

Interplay Between Tax Laws and Insolvency and Bankruptcy Code on Liquidation

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ABSTRACT

The Insolvency and Bankruptcy Code, 2016 was passed to provide a clear set of rules for bankruptcy resolution and liquidation in India. Its goal is to make it easier to resolve claims quickly and get the most money possible. Still, its interaction with present Indian tax laws has made things very difficult, particularly when it comes to sorting out and prioritising tax claims during liquidation proceedings. The Code puts government debts lower on the list of priorities, but traditional tax laws generally put the government first, which leads to confusion and disagreement. This study analyses the interplay between tax claims and liquidation processes under the IBC, alongside the challenges in reconciling the divergent interests of creditors and tax authorities. The used methodology is doctrinal and analytical, using legislative interpretation, judicial precedents from the Supreme Court, NCLT, and NCLAT, with comparative analyses from the United States, the United Kingdom, and Singapore. Secondary literature and policy papers have been analysed to include the wider academic and policy discourses. The findings show that there is always a contradiction between the IBC's waterfall procedure as described in Section 53 and the claims made by tax authorities under other laws at the same time. Judicial interpretations, while mostly affirming the primacy of the IBC, have sometimes resulted in ambiguity, shown by cases such as Rainbow Papers. These arguments cause delays, unpredictable recoveries, and less confidence from creditors in the bankruptcy process. This article improves the current conversation by making clear the similarities and differences between tax law and the IBC framework. It calls for further harmonisation via reforms to the law and procedures to make liquidation processes more predictable, fair, and efficient, while also balancing the needs of creditors, tax authorities, and the economy as a whole

Keywords: *Insolvency, Bankruptcy, Liquidation, Tax laws, Committee of creditors, Recovery of debt, Sovereign claims, Tax loss, Banks, Secured creditors, Operational creditors*

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (IBC) was made to bring together and change all of India's laws around insolvency and bankruptcy. It was created to provide a structured and time-bound process for settling bankruptcies and liquidating businesses, partnerships, and people. This makes it easier for businesses to operate and protect the interests of creditors. The IBC intends to bring together the long and complicated insolvency processes that are spread out over various laws so that asset value is maximised, stakeholder interests are adequately addressed, and businesses are either rehabilitated or liquidated in a fair and open way. The creation of a single, unified code is a major transformation in India's financial and business system. However, putting it into action has caused a number of complicated challenges, particularly when it comes to how it interacts with current laws. A major issue is how to handle tax demands throughout the liquidation process. The State, via its tax authorities, often asserts its right to recover statutory liabilities such as income tax, goods and services tax, excise charges, and other indirect taxes. On the other hand, private creditors, such as both secured and unsecured financial institutions, try to make their claims in conformity with the priority distribution scheme set forth in Section 53 of the IBC. This creates a basic tension between the government's need for money and the rights of creditors, who both want a piece of the debtor's limited assets. There has been a lot of talk over whether tax debts should come before other debts or be treated as operational debts that are the same as trade debts. This is because the answer has a big impact on how much money stakeholders may get back in liquidation. The problem is clearer when one looks at how the IBC rules and tax laws don't line up. Section 53 of the IBC describes the "waterfall mechanism," a structured hierarchy that sets the order in which liquidation monies should be distributed. Still, tax laws like the Income Tax Act, 1961 and the Goods and Services Tax (GST) Act of 2017 make it clear that government debts come first. This duality has led to jurisdictional overlaps and conflicting interpretations, as both tax officials and bankruptcy professionals attempt to assert the superiority of their own frameworks. Judicial decisions have attempted to clarify the boundaries of Section 53 regarding statutory tax claims; nonetheless, inconsistencies in judgements and a deficiency in legal coherence continue to create uncertainty for stakeholders.

This underscores a notable research gap: the lack of clarity and coherence between the taxation system and the bankruptcy resolution and liquidation mechanism established by the IBC. The Code was created to provide a uniform and predictable way of doing things. However, its connection with current tax laws has caused confusion, which has made liquidation procedures less fair and less efficient. Additionally, there is insufficient thorough academic and policy research into the ideal resolution of these opposing interests without undermining the State's revenue needs or the entitlements of creditors. Fixing this problem is important to strengthen the insolvency system, make sure assets are fairly divided, and keep the IBC's principal goal of maximising value and economic stability. The Insolvency and Bankruptcy Code, 2016 (IBC) is one of the most important legal and economic changes in India in a long time. Before it was put into effect, the Sick Industrial Companies (Special Provisions) Act, 1985, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, and the Companies Act, 1956 all had different rules for dealing with insolvency and liquidation. This fragmentation often resulted in protracted litigation, asset value loss, and uncertainty for both creditors and debtors. The IBC was created to be a unified system that would help resolve bankruptcies, quickly close down companies that weren't making money, and get the most value for stakeholders' assets. The Code's emphasis on creditor-driven processes and strict deadlines was meant to make India's business climate better and boost investor confidence. Even nevertheless, the interaction between the IBC and other existing laws, notably tax laws, has led to complicated legal and policy debates that have not yet been settled. One of the main issues is how to deal with government tax requests during liquidation. The State, as a sovereign organisation, often has precedence in revenue collection, a principle established in many tax laws, including the Income Tax Act of 1961 and the Goods and Services Tax Act of 2017. The IBC, on the other hand, breaks from this long-held view by classifying government debts as operational obligations. This gives them a lower priority in the distribution structure set forth in Section 53. The "waterfall mechanism" puts secured creditors, employee pay, and the costs of resolving bankruptcy ahead of tax payments. This method has produced conflicts between debtors and tax authorities since it has a direct impact on how much money the government can get back. In the case of *PR Commissioner of Income Tax v. Monnet Ispat and Energy Ltd.* (2018), the Supreme Court made it clear that the insolvency and Bankruptcy Code (IBC) takes precedence over the Income Tax Act in bankruptcy situations. This means that Section 238 of the Code, which has an overriding effect over conflicting statutes, is the most important part of the Code. This verdict made it clear that the goal of the law is to protect creditors' rights and speed up settlements. However, it also led to questions about how the State's fiscal claims may lose value and how that would affect public revenue collection. Judicial decisions have always tried to find a way to balance this complicated situation. The Supreme Court's decision in *State Tax Officer v. Rainbow Papers Ltd.* (2022) offered a distinct interpretation by concluding that government dues protected under the Gujarat VAT Act could not be categorised exclusively as operational debt, as the statutory lien imposed on assets designated the State as a secured creditor. This decision caused uncertainty in the law, which led to different

