

ACUITY **LAW**

**INSOLVENCY  
LAW NEWSLETTER**

FEBRUARY 2021  
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## ABOUT ACUITY LAW LLP

Acuity Law LLP was founded in November 2011. Acuity Law LLP comprises of a team of young and energetic lawyers/ professionals led by Souvik Ganguly, Gautam Narayan and Deni Shah who have deep and diverse experiences in their chosen areas of practice. We advise Indian and multinational companies, funds, banks and financial institutions, founders of companies, management teams, international law firms, domestic and international investment banks, financial advisors and government agencies in various transactions in and outside India.

Acuity Law LLP takes pride in rendering incisive legal advice taking into consideration commercial realities. Our areas of practice are divided into three departments. The Corporate practice is led by Souvik Ganguly, the Global Trade and Tax practice is led by Deni Shah and the Disputes practice is led by Gautam Narayan.

As part of the Corporate practice, Acuity Law LLP advises on:

- Mergers and acquisitions;
- Distressed mergers and acquisitions;
- Insolvency Law;
- Private Equity and Venture Funding;
- Employment and labour laws;
- Commercial and trading arrangements; and
- Corporate Advisory

As part of the Global Trade and Tax practice, Acuity Law LLP under the leadership of Deni Shah advises on:

- Cross-border tax planning and jurisdiction analysis
- Strategies for acquisitions, mergers, divestitures, diversification or consolidation of businesses
- Inbound and outbound investment structuring
- Endowment planning / wealth management strategies
- Global Trade & Customs laws, including foreign trade policy
- International supply chain optimization
- Goods & Services Tax and other Indirect taxes

As part of the Disputes practice, Acuity Law LLP under the leadership of Gautam Narayan advises and represents clients on domestic and cross - border:

- Civil disputes;
- Criminal law matters; and
- Arbitration matters

Acuity Law LLP actively follows legislative and policy developments in its chosen areas of practice and shares such developments with clients and friends on a regular basis.

If you want to know more about Acuity Law LLP, please visit our website [acuitylaw.co.in](http://acuitylaw.co.in) or write to us at [al@acuitylaw.co.in](mailto:al@acuitylaw.co.in).

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## INTRODUCTION

This newsletter covers key updates about developments in Insolvency Law during the month of February 2021.

We have summarized the key judgments passed by the Supreme Court of India (“**SC**”) and the National Company Law Appellate Tribunal (“**NCLAT**”). Please see below the summary of the relevant regulatory developments.

### 1) **TRANSACTIONS BETWEEN THE CORPORATE DEBTOR AND RELATED PARTIES THAT ARE COLLUSIVE IN NATURE DO NOT QUALIFY AS FINANCIAL DEBT FOR THE PURPOSE OF INSOLVENCY AND BANKRUPTCY CODE, 2016 (“IBC”)**

**Matter:** Pheonix ARC Private Limited v. Spade Financial Services Limited & Others.

**Order dated:** 01 February 2021

#### **Summary:**

Under the IBC, financial creditors that are related parties of the corporate debtor are excluded from the Committee of Creditors (“**CoC**”). This is to prevent such related parties from controlling the CoC to unfairly benefit the corporate debtor. In the present case, the National Company Law Tribunal (“**NCLT**”) held that AAA Landmark Private Limited (“**AAA**”) and Spade Financial Services Private Limited (“**Spade**”) are related parties of AKME Projects Limited (“**Corporate Debtor**”), and the transactions between Corporate Debtor and Spade and AAA are collusive in nature and do not qualify as financial debt for the purpose of the IBC. In the appeal, NCLAT held that although Spade and AAA are financial creditors, they are related parties of the Corporate Debtor and therefore to be excluded from the CoC.

In the appeal, the SC considered the following issues:

- (i) Whether Spade and AAA are financial creditors of the Corporate Debtor ?
- (ii) Whether Spade and AAA are related parties of the Corporate Debtor ?
- (iii) Whether Spade and AAA have to be excluded from the CoC?

The three judge bench of the SC observed that the commercial arrangements between Spade and AAA, and the Corporate Debtor were collusive in nature, and executed only to create an illusion that money was disbursed from Spade and AAA to the Corporate Debtor. In fact, the parties had entered into the transaction with an ulterior motive of ensuring that Spade and AAA can be part of CoC. The real nature of the transactions had to be unearthed in order to prevent any person from taking undue benefit of the provisions of IBC to the detriment of the rights of legitimate creditors of the Corporate Debtor. The SC also took note of the close relationship between the key managerial personnel of the Corporate Debtor, Mr. Anil Nanda and the director of Spade and AAA, Mr. Arun Anand. It also observed that Mr. Arun Anand had served as an employee in various companies of Mr. Anil Nanda and was even previously a shareholder and director of the Corporate Debtor.

The SC was of the opinion that there existed a deeply entangled relationship between Spade, AAA and Corporate Debtor, when the alleged financial debt arose. Even if their present status as related parties may no longer stand, there was a pervasive influence of Mr Anil Nanda over Spade and AAA and allowing them in the CoC would definitely affect the other independent financial creditors. The decision of the NCLAT, in as much as it referred to Spade and AAA as financial creditors, was set aside by the SC. Whereas decision of the NCLAT, in as much as it referred to Spade and AAA as related parties of the Corporate Debtor and excluded them from the CoC was affirmed.

### 2) **A BUYER WHO PURCHASES AN IMMOVEABLE PROPERTY THROUGH AUCTION FROM A COMPANY UNDERGOING LIQUIDATION UNDER IBC, IS NOT REQUIRED TO DEDUCT TAX AT SOURCE FROM THE SALE CONSIDERATION, AT THE TIME OF MAKING PAYMENT FOR SUCH TRANSACTION.**

**Matter:** Om Prakash Agrawal, Liquidator of S. Kumars Nationwide Limited v. Chief Commissioner of Income Tax (TDS) & Another.

**Order dated:** 08 February 2021

#### **Summary**

The Liquidator filed an application before NCLT against the successful bidder of assets of the corporate debtor and the income tax authority. The Liquidator sought directions from the NCLT that Tax Deducted at Source (“**TDS**”) should not be deducted from the sale consideration. The contention of the Liquidator was that income tax dues can be recovered by the department as per waterfall mechanism set out under section 53 of the IBC. The NCLT dismissed the application and an appeal was preferred by the Liquidator before NCLAT.

NCLAT observed that as per section 194 IA of the Income Tax Act, 1961 (“**IT Act**”), 1% TDS is recovered on priority to other creditors of the transferor, which is partial capital gain tax, whereas section 53 of the IBC provides for a waterfall mechanism in which the government dues comes fifth in the order of priority. Therefore, there is inconsistency between section 194 IA of the IT Act and section 53 of the IBC. However, section 238 of the IBC grants overriding effect on the inconsistent provisions of IT Act, and accordingly TDS cannot be deducted and paid to the income tax authority in priority to other creditors. NCLAT set aside the order of NCLT and further directed the income tax authority to refund the TDS amount to the Liquidator.

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