

The Clean Slate Doctrine and the tax quandary

By: Ravi S. Raghavan, Partner, Tax and Private Client Group, Majmudar & Partners, India

Background

The Clean Slate Doctrine is a key legal principle embedded in the Insolvency and Bankruptcy Code, 2016 (“**IBC**”), which plays a pivotal role in the corporate insolvency process in India. The doctrine suggests that once a company successfully undergoes the insolvency resolution process and is taken over by a new buyer, the new owner should not be held accountable for any of the company’s pre-existing debts, penalties, or liabilities. This principle is designed to give the company a fresh start, essentially, a “clean slate” free from the baggage of its prior financial troubles. The Clean Slate Doctrine has been upheld in several landmark rulings by India’s Supreme Court, reaffirming its crucial role in the IBC framework.

In the *Essar Steel India* case, India’s Supreme Court (“**SC**”) emphasized that one of the primary objectives of the IBC is to streamline insolvency procedures in India and bring all claims under a unified system. The SC ruled that once a resolution plan is approved by the National Company Law Tribunal (“**NCLT**”), any and all previous liabilities, including debts and penalties, are extinguished. This means no party can initiate or continue any legal proceedings related to a claim that is not included in the approved resolution plan.

In the *Edelweiss Asset Reconstruction* case, the SC held that government dues, such as taxes and duties, are extinguished if they are not part of the resolution plan.

In the *Surya Exim* case, the Gujarat High Court, following the SC rulings, held that any tax demands issued after the NCLT’s approval of a resolution plan should be cancelled, reinforcing the idea that claims not included in the approved plan are no longer valid.

Despite these judicial rulings, recent developments have raised concerns about the continued enforcement of the Clean Slate Doctrine. Reports suggest that Indian tax authorities, including the Goods and Services Tax (“**GST**”) authorities, have issued notices to companies like Tata Steel and B&B Global Enterprises, both of which successfully underwent the IBC resolution process, demanding payment of pre-resolution GST dues on outstanding tax assessments. The chief argument of the tax authorities is that statutory dues, such as taxes, are sovereign in nature and are not subject to the same treatment as other liabilities in the IBC resolution process. Unless these dues are explicitly waived, they argue, tax claims survive the insolvency resolution, as they cannot be overridden by the provisions of the IBC.

Our comments

Section 31 of the IBC clearly provides that once a resolution plan is approved by the NCLT, it is binding on all stakeholders including the corporate debtor, its creditors, employees, and even the tax authorities. If the tax authorities fail to file their claims during the insolvency proceedings, they should not be allowed to assert such claims afterwards. This is especially true in cases where the authorities do not actively participate in the resolution process or

miss the filing deadlines, only to return with notices post-approval. Such actions are legally unjustifiable and procedurally flawed. The IBC framework is built on judicial discipline, with High Court and Supreme Court precedents setting the tone for lower authorities to follow. Allowing tax authorities to act in contradiction to these rulings erodes this discipline. By going after companies post-resolution, the Indian tax and GST authorities are not only contravening Supreme Court rulings, but they are also undermining the entire IBC framework, creating confusion, and adding to the legal and financial uncertainty that plagues businesses in the country.

The primary objective of the IBC is to facilitate the revival of distressed companies, and the Clean Slate Doctrine is crucial to this objective. If businesses that go through the IBC resolution process are burdened with past financial and legal liabilities, particularly tax claims that are initiated after the resolution, then the very purpose of the insolvency framework is undermined. Potential investors, wary of inheriting unresolved liabilities, will be hesitant to participate in the IBC process, stymying the revival of distressed companies.

It is imperative that there is clearer administrative discipline within tax departments and greater coordination between insolvency professionals and tax officers. What is needed urgently is a directive from the Central Board of Direct Taxes, Ministry of Finance, refraining Indian tax officers from making tax or GST demands on companies that have undergone an IBC resolution process.