;

(vi) Refer to arbitration or compromise;

(vii) Make compromise or other arrangement with creditors;

(viii) Make compromise or other arrangement with respect to any

(ix) Claim arising out of or incidental to the bankrupt's estate;

(x) Appoint the bankrupt to —

- Supervise the management of the estate of the bankrupt;

- Carry on his business for the benefit of his creditors;
- Assist the BT in administering the estate of the bankrupt.

**g. Vesting of estate of Bankrupt in BT**

The estate of the bankrupt shall vest in the bankruptcy trustee immediately from the date of his appointment without any conveyance, assignment or transfer. It operates as an act of taking away the rights from the bankrupt. A discharge from the bankruptcy releases the bankrupt from the debts and enables him to retain property which he subsequently acquires free of any claim by trustee. However, a discharge does not cause to be re-vested in the bankrupt any property which he vested in the trustee prior to the discharge from bankruptcy.

**h. Estate of Bankrupt**

1. All property belonging to or vested in the bankrupt, however, the estate of the bankrupt shall not include —

   (i) Excluded assets;

   (ii) Property held by the bankrupt on trust for any other person;

   (iii) All sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund; and

   (iv) Such assets as may be notified by the Central Government in consultation with any financial sector regulator.

2. Various questions arise for joint ownership properties in UK where wives have challenged sale of the family house on account of husband's bankruptcy. First offer should be invited from joint owner. In UK, section of the Welfare Reform and Pension Act, 1999 states that the benefit of an "approved pension arrangement" does not form part of the bankrupt's estate. The code is silent about the various funds like Provident fund, Gratuity Fund – Central Government may notify under clause (iv) above.

3. Delivery of property and document to BT – The bankrupt, his banker or agent or any other person having possession of any property, books, papers or other records which BT is required to take possession of, shall deliver the said property and documents to the BT. The BT shall take possession and control of the same. Actionable claims shall be deemed to have been assigned to the BT.

4. Restriction on disposition of property by debtor between filing of bankruptcy application and commencement date shall be void. This is to prevent the bankrupt from siphoning away property, which may be used for distribution amongst creditors and also to ensure that the estate is preserved in the period between the service of the petition and the making of the order. However, this shall not give rise to any right against any person, in respect of such property, who has received such property before the bankruptcy commencement date in— (a) good faith; (b) for value; and (c) without notice of the filing of the application for bankruptcy. The section grants protection to *bona fide* transferees for value.

**i. After acquired property of bankrupt**

The BT shall be entitled to claim for the estate of the bankrupt, any after-acquired property exclusions are

(i) Excluded assets; or

(ii) Property acquired after a discharge order is passed.

**j. Disclaim any Onerous Property of Bankrupt**

The BT may disclaim any onerous property which forms a part of the estate of the bankrupt. Notwithstanding that he has taken possession a notice of disclaimer shall not affect the rights or liabilities of any other person and any person who sustains a loss or damage in consequence of the operation of a disclaimer under this section shall be deemed to be a creditor of the bankrupt to the extent of the loss or damage.

***Explanation.***— The term "onerous property" *means* —

*(i) Any unprofitable contract; and*

*(ii) Any other property comprised in the estate of the bankrupt which is unsaleable or not readily saleable, or is such that it may give rise to a claim.*

An unprofitable contracts or property that may actually give rise to a liability to the estate may reduce realisable assets to the detriment of the creditors. Therefore code provides for its exclusion by bankruptcy trustee. Any property which cannot be disclaimed due to non–issuance of disclaimer notice due to such application will be deemed to be a part of the estate of bankrupt.

**k. Disclaimer of leaseholds**

The BT shall not be entitled to disclaim any leasehold interest, unless a notice of disclaimer has been served on every interested person. The example is of disclaimer of property leased where the rentals earned are meagre. If an application of objection is received, the disclaimer will take effect only if the DRT has directed so. The DRT may make an order for the vesting of the disclaimed property in, or for its delivery to any of the person/s.

**l. Treatment of undervalued transaction**

The BT may apply to the DRT for declaring the undervalued transactions as void. The transactions covered are those which were entered in preceding two years or which caused the bankruptcy process to be triggered. Transaction between bankrupt and associate will be deemed to be undervalued. The property transferred as a part of undervalued transaction can be vested back with the BT. The following types of transactions are covered –

- Gift,
- No consideration received,
- In consideration of marriage and
- Consideration significantly less than the value.

Similar provisions are there for **"Preference Transactions"** DRT may pass an order for property transferred to be vested with the BT. These provisions would not apply to the *bona fide* purchases.

**m. Extortionate credit transaction**

(Exorbitant payment terms for credit)

The BT may apply for suitable orders to DRT in respect such transactions entered during the preceding two years. DRT by order may set aside the debt or vary the terms or return part of amount to BT, to surrender any property to BT.

**n. Administration of estate of deceased bankrupt**

If a bankrupt dies during the bankruptcy process, the bankruptcy proceeding shall, continue as if he were alive. Bankruptcy proceedings will not abate and the BT will continue with the administration and distribution of the estate. Surplus if any will be paid to legal representatives of the deceased. The representative has similar duties to that of a bankrupt in the bankruptcy.

**o. Bankruptcy Claims (Proof of debts)**

Creditors are required to submit proof of debt to BT, giving full particulars of debt and particulars of security, copy of decree. Including the date on which the debt was contracted and value. BT shall estimate the value of bankruptcy debt which does not have specific value.

The BT may with the leave of DRT sell or dispose of any property that was subject to security, free of that security. A provable debt will be discharged in the bankruptcy process; a non-provable debt is not discharged. Interest stops accruing from bankruptcy commencement date. bankruptcy puts a freeze on debts on that date. Where the secured creditor's realisation from security falls short, he may produce proof of the balance due to him. If secured creditor surrenders his security to the BT for the general benefit of the creditors, he may produce proof of his whole claim. Mutual Credit and Set-off is to be done where there have been mutual dealings. Where before the bankruptcy commencement date, there have been mutual dealings between the bankrupt and any creditor the BT shall set off the dues and only balance amount shall be provable as a bankruptcy debt or amount payable to BT as a part of the estate of the bankrupt. A debt due to joint creditor cannot be set off against a separate debt due from one of the joint creditors.

## 5. Distribution

- **Interim dividend**

After giving notice of such dividend and the manner in which it is proposed to be distributed. BT having sufficient funds – money received on realisation of the assets, may declare and distribute interim dividend in respect of bankruptcy debt which they have respectively proved.

After making provisions for:

(i) Due to person who by reason of the distance may not had sufficient time to establish their debts.

(ii) Bankruptcy debts which are subject to claims which have not yet been determined

(iii) Disputed proofs and claim

(iv) Expenses necessary for the administration.

**Distribution of property:**

BT may with the approval of COC divide for distribution, in its existing form any property according to its estimated value, the property which cannot be readily and advantageously sold.

- **Final dividend**

After realising the entire estate or as much as could be realised, BT shall give notice of his intention to declare a final dividend or no final dividend shall be declared. The notice shall give all particulars of all claims. The DRT on application of any person may postpone the final date referred to in notice. If a surplus remains after payment in full with interest to all creditors of the bankrupt and payment of expenses the bankrupt shall be entitled to

the surplus. Where a bankruptcy order has been passed in respect of one partner in a firm, a creditor to whom the bankrupt is indebted jointly with the other partners in the firm or any of them shall not receive any dividend out of the separate property of the bankrupt until all the separate creditors have received the full amount of their respective dues.

- **Re-vesting of property**
  Though the property vests in the BT by operation of law, the transfer by him is a transfer by one party to another (BT to creditors) and cannot be said to be a transfer by operation of law. Stamping and registration would be required. A creditor who has not proved his debt before the declaration of any dividend is not entitled to dividend declared before his debt was proved. After proving his debt he is entitled to recoup his shortfall out of any money for the time being available for the payment of any further dividend. If the BT refuses to pay a dividend which is legitimately payable one the DRT may order him to a) pay the dividend b) pay out of his own money. i) Interest on the dividend and ii) the cost of the proceedings in which the order to pay has been made.

## 6. Priority of Payment of Debts also known as waterfall of liabilities

**a)** The priority of distribution is one of the most significant provisions of insolvency law as who gets paid and who is left out is determined on the basis of it. The hit (popularly known as hair cut) is determined in the order of priority. The section starts with non obstante clause which overrides anything to the contrary in any law enacted by the Parliament or the State Legislation for the time being in force. In the Presidency Town Insolvency Act, 1909 and Provincial Insolvency Act, 1920 all the debts due to the Government or to any local authority was 2nd priority after cost and expenses of bankruptcy process. Due to which in most of the bankruptcy cases except Government no other creditors were receiving / getting any dividends. In the newly introduced insolvency laws the Government dues is 4th in priority. This is a very bold step taken by the existing Government.

**b)** **Priority of distribution is as follows :-**

(i) Firstly, the costs and expenses incurred by the BT for the bankruptcy process in full;

(ii) Secondly,—

- the workmen's dues for the period of twenty-four months preceding the bankruptcy commencement date; and
- debts owed to secured creditors;

(iii) Thirdly, wages and any unpaid dues owed to employees, other than workmen, for the period of twelve months preceding;

(iv) Fourthly, any amount due to the Central Government and the State Government in respect of the whole or any part of the period of two years;

(v) Lastly, all other debts and dues owed by the bankrupt including unsecured debts.

**c)** The debts in each class shall rank in the order mentioned but debts of the same class shall rank equally amongst themselves, and shall be paid in full, unless the estate of the bankrupt is

insufficient to meet them, in which case they shall abate in equal proportions between themselves.

**d)** Where any creditor has given any indemnity or has made any payment of moneys by virtue of which any asset of the bankrupt has been recovered, protected or preserved, the DRT may make such order as it thinks just with respect to the distribution of such asset with a view to giving that creditor an advantage over other creditors in consideration of the risks taken by him in so doing.

**e)** Unsecured creditors shall rank equally amongst themselves unless contractually agreed to the contrary by such creditors.

**f)** Any surplus remaining after the payment of the debts shall be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the bankruptcy commencement date.

**g)** Interest payments under (5) shall rank equally irrespective of the nature of the debt.

**h)** In the case of partners, the partnership property shall be applicable in the first instance in payment of the partnership debts and the separate property of each partner shall be applicable in the first instance in payment of his separate debts.

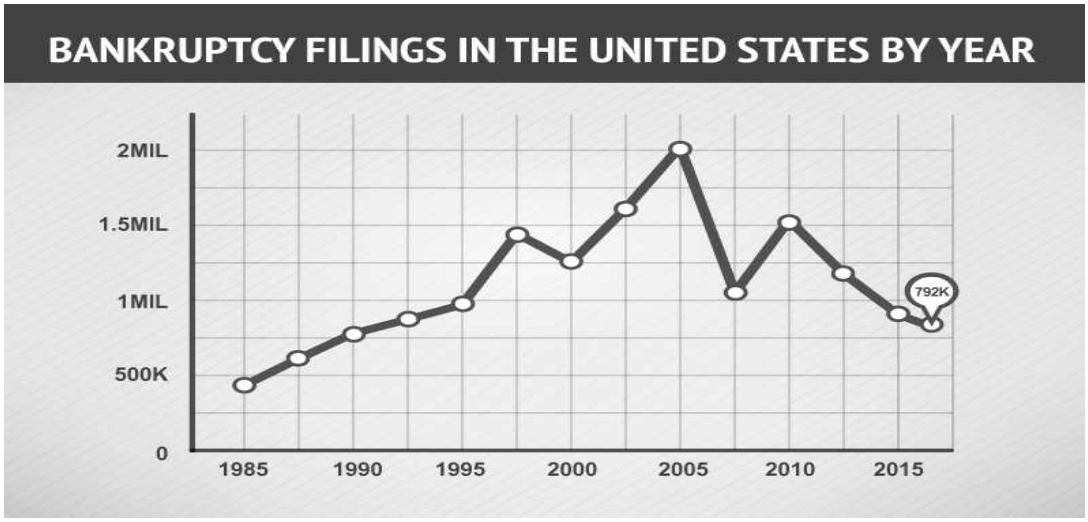
**i)** Where there is a surplus of the separate property of the partners, it shall be dealt with as part of the partnership property; and where there is a surplus of the partnership property, it shall be dealt with as part of the respective separate property in proportion to the rights and interests of each partner in the partnership property.

## 7. Practical Tips for the Bankruptcy Process

**a.** Identify the estate early, so as to avoid problems later.

**b.** Do not pay anyone anything, until you know what all the assets and liabilities of the estate are. There is always an urge to pay a creditor or a beneficiary who is pursuing "what is theirs" a bit aggressively. However, the approach of "I will get rid of problem one and deal with the rest later" will not pay off! When the estate is insolvent, the BT is obliged to pay the liabilities and debts in a specific order. Costs and expenses of administration are payable before any creditors. Secured creditors are those whose debt is secured. They get paid out of that asset. If the value of the asset is not sufficient to satisfy the debt, any unpaid balance of the debt becomes an unsecured debt. Unsecured creditors are all the other creditors whose debts are not a priority. If the assets of the estate are not enough to pay all, the unsecured creditors get paid on a pari passu. Bankrupt gets only if there are assets left (left over) in the estate after payment to all secured and unsecured creditors. In other words, when an estate is bankrupt, the bankrupt usually get nothing. The consequences of getting the above wrong may be catastrophic. If a BT pays a debt to an unsecured creditor in full, he is obliged to pay the liabilities due to all the other creditors in full, the liability is a personal one. If you have paid out 100% of any debt, you may have to refund the balance over the % that should have been distributed. Hence, if the assets in the estate are not sufficient, the BT will be personally liable for any balance due to the creditors.

## 8. Expected numbers




In India with 3 times higher population and growing culture of consumer finance similar numbers are expected. Presently as on 27-8-2017 only 904 Insolvency Professional are registered with IBBI.

**9.** IBBI should consider the following challenges before notifying the Code for Individuals and Partnership Firms:

(i) No. of DRT benches – Presently only 38 DRT's and 5 DRAT' are functioning in India. Including 3 each at 4 Metro cities (12). If we exclude them then in rest of India there are 26 benches only. In Maharashtra the DRTs are at Mumbai, Pune, Nagpur and Aurangabad only four cities. At least there should be a bench in all Districts. Further to adhere to strict time would be a big challenge as we are not used to same.

(ii) Information utilities as provided in IBC has to be properly functioning otherwise for Bankruptcy Trustee ascertaining the debt of bankrupt would be huge challenge. For corporate its comparative easy with audited balance sheet and charges record at ROC.

(iii) The monetary threshold of ₹ 1,000/- needs to be suitably raised.

(iv) Investigating the affairs of bankrupt for preference, undervalued transactions with associates and relatives would be difficult and costly task for BT to perform.

If patience is worth anything, it must endure to the end of time. And a living faith will last in the midst of the blackest storm.

*— Mahatma Gandhi*

CA P. R. Rajagopal

# How Finance sector & economy is likely to be benefitted – impact of code on creditors/lenders & debtors/ borrowers. Whether IBC can be misused by creditors

## Introduction

The Insolvency and Bankruptcy Code, 2016 (the Code) is a consolidating law that combines laws relating to corporate and personal insolvency in a single code. The code shifts powers of insolvency adjudication hitherto vested in High Courts and Civil Courts to specialized tribunals. For adjudication of corporate insolvency the power now is conferred on National Company Law Tribunals (NCLT) and for insolvency of individuals, the powers are now given to Debt Recovery Tribunals. Provisions of law with respect to corporate insolvency have since come into force and the provisions relating to individuals are yet to be notified. NCLTs have started functioning in a full-fledged manner. Many cases have come to be filed by banks and the general creditors against defaulting companies.

Internationally Insolvency Bankruptcy law for resolution of financial distress induced by debt default is one of the essential structures that sustain the economy through its downward spirals. The law provides a framework that helps lenders to resolve unforeseen fallouts arising when a company defaults on its debt payments. The law delineates the supervision over the distressed company for the benefit of various creditors and enunciates mechanisms for financial and business restructuring. The law primarily aims to foster an economic climate that facilitates investors' willingness to provide capital ex-ante and ex-post and thus may determine choice of capital structure and cost of capital. The framework of bankruptcy law varies widely across the world. Some countries, like the U.S. and France, have laws that encourage active involvement of promoters in financial restructuring and retain the management. Whereas other countries, like the U.K. and Sweden encourage creditors to control the financial restructuring of insolvent company through court supervised resolution professionals. India has borrowed heavily from U.K. and retained some of the features of U.S. in the code. In other Insolvency and Bankruptcy code in India is an eclectic mixture of U.K. and U.S. law.

## Framework under the Code

Objects and purposes of the Code is time-bound insolvency resolution where interests of company, banks, creditors and employees are balanced such that a resolution plan drawn up and implemented maximizes the value of

a distressed business. Positive impact on the overall economy that insolvency resolution brings about is proven and is supported by copious economic literature. In order to achieve the objects and purposes of quick and efficient insolvency resolution the Code prescribes a new quasi-judicial set-up comprising four critical pillars:

1. An expert adjudicatory body in National Company Law Tribunal comprising both Judicial and Technical members.
2. A support structure in the form of experts appointed as resolution professionals and subjected to regulation by regulatory body namely Insolvency and Bankruptcy Board of India to control and give fillip to positive outcomes in financial restructuring exercise.
3. An information network structure in the form of information utilities (IUs) to facilitate ascertainment and validation of financial defaults to quicken the insolvency resolution process.
4. Insolvency and Bankruptcy Board of India (IBBI) as an independent regulator to institutionalize strengthen and firmly establish a robust legal and regulatory framework for resolution of insolvency and financial distress.

As of date the entire institutional infrastructure has been put in place and has started functioning. All the enabling rules, regulations stand notified as of date. There are now 11 NCLTs and an Appellate Tribunal known NCALT. The IBBI has been constituted and has started building capacity. The regulatory framework for IPs and IPAs is in place and some IPs and IPAs have already been registered by the IBBI. It may take some time for new IUs to get registered but even without the IUs in place, the provisions of the IBC related to the Corporate Insolvency Resolution Process (CIRP) has since been implemented. The judicial forums including NCLT,NCALT and Supreme Court have since handed down some very important judgments and to a great extent cleared the clouds in implementation of the Code.

## Benefits to Financial Sector and Economy

The Code, if implemented in its spirit and if the stakeholders gain the maturity to appreciate the benefits of financial and business restructuring as opposed to liquidation of companies, will bring long-term benefits to the financial sector in particular and to the economy in general. It is common knowledge that financial distress involves default in financial contracts by a company. There may be several causes that lead to financial distress, prominent among them being finance costs being more than the net revenues or the value of assets not being adequate to meet the liabilities. Economic research proves that Company's tend to service finance costs and postpone payment towards operating expenses leading to accumulation of dues towards operating expenses, which in turn deepens the company's financial distress. Resolution of financial distress is achieved either through liquidation of assets or through restructuring financial contracts. The code provides for the mechanism for resolution of financial distress through two-step method. Firstly the code prescribes 180 days plus another 90 days to renegotiate and redraw financial contracts with the lenders and the creditors such that the company can come out of financial distress. The second and the last step is lenders and creditors are paid off through liquidation of assets. Between the two steps, the first step is considered economically efficient as it addresses the financial distress on one hand and protects the value of the company on the other hand.

To quote economic survey, India has been trying to solve its Twin Balance Sheet problem. Overleveraged companies and bad-loan-encumbered banks created by biggest investment boom in the country's history in the

infrastructure related areas, which is financed by banks. It is known that just as companies were taking more risk, things started to go wrong. Costs soared far above the budgeted levels, as securing land and environmental clearances proved much more difficult and time consuming than expected. These problems were compounded by phenomenal increase in finance costs. In nutshell, higher costs, lower revenues and greater financing costs squeezed corporate cash flow, leading to debt servicing problems. Economic Survey notes that NPA resolution is littered with several obstacles, notable amongst them being (i) severe viability issues (ii) acute coordination failures (iii) unwanted attention from investigating agencies and negative perception of public about write offs for big borrowers (iv) insufficient capital of public sector banks severely curtailing banks' ability to take hair cuts. Unsatisfactory experience of the previous years in implementation of various schemes of restructuring permitted by RBI reinforced the long held belief amongst bankers that the above obstacles cannot be overcome in the framework of bilateral renegotiation of loan contracts. There are hardly any successful restructuring stories during the last two years. In that backdrop the Code brings about the necessary framework for smoothening the process of financial restructuring of big companies and further enables banks to realize the assets of the companies that are completely insolvent.

As a further follow up in expediting the resolution NPAs, Banking Regulation Act was amended and RBI has been conferred power to direct banks to refer the companies for insolvency resolution under the Code where banks could not find resolution bilaterally. Consequently, 12 companies comprising 25% of NPAs of banks stand referred to NCLT for resolution. Proceedings before NCLT, deliberation in the meetings of committee of creditors and media reports suggest that financial restructuring through NCLT is not plagued by the obstacles otherwise found in the RBI schemes. Further, initial reports suggest that banks have been constructively engaging with the resolution professionals for deep financial restructuring involving combination of resolution strategies in the sense that typical proposals involve all the elements namely; renegotiated loan contracts, liquidation of non-core assets and conversion of debt into equity, dilution of promoters stake thus ensuring share of loss is borne by the promoters etc. Swiftness with which the code is implemented and intent to resolve the financial distress associated with the same has encouraged investors to show willingness to participate actively in the restructuring plan through capital infusion in the troubled companies.

From that perspective the Code is a decisive step towards resolution of financial distress in the companies, consequently resolution of NPAs. From that perspective it would directly benefit the financial sector. Apart from the same, the regime under the code which lays down creditor in possession during insolvency resolution has pushed the promoters to scramble to protect their capital by ensuring revival of the company through capital infusion and even divestment of control to other business groups. In my view, the fallout of the code in the medium to long term will be desired deleveraging of the corporate balance sheets such that the twin balance sheet problem may not recur again.

The code has a framework that allows banks to renegotiate loan contracts without the Damocles sword of investigating agencies hanging over them. Once NPAs are taken out of the books of the Bank, the government will recapitalize them, thereby restoring them their financial health. Banks once recapitalized will be able to lend to productive sectors, which in turn will help the economy. Apart from the same the insolvency regime under the Code, if backed efficient and quick judicial decision-making, would foster a climate of measured risk taking by the investors and the promoters. To elaborate, the Code as exists today heavily favours financial

creditors and subordinates the rights of equity shareholders. Thus the framework has already sent out signals that in the event of insolvency proceeding before NCLT, equity shareholders are likely to lose control, value of their investments and the unsecured creditors are likely to lose their money. Hence, in my view, the regime is likely to force all the stakeholders to come together and encourage resolution of financial distress in quick and effective manner when the financial distress is nascent instead of precipitating the distress. This is a big positive for the economy.

## Whether Creditors will misuse the Code

As an avid watcher of the working of the Code from close quarters, one of the skeptical posers, I encounter is whether creditors will misuse the Code. The apprehension mainly arises from the fact that the Code empowers operational creditors to trigger the insolvency and the threshold for insolvency trigger is measly Rs.1 lac. I would like to answer the poser by copiously borrowing from the observations of the authors Stijn Claessens of University of Amseterdam and Leora F. Klapper of World Bank in their working paper on Bankruptcy around the World: Explanations of its Relative Use. I record my acknowledgement to the authors in this regard. Authors have studies the insolvency law across the Europe and summary of their findings is that:

- Law that protects creditors' rights and provides for payment of creditors first has discouraged risky behavior by the promoters and companies and thus reduces probability of financial distress.
- Law that provides for replacement of existing management upon invocation of insolvency is not appealing to creditors used to dealing with the existing promoters and hence right to file for bankruptcy may not be frequently invoked
- Well functioning courts tend to balance the rights of all stake holders and reduce the misuse of bankruptcy procedures
- The scheme of the law that provides for payment of secured creditors first discourages other creditors to invoke bankruptcy procedures, as they tend to realise overtime that in the bargain they may lose their entire money.
- In countries with weak judicial efficiency, bankruptcy proceedings tend to prove costly for creditors and hence over a period of time the use of bankruptcy will be less and less.

## Conclusion

In my view once the initial euphoria dies, things will be back to normal in so far as indiscriminate invocation of the Code. The promoters, the banks and the creditors are slowly realizing that the insolvency resolution in the current context where companies have bloated balance sheets will prove costly for the creditors than the promoters. I am of the view the Code is a big positive for long term health of the credit markets and in the short term there will be pain that the creditors may have to endure considering that many companies have borrowed beyond their capacity to repay.

The moment there is suspicion about a person's motives, everything he does becomes tainted.

*— Mahatama Gandhi*

CA Abizer Diwanji

# Eligibility, roles, responsibilities, opportunities, risk of Insolvency Practitioners (including that of IPE)

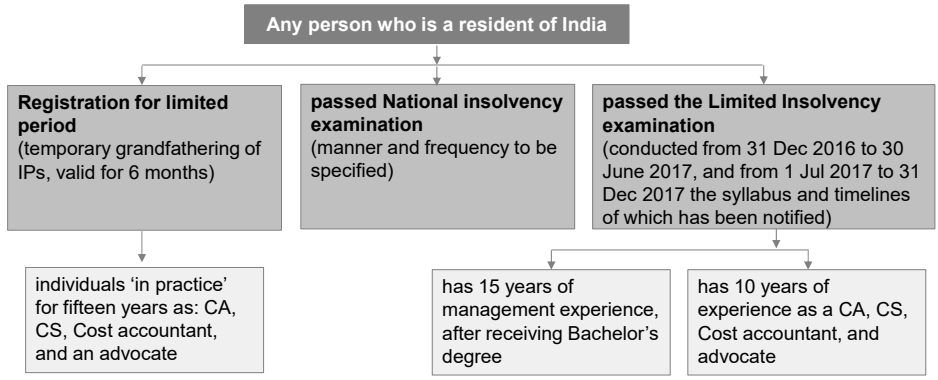
The Insolvency and Bankruptcy Code ('IBC') has created a new breed of professionals who would have the expertise in dealing with distress resolution, and they are called Insolvency professionals. IPs are licensed professionals enrolled as a member of an Insolvency Professional Agency ('IPA') and registered with Insolvency and Bankruptcy Board of India ('IBBI'), the regulator. There are 3 such IPAs created so far, namely: (i) Indian Institute of Insolvency Professionals of ICAI; (ii) ICSI Insolvency Professionals Agency; (iii) Insolvency Professional Agency of Institute of Cost Accountants of India.

The country has a large eclectic pool of competent professionals who can shoulder the responsibility of Insolvency resolution. However this talent pool needs to be channelised into a specialised force in order to fast track development of insolvency industry. In order to utilise the existing talent pool, the IBBI has allowed experienced professionals a direct entry into the IP profession through:

(i) Limited insolvency Examination for certain professionals with 10 years of experience "in practice" or 15 years in management. 71 professionals have already been registered under this category as on 17th March 2017;

(ii) Registration for limited period for certain professionals with over 15 years of experience "in practice", which is valid for 6 months. 977 professionals have already been registered under this category as on 17th March 2017;

until the time it implements the full-fledged National Insolvency examination system.



## Insolvency Professional Entities (IPE)

- A limited liability partnership, a registered partnership firm or a company may be recognised as an insolvency professional entity if-
- a majority of the partners of the limited liability partnership or registered partnership firm are registered as insolvency professionals; or
- a majority of the whole-time directors of the company are registered as insolvency professionals

The regulator could have moved slow and create a highly trained pool of professionals before allowing IBC to permeate into the India Inc. The collective wisdom, however, led to easier licensing of the existing experienced professionals into becoming insolvency professionals through passing of the Limited Insolvency examination. The rationale behind this stems from the urgency to resolve the bad loans which could derail India's growth story, if not tackled now. It does carry risk of mishandling of large insolvency cases by greenhorn insolvency professionals, which could accelerate value destruction in the insolvent debtor. Despite easier licensing, the choice of IP is best left to the market participants, i.e the Committee of Creditors, who can appoint the IP who, in their collective wisdom, is the best professional to protect their interest. The CoC has by far been rational in its appointments.

The IPs shall play a pivotal role in the resolution/liquidation process under the Code, and shall act as an interface between all other stakeholders including corporate debtors, its creditors, regulators, judiciary, authorities etc. IP shall indeed be a ringmaster as we shall know in further discussion.

## A) IP in the letters of the Code:

- **What does an IP do?**

An IP shall take necessary action in the following matters:

a) a fresh start order process

b) individual or partnership firm insolvency resolution process

c) corporate insolvency resolution process

d) individual bankruptcy process

e) Liquidation of a corporate debtor firm

IPs would act as resolution professional or liquidator in case of corporate insolvency, or bankruptcy trustee in case of individual bankruptcy. For corporates the IP would act in three capacities depending on the stage of insolvency process, namely, interim resolution professional, resolution professional and liquidator.

**"Resolution professional" (RP),** for the purposes of corporate insolvency, means an insolvency professional appointed to conduct the corporate insolvency resolution process and includes an interim resolution professional. "Liquidator" means an insolvency professional appointed as a liquidator for the liquidation of the company.

- **Appointment and tenure of interim resolution professional/ Resolution professional**

An insolvency professional is appointed by NCLT based on recommendation made by IBBI or as proposed by the financial creditor or corporate debtor in the application. The IP so appointed is called interim resolution professional (IRP) as the terms of appointment would be for thirty days only. Subsequently the committee of creditors in the first meeting may either resolve to appoint the IRP as RP or to replace the IRP by another RP. This would however be subject to confirmation by the Board.

- **Management of affairs of corporate debtor by the resolution professional**

One of the striking features of the code is to shift the management of the company under resolution in the hands of IP who shall report to

the creditors committee. The insecurity around losing control has created many scepticism and hence, defensive action. The media on its part has leveraged this fear immensely.

The appointed IP shall exercise all the powers of the board of directors or the partners of the corporate debtor. For the purpose IP can appoint other professionals; enter into contracts on behalf of the corporate debtor; raise interim finance; issue instructions to personnel; or any other action as may be necessary for keeping the corporate debtor as a going concern.

- **IP as a resolution planner**

The law doesn't require the resolution plan to be prepared by the RP. Any resolution applicant can prepare and submit the plan. But RP is required to prepare and submit information memorandum as prescribed, and provide any relevant information required by the CoC. Further it is RP's responsibility to ensure that the plan to be approved meets all the requirement of Code and does not contravene any of the provisions of the law for the time being in force.

IP may however be asked by the members of the CoC or other stakeholders to help them in preparation of the resolution plan, which shall be additional responsibility over and above what is prescribed in the Code.

- **Duties of resolution professional**

The Code lays down several procedural duties, functions and responsibilities entrusted on the IP. Some noteworthy duties include:

- take control and custody of any asset over which the corporate debtor has ownership rights; but not the assets of any subsidiary of the corporate debtor
- prepare the information memorandum (IM) and invite prospective lenders, investors, and any other persons to put forward resolution plans. The form and manner of IM and Plan shall be separately specified by the Board
- investigate the financial affairs of the corporate debtor to determine undervalued or preferential transactions
- examine the resolution plans to confirm that it provides for: a) the payment of insolvency resolution process costs; b) repayment of the debts of operational creditors; c) management of the affairs of the Corporate debtor; d) implementation of the resolution plan
- present the plan to the CoC for its approval and submit the approved plan to the Adjudicating Authority
- Additionally the IRP is also required to make a public announcement for inviting claims from all creditors and verify the same, appoint valuers for calculation of liquidation value

Remember the IP is required to manage the business as a going concern. Therefore, the IP is expected to make decision on several matters which cannot be anticipated in advance. It calls for application of professional judgment, decision making, remain updated and well informed, being transparent and proactively communicate with various stakeholders.

- **IP as a liquidator**

The corporate debtors shall go into liquidation if the CoC fails to approve a resolution plan or resolves for liquidation. The RP appointed for the corporate insolvency resolution process shall continue and act as the liquidator for the purposes of liquidation unless replaced by the NCLT. As in case of RP, all powers of the board of directors, key managerial personnel and the partners of the corporate debtor shall be vested in the liquidator.

- **Powers and duties of liquidator**

Further the liquidator shall have the following powers and duties, namely:

- receive, verify and value claims of all the creditors, and settle such claims
- take into his custody or control all the assets, property, effects and actionable claims of the corporate debtor
- carry on the business of the corporate debtor for its beneficial liquidation as he considers necessary
- sell the assets by public auction or private contract
- obtain any professional assistance from any person
- investigate the financial affairs of the corporate debtor to determine undervalued or preferential transactions
- take all such actions as may be necessary for liquidation
- form an estate of the assets which will be called the liquidation estate in relation to the corporate debtor holding the liquidation estate as a fiduciary for the benefit of all the creditors
- access any information systems for the purpose of admission and proof of claims and identification of the liquidation estate assets from several specified sources
- apply to the Adjudicating Authority for avoidance of preferential transactions and undervalued transactions

- **Penalties**

If an insolvency professional deliberately contravenes the provisions of the Code, he shall be punishable with imprisonment for a term which may extend to six months, or with fine which shall not be less than one lakh rupees, but may extend to five lakhs rupees, or with both.

Also for fraudulent actions of the Bankruptcy trustee (in case of individual and partnership insolvency), it provides for imprisonment for a term which may extend to three years, or with prescribed fine.

- **Protection of action taken in good faith**

Along with the onerous risk and responsibility on the IP, the Code also provides protection from any legal action to the various participants of the insolvency process, including IPs, for actions taken in good faith. Section 233 protects Government or any officer of the Government, or the Chairperson, Member, officer or other employee of the Board or an insolvency professional or liquidator for anything which is in done or intended to be done in good faith.

## B) IP in the real world

Given the novel role of IPs as a custodian of a company under insolvency process, it is difficult to envisage and regulate all matters that an IP may have to deal with. Each case will be different than the other with complexities of various degree and in unexpected forms. While the law has provided a broad framework on which detailed regulation and guidance will be developed as the industry progresses, the expectation of all stakeholders is driving and shall continue to drive the roles and responsibilities of the IP.