ways of enforcing Section 53. The Supreme Court of India in the case of *Monnet Ispat Ltd.* upheld the primacy of the IBC's waterfall procedure, whereas in case of *Rainbow Papers* re-examined the question of whether tax authorities might achieve equivalence with secured creditors under certain circumstances. These different interpretations not only make things unclear for bankruptcy lawyers and creditors, but they also show how hard it is to make insolvency laws and tax laws work together. Outside of court, people are talking about policy issues related to how to prioritise claims in liquidation. People who support the IBC's structure say that putting tax claims first will make it harder to get credit, make it harder to invest, and lower the overall recovery for secured creditors. This will make the Code's main goal of maximising value less effective. On the other hand, tax officials and some politicians say that making it harder for the government to collect money hurts the public purse and makes it harder to stick to the budget. The Insolvency and Bankruptcy Board of India (IBBI) and the Ministry of Corporate Affairs (MCA) have both acknowledged this problem, but they have not yet come up with a clear plan on how to fix it via legislation. Scholarly discourse has underscored the need for more specific legislative guidance and uniform judicial interpretation to prevent protracted litigation that undermines the Code's effectiveness. The research gap in this area is that there isn't enough clarity and congruence between the IBC's insolvency structure and tax laws. The Code strives to provide a reliable and prompt settlement process; nevertheless, the inconsistent treatment of tax claims in judicial decisions and legislative measures has led to legal uncertainty. Insolvency practitioners, creditors, and tax authorities are unsure about how enforceable claims are, how much the government should be owed during liquidation, and how much Section 238 of the IBC should take precedence over tax law. Lack of harmonisation makes liquidation less efficient and puts the IBC's main aims at risk. To strengthen the bankruptcy framework, ensure equitable distribution of liquidation profits, and find a long-term balance between public revenue interests and creditor rights in India's changing financial environment, it is important to address this gap via doctrinal and analytical investigation.

Material

This study utilises a doctrinal and analytical legal research technique to examine the link between tax law and the Insolvency and Bankruptcy Code, 2016 (IBC), with a particular emphasis on liquidation. A doctrinal approach is considered the most suitable, since the study primarily relies on existing legal frameworks, legislative laws, judicial decisions, and scholarly commentary to build a comprehensive understanding of the subject matter. The analytical component is used to evaluate the practical implications of legal acts and case law interpretations, therefore revealing inconsistencies and conflicts that arise throughout liquidation procedures. This comprehensive methodology allows a thorough examination of the black-letter law in conjunction with an exploration of its practical applications and limitations. This study employs data from both primary and secondary sources. Primary sources include legislative statutes, such as the Insolvency and Bankruptcy Code, 2016, the Income Tax Act, 1961, and Goods and Services Tax legislation, along with other tax-related rules that directly impact the liquidation process. Judicial precedents represent an essential component of the dataset, encompassing landmark decisions rendered by the National Company Law Tribunal (NCLT), the National Company Law Appellate Tribunal (NCLAT), and the Supreme Court of India, which have profoundly impacted the interpretation of tax claims in insolvency proceedings. Additionally, publications, discussion papers, and recommendations issued by the Insolvency and Bankruptcy Board of India (IBBI) and the Ministry of Corporate Affairs are used to understand the regulatory perspective and policy aims behind the IBC framework. Secondary sources, such as scholarly articles, critiques, and policy papers, provide vital insights and theoretical underpinnings that enrich the discourse and contextualise the issues within a more expansive legal and economic framework. The analytical methodology combines comparison and critical methodologies to provide a complete understanding of the issues. A comparative analysis of legislative provisions is undertaken to assess the interplay between the IBC framework and concurrent tax law, ascertaining whether one regime effectively prevails over the other. In this process, it is very important to understand case law since court decisions not only decide individual cases but also set precedents that affect the whole insolvency framework. The study identifies similarities in judicial reasoning, inconsistencies in interpretation, and emerging trends in the management of government debts during liquidation via a meticulous analysis of case law. A thorough look at the real-world problems that come up during liquidation proceedings adds to the doctrinal analysis, especially when it comes to the different interests of tax authorities and private creditors, the problems that insolvency practitioners have to deal with, and the uncertainty about how to enforce Section 53 of the IBC in relation to tax laws. This all-encompassing approach ensures that the research goes beyond theoretical concepts and engages with the tangible realities of liquidation operations, therefore yielding findings that are both legally sound and practically applicable.

RESULTS

The analysis of Section 53 of the Insolvency and Bankruptcy Code, 2016, clarifies the complex legal and policy dilemmas concerning the priority of tax claims in liquidation proceedