

**The ambiguity in the treatment of statutory dues under the Insolvency and Bankruptcy Code 2016:
Rainbow or PVVNL? The Saga Continues**

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The Supreme Court of India (**Supreme Court**) in *State Tax Officer v Rainbow Papers Limited*¹ (**Rainbow Papers Judgment**) held that a statutory authority, in whose favor a charge is created under a statute, would be treated as a secured creditor under the Insolvency and Bankruptcy Code 2016 (**IBC**). The Rainbow Papers Judgment was distinguished by the Supreme Court in *Paschimanchal Vidyut Vitran Nigam Limited v Raman Ispat Private Limited*² (**PVVNL Judgment**). The Supreme Court, in the PVVNL Judgment, observed that the findings in the Rainbow Papers Judgment should be limited to the specific facts of the Rainbow Papers Judgment given that Rainbow Papers Judgment did not consider the priority of claims provided under section 53 of the IBC. Subsequent to the pronouncement of the PVVNL Judgment, the Review Petitioners (*defined below*) filed five review petitions³ before the Supreme Court for review of the Rainbow Papers Judgment (**Review Petitions**). The Supreme Court rejected the Review Petitions on the basis that the scope and ambit of review was not met (**Rainbow Paper Review Judgment**).

Section 53 of the IBC provides for the order of distribution of proceeds from the sale of assets under liquidation (such order of distribution, **Waterfall Mechanism**). In the Waterfall Mechanism, subsequent to the distribution of the insolvency resolution process cost and liquidation cost, the debt owed to secured creditors where such secured creditors have relinquished security (pari passu with workmen dues for a period of twenty-four months preceding liquidation commencement date) is given priority over debt of all other stakeholders.

In this context, we have analysed the three judgments of the Supreme Court and their ramifications in this article.

I. The Rainbow Papers Judgment

- a. The corporate insolvency resolution process (**CIRP**) in respect of Rainbow Papers Limited commenced on 12 September 2017. Rainbow Papers Limited, the corporate debtor, had defaulted on the payment of amount towards value added tax and central sales tax under the Gujarat Value Added Tax Act 2003 (**GVAT Act**). Section 48 of the GVAT Act creates first charge in favor of the state tax department on the property of the defaulter for any outstanding amounts payable under the GVAT Act. Set out below is section 48 of the GVAT Act:

“48. Tax to be first charge on property. - Notwithstanding anything to the contrary contained in any law for the time being in force, any amount payable by a dealer or any other person or

¹ (Civil Appeal Nos. 1661 of 2020).

² (Civil Appeal Nos. 7976 of 2019).

³ Review Petition (Civil) No. 1620, 1621, 1622, 236 and 1623 of 2023 in Civil Appeal No. 1661 of 2020.

account of tax, interest or penalty for which he is liable to pay to the Government shall be a first charge on the property of such dealer, or as the case may be, such person.”

- b. The committee of creditors of Rainbow Papers Limited had approved the resolution plan submitted by Kushal Limited, jointly with Sandip Aggarwal.
- c. Subsequent to the approval of the resolution plan by the committee of creditors, the state tax authority had filed claims in respect of its pending dues with the resolution professional of Rainbow Papers Limited. The resolution professional informed the state tax authority that its claim has been waived under the resolution plan.
- d. The resolution professional of Rainbow Papers Limited filed an application before the National Company Law Tribunal (**NCLT**) for approval of the resolution plan. In this application, the state tax officer filed an interim application contending that government dues cannot be waived off in a resolution plan.
- e. The NCLT, while approving the resolution plan, held that the objection against the resolution plan was not maintainable given that the resolution plan was already approved by the committee of creditors. The National Company Law Appellate Tribunal (**NCLAT**), in an appeal filed by the state tax officer against the NCLT’s decision, held that section 48 of the GVAT Act does not prevail over section 53 of the IBC and that the government cannot claim first charge over the assets of Rainbow Papers Limited. Subsequently, the state tax officer filed an appeal before the Supreme Court against the decision of NCLAT.
- f. The Supreme Court held that a charge created under a statute would create a security interest in favour of the statutory authority making such statutory authority a charge holder and thereby a secured creditor. Further, section 48 of the GVAT Act is not inconsistent with section 53 or any other provisions of the IBC. The Supreme Court held that the debt arising out of or in connection with the GVAT Act will be secured debt and will fall under section 53(1)(b)(ii) of the IBC which provides for priority of dues to secured creditors. Thus, the Supreme Court set aside the NCLAT’s order along with the approved resolution plan and provided the resolution professional with an opportunity to consider fresh resolution plans.

II. The PVVNL Judgment

- a. Paschimanchal Vidyut Vitran Nigam Limited (**PVVNL**) had entered into an agreement with Raman Ispat Private Limited (**Raman Ispat**) for the supply of electricity. Given that Raman Ispat had failed to repay the electricity bills, PVVNL attached the properties of Raman Ispat. Under clause 4.3(f)(iv) of the Uttar Pradesh Electricity Supply Code 2005, the outstanding electricity dues constituted a charge on the assets of the debtor in favor of the state tax department. Set out below is clause 4.3(f)(iv) of the Uttar Pradesh Electricity Supply Code 2005:

“(iv) The outstanding dues will be first charge on the assets of the company, and the licensee shall ensure that this is entered in an agreement with new applicant”.

- b. As a part of recovery proceedings initiated by PVVNL against Raman Ispat for recovery of its dues, the tehsildar created a charge over the assets of the Raman Ispat by way of its order dated 23 January 2016.
- c. Subsequently, the CIRP in respect of Raman Ispat commenced on 11 April 2017 under the provisions of the IBC. Given that the resolution plan submitted by a resolution applicant was rejected by the committee of creditors, the NCLT Allahabad passed an order for commencement of liquidation proceedings in respect of Raman Ispat. The liquidator approached the NCLT for setting aside of the attachment orders to be able to sell the assets of Raman Ispat under liquidation proceedings under the IBC. The NCLT directed the tehsildar to release the attached property to enable the liquidator to sell the property and distribute the proceeds of the sale in accordance with the provisions of the IBC. This order of the NCLT was also upheld by the NCLAT. Aggrieved by this order of the NCLAT, PVVNL filed an appeal before the Supreme Court.

Statutory Dues v Government Dues

- d. The Supreme Court distinguished statutory dues from government dues and held that not all dues owed under a statute would amount to government dues. The statutory corporations created under a statute are distinct juristic entities. Albeit such statutory corporations might have government participation, but these are not government authorities. For statutory corporations, the dues may be of operational, financial and/or secured in nature depending upon the underlying transaction. For instance, in the PVVNL Judgment, PVVNL was supplying electricity to Raman Ispat which is not a statutory function given that electricity can be supplied by private entities as well. Given this, the Supreme Court held that the dues owed to PVVNL were not government dues.
- e. While distinguishing government dues from statutory dues, the Supreme Court observed that the dues which are payable or required to be credited to the treasury such as tax, tariffs etc. which broadly fall within the ambit of Article 265 of the Constitution of India are government dues. Given that PVVNL was not performing a statutory function, the Supreme Court held that its dues will not amount to government dues. The Supreme Court, therefore, directed the liquidator to decide the claim in the manner required by law.

Supremacy of the IBC over the Electricity Act

- f. The Supreme Court relied on *Sundaresh Bhatt, Liquidator of ABG Shipyard v Central Board of Indirect Taxes and Customs*⁴ (**Sundaresh Bhatt Judgment**) to uphold the supremacy of the IBC over the Electricity Act 2003 (**Electricity Act**). In the Sundaresh Bhatt Judgment, it was held

⁴ (2022 SCC Online SC 1101).

that the moratorium under section 14 and section 33 of the IBC prohibits the statutory authority i.e., Central Board of Indirect Taxes and Customs from recovering its dues through sale/confiscation of assets of the corporate debtor. The Supreme Court held that the IBC would prevail over Customs Act 1962 (**Customs Act**) and the authority under the Customs Act cannot initiate recovery of dues during the period of moratorium. In the PVVNL Judgment, the Supreme Court ordered the tehsildar to remove the attachment over the assets of Raman Ispat. However, given that the Sundaresh Bhatt Judgement is on applicability of the moratorium over proceedings of the custom authorities, the ruling of the Supreme Court that the IBC takes precedence over the Customs Act is not applicable in context of priority of secured government dues.

Rainbow Papers Distinguished

- g. The Rainbow Papers Judgment was a shift from the general legal position which provides that dues owed to government authorities should be given lower priority in the Waterfall Mechanism. In relation to this, the Ministry of Corporate Affairs, in its discussion paper dated 18 January 2023 has also proposed to amend the IBC to provide that *'all debts owed to Central Government and the State Government, irrespective of whether they are secured creditors pursuant to a security interest created by a mere operation of statute (and in absence of any consensual transaction), shall be treated equally with other unsecured creditors'*. This intent is also reflected in the preamble of the IBC, as reproduced below:

*"An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders **including alteration in the order of priority of payment of Government dues** and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto."*

- h. The PVVNL Judgment also clarified the issues which had arisen from the Rainbow Papers Judgment. The Supreme Court observed that the Rainbow Papers Judgment appears to have missed the Waterfall Mechanism. Further, it was noted that the Rainbow Papers Judgment was in context of CIRP whereas the factual matrix in the PVVNL Judgment is in context of liquidation. The Supreme Court observed that the Rainbow Papers Judgment has not considered the Waterfall Mechanism under the IBC for treatment given to dues payable to the Central or State Government.

III. Review of the Rainbow Papers Judgment

- a. The petitioners, Sanjay Kumar Agarwal, Ramchandra Dallaram Choudhary, State Bank of India, Chandra Prakash Jain, and Indian Overseas Bank (**Review Petitioners**) had filed the Review Petitions before the Supreme Court for review of the Rainbow Papers Judgment. The Review Petitioners submitted that the Supreme Court in the Rainbow Papers Judgment had failed to consider the Waterfall Mechanism under section 53 of the IBC.

- b. The Supreme Court, in the Rainbow Paper Review Judgment, observed that the Review Petitions have been filed primarily on the basis of the observations made by the Supreme Court in the PVVNL Judgment. The Supreme Court observed that the strength of the bench in the PVVNL Judgment was same as the strength of the bench which had delivered the Rainbow Papers Judgment. Given this, the observations made by Supreme Court in the PVVNL Judgment cannot be used as a ground to review the Rainbow Papers Judgment. Further, the Supreme Court held that the Rainbow Papers Judgment has considered the Waterfall Mechanism and other relevant provisions of the IBC. Thus, there exist no ground for maintainability of review of the Rainbow Papers Judgment.

IV. Applicability of the Rainbow Papers Judgment

- a. The applicability of the Rainbow Papers Judgment has been distinguished by the various NCLTs even before the PVVNL Judgment.

Statutes with savings clause for the IBC

- b. In the Rainbow Papers Judgment, given that the underlying statute created security interest in favour of the state tax authority, it was held that state tax authority was a secured creditor. However, certain statutes which creates security interest in favour of statutory authority also includes a savings clause for the application of the IBC. For example, such specific exclusion is provided under section 82 of the Central Goods and Services Tax Act 2017 as set out below:

*“Notwithstanding anything to the contrary contained in any law for the time being in force, **save as otherwise provided in the Insolvency and Bankruptcy Code, 2016 (31 of 2016)**, any amount payable by a taxable person or any other person on account of tax, interest or penalty which he is liable to pay to the Government shall be a first charge on the property of such taxable person or such person.”*

This means that the application of IBC takes precedence over application of the underlying provision of the statute which creates security interest in favour of statutory authority. In such cases, it is held that the Rainbow Paper Judgment will not be applicable.

- c. The NCLAT New Delhi in *Jet Aircraft Maintenance Engineers Welfare Association v Ashish Chhawchharia, Resolution Professional of Jet Airways (India) Limited and Ors.*⁵ (**Jet Airways Case**) observed that the ruling in the Rainbow Papers Judgment could not be applied in the Jet Airways Case due to the specific exemption under section 82 of the Maharashtra Goods and Services Tax Act 2017 (**Maharashtra GST Act**) which provides for precedence of the IBC over section 82 of Maharashtra GST Act.

⁵ (CA (AT) (Ins) No. 752 of 2021)

- d. In a similar situation the Delhi High Court, in *Sree Metaliks Limited v Additional Director General and Others*⁶ (**Sree Metaliks Case**), distinguished the Rainbow Papers Judgment. Under section 142A of the Customs Act, the dues of customs authorities had first charge in respect of liability under the Customs Act. In the Sree Metaliks Case, it was held that given that specific exemption is provided under section 142A of the Customs Act which provides for precedence of the IBC over section 142A of the Customs Act, the Rainbow Papers Judgment will not be applicable. Further, it was observed that the factual matrix in the Rainbow Papers Judgment was different given that it involved the filing of the claim post the last date of submission of claims and after the resolution plan was approved by the NCLT. However, in the Sree Metaliks Case the statutory authorities never submitted the proof of claim.

Statutes not creating security interest in favour of government authorities

- e. In cases where the underlying statute in respect of government dues does not provide for creation of a security interest, it is held that the Rainbow Paper Judgment will not be applicable.
- f. The Income Tax Act 1961 does not provide for creation of charge in favour of income tax department. In *PR Commissioner of Income Tax v Monnet Ispat and Energy Limited*⁷, in the context of income tax dues, it was held that the government dues cannot be given precedence over secured creditor dues, who are private persons.
- g. Similarly, in *Income Tax Department v Mr. G. Madhusudan Rao RP & Anr*⁸, it was submitted by the income tax department that it was a secured operational creditor and was entitled to the benefit of the Rainbow Papers Judgment. The NCLAT however held that in the Rainbow Papers Judgment, the operational creditor was held to be a secured creditor on the basis of relevant statutory provisions whereas in this case there is no basis to contend that income tax department is a secured operational creditor.
- h. The Rainbow Paper Review Judgment was expected to settle the ambiguity regarding the treatment of dues of a statutory authority in favor of whom a charge is created under a statute. Given the dismissal of the Review Petitions, the uncertainty still persists given that the two decisions of benches which have equal strength have provided different views in relation to such dues. However, it may be inferred from the Jet Airways Case and the Sree Metaliks Case that the Rainbow Papers Judgment will not have application in cases where the specific exemption is provided under the underlying provision for precedence of the IBC over such provision.

⁶ (2023 SCC OnLine Del 941).

⁷ (208)18SCC786.

⁸ CA (AT) (Insolvency) No. 1302 of 2023.

V. The legal position post the PVVNL Judgment

- a. The PVVNL Judgment has been followed by the NCLAT and NCLTs while adjudicating on the treatment of statutory dues under the IBC. The NCLAT in *Assistant Commissioner of Commercial Taxes LGSTO v Alok Kailash Saksena and Ors*⁹ relied on the PVVNL Judgment to hold that the claim under section 82 of the Karnataka Goods and Services Act 2017 would not constitute first charge at par with secured creditors due to the specific exemption provided under section 82 of the Karnataka Goods and Services Act 2017.
- b. Various NCLTs have also followed the PVVNL Judgment. The NCLT Chennai in the CIRP of *M/s. UCAL Products Private Limited*¹⁰ relied on the PVVNL Judgment to hold that the dues of the government in the absence of creation of security interest cannot be treated at par with the secured creditors. Such cases also include *State Bank of India v Mackeil Ispat & Forging Limited*¹¹ and *M/s Positron Biogenics Private Limited v Kanpur Electricity Supply Company Limited & Ors*¹² where it was held that the IBC has supremacy over the Electricity Supply Code 2005.

VI. Conclusion

- a. The Supreme Court has held the primacy of the IBC over other statutes in the PVVNL Judgment. Further, it bolsters the intent of the IBC to provide primacy to the claims of the creditors over government dues.

Validity of distinguishment of the Rainbow Papers Judgment by the PVVNL Judgment

- b. The PVVNL Judgment cannot distinguish the Rainbow Papers Judgment for the reasons set out below:
 - i. Both the PVVNL Judgment and the Rainbow Papers Judgment are pronounced by benches of equal strength. Given this, the PVVNL Judgment does not overrule the Rainbow Papers Judgment.
 - ii. The Rainbow Papers Judgment is in context of resolution plan submitted in the CIRP under the IBC whereas the PVVNL Judgment is in context of the liquidation process under the IBC.
 - iii. The Rainbow Papers Judgment deals with the dues of a government entity whereas the PVVNL Judgment deals with the dues of a private statutory entity. Additionally, in the PVVNL Judgment the Supreme Court did not make a determination on secured

⁹ (CA (AT) (CH)(Ins) No. 302/2023).

¹⁰ (IA (IBC)/1113 (CHE) 2023 in CP (IB)/78 (CHE)2021).

¹¹ (I.A. (IB) No. 1336/KB/2022 in I.A (IB) No. 463/KB/2022 in CP (IB) No. 213/KB/2019).

¹² (IA No. 99/2023 in CP (IB) No. 55/ALD/2017).

or unsecured status of the dues of private statutory entity and directed the liquidator to make such determination in accordance with law.

- c. As stated above, the facts and determination of the Rainbow Papers Judgment and the PVVNL Judgment are distinct, and the Supreme Court in the PVVNL Judgment seems to have only made an observation in respect of the Rainbow Papers Judgment. Given this, the PVVNL Judgment should not be applicable in the context of treatment of secured statutory dues in a resolution plan under the IBC.

Impact of dismissal of review of the Rainbow Papers Judgment

- d. The Rainbow Papers Judgment has effectively made the payment of secured government dues a mandatory content for approval of a resolution plan. Given this, financial creditors are required to take a higher haircut which will impact the overall recovery for financial creditors under the IBC.
- e. Additionally, given the dismissal of the Review Petitions, the ambiguity in the treatment of statutory dues continue to persist with the PVVNL Judgment and the Rainbow Papers Judgment providing for different treatments to statutory dues. A reference to a larger bench of the Supreme Court is required to clear the ambiguity created by the different rulings on this crucial question of law. However, one aspect is clear that in view of the precedents following the Rainbow Papers Judgment, the Rainbow Papers Judgment will not be applicable in cases where the underlying provision for creation of security interest also provides for a specific exemption for precedence of the IBC over such provision.