It is difficult for the law to distinguish between a good and a bad IP, and it is left to market participants to make the best out of the available pool of IPs. The IP's role on ground is much wider and deeper than what is understood by bare reading of the law. Based on recent few cases of insolvency, the following issues can only give a small insight into what an enigmatic IP does on ground and the inherent risk he is exposed to:

| Area | Description |
|---|---|
| Communication | Communication always remains a corporate activity with underestimated importance, but in the insolvency resolution process, it can easily be the difference between success and failure of the process.<br><br>In a CIR process, almost anyone associated with the company is a stakeholder. Depending upon the industry, the no. of vendors, employees, and customers can run into thousands and even more. They tend to start with a negative perception about the entire process, and the IP has to engage with each one of them, directly or indirectly, to ensure a full-fledged cooperation, because a chain is as strong as its weakest link. Even a small miscreant stakeholder could play spoilsport and delay or derail the entire CIR process.<br><br>Also, the various statutory and Government authorities in our country are not known to be proactive when it comes to dealing with corporates particularly in crisis situation. The onus to engage with them lies with the business managers, i.e., the IP during CIR process. |
| Industry knowledge | It is the collective wisdom of the applicant and the CoC to decide which IP is fit and proper to safeguard their interest. But one cannot deny the utmost importance of industry knowledge that the IP must have. Or else he can be taken for a ride by the company's official. Also a company under insolvency is not supposed to be a learning school for beginner IPs.<br><br>While one expects that the IPs of future will be industry specialists who can manage the business with ease, the IPs currently are in embryonic stage. It is therefore critical that the IPs who are appointed are prepared well with relevant industry knowledge. |
| Team work | The law contemplates the IP to be an individual, but an individual cannot be expected to carry out all the required functions. It is understandable that IP shall rely on his own team and/or on the existing team of the corporate debtor. The entire process is time bound and each activity has to be completed on time in coherence with the overall objective. All participants during the process should respect the mandate and fully support the IP, but getting such support is easier said than done.<br><br>Further it is important that the IP has the ability to mobilise organisational resource at short notice through in-sourcing or out-sourcing in anticipation of the volume of work on a case-to-case basis. |
| Independence and integrity | How easy it would be for a corporate debtor to allege malfeasance on the part of the IP? While the law does protect IPs for actions taken in good faith, but a small error on his part can invite criticism and land him into legal tangles only to prove he undertook actions in good faith. Few such cases can potentially act as a deterrent for the future IPs to come into this industry.<br><br>It is in the current IPs themselves to ensure they maintain highest standard of integrity and independence, and follow the code of conduct both in letter and spirit with a zero tolerance approach. |
| Information management | All decision made during the process depends on the information shared by the IP. The timeline is too short for the IP to ensure all information that he gathers |

| Area | Description |
|---|---|
| | and presents are accurate. Information memorandum is just one set of prescribed information that the law could contemplate, but in reality the members of CoC would want to know so much more before voting on any matter. There may be issues of data security, IT systems, or even a genuine mistake. But such issues can result into bad resolution planning, or even unjust enrichment of some creditors over the other. Again it is left to the wisdom of the IP how best he ensures utility and accuracy of the information. |
| Claims management | One of the most important activity of the CIR process is the verification of claims. The vendors would tend to overstate their claims, or make good their disputed claims forcing the IP to process them in order to continue doing the business. Depending upon the quantum of claims and historical unreconciled transaction, it may become a mammoth task to admit the claims and consider it as part of the resolution plan.<br><br>Sometimes dispute over old claims may become an obstacle in day to day support by the vendors. |
| Compliance | India Inc. is infamous for non-compliance partly because of their apathy, and partly due to sheer volume of compliances that are applicable to a business entity. Issues of compliance is always a non-negotiable subject in professional circles, but during the CIR process, the IP has to judicially channelise his energy between compliance and business issues. There may be instances where commercial sense and compliance come at loggerheads, but it is important that IP is unperturbed by it, and continue to put utmost importance on compliance of the law of the land, and educate the CoC on the same. |
| Safety and insurance | Unsafe workplace and uninsured assets is the last thing that the CoC would want to inherit as part of CIR process. Due to cash flow issues or purely callous outlook of the management, the corporate debtor may have remained under insured or unsafe, but an IP wouldn't want to continue the mistake and carry the same risk on his shoulder. He has to set the priorities safety right at the top before any discussion on resolution plan could be discussed.<br><br>Additionally, specialised insurance products would have to be developed for professional indemnity of the IPS themselves. |
| Business improvement | The CoC may take the moratorium period to approve and implement the resolution plan, but improvement initiatives cannot be ignored till then. A business may be in need of immediate first–aid either in the form of Interim finance, or other operational interventions. The IP has to try to improve the existing condition than just maintaining the status quo. |

There are many other areas, all equally important if not more, which an IP is expected to work on simultaneously, and proactively engage with all stakeholders. There cannot be a litmus test for the work of IP, but the effort has to be result oriented and best foot should be put forward.

Whilst the working knowledge of local laws is a must, an IP needs entrepreneurial qualities. He needs to be able to manage various stakeholders, take business decisions, deal with hostile environments mainly caused by pent up frustrations as well as be firm in his resolve. These qualities are useful to deal with

the insecurities of the promoters and making sure the business gets the right level of interim financing at the right time to keep the enterprise value going.

On resolution plans, not only does an IP need to make sure that the law is complied with in all respects, he needs to make sure that the information memorandum is in the spirit of distributing equitable information to the right parties without having to impact the company's competitive advantage. Excessive information could destroy value as much as limited information would in terms of appreciating value.

While evaluating resolution plans, the IP should formulate, document and communicate clearly and as far as possible measurable basis of evaluation. This would enable the IP to be objective and reduce the risk of potential litigation.

## C) Opportunities for IPs

India Inc's capital is primarily debt funding and less of equity, and debt portion is primarily in the form of bank loans. Of the total INR88 trillion domestic debt outstanding in the capital market, sovereign debt accounts for INR64 trillion, while corporate debt accounts for the remaining INR24 trillion. India Inc.'s debt capital is primarily funded by bank loans (total bank loan to corporates is 2.8 times corporate bonds outstanding as on December 2015).

The Banking industry is facing a deluge of stressed assets, with over INR 9.64 lakh crore of stressed assets (gross non-performing assets and restructured standard advances) as on 31st December 2016. Similar bad loans in the form of non-banking loans and bad loans in unorganised sector could be anybody's guess.

Continuation of such large bad loan means risk of capital inadequacy. Failure of even one bank shall have chain effect on the economy, creating structural imbalances. Therefore, the resolution of this bad loan is critical to the success story of India Inc. and is of utmost focus for the incumbent Government.

Resolving this would require concerted effort from all stakeholders and IPs shall drive the process of resolution. While the role of RP in the CIR process is statutory requirement, professionals of all hue shall have opportunities to act as consultants representing stakeholders for various activities, such as resolution planning, making representation to the CoC, legal counselling, transaction advisor, interim management, due-diligence and allied activities, valuation, business turnaround and performance improvement services, and many others.

The remuneration available to professionals can be a combination of fixed and success based fee. Let's assume, resolution of bad loans could entail a resolution cost of 1%, which gives a professional services market of 10 thousand crore over the next few years for the existing reported bad loans.

Moreover, the opportunities in IBC is not a one-time wonder. It would help develop the debt-market and consequent flow of capital, both new and old, would continue to offer many opportunities to the professionals evolved from the churning of insolvency market. The debt cycle would result perpetual rechannelling of debt funds, through resolution of newer insolvency cases, hence the opportunities to IPS and other professionals will only increase in many forms. In addition a small portion of the insolvency market would also be contributed by individual insolvency under IBC, the legal framework for which is yet to come into force.

There already are 826 registered IPs and 27 registered IPEs as on 16th August 2017, which clearly show the immense popularity of the IP profession among the professional community. In over 200 cases, CIRP has already been initiated by both debtor and creditor. Around 20 cases have also opted for voluntary liquidation under the Code. These are relevant barometers of the demand of insolvency professionals and the confidence of the business community to resolve the distress under the aegis of IBC.

CA Pankaj Majithia

# Challenges/Contentious issues/hiccups – How to overcome – Will it be panacea for NPAs & Bad Debts

## Background

At the closure of Financial Year March, 2017, the gross non-performing assets of Indian banks were ₹ 12 lakh crore (or 10% of total advances) approximately (after huge amount of write offs). Number of Banks as result thereof are either merged or planning to merge or are placed under close supervision of RBI restricting their Independence (P.C.A). One of the reasons for such high level of NPA's were slow process of Resolution at lenders end. Fear of vigilance action and very slow legal assistance for quick recoveries which had to great extent emboldened the borrowers to wilfully default also. The delays were so much which can be appreciated from following table.

| | **Time taken** |
|---|---|
| BIFR Reference hearings | 0 – 2 years |
| BIFR Reference & Decision including Appeal | 5 – 10 years |
| DRT – Along with or without BIFR | 5 – 7 years |
| Winding up Petition with High Courts | 4 – 5 years or even more. |

Such delays defeat the whole recovery mechanism. It not only affects lenders but borrowers also as they unnecessarily fight legal battles for loss making entities and lose their fruitful working years.

In assessing the effectiveness of insolvency regimes, the efficiency and timeliness of the process are emphasised as delays go against the grain of preserving and maximising the value of the debtor's assets.

**In order to assist woes of Financial sectors & also ailing business for revival, new enactment i.e. Insolvency & Bankruptcy Code, 2016 came into existence. The 2016 Code proposes a watershed shift from the existing regime of 'Debtors-oriented' to 'Creditors oriented'. The 2016 Code aims at consolidating all the existing insolvency related laws as well as amending multiple legislation including the Companies Act, 2013 and has an overriding effect on all other laws relating to insolvency and bankruptcy.**

The Code deals with insolvency resolution and liquidation of corporate entities, with most of the work concerning the insolvency resolution/ liquidation been dealt with by the registered insolvency professionals under the supervision of the NCLT. Once the corporate insolvency process is initiated, the insolvency professional will be required to form a Committee of Creditors, and with their consensus efforts will be made to bring forth a plan to revive the corporate entity. First time, there is time bound programme at least now intended (to what extent, it will be successful, only time can say).

The corporate insolvency resolution process is to last for 180 days with further maximum period of extendable time of 90 days more, whereby efforts will be made to evolve a resolution plan to revive the ailing entity, in the event of failure, the corporate person will be liquidated in time-bound manner. A 'Fast Track Corporate Insolvency Resolution' will be available to small corporate entities. As far as the corporate insolvency resolution process is concerned the NCLT is the adjudicating authority and NCLAT is the appellate authority. Part III of the 2016 Code deals with insolvency resolution process and liquidation proceedings *qua* the individuals and the firms. There are two distinct processes, namely, fresh start and insolvency resolution, for the individuals and the firms. These processes are followed by the 'bankruptcy order'. It is the DRT which will be the adjudicating authority and DRAT which will be the appellate authority for the individuals and the firms so far as insolvency resolution and liquidation proceedings are concerned.

## Critical Analysis – Pitfalls – Can it really be panacea for troubled finance sector

Admittedly, the new enactment shows keen interest and attention focused Financial Recovery Mechanism and delays in getting recoveries due to number of loopholes and delay in legal system and is a welcome move and beginning on right direction and yet when the topic entrusted is to give critics perspective, followings are the key observations where again some amendments/rectifications are required or by proper implementation, our apprehensions can be addressed suitably.

### 1. Violation of Natural Justice

The trigger for filing application for corporate insolvency resolution process is default in repayment of financial debt or operational debt. There is no requirement of any notice before filing for insolvency resolution process by financial creditor. No opportunity is given to the borrower like what is provided under Eecuritisation Act i.e., of notice to borrower and reply to their initial objections before proceeding for Insolvency.

### 2. Too harsh for borrowers

The law of insolvency as it stands is interpreted by Courts and insolvency orders are passed in extreme cases. The proposed Insolvency & Bankruptcy Law is a major change and departure from the existing law, which is normally found to be interpreted by the Courts in favour of debtors. The order of winding up should be made in rarest of rare cases. It is like signing a DEATH WARRANT, and such insolvency proceedings which are creditor oriented can be initiated immediately even on single default.

### 3. No protection even for genuine reason or force majure

The default is a solitary one without any delays in payment of other dues for valid and satisfactory reasons: OR

The default is on account of delays in payment for supply of goods / services to Government Departments, other public authorities and public-sector enterprises or large undertakings: OR

The default is on account of some accident or natural calamity, requiring compassionate treatment of default including grant of debt relief may not work as an excuse or logical reason for not applying Insolvency Act.

### 4. Mammoth work – Low infrastructure

If really workable plan for revival is to be made, the time period as stipulated of 180 + 90 days of extension will in practice be found to be too short. Just to prepare information memorandum from the available data and support of existing staff (who in most of the cases will be hostile mainly on account of non-payment of salary or late salary payment and no chance of increment) will be a stupendous task. Moreover, most of the present flock of Insolvency Resolution Professionals are hailing either from accounting field or secretarial or legal field, who will hardly have any knowledge of the product or industry, or manufacturing process

and to expect revival plans from them is going to be sort of miracle.

Today, long pending demand from judiciary is lack of proper facilities for holding of Courts, Judges Rooms, Proper Air conditioning or even Toilet facilities is not getting Resolved. Now New Courts -NCLT, NCLAT will again require Court Rooms, support staff, Library data Bank, connectivity of internet & properly qualified Adjudicating Authorities otherwise sensibly & diligently prepared revival plan will either gather dust or will be rejected on finding of small procedural errors of claimants.

## 5. Probable delays when the numbers will increase

All the existing Acts including The SARFAESI Act, under Section 17, empowers debtors to file an appeal against any action taken by creditors with the Debt Recovery Tribunal and the Debt Recovery Tribunal is required to decide such applications within 4 months. There is hardly any case till date, that has been decided within a span of 4 months by the DRT. And now to expect that the 2016 Code will turnaround things in a way that will make insolvency resolution a smooth and time-effective stroll to recovery or liquidation is too much to expect.

## 6. Low Trigger Point

Triggening of insolvency process at very low level will increase lots of work at NCLT which again like Internet will crash under the load. Even an executive drawing salary of ₹ 1.00 Lakh can now approach NCLT if his salary remains unpaid for one month. Even CA/Advocate can now get the client declared insolvent if his fees is outstanding / exceeding ₹ 1.00 Lakh. Such low limit will also increase the workload.

## 7. Operational creditor in weal position

In creditors committee, no place is allowed for operational creditors. Now, if we really consider our GDP figures, more than 50% contribution comes from services, who will form part of operational creditors and to quarantine such large group even in decision making process is not going to help revival/ restructure plan viable.

## 8. Technology & knowledge Glitch

In the case of intricate manufacturing plant, even by taking control of the unit and placing under some not related field expert i.e., Resolution professional cannot help the recovery process and there is an apprehension of sabotage or accident in such case. Without active help of original promoter's chances of actual restructuring or revival is very dim.

## 9. Concurrence of majority creditors

Unless there are small numbers of large creditors or say single creditors like Bank, to take concurrence of 75% of creditors will be very very difficult. Some of the creditors may be serviced regularly or if they have any other family relations, may not join for such harsh action against the defaulter and may not concern for insolvency proceedings.

## 10. Reimbursement Hurdles

In some cases, I.R.P. is required to incur certain expenses from his pocket which will be subject to creditors committee approval for reimbursement. Such kind of impractical solutions will work more in breaches than in implementation.

## 11. Self-Esteem of IRP's

Most of the NCLT are in practice asking IRP.'s to show his/her face, even when their appointment is approved by creditors committee. Some senior level professionals are finding it humiliating and hence are reluctant to take up the assignment.

## 12. Non-acceptance/rejection of interim IRP's appointment by creditors committee or even by NCLT

On number of occasions even after initial appointment of 30 days, Interim IRP who has worked diligently for more than 30 days (including meeting days initial homework etc.) is denied any fees whatsoever under pretext of rejection of initial

report and cancellation/ replacement by another R.P. of their preference. Such kind of treatment will kill independence of IRPs.

## 13. Issue regarding quality professionals – as IRP's, valuers or even as nclt members

One needs to understand techno-commercial legal aspect of entire insolvency process where again human aspect also gets entangled like workers dues, small depositors' money etc. It is actually to be seen in practice how the creditors, who in most of the cases will be Bankers or IRPs or even NCLT/ NCLAT members who are from legal back ground can resolve such complex business propositions successfully. In practice, it may prove like camouflage or an eyewash to support Bankers to take huge haircut, for settlement and to avoid vigilance or CBI enquiries at later stage. To actually work out real workable proposition for successful revival like Arvind Mills Ltd. is going to be a mammoth task and will need great involvement for all the parties concerned including promoters, lenders, Govt. authorities and even NCLT. Let us hope, it will not become another CDR/ SDR mechanism which only deferred NPA Classification, which in most of the cases happened after the period of CDR/SDR period got over and that exactly has been happening since last 1 year and aggrevating the problem destroying financial results of most of the Banks.

## 14. Individual bankruptcy or fresh start

Biggest mockery observed in this code is "Fresh start process" where the eligibility criteria at such low level is only increasing size of Act's sections which may not find many takers. Such ridiculous low level of income criteria of ₹ 5000 (below even minimum or debt within wage) and debt liability of ₹ 35,000 !! shows lack of understanding ground realities by bureaucrats. Some borrowers at such low level of income will either be exempted benevolently by State / Central Govt.'s particularly at election year or will be forced by loan mafias to take away whatever assets they have.

## 15. Limitation of Individual IRPs

IRP's are to be appointed in their Individual capacity & not as an organisation like CA Firm which can be appointed to take care of such huge pile of work. Though he will be allowed to take help of other professionals, whether paying his/ her own firm for whatever help/infrastructure use he/she is going to make, may be constructed as loss of independence. And to expect an individual to take care of all records, list of DRs/CRs, all receivables/payables, statutory dues & pending claims, ongoing litigations, take care of all assets, their security including Insurance and over & above that to manage & run business also as per directions of creditors committee will be like job of crusader or superman. Lots of time will be required just to prepare report, collect data & organising & reporting to creditors committee.

## 16. Individual bankruptcy initiative by borrowers – Pitfalls

In the case of individual bankruptcy, the consequences of filing bankruptcy create a negative credit score impact, and potential lenders will see it immediately on your credit report. Eligibility for declaring an insolvency status is not a credit relief, but merely a reprieve from the credit pressure.

Aside from your social reputation, the one great factor affected is your credit standing. All declarations of insolvency are reported to credit bureaus. These entities store the information in their databases and include it in your credit report for a long period of time. In time, you may be able to settle all your debts, but this piece of Information will remain in your credit report for long period of time.

The consequences of filing for bankruptcy in real life are much more complicated. The social status, your immediate financial obligations and the future credit eligibility are the things person has to consider. Becoming insolvent is a poor reflection of person's buying and paying habits, and lenders will reject any credit applications.

One needs to keep it in mind that the eligibility to file for insolvency does not actually relieve

one of one's credit obligations; it merely relieves the pressures of being pressed for payment by creditors.

Whether persons like it or not, his life after bankruptcy has been filed becomes stigmatised. That is one of the reasons why applicant should be advised to think things over carefully before deciding to take such action.

There are high-end lenders from whom one can obtain credit despite the insolvency stigma on one's record. Again, this is also a matter one should carefully think about since the purpose of the loan may not be worth the credit cost one will be required to pay.

It is rather advisable that if someone is earning some income, or have some assets that he is willing to put up for sale, then he might as well just negotiate with your creditors.

## 17. Lack of Counselling Agencies

In developed countries, they have established system of credit counselling agency for proper consultation. No credit counselling agencies in India is there as of now for lower strata borrowers. This will be same requirement in future particularly when there are forced or pressurised loan selling for individual's performance benefits without properly guiding the proposed borrower.

## 18. Ostrich Mentality

There are some cases when doing nothing at all is the best approach. This is applicable to those who have little or no income (due to unemployment or retirement) or property, and are known as empty pockets or where any bankruptcy judgment would have no impact on them.

Gifting is a popular way of disposing off estates prior to death. But gifters (and their recipients) should be aware that sudden financial downturns can cause creditors to "claw back" gifts because of the curious rules defining "insolvency".

## "Fraudulent" Transfers

Insolvency has important implications for clients making gifts to those close to them. First, such gifts may be considered "fraudulent" as to the giver's creditors.

Though the law states that an insolvent generally must "intend" to defraud creditors by the gift, Courts will find such "intent" based upon objective circumstances. For example, if an insolvent gives most of his assets to his daughter and then buys an expensive car the next day, the courts will ordinarily recover the transfer to the daughter.

## How to Overcome

These are some of the critics' point of view which hopefully be cured or managed with proper implementation. There should be proper support to NCLT by way of infrastructure facility & some targets for them also. Judiciary also should understand the need of the hour & rather than tweaking/rejecting application for small miss-outs, should give time to application for rectification & move it forward, which will in a way help the financial sector, economy & thereby nation. Even the lenders / suppliers / creditors must use provisions of this Act judiciously and should not rush to NCLT, at the first instance of default. Proper notice, follow up, addressing the grievances of defaulter should be done before taking resource to NCLT Trade and Industry Associates should open special cell of exports preferably on regular counselling basis to guide the borrowers who are in distress.

Even IBBA also should start pre NCLT counselling cell. Sincere effort should be made to support genuine business people during crisis and fraudulent people must be identified and be punished. Amendment will also be desired to raise the bar from ₹ 1.00 lakh to at least ₹ 10 lakhs.

Ranit Basu, *Advocate*

# Other laws applicable to NPAs recovery and impact of Insolvency and Bankruptcy Code, 2016. Whether provisions under any of those laws prevail over IBC

Post-globalisation one problem which has plagued the Indian Economic System is the problem of Non-Performing Assets (NPAs). This threat has become extremely severe in the recent years and thus poses a serious impediment for India to become a global superpower due to depleting Credit Rating. The NPAs growth is a corollary to the reduction of profitability of a bank.

Time and again the Government has brought in different and proactive legislations to curb the menace but none have been effective enough to ensure that the financial system is adequately resuscitated by a calculated clampdown on the defaulters. But all this is likely to change very soon with the advent of the Insolvency and Bankruptcy Code, 2016 which has the potential to revamp the existing laws on Insolvency and provide the aggrieved parties a fast tract resolution for recovery of debt.

Bankers are vested with the responsibility to act as custodians of the liquid capital of the country and their effective distribution. This function is performed by the banks by inducing the capital accumulated in the form of deposits by the people. The Bankers become the trustees of the surplus balances of the public. By effectively inducing these deposits into the economy by way of loans and advances the bankers ensure the economic prosperity of the country. This process is done by various deposit schemes as per people from different stratas.

Among the varied and different kinds of assets vested in the banks the NPAs are restricted to loans and advances and investments. As long as the asset is profit making and exhibits controlled risk, it is considered as performing asset. When there is an apparent failure in generating the expected income it becomes a "Non-Performing Asset".

RBI has classified Non-Performing Assets as per the given situations:

*A Non-performing Asset (NPA) is a loan or an advance where*

*I. interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan,*

*II. the account remains 'out of order' as indicated at paragraph 2.2 below, in respect of an Overdraft/Cash Credit (OD/CC),*

*III. the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted*

*IV. the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops*

*V. the instalment of principal or interest thereon remains overdue for one crop season for long duration crops*

*VI. the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006*

*VII. in respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.*

If the loan or advance falls within any of the above given situation then it is classified as an NPA. The banking industry is burdened with gross NPAs to the tune of almost ₹ 620 billion; this is a huge threat to the industry's health. NPAs are at a much higher level than most other countries and therefore recovery has become a key performance area for the banks.

In India, total bad debts amount to 11% of the total lending and the time for recovery or settlement is much more than other countries thus India stands at lowly no. 130 out of total 190 countries in ease of doing business. Corporate bad debts constitute 56% of the total bad debts of nationalised banks. Huge pendency of cases is largely attributable to the overlapping jurisdictions and lack of effective legal machinery incapable of untangling the enigmatic laws to build a cohesive approach towards insolvency resolution.

## Asset Classification

**There are broadly three categories of NPAs**
Banks are required to classify Non-Performing Assets into the following three categories based on the period for which the asset has remained non-performing and the realisation of the dues being:

i. **Sub-standard Assets**

ii. **Doubtful Assets**

iii. **Loss Assets**

**The basic description of the assets being:**

**i. Sub-standard Assets**
A substandard asset is one, which has remained NPA for a period less than or equal to 12 months. In such cases, the current net worth of the borrower/ guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full. In other words, such an asset will have well-defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

**ii. Doubtful Assets**
An asset would be classified as doubtful if it has remained in the sub-standard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as sub-standard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values –highly questionable and improbable.

### iii. Loss Assets
A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

Given below is the data indicating the recent trends of NPAs as published by RBI.

**Table IV.13: Trends in Non-Performing Assets – Bank Group-wise**

(Amount in ₹ billion)

| Item | Public sector banks | Nationa-lised banks* | SBI Group | Private sector banks | Old private sector banks | New private sector banks | Foreign banks | Scheduled commercial banks |
|---|---|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| Gross NPAs | | | | | | | | |
| Closing balance for 2011-12 | 1,178 | 696 | 482 | 187 | 42 | 145 | 62 | 1,429 |
| Opening balance for 2012-13 | 1,178 | 696 | 482 | 187 | 42 | 145 | 62 | 1,429 |
| Addition during 2012-13 | 1,198 | 772 | 425 | 128 | 41 | 87 | 41 | 1,368 |
| Recovered during 2012-13 | 648 | 429 | 219 | 63 | 30 | 33 | 24 | 736 |
| Written off during 2012-13 | 78 | 17 | 60 | 42 | 1 | 40 | 0 | 120 |
| Closing balance for 2012-13 | 1,650 | 1,022 | 627 | 210 | 52 | 158 | 79 | 1,940 |
| Gross NPAs as per cent of Gross Advances** | | | | | | | | |
| 2011-12 | 3.3 | 2.8 | 4.6 | 2.1 | 1.8 | 2.2 | 2.6 | 3.1 |
| 2012-13 | 4.1 | 3.6 | 5.0 | 2.0 | 1.9 | 2.0 | 2.9 | 3.6 |
| Net NPAs | | | | | | | | |
| Closing balance for 2011-12 | 593 | 391 | 202 | 44 | 13 | 30 | 14 | 652 |
| Closing balance for 2012-13 | 900 | 619 | 281 | 59 | 20 | 39 | 26 | 986 |
| Net NPAs as per cent of Net Advances | | | | | | | | |
| 2011-12 | 1.5 | 1.4 | 1.8 | 0.5 | 0.6 | 0.4 | 0.6 | 1.3 |
| 2012-13 | 2.0 | 2.0 | 2.0 | 0.5 | 0.8 | 0.4 | 1.0 | 1.7 |

Notes: 1. *: Includes IDBI Bank Ltd.

2. **: Calculated taking gross NPAs from annual accounts of respective banks and gross advances from off-site returns.

*Source: Annual Accounts of banks and off-site returns.*

The above table clearly indicates that the recovery is much lesser than the total NPAs, the existing provisions have failed to achieve the required results.

## Existing Special Provisions for Recovery

The special laws enacted for the purpose of recovery and settlements are:

**I. Recovery of Debts due to Banks and Financial Institutions Act, 1993**

This Act has been enacted for the purpose of removing difficulties in the imminent recovery procedure faced by the banks and financial institutions and to enable effective enforcement of securities. The Narsimhan Committee report had suggested the set-up of special Tribunals

with special powers for adjudication of such matters and speedy recovery as critical to the successful implementation of the financial sector for reforms.

The Act provides for a suitable mechanism through which the dues of the banks and financial institutions could be realised without delay.

The Act provides for an application to be made to the Tribunal by banks or financial institution for recovery of debt from any person.

**II. Sick Industrial Companies (Special Provisions) Act, 1985. (now repealed)**

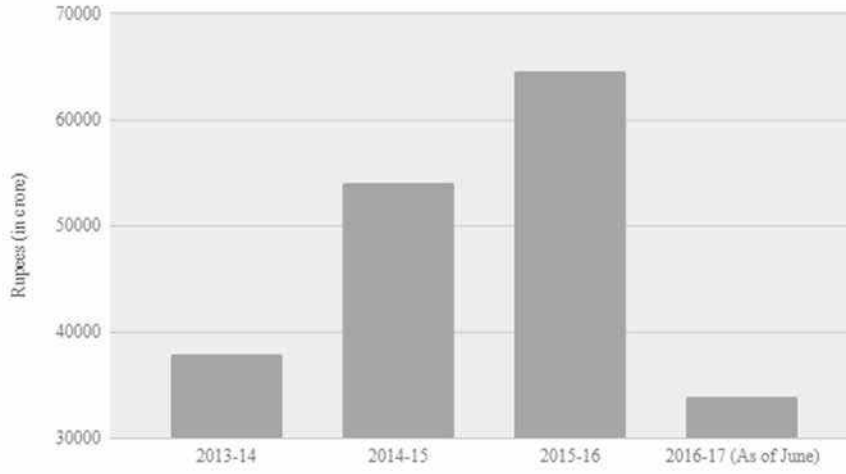
The prime objective of the SICA was the timely detection of sick or potentially sick companies owning industrial undertakings, and their speedy revival, wherever possible, or closure thereof.

**III. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002**

This Act empowers bank to take possession, manage and sell securities of the debtor. In the recent years it has been effective for the enforcement of security interest and reforming the financial sector.

Given below is the number of property seized under SARFAESI Act

Number of Properties seized/possessed under SARFAESI Act




In addition to taking steps as per the above-mentioned laws banks have the option of making a reference to the Lok Adalats established by the Legal Services Authorities Act, 1997, filing of winding up petitions or at the last resort filing of suits.

In spite of the banks having numerous options for initiation of recovery measures none of the above-mentioned measures have been able to ensure effective recovery or reconstruction of debts.

## Effectiveness of the prevailing laws

To get a proper idea of the extent to which the above-mentioned laws have been effective in the recovery of NPAs given below is a table of amounts recovered by the different channels as procured from the data of the Reserve Bank of India.

**NPAs of Scheduled Commercial Banks Recovered through various channels**

(Amount in ₹ billion)

| Year | Sr. No. | Recovery Channel | Lok Adalats | DRTs | SARFAESI Act | Total |
|---|---|---|---|---|---|---|
| 2012-13 | 1 | No. of cases referred | 840,691 | 13,408 | 190,537 | 1,044,636 |
| | 2 | Amount involved | 66 | 310 | 681 | 1,057 |
| | 3 | Amount recovered* | 4 | 44 | 185 | 233 |
| | 4 | 3 as per cent of 2 | 6.1 | 14.2 | 27.2 | 22 |
| 2013-14 | 1 | No. of cases referred | 1,636,957 | 28,258 | 194,707# | 1,859,922 |
| | 2 | Amount involved | 232 | 553 | 953 | 1,738 |
| | 3 | Amount recovered* | 14 | 53 | 253 | 320 |
| | 4 | 3 as per cent of 2 | 6 | 9.6 | 26.6 | 18.4 |
| 2014-15 | 1 | No. of cases referred | 2,958,313 | 22,004 | 175,355 | 3,155,672 |
| | 2 | Amount involved | 310 | 604 | 1,568 | 2,482 |
| | 3 | Amount recovered* | 10 | 42 | 256 | 308 |
| | 4 | 3 as per cent of 2 | 3.2 | 7 | 16.3 | 12.4 |
| 2015-16 | 1 | No. of cases referred | 4,456,634 | 24,537 | 173,582 | 4,654,753 |
| | 2 | Amount involved | 720 | 693 | 801 | 2,214 |
| | 3 | Amount recovered* | 32 | 64 | 132 | 228 |
| | 4 | 3 as per cent of 2 | 4.4 | 9.2 | 16.5 | 10.3 |

In a nutshell the rate of recovery of Non-Performing Assets (NPAs) was 10.3 per cent, or ₹ 22,800 crore, out of the total NPAs of ₹ 221,400 crore during fiscal ended March 2016, against ₹ 30,800 crore (12.4 per cent) of the total amount of ₹ 248,200 crore reported in March 2015, data from the Reserve Bank of India (RBI) has said.

According to the RBI, the rate of recovery was 18.4 per cent, or ₹ 32,000 crore out of the total NPAs of ₹ 173,800 crore reported in March 2014. The recovery rate was at 22 per cent (₹ 23,300 crore) in March 2013 out of the total reported NPAs of ₹ 105,700 crore, the RBI said in its database on the Indian economy.

These statistics reflect that the total bad debts amount to 11% of the total lending and is likely to increase. The time taken for resolving insolvency is much more. There are innumberable pending litigations as discussed above.

## Effect of Insolvency and Bankruptcy Code, 2016 regarding the recovery of NPAs

### The Code

The purpose of the IBC is to consolidate the existing laws and remove the apparent difficulties which have prevailed for a very long time. The main focus is to have an effective and time bound insolvency resolution process with regards to Companies, Limited liability Partnerships, Individuals and Partnership firms.

The main focus of this legislation is at providing resurrection and resolution in a time bound manner for maximisation of value of debtor's assets and the Code is bound to play a pivotal role in resolving the difficulties arising in the NPA recovery. The Code prescribes broadly three classes of persons who can initiate corporate insolvency

resolution process being the Financial Creditor, Operational Creditor and Corporate applicant. A Financial Creditor is a person to whom a financial debt is owed and therefore the banks fall in the definition of financial creditors.

The most important feature of the Code is that it does not make any distinction between the rights of international and domestic creditors or between classes of financial institutions thus ensuring that a balance is maintained in regard to the interest of the stakeholders although Section 53 of the Code stipulates the priority list regarding the distribution of assets akin to international standards.

By doing this the legislators have ensured that the entire process of resolution is done in the interest of the economy and bring down unnecessary litigation. The role of the Adjudicating Authorities being the NCLT for Companies and Limited Liability Partnership and DRTs for individuals and Partnerships have been restricted to ensuring that compliance and due process is administered effectively rather than going into the merits of the matter.

## Effect of Code on other laws applicable to NPAs

In broader terms with regard to the overall impact of IBC, the Code repeals the Presidency Towns Insolvency Act, 1909, and Provincial Insolvency Act, 1920, as well as amends 11 legislations, including:

i. Indian Partnership Act, 1932

ii. The Companies Act, 2013

iii. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

iv. Limited Liability Partnership Act, 2008

v. Sick Industrial Companies (Special Provisions) Repeal Act, 2003

The amendments brought out by the Code are stipulated in the Schedules to the Code which give an idea of the changes brought out to different legislation by the Code.

## Overriding effect of IBC

The code has been drafted to ensure avoidance of overlapping of the Code with the existing legislation to an extent that it has an overriding effect over all other laws including laws which deal with the recovery of NPAs. This at the initial stage has caused difficulties for litigants as proceeding under other legislations have got hampered, but in due course it is gradually becoming the major catalyst in effective resolution of corporate insolvency.

Section 14 of the Code which deals with moratorium subsequent to the application filed under the provisions of the Code being admitted states as under:

**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;*

*(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.*

*(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.*

*(3) The provisions of sub-section (1) shall not apply to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.*

*(4) The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process: Time-limit for completion of 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.*

A plain reading of the above-mentioned section makes it amply clear that once an application under the Code is accepted it automatically stays institution or further prosecution of the Corporate Debtor before other forums and as per other legislations including any execution application against the Corporate. Hence, when a resolution process is initiated against a Corporate Debtor it is more in the nature of protecting the debtor from further hardships and the interest of the entity holds utmost importance. In simple words the Code clearly prevails over any other legislations.

Further analysing the Code's effect over other laws some of the major changes brought out in regards to other laws related to NPAs in various legislations are by the Code:

**The Sick Industrial Companies (Special Provisions) Act, 1985:** Was enacted to make special provisions for the timely detection of sick (and potentially sick) companies owning industrial undertakings. The Board for Industrial and Financial Reconstruction (BIFR) was formed under the SICA to determine the sickness of such industrial companies and to prescribe measures either for the revival of potentially viable units or the closure of unviable companies.

With the Bankruptcy Code coming into effect, all proceedings pending before the BIFR and AAIFR stand abated. However, the entity whose reference has abated may initiate fresh proceedings before the NCLT under the Bankruptcy Code (that of corporate insolvency resolution), within 180 days of the commencement of the Bankruptcy Code, i.e., December 1, 2016. Further, as per the provisions of the Repeal Act, the repeal of SICA would not affect any orders sanctioning a scheme under SICA.

**The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and THE RECOVERY OF DEBTS DUE TO BANKS**

**AND FINANCIAL INSTITUTIONS ACT, 1993:** By the Code certain amendments have been brought in both the legislations to bring it in consonance with the Code to give the respective Adjudicating Authorities Powers to exercise their authorities as per the Code and in the manner provided in the Code.

**Companies Act, 2013:** All the winding up petitions which were earlier made in accordance to the Act after the enforcement of the Code are being made and have to be made as per the Code.

The Code has also repealed Chapter XIX of the Act which dealt with the Revival and Rehabilitation of Sick Companies thus, removing any possible ambiguity which could have come up. This has been done to enable the provisions of the Code be dealt in isolation without the overlapping of the same with the Act.

## Conclusion

The beauty of the Code is in the Intentions sought to be achieved by it. As time and again reiterated by Legislators notably Shri. Arun Jaitley, Hon'ble Finance Minister the key objective of the NPA resolution is not liquidation of businesses but to save them. After the commencement of the Insolvency resolution process various options can be considered for the revival of the sick entity. It can either be done by the existing promoters with or without new partners or new entrepreneurs to come in and make sure that the valuable assets.

The Code also seeks to demolish the system of protection of the debtors which has existed since time immemorial by imposing strict timelines and ensuring that the timeline is adhered to.

The Code is the need of the hour especially from the NPAs perspective as Gross NPAs have crossed 9.6 per cent as of March, 2017 while the stressed loans ratio is 12 per cent. According to the RBI the major cause of concern are the 12 large defaulters which together owe more than ₹ 2.5 Lakh crore which is a meaty chunk of the total default. An apparent tension grew among the large defaulters after The Banking Regulation (Amendment) Oridinance, 2017 recently empowered RBI to issue directions to banks for resolution of stressed assets. After this, RBI issued a Press Release dated June 13, 2017 explaining the process it is following to direct banks to refer certain accounts for resolution under the Code. It also named 12 of the largest defaulters. It is a matter of time till we get to know how the Resolution Professionals carve out a resolution mechanism in each of the cases and enable the effective resolution along with solving the bad debt crisis. It becomes amply clear that now more and more banks will take the Insolvency route to resolve their bad debt crisis.

*Source of Article:*

1. RBI Circulars and data published in its official website.

2. Various publications and newspaper articles.

An ounce of practice is worth more than tons of preaching.

*— Mahatma Gandhi*

Ms. Misha, *Advocate*

# Role of the Adjudicating Authority and the procedure before them with respect to proceedings under the Insolvency and Bankruptcy Code

## Introduction

It has been more than about eight months since the provisions of the Insolvency and Bankruptcy Code, 2016 **("the Code")** have been brought into effect with respect to corporates. These last few months have seen a lot of exciting developments and several nuances with respect to implementation and interpretation of the Code.

The Code provides for a time-bound Corporate Insolvency Resolution Process **("CIR Process")** for all corporates prior to liquidation, during which creditors have the ability to consider measures to resolve the financial distress of the corporate and to maintain and preserve its continued business operations by framing a plan referred to as a resolution plan. Only upon the failure of the CIR process can the corporate be liquidated under the Code.

The Code has designated the National Company Law Tribunal **("NCLT")** as the adjudicating authority for admission and governance of the CIR process and liquidation process with respect to the corporates. Under the Code, appellate power over the decisions of the NCLT lies with the National Company Law Appellate Tribunal **("NCLAT").** The NCLAT is also the appellate authority designated to hear appeals arising out of the orders passed by the sector regulator set up under the Code – the Insolvency and Bankruptcy Board of India (in relation to the insolvency professional agencies and information utilities).

## Section I

## Role of the NCLT in the CIR process

### 1.1 Adjudicatory Role

The CIR Process commences upon admission of an insolvency application by NCLT, which can be filed by financial or operational creditors of the corporate or the corporate itself. Upon receipt of such an application, the NCLT has to, in the case of a financial creditor, adjudge the existence of 'default' in this regard, by perusing the records maintained by an Information Utility, or other evidence furnished by the creditor. In case of applications by operational creditors, the NCLT, apart from determining a default, has to preliminarily *inter alia*, ascertain the existence of dispute if any, and repayment of unpaid operation debt and if the NCLT comes to a conclusion that there exists a dispute in respect of the amount claimed by the operational creditor, the NCLT shall dismiss the application.

The NCLT has further been granted the power to initiate liquidation proceedings under the Code, in the event the resolution plan does not get formulated, or gets rejected by it or is contravened.

### 1.2 Role in maintenance of status quo and preservation of assets

The Code envisages declaration of a moratorium by NCLT against the institution of new legal proceedings or continuation of pending proceedings or proceedings against a corporate on transfer, alienation, disposal by the corporate of any of its assets or any legal right or beneficial interest therein; any action to foreclose, recover or enforce any security interest including any action under the SARFAESI, 2002; or any action to recover property in ownership or possession of the corporate. The moratorium period is in force till the completion of the CIR Process subject to approval of a resolution plan or initiation of liquidation proceedings in respect of the corporate.[1]

### 1.3 Supervisory Role

The NCLT indirectly exercises control over the CIR Process through an Interim Resolution Professional **("IRP")** appointed by it. The NCLT sanctions the appointment of the IRP, the confirmation, re-appointment or replacement of the IRP by the Committee of Creditors with assistance and concurrence from the IBBI.

The NCLT further confirms the appointment of the liquidator in the event that liquidation proceedings are initiated. The NCLT exercises control and supervision over the powers of the liquidator, during the liquidation process, in various ways. The exercise of powers by a liquidator in respect of companies sought to be liquidated are subject to strict judicial scrutiny in terms of the Code. The NCLT has vast jurisdiction to entertain and dispose of any application or proceedings by or against the corporate including any question of priorities or any question of law or facts, arising out of or in relation to the CIR process or liquidation of the corporate. The NCLT has the power to issue directions in relation to the liquidation process and to receive reports of progress of the liquidation process.

### 1.4 Role as approving authority/ sanctioning authority

The NCLT is also vested with the power to sanction or reject the resolution plan passed by the Committee of Creditors and to make it binding and legally enforceable on the corporate and its employees, members, creditors, guarantors and other stakeholders involved in the said resolution plan.

### 1.5 NCLT and NCLAT as interpreters of the Code

Apart from each of the above specified roles, NCLT and NCLAT, in exercise of their respective jurisdictions, are the primary interpreters of the Code. It is in this role, that the NCLT and NCLAT are shaping up the law and defining the exact contours of the Code.

One of the most significant contributions of the NCLT and NCLAT in the eight months of Code's life, has been to introduce principles of natural justice in the process envisaged under the Code and reading into law the principles, which rather smoothen the sharp edges of the law.

It has been held that principles of natural justice at the time of the admission of the application for initiation of the CIR process require notice and limited hearing to be provided to the corporate. The NCLAT, in its judgment of *M/s. Innoventive Industries Ltd. vs. ICICI Bank and Anr*[2] and *Kaliber Associates Pvt. Ltd. vs. Mrs. Tripat Kaur*[3], has concluded that it is imperative that the principles of natural justice are followed at the time of admission of the application for initiation of CIR process. Accordingly, the NCLAT held that a limited notice shall have to be issued to a corporate before admitting an application for CIR process for ascertaining whether the corporate has committed a default and to ensure that the application is complete and defect free. Applying the said ratio further, in *Inox Wind v. Jeena & Co.*[4] wherein an application filed by an operational creditor was

1 Section 13(1), 14(1), Code.

2 C. P. No. 1/I&BP/NCLT/MB/MAH/2016) [NCLAT, 15.05.2017].

3 Company Appeal No. 52 of 2017 [NCLAT, 26-5-2017].

4 Company Appeal No. 103 of 2017 [NCLAT, 17-7-2017].

not served upon the corporate well in time and the date of hearing was fixed on the next day of the filing of the notice, the NCLAT on the grounds of violation of the rules of natural justice, set aside the orders of the NCLT which had admitted the application of the operational creditor.

In another significant judgment, the NCLAT in its decision in *Kirusa Software Pvt. Ltd. vs. Mobilox Innovations Pvt. Ltd.*[5] has settled the dispute with respect to the interpretation of the term "dispute" under Section 5(6) of the Code.[6] The NCLAT held that the usage of the word "includes" in a provision enlarges the meaning of the defined expression so as to include the natural meaning of the defined term into the ambit of the statute. The NCLAT thereby proceeded to hold that the term "dispute" in its natural and ordinary meaning, should cover all disputes and not be limited to only two ways of disputing a demand made by the operational creditor (i.e. suit or arbitration proceedings) and affirmed that the NCLT shall be duly empowered to ascertain whether a valid dispute exists between the operational creditor and the corporate.

The above two decisions, go a long way in saving the vires of the Code, and diminish the vulnerability of this law in a constitutional challenge, atleast, on these two specific counts. Admission of a CIR process without notice to a corporate and admission of a CIR process merely on the basis of a demand by operational creditor, although disputed, but not pending as a dispute in a suit or arbitration, shakes the conscience of a judicial system and the pronouncements of the NCLAT on both these counts are encouraging.

There are however, certain fundamental issues in the scheme of the Code causing a void and these issues cannot really be filled with mere judicial interpretation. One such aspect is the categorization of creditors under the Code. Primarily, the Code recognizes financial and operational creditors and grants specific rights and protection to them, with respect to the CIR process. These two categories however, do not form perhaps even half the universe of creditors of a corporate.

The NCLAT, *Nikhil Mehta & Sons vs. M/s. AMR Infrastructures Limited*[7], was faced with a question whether a clause in a builder-buyer agreement for assured returns would constitute 'financial debt' within the meaning assigned to it under the Code and whether the buyer could be treated as a 'financial creditor'. The NCLAT clarified that the debt alongwith interest disbursed against the consideration for time value of money is a financial debt. The NCLAT held the meaning of the term 'time value' under the Code to mean 'the price associated with the length of time that an investor must wait until an investment matures or related income is earned'. In the facts of the case, as the flat buyers were assured returns even before delivery of flats, it was held that such flat buyers are financial creditors. While the said judgment delivers emphatic relief to a category of reeling home buyers across the country, it also introduces a major lacunae as a clear line of difference is drawn between the buyers assured of returns and other home-buyers in different development projects, who are subjected to the lower rungs of the waterfall mechanism under the Code.

The issue of categorisation of creditors into the two buckets of financial or operational creditors has arisen in many more proceedings and in the decisions such as *Sajive Kanwar vs. AMR Infrastructure*[8]; *Sanjeev Jain vs. M/s. Eternity Infracon*

5 Company Appeal No. 6 of 2017 [NCLT, 24-5-2017].

6 '5. In this Part, unless the context otherwise requires……— (6 ) "dispute" includes a suit or arbitration proceedings relating to—

(a) the existence of the amount of debt;

(b) the quality of goods or service; or

(c) the breach of a representation or warranty."

7 Company Appeal (AT) (Insolvency) No. 09 of 2017 [NCLAT, 1-5-2017].

8 C.P. No. 06/ 2017 [NCLT, Principal Bench, 16-2-2017].

*Pvt. Ltd*[9] the NCLT has strictly interpreted the term "operational debt" to be confined to be arising in respect of transactions limited to four categories i.e. goods, services, employment and dues owed to the government. In these proceedings, the NCLT held that since the debt had not arisen out of provision of goods or services or as a result of employment or did not include any dues payable under the statute to the Centre/State Government or local body, the claim of the applicants could not be 'operational debt' under the Code and similarly the same did not satisfy the test of financial debt as the same was not disbursed against the consideration for time value of money. Therefore, it is evident that given that the two categories of financial and operational creditors is not exhaustive, a large number of creditors are left outside this universe, depriving them of an ability to initiate CIR process nor gives them any right (such as liquidation value) as part of a resolution plan.

This lacunae in the drafting of the Code assumed significance, when a new Form F was introduced in the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process or Corporate Persons) Regulations, 2016 to enable such a large body of home buyers to file their claims. The introduction of Form F has hardly resolved the issue however, given that neither such category of creditors have right to initiate processes under the Code, nor are their rights protected as part of a resolution plan.

Clearly, in such aspects, there is only as much as judicial interpretation can do to resolve issues on account of drafting of the law itself. In fact, it is appreciable that the NCLT and NCLAT have not taken it upon themselves to substitute the role and function of the legislature and appropriate changes in Code and/or regulations need to be considered to provide answer to such issues.

Judicial restraint where the scheme of the Code is not capable of any other possible interpretation, although may lead to absurdity, in instances such as above issue of categorisation of creditors, is appreciable, however, there have been some few rulings, where it appears that a more technical interpretation has been preferred over a purposive interpretation leading to consequences which are contrary to the objects of the Code. For instance, the NCLAT in *Smart Timing Steel vs. National Steel and Agro Industries*[10] **("Smart Timing Steel decision"),** has held that the requirement of filing of a certificate from the financial institution maintaining accounts of the operational creditor is a mandatory requirement, in the absence of which the application so preferred would be liable to be rejected. As the term financial institution is a defined term, the same has been interpreted to mean and include only Indian banks and financial institutions. As a result, the foreign operational creditors who do not maintain an account with an Indian bank or financial institution, have been deprived of their right to invoke the process under the Code on a strict and technical interpretation of Section 9 of the Code. This defeats the very basic scheme of the Code, to allow the foreign creditors to be able to initiate CIR process under the Code. One wonders, if in this instance as well, it wasn't possible for the NCLAT to interpret the term "financial institution" in its ordinary meaning so as to aid the object of permitting foreign creditors to have equal rights as domestic creditors under the Code.

It is hoped that the interpretation of NCLT and NCLAT aid and strengthen the overall scheme and objectives of the Code and wherever it is possible to resolve issues on the basis of purposive interpretation of the Code to do substantial justice, the jurisdiction is accordingly exercised. Although, by no stretch of imagination, judicial interpretation can substitute the legislative function and there may be requirement for intervention by the legislature or the Central Government to appropriately, amend or clarify the provisions.

### 1.6 Conflicting interpretations of the Code

The NCLT and NCLAT have at times delivered judgments which have been either at variance with the Code, or with a view taken by another Bench.

9 113(ND)/2017 [NCLT, Delhi, 31-5-2017].

10 06/1 & BP/NCLT/MAH/2017 [NCLAT 19-5-2017].

For instance, the Code stipulates that the NCLT must admit/reject an application for institution of the CIR Process within a period of fourteen days. However, while the NCLAT has held that the time period of fourteen days granted to the NCLT under the Code, for admitting or rejecting an application provided, is merely directory and not mandatory, the Hon'ble Supreme Court in its recent ruling in *Innoventive Industries vs. ICICI Bank* has held that the said time limit is mandatory.[11] Time-bound resolution is a cornerstone of the Code. It is critical, especially at a time when the Government is utilising the Code to speedily recover stressed assets, for the NCLT to interpret Code in harmony with its objectives.

The different Benches of NCLT are also divided on the issue of maintainability of applications under the Code, when winding up petitions are pending before a High Court against the concerned corporate. In *Nikhil Mehta & Sons vs. AMR Infrastructure Ltd*[12], the Principal Bench of the NCLT held that the application would not be maintainable since many winding up petitions had been filed against the corporate in the Delhi High Court and that a provisional liquidator had been appointed in this matter, even though the matter was pending before the Appellate Bench with interim directions. However, in *Alcon Laboratories (India) Private Limited vs. Vasan Health Care Private Limited*[13], NCLT, Chennai, held that the pendency of the winding up petition cannot be a bar under the Code which was also reiterated in *Canara Bank v. Deccan Chronicles*[14] by NCLT Hyderabad.

The tribunals are also divided on the applicability of the Limitation Act, 1963 on the provisions of the Code. While the principal bench of the NCLT has held the Act to be applicable[15], the NCLAT has clarified that since there is nothing to show under the Code that the Limitation Act is applicable, argument of a corporate that a claim is time barred cannot be accepted.[16] The decision of the NCLAT although has not been interfered with, by the Supreme Court in the appeal, however, the issue of applicability of the Limitation Act on provisions of the Code, has specifically been kept open by the Hon'ble Court.

The tribunals have also classified similarly placed class of persons, differently. For instance, the NCLAT has allowed home buyers who have been granted assured returns by their respective developers to come within the definition of "Financial Creditors" under the Code. However, the NCLTs have refused to entertain Insolvency Applications by home buyers in *Sajive Kanwar vs. AMR Infrastructures Ltd*.[17] and *Col. Vinod Awasthy vs. AMR Infrastructures Ltd*.[18] ("AMR Infrastructure decisions"), holding therein that apartment owners/ those who had booked apartments with builders, would not fall within the criteria of either operational or financial creditor and would consequently not have the locus standi to file an application to institute the CIR Process. Therefore, while one class of home buyers are put at par with other secured creditors in the waterfall mechanism envisaged under the Code, the other class of home buyers are deprived of that benefit, thereby creating an anomaly in the interpretation and understanding of the Code.

These are some of the aspects which require ironing and it is hoped that definitive legal position arises on such issues to enable smooth implementation of the law.

11 Supreme Court order dated 31-8-2017.

12 C.P. No. (ISB) – 03 (PB)/ 2017[NCLT, Principal Bench 23-1-2017].

13 *Supra* note 9.

14 CP No. IB/41/7/ HDB/ 2017 [NCLT, Hyderabad Bench 19-7-2017].

15 Deem Roll-Tech vs. R.L. Steel & Energy, I.B. 24/ PB/ 2017[ NCLT, Principal Bench 31-3-2017]

16 Neelkanth Township and Construction v. Urban Infrastructure Trustees Limited COMPANY APPEAL (AT) (Insolvency) NO.44 OF 2017 [ NCLAT 11-3-2017]

17 C.P. No. (ISB) – 03 (PB)/ 2017 [NCLT, Principal Bench 17-2-2017].

18 C.P. No. (IB) – 10 (PB)/ 2017 [NCLT, Principal Bench 20-2-2017].

## Section II
## Infrastructure related issues in relation to the tribunals

The other major aspect of concern with respect to functioning of the NCLT and NCLAT's in context of the Code specifically, has been some teething issues with respect to infrastructure related aspects. The speed with which the law has been brought into force and the tremendous effort on the part of the Tribunals to cope up with the load has been extraordinary. There are however, aspects which need urgent and immediate attention.

### 2.1 Enormous pending load of corporate default cases

The NCLT was constituted on June 1, 2016 under Section 408 of the Company's Act, 2013.[19] The Code designates NCLT as the adjudicating authority for all corporate default cases, apart from a huge jurisdiction under the Companies Act, 2013, with respect to shareholders disputes, class actions, schemes of amalgamation and reconstruction etc. This leaves NCLT with the daunting task of resolving thousands of pending bankruptcy and insolvency cases apart from other subject matters brought under its jurisdiction by Companies Act, 2013. Additionally, some of the category of cases pending before the erstwhile Company Law Boards and the Board for Industrial and Financial Reconstruction stand transferred to the NCLT, while the rest have to be heard afresh in terms of the amended Companies Act, 2013 and the Code. Accordingly, the pending winding up cases filed before High Courts are also transferred to the NCLT in which notices have not been issued. Therefore, the NCLTs are faced with a huge number of pending cases under different prior laws, which may increase the burden of disposal of cases manifold on the NCLTs constituted under the Code.

### 2.2 Short staffed tribunals

Currently there are eleven NCLT benches headed by a President, fourteen judicial members and nine technical members cumulatively, at different locations. With the increasing backlog of cases, these tribunals seem to lack sufficient resources to handle pending cases. It is necessary to ensure that the current technological framework of the NCLTs across India are brought in conformity with the global standards to ensure maintenance of parity amongst the litigants. The online access to information related to cases filed before various NCLTs is not immediately available which proves to be cumbersome for persons desirous of filing appeals against orders before the NCLAT. While the provisions of the Code provide for time-bound determination of insolvency of Companies and its resolution, the technical facilities with respect to cases filed before NCLT must complement the nature of the Code. With a growing impetus on digitalising legal procedures around the world, India needs to catch on the trend and the Code provides a huge platform to ensure setting up of a robust cyber and technical infrastructure from the inception itself. With the necessary initiative of the Central Governments, the NCLT and NCLAT can be technologically and infrastructurally empowered to deliver and keep up with the time efficiency envisaged in the Code.

## Conclusion

The Code should be credited with providing judicially controlled and time bound procedures to mitigate the rising amount of non-performing assets in the country. More importantly, with respect to the NCLT and NCLAT, the Code has created a more decentralised system where several Benches exist across the nation which are easily accessible by prospective applicants. However, in order to address the issues in execution of the Code, it is required that the judiciary and the legislature act in a coherent manner with a common objective of making the Code dynamic to meet the issues that arise in its implementation. Since the law is at the nascent stage itself, the same requires participation from all agencies to work together and reduce the burden of bad debts in the economy. It is hoped that once the Code and its surrounding jurisprudence matures, the position of law and the interpretation of the terms contained within the Code, would get more lucid.

19 The NCLT was constituted on June 1, 2016 vide Notification No. [F. No. A-45011/14/2016-Ad. IV].

Vamshi Krishna, *Executive Director and Head, Valuation and Advisory Services*

# Valuation under IBC

In one of the biggest reforms in the recent past, the Government of India has decided to address the challenges faced by various stressed companies and their lenders through a dedicated platform. The problem of stressed assets in India is significant with some estimates pegging the total value of stressed assets at approximately INR 10 lakh crore. Over the years, the Government has tried to address the issue around stressed assets through various laws – The SARFAESI (Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest) Act, Scheme for Sustainable Structuring of Stressed Assets (S4A), Companies Act, Sick Industrial Companies Act, Recovery of Debts due to Banks and Financial Institutions Act, etc. However, these Acts have been unable to resolve these matters in a structured and time-bound manner.

The Insolvency and Bankruptcy Code, 2016 (the Code) provides a structured and time bound platform for resolution of such cases. The Code revolves around various key stakeholders including creditors, resolution professionals, valuers, Insolvency & Bankruptcy Board, adjudicating authority, etc.

While the roles and responsibilities of each of these stakeholders has been clearly defined, it is imperative for all participants to work in a symbiotic approach towards resolution and / or liquidation of these companies. It is the responsibility of all participants to make every endeavour to protect and preserve the value of the companies (and the value of their underlying assets in turn) of respective debtors. Amongst all participants, the valuer assumes a critical role in defining the liquidation value of these companies and underlying assets. As part of the resolution process, the resolution professional is required to appoint two Registered Valuers (persons registered as such in accordance with the Companies Act, 2013 (18 of 2013) and Rules made thereunder) within 7 days of being appointed as the resolution professional for any case. However, since the guidelines for Registered Valuers is yet to be notified under the Companies Act, various market intermediaries including public as well as private sector banks, Non-Banking Financial Companies (NBFCs) and other financial institutions have relied on and continue to rely on valuers with strong local multi-market presence and knowledge (such as CBRE) to provide unbiased opinion on the value of assets based on globally accepted valuation principles backed by thorough research and in-depth analysis.

As stated earlier, as part of the Insolvency and Bankruptcy Code, the valuers are required to provide 'Liquidation Value'. Liquidation Value

has been defined as the estimated realisable value of the assets of the corporate debtor if the corporate debtor were to be liquidated on the insolvency commencement date. Key consideration that valuers need to deliberate on while assessing the Liquidation Value would be the adjustment of market value for constrained / restricted marketing timeframe thereby hampering the effective marketing of the property and hence the value of the companies and underlying assets. Among other considerations, the valuers should refer to the internationally accepted valuation standards with special emphasis on Forced Sale valuation principles and guidelines.

The companies referred as part of RBI's defaulter lists cover approximately 50 conglomerates with varying businesses spread across arterial sectors of the economy including infrastructure, power, mining, real estate, etc. The composition of underlying assets part of each of these companies include an array of intricate tangible as well as intangible assets. Considering that the underlying businesses of the cases referred for insolvency proceedings are presently strained, the tangible assets forming part of the books of these companies are expected to be the primary means of driving value of these companies.

Some challenges that valuers could face while ascertaining the liquidation value of assets such as plant & machinery, real estate (including buildings) and balance sheet items could be assessing the realisable value considering the limited marketing timeframe consideration, availability of liquidity in the system, identifying the set of buyers and their willingness to expand / acquire more assets. It becomes imperative for valuers undertaking such assignments to rely heavily on primary research to understand the pulse of the local market while relying on global benchmarks, international standards and globally accepted best practices for such valuations.

The valuer should adopt appropriate techniques depending on the company, the industry sector, the prevailing market conditions as well as the potential buyer segments. Various extrinsic and intrinsic valuation methods such as relative comparison approach, forecasting cash flows etc., can be employed by the valuer keeping the above factors in consideration. A valuer should understand the uncertainties with respect to the company, the sector while building in any forecasts to assess the value. Also, the value opinion provided should be free from any pre-determined biases – for e.g., the fact that the company's stressed position might drive the valuer to adopt a conservative position even when the associated sector is performing well. Such biases and pre-formed opinions might provide depressed liquidation values and hinder the resolution possibilities that could be evaluated.

To address the above challenges, it becomes pertinent that the valuers appointed should have relevant expertise on applicable rules & regulations, as well as expertise on the subject matter under the purview of respective cases they are handling. Considering that the cases referred under IBC would be spread across different regions within India, it becomes important for valuers to have relevant exposure through presence of localised teams across regions in order to determine the optimal discounts to market value while arriving at the liquidation value.

Drawing inspiration from the standards for valuation set forth by Royal Institute of Chartered Surveyors and International Valuation Standards, valuer, need to understand the importance of unbiased valuations and concur strongly with the intent of the Code to provide resolution to stressed companies. In an economy which has grown exponentially over the past two decades and aspires to grow by leaps and bounds in times to come, a systematic approach towards assessing the value of assets spread across varied unorganised (majority) sectors is quintessential.

Madhukar R. Umarji, *Chief Advisor – Legal of the Indian Banks' Association*

# Rights of shareholders of a company under insolvency resolution process

The provisions of the Insolvency and Bankruptcy Code, 2016 (IBC, 2016) are not clear on the issue whether consent of shareholders is required on the approved plan for sale of assets, mergers and amalgamations, as per the provisions of the Companies Act, 2013. Section 17 of IBC, 2016 provides that from the date of appointment of the Interim Resolution Professional (IRP)the management of the affairs of the corporate debtor shall vest in the IRP and the powers of the board of directors of the company shall stand suspended and be exercised by the IRP. The IBC, 2016 makes further provisions for constitution of Committee of Creditors by the IRP and lists out various powers which can be exercised by the IRP with the approval of the Creditors Committee. It is also provided that such powers can be exercised by the IRP with the approval of Creditors Committee, notwithstanding anything contained in any other law. Amendment to Articles of Association and on the constitutional documents of the debtor, change of capital structure, issue of securities or redemption of securities etc. can be done by IRP only with the approval of the Creditors Committee. In regard to the resolution plan there is a provision in Section 30(1)(e), stipulating that the IRP shall ensure that resolution plan does not contravene any of the provisions of the law for the time being in force. In the absence of specific exclusion, provisions of the Companies Act which are applicable, it is not clear whether resolution plan needs to be approved by the general body of shareholders as required by certain provisions such as Section 180 or 230. The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 provide that a provision in a resolution plan which would otherwise require the consent of the members of the corporate debtor under the terms of the constitutional documents of the corporate debtor shareholders agreement etc. shall take effect notwithstanding that such consent has not been obtained. Considering the above provisions which suspend the powers of the board and dispense with the requirement of shareholder consent or approval, a view can be taken that the IRP and Creditors Committee can approve any resolution plan and implement the same and no compliance with the provisions of the Companies Act, 2013 is necessary. Such interpretation can be justified in many cases where the borrowings of the company and other liabilities are far in excess of assets value and there is total erosion of the net worth and value of shares.

But the above interpretation may not be justified in all cases. It is therefore advisable to amend the existing provisions of IBC, 2016 to clarify the position regarding applicability of the provisions of the Companies Act in regard to the rights of the shareholders if Resolution Plan provides for merger, or sale of any division or subsidiary or other assets of the company.

While considering such amendments certain basic principles applicable to the rights of the shareholders with reference to the financial position of the debtor company, need to be noted as under:

a) The shareholders of a company have ownership rights in the assets of the company and at the same time their liability is limited to the extent of the capital contribution done by them. Any provision of law which results in the deprivation of the property or curtailing the rights of the shareholders will have to be specifically provided by statute and justified as fair and reasonable.

b) The IBC, 2016 provides for initiation of insolvency resolution process immediately on default in repayment of any debt of ₹ 1 lakh and above. At this stage when the petition is filed there is no assessment of the net-worth of the debtor company. However in most of the cases the total liabilities of the company would be in excess of the total value of the assets and there may be erosion of the net worth of the company. In such a case the shareholders may not be retaining any value in their shareholding and any actions taken for resolution plan would be for their benefit if they continue to retain the shareholdings. In such a case there may be a justification to work out the resolution plan without requiring approval of the shareholders.

c) On the other hand there could be a situation that the insolvency process has started on account of default but the value of the assets of the company is more than the liabilities and the reason for default may be some temporary problems in the cash flows of the company. In such a case the shareholders of the company would continue to hold value in the assets of the company and any scheme adversely affecting such property rights of the shareholders without due process of law and pursuant to clear statutory provisions may not be justified.

d) One other very important factor which needs to be noted is that the resolution process is for the existing management to examine and place before the Creditors Committee through the insolvency practitioner. For the purpose of examining such a plan initiated by the existing management of the company it will be necessary that certain powers of the board are retained including stipulating approval of the general body of shareholders for such a plan.

e) There could be a situation where the net worth of the companies is eroded and value of the shares has become negative and the resolution professional has to work out a resolution plan to realise optimum value for the assets either as a going concern or operating a resolution plan. In such a situation a provision could be made stipulating that the shareholders will be informed about the proposed plan but their consent shall not be necessary because the shares have become worthless.

f) A resolution plan may contemplate replacing the existing management and handing over the entire undertaking of the debtor company to a new management. Such an action may be justified as a resolution method but in order to acquire ownership in the assets of the company it will be necessary that the shareholdings of the promoters is transferred to the new management and provision is also made for acquisition of the shares held by other shareholders by the new entity. It will be necessary that clear provisions are made for this purpose so that shareholders rights are protected and where necessary the resolution professional is empowered to acquire the assets in cases where there is erosion of net worth .

While such modifications in law will be considered, all the debtor companies need to ensure that all commitments to pay are honoured on due dates and no defaults are committed. The provisions of IBC, 2016 are very stringent and in the event of default I a resolution plan is not worked out to the satisfaction of the creditors the consequence is liquidation of the company. It is therefore in the interest of the companies to ensure that the causes for default are examined and a resolution plan proposing corrective steps is placed before the Creditors Committee and got approved by the National Company Law Tribunal, so that liquidation of the company is avoided.

CA Sudha Navandar

# Fast Track Corporate Insolvency Process – A short Note

**(Chapter IV of the Code – Sections 55 -58, Notified on 14-6-2017)**

Insolvency is a situation where company is unable to pay its due debt on due date (default on existing debt) and resolution process is a process whereby the corporate insolvency is resolved. Resolution process is curing period. If resolution fails, company automatically goes for liquidation. Speedy process has been formulated for a simple case. Compared to normal period of 180 days only 90 days has been provided. Speedy insolvency, resolution process, for small or less complex, corporate entities. For others there is Corporate Insolvency Resolution Process (CIRP).

| | **Fast Track** | **Normal Process (CIRP)** |
|---|---|---|
| Fast Track Corporate Insolvency Process Eligibility | Additional condition to be notified by Central Government :<br>• Assets and income below a level as may be notified<br>• With such class of creditors or such amount of debt as may be notified.<br>• Such other category of Corporate Person as may be notified<br>*(None of the conditions have been notified – till date)* | No such additional condition |
| How to initiate the fast track process | • First and foremost there must be existing default by the Corporate and one must prove it with proper evidence<br>• Application to NCLT may be filed by a creditor or Company (CD) itself, with proof of the existence of a default as record available with information utility or such other means as may be specified by the Insolvency Board (IBBI) | As specified in sections 7,9 & 10 of the IBC, 2016, three different persons can file application<br>a) Financial creditor<br>b) Operational creditor<br>c) Corporate Debtor i.e company itself. |

| | Fast Track | Normal Process (CIRP) |
|---|---|---|
| | • Such other information as may be specified by the IBBI to establish that the company is eligible for fast track corporate insolvency resolution process.<br>• On the basis of application the NCLT will determine to accept or not to accept the application | |
| Time Period for completion and Extension | Initial time period for process 90 days. On application by resolution professional to NCLT, if instructed by 75% voting in favour by committee of creditors then NCLT may grant the extension of maximum 45 days ( Total 135 days) | Similar Provisions. Only the difference is initial period is 180 days and extension by NCLT may be granted maximum 90 days. (Total 270 days) |
| The process for conducting a corporate insolvency resolution process under Chapter – II and the provisions relating to offences and penalties under Chapter VII shall apply to this Chapter as the context may require. The process remains the same as corporate Insolvency Resolution Process. | | |

## Regulations

Apart from Insolvency Code, for the process, one has to refer to the IBBI regulations known as Insolvency and Bankruptcy Board of India (Fast Track Insolvency Resolution Process for Corporate Persons) Regulation, 2017. The same has been notified on 14th June, 2017 (source IBBI website http://www.ibbi.gov.in/webfront/legal_framework.php )

## Converting from Fast Track to Normal – CIRP ( if landed by mistake, then opportunity to rectify)

Based on records and claims, if the Interim Resolution Professional is of the opinion that the fast track process is not applicable to the company, he shall file an application to NCLT to pass an order for converting the fast track process to CIRP under Chapter – II. If accepted, the process gets converted to normal – CIRP. Note IRP can go only in case if the fast track conditions are not satisfied. No need of COC – permission.

If the fast track resolution process is not completed within the initial time of 90 days or extended maximum time of 45 days ( if granted ), it would lead automatically to liquidation of company. In view of same one should think twice before opting for this shorter process. Even if one is eligible for fast track corporate insolvency process, as a matter of precaution, it may be advisable not to opt for the same, unless one is well prepared or it's a very simple case or one is determined to go for liquidation.

IBBI puts on its website all cases on which the various processes are going on – CIRP, Voluntary Liquidation, Liquidation – till date (10.09.2017) not a single case has been listed for Fast Track Resolution Process.

*[Note as Corporate Insolvency Resolution Process has been covered in detail, to avoid repetition, only the part which is differing from the CIRP has been covered].*

# INTERNATIONAL TAXATION CONFERENCE 2017

**JOINT CONFERENCE IN CO-OPERATION BETWEEN**
**FOUNDATION FOR INTERNATIONAL TAXATION (FIT) INDIA AND**
**INTERNATIONAL BURREAU OF FISCAL DOCUMENTATION (IBFD) AMSTERDAM**
**IN COOPERATION WITH THE ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, PARIS**
**DECEMBER 7-9, 2017, ITC MARATHA HOTEL, MUMBAI**
**(Provisionally as at August 22, 2017)**

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## BEPS AND MULTILATERAL INSTRUMENT (MLI)

Our 22nd Annual Conference in 2017 continues from our 2016 conference with "**MLI**" (Action 15). Our keynote topic is **MULTILATERAL INSTRUMENT UNDER BEPS IN ACTION: IMPACT ON BILATERAL TREATIES.** This year our conference is organised by us in cooperation with the Organization for Economic Co-operation and Development, Paris. Like last year, it is also a Joint Conference with the IBFD, Amsterdam. IBFD is the sister organization of International Fiscal Association. It was set up as its publications, research and training arm in 1938. Set up as a charity, it is the largest institution of its kind in the world. FIT as a charity runs the leading conference annually on International Taxation in India since 1995. We welcome them to our Conference.

Our first speaker will be Porus Kaka from India, President of International Fiscal Association - Worldwide. Our keynote ("Klaus Vogel") speaker is Pascal Saint-Amans, Director of the OECD's Center for Tax Policy, Paris. He also heads the BEPS Project since its inception and reports regularly to the G20 Finance Ministers. The theme of our Plenary session on Day One is Action 15 on Multilateral Instrument (MLI) which is needed to comply with the recommendations of the BEPS Reports without making bilateral treaty changes. The speakers will make presentations, followed by panel discussions, to clarify some of the key issues underlying **MLI.**

On Day Two morning, we have a half-day session on BEPS and Indian Tax Policy, Practice and Compliance. Our speakers include Akhilesh Ranjan, Principal Chief Commissioner of Income Tax (International) in India, Rajat Bansal, Competent Authority, India, Mrs. Pragya Saksena, Joint Secretary (FT & TR I) and Parthasarathi Shome former Minister of State, Finance. The session includes a major panel discussion to review the Impact of BEPS on Indian Tax Policy, Practice and Compliance with some of the leading Indian professionals as expert panelists. We expect several speakers as well as delegates from the international division of Indian Revenue Service to participate in the conference as speakers and delegates.

The rest of the conference covers panel discussions by global experts of recommendations under BEPS Action Points with 15 selected issues.

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Ms. R. Harishni

# Freedom of Expression and Action: Can it ever be curtailed?

The freedom of expression and action is the fundamental freedom of a human. The freedom of expression and action means expressing one's own views and opinion freely in the society. This freedom ensures the democracy policy of the State.

The freedom of expression and action is guaranteed by the Indian Constitution in Part 3 under Art.19(1)(a). It is a fundamental freedom given to citizen of India. But this freedom is not absolute, it can be curtailed by the State if it falls under the scope of article 19(2). The freedom so guaranteed is also taken away by the State if it harms the other person under Indian Penal Code.

## INTRODUCTION

Freedom of expression is a fundamental right in modern societies, and it has particular significance in relation to the well-functioning of the Constitutional democratic process.[1] Freedom of expression is a freedom wherein a person is allowed to speak freely and without a fear of punishments. The other freedom that is freedom of action does not mean freedom to act by permission, which may be revoked at any dictatorial tyrant's, or democratic mob's whim, but freedom to act as an absolute — by right.[2] The liberty to express ones own views and opinion without fear of punishment is important for the development of that State. Freedom of expression has four broad social purposes to serve 1) It helps an individual to attain self-fulfilment, 2) It assists in the discovery of truth 3) It strengthens the capacity of an individual in participating in decision making and 4) It provides a mechanism by which it would be possible to establish reasonable balance between stability and social change.[3] Because of the importance of these liberties, the freedom of expression was recognised as Human right in International law and State laws. The right is enshrined in Article 19 of the International Covenant on Civil and Political Rights[4] and under Article 19 of the Universal Declaration of Human Rights[5] which is indicated as "Everyone has the right to freedom of opinion and expression; this right includes freedom to hold opinions without interference to seek, receive

1 BEATSON and CRIPPS, Freedom of expression and freedom of information: essays in honour of Sir A. Mason (Oxford University Press, Oxford 2000) 17.

2 WHAT DO YOU MEAN BY "FREEDOM OF ACTION"? THE CAPITALISM SITE, http://capitalism.org/freedom/what-do-you-mean-by- freedom-of-action/ (last visited Mar 28, 2017)

3 The Law Lexicon Vol. 3 P. 2796

4 International Covenant on civil and political rights (adopted 16th December 1966, entered in to force 23rd March 1976) 999 UNTS 171 (ICCPR) Art 19.

5 Universal Declaration of Human Rights (adopted 10 December 1948) UNGA Res 217 A (III) (UDHR) art 19.

and impart information and ideas through any media regardless of frontiers".

After many debates and discussions in the constituent assembly the Indian Constitution which came into force in 26th January, 1950 had provision relating to freedom of speech and expression. Article 19(1)(a) deals with the freedom of speech and expression and Article19(2).

## HISTORY OF THE FREEDOM OF EXPRESSION

Before independence, the liberty to express and act on one's own will was not allowed by the British Rulers. The agitations during the independence movements where all set away to Liberty as a Right. Hartals and satyagraha became quite a common form of peaceful Constitutional agitation for the cause of civil liberties. The congress in its session at Calcutta (1917) reiterated its strong protest against the wide and arbitrary powers conferred by the Press Act. Even in 1917, order of internment had been passed against Tilak and B. C. Pal, from Punjab and Delhi. But popular agitation continued vigorously. In August 1918, Tilak was served with an order as per which he had to take the permission of the District Magistrate to deliver a lecture. This shows that the right to liberty was not at all recognised during Pre-Independence period.[6]

After the independence, the framers of Constitution recognized the Right to Liberty. The preamble of the Constitution states that "to secure to all its citizens liberty of thought, expression, belief, faith and worship." The liberty of thought and expression is given more priority than other liberties. This freedom is regarded as the Mother of all other liberties.[7]

## FREEDOM OF EXPRESSION AS GUARANTEED UNDER CONSTITUION

The freedom of expression was clearly stated under Article 19(1)(a) of the Indian Constitution as all citizens shall have the freedom of speech and expression. It is given under Part 3 of the Constitution which is a fundamental right of a citizen. The Article 19(1)(a) guarantees to all the citizens the right to freedom of speech and expression" which includes the right to express ones views and opinion at any issue through any medium like by word of mouth, writing, printing, picture, film, movie etc., Freedom of expression is an essential process of advancing knowledge and discovering truth. It includes within its bounds, the freedom of communication and the right to publish opinion or propagate it. The Supreme Court of India has attached the importance of the freedom of speech and expression while delivering them judgment in the case *Romesh Thappar vs. The State of Madras* observed "there can be no doubt that freedom of speech and expression includes freedom of propagation of ideas and the freedom is ensured by the freedom of circulation. Indeed, without circulation the publication would be of little value".

The fundamental right to freedom of speech and expression is regarded as one of the most basic elements of a healthy democracy for it allows its citizens to participate fully and effectively in the social and political process of the country. The Supreme Court while emphasising the freedom of speech and expression in *Maneka Gandhi vs .Union of India*[8] held that: "If democracy means Government of the people by the people, it is obvious that every citizen must be entitled to participate in the democratic process and in order to enable him to intelligently exercise

6 Dr.Pattabhisitaramayya, History of Indian National Congress, Vol. 1, Indian Congress, Working Committee,Allahabad,1935 pp.260=261 quoted in Dr.C.K.N.Raja, Freedom of speech and Expression under the constitution of India and the United States, Karnataka University, Dharwad,1979,p.52

7 Second Press Commission report Vol.1, 34-35 quoted in Indian Constitutional Law by M. P. Jain, 6th Edition,Vol. 1, 2010, LexisNexis, Butterworths wadhwa, Nagpur, P.1414

8 AIR 1978 SC 597.

his right of making a choice, free and general discussion of public matters is absolutely essential." This judgment shows about the relationship between the concept of freedom of speech and expression which is extended to the concept of socio political participation of the citizen.

It is important to note that the scope of the "freedom of speech and expression" in Article 19(1)(a) of the Constitution has been expanded to include the right to receive and disseminate information. It includes the right to communicate and circulate information through any medium including print media, audio, television broadcast or electronic media.[9] In deciding the Cricket Association Bengal case[10], the Court held that "The freedom to receive and communicate information and ideas without interference is an important aspect of the freedom of speech and expression".

## RESTRICTION ON FREEDOM OF EXPRESSION

As we say the right of one person stops when he touches the other person's nose. It becomes the duty of every citizen not to injure other either by words or by an action. Article 19(2) speaks about the restriction on the freedom of speech and expression. In the case *Sahara India Real Estate Corporation Ltd. and others vs. Securities and Exchange Board of India and another*[11] being extremely significant in the present context are extracted below:

"Freedom of expression which includes freedom of the press has a capacious content and is not restricted to expression of thoughts and ideas which are accepted and acceptable but also to those which offend or shock any section of the population. It also includes the right to receive information and ideas of all kinds from different sources. In essence, the freedom of expression embodies the right to know. However, under our Constitution no right in Part III is absolute. Freedom of expression is not an absolute value under our Constitution. It must not be forgotten that no single value, no matter exalted, can bear the full burden of upholding a democratic system of government."

Under the First Amendment to the Constitution, made on June 18, 1951, it clearly states that this right is not absolute right and the State may make a law imposing "reasonable restrictions" on the exercise of the right to freedom of speech and expression "in the interest of the public" on the following grounds:

1. Sovereignty and Integrity of India

   Laws imposing restriction on statements or expression which change the sovereignty and integrity of India which is likely to cause violence.

2. The Security of the State

   Legislature can enact laws which would impose restrictions on expressions which endanger the security of the state and is intended to overthrow the Government or waging a war or rebellion against the Government.

3. Friendly relations with foreign states

   The object behind the provision is to prohibit unrestrained malicious propaganda against a foreign friendly state, which may jeopardize the maintenance of good relations between India, and that State. However, interest of friendly relations with foreign States, would not justify the suppression of fair criticism of foreign policy of the Government.

9 M. P. Jain, Indian Constitutional Law, Wadhwa and Co. (5th ed.: 2003), pp. 1154-1157

10 Secretary, Ministry of Information & Broadcasting, Govt. of India and others vs. Cricket Association of Bengal and others 1995 2 SCC 161

11 (2012) 10 SCC 603 158

4. Public Order

Public order means public peace, safety and tranquility of the people at large. The absence of public order is an aggravated form of disturbance of public peace, which affects the general life of the public. Any speech which intends to disturb public order can be restricted by enacting laws. mere criticism of Government does not necessarily disturb public order. The words 'in the interest of public order' includes not only such utterances as are directly intended to lead to disorder but also those that have the tendency to lead to disorder. Thus, a law punishing utterances made with the deliberate intention to hurt the religious feelings of any class of persons is valid because it imposes a restriction on the right of free speech in the interest of public order since such speech or writing has the tendency to create public disorder even if in some case those activities may not actually lead to a breach of peace.

5. Decency and Morality

The State can put restriction on forms of expression if they are considered to be indecent, immoral or obscene. Sections 292 to 294 of the Indian Penal Code provide instances of restrictions on the freedom of speech and expression in the interest of decency or morality. These sections prohibit the sale or distribution or exhibition of obscene words, etc. in public places.

6. Relation to Contempt of Court

The legislation has enacted laws which restrict the exercise of one's right of freedom of speech and expression if it interferes with due course of justice or lowers the authority or statute of the court. Although criticism of the judicial system or judges is not restricted it must not impair or hamper the administration of justice.

7. Relation to defamation

Defamation is an intentional false statement either published or publicly spoken that injures another person's reputation or good name. Defamation consists in exposing a man to hatred, ridicule, or contempt.

8. Incitement to an offence

This ground permits legislations to punish or prevent incitement to commit an offence including serious offence like murder which lead to breach of public order. The word 'offence' is defined as any act or omission made punishable by law for the time being in force.

The above eight restrictions show that restrictions are on the basis that public should not be affected and in the interest of State. The problem arises when the freedom of expression is under a responsible use it makes it as censored to the citizen. Reasonable restriction cannot assume any disproportionate characteristic in the name of reasonableness, for the concept of reasonableness, as a Constitutional vehicle, conceives of the doctrine of proportionality. The Constitution requires the legislature to maintain a balance between the eventual adverse effects and the purpose it intends to achieve and as the provisions under assail do not meet the test of proportionality or least restrictive measure, they do not withstand the litmus test as postulated under Article 19(2) of the Constitution. The Court has explained about the restriction in S. Rangarajan's case[12] as follows: "But we cannot simply balance the two interest as they are of equal weight. Our commitment to freedom of expression demands that it cannot be surpassed unless the situations created by allowing the freedom are pressing and the community interest

12 S. Rangarajan v. P. Jagjivan Ram, (1989) 2 S.C.C. 574, 592.

is endangered. The anticipated anger should not be remote, conjectural or far-fetched". The liberty of one must not offend the liberty of others. Patanjali Shastri, J. in A. K. Gopalan[13] case, observed, "man as a rational being desires to do many things, but in a civil society his desires will have to be controlled with the exercise of similar desires by other individuals".

In *Chintaman Rao vs. State of M.P.*[14], this Court opined as under: "The phrase "reasonable restriction" connotes that the limitation imposed on a person in enjoyment of the right should not be arbitrary or of an excessive nature, beyond what is required in the interests of the public. The word "reasonable" implies intelligent care and deliberation, that is, the choice of a course which reason dictates. Legislation which arbitrarily or excessively invades the right cannot be said to contain the quality of reasonableness and unless it strikes a propArticle 19(1)(g) and the social control permitted by clause (6) of article 19, it must be held to be wanting in that quality."

The freedom of expression is covered under Article 19(1)(a) under the head freedom of speech and expression. The word freedom of action is not directly made out in the Indian Constitution but it can be impliedly founded that the action is also guaranteed. The meaning of action means the way of expressing of something. The same principle lies hereto until and unless the act of expressing injures the other person that makes the right to be infringed by the action of State. The only remedy available to the citizen if his/her fundamental right is violated is to approach the High Court under Article 226 and Article 32 of the Constitution. An individual as well as a corporation can invoke freedom of expression and action and for other fundamental rights against the State by way of a Writ Petition under Articles 32 and 226 of the Constitution of India subject to the State imposing some permissible restrictions in the interests of social control. But this freedom is suspended during the Emergency period.

## FREEDOM RESTRICTED BY OTHER LEGISLATION

1. The Indian Penal Code has several clauses that make it contingent upon the person "expressing" himself or herself not to hurt sentiments or cause public discord, something that is open to interpretation. The freedom of expression and action is curtailed by the legislation if the excising of the same affects the public order and public peace.

**Section 153A**[15] : Deals with words, spoken or written, or representations that promote disharmony and feelings of enmity, hatred or ill-will between groups. The penalty is 3 years in jail and/or fine.

**Section 292**[16]: Makes obscene publications (book, paper, pamphlet, writing, drawing, painting, representation, figure or any object) an offence. The penalty is 2 years (first conviction) or 5 years (second conviction), and/or fine.

**Section 295A**[17]: Criminalizes "deliberate and malicious acts, intended to outrage religious feelings, including words, signs, visible representations"; entails 3 years and/or fine.

**Section 298**[18]: Penalises the "utterance of words" that might hurt the religious feelings of any person; the penalty is 1 year and/or fine. There are other laws including the Indecent Representation of Women (Prohibition) Act of 1986, and the SC and ST (Prevention

13 A. K.Gopalan vs. State of Madras 1950 AIR 27

14 Chintaman Rao vs. State of M.P 1951 AIR 118

15 Section 153A of Indian Penal Code

16 Section 292 of Indian Penal Code

17 Section 295A of Indian Penal Code

18 Section 298 of Indian Penal Code

of Atrocities) Act enacted to protect specific sections from representations and speech which they find offensive or which mocks or insults them.

**Sections 499:** Defines defamation and Section 500 IPC for punishment in respect of the said offence. The said provisions read as follows: "Whoever, by words either spoken or intended to be read, or by signs or by visible representations, makes or publishes any imputation concerning any person intending to harm, or knowing or having reason to believe that such imputation will harm, the reputation of such person, is said, except in the case hereinafter expected to defame that person.

Explanation 1: It may amount to defamation to impute anything to a deceased person, if the imputation would harm the reputation of that person if living, and is intended to be hurtful to the feelings of his family or other near relatives

Explanation 2: It may amount to defamation to make an imputation concerning a company or an association or collection of persons as such.

Explanation 3: An imputation in the form of an alternative or expressed ironically, may amount to defamation.

Explanation 4: No imputation is said to harm a person's reputation, unless that imputation is directly or indirectly, in the estimation of others, lowers the moral or intellectual character of that person, or lowers the character of that person in respect of his caste or of his calling, or lowers the credit of that person, or causes it to be believed that the body of that person is in a loathsome state, or in a state generally considered as disgraceful.[19]

**First Exception: Imputation of truth which public good requires to be made or published**
It is not defamation to impute anything which is true concerning any person, if it be for the public good that the imputation should be made or published. Whether or not it is for the public good is a question of fact.

**Second Exception: Public conduct of public servants**
It is not defamation to express in good faith any opinion whatever respecting the conduct of a public servant in the discharge of his public functions, or respecting his character, so far as his character appears in that conduct, and no further.

**Third Exception: Conduct of any person touching any public question.**
It is not defamation to express in good faith any opinion whatever respecting the conduct of any person touching any public question, and respecting his character, so far as his character appears in that conduct, and no further.

**Fourth Exception: Publication of reports of proceedings of Courts**
It is not defamation to publish substantially true report of the proceedings of a Court of Justice, or of the result of any such proceedings.

**Fifth Exception: Merits of case decided in Court or conduct of witnesses and others concerned**
It is not defamation to express in good faith any opinion whatever respecting the merits of any case, civil or criminal, which has been decided by a Court of Justice, or respecting the conduct of any person as a partly, witness or agent, in any such case, or respecting the character of such person, as far as his character appears in that conduct, and no further.

**Sixth Exception: Merits of public performance**
It is not defamation to express in good faith any opinion respecting the merits of any performance which its author has submitted to the judgment of the public, or respecting the character of the author so far as his character appears in such performance, and no further.

19 Section.499 of Indian Penal Code.

**Explanation:** A performance may be substituted to the judgment of the public expressly or by acts on the part of the author which imply such submission to the judgment of the public.

**Seventh Exception: Censure passed in good faith by person having lawful authority over another**

It is not defamation in a person having over another any authority, either conferred by law or arising out of a lawful contract made with that other, to pass in good faith any censure on the conduct of that other in matters to which such lawful authority relates.

**Eighth Exception: Accusation preferred in good faith to authorised person**

It is not defamation to prefer in good faith an accusation against any person to any of those who have lawful authority over that person with respect to the subject-matter of accusation.

**Ninth Exception: Imputation made in good faith by person for protection of his or other's interests**

It is not defamation to make an imputation on the character of another provided that the imputation be made in good faith for the protection of the interests of the person making it, or of any other person, or for the public good.

**Tenth Exception: Caution intended for good of person to whom conveyed or for public good**

It is not defamation to convey a caution, in good faith, to one person against another, provided that such caution be intended for the good of the person to whom it is conveyed, or of some person in whom that person is interested, or for the public good.

Here the issue is whether Section 499 of IPC has violated Article 19(1)(a)? The constitution guarantees the right to express oneself and the penal provision making it liable for the expression, whether this is acceptable? Whether the defamation under Article 19(2) includes criminal defamation? The right to free speech under Article 19(1)(a) is itself conditioned qualified by the restrictions contained in Article 19(2) which includes "defamation" as one of the grounds of restriction and the term "defamation" has to include criminal defamation, and there is nothing to suggest its exclusion. Although "libel" and "slander" were included in the original Constitution, yet the same were deleted by the First Amendment, whereas defamation continues to be a part of the Constitution. Therefore, it is fallacious to argue that defamation under Article 19(2) covers only civil defamation when at the time of the enactment of the Constitution, Section 499 IPC was the only provision that defined defamation and had acquired settled judicial meaning as it had been on the statute book for more than 90 years.

Right to reputation is an insegregable part of Article 21 of the Constitution. A person's reputation is an inseparable element of an individual's personality and it cannot be allowed to be tarnished in the name of right to freedom of speech and expression because right to free speech does not mean right to offend.

**Noise Pollution (V), In re**[20] would be apposite. It reads as follows: - "... Undoubtedly, the freedom of speech and right to expression are fundamental rights but the rights are not absolute. Nobody can claim a fundamental right to create noise by amplifying the sound of his speech with the help of loudspeakers. While one has a right to speech, others have a right to listen or decline to listen. Nobody can be compelled to listen and nobody can claim that he has a right to make his voice trespass into the ears or mind of others. Nobody can indulge in aural aggression. If anyone increases his volume of speech and that too with the assistance of artificial devices so as to compulsorily expose unwilling persons to hear a noise raised to unpleasant or obnoxious levels, then the person speaking is violating the right of others to a peaceful, comfortable and pollution-free

20 (2005) 5 SCC 733

life guaranteed by Article 21. Article 19(1)(a) cannot be pressed into service for defeating the fundamental right guaranteed by Article 21.

The State is under an obligation to protect human dignity of every individual. Simultaneously, freedom of speech has its Constitutional sanctity; and in such a situation, balancing of rights is imperative and, therefore, the Court should not declare the law relating to criminal defamation as unconstitutional on the ground of freedom of speech and expression as it is neither an absolute right nor can it confer allowance to the people to cause harm to the reputation of others.

## 2. UNDER INFORMATION TECHNOLOGY ACT, 2000

We are living in a modern technological era where a person shares and comments more on the social networks than to the person sitting next to him. The Information Technology Act, 2000 criminalizes "causing annoyance or inconvenience" online or electronically. The section which violates the freedom of expression is Section 66A of the Act. The verbatim of the section is as follows:

Sec.66-A: Punishment for sending offensive messages through communication service, etc. — Any person who sends, by means of a computer resource or a communication device,— (a) any information that is grossly offensive or has menacing character; or (b) any information which he knows to be false, but for the purpose of causing annoyance, inconvenience, danger, obstruction, insult, injury, criminal intimidation, enmity, hatred or ill will, persistently by making use of such computer resource or a communication device; or (c) any electronic mail or electronic mail message for the purpose of causing annoyance or inconvenience or to deceive or to mislead the addressee or recipient about the origin of such messages, shall be punishable with imprisonment for a term which may extend to three years and with fine.

The legislature in its wisdom has not thought it appropriate to abolish criminality of defamation in the obtaining social climate. In this context, the pronouncement in Shreya Singhal[21] becomes significant, more so, as has been heavily relied upon by the learned counsel for the petitioners. In the said case, Constitutional validity of Section 66-A and ancillary thereto Section 69-A of the Information Technology Act, 2000 was challenged on the ground that they infringe the fundamental right to free speech and expression and are not saved by any of the eight subjects covered in Article 19(2). The two-Judge Bench has expressed the view that both US and India permit freedom of speech and expression as well as freedom of the press. So far as abridgement and reasonable restrictions are concerned, both the US Supreme Court and this Court have held that a restriction in order to be reasonable must be narrowly tailored or narrowly interpreted so as to abridge or restrict only what is absolutely necessary. The Court has observed that only when it comes to the eight subject matters in Article 19(2) that there is vast difference. The Court has further observed thus: "… In the US, if there is a compelling necessity to achieve an important governmental or societal goal, a law abridging freedom of speech may pass muster. But in India, such law cannot pass muster if it is in the interest of the general public. Such law has to be covered by one of the eight subject-matters set out under Article 19(2). If it does not, and is outside the pale of Article 19(2), Indian Courts will strike down such law."

## 3. CENSORSHIP OF MOVIES

The suppression or control of ideas, public communication and information circulated within a society is termed as censorship. The freedom of expression shall be curtailed and suppressed if it is considered objectionable, harmful, or necessary to maintain communal harmony. The first and foremost thing that comes to mind when we hear the word censorship is movies. Even though the

21 Shreya Singhal vs. Union of India AIR 2015 SC 1523,

Constitution of India does not expressly mention motion pictures as a medium of speech and expression, they have been so accepted through various Court decisions. For the first time before the Supreme Court the Constitutionality of censorship under the 1952 Act along with the Rules framed under was challenged in the case of *K. A. Abbas v. Union of India*.[22] The Supreme Court upheld the Constitutionality within the ambit of Article 19(2) of the Constitution and added that films have to be treated separately from other forms of art and expression because a motion picture is "able to stir up emotions more deeply than any other product of art". At the same time it cautioned that it should be "in the interests of society". "If the regulations venture into something which goes beyond this legitimate opening to restrictions, they can be questioned on the ground that a legitimate power is being abused."

In the *Rangarajan vs. P. Jagjivan Ram*[23] case, the decision of the Madras High Court which revoked the 'U-Certificate' issued to a Tamil film called 'Ore Oru Gramathile' (In One Village), was challenged through an appeal before the Supreme Court. The film criticized the reservation policy in jobs as such policy is based on caste and was unfair to the Brahmins. The High Court had held that the reaction to the film in Tamil Nadu is bound to be volatile considering the fact that a large number of people in Tamil Nadu have suffered for centuries. Certain remarks were also made against Dr. B. R. Ambedkar and several Tamil personalities. The Supreme Court overruled the High Court decision and upheld the freedom of speech and expression. It held that, movie is the legitimate and the most important medium in which issues of general concern can be treated. The producer may project his own message which the others may not approve of it. But he has a right to 'think out' and put the counter appeals to reason. It is a part of a democratic give-and-take to which no one could complain. The State cannot prevent open discussion and open expression, however, hateful to its policies.

The power to impose restrictions is not the power which is available for exercise in an arbitrary manner or for the purpose of promoting the interest of those in power or suppressing dissent. The artists, film makers also enjoy the right to freedom expression. If at all any restriction is made it shall be on the basis of restriction mentioned in Article. 19(2) of the Indian Constitution.

## CONCLUSION

As seen above the Judgment of the Courts plays the important role in protecting the freedom guaranteed under the Constitution. State has the duty to protect the rights of the citizen, But at times State evens act arbitrarily. So, the only saver of freedom and rights guaranteed in Constitution is the Judiciary. The act of the State whether it really violates the fundamental right are decided by the Judiciary. There are some important judgments quoted above like Ragarajan's case, Maneka Gandhi's case, *Subramaniya Swamy vs Union of India* and *Shreya Singal vs. Union of India shows* how the freedom of expression is been protected by the Court of Law.

The freedom of expression is clearly made out in the Indian Constitution and restriction where are also clearly mentioned in the Constitution. But the freedom of action is not directly mentioned in the Constitution. The action means way of expressing, so this means freedom of action is also indirectly said in the Constitution. The Act will not be restricted unless and until it affects the other. For example, raising a hand to say hello is different. But the hand which is raised to slap the other person is not allowed in the Constitution. So the act so specified should not affect the other person or the public at large. Thus the freedom so guaranteed shall be curtailed but not wholly, if it is reasonable restriction it can be curtailed.

22 1971 SCR (2) 446
23 supra

B. V. Jhaveri, *Advocate*

# DIRECT TAXES
## Supreme Court

**Where assessee society was engaged in activity of finance business and was also engaged in activity of granting loans to general public as well, it could not be termed as co-operative society meant only for its members and providing credit facilities to its members, hence not entitled to deduction under section 80P**

*Citizen Co-operative Society Ltd. vs. ACIT, Circle-9(1), Hyderabad – [Civil Appeal No. 10245 of 2017 (arising out of SLP (C) No. 20044 of 2015)] – [(2017) 84 taxmann.com 114 (SC)]*

Their Lordships of the Supreme Court held as under:

(i) We may mention at the outset that there cannot be any dispute to the proposition that Section 80P of the Act is a benevolent provision which is enacted by the Parliament in order to encourage and promote growth of co-operative sector in the economic life of the country. It was done pursuant to declared policy of the Government. Therefore, such a provision has to be read liberally, reasonably and in favour of the assessee.

(ii) Sub-section (i) of clause (a) of sub-section (2), recognises two kinds of co-operative societies, namely: (i) those carrying on the business of banking and; (ii) those providing credit facilities to its members.

(iii) In the case of *Commissioner of Income Tax vs. Punjab State Co-operative Bank Ltd. (2008) 300 ITR 24 (Punjab & Haryana H. C.)*, while dealing with an identical issue, the High Court held as follows:

"8. ….. It means that a co-operative society engaged in carrying on the business of banking and a co-operative society providing credit facilities to its members will be entitled for exemption under this sub-clause. The carrying on the business of banking by a co-operative society or providing credit facilities to its members are two different types of activities which are covered under this sub-clause.

xx xx xx".

"13. So, in our view, if the income of a society is falling within any one head of exemption, it has to be exempted from tax notwithstanding that the condition of other heads of exemption are not satisfied. A reading of the provisions of Section 80P of the Act would indicate the manner in which the exemption under the said provisions is sought to be extended. Whenever the Legislature wanted to restrict the exemption to a primary co-operative society, it was so made clear as is evident from clause (f) with reference to a milk co-operative society that a primary society engaged in supplying milk is

entitled to such exemption while denying the same to a federal milk co-operative society."

(iv) The aforesaid judgment of the High Court correctly analyses the provisions of Section 80P of the Act and it is in tune with the judgment of this Court in Kerala State Co-operative Marketing Federation Limited (5 SCC 48).

(v) With the insertion of sub-section (4) by the Finance Act, 2006, which is in the nature of a proviso to the aforesaid provision, it is made clear that such a deduction shall not be admissible to a co-operative bank. However, if it is a primary agriculture credit society or a primary co-operative agriculture and rural development bank, the deduction would still be provided. Thus, co-operative banks are now specifically excluded from the ambit of Section 80P of the Act.

(vi) Undoubtedly, if one has to go by the aforesaid definition of 'co-operative bank', the appellant does not get covered thereby. It is also a matter of common knowledge that in order to do the business of a co-operative bank, it is imperative to have a licence from the Reserve Bank of India, which the appellant does not possess. Not only this, as noticed above, the Reserve Bank of India has itself clarified that the business of the appellant does not amount to that of a co-operative bank. The appellant, therefore, would not come within the mischief of sub-section (4) of Section 80P.

(vii) It is significant to point out that the main reason for disentitling the appellant from getting the deduction provided under Section 80P of the Act is not sub-section (4) thereof. What has been noticed by the Assessing Officer, after discussing in detail the activities of the appellant, is that the activities of the appellant are in violation of the provisions of the MACSA (Mutually Aided Co-operative Societies Act, 1995) under which it is formed. It is pointed out by the Assessing Officer that the assessee is catering to two distinct categories of people. The first category is that of resident members or ordinary members. There may not be any difficulty as far as this category is concerned. However, the assessee had carved out another category of 'nominal members'. These are those members who are making deposits with the assessee for the purpose of obtaining loans, etc. and, in fact, they are not members in real sense. Most of the business of the appellant was with this second category of persons who have been giving deposits which are kept in Fixed Deposits with a motive to earn maximum returns. A portion of these deposits is utilised to advance gold loans, etc. to the members of the first category. It is found, as a matter of fact, that the depositors and borrowers are quiet distinct. In reality, such activity of the appellant is that of finance business and cannot be termed as co-operative society. It is also found that the appellant is engaged in the activity of granting loans to general public as well. All this is done without any approval from the Registrar of the Societies. With indulgence in such kind of activity by the appellant, it is remarked by the Assessing Officer that the activity of the appellant is in violation of the Co-operative Societies Act. Moreover, it is a co-operative credit society which is not entitled to deduction under Section 80P(2)(a)(i) of the Act.

(viii) It is in this background, a specific finding is also rendered that the principle of mutuality is missing in the instant case. Though there is a detailed discussion in this behalf in the order of the Assessing Officer, our purpose would be served by taking note of the following portion of the discussion:

"As various courts have observed that the following three conditions must exist before an activity could be brought under the concept of mutuality;

that no person can earn from him;

that there a profit motivation;

and that there is no sharing of profit.

It is noticed that the fund invested with banks which are not member of association welfare fund, and the interest has been earned on such investment for example, ING Mutual Fund [as said by the MD *vide* his statement dated 20-12-2010]. [Though the bank formed the third party *vis-à-vis* the assessee entitled between contributor and recipient is lost in such case. The other ingredients of mutuality are also found to be missing as discussed in further paragraphs]. In the present case both the parties to the transaction are the contributors towards surplus, however, there are no participators in the surpluses. There is no common consent or whatsoever for participators as their identity is not established. Hence, the assessee fails to satisfy the test of mutuality at the time of making the payments the members as referred as members may not be the member of the society as such the AOP body by the society is not covered by concept of mutuality at all."

(ix) Once we keep the aforesaid aspects in mind, the conclusion is obvious, namely, the appellant cannot be treated as a co-operative society meant only for its members and providing credit facilities to its members. We are afraid such a society cannot claim the benefit of Section 80P of the Act.

**S.153A/ 153C : The seized incriminating material have to pertain to the A.Y. in question and have co-relation, document-wise, with the A.Y. This requirement u/s. 153C is essential and becomes a jurisdictional fact. It is an essential condition precedent that any money, bullion or jewellery or other valuable article or thing or books of account or documents seized or requisitioned should belong to a person other than the person referred to in S. 153A. Kamleshbhai Dharamshibhai Patel 31 taxmann.com 50 (Guj.) approved. SSP Aviation 20 taxmann.com 214 (Del.) distinguished**

*CIT, Pune vs. Sinhgad Technical Education Society – Civil Appeal No. 11080 of 2017 – (arising out of SLP (C) No. 25257 of 2015, dated 29th August, 2017)*

(i) The CIT filed four SLPs before the Supreme Court for the A.Ys. 2000-01, 2001-02, 2002-03 and 2003-04 against the common judgment of the High Court dated 25th March, 2015 raising the issue of validity of the proceedings initiated u/s. 153C of the Act against the assessee trust which is registered under the Bombay Public Trust Act, 1950 and registered u/s. 12AA of the I.T. Act, 1961 since A.Y. 1994-95.

(ii) Pursuant to the search u/s. 132 of the Act at the premises of one Mr. M.N. Navale, president of the assessee trust, and his wife on 20th July, 2005, certain documents were seized. On the basis of these documents, which according to the Revenue contained notings of cash entries pertaining to capitation fees received by various institutions run by the assessee, a notice u/s. 153C of the Act was issued on 18th April, 2007 for the A.Ys. 2001-02 to 2005-06.

(iii) After receipt of the Special Audit Report u/s.142(2A) of the Act, the AO passed the order on 7th August, 2008 for the A.Ys. 1999-2000 to 2006-07. The assessment for A.Y. 1999-2000 was covered u/s. 147 whereas the assessment for A.Y. 2006-07 was covered u/s. 143(3) of the Act. In the order, the AO observed that the net taxable incomes for A.Ys. 1999-00 to 2006-07 were worked out on the basis of re-cast account and taxed. The AO further observed that undisclosed income on account of donation collected for A.Y.2006-07 was worked out and taxed. Accordingly, the AO computed total income at ₹ 3,54,46,432/-. The CIT(A) held that the assessee was not eligible for exemption

u/s.11 of the Act and therefore, the donations received were rightly treated as income.

(iv) In the appeal before the Appellate Tribunal, the assessee raised additional ground questioning the validity of the notice u/s. 153C of the Act on the ground that satisfaction was not properly recorded and also the notice u/s. 153C for A.Ys. 2000-01 to 2003-04 were time-barred.

The ITAT allowed the assessee to raise the additional ground and quashed the notice u/s. 153C for the A.Ys. 2000-01 to 2003-04.

The said order of the ITAT was upheld and the Revenue's appeals for A.Ys. 2000-01 to 2003-04 were dismissed by the High Court.

(v) In the appeals for the aforesaid four assessment years, the first objection of the Solicitor General was regarding admission of the ground challenging the notice u/s.153C of the Act as the same was raised for the first time before the Tribunal and the assessee had not objected to the jurisdiction u/s.153C of the Act before the A.O.

(vi) Dismissing the appeal of the Revenue, their Lordships of the Supreme Court held as under:

"18. The ITAT permitted this additional ground by giving a reason that it was a jurisdictional issue taken up on the basis of facts already on the record and, therefore, could be raised. In this behalf, it was noted by the ITAT that as per the provisions of Section 153C of the Act, incriminating material which was seized had to pertain to the Assessment Years in question and it is an undisputed fact that the documents which were seized did not establish any co-relation, document-wise, with these four Assessment Years (i.e., A.Ys. 2000-01 to 2003-04). Since this requirement under Section 153C of the Act is essential for assessment under that provision, it becomes a jurisdictional fact. We find this reasoning to be logical and valid, having regard to the provisions of Section 153C of the Act. Para 9 of the order of the ITAT reveals that the ITAT had scanned through the Satisfaction Note and the material which was disclosed therein was culled out and it showed that the same belongs to Assessment Year 2004-05 or thereafter. ….. . It was specifically recorded that the counsel for the Department could not point out to the contrary. It is for this reason the High Court has also given its imprimatur to the aforesaid approach of the Tribunal. .. ."

"19. We, thus, find that the ITAT rightly permitted this additional ground to be raised and correctly dealt with the same ground on merits as well. Order of the High Court affirming this view of the Tribunal is, therefore, without any blemish. Before us, it was argued by the respondent that notice in respect of the Assessment Years 2000-01 and 2001-02 was time barred. However, in view of our aforementioned findings, it is not necessary to enter into this controversy."

"20. Insofar as the judgment of the Gujarat High Court in *Kamleshbhai Dharamshibhai Patel vs. Commissioner of Income Tax-III, (2013) 31 taxmann.com 50 (Gujarat)* relied upon by the learned Solicitor General is concerned, we find that the High Court in that case has categorically held that it is an essential condition precedent that any money, bullion or jewellery or other valuable articles or thing or books of account or documents seized or requisitioned should belong to a person other than the person referred to in Section 153A of the Act. This proposition of law laid down by the High Court is correct, which is stated by the Bombay High Court in the impugned judgment as well. The judgment of the Gujarat High Court in the said case went in favour of the Revenue when it was found on facts that the documents seized, in fact, pertain to third party, i.e., the assessee, and, therefore, the said condition precedent for taking action under Section 153C of the Act had been satisfied."



Paras S. Savla, Jitendra Singh, Nishit Gandhi
*Advocates*

# DIRECT TAXES
## High Court

### 1. Revision u/s. 263 – Deduction u/s. 35D

*Pr. CIT vs. Yes Bank Ltd. – [Income Tax Appeal No. 599 of 2015, Bombay High Court]*

A claim was made u/s. 35D of the Income Tax Act by the Assessee in its return of income along with a note stating its allowability and the same was allowed by the Assessing Officer while framing the assessment order u/s. 143(3) of the Act. Exercising power u/s. 263 of the Income-tax Act, the Commissioner sought to withdraw deduction granted to the assessee u/s. 35D of the Act on the ground that only an industrial undertaking is entitled to claim deduction u/s. 35D and since the assessee is a bank and not an industrial undertaking and therefore ineligible for claim u/s. 35D. The Tribunal quashed the revision order passed by the CIT u/s. 263 of the Act. Before the High Court the assessee relied on the Judgment of the Hon'ble Bombay High Court in the case of *CIT vs. Emirates Commercial Bank Ltd.* wherein it was held that the banks are industrial undertakings and eligible for deductions under Section 32A. On an appeal by the Department, the Hon'ble High Court affirmed the order of the Tribunal. The High Court observed that the Assessing Officer sought clarification from the assessee about the correctness of the amount of one-fifth of the total expenses incurred under Section 35D of the Act. The assessee under letter dated 26-10-2004 gave specific explanation on the issue raised by the Assessing Officer and thereafter, the assessment order was passed. To substantiate his claim, the assessee has placed reliance upon Malabar Industrial Co. Ltd. (supra). The possible view, it appears, was taken by the Assessing Officer. The Tribunal on the said count has held that the revisional jurisdiction ought not to have been exercised by the CIT(A). Only because the Commissioner thought that other view is a better view, would not enable Commissioner of Income Tax to exercise power under Section 263 of the Act. It would not be a reopening of assessment or reassessment. The High Court dismissed revenue's appeal.

### 2. Deduction u/s. 10A – Expansion of unit

*Pr. CIT vs. Hinduja Ventures Ltd. – [ITXA No. 63 of 2016, Bombay High Court]*

Assessee claimed deduction u/s. 10A in 2 out of 4 units which was denied by the AO and confirmed by the CIT(A) on the grounds that the said two units were mere expansion of the existing units and not new industrial undertakings. Further, the assessee

itself in its application to STPI had stated that the said units constituted expansion of existing units and not a new and distinct undertaking or unit. As such there was no independent registration of Unit II and Unit III with STPI. The same was reversed by the Hon'ble Tribunal primarily on the basis of the remand report of the AO which stated certain crucial factors that; (i) Both units were set up with fresh investments and new plant and machinery was purchased using the same; (ii) Separate books of accounts have been maintained by each units; (iii) The employees employed in each of the units were fresh set of employees; (iv) The nature of activity of both the units is totally different vis-a-vis the activity carried on by each other as well as that by the first unit; (v) both units have new and independent sources of income; etc. The Hon'ble High Court affirmed the order of the Tribunal. It observed that the Unit II and Unit III cannot be said to be formed by reconstruction nor can be said to be an expansion of earlier same business. Though the permission was sought by way of an expansion, the facts on record categorically and succinctly establish that the business of Unit II and Unit III were independent, distinct and separate and are not related with each other or even with Unit I. In case of Textile Machinery Corporation Ltd., the Apex Court was considering the provisions of Section 15(C) of the Act as it stood then, dealing with similar provisions. The Apex Court in the said case observed that the true test is not whether the new industrial undertaking connotes expansion of the existing business of the assessee but whether it is all the same a new and identifiable undertaking, separate and distinct from the existing business.

### 3. Disallowance u/s. 14A – No exempt income – no disallowance under section 14A r.w. Rule 8D even if auditor indicates in tax audit otherwise

*PCIT vs. IL & FS Energy Development Company Ltd. [2017] 84 taxmann.com 186 (Delhi)*

Assessee company was engaged in the business of providing consultancy services. It filed its return at a loss of ₹ 2,42,63,176/-. During the course of assessment proceedings the Ld. A.O. show caused to explain why disallowance should not be made under Section 14A of the Act read with Rule 8D of the Rules for the purpose of normal computation of book profit as well as for the purpose of Minimum Alternative Tax ('MAT') under Section 115JB of the Act. In reply it was explained that it had made investment in mutual funds and that no interest-bearing funds were invested to earn tax free income. Hence, no disallowance is required to be made. The Ld. A.O., however, finalised the assessment by making disallowance under section 14A r.w. rule 8D relying on the decision of Delhi Tribunal in the case of *Cheminvest Ltd. vs. ITO [2009] 121 ITD 318 (Delhi)(SB)* wherein it was held that Section 14A would apply even if during the AY in question, the investment has not actually yielded any exempt income. On appeal, the First Appellate Authority allowed partial relief to the assessee by reducing the quantum of disallowance made under Section 14A r.w. Rule 8D. The assessee being aggrieved by the order passed by Ld. CIT(A) filed further appeal before the Delhi Appellate Tribunal. Hon'ble Appellate Tribunal has allowed the appeal of the assessee and deleted the disallowance made by the Ld. A.O. On further appeal by the revenue, Hon'ble High Court observed that if no exempt income is earned in the Assessment Year in question, there can be no disallowance of expenditure in terms of section 14A read with Rule 8D even if tax auditor has indicated in his tax audit report that there ought to be such a disallowance. The Hon'ble Court has further held that

mere fact that in the audit report for the AY in question, the auditors may have suggested that there should be a disallowance cannot be determinative of the legal position. That would not preclude the assessee from taking a stand that no disallowance under Section 14A of the Act was called for, as no exempt income was earned. The Hon'ble Court had also considered the CBDT Circular No. 5/2014 dated 11th February 2014 which clarified that Section 14A would apply even when exempt income was not earned in a particular AY and held that the same cannot override the expressed provisions of Section 14A read with Rule 8D.

## 4. Recovery of demand u/s. 226(3) – Garnishee proceedings – attachment of cash credit and term loan accounts with bank is invalid

*Kaneria Granito Ltd. vs. ACIT [2017] 154 DTR (Guj.) 281*

The Ld. A.O. after finalising the assessment of the assessee under section 143(3) of the Act raised demand of ₹ 5.42 crores. The assessee's appeal filed before the Ld. CIT(A) against the assessment order was pending for disposal. The Ld. A.O. in the meantime initiated recovery proceedings by issuing notice under section 226(3) of the Act to the Allahabad Bank wherein the assessee was having cash credit account and term loan account. The Ld. A.O. conveyed to them that a sum of ₹ 5.85 crores is due from the assessee to the department and called upon to pay to the department forthwith any amount due from the bank or held by the assessee for or on account of the assessee up to the limit of arrears of tax shown in the said notice. Assessee aggrieved by the coercive action of the Ld. A.O. approached the Hon'ble Gujarat High Court to stay the recovery proceedings initiated against it. It was argued before the Hon'ble Court that the accounts attached by the Ld. A.O. are either in the nature of cash credit account or term loan account. Therefore, it cannot be stated that there was any money due to the assessee from the bank which can be recovered in terms of sub-section(3) of section 226 of the Act. The Hon'ble court allowed the petition and quashed the notice of attachment issued by Ld. A.O. by observing that in proceedings under section 226(3) attachment of cash credit account and term loan account of the assessee with the bank is invalid.

## 5. Powers of CIT(A) u/s. 251 – dismissal of appeal for non-prosecution – CIT(A) is not empowered to dismiss the appeal for non-prosecution

*CIT vs. Premkumar Arjundas Luthra (HUF) [2017] 154 DTR (Bom.) 302*

Assessing Officer had passed order under section 271(1)(c) levying concealment penalty. The assessee being aggrieved by the penalty order preferred an appeal before the Ld. CIT(A). However, none appeared for hearing before the Ld. CIT(A) on the appointed date, and hence the Ld. CIT(A) dismissed the appeal of the assessee for non-prosecution. The assessee carried the matter before the Appellate Tribunal, Mumbai. The Appellate Tribunal allowed the appeal of the assessee by observing that in view of section 250(6) of the Act, the CIT(A) has no power to dismiss an appeal on account of non-prosecution. On further appeal, the Hon'ble Court dismissed the appeal of the department by observing that once an assessee filed an appeal under section 246A of the Act, it is not open to him as a matter of right to withdraw or not press the appeal. In fact with effect from 1st June, 2001 the power of the CIT(A) to set aside the order of the Assessing Officer and restore it to the AO for passing a fresh order stands

withdrawn. Therefore, it would be noticed that the powers of the CIT(A) is coterminus with that of the AO i.e., he can do all that Assessing Officer could do. Therefore, just as it is not open to the AO to not complete the assessment by allowing the assessee to withdraw its return of income, it is not open to the assessee in appeal to withdraw and/or the CIT(A) to dismiss the appeal on account of non-prosecution of the appeal by the assessee.

## 6. Disallowance u/s. 37 – Commission – Agent not traceable – Assessee only received balance amount and hence such commission cannot be taxed

*CIT vs. Olam Export India Ltd. – [Income Tax Appeal No. 1623 of 2009, Kerala High Court]*

Assessee, an exporter had during the relevant years paid substantial amounts towards sales commission to one M/s. Lovely Enterprises, Delhi for consignment sales. The Assessing Officer disallowed the claim, on the ground that the existence of such agent itself was in doubt. Disallowance was confirmed by the CIT(A) after making further enquiries. The Tribunal held that the amount received by the assessee was 95% and was net of commission at 5% and hence the same could not be taxed in the hands of the assessee since it was never received by the assessee. Tribunal relied on *Godhra Electric Supply Co. vs. CIT - (1997) 225 ITR 746 (SC).* The Department filed appeal to the High Court against the said order on the ground that the payee was not traceable and hence there is no proof of payment of commission and thus the Tribunal order was perverse and unwarranted. The Hon'ble High Court affirming the decision of the Tribunal observed that though there are circumstances which are capable of creating a reasonable suspicion about the existence of the agency, M/s. Lovely Enterprises, fact remains such a concern had CST Registration. There were transactions between the assessee and the said concern and the invoices which were raised by the assessee in the name of the agent contained the gross sale price and the net amount payable, after recovery of 5% towards commission and other expenses due. Based on such transactions, the amounts were realised by the assessee through banking channels and F forms under the CST Act were also obtained by them from the Agent. These admitted facts, therefore, show that the assessee had received only 95% of the gross price and the revenue has no material before it that the assessee had received anything in excess thereof either directly or otherwise. The principles laid down by the Apex Court in Godhra Electricity's case (supra) clearly indicate that the assessee could be taxed only for the income that it has derived. If that be so, despite the contentions raised regarding the doubtful existence of the agent, the assessee having received only 95% of the gross value, could have been taxed, only for what it had actually received.

All compromise is based on give and take, but there can be no give and take on fundamentals. Any compromise on mere fundamentals is a surrender. For it is all give and no take.

*— Mahatma Gandhi*



Neelam Jadhav, Keerthiga Sharma &
Neha Paranjpe, *Advocates*

# DIGEST OF CASE LAWS
## Tribunal

### Reported Decisions

### 1. Exemption – Section 54F – Assessee owned only one residential house – The deduction under section 54F is allowable for investment in construction of house property against capital gains on sale of house properties

*ACIT vs. Mohinder Kumar Jain [2017] 84 taxmann.com 141 (Delhi - Trib.) (Assessment Year: 2011-12)*

**Facts**

The assessee is an individual. During the year, the Assessee sold 5 house properties and invested the sale consideration in construction of house at 9, Mehandi Farms, Bhatti Mines, New Delhi. The assessee in his return of income claimed deduction under section 54F of the Income-tax Act, 1961 ('Act') for investment in residential house against the capital gains on sale of house properties. The Assessing Officer ('AO') denied the claim of exemption under section 54F of the Act by observing that on the date of transfer of the original asset, the assessee owned more than one residential house and therefore it was not eligible for deduction under section 54F of the Act. On appeal, the Commissioner of Income-tax (Appeals) ('CIT(A)') gave partial relief and allowed deduction of ₹ 1,59,77,680/- under section 54F of the Act. The Department, being aggrieved by the appellate order preferred the appeal before the Hon'ble Income tax Appellate Tribunal ('Tribunal').

**Held**

The Hon'ble Tribunal held that the appellant had one house at D-3/8 Vasant Vihar, New Delhi, the same was let out during the year, which is also evident from the computation of income for the relevant assessment year, wherein the rental income from the same house has been declared as income from house property. This indicated that the Appellant was not using that house as his residence during the relevant assessment year. At the same time, the construction of residential house at 9, Mehendi Farms, Bhatti Mines, Chhatarpur New Delhi was also not complete. The appellant was residing during the relevant period in a residential property in the name of Hindu undivided family at E-222, Naraina Vihar, New Delhi. Thus, the assessee was entitled for deduction under section 54F of the Act because house property at 9, Mehandi Farms was under construction during the year and it could not be said that

another residential house was owned by the assessee. As the assessee owned only one residential house at D-3/8 Vasant Vihar, New Delhi, he was entitled for deduction under section 54F Act for investment in construction of the house property at 9, Mehandi Farms. Accordingly, the appeal of the Revenue was dismissed.

## 2. Set-off of business loss – Section 69B r.w.s 115BBE – Business loss is to be set off against undisclosed investment prior to the A.Y. 2017-18.

*ACIT vs Sanjay Bairathi Gems Ltd. [2017]84 taxmann.com 138 (Jaipur - Trib.) (Assessment Year: 2013-14)*

**Facts**

The assessee company was engaged in the business of export, import and manufacture of precious & semi-precious stones and jewellery. A survey under section 133A of the Act was conducted on 31st October, 2012 at its business premises, which was converted into search. During the course of survey, assessee admitted the excess stock of ₹ 2,43,77,004/-. Thereafter, on verification, it was explained that the correct excess stock found in survey works out to ₹ 231.41 lakhs as against the amount of ₹ 243.77 lakhs worked out at the time of survey. This was due to the valuation of the stock at market price instead of the purchase price. In the return of income, assessee declared an income of ₹ 1,44,61,040/- after reducing business loss. The AO accepted the value of excess stock surrendered in search. However, he assessed the income on account of excess stock under section 69B of the Act without allowing the set-off of business loss as per the provisions of section 115BBE. On appeal, the CIT(A) held that in the amendment to the proviso of Section 115BBE the word "or set off of any loss" is introduced by Finance Act, 2016 w.e.f. 1st April, 2017. Thus, the set off of business loss was to be allowed against the excess stock found in the search for the year under consideration. The Department being aggrieved by the appellate order preferred the appeal before Hon'ble Tribunal.

**Held**

The Hon'ble Tribunal observed that the AO had brought to tax the undisclosed investment in excess stock of stones, gold and jewellery, without allowing set-off of business loss of ₹ 86,96,733 against the said income of ₹ 2,31,41,217 which was brought to tax under section 69B r.w.s 115BBE of the Act. The AO, however, allowed the carry forward of said business loss to be set-off in the subsequent assessment years. Thus, the fact that business loss had been incurred during the year was disputed. Further, the amendment brought in by the Finance Act, 2016 whereby set off of losses against income referred to in section 69B was not allowed, is stated clearly to be effective from 1st April 2017 and would accordingly, apply to assessment year 2017-18 onwards. Accordingly, for the year under consideration, there was no restriction to set off of business losses against income brought to tax under section 69B of the Act. Thus, the Hon'ble Tribunal allowed set-off of business losses against income brought to tax under section 69B of the Act.

## 3. Bad debts (writing off of debt) – Section 36(1)(vii) – Since assessee could not produce any evidence to show that suppliers refused to pay outstanding amount or denied their liability, claim that it was a mere 'provision for bad debts' could not allowed

*Elite International (P.) Ltd. vs. ACIT ([2017] 83 taxmann.com 213 (Mum.)(Trib.)) (Assessment Year: 2009-10)*

**Facts**

Assessee was engaged in business of manufacturing and export of textile made-ups and handloom products. It gave certain advance to suppliers for processing raw materials, since ratio of wastage at suppliers end was very high during processing, Assessee raised debit notes against those parties who refused to pay outstanding amount. Assessee debited said amount in profit and loss account and claimed deduction for same. The AO rejected claim holding that it was a mere provison for certain doubtful advances which could not be allowed as deduction. The CIT(A) also confirmed the decision of the AO.

**Held**

The Hon'ble Tribunal held that since Assessee could not produce any evidence to show that suppliers refused to pay outstanding amount or denied their liability in any manner, which could lead to conclusion that impugned provision crystallized during relevant year, the treatment of the amount in the books of account and an analysis of other documents led to an opinion that the impugned expenditure, being mere provision, did not crystallize during the year and therefore it was not allowable to the assessee.

## 4. Section 92C – Transfer Pricing – Payment of Management Fees should be considered to be at arm's length even though only certain services were availed and not all services mentioned in the agreement with the AE

*Dimension Data India Pvt. Ltd. vs. DCIT (ITA No. 2280/Mum/2016) (Date of Order: 16th August, 2017) [TS-644-ITAT-2017(Mum.)-TP] (Assessment Year: 2010-11)*

**Facts**

During the year, the assessee company had made a payment of management fees to its associated enterprise ('AE') for numerous services including, finance, business development support services, information technology, etc. The Transfer Pricing Officer ('TPO') rejected the application of Transactional Net Margin Method to benchmark the international transaction of payment of management fees. He applied Comparable Uncontrolled Price Method and made an adjustment to the extent of payment for three services, namely corporate communication and brand management services, human resources services and sales and marketing services, while considering the payment for all other services to be at arm's length. The Dispute Resolution Panel ('DRP') partly upheld the order of the TPO and the assessee filed an appeal before the Hon'ble Tribunal.

**Held**

The Hon'ble Tribunal observed that as per the agreement with the AE, the assessee was entitled to avail ten different services, but during the year it had not availed three services, namely corporate communication and brand management services, human resources and sales and marketing services. The Hon'ble Tribunal held that the TPO could not reject the Transfer Pricing Study Report merely because the assessee availed only a few services in a composite agreement. The Hon'ble Tribunal held that availing certain services was sufficient for the assessee to claim a deduction and following the decisions of *Merck Ltd. [389 ITR 70] and Nielsen (India) Private Limited (ITA No. 8799/Mum/2012).*

## Unreported Decisions

## 5. Business Expenditure – Section 37 (1) – Expenditure for improvement of existing business and had not

### created new business, it would be revenue expense

*Spectrum Coal & Power Ltd. & Anr. vs. ACIT (ITA No. 1880/Mum/2010 (Mum)(Trib.)) (Date of Order: 3rd August, 2017) (Assessment Year: 2004-05*)

**Facts**

The AO noted that the assessee had claimed technical knowhow as capital expenditure. During the assessment, the assessee submitted that he had added in the balance sheet under the head 'Plant & Machinery' as an amount paid for technical knowhow and claimed depreciation. This expenditure was incurred for coal beneficiation and, therefore it was in the nature of revenue expenditure and not a capital expenditure. The AO did not agree with the same and treated the same as capital expenditure in view of the provisions of S.32(1)(ii) of the Act, which categorizes that technical know-how acquired by the assessee as an intangible asset and any expenditure incurred towards acquisition of such asset as capital expenditure, eligible for depreciation. The AO therefore rejected the claim of the assessee treating the same as revenue expenditure. The CIT(A) upheld the order of the AO and rejected the claim of the assessee.

**Held**

The Hon'ble Tribunal held that the coal beneficiation was defined as cost effective and significant step towards improving power plant efficiency and reducing the GHG emissions from the coal fired power plants in India would increase the availability of clean beneficiated coals using appropriate beneficiation technologies. Power grade coal was the existing business of the assessee; his means of improvement in the coal beneficiation affected the day-to-day business of the assessee and improved the operations of the existing business. It did not relate to a new product and therefore since the expenditure incurred was for the improvement of the existing business and had not created a new business, it would be allowed as revenue expense.

### 6. Rectification Application – Section 254(2) – The amendment by the Finance Act 2016 w.e.f. 1-6-2016 applied even to applications filed with respect to the appeal orders passed prior to the date of the amendment

*DCIT vs. Lavanya Land Private Limited (MA No. 108/Mum/2017 arising out of ITA No.8228/Mum/2011) (Date of Order: 25th April, 2017) (Assessment Year: 2009-10)*

**Facts**

The Department preferred a Miscellaneous Application before the Hon'ble Appellate Tribunal on 28th February, 2017 against the ITAT order dated 22nd March, 2013. The Department in its application contended that the Tribunal allowed the ground numbers 1 and 2 of assessee's appeal for AY 2007-08, 2008-09 & 2009-10 presuming that the assessment orders for all the years were passed under section 143(3) r.w.s 153C of the Act. However, the assessment order for A.Y. 2009-10 was passed under section 143(3) and not under Section 143(3) r.w.s 153C of the Act. Therefore, a mistake apparent from record had crept into the order and the matter for 2009-10 required fresh adjudication.

**Held**

Regarding the preliminary legal objections with respect to admissibility of these rectification applications, the Hon'ble Tribunal observed that the date of order passed by the Tribunal was 22nd March, 2013 and the Revenue had filed the applications on 28th February, 2017 which was clearly beyond a period of six months as provided in Section 254(2) of the Act. It was to be

noted that the earlier period of 'four years' had been substituted with 'six months' by the Finance Act, 2016 w.e.f 1st June, 2016. However, no distinction had been made in the said section between the orders passed before 1st June, 2016 and orders passed thereafter. In the present case the Tribunal had passed the order on 22nd March, 2013. Thus, the Revenue had ample time to go through the same and pinpoint the mistakes in the order but it had failed to do so. Therefore, there was no force in the miscellaneous petitions primarily because of the reason that the statute did not authorise them to entertain any petition which had been filed under section 254(2) of the Act at any time beyond a period of six months from the date of the order. If such a power was not given to the Tribunal, then it was not expected to exercise such power which was not provided in the Act. The Tribunal, being creation of law, was bound by the statutory provisions and their jurisdiction was to simply interpret and follow the statute. There was no scope to import any word into the statute which was not present therein. Hence, the Tribunal held that it could condone the delay of the miscellaneous petitions as it was beyond their jurisdiction and accordingly, the miscellaneous applications filed by the Department was dismissed.

## 7. Section 263 – Revision of Order – If all relevant details were submitted at the time of assessment proceedings and the assessment order was passed after considering the same, then it cannot be considered that the assessment was erroneous and prejudicial to the Revenue.

*Basudev Kumar Sanghai vs. CIT (ITA No. 5300/Mum/2014) (Date of Order: 21st August, 2017) (Assessment Year: 2011-12)*

**Facts**

The assessee earned rental income from properties and offered the same under the head Income from House Property. Details of leave and licence agreement and the licensees was submitted by the assessee at the time of assessment. Assessment was completed by the AO under section 143(3) of the Act. Thereafter, the Commissioner of Income-tax ('CIT') exercising his revisionary powers under section 263 of the Act set aside the order of assessment on the basis that the said properties were given on rent for commercial purposes for the period of 3 to 5 years and the same was to be taxed as business income and not as income from house property. The CIT held that the AO had failed to consider the fact that the assessee was into the organized business of hiring properties in various parts of Mumbai and received huge amounts of refundable interest free security deposits. The assessee filed an appeal against the order of the CIT.

**Held**

The Hon'ble Tribunal observed that the assessee had offered to tax all the rental income earned by him as Income from House Property for the impugned assessment year as well as preceding years, which was accepted by the Revenue. Further, the Hon'ble Tribunal also observed that all the necessary license agreements were submitted by the assessee at the time of assessment proceedings and the assessment order was framed only after examining the same. It was held that the CIT had failed to point out how the assessment was erroneous and prejudicial to the interest of the Revenue and therefore, the power exercised by the CIT under section 263 of the Act was without any valid reason or justification.


CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

# INTERNATIONAL TAXATION
## Case Law Update

## HIGH COURT

### 1. Where the Revenue had not determined as to whether the AMP was an international transaction, the Tribunal was not justified in remanding the issue to TPO

*Valvoline Cummins Private Ltd. [TS-610-HC-2017(Del.)-TP]*

**Facts**

(i) The assessee, engaged in the manufacturing and marketing of automotive lubricants had incurred certain advertisement, marketing and brand promotion ('AMP') expenses.

(ii) The TPO applying the 'Bright Line Test', compared the proportion of AMP expenses to total turnover of the assessee with that of the comparables and since the AMP expenses as a percentage of the total turnover of the assessee was 4.20% as opposed to 0.51% of the comparables, he made an addition.

(iii) The DRP upheld the order of the AO.

(iv) On appeal to the Hon'ble Tribunal, the assessee contended that the BLT had no validity in light of the decision of the Hon'ble Delhi High Court in the case of *Sony Ericsson India Pvt. Ltd. vs. CIT (2015) 374 ITR 118 (Del)* and therefore that the TPO erred in considering the excess expenditure beyond the Bright Line as an international transaction. Accordingly, the Tribunal remitted the matter to the TPO and directed him to follow the judgment of Delhi High Court in the case of Sony Ericsson (supra).

(v) Aggrieved, the assessee appealed before High Court contending that in light of decision of this Court in the case of *Maruti Suzuki Ltd. vs. CIT (2016) 381 ITR 117 (Del.),* the Tribunal was not justified in remanding the matter to the TPO for determining the ALP of AMP transaction as there was sufficient material on record before the Tribunal to arrive at a conclusion as to whether or not there was an international transaction involving the assessee and its AE with regard to the AMP expenses.

**Held**

(i) The Court distinguished the Revenue's reliance on the decision of this Court in the case of *Le Passage* to *India Tour & Travels (P) Ltd. vs. The Deputy Commissioner of Income Tax (2017) 391 ITR 207* (wherein the Court remitted the matter to TPO for determining whether AMP constituted international transaction) on the ground that in that case there was no determination by the TPO regarding existence of an international transaction whereas in the present case the TPO had applied his mind and concluded AMP expenditure incurred by

assessee was in excess of that incurred by the comparables and the TPO had arrived at that conclusion based on BLT.

(ii) The Court observed that in the case of *Sony Ericsson India Pvt. Ltd. (supra)* setting aside the decision of the Full Bench of the Tribunal in *L.G. Electronics India Pvt. Ltd. vs. ACIT (2013) 22 ITR (Trib.)* it was observed that the BLT was not an appropriate yardstick for determining the existence of an international transaction.

(iii) It further held that the mere fact that the assessee was permitted to use the brand name 'Valvoline' would not automatically lead to an inference that any expense that the assessee incurred towards AMP was only to enhance the brand 'Valvoline' and that the onus was on the Revenue to show the existence of any arrangement or agreement on the basis of which it could be inferred that the AMP expense incurred by the assessee was not for its own benefit but for the benefit of its AE and it was an international transaction. It observed that the TPO had found no basis other than by applying the BLT, to discern the existence of international transaction and accordingly, it concluded that no purpose would be served if the matter was remanded to the TPO, or the Tribunal, for this purpose.

(iv) Accordingly, it held that the Tribunal was not justified in remanding the matter to the AO/TPO for determining the ALP of the alleged international transaction involving AMP expenses, when in fact, the Revenue was unable to show that there existed an international transaction between the assessee and its AE in the first place. Accordingly, it allowed the assessee's appeal and deleted the addition made by the TPO.

## 2. The Court directed the Tribunal to decide TP issues without remanding matter for *de novo* adjudication where all the facts where available on record before the Tribunal

*Bechtel India Private Limited [TS-606-HC-2017(DEL)-TP]*

**Facts**

(i) The assessee was engaged in the business of providing Engineering Design Support Services ('EDS'), Informational Technology Infrastructure Support Services ('IT Infra') and Financial Accounting Support Services ('FAS') to its AEs. The assessee adopted TNMM as the MAM for benchmarking its international transaction. Further, there was delay in receipt of payments from AEs on which no interest was charged.

(ii) The TPO adopted set of comparables for all the 3 segments and made TP adjustment as the margin of the comparables was more than that of the assessee. Further TPO made an adjustment on account of period of delay in receipt of payments from AEs by imputing an Indian based interest at the rate of 10.84% p.a. for the period of delay in receipt of payments from AEs beyond 60 days alleging that the assessee ought to have charged interest on the delay in receipt of payments in an ALP situation.

(iii) The DRP in respect of:

a) **EDS Segment:** Recharacterised functional profile of the assessee as being engaged in providing Engineering Procurement Construction and directed to exclude four companies from comparable set and include one comparable.

b) **IT Infra Segment:** Recharacterised the functional profile of the assessee as a high end Knowledge Process Outsourcing ("KPO") and upheld the comparable set considered by TPO.

c) **FAS Segment:** Recharacterised the functional profile of the assessee as a high end Knowledge Process Outsourcing ("KPO").

d) **Interest on receivables:** Directed the TPO to use 6 month LIBOR plus 300 basis

points as the interest rate while computing the interest on intercompany receivables.

(iv) On further appeal, the Tribunal held as follows:

a) **EDS Segment:** Remanded the issue to the TPO for *de novo* consideration by observing that there were multiple changes in the comparable set from the TP study to different levels of assessment.

b) **IT Infra Segment:** Remanded the selection/rejection of Sankhya Infotech Ltd. and Sasken Communications Technologies Ltd. to the file of the TPO as the ground for their exclusion was raised for the first time before the ITAT. Also directed exclusion of Infosys Limited, EInfochips India Pvt. Ltd. and E-Zest Solutions as comparables on grounds of functional dissimilarity.

c) **FAS Segment:** Directed exclusion of TCS E Serve Ltd. as a comparable as it was functionally different.

d) **Interest on receivables:** Restored the matter to the TPO to examine the assessee's reliance on Co-ordinate Bench ruling for earlier AY 2010-11 wherein this adjustment was deleted

(v) Aggrieved, the assessee appealed before the High Court contending that the Tribunal erred in ordering a *de novo* determination of the Arm's Length Price by the Transfer Pricing Officer upon a fresh benchmarking.

**Held**

(i) The Court observed that the assessee had produced a detailed chart explaining the approach of the TPO, DRP and the Tribunal in respect of determination of ALP for each of the segments which clearly showed that the Tribunal had failed to render a finding, even though, the facts were available on record before it.

(ii) Accordingly, it held that the Tribunal ought not to have remanded the matter to the TPO for the *de novo* determination of the ALP of the international transactions in the various segments and should have performed this exercise itself. Therefore, it listed the appeal before Tribunal for directions.

## 3. For the purpose of determining the ALP of services rendered by the assessee to its AE i.e., arranging borrowers for obtaining foreign currency loans from AEs, the interest earned by the foreign AE could not be considered as the income of the assessee as the assessee had not contributed to the loan amount on which the foreign AEs had earned interest income

*Credit Lyonnais [TS-608-HC-2017(Bom.)-TP]*

**Facts**

(i) The assessee had arranged borrowers for obtaining foreign currency loan from its AE and computed *suo motu* TP adjustment @ 20% of fees and other charges received by AE.

(ii) The TPO included interest income received by the AE in computing the ALP of the services rendered by the assessee and made TP adjustment.

(iii) The CIT(A) noted that the assessee had not contributed to the loan amount and held that the interest income was not to be included. However, relying on the Tribunal's decision in the case of the assessee in the earlier years, he held that the allocation of 20% of the fee received by the AE was correctly adopted by the assessee.

(iv) The Tribunal relying on its own decisions in the case of the assessee for the earlier years, upheld the order of the CIT(A).

(v) Aggrieved, the Revenue appealed before the High Court contending that the Tribunal had erred in holding that no interest income earned

on the loan by AE could be taken into account while determining the ALP of the services rendered by the assessee.

**Held**

(i) The Court, relying on the Co-ordinate Bench ruling in the assessee's own case for the earlier years wherein the Revenue's appeal was dismissed, dismissed the Revenue's appeal.

## 4. The Court quashed the final order passed by the AO as the same was passed without passing the draft assessment order

*Control Risks India Pvt. Ltd. [TS-603-HC-2017(Del.)-TP]*

**Facts**

(i) The petitioner was engaged in the business of providing specialist risk consultancy services to its AEs.

(ii) The TPO characterised the Petitioner as engaged in providing "Investment and other Financial Advisory and making the TP adjustment. Subsequently, the AO passed the draft assessment order.

(iii) The DRP confirmed the order of the TPO.

(iv) Before the Tribunal, the petitioner filed additional evidence on record viz., copy of Distribution and Sale Agreement with AEs along with engagement letters and invoices in support of its claim that it was not engaged in pure financial services and it provided a wide range of consultancy services. The Tribunal admitted the evidences filed by the petitioner and remitted the issue to TPO to carry out FAR analysis of petitioner after characterizing its activity on the basis of evidence on record and then proceeded to select comparables as per law.

(v) Thereafter, the TPO undertook a fresh benchmarking analysis and passed an order proposing TP adjustment to ALP. The AO instead of passing the draft assessment order passed a final assessment order u/s. 143(3) and raised demand *vide* notice u/s. 156.

(vi) Aggrieved, the petitioner challenged the order of the AO passed u/s. 143(3) as well the demand raised u/s. 156.

**Held**

(i) The Court, relying on its decision in the case of *Turner International India Pvt. Ltd. vs. DCIT, (2017) 82 taxmann.com 125 (Del.),* held that it is incumbent upon the AO to pass a draft assessment order under Section 144C of the Act consequent upon an order of the TPO under Section 92 CA(3) of the Act.

(ii) It observed that the AO overlooked the above legal position and proceeded to pass a final assessment order, thereby depriving the petitioner of an opportunity of questioning the draft assessment order under Section 144C of the Act before the DRP. Accordingly, it quashed the order passed by the AO and notice of demand u/s. 156.

## 5. The Court held that the capital gains on sale of shares of Indian company by the Maurtitus company was not taxable in India as per Article 13 of India-Mauritius DTAA

*JSH (Mauritius) Ltd. [TS-308-HC-2017(Bom.]*

**Facts**

(i) The Respondent company, incorporated in Mauritius was a resident of Mauritius as per Article 4(1) of India-Mauritius DTAA. It did not have any business presence or PE in India. It was holding a valid Category 1 Global Business Licence issued by Financial Services Authority of Mauritius and TRC and had filed return of income in Mauritius and had paid taxes therein. It was holding shares of Tata Industries Limited (TIL) for 13 years which it transferred to Tata Sons Limited (TSL) consequent to which it realised the said capital gains on sale of shares. It had invested the entire sale proceeds in Tata

Power Limited increasing its existing investment in Tata Power Limited. It obtained the ruling from AAR on the following issues:

a. Whether the petitioner was entitled for benefits under India-Mauritius DTAA

b. Whether the capital gains arising to the petitioner on sale of shares of TIL to TSL would not be taxable in India as per Article 13 of India-Mauritius DTAA

(ii) The AAR answered in favour of the Respondent holding that it was entitled for the benefits under India-Mauritius DTAA and that the capital gains arising to the petitioner on sale of shares of TIL to TSL would not be taxable in India and would be taxable in Mauritius as per Article 13 of India-Mauritius DTAA.

(iii) Aggrieved, the Revenue filed a Writ Petition before the High Court contending that the Respondent company was a shell company not having business/commercial substance of its own and the Respondent had not incurred any expenses except interest received or paid to the group entities and had also not appointed any member on the board of TIL which demonstrated that it was not having business/commercial substance and was created only for the purpose of taking advantage of tax treaty with Mauritius and therefore, the DTAA benefits were not to be granted. The Revenue further contended that the transaction was taxable in India as per Explanation 5 to section 9(1)(i).

**Held**

(i) The Court observed that the Respondent had valid TRC evidencing that it was tax resident of Mauritius and had held shares of TIL for 13 years and had invested the proceeds in another group company in India (Tata Power Limited) which was also being held by the Respondent. Accordingly, it held that it was a *bona fide* and not a shell company.

(ii) It observed that the AAR on considering the application and the documents and the facts on record had conclusively held that the transaction was not designed for avoidance of income-tax. Accordingly, it held that once such conclusive finding was given it was not open for the petitioner to contend that AAR should not have allowed the application where the transaction was designed for the avoidance of income-tax as per the provisions of section 245R(2)(iii).

(iii) Accordingly, it rejected Revenue's contention that the transaction of capital gains was taxable in India as per Explanation 5 to section 9(1)(i) since the capital gains were not taxable in India. Relying on the Apex Court decision in the case of Azadi Bachao Andolan & Anr., it held that the provisions of DTAA would prevail over the Act. Accordingly, capital gains would not be taxable in India.

## 6. The Court held that liaison office of the assessee was not PE in India as the Revenue could not demonstrate business activity being carried out by the liaison office

*Mitsui & Co. Ltd. [TS-310-HC-2017(Del.)]*

**Facts**

(i) The assessee, a non-resident company headquartered in Japan had two projects in India viz., the Anpara Thermal Power Project of the UPSEB ('Anpara') and the New Delhi Cable Project of DESU ('DESU'). In respect of Anpara project, the assessee had offered its income to tax u/s. 44BB @ 10% of the entire value of the contract. In respect of DESU project, it contended that it had no PE in India. The assessee had a Liaison Office (LO) in India for providing information to the overseas offices and had declared Nil income in respect of its liaison activity in India as the business activity carried out was preparatory and auxiliary in nature.

(ii) The AO observed that the LO of the assessee helped it in finding new purchasers and sellers of goods and merchandise. It rejected the

contention of the assessee that it had complied with the conditions imposed by the RBI of not carrying on any trading, commercial or industrial activity and concluded that the assessee's LO constituted a PE in India as per India-Japan DTAA. The AO further observed that the same chief representative supervised the LO and the DESU project and certain telephone expenses of the DESU Power Project pertained to the LO and therefore, it concluded that the LO was part of the project operations. Further, in respect of the DESU project office, the AO held that assessee should follow same method of taxing its income for both the projects u/s. 44BB and accordingly, profit from DESU project should be taxed @ 10% of total turnover.

(iii) The CIT(A) observed the fact that the chief representative supervised the LO and the DESU project would not lead to the conclusion that the LO was connected to the DESU project and no facts were produced by AO to conclude that the LO was connected to the project offices. Accordingly, it held that since the assessee was showing the income from the project work separately, treating the income of the project office as that of LO was not valid. It upheld the AO's order of treating the income of the DESU project u/s. 44BB.

(iv) The Tribunal observed that it was held in the earlier years that the assessee did not have PE in India and accordingly, it upheld the order of CIT(A).

(v) Aggrieved, the Revenue appealed before the High Court contending that the LO was the assessee's PE in India since it was carrying on business in India. Alternatively, it contended that even assuming that the LO was not a PE, then the Project Offices (Anpara & DESU) of the assessee should be treated as PE in India and the profits should be taxable in India.

**Held**

(i) The Court observed that the onus was on the Revenue to demonstrate that the LO was the assessee's PE in India within the meaning of Article 5 of the DTAA and that the Revenue was required to prove that the LO was a fixed place of business through which the business of an enterprise is wholly or partly carried out. It further observed that the LO of the assessee was not in fact used for the purpose of business.

(ii) It further observed that the assessee was adhering to the conditions imposed by the RBI for running a LO, and the RBI had accepted the functioning of the assessee's LO for over three decades, which demonstrates that the LO was not carrying on any business or trading activity.

(iii) It held the fact that the same chief executive officer supervised the LO and the project office and part of the telephone expenses were attributable to the LO was hardly sufficient to conclude the LO was being used to carry on the business of the enterprises.

(iv) It further held that since the project offices were separately taxable u/s. 44BB, the project offices [i.e. Anpara & DESU] also could not be held to be PE of the assessee in India. It further rejected the alternate argument of the Revenue since the same was not raised before the lower authorities.

(v) Accordingly, it held that since the Revenue could not bring anything on record to show that the LO was carrying on the business activity in India, the assessee cannot be said to have PE in India.

## 7. The Court held that the order of AO was illegal as no draft assessment order had been passed as mandated by the provisions of section 144C

*C-Sam (India) Pvt. Ltd. [TS-626-HC-2017(GUJ)-TP]*

**Facts**

(i) The assessee entered into certain international transactions with its AEs.

(ii) The AO passed the final assessment order u/s. 143(3) for AY 2009-10 making upward revision in the income of the assessee on the

basis of the TPO's order without issuing draft assessment order as required u/s. 144C.

(iii) The CIT(A) quashed the assessment order passed u/s. 143(3) on the ground that the final order was passed without passing the draft assessment order u/s. 144C.

(iv) The Tribunal upheld the order of the CIT(A) quashing the assessment order passed u/s. 143(3) by relying on the decisions of Madras High Court in the case of *Vijay Television Ltd. vs. DRP [2014] 46 taxmann.com 100 (Mad.)* and of Andhra Pradesh High Court in case of *Zuari Cements Ltd vs. ACIT Writ Petition No. 5557 of 2012* wherein it was held that procedure laid down under Section 144C was mandatory and the order passed by the AO without following such procedure was illegal and the defect was not a curable defect.

(v) Aggrieved, the Revenue appealed before the High Court contending that the Tribunal was not justified in upholding the order of CIT(A) and it should have set aside the assessment order u/s. 143(3) to the file of the AO with a direction to make fresh assessment after following the procedure laid down in Section 144C as it was mere procedural requirement and therefore was a curable defect.

**Held**

(i) The Court observed that the provisions of Section 144C were mandatory in nature and the AO had to issue the draft order as per the provisions of section 144C before he made any variations in the returned income of the assessee.

(ii) It rejected Revenue's argument that the requirement u/s. 144C was mere procedural as it gave substantive rights to the assessee to object to any additions before the DRP and such right could not be taken away. It further noted that as per the provisions of Section 144C(5), the AO was expected to pass the order as per the directions of DRP and the order of DRP was final for the AO as well as the assessee at the stage of assessment.

(iii) It rejected the Revenue's contention that a) the Circular dated 3-6-2010 specified that Section 144C would apply from AY 2010-11 and that b) Circular dated 19-11-2013 clarified that the aforesaid Circular dated 3-6-2010 and Section 144C would apply w.e.f. October 1, 2009 was not available when the AO passed the order u/s. 143(3). The Court held that the Circular dated 19-11-2013 merely clarified that the provisions of Section 144C would apply from October 1, 2009 and held that the assessee could not be made to suffer on account of any inadvertent error which runs contrary to the statutory provisions.

(iv) Accordingly, it dismissed the appeal of the Revenue.

## Tribunal Decisions

### 8. India-Netherlands DTAA – Articles 5(5) & 5(6) – CBDT Circular # 742 dt. 2-5-1996 – Taxability of the Commission earned by the Indian Agent in the hands of the Parent Company – Indian Company held to be an Independent Agent under Article 5(6) – in favour of the assessee

*International Global Networks BV vs. ADIT (International Taxation), TS-340-ITAT-2017(Mum) – Assessment Years : 1998-99 to 2004-05*

**Facts of the case**

(i) International Global Networks BV (formerly known as 'Satellite Television Asian Region Advertising Sales BV') ('assessee') is incorporated in the Netherlands and is a wholly owned subsidiary of Satellite Television Asia Region Limited ('STAR Limited') based in Hong Kong,which is a subsidiary of STAR Television Limited.

(ii) It had been granted the exclusive right for sale of advertising time, in India, on the channels of the STAR TV Network, which was owned by STAR Limited.

(iii) It engaged STAR India Pvt. Ltd. (earlier known as News Television (India) Limited), an Indian entity, to procure business from Indian advertisers, on a commission of 15% of receipts from such business. The revenue, so earned by it, was offered to tax @ 10% on the basis of CBDT Circular 742, dated May 2, 1996.

(iv) However, for AYs 1998-99 to 2004-05, the AO held that such income was to be assessed in the hands of STAR Limited, Hongkong, that the assessee was only a conduit – company, that it was brought into picture only because of India having a favourable DTAA with the Netherlands, and Hong Kong did not have any tax treaty with India, that it was a clear case of treaty shopping. Thus he held that the income actually belonged to STAR Limited.

(v) The A.O. declined benefit of Circular 742 to the assessee,on the ground that it was not a telecasting or broadcasting company and invoked Rule 10 of the Income Tax Rules, 1962 (Rules), to estimate profit @ 20% of gross advertising revenues.

(vi) On appeal, CIT(A) upheld AO's order and on appeal to the tribunal, matter was restored back to FAA.

(vii) CIT(A) who noted that STAR Ltd., assessee and STAR India were part of the same group, that STAR India had been incorporated primarily to promote business activities of other entities. CIT(A) relied on ruling in the case of DHL Operations NV and held that due to close proximity between companies operating in India and outside India if it was found that foreign company substantially conducted its business in India then it had to be held that Indian company was a PE.

**Decision**

On appeal by the assessee, the Tribunal held in its favour as follows:

(i) The Tribunal perused Paragraph (v) and (vi) of Article 5 of the India-Holland DTAA to hold that if the agent satisfies the conditions laid down in paragraph 6 (independent agent),it would not constitute a PE in India even if the independent agent satisfies the condition laid down in paragraph 5. the tribunal observed that STAR India is an independent agent under Article 5(6) of the

DTAA, and was not economically dependent on the assessee, as it was engaged in other business activities as well. the tribunal noted that India-Netherlands DTAA provides that when the activities of the agent are devoted wholly or almost wholly on behalf of the enterprise it would not be considered to be an agent of an independent status unless it was shown that the transactions between the agent and the principal were made on arm's length conditions.

(ii) Upon consideration of arm's length in assessee's case, the tribunal held that STAR India was an independent agent, acting in its ordinary course of business. The tribunal further observed that assessee had paid commission to STAR India at the rate of 15% and the rate was as per the norms of the industry, thus there cannot be further attribution of income in the hands of the assessee and from the AYs 1998-99 to 2001-02 transfer pricing provisions were not applicable to the international transactions entered in to by the assessees with their AEs.

(iii) The Tribunal noted that Circular 5 dated September 28, 2004 stipulates that amount of profits attributable to a PE should be determined based on arm's length principle and Circular 23 dated July 23, 1969 had provided that the amount of profits attributable to PE should be determined as on the arm's length remuneration and that if transaction between a foreign enterprise and its PE were at arm's length it would extinguish the tax liability of the foreign entity. The Tribunal also mentioned that CBDT Circular No. 742 had recognized that rate of 15% commission payable to the Indian agents by the foreign telecasting companies was to be considered normal. Thus, held that payment made by assessee to STAR India was at arm's

length and that the rate of 15% was as per the industry norms.

(iv) The Tribunal upheld the applicability of Circular 742 (which was introduced to lay down mechanism for determination of taxability of advertisement revenue earned by foreign companies) to assessee's case. The Tribunal relied on Bombay HC ruling in the case of Set Satellite Singapore PTE Ltd. [TS-5893-HC- 2008 (Bombay)-O], Mumbai. The Tribunal ruling in the case of B4U International Holding Ltd. [TS-358 – The Tribunal-2012(Mum)] and Delhi HC ruling in the case of BBC Worldwide Limited [TS-162-HC- 2016(Del.)], to hold that "if correct ALP was applied and paid nothing further would be left to be taxed in the hands of the foreign enterprise. It also placed reliance on Circular No.742 and held that CBDT itself had considered 15% commission as normally accepted commission rate payable to the agents of telecasting companies".

(v) Thus, the Tribunal held that "the assessee did not have a PE in India, that it was not carrying out any business activities in India and therefore no part of its revenue was attributable to India, that SIPL was an independent agent under Article 5(6)of the tax treaty between India and Holland, that the activities of the agent were carried out in its ordinary course of business, that the agent was not wholly and exclusively devoted to the assessee, that payments made to SIPL were at arm's length, that provisions of Circular 742 were applicable for determining the tax liability of the assessee.In short, the assessee was not liable to pay tax in India in any of the Assessment Years mentioned above".

## 9. Section 40(a)(ia) – Disallowance for non-deduction of tax at source from certain payment – No tax withholding required on reimbursement of expenses claimed through separate bills

*ACIT vs. St. Mary's Rubbers Private Limited*
*Assessment Year : 2011-12*

**Facts of the case**

(i) The assessee was engaged in manufacturing and selling of centrifuged latex. During the course of reassessment proceedings, it was noticed that the assessee had paid C&F charges without withholding tax.

(ii) The assessee claimed that such C&F charges were in the nature of reimbursement of expenses incurred by the C&F agent on behalf of the assessee, and therefore, it was not liable to withholding tax on such payments. The claim of the assessee was rejected and the payment was disallowed under the provisions of section 40(a)(ia)2 of the Income-tax Act, 1961 (the Act).

(iii) On appeal before the Commissioner of Income-tax (Appeals) [CIT(A)], the assessee submitted a statement regarding the amounts given by the assessee to the C&F agent as reimbursement of expenses and not C&F charges. Based on the above, the CIT(A) accepted the contentions of the assessee and deleted the disallowance, which was contested before The Tribunal by the Revenue authorities.

**Decision**

(i) The documents furnished by the assessee clearly showed that the payment made was in the nature of reimbursement of expenses incurred by the C&F agent on behalf of the assessee, for which a separate bill was raised.

(ii) CBDT Circular No. 715 dated 8th August, 1995, which provides clarification on the applicability of withholding tax provisions, was applicable only where consolidated bills were raised inclusive of contractual payments and reimbursement of actual expenditure.

(iii) No withholding tax was required where separate bills were raised by the C&F agent for claiming reimbursement of expenses.

## 10. Disallowance u/s. 40(a)(i) for non-deduction of tax from certain payments such as professional charges,

## corporate management charges, server maintainence charges, testing & development charges – partly in favour of the assessee

*Cooper Standard Automotive India Pvt. Ltd. [TS-311-ITAT-2017(CHNY)] Assessment Year : 2003-04*

**Facts of the case**

(i) Re: Payment for professional charges and corporate management charges

- During the AY 2003-04, the assessee has made payment for professional charges and corporate management charges after deducting TDS under Section 195 of the Act. However, payment for TDS was remitted to the Government of India beyond the due date specified under Section 200(1) of the Act. The Assessing Officer (AO) made the disallowance under 40(a)(i) of the Act. The Commissioner of Income-tax (Appeals) [CIT(A)] confirmed the disallowance made by the AO.

(ii) Payment for server maintenance charges and testing and development charges

- The assessee had made the payment for server maintenance charges for the usage access of the server belonging to the parent company based at Germany. All the activities of the parent company as well as subsidiary companies based around the world are routed through the server. According to the assessee, the server maintenance charges are in the nature of reimbursement charges paid to parent company using software related issues, and hence TDS is not applicable.
- The AO made addition holding that services rendered outside India is taxable, even though there is no Permanent Establishment (PE) in India. By virtue of an amendment to the Explanation of Section 9(2) of the Act, the FTS payable outside India would be deemed to accrue or arise in India and hence TDS is deductible.
- Similarly, the assessee also paid testing and development charges to Hutchinson Italy for the services rendered in the vendor location in Italy. However, no tax was deducted on such payment under Section 195 of the Act. Therefore, the AO made the addition under Section 40(a)(i) of the Act. Subsequently, the CIT(A) confirmed the addition made by the AO.
- The auto components of power steering system consisting of three hoses 'suction line, pressure line, and return line' are tested for various parts. The assessee manufactures the said parts according to drawing and specifications and designs of the company and subsequently sent to vendor location in Italy for testing on their efficiency and strength.
- The assessee contended that the testing was largely done on machines with very little of human judgment or skill. The only skill required was knowledge to operate the machine and to take readings. The only task of non-resident was to give a report on the performance of component by giving actual values based on readings and design specifications.

**Decision**

The Tribunal held as follows:

(i) Payment for professional charges and corporate management charges – Amendment made by the Finance Act, 2003 in Section 40(a)(i) of the Act.

- The provisions of Section 40(a)(i) of the Act as stood prior to amendment by the Finance Act, 2003 prescribe the disallowance for non-deduction or non-payment. The proviso to the said Section provides that where the tax has been deducted but paid in any subsequent year,

the same will be allowed as deduction in the year in which tax has been paid or deducted. The Circular No. 7, dated 5th July 2003 referred by the assessee also states the same. Therefore, for allowing the deduction of the expenditure, not only deduction of tax at source but also remittance to the Government account is a mandatory requirement. The proviso to Section 40(a)(i) of the Act makes it very clear that expenditure is allowed in the year in which the tax has been remitted to the Government account. Thus, the assessee is entitled to claiming the expenditure in the year in which it was paid.

- In the assessee's case, though the tax was deducted but remitted to the Government account in the subsequent year. Therefore, the AO has rightly applied the disallowance under Section 40(a)(i) of the Act.

(ii) Payment for professional charges and corporate management charges – Applicability of non-discrimination clause

- In the case of *Millennium Infocom Technologies Ltd. vs. ACIT [2009] 117 ITD 114 (Del.),* the Delhi Tribunal has held that similar payments in the case of residents do not attract the disallowance in the event of non-deduction of tax at source. Thus, taxing the amount under Section 40(a)(i) for non-deduction of tax at source on similar amounts tantamount to discrimination. Therefore, the tax treaty and the decision relied on by the assessee for non-discrimination clause squarely applicable in the assessee's case. Accordingly, it has been held that the disallowance under Section 40(a)(i) of the Act would not be applicable in the case of the assessee.

(iii) Server maintenance charges

- The server maintenance charges are paid for usage of the intranet, the internet, mail data backup, etc., located at Germany. The server is administered by the parent company, and the activities support the periodical data backup, software upgradation, and renewal, inter-office communication like messenger and communicator, etc.

- On perusal of decision in *Siemens Ltd. vs. CIT [2013] 142 ITD 1 (Mum.), CIT vs. Bharti Cellular Ltd. [2009] 319 ITR 139(Del.),* the FTS involve human element and consideration is for rendering the managerial, technical and consultancy services. Therefore, applying the rule of *noscitur a sociis* the word 'technical' as appearing in Explanation 2 to Section 9(1)(vii) of the Act would also have to be construed as involving a human element.

- However, the facility provided by the parent company in the case of server maintenance charges was the usage of various activities, and no human interface is involved. The only actual costs are recovered by the parent company from group constituents, and there was no profit element.

- From the facts of the present case, it is observed that the assessee is merely using the technology provided by the parent company and no managerial, consultancy and technical services are provided by the parent company. Therefore, it has been held that the payment made is not for FTS and the decisions relied upon by the assessee are squarely applicable in the assessee's case. Therefore, it has been held that the payment was for reimbursement of expenses and hence no tax is deductible under Section 195 of the Act as held by the Tribunal in the case of *Cairn Energy Pvt. Ltd. vs. ACIT [2010] 2 ITR 38 (Chennai).*

iv) Testing and development charges

- The activity of testing, operating of the machine and noting of actual reading,

whether it suits to the design specifications or not is a specialised activity only a technical person can do but not the machines alone. The machine cannot discharge such functions, and human expert knowledge only can decide whether the parts are acceptable or not. The mere machine operator cannot decide whether the auto parts are as per the specifications and drawings or not. Therefore, the payment is made for technical services.

- The assessee contended that the services are rendered outside India and to tax the income under Section 9(1)(vii) of the Act the services should have been rendered in India and utilised in India. The Explanation to Section 9(2) of the Act was introduced in 2007 with effect from 1976 and the AY under consideration is 2003-04, the assessee cannot predict the amendment and deduct the TDS which is an impossible task.
- The payment was made for FTS, and it is taxable under the Act and the tax treaty. However, the services are rendered outside India and utilised in India. As per the decision of Supreme Court in the case of 6 *Ishikawajima-Harima Heavy Industries Ltd vs. DIT [2007] 288 ITR 408 (SC)*, it is clarified that despite the deeming fiction in Section 9, for any such income to be taxable in India, there must be sufficient territorial nexus between such income and the territory of India. It further held that for establishing such territorial nexus, the services have to be rendered in India as well as utilised in India.
- The Explanation to Section 9(2) of the Act was introduced by the Finance Act, 2007 with effect from 1976 and as on the date of assessment there was no provision to tax the FTS rendered outside India and hence it has been held that no tax is deductible under Section 195 and consequent disallowance is not called for. This view is supported by the Mumbai Tribunal in the case of *Channel Guide India Ltd. vs. ACIT [2012] 25 taxmann.com 25 (Mum).*
- Therefore, it has been held that the payment made by the assessee for FTS for the services rendered outside India are not taxable under Section 9(1)(vii) of the Act and the disallowance was to be deleted.

Parth Badheka, *Advocate*

# INDIRECT TAXES
## GST Gyan

## Transitional Provisions under GST

*You're in this constant state of flux and transition, as if you had jet lag all the time. The acting part of it is easy. It's all the other things that come with it that are a bit difficult.*

*– By Don Johnson (American actor, singer, etc.)*

As we all know, however half-baked or under prepared we or the Government Machinery is, the current set of GST Laws are a reality. The first month was indeed very smooth, since there was no compliance burden upon the trade. There was a promise by the Government that the compliance will be smooth sailing and at the same time the IT heavy system of the Government will be fully primed to ensure that the nerves associated with such a tectonic change in the way India collects indirect taxes will be relatively settled. Whether any of it is actually true on the ground is anybody's guess. It is in that vein that I have chosen to mention the above quote.

In this article, I will be discussing certain legal and practical aspects of transitional provisions. For the sake of clarification unless specified otherwise any reference to the section would be to CGST and MGST only, unless specified otherwise.

The whole aspect of transition from previous laws (hereinafter called 'Existing Laws' for the sake of uniformity with the language used in the sections) can be divided into 4 main aspects.

1. Registration
2. Transition of credits
3. Treatment in special circumstances
4. Treatment of pending proceedings and contracts

### Transitional Provisions relating to Registration

Sec 139. This section basically ensures that every person who has a Registration under any of the existing laws holding a valid PAN other than an ISD or person deducting tax will be granted provisional registration under GST. Final RC to be granted in FORM GST REG-06 online after verification of information. Such a Provisional RC may be cancelled if no information is furnished within the validity period or the information furnished is incorrect or incomplete.

If a registered person for any reason wishes to not continue business under the GST regime, in such an event an application for cancellation of provisional RC has to be submitted within 30 days from the AD (Appointed Day) in FORM GST REG-29.

In the event a person wishes to opt for composition levy under GST, they must do so within the validity period.

There are several technical issues that have come up during the course of the past months. There are still cases where ARN nos. have not been generated due to system issues mainly PAN validations, etc. These persons whenever and if they do receive the registration will have already lost out on the opportunity to opt for composition and may even skip several returns filing compliance dates. Grave situations arise in case of active businesses since the system does not allow them make the payment of their taxes collected. The invoices may already have been issued as per provisional IDs pending the receipt of ARN Nos.

One can only wish that prompt administrative relief is provided to such persons to aid them in regularising their compliance which was stalled due to technical issues.

There are also cases, where registrations are now being cancelled under the GST on the grounds that registration under the MVAT law has been cancelled, when in fact the registration was cancelled many years back and the fact that the provisional IDs were issued under the Service tax laws and not under the MVAT law. These persons are advised by departmental help desks to take fresh registrations. This is patently unjust and unfair, since it would prejudice their buyers and suppliers and also put their own ITC in jeopardy.

There are several other individual unique issues that are currently arising during the initial months which I am not discussing for the sake of brevity. In any case most of these issues are actually pending due to technical issues and not really any legal issues. It is expected that the GST Governing council must take a liberal approach and businesses are not penalised for issues coming up in registration or transition into GST at least for the initial period.

## Section 140: Transitional arrangements for input tax credit

This section is the toast of contemporary times and almost entirely deals with carrying forward transitional credits. The following are the major highlights of this section:

1. Credit of taxes carried forward in the last return
2. Credit on capital goods not carried forward in the last return
3. Credit of taxes on inputs held in stock
4. Credit of taxes on inputs or services in transit
5. Credit of taxes on inputs held in stock in case of composition dealer under existing law.
6. Credit distributed by ISD.
7. Credit in case of centralised registration.
8. Reversed credit under existing law

## Section 140(1)

This section is applicable to any person who has carried forward of credit in any return under the existing law, as on 30-6-2017. The carry forward of CENVAT credit to the GST regime is subject to the following conditions

- Such credit must also be admissible as ITC under CGST Act;
- RP (Registered Person) has furnished all the returns for the 6 months immediately preceding the AD (Appointed Day)
- Such credit should not relate to exempt goods.

## MVAT Credits

Conditions given in clauses (i) to (iii) are required to be strictly adhered to. Proviso to the above section inserted in the MGST Act makes it abundantly clear that any credit which

is attributable to any claim related to receipt of declarations or differential tax liability as is likely to arise under Central Sales Tax, 1956 (CST Act) in Forms C, H, I, F, EI/II will not be available as MGST credit unless all the forms are received and details produced in FORM GST TRAN-1.

In the event the credit is disallowed due to non-receipt of CST forms and they are received at a later date, the Dealer, instead of carrying forward the credit, will have to claim for refund under the existing law. This may lead to a complex situation in absence of any clarification coming from Sales Tax Department.

It has been a long standing experience of the dealers that declarations under CST Act are not received for years, let alone ninety days. As such, dealers may consider not carrying forward the MVAT credit equivalent to the amount of pending forms and instead claim refund of the said amount in the last return. As regards the pending forms, they may be produced at the time of assessment that may be taken up for granting MVAT refund.

It would be wise to clarify that, in the absence of any prescribed manner, it would be an uphill task to actually bifurcate credit attributable to CST declarations and credit attributable to intra state sales. Therefore the decision to carry forward any credit in the absence of CST declarations should be taken after verifying the books of account and declaration status of every particular business.

It must be noted that provision relating to reduction of credit on account of non-production of declarations under CST Act is applicable only to the MGST Act and not to the CGST Act.

Once the credit is availed and transitioned into the GST there is no limit prescribed under the law to utilise the credit. Such credit in the respective tax ledgers can be utilised up to their exhaustion after setting off liabilities towards outward supplies made in course of or furtherance of business under the GST Regime.

## Part 5 of the Tran-1 form deals with credits under section140(1)

### Section 140(2): Unavailed CENVAT credit on capital goods

This section deals with the credit which is essentially not important from the MVAT perspective, but is important in States where credit on capital goods is granted in a staggered manner.

Under the Service Tax/Excise regime, as per Rule 4(2)(a) of the CENVAT Credit Rules, 2004, CENVAT credit of capital goods is granted in two parts, up to 50% in the year in which they are received and balance in the subsequent year, subject to certain conditions. Therefore 50% of the CENVAT credit will remain unavailed in respect of capital goods for period prior to appointed day. This credit, since not shown under the last return filed under the aforesaid laws, is not 'carried forward' into the CGST Act. Sub-section (2) is a beneficial section which lays down conditions for carrying forward such unavailed credit though it cannot be shown in the last return.

It must be pointed out that the conditions for availing such credit is that such a credit must be eligible for credit under both the laws.

### Section 140(3): Carry forward of ITC by specified persons on duties and taxes held in stock

This is a provision which attempts to bring parity between the tax rates under GST and the taxes paid under existing laws on inputs. There are several classes of dealers who have excise paid invoices but were not eligible to take credit under the existing laws since they were neither manufacturers nor service providers. But their further outward supply under GST is at a rate which subsumes the excise component in the rate of tax. Therefore they are allowed to take credit of inputs of raw material, finished goods, or semi finished goods held in stock subject to following conditions.

- Inputs/goods are used or intended to be used for making taxable supplies;
- RP is eligible for ITC on such inputs;
- RP is in **possession of invoice or other prescribed documents evidencing payment of duty under the existing law;**
- Such invoice or other document was issued within **12 months prior to the AD;**
- Supplier of services is not eligible for any abatement under this Act.

This section deals with dealers or Registered Persons who were :-

1. Not liable to be registered under any of the existing laws (MGST Act and CGST Act) ,
2. Dealers/manufacturers of tax free or exempt goods (MGST Act and CGST Act),
3. Providing exempted services (CGST Act),
4. Providing works contract service and availing the benefit of abatement under Notification No. 26/2012-Service Tax dated 20th June, 2012 (CGST Act),
5. First stage or second stage dealers under the Excise Act (CGST Act),
6. Registered importers or depot of a manufacturer (CGST Act),
7. Dealing in goods which have been taxed at the first point and subsequent sale of which were not subject to tax (MGST Act);

**Credit under Rule 52B of MVAT Rules relating to aerated beverages, cigarettes, mobile phones, etc.?**

Rule 52B of the MVAT Rules specifies that set off in respect of such goods can be claimed only in the month of sale of such goods.

Under Sec. 140(1) of the MGST Act, only such credit which is carried forward in the final return can be taken to the GST regime. Since one can only show eligible credit in the returns, for the stocks which are unsold before the appointed day credit under the existing laws. However, Section 140(3) of the MGST Act covers this situation where a dealer who is entitled to claim credit of input tax only at the time of sale of goods can claim the credit.

**In case of traders**

- If no document evidencing payment of duty is in possession
- Credit of duty in respect of inputs held in stock shall be allowed to be taken to ECL
- Subject to such conditions/limitations/ safeguards as prescribed
- He shall pass on the benefit of such credit by way of reduced price
- Rule 117 4(a)- to be filed in Tran-2 after tax is paid on sales under GST
- Credit shall be allowed at 60%/40% of applicable CGST on outward supply
- Credit to ECL after payment of CGST
- Available for 6 months
- Document for procurement is available with RP
- Monthly submission of prescribed stock details – Tran-2 (Form not yet notified)

In the above case, it is important that traders who wish to take such deemed credit as per the rules, such stock for which they wish to take credit be separately identifiable. Such deemed credit would be allowed starting August 2017 for outward supplies made July 17 onwards. It would be prudent for the Government to either notify the Tran-2 in a timely manner otherwise grant suitable extensions such as to not deprive the dealers from taking such credit.

## Part-7 of the Tran-1 deals with the above section

### Section 140(4): Credit of duties & taxes on inputs held in stock

A RP engaged in manufacture of **taxable as well as exempted** goods under Central Excise Act or provision of taxable as well as exempted services under Service Tax law and where such goods or services are liable to tax under the CGST Act is entitled to take transition the credit into his ECL to the extent of:

- Amount of CENVAT credit carried forward in the last return filed under earlier law in terms of section 140(1) and – **Part 5 of Tran-1**
- Amount of CENVAT credit of eligible duties in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock on the AD, relating to exempted goods or services, in terms of section 140(3) **– Part-7 Tran-1**

### Section 140(5): Credit of taxes paid on inputs/input services in transit

This is also an important provision providing guidelines for a scenario where duty or tax is already paid before the AD but such inputs or input services are received under the GST regimes subject to following conditions

- Invoice or other duty paying document recorded in the books of accounts within 30 days from the AD
- RP shall furnish a statement of such credit taken in the prescribed form
- To be submitted in **Part 7(b) of Tran-1**

### Section 140(6): Credit of taxes on inputs held in stock by a composition dealer under existing law

This applies to a RP who was paying tax at a fixed rate or paying a fixed amount in lieu of tax (composition scheme) under the existing law. They are entitled to take credit of eligible duties paid on inputs held in stock and inputs contained in semi-finished and finished goods held in stock on the AD.

Following conditions need to be adhered to:

- Inputs/goods used or intended to be used for making taxable supplies;
- Said person has not opted for composition levy under GST;
- Such inputs are eligible for ITC under GST;
- RP is in possession of invoice or other prescribed duty paying documents issued within 12 months prior to the appointed day.

***Part 7 of the Tran-1 covers such transactions.***

### Section 140(7): Distribution of credit by Input Service Distributor

This provision in case of services is similar to Sec. 140(5) in case of goods. It provides that CENVAT credit relating to services received prior to appointed day, shall be available as CGST credit to the Input Service Distributor even if the invoice is received after the appointed day.

It is noteworthy that even if the main unit/ branch providing services and also acting as an ISD for other units across India has already migrated into the GST regime and obtained the ARN, such Input Service Distributors (ISD) must obtain a fresh registration as such under the GST regime after the appointed day.

### Section 140(8) of the CGST Act: ITC in case of Centralised Registration under existing law

Under the current service tax or excise regime, several large establishments have a centralised registration despite having several units across various States. Such a situation shall not exist

under the GST regime, as separate registration is required in each State. This sub-section facilitates availment of CGST credit by such establishments and transfer of such credit to the various units which are distinct persons having the same PAN.

Any registered person having a centralised registration will be allowed a one time window to transfer the CENVAT credit as per the choice of such a person to various units at the which are now distinct persons under GST on the condition that the credit shown as carried forward in the last return under the existing laws. **Part 8 of the Tran 1 form.**

It must be taken care that revised returns is allowable only if it results in decrease in CENVAT credit to be carried forward.

## Section 140(9) of the CGST Act: Reclaim of credit reversed under existing law

CENVAT Credit Rules calls for reversal of credit taken by the recipient of service in case of non-payment of consideration within three months to the service provider.

Under the GST regime, this time limit has been extended to 180 days as per the Second Proviso to sub-section (2) of section 16. To bring parity between the two regimes, sub-section (9) of section 140 provides allowance of three months from the appointed day for reclaiming the credit reversed due to non-payment under the earlier law.

It may be noted that no time limit has been prescribed within which such reversal of credit should have taken place. As such, credit reversed at any time before the appointed day can be reclaimed on payment of consideration within three months of the appointed day.

## Section 141 : Transitional provisions relating to Job work

Inputs, semi-finished, or finished goods, having been dispatched from the place of business of the principal without payment of tax under the MVAT Act, 2002, and are returned to the said place of business on or after the appointed day. If such goods are returned within six months from the appointed day, no tax shall be payable on the same. Such period of six months can be extended by the Commissioner of GST for a further period not exceeding two months on sufficient cause being shown.

The principal as well as the job worker must declare the details of such goods held in stock by the job worker on behalf of the principal on the appointed day in **Part 9 of Form TRAN-1** to be filed within ninety days from the appointed day.

If the goods are not returned within the prescribed period, an amount equal to the input tax credit relating to the said goods shall be recovered as an arrear of tax of the GST Act, unless it is recovered under the MVAT Act, 2002.

An issue which needs to be highlighted under these provisions is as follows:

Under the existing law, any person sending the goods to another State for job work is required to produce a declaration in Form 'F'.

In such situation, despite a time limit of six months for return of goods sent for job work under this section, the principal would face difficulty in taking the benefit of this provision. There is a possibility of disallowance of SGST credit for contravention of the Second Proviso to section 140(1), which mandates that forms should be received as per Rule 12(7) of the CST (Turnover and Registration) Rules (i.e 3 months).

## Sec 142 deals with several scenarios which mainly deal with pending proceedings under existing laws and also taxability of contracts which are entered into prior to Appointed Day but continue to remain in operation after the AD

For the sake of brevity, I will only deal with two important sub sections which are important for the Transition Forms point of view.

The other sections essentially deal with Assessment, refund, appeal, etc. proceedings under existing laws which are initiated before the GST but culminate under the GST Regime. As a thumb rule any refund or credit that becomes admissible will be refunded in cash on the other hand if any recovery is due in that case the amount due will be recovered as per the recovery provisions of the GST Law.

## Section 142(11): Treatment of tax paid to the extent leviable in case of continuous supply of goods/services

### Section 142(11)(C)

Taking an example of a works contracts which was liable to VAT as well as Service Tax. Clause (c) provides that in case of such contracts, tax shall be levied under the GST law to the extent of supplies made after the appointed day and credit of VAT and Service Tax paid earlier shall be granted as credit, which shall be calculated in the manner prescribed.

**Issue**

**Advances received by Builders and Developers are liable to Service Tax at the time of receipt of each instalment. MVAT in case of such contracts is only payable at the time of final sale. What will be the taxability of such construction contracts which continue even after commencement of GST Act?**

As per clause (c) of sub-section (11) of section 142, GST shall be leviable on the supplies made after the appointed day. Credit of Service Tax paid earlier shall be available as CGST to discharge this liability. To overcome the disparity between the MVAT Act and the Service Tax law, Trade Circular 18T of 2017 dated 31-5-2017 has been issued by the Commissioner of Sales Tax of Maharashtra requiring the Builders and Developers to pay MVAT on advances received till date, effectively delinking payment of tax on any advance received and registration. Accordingly, such MVAT shall be available as SGST credit at the time of discharging GST liability in future.

***These credits are available after submitting Part 11 of the Tran-1.***

The caveat here is that carry forward of credit for works contractors, builders,etc is not merely dependent on 142(11)(c). Such persons are eligible to credit under section 140(1),(3),(6) depending on the nature of business.

Despite the press release by the Finance Ministry for compulsorily passing on entire credit embedded in the transaction, there are builders/ developers who are not passing on adequate credits to the buyers by taking umbrage under the fact that for near completion project, there is barely any ITC which would be made available. There are cases of reputed builders passing on a measly 2% credit as an arbitrary measure, in some cases in other towns the credit passed on is 6%. Though specific calculation can be determined only on a case to case basis, for consumers and practitioners it is important to be aware that there is indeed a significant amount of credit which is being carried forward and there is no significant addition in liability even by the most conservative calculations. This calculation will always remain contentious because the incredible difference in the quantum of tax involved and there not being any straight jacket formula for actual determination. The blame for creating such a confusion lies solely on the myopic law making. This is despite the admitted fact that in such cases a direct and obvious result of not passing on adequate and correct credit under transitional provisions will lead to a monumental increase in tax burden which is eventually passed on the final buyer in its entirety. It is important to understand that it is a settled law that profit cannot be made on account of tax collection and ITC is equivalent to tax paid.

It must also be pointed out that under no circumstances is GST leviable on any contract if the Supply has exhausted during the earlier

law i.e. Occupation Certificate is received before the appointed Day and mere consideration is received after the appointed day. GST remains payable on supply and if there is no supply under GST mere consideration is not basis of any tax.

## Section142(12): Treatment of goods sent on approval basis

Where goods sent on approval basis not earlier than six months prior to the appointed day are rejected and returned within six months from such day, no tax shall be payable.

The Commissioner may extend this period of six months up to further 2 months if sufficient cause is established.

If such goods are not returned within the said period, it shall be deemed to be a supply by the person who sent the goods on approval basis. In future, if the goods are rejected and returned after expiry of prescribed period, it shall be deemed to be a supply by the person returning the goods. It is needless to say that the person returning the goods will take credit of taxes paid on the deemed supply made to him earlier.

Every person who has sent goods on approval basis within six months prior to the appointed day must record the details of such goods in Part 12 of FORM GST TRAN-1. Such details need to be provided irrespective of whether he is carrying forward any credit to the GST credit ledger.

## Section 142(14) of the MGST Act: Treatment of goods or capital goods belonging to principal lying at the premises of agent

Since under the GST law, agent is a separate taxable person and is liable to pay tax on the supplies effected by him. Accordingly, this provision facilitates credit of goods/capital goods held in stock by such agent on the appointed day, which shall be taxable in his hands under GST subject conditions laid down in the section.

In the above scenario the principal as well as the agent must declare the details of such stock held by the agent on the appointed day in Part 10 FORM GST TRAN-1.

There remain several unanswered issues under the transitional provisions especially with regards to revision of Tran-1 whether allowed or not, cancellation of works contract which are entered into prior to the appointed date. In the absence of any advance ruling authority coupled with a completely dismissive approach by the Revenue by not providing on time excel utilities for large number of transactions and highly restrictive and rushed due date calendar, Transitional provisions will remain an uphill struggle for practitioners unless a far more pragmatic and liberal approach is taken by the Government expediently.

Note: Several parts of this article are extracts of a publication of GSTPAM which is Co-authored by me and my colleague Aditya Surte, due credits to them. The extracts are used for educational purposes only.

Happiness is when what you think, what you say, and what you do are in harmony.

— *Mahatma Gandhi*


CA Naresh Sheth and CA Kush Vora

# INDIRECT TAXES
## GST – Legal Update

## A. CUSTOMS

### 1. IGST on high seas sale transactions *(Circular No. 33/ 2017 dated 1st August 2017)*

The CBEC clarified leviability of IGST on high seas sale ('HSS') transactions.

As per the Circular, it has been decided by the GST council that IGST on HSS transactions will be levied only at the time of actual importation i.e., at the time of filing import declarations at the Customs.

The said Circular has been issued under the Customs Act and whereas the levy of GST has been provided under GST Act. No such clarification or circular provided under GST legislation.

## B. Central Goods & Services Tax (CGST):

### 1. Clarification on exports procedure relating to Bond/ LUT *(Circular No. 5/5/2017 dated 11th August 2017)*

There is one notification and two circulars on the above mentioned issue in past 2 months. One more Circular is issued in the month of August on pending issues under exports/ SEZ supplies under GST.

*Vide* the said Circular, following points are clarified by the Board:

***a) Eligibility to export under LUT***

The facility of LUT can be availed only by those persons who had received foreign inward remittance of 10% of export turnover in preceding financial year or INR 1 Crore (whichever is more).

The status holders as per paras 3.20 and 3.21 of FTP 2015-2020 are eligible for LUT without the above conditions.

***b) Time limit for acceptance of Bond/ LUT by GST officers***

The application for Bonds/ LUT should be processed on top priority and within 3 working days from date of submission of complete documents.

***c) Form CT-1 transactions***

Earlier purchase of goods by merchant exporter from a manufacturer was exempted from excise duty on furnishing of Form CT-1. However, under GST supply from manufacturer to merchant exporter is treated as normal supply therefore subjected to GST. It has been expressly clarified that 'zero rated' supplies would not cover such transactions and Form CT-1 has no relevance under GST.

***d) EOU transactions***

There was huge hue and cry amongst the industry with relation to specific clarification regarding supplies to EOU. It is now expressly clarified that supplies to EOU are not 'zero rated' unlike supplies to SEZ. Therefore, GST is chargeable on supplies to EOU and shall be treated as 'normal supply'.

***e) Foreign Inward remittance in Indian Rupees***

The concept of foreign inward remittance is imposed under GST in two major situations i.e. for the purpose of complying with LUT and for the purpose of qualification as 'export of service'.

While supplying goods or services to Nepal, Bhutan, SEZ developers/ SEZ unit, consideration is normally received in Indian Rupees and not in foreign inward remittance as mandated under LUT conditions.

Supplies to Nepal, Bhutan, SEZ, LUT will be permissible irrespective of whether the payments are made in Indian currency or convertible foreign exchange as long as they are in accordance with RBI guidelines.

Service to SEZ permissible on above lines. However, for the purpose of export of services to Nepal or Bhutan, payment of such services should be in convertible foreign exchange. Otherwise same will not be treated as export of service.

***f) Bank Guarantee ('BG')***

For the purpose of Bond procedures, BG (maximum 15%) is to be placed with the GST office.

Export Promotion Council recognized exporter will be allowed to submit bond without BG.

For persons having multiple registration on same PAN, foreign remittance condition has to be complied at PAN level and not at GST registration level. Therefore, if at a company level the requirement of maintaining foreign inward remittance is satisfied, registered person may be allowed to submit bond without BG.

***g) Jurisdictional officers***

Bonds/ LUT are to be furnished to CGST officers till the time administrative mechanism is developed by State offices.

***h) Documents for LUT***

Self-declaration regarding 'status holder' and 'no prosecution' would suffice for the purpose of meeting conditions as per Notification No. 16/ 2017.

***i) Applicability of Circular***

Above circular is effective from 1st July 2017 and not from the date of issuance of circular.

## 2. Amendment to CGST Rules – Fifth Amendment Rules *(Notification No. 22/2017 dated 17th August 2017)*

The time limit for filing of stock declaration in case of composition dealer in Form GST CMP 03 is extended to ninety days as compared to original sixty days.

The Fifth Amendment Rules provides for reversal of Input Tax credit of additional duty of Customs paid on importation of gold dore bar held in stock as on 1-7-2017. The said reversal has to be done to the extent of 5/6th of duty amount.

## 3. Notification No. 20/2017 (Rate) dated 22nd August 2017 (Reduction of GST Rates)

GST rates for some of the services have been reduced *vide* above notification. The summary of the same is as under:

| Sr. No. | Services | From | To |
|---|---|---|---|
| 1. | Certain specified works contract services | 18% | 12% |
| 2. | Job work services of textile and textile products | 18% | 12% |
| 3. | Rent-a-Cab services | 5% with no ITC | 12% with Full ITC or 5% with no ITC |
| 4. | Goods Transport Agency | 5% with no ITC | 12% with full ITC or 5% with no ITC |
| 5. | Services by way of printing of newspapers, books, journals and periodicals, (where only content is supplied by the publisher and the physical inputs including paper used for printing belong to the printer) | 18% | 12% |
| 6. | Admission to planetarium | 28% | 18% |

## 4. Notification No. 21/2017- Central Tax (Rate) dated 22nd August 2017 *(Changes to exemption notification)*

Exemptions have been extended to service provided by and to FIFA and its subsidiaries in relation to any events under U-17 World Cup 2017 to be hosted in India.

Exemption is also granted for services provided by Fair Price Shops to Central Government, State Government or Union Territory for distribution of specified goods under public distribution system where consideration is in form of commission or margin.

Further, explanation is inserted so as to consider LLP as partnership firm. LLP's are to be considered as partnership firms for claiming exemption.

## 5. Notification No. 22/2017- Central Tax (Rate) dated 22nd August 2017 *(Changes to RCM notification)*

In case where GTA charges CGST @ 6% (total GST 12%), RCM would not apply. In all other cases, RCM would be applicable.

Further, explanation is inserted so as to consider LLP as partnership firm.

## 6. Notification No. 23/2017 – Central Tax (Rate) dated 22nd August 2017

In case of small house-keeping service providers (plumbers/carpenters) providing services through E commerce Operators, liability to pay GST is caste on the E-Commerce Operators.

## 7. Notification No. 25/2017 – Central Tax, dated 28th August, 2017

The Central Government has extended the time limit for filing of details in form GSTR-5A (Form for submission of return by persons providing online information and database access or retrieval services from a place outside India to unregistered person in India) for the month of July 2017 up to 15th September 2017. Prior to this notification, the time limit for filing such details was on or before the twentieth day of the month succeeding the calendar month i.e. 20th August,2017.

## 8. Notification No.26/2017-Central Tax, dated 28th August, 2017

The Central Government has extended the time limit for filing of details in form GSTR-6 (Form for submission of return by input service distributor) for the month of July 2017 up to 8th August 2017 and for the month of August up to 23rd September 2017. Prior to this notification, the time limit for filing such details was on or before the 13th day of the month succeeding such calendar month.

## 9. Notification No.27 /2017 – Central Tax dated 30th August, 2017

Rules pertaining to E-Way bills are now notified in detailed manner. However, the date of effect for E-Way bills is yet to be notified.

Janak C. Pandya, *Company Secretary*

# CORPORATE LAWS
## Company Law Update

*Case Law # 1*

*[2017] 203 Comp Cas 714 (NCLT)*

*[Before the National Company Law Tribunal – Mumbai Bench]*

**L and T Electricals And Automation Ltd., In re**

**The word "may" in sub-section 230(1) of the Companies Act, 2013, cannot be construed as discretion to dispense with member's meeting as well just like creditors meeting as allowed under section 230(9).**

**The plethora of judgments passed in the past laying *stare decisis* to the inferior courts cannot remain in force subsequent to the repeal of the provisions of sections 391 to 394 of the Act. Thus, due to new provisions, inferior courts have to lay down a new road path and not based on the *stare decisis*, which has no support of law.**

**Brief case**

This is an application for demerger of two public companies viz., L and T Valves Ltd., demerged company ("Dco") and L and T Electricals and Automation Ltd, a resultant company ("Rco"). The original applications by both the companies were filed with Hon. High Court, Bombay under section 391 read with section 394 of the Companies Act, 1956. ("Act"). Upon transfer of jurisdiction to National Company Law Tribunal ("NCLT"), the said applications are now before the Mumbai Bench under Chapter XV *vide* section 230-240 of the Companies Act, 2013 ("CA 2013").

The applicants while seeking various directions under section 230 and 232 of the CA 2013 also sought a direction for dispensing with calling and holding meetings of shareholders and secured creditors as they have given their written consent for the Scheme. Further, the applicants also sought for dispensing of meeting of the unsecured creditors upon giving undertaking to send notices by Dco.

The following are the submissions in support of seeking (1) direction for dispensing with calling and holding meetings as mentioned above; (b) giving shorter notice for calling and holding meetings.

1. As precedents, under section 391(1) almost all the High Courts exercised discretion of the Act in dispensing with calling meetings of shareholders, when such company has (a) positive net worth; (b) and has few shareholders and whole of them have given their consent to the scheme or arrangement.

2. The language of section 391(1) of the Act and section 230(1) of the CA 2013 being *pari materia* to each other.

3. The purpose of calling and holding meetings for getting approvals of members and creditors is served by their 100% consent.

4. The judgments in the cases of *(a) Ansal Properties and Industries Ltd., In re [1978] 48 Comp Cas 184 (Delhi), (b) Kirloskar Electric Co. Ltd., In re [2003] 116 Comp Cas 413 (Karn); [2003] SCC online 939 (Karn.); (c) Adobe Properties P. Ltd., In re [2017] 201 Comp Cas 679 (Delhi). etc.*

5. There is no express mandate of exemption for calling and holding members meeting similar to creditors meetings as per section 230(9) of CA 2013, thus, the principal Bench of NCLT at Delhi in its order in the case of *JVA Trading P. Ltd., In re [2017] 203 Comp Cas 702 (NCLT) (C.A. No. A.1/ PB/2017, dated January 13, 2017)* holding that there is no power to dispense with meetings of shareholders under the CA 2013.

6. However, Hon'ble NCLT, Bengaluru on February 2, 2017 in the case of *Coffee Day Enterprises Ltd., in re [2017] 203 Comp Cas 710 (NCLT),* has allowed the dispensing with calling and holding of meeting of equity shareholders in similar facts that equity shareholders has given their consent.

7. In support of facts as mentioned in (6) above, it is submitted that when there are conflicting decisions from Co-ordinate Benches, this Bench can also pass an order ignoring the decision of the Principal Bench of the Hon'ble NCLT.

8. Thus as mentioned in clause 7 above, when there exists a directly conflicting judgment of equal authority, then a choice is to be made with a judgment which appears to it to have laid down the law more elaborately and accurately. Reliance was placed on the judgment of Hon. High Court of Punjab and Haryana Full bench of in the case of *Indo Swiss Time Ltd. vs. Umrao, AIR 1981 P & H 213 [FB].*

**Judgment and reasoning**

The Hon'ble NCLT, Mumbai Bench has rejected the submission made by the applicants as above for dispensing with the calling and holding meetings of members and creditors. The Bench also passed an order directing the Companies as to how to issue notices, time line etc. The Bench has analysed the provisions of Act and CA 2013. The Bench has also taken into account the legislative's intention, and views of Standing Committee and MCA on the draft companies' bill which has ultimately resulted into passing of CA 2013. Followings points are considered:

1. Upon review of section 230(1) of CA 2013, there is an additional requirement that applicant based on kind of the scheme, shall disclose the kind of meeting that is required, various disclosures, timelines and conferring right of postal ballot etc., for conduct of meeting.

2. Two new clauses added with regards to reduction of share capital and scheme for debt restructuring, which requires the consent of at least 75% of secured creditors before making an application.

3. Under section 391(1) of the Act, Company has to send notice to either members or creditors and not to any other stakeholders. Under CA 2013, individual notice has to be sent to the members, creditors, debenture holders and various statutory authorities. Further, such statutory authorities like RoC, R.D, RBI, Income Tax, O.L, CCI etc. has to provide their objection, if any, within 30 days.

4. In case of listed company, such notice must be placed on the website of the Company. In case of other companies, it is to be placed, if it has website. While under section 391(1)(b) of the Act, it was only a newspaper advertisement.

5. Section 230 (4) under CA 2013 provides for voting by postal ballot, which was not the case under the ACT, further, it gives a clear 30 days' time for voting and hence, calling meeting at a shorter notice is not allowed.

6. CA 2013 provides for qualification for raising any objection against the scheme, thus, not everybody or anybody can raise objection. This will avoid unscrupulous and vexatious litigation under the garb of objection.

7. There is a change under CA 2013 as to obtaining approvals of members and creditors. Under the Act, majority was required in numbers and value of the shareholding or value of creditors, but CA 2013 provides only for valuation, thus it is now a single requirement.

8. Under CA 2013, *vide* section 232, the merger and amalgamation have been separately dealt with and that procedure under sub-section (3) to (6) of section 230 shall apply *mutatis mutandis* to section 232.

9. When Parliament has permitted creditors to give consent for the scheme and thus allows to dispense with calling and holding creditors meeting, had it been the intention of Parliament, it could have extended and allowed members to give consent.

10. The Standing Committee on companies' bill has suggested to extend the same liberty for members consent, however, the Government gave its reason as to why the same has not been extended.

11. Due to many frauds taken place in the past, making the Act otiose rather than effective, CA 2013 provides for stricter enforcements of provisions, higher levels of transparency, business friendly corporate regulations, improved corporate governance norms, enhanced accountability of key management and auditors, investors protection, whistle blower protection and corporate social responsibilities.

12. By passing the Insolvency and Bankruptcy Act, Parliament has strengthened CA 2013 for sheltering the creditors.

13. Under CA 2013, the applicant has to first apply its wisdom as to what meeting is to be held, make an application for calling a meeting of members and / or shareholders for the approval of scheme. The Tribunal has a limited role for either giving or not giving approval for calling meeting and has no role as to decide as to which meeting is to be held.

14. The word "may" in sub-section 230(1) of CA 2013, cannot be construed as discretion to dispense with member's meeting unlike the creditors meeting as allowed under section 230(9) of CA 2013.

15. The purposive interpretation (mischief rule) has come in to existence in Heydon's case [1584] 76 ER 637 when common law was prevalent, but not after Parliament sovereignty has become rule of law.

16. The analysis of legislative history of CA 2013 for the approval of scheme, suggestion by standing committee and Government comments clearly provides that CA bill was introduce without adding any provisions for dispensing with holding member's meetings.

17. The plethora of the judgments passed in the past laying *stare decisis* to the inferior courts cannot remain in force subsequent to the repeal of the provisions of sections 391 to 394 of the Act, which has given foundation to that *stare decisis*. Thus, due to new provisions, inferior courts have to lay down a road path on the same and not based on the *stare decisis*, which has no support of law.

CA Sheetal Nagle

# CORPORATE LAWS – RECENT DEVELOPMENTS

## Next PE Wave – Need for reforms

The private equity and venture capital eco-system in India has played a crucial role in providing much-needed growth and high-risk capital to companies and businesses over the last fifteen years. Since early 2000s, private equity and venture capital funds have invested over USD 150 billion in India and have also generated market-beating returns.

From a tax and regulatory perspective, the overall investment landscape has witnessed a number of positive changes over the last couple of years. Some of the measures include easing of FDI norms in key sectors and providing more clarity and certainty by renegotiating double tax avoidance treaties with countries such as Mauritius, Cyprus and Singapore. Further, relaxations including permitting FDI into LLP firms under the automatic route where 100 per cent FDI is allowed and removal of restrictions on LLPs to avail ECBs (external commercial borrowings), has also given a fillip to the investment community.

Looking ahead, India is on the cusp of a renewed growth trajectory and the private equity industry is geared to partake in this growth. With over USD 7 billion worth of dry powder committed to India and fresh fund-raises alone topping USD 2 billion in 2016, there is sufficient capital available to be deployed. Buoyant capital markets, a hot M&A market and a vibrant economic outlook are also helping shape a favourable investment environment in India, as well as in opening doors for profitable exits. Further, with over USD 42 billion worth of large ticket (greater than USD 50 million size) private equity investments over two years in vintage, still un-exited or partially exited, exit activity is also expected to pick up in the near future.

Keeping this in perspective, we have made an attempt to list down some of the reforms that are required to propel private equity activity in India, to a significantly higher level.

The Union Budget 2017 was announced against the backdrop of a lot of expectations from across sectors. The Finance Minister did well by not disturbing the growth momentum and there were not too many unwelcome surprises. However, on the tax front, there were a few misses, which have been summarised below.

- Deferral of POEM to provide adequate time to analyse the impact of the final POEM guidelines
- Increasing the threshold limit for triggering indirect transfer provisions from the existing level of 5 per cent to carve out overseas transfer not resulting in change in control or management of underlying Indian entity
- Relaxations were expected in conditions relating to investor diversification and threshold of participation interest of a single investor in funds to make Safe Harbour Norms practically implementable

- Tax pass-through status for Category III AIFs

Addressing the above would go a long way in dispelling some of the tax related uncertainties.

The next jump for the PE industry in India would come from developing a robust local fund of funds industry. A 'fund of funds' (FOF) is an investment strategy of holding a portfolio of other investment funds rather than investing directly in stocks, bonds or other securities. PE FOF are investment vehicles that pool in capital from people to invest in several different private equity funds. Through these funds, investors can create a highly diversified and comprehensive portfolio of indirect investments in several companies from some or all of the categories of private equity. In India, FOF has been used as an entry strategy by several large private equity and sovereign wealth funds to test Indian markets, before setting up full-fledged advisory operations in India. The FOF industry has not taken off in India as compared to other markets.

On the regulatory front, allowing foreign investors to invest in AIF under the automatic route is a welcome step and would go a long way in promoting FOF. Further, since investments of India-managed AIF would be considered as domestic investment, with foreign investment restrictions not being applicable, regardless of the source of monies in such AIFs, this opens up a new avenue for FOF to access Indian markets in a much broader manner. It would help if clarity is issued to banks permitting repatriation of returns from AIFs to foreign investors under the automatic route, without any approval. While the position under law is clear, there may still be certain operational glitches, and any clarification in this matter would help.

On the tax side, there are a few issues that need to be ironed out to boost FOF investment in India — either in AIF or offshore India-dedicated funds. The same have been listed below.

**Exemption from filing of return of income to foreign investors**

- Category I and II AIFs are pass-through Trusts. The income accruing/arising to these AIFs is taxable in the hands of investors. Such AIFs are required to withhold tax at the rates in force on the distribution of fund income to non-resident investors.
- In case of non-resident investors in AIFs, the entire tax in respect of income from investment in AIF is discharged by way of withholding tax. Hence, such investors, should not be subject to further burden of tax filing in India, as long as income from AIF is their only Indian sourced income.

**Indirect transfer**

- It was mentioned in the 2017 Budget Speech that a separate clarification will be issued that indirect transfer provision shall not apply in the case of redemption of shares or interests outside India as a result of or arising out of redemption or sale of investment in India which is chargeable to tax in India. However, no such amendment has been made to the Act. This continues to be a matter of concern to FOF investments in India dedicated offshore funds.

**Availability of tax credit to FOF**

FOF, that are taxable entities in their home countries, need to have a mechanism to claim credit for Indian taxes paid in respect of their share of income by offshore funds in which the FOF would have invested. For this purpose, a separate definition of FOF needs to be introduced and in certain situations, on fulfilment of certain specified conditions, proof of proportionate taxes paid in India can be issued in the name of FOF, instead of the offshore fund investing in India.

**Exemption for AIFs under section 56(2)(viib)**

Section 56 (2)(viib) of the Income-tax Act, 1961 (Act) provides that in case of issue of shares for a consideration exceeding the face value of shares, the difference between the fair market value of the shares and the consideration received is taxable in hands of the recipient company. Presently, there is a specific exemption for companies where the consideration for issue of shares is received from 'venture capital funds'. Such exemption should also be extended to all AIFs and their investee companies.

**Safe Harbour**

The norms laid down in the Safe Harbour provisions for onshore fund managers under Section 9A of the Act, require relaxation. The fund industry is currently not utilising these provisions as there are certain grey areas which require clarification and some conditions relating to investor diversification, investment related conditions, etc., need further relaxation to attract more fund managers to locate to India.

**GST**

Any services availed by AIF (from fund manager or other) are liable to GST and in the absence of output GST liability, such GST is charged on services consumed by non-resident investors of AIF. However, GST is not applicable on a non-resident investor investing directly in a start-up or on services provided by overseas fund manager to the offshore pooling vehicle. Thus, offshore funds are encouraged to pool outside India.

In order to encourage investment in AIF, GST should be levied at a lower rate where majority investors are non-residents.

Some of the other areas where reform is required have been briefly discussed below.

**Disclosures**

The present AIF Regulations provide for certain disclosures to be made in the placement memorandum. These disclosures do not include certain critical information which may be necessary in the context of making an investment into the fund. There is a need to increase the level of disclosures in the placement memorandum on matters such as past performance, investment strategy and objectives. In order to increase investor confidence and to enable investors to take an informed decision whilst investing in a fund, certain additional disclosures should be required to be made by fund managers in the placement memoranda.

**Investment in Cat II AIF**

Presently, insurers and the National Pension Scheme (NPS), are permitted to invest in Category I II AIFs subject to the condition that at least 51% of the funds shall be invested in infrastructure entities, or SMEs, or venture capital, or social welfare entities, as per the IRDA and PFRDA regulations respectively. The AIF Regulations in relation to Category II AIFs, only provide that they shall invest primarily in unlisted investee companies without restricting investments to infrastructure entities, or SMEs, or venture capital, or social welfare entities.

NPS Scheme and insurers should be permitted to invest in Category II AIFs so long as such AIFs invest primarily in unlisted investee companies and in accordance with the AIF regulations. This will help better the risk return profile of the NPS scheme / insurers and in helping formation of domestic pools of growth and development capital critical to India's success.

**LLPs as Funds**

The Registrar of Companies should allow LLPs to be registered for the object of investment. As a safeguard, the LLP may self-certify that all capital is contributed by partners, and that they do not accept public deposits or use borrowed funds.

**Investments in AIF-II by Scheduled Banks**

RBI has, *vide* its circular, permitted banks to invest in Category I AIFs up to 10% of their paid-up share capital and reserves but has made no mention of investment by banks in Category II AIF which has led to ambiguity. Under the VCF regime, banks were permitted to invest in all funds.

In summary, the current macro-economic situation of the economy, the abundance of investment opportunities and the availability of capital ready to be pumped into India offer a positive outlook for the private equity and venture capital market. Providing an enabling environment by way of the next generation of reforms, as has been discussed above, would help hugely in the process.



CA Mayur Nayak, CA Natwar Thakrar &
CA Pankaj Bhuta

# OTHER LAWS
## FEMA Update and Analysis

In this article, we have discussed recent amendments to FEMA through Circular issued by RBI and updated FAQ. We have also covered the notifications issued by Department of Industrial Policy, Government of India.

### 1. Investment by Foreign Portfolio Investors (FPI) in Government Securities Medium Term Framework (MTF)

RBI has reviewed the Medium Term Framework for Investment by Foreign Investors (FPI) in Central and State Government Securities which was introduced in October, 2015. In order to reform the MTF to meet the objective of a preference for long-term investors and to manage the macro-prudential implications of evolving capital flows, the following modifications are made to the Framework.

**Review of the Medium term Framework**

a) The overall cap of 5% for Central Government Securities (G-Secs) and 2% for State Development Loans (SDLs) remain unchanged.

b) Future increases in the limit for FPI investment in Central Government securities will be allocated in the following ratio –
   - 75% for 'Long-Term' category of FPIs and
   - 25% for 'General' category

c) The practice of transferring unutilised limits of 'Long-Term' category to 'General' category of FPIs is done away with.

d) To harmonise the approach to FPI investments in SDLs with that for Central Government securities, future increases in SDLs would be in the ratio of 75% for 'Long Term' category and 25% for 'General' category of FPIs.

**Revision of Limits for the July-Sept. 2017 Quarter for FPI Investment**

The limits for investment by FPIs in G-Secs and SDLs for the quarter July-September 2017 are increased by INR 110 billion and INR 61 billion, respectively, and allocated as under:

**Limits for FPI investment in Government Securities**

(INR Billion)

| | Central Government Securities | | | State Development Loans | | | Aggregate |
|---|---|---|---|---|---|---|---|
| | General | Long Term | Total | General | Long Term | Total | |
| Existing Limits | 1,849 | 461 | 2,310 | 270 | -- | 270 | 2,580 |
| Revised limits | 1,877 | 543 | 2,420 | 285 | 46 | 331 | 2,751 |

The revised limits will be effective from July 4, 2017.

*[A.P. (DIR Series) Circular No. 1 dated 3rd July, 2017]*

***(Comments: Timely review of the MTF to calibrate features of the MTF in line with evolving macro-economic conditions is always welcome)***

## 2. FAQ on Miscellaneous Forex Facilities

RBI has issued revised FAQs on Miscellaneous Forex Facilities dated August 1, 2017 which now contains 16 FAQs wherein FAQ No. 6 issued earlier (on 4-8-2016) has now been deleted.

*FAQ No.6 of the FAQs issued on 4-8-2016 on Miscellaneous Forex Facilities has been reproduced below:*

***Q.6.** How many days in advance one can buy foreign exchange for travel abroad?*

***Ans:** Permissible foreign exchange can be drawn 180 days in advance by an individual, resident in India.*

*Refer https://www.rbi.org.in/scripts/FS_FAQs.aspx?Id=66&fn=5*

***(Comments: Since the limit is subsumed within the total LRS limit of US $ 250,000, keeping a time limit for drawal of forex from banks would only add to confusion. Therefore, it is beneficial to remove such FAQ in absence of any such corresponding regulation in the notification and master direction.)***

## 3. Standard Operating Procedure (SOP) for Processing FDI proposals

After the abolition of Foreign Investment Promotion Board (FIPB) it has been renamed as Foreign Investment Facilitation Portal.

As per the Standard Operating Procedure for processing of FDI proposals issued by DIPP *vide* No.1/8/2016-FC-1 dated June 29, 2017, an applicant would be required to submit its proposal for foreign investment online on this said FIPB Portal for onward submission by DIPP to the concerned Administrative Ministry/Department (Competent Authority) within 2 days. The following ministries shall be considered as the Competent Authority for approval of foreign investment in certain sectors/activities:

| Sr. No. | Activity/ sector | Administrative Ministry/ Department |
|---|---|---|
| 1. | Mining | Ministry of Mines |
| 2. | Defence | |
| | a) Items requiring Industrial Licence under the Industries (Development & Regulation) Act, 1951, and/or Arms Act, 1959 for which the powers have been delegated by Ministry of Home Affairs to DIPP | Department of Defence Production, Ministry of Defence |
| | b) Manufacturing of Small Arms and Ammunitions covered under Arms Act 1959 | Ministry of Home Affairs |
| 3. | Broadcasting | Ministry of Information & Broadcasting |
| 4. | Print Media | |
| 5. | Civil Aviation | Ministry of Civil Aviation |
| 6. | Satellites | Department of Space |
| 7. | Telecommunication | Department of Telecommunications |
| 8. | Private Security Agencies | Ministry of Home Affairs |
| 9. | Applications involving investments from Countries of Concern which presently include Pakistan and Bangladesh, requiring security clearance as per the extant FEMA 20, FDI Policy and security guidelines, amended from time-to-time | |

| Sr. No. | Activity/ sector | Administrative Ministry/ Department |
|---|---|---|
| 10. | Trading (Single, Multi brand and Food Product Retail Trading) | Department of Industrial Policy & Promotion |
| 11. | FDI proposals by Non-Resident Indians (NRIs)/ Export Oriented Units (EOUs) requiring approval of the Government | |
| 12. | Application relating to issue of equity shares under the FDI policy under the Government route for import of capital goods/machinery/equipment (excluding second-hand machinery) | |
| 13. | Applications relating to issue of equity shares for pre-operative/pre-incorporation expenses (including payments of rent etc.) | |
| 14. | Financial services which are not regulated by any Financial Sector Regulator or where only part of the financial services activity is regulated or where there is doubt regarding the regulatory oversight | Department of Economic Affairs |
| 15. | Applications for foreign investment into a Core Investment Company or an Indian company engaged only in the activity of investing in the capital of other Indian Company/ies | |
| 16. | Banking (Public and Private) | Department of Financial Services |
| 17. | Pharmaceuticals | Department of Pharmaceuticals |

It has also been clarified that in respect of applications in which there is a doubt as to which is the concerned Administrative Ministry/Department, DIPP shall identify the Administrative Ministry/Department where the application will be processed for decision.

The SOP also provides procedures related to the following for processing FDI proposals:

- Online filing of Application
- Competent Authorities for Approval of Foreign Investment
- Procedure for Processing of Application Seeking Approval for Foreign Investment
- Time Limits
- Monitoring & Review
- List of Documents to be submitted alongwith application
- Approval Letter Format

The full details are available on DIPP website. Refer Link: http://dipp.nic.in/whats-new/standard-operating-procedure-sop-processing-fdi-proposals

*[No.1/8/2016-FC-1 dated June 29, 2017 issued by DIPP]*

## 4. Consolidated FDI Policy dated August 28, 2017

The Department of Industrial Policy and Promotion (DIPP) has issued the Consolidated FDI policy dated August 28, 2017. The policy can be found at http://dipp.nic.in/policies-rules-and-acts/policies/foreign-direct-investment-policy.

Salient features of this Consolidated FDI Policy 2017 along with comparison with the Consolidated FDI Policy 2016 shall be covered in our next month's FEMA updates.


CA Hemal Shah & CA Juhi Virwani

# In Focus – Accounting and Auditing

## Property, Plant and Equipment – Key changes under Ind AS

Fixed assets or Property, Plant and Equipment as referred in Ind AS attracts major investment by any company and generally this is the largest item on balance sheet in most of the financial statements. Considering this, it is very important to know how Ind AS will impact values of the fixed assets going forward. This article is trying to throw light on few of the major differences between Ind AS and Indian GAAP and how these will affect the financial statements of Indian companies.

Under Ind AS, following standards are relevant for accounting of fixed assets:

| | |
|---|---|
| Ind AS 16 | Property, Plant and Equipment |
| Ind AS 17 | Leases |
| Ind AS 36 | Impairment of Assets |
| Ind AS 38 | Intangible Assets |
| Ind AS 40 | Investment Property |
| Ind AS 105 | Non-current Assets Held for Sale and Discontinued Operations |

Under Accounting Standards followed in the past, main thrust was given on historical cost. However, Ind AS brings concept of regular periodic revaluation and also few other new concepts like provision for asset retirement obligations, treatment of major overhaul expenses as a separate component etc which can have significant impact on companies in different industries.

Ind AS 16 – Property, Plant and Equipment covers accounting for all the fixed assets, however there are few assets which are scoped out from Ind AS 16. These mainly include biological assets related to agricultural activity other than bearer plants, exploration and evaluation of mineral resources, mineral rights and mineral reserves as there are separate Ind AS issued giving detailed guidance on these topics.

### Major changes brought by Ind AS

**a) Component accounting**

Ind AS 16 is based on the component approach. Under this approach, each major part of an item of property plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately. Existing AS 10, though recommended for adoption of the component approach, it did not make it

compulsory. Though, with the introduction of the Companies Act, 2013 this has undergone a change, as the Schedule II of Companies Act 2013 requires useful life and depreciation for significant components of an asset to be determined separately.

With component accounting now being mandatorily applicable, depreciation charge could be quite different as many components may have different useful lives as compared to its mother asset. Considering this, the exercise of identification of component is of utmost important and often involve technical experts to assess and determine useful lives of different major parts of the assets.

**b) Spare parts, stand-by equipment, service equipment**

As per Ind AS 16, initial costs as well as subsequent costs incurred are evaluated on the same recognition principles. Major parts qualify as Property, Plant and Equipment when an entity expects to use them during more than one period. However according to AS 10, subsequent expenditures related to an item of fixed asset are capitalised only if they increase the future benefits from the existing asset beyond its previously assessed standard of performance.

Under Indian GAAP currently, machinery spares are usually charged to the profit and loss statement as and when consumed. However, if such spares can be used only in connection with an item of fixed asset and their use is expected to be irregular, these are capitalised and depreciated for a period not exceeding the useful life of the principal item.

Thus under Ind AS, capitalisation for stores, spare parts and service equipment is much broader as compared to Indian GAAP which specified capitalisation of only machine spares.

**c) Major inspection and overhaul expenses**

Ind AS 16 acknowledges subsequent costs which are critical and necessary to operate an item of Property, Plant and Equipment. Performing regular major inspection for faults is very critical and cost of these inspections can be capitalised as part of fixed assets provided recognition criteria are met. This is regardless of whether any parts of the item are replaced or not.

Any remaining carrying amount of the cost of the previous inspection is derecognised. This is irrespective of whether the cost of the previous inspection was identified in the transaction separately i.e., if this cost was not identified separately at the time of acquisition of the asset, an estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired.

This is a major change as compared to current Indian GAAP, as major inspection or overhaul expenses even though these had enduring benefits were charged off to Profit and Loss Account as and when incurred as these did not meet definition of assets under AS-10 and AS-26.

**d) Provision for decommissioning liability/ site restoration costs**

Ind AS 16 recognises obligation on companies towards asset retirement. This could be in the form of dismantle, removal and restoration liabilities connected with Property, Plant and Equipment. It requires companies to estimate costs of dismantling and removing the item/ restoring the site and make a provision with corresponding adjustment in the cost of respective item of Property, Plant and Equipment. This is in line with the requirement of Ind AS 37 to create a provision towards the cost of these types of obligation.

This is a new concept for Indian corporates and companies now will have to capitalise the assets after considering liability for site restoration and dismantling. This can have wide impact on companies in different industries e.g. companies in mining industries will have to make an estimate of restoring the land on completion of mining. Site restoration cost

would in this case comprise of costs such as boundary wall, cost of plantation or cost of creating water reservoir etc. This can also have impact on retail or hospitality industry as the companies generally take spaces on a rental basis and add leasehold improvements to meet their standard requirements. Rental agreements with landlords however, often have obligation for restoring the premises after the completion of lease term. This means the companies will have to incur extra cost for removal of leasehold improvements added to the store and restore the premises back to its original condition. An estimate for these costs needs to be made at the start. Current present value of these obligations need to be capitalised as part of the cost of leasehold improvements and depreciated over the useful lives. An increase in the liability reflecting passage of time from net present value to estimated cost of obligation i.e., unwinding of the discount is recognised as a finance cost as it occurs over the period.

**e) Option of Cost model or Revaluation model**

Ind AS 16 requires an entity to choose either the cost model or the revaluation model as its accounting policy and to apply that policy to an entire class of property plant and equipment.

Under revaluation model, assets are revalued based on fair value of items of property plant and equipment so that at the reporting date carrying values are not materially different from those values which would be the fair value.

If an asset's carrying amount is increased as a result of a revaluation, the increase needs to be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. If an asset's carrying amount is decreased as a result of a revaluation, the decrease needs to be recognised in profit or loss. However, the decrease needs to be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

Revaluation option once chosen, necessarily means revaluation of assets on a regular periodic basis. Revaluation can be carried out every three or five years unless more frequent revaluations are necessary due to significant changes in fair value.

Companies opting for revaluation model will be able to reflect current fair value of assets on the balance sheet and thereby true return on investment earned. However, this may also mean change in depreciation amount in future years. Further, it will also involve extra efforts in updating revaluation on a regular basis.

It is worth noting that the option of cost and revaluation value model is available for each class of property, plant and equipment. Hence a company may choose revaluation model for few asset classes e.g. Land and Building and cost model option for other asset classes.

**f) Arrangements containing lease**

Ind AS 17 requires an entity to determine whether an arrangement that does not take the legal form of a lease but conveys a right to use an asset in return for a payment or series of payments, is a lease. Under Appendix C of Ind AS 17, determining whether an arrangement contains a lease, such determination is based on the substance of the arrangement, e.g., power purchase agreements and outsourcing contracts may have the substance of lease. Indian GAAP does not provide any guidance for such arrangements.

This can have a very wide impact in companies which are in pharmaceutical or FMCG industry and which operate either through toll manufacturing arrangement or job work arrangements. In this case, each arrangement would be assessed whether it contains a lease and further, whether the lease is finance lease or operating lease. In case, arrangements contain finance lease, then companies giving contracts for job work will have to capitalise the assets of the job workers in their own financial statements.

This can result in significant increase in the asset base and also financial liabilities of companies entering into such arrangements. Further, job work charges/toll manufacturing charges will be split into Profit and Loss account into different components like conversion cost comprising of material and labour cost and depreciation cost representing cost of using the assets.

This can also have impact on service contracts, such as power purchase contracts, waste management contracts and outsourcing contracts, as these may have to be accounted for as leases, if the use of the specific asset is essential to the operations and satisfies certain conditions.

This can have a substantial impact on service providers also, as they may be required to derecognize the asset from books if it satisfies the finance lease classification.

**g) Other differences**

1. Under Indian GAAP, foreign exchange differences pertaining to fixed assets were charged off to Profit and Loss account. However, immediately after global financial crisis of 2008, Indian GAAP allowed an option to Indian companies to recognise unrealised exchange differences on translation of certain long-term monetary assets/liabilities as adjustment to cost of an asset. Such an amount needs to be depreciated over the balance useful life of the asset. Under Ind AS, all foreign exchange differences shall generally be charged to Profit and Loss account. However, the transitional relief under Ind AS allows companies to continue with the capitalisation of foreign exchange differences for long term monetary items that were recognised under Indian GAAP.

2. Ind AS 16 states that the cost of Property, Plant and Equipment should be the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total is recognised as interest over the period of credit unless such interest is capitalised in accordance with Ind AS 16.

3. Under Ind AS 16, an item of Property, Plant and Equipment is depreciated based on its estimated useful life and residual value. Companies now cannot directly adopt useful lives or residual values prescribed in Schedule II to the Companies Act, 2013. However, companies will need to disclose justification for different useful lives or residual value in the financial statements.

4. Ind AS 16 requires depreciation method applied to an asset to be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. In existing AS 6, change in depreciation method can be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements

5. Any change in depreciation method is treated as an accounting policy change under Indian GAAP whereas it is treated as a change in estimate under Ind AS.

6. As per Ind AS 38, intangible assets can have indefinite useful lives. Such assets are required to be tested for impairment and are not amortised. Whereas current AS 26 contains a presumption that the life of intangibles should not exceed 10 years.

## Exemptions available for Property, Plant and Equipment for first time adopters

In principle, a first time adopter needs to prepare its first Ind AS financial statement as if it has always applied Ind AS. However this may not be possible to achieve or it may require enormous efforts in few cases. Hence, Ind AS 101 gives certain relaxations in form of exemptions with an objective that financial statement contain high quality information that is transparent and can be generated at a cost that does not exceed benefits to users.

Few of the exemptions given in Ind AS 101 are also pertaining to the area of Property, Plant and Equipment which are discussed below:

(A) Use of fair valuation or revaluation as deemed cost:

A first time adopter is permitted to measure individual items of Property, Plant and Equipment as deemed cost at the date of transition to Ind AS. Under this approach, the deemed cost can be either:

1. Fair value of assets on the date of transition to Ind AS
2. A revaluation under previous GAAP at or before the date of transition to Ind AS, if the revaluation, at the date of revaluation, was broadly comparable to
   a. Fair value, or
   b. Cost or depreciated cost in accordance with Ind ASs, adjusted to reflect, for example, changes in a general or specific price index

The above option of using fair value is allowed on transition date to Ind AS irrespective of the company planning to follow cost model going forward in future. Deemed cost is an amount used as a surrogate for cost or depreciated cost at a given date.

The above option of fair value can be applied asset by asset. Hence it may be possible that the Company applies this option for one type of assets eg land only and it may take other option for other items of fixed assets.

(B) Use of Previous GAAP carrying value:

Where there is no change in its functional currency on the date of transition to Ind AS, a first-time adopter may elect to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition, measured as per the previous GAAP and use that as its deemed cost after making necessary adjustments in order to include the cost of restoration of the site on which the asset is located.

If an entity avails the option under this paragraph, no further adjustments to the deemed cost of the Property, Plant and Equipment so determined in the opening balance sheet needs to be made for transition adjustments that might arise from the application of other Ind AS.

It is worth noting that option of Use of Previous GAAP Carrying Value as given in (B) above is not part of global IFRS. This is specifically introduced in Ind AS in India with an objective to make transition to Ind AS smoother. However if any company wants to also align its Ind AS financial statement with IFRS as issued by IASB, then it may not opt for this option.

If this option is selected, carrying value as per previous GAAP does not require any adjustment except for adjustments to be made for decommissioning liability. Hence this option can save lot of efforts and time for companies going for Ind AS adoption.

The option of previous GAAP carrying value needs to be applied to all the items of property, plant and equipment and hence currently there is no option to apply this selectively to few assets. However an exposure draft is issued which if passed will allow application of this option asset by asset.

The exemptions in above paragraphs are also available for intangible assets that meet the recognition criteria in Ind AS 38.

Apart from the above important exemption, Ind AS 101 also gives few relaxations in areas of capitalisation of foreign exchange differences and provision for decommissioning liabilities.

## Study of companies which have adopted Ind AS in Phase 1

To summarise, there are three possible alternates available for any company going for Ind-AS adoption. First alternate is retrospective application of Ind AS 16 principles i.e., without using any exemptions as given in Ind AS 101, recompute cost of fixed assets as per Ind AS 16. Alternatively it may choose exemptions given in Ind AS 101 – either of the options A or B as discussed above, considering the objective it wants to achieve.

There has been a mixed trend observed on study of Indian companies who have implemented Ind AS in phase 1 with companies like TCS, Bharati Airtel, Hindalco going for retrospective Ind AS application, few other companies like Tata Steel has opted for fair value as deemed cost, Tata Motors and Tata Power going for this option for few of the assets. Whereas most of the other companies like Larsen & Toubro, Grasim, Ultratech Cement, HUL, ITC, Wipro have opted for previous GAAP carrying value exemption

As per a recent report, only 27% of the companies who adopted Ind AS for financial year ended March 31, 2017, reported adjustments related to Property, Plant and Equipment. This is an indication that most of the corporates have selected option of Ind AS 101 of continuing with previous GAAP carrying value.

## Clarifications and Interpretations by Ind AS Transition Facilitation Group

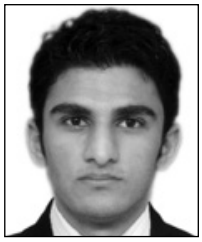
The Institute of Chartered Accountants of India has formed "Ind AS Transition Facilitation Group" (ITFG) to provide guidance to members on Ind AS transition. The group has come out with 11 bulletins so far comprising of many clarifications on transition to Ind AS. Few of these clarifications are related to property, plant and equipment and can have significant impact. Few of these important clarifications will be discussed in the next article.

## To summarise

There are significant GAAP differences between Indian GAAP and Ind AS. The differences are in the areas of component accounting, asset-retirement obligations, depreciation based on useful lives and capitalisation of exchange differences.

However, the impact of many of these GAAP differences was neutralised by Ind AS 101 exemption for Property, Plant and Equipment, especially allowing companies to grandfather previous GAAP carrying values without any adjustment. Hence, it is not surprising that only 27% of the companies reported adjustments on this front.

However corporates need to be mindful of the new requirements for any additions to be made to fixed assets going forward considering these vast differences between both the GAAPs.



Rahul Sarda, *Advocate*

# BEST OF THE REST

## 1. Appointment of Court Receiver – Court Receiver, High Court cannot be appointed as Court Receiver by an arbitral tribunal

The Notes on Clauses to the Arbitration and Conciliation (Amendment) Bill, 2015, says that the arbitral tribunal "shall have power to grant all kinds of interim measures which the Court is empowered to grant under Section 9." This raises a question whether the Court Receiver, High Court can be appointed by an arbitrator in a dispute before him between parties.

Held, the Court Receiver, High Court, Bombay, was an employee or a Department of the High Court and that it was the High Court that has the powers to direct its duties and responsibilities. Even where another Tribunal, such as the Debt Recovery Tribunal, was allowed to give directions to the Court Receiver in the past, it was for a limited transitory period of one year and only in those cases where the Court Receiver had already been appointed by this Court and that too this was permitted to be done by an Order of this Court on its judicial side (speaking through the Larger Bench/Division Bench, as indicated above).

The appointment, functioning and discharge of the Court Receiver is governed by Chapter XXX of the Bombay High Court (Original Side) Rules in addition to the provisions of Order XL of the CPC. These rules further establish that the Office of the Court Receiver, High Court, Bombay, functions only under the supervision and control of this Court. These Rules institutionalise the manner of functioning of the Office of the Court Receiver, High Court, Bombay. Therefore, it cannot be said that the Court Receiver, High Court, Bombay is capable of being appointed by an arbitral tribunal.

Furthermore, it was also observed that if the Court Receiver, High Court, Bombay were appointed to act as a Receiver in arbitrations, there would be no room for supervising such appointments by this Court and such Officers would be answerable only to the arbitral tribunals. Such arbitrations would be held at different locations in Mumbai and sometimes outside Mumbai, at times there would be a clash in the working hours and days of the Bombay High Court and the arbitral tribunals. Such officers and personnel would also have commitments in Court or in relation to Court matters. The situation that may result would be very difficult to manage and streamline which would affect the functioning of the office of the Court Receiver, High Court, Bombay.

For the above reasons, held, Court Receiver, High Court, Bombay could not be appointed by an arbitral tribunal.

*Shakti International Private Limited vs. Excel Metal Processors Private Limited 2017 3 ABR 388 (Bom.)*

## 2. Arbitration – Jurisdiction – Applicability of Clause – Despite no cause of action arising in a place, Courts

**in that place can have jurisdiction by agreement of parties with respect to jurisdiction**

The parties to the arbitration agreement expressly agreed that all disputes and differences of any kind between them arising out of or in connection with that agreement shall be subject to the exclusive jurisdiction of courts of Mumbai only. When an application was made to the Delhi High Court by one of the parties, the Delhi High Court held that no part of the cause of action arose in Mumbai, only the courts of three territories could have jurisdiction in the matter, namely, Delhi and Chennai (from and to where goods were supplied), and Amritsar (which is the registered office of the Appellant company), and hence, passed orders in the application. The Delhi High Court therefore held that the exclusive jurisdiction Clause would not apply on facts, as the courts in Mumbai would have no jurisdiction at all.

On appeal to the Supreme Court, held, the moment the seat of arbitration is designated, it is akin to an exclusive jurisdiction clause. On facts it was held that since the seat of arbitration was Mumbai and arbitration agreement further made it clear that jurisdiction exclusively vested in the Mumbai courts, courts in Mumbai alone would have jurisdiction. Under the Law of Arbitration, unlike the Code of Civil Procedure which applied to suits filed in courts, a reference to "seat" is a concept by which a neutral venue can be chosen by the parties to an arbitration clause. The neutral venue may not in the classical sense have jurisdiction – that is, no part of the cause of action may have arisen at the neutral venue and neither would any of the provisions of Section 16 to 21 of the Code of Civil Procedure be attracted. In arbitration law however, the moment "seat" was determined, the fact that the seat was at Mumbai would vest Mumbai courts with exclusive jurisdiction for purposes of regulating arbitral proceedings arising out of the agreement between the parties.

*Indus Mobile Distribution Private Limited vs. Datawind Innovations Private Limited and Ors. AIR 2017 SC 2105*

**3. Service of summons – Defendant evading service – Validity of Service by WhatsApp – Truecaller showed details of Defendant – In-phone apps and services**

Pursuant to a previous order of the Court, the Plaintiffs obtained addresses of the Defendant from the Central Board of Film Certification. The Plaintiffs then attempted to serve the Defendants at those addresses by courier and hand delivery. They were told that the 1st Defendant had shifted its address. The courier was told that the address of the Defendant was changed solely with an intention to evade or avoid service. The Plaintiffs' Advocates attempted to contact the 1st Defendant, on his mobile number. The Truecaller mobile phone app showed this to be 1st Defendant's mobile number. It was also reflected on his WhatsApp contact information. In subsequent messages exchanged, 1st Defendant accepted that he was the producer of the alleged infringing Kannada film *Pushpaka Vimana*. He also responded to the messages.

Held, the past record showed that the Defendants were only avoiding service. It could not be that the rules and procedure are either so ancient or so rigid (or both) that without some antiquated formal service mode through a bailiff or even by beat of drum or pattaki, a party cannot be said to have been 'properly' served. The purpose of service was put the other party to notice and to give him a copy of the papers. The mode was irrelevant. Where an alternative mode was used and service was shown to be effected, and was acknowledged, then it could not be suggested that the Defendants had 'no notice'. When somebody called and a person responded, details could be obtained from in-phone apps and services, and these were very hard to obscure or disguise. Therefore, the Defendants were held to be properly served.

*Kross Television India Pvt. Ltd. & Anr vs. Vikhyat Chitra Production & Ors. – Notice of Motion (L) No. 572 of 2017 in Suit (L) No. 162 of 2017 dated 27th March, 2017*

CA Ninad Karpe

# The Lighter Side

## Those were the days!

Deadlines for filing tax returns have always been the bane of tax consultants. Till the penultimate day there is chaos, with reams of data and information gathering force and magically, it all comes together on that final day.

In the good old days, there were long queues outside Aayakar Bhavan with people carrying physical copies of tax returns to "file" them at the tax office. The thrill of making it to the counter and coming back victorious to the office with an acknowledgement from the tax office was palpable. All that has now gone! And there is a significant number of people who feel almost cheated, being denied this.

With online filing of returns, tax consultants now hope and pray that their internet-services and the tax website are up and running. So, what will happen in future? Will filing tax returns remain the same in 2025? Here are two likely scenarios.

**Scenario 1:** Income tax gets abolished and is replaced by GST on everything – not just goods and services. As the famous song of rock singer Sting goes "Every step you take, every move you make" – you will be taxed on all this and more. It will be captured digitally and tax consultants will be busy filing tax returns on that.

**Scenario 2:** The tax department becomes a "customer service" department. It prepares the tax return for you and sends it to you. You can contest the amount calculated or meekly accept it. The department also gives you "reward points" for every Rupee of tax paid. The more tax you pay, the more reward points you earn! These points can then be redeemed for purchase of goods on the e-Commerce site (www.taxshopping.in), which is managed by the tax department.

There are many other likely scenarios – but, irrespective of what happens, the thrill of physically filing a tax return is gone. And with that, so has the joy of accomplishing the harsh struggle to get to the "filing" counter! Aha, those were the days!


CA Ketan Vajani & CA Nishtha Pandya
*Hon. Jt. Secretaries*

# The Chamber News

Important events and happenings that took place between 9th August, 2017 and 8th September, 2017 are being reported as under.

## I. ADMISSION OF NEW MEMBERS

1) The following new members were admitted in the Managing Council Meeting held on 1st September, 2017.

**Life Membership**

| | | | |
|---|---|---|---|
| 1 | Sharma Manish Bhagwan | CA | Mumbai |
| 2 | Agarwal Somil Raj | Advocate | New Delhi |
| 3 | Agarwal Akul Pawan | CA | Faridabad |
| 4 | Parekh Siddharth Sunil | CA | Mumbai |
| 5 | Sanchania Harsh Mahendra | CA | Mumbai |
| 6 | Maru Girish Devraj | CA | Mumbai |

**Ordinary Membership**

| | | | |
|---|---|---|---|
| 1 | Mehta Sanjiv Batukbhai | CA | Mumbai |
| 2 | Moyal Manoj Hanuman | CA | Bengaluru |
| 3 | Rathi Surendra Ram | CA | Mumbai |
| 4 | Varodia Kailashkumar Dahyabhai | CA | Mumbai |
| 5 | Anajwalla Khozema Fakhruddin | CA | Mumbai |
| 6 | Palo Keshaba Govind | CA | Mumbai |
| 7 | Sonawala Manoj Kishorchandra | CS | Mumbai |
| 8 | Khetan Anand Radheshyam | CA | Pune |

**Student Membership**

| | | | |
|---|---|---|---|
| 1 | Kacha Nirav Anilbhai | Student | Mumbai |

## II. PAST PROGRAMMES

### 1. ACCOUNTING AND AUDITING COMMITTEE

Seminar on "Tax Audit Reporting Issues for ICDS under IND AS and IGAAP – Challenges" was held on 16th August, 2017 at Kilachand Hall, IMC. The Seminar was

addressed by CA Jayant Gokhale and CA Nihar Jambusaria. The Seminar was attended by 85 participants.

**2. CORPORATE CONNECT COMMITTEE**

Public Lecture Meeting on Recent and Proposed Changes to The Companies Act, 2013 was held on 8th September, 2017 at Walchand Kilachand Hall, IMC. The Lecture Meeting was addressed by CS Savithri Parekh – Head – Legal and Secretarial at Pidilite Industries Ltd. The Lecture Meeting was well attended by 152 participants.

**3. LAW & REPRESENTATION COMMITTEE**

**Writ Petition**

A) Writ petition on ICDS was filed before the Hon. Delhi High Court for which hearing was held on 28th August, 2017. At the time of the hearing on 28th August, 2017 the matter has been adjourned to 7th September 2017.

**4. MEMBERSHIP & PUBLIC RELATION COMMITTEE**

Half day Seminar on Tax Audit Reporting Issues with reference to ICDS, Demonetisation – Tax and Legal Issues and Brain Trust was held on 3rd September, 2017 at ICAI Hall, Jalgaon. The seminar was addressed by CA Kalpesh D. Katira and CA Devendra H. Jain.

**5. STUDENT COMMITTEE**

Half day Workshop for Students on "Basics of GST" was held on 11th August, 2017 at Maharashtra Sewa Sangh Hall, Mulund. The Workshop was addressed by CA Parag Sheth, CA Sanjay Gajra and Mr. Hiral Soni. The Workshop was well attended by 221 participants.

## III. FUTURE PROGRAMMES

**(For details of the Future Programmes, kindly visit www.ctconline.org or refer The CTC News of September, 2017)**

## The Chamber of Tax Consultants

# Vision Statement

The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre–eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.

## Direct Taxes Committee

**Intensive Study Group Meeting held on 9th August 2017 at CTC Conference Room**

CA Shailesh Bandi (Speaker) addressing the participants

**Webinar on Deduction u/s 80P - in respect of Income of Corporate Societies held on 19th August 2017**

Mr. Dharan Gandhi, Advocate (Speaker) addressing the participants

**Webinar on Reporting Requirements and Responsibilities of Tax Auditors held on 6th September 2017.**

CA Mehul C. Shah (Speaker) addressing the participants

## Accounting & Auditing Committee

**Tax Audit Reporting Issues for ICDS under Ind AS and IGAAP – Challenges held on 16th August 2017 at Kilachand Hall, IMC**


Mr. Ajay R. Singh, Advocate (President) giving opening remarks. Seen from L to R – CA Heenel K. Patel (Chairman), CA Nihar Jambusaria (Speaker), CA Jayant Gokhle (Speaker) and CA Arpita Gadia (Convenor)

**Speakers**

CA Heenel K. Patel (Chairman) – welcoming the Speakers

CA Nihar Jambusaria addressing the participants

CA Jayant Gokhle addressing the participants

Group Photo – Seen from L to R: CA Deepak Shah (Convenor), CA Arpita Gadia (Convenor), CA Tejas Parikh (Vice-Chairman), CA Heenel K. Patel (Chairman), CA Jayant Gokhle (Speaker), Mr. Ajay R. Singh, Advocate (President), CA Hinesh Doshi (Vice-President), CA Parth Patel & CA Nikita Dattani

## Study Circle & Study Group Committee

**Study Circle on ICDS – I – Accounting Policies, ICDS III – Valuation of Inventories & ICDS IV – Revenue Recognition held on 17th August, 2017 at Babubhai Chinai Committee Room, IMC.**

CA Ravikant Kamath (Speaker) addressing the participants.

**Study Circle on ICDS – V – Tangible fixed, ICDS IX – Borrowing Cost held on 4th September, 2017 at SNDT Committee Room.**

Mr. Dharan Gandhi, Advocate (Speaker) addressing the participants

**Study Circle on ICDS – III Construction Contracts, ICDS - VII Government Grants, ICDS – VIII Securities Cost held on 7th September, 2017 at SNDT Committee Room.**

CA Vyomesh Pathak (Speaker) addressing the participants

## Indirect Taxes Committee

**Study Circle on Issues of Classification and Exemption under GST held on 11th August 2017 at A.V.Room, Jai Hind College.**

CA Prerna Shah (Group Leader) addressing the participants.

Mr. Shailesh Sheth, Advocate (Chairman) addressing the participants.

**Webinar on Transition Issues held on 24th August 2017**

Mr. Parth Badheka, Advocate (Speaker) addressing the participants

**Study Circle on "Work Contract, Mixed Supply & Composite Supply" held on 6th September, 2017 at A. V. Room, Jai Hind College.**

**Speakers**

CA Keval Shah

CA Kush Vora

Mr. Harsh Shah, Advocate (Chairman) addressing the participants

## Allied Laws Committee

**Allied Laws Study Circle Meeting on Insolvency & Bankruptcy Code, 2016 held on 10th August 2017 at SNDT Conference room.**

Mr. Ranit Basu, Advocate (Speaker) addressing the participants

## Delhi Chapter

**Full day workshop on "Goods and Services Tax Act with emphasis on understanding Critical Aspects with Case Studies" organized by Delhi Chapter of CTC on Saturday, August 19, 2017 at IIC**


Dignitaries on dais – Seen from L to R - Mr. R. P. Garg, Advocate (Chairman), Mr. Saurabh Agarwal (Speaker), Ms. Sonam Bhandari (Speaker) and Mr. V. P. Verma, Advocate (Advisor)

Mr. Saurabh Agarwal (Speaker) addressing the participants

Ms. Sonam Bhandari (Speaker) addressing the participants

## Corporate Connect Committee

**Public Lecture Meeting on Recent and proposed changes to The Companies Act, 2013 held on 8th September 2017 at IMC**

Dignitaries on Dais – CA Anish Thacker (Chairman), Ms. Savithri Parekh (Speaker), Mr. Ajay R. Singh, Advocate (President) and CA Vitang Shah (Convenor)


CA Anish Thacker (Chairman) welcoming the speaker. Seen from L to R – Ms. Savithri Parekh (Speaker), Mr. Ajay R. Singh, Advocate (President) and CA Vitang Shah (Convenor)

Ms. Savithri Parekh (Speaker) addressing the participants. Seen from L to R - CA Anish Thacker (Chairman), Mr. Ajay R. Singh, Advocate (President) and CA Vitang Shah (Convenor)

Section of Members

## International Taxation Committee

**FEMA Study Circle on ECB Guidelines held on 7th September 2017 at CTC Conference Room**

CA Shabbir Motorwala (Speaker) addressing the participants

CA Isha Sekhri (Group Leader) addressing the participants

## Membership & Public Relations Committee

**Half Day Seminar on Tax Audit Reporting Issues with reference to ICDS, Demonetisation – Tax and Legal Issues and Brains' Trust held on 3rd September 2017 at ICAI Hall, Jalgaon.**


Mr. Ajay R. Singh, Advocate (President) inaugurating the Seminar by lighting the lamp. Seen from L to R – CA Niranjan Doshi, CA Nitin Jazawar, CA Devendra Jain (Speaker), CA Mitesh Katira (Speaker), CA Ajay Jain, Mr. Sahebrao Patil, Tax Consultant and CA Smita Bafna


Mr. Ajay R. Singh, Advocate (President) giving opening remarks. Seen from L to R – CA Smita Bafna, CA Ajay Jain, CA Niranjan Doshi, Mr. Sahebrao Patil, Tax Consultant and CA Bhagwan Tiwari.


CA Mitesh Katira (Speaker) addressing the participants

CA Devendra Jain (Speaker) addressing the participants


Dignitaries on the Dais. Seen from L to R : CA Niranjan Doshi, Mr. Ajay R. Singh, Advocate (President), CA Devendra Jain (Speaker) , CA Mitesh Katira (Speaker) and CA Bhagwan Tiwari.

## Student Committee

**Half Day Workshop on Basics of GST, Returns, Accounting and Return Filing Features in Tally held on 11th August, 2017 at Maharashtra Seva Sangh Hall, Mulund**


Dignitaries on dais. Seen from L to R: CA Sachin Maher, CA Sanjeev Lalan (Chairman), CA Sanjay Gajra (Speaker), Mr. Ajay R. Singh, Advocate (President) and CA Parag Sheth (Speaker).


Mr. Ajay R. Singh, Advocate (President) giving opening remarks. Seen from L to R: CA Sachin Maher, CA Sanjeev Lalan (Chairman), CA Sanjay Gajra (Speaker) and CA Parag Sheth (Speaker)


CA Sanjeev Lalan (Chairman) welcoming the Speakers Seen from L to R: CA Sachin Maher, CA Sanjay Gajra (Speaker), Mr. Ajay R. Singh, Advocate (President) and CA Parag Sheth (Speaker)

**Speakers**

CA Sanjay Gajra addressing the participants

CA Parag Sheth addressing the participants

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Date of Publishing 12th of Every Month

# CTC PUBLICATIONS

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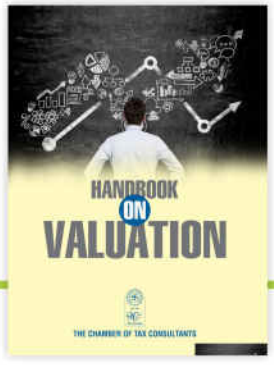


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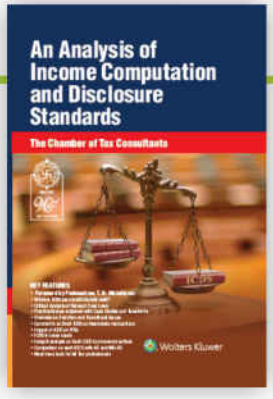


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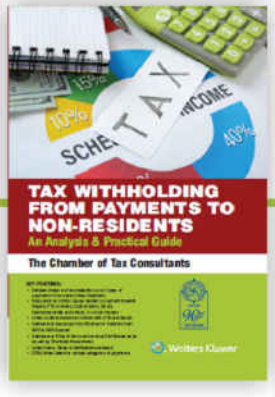


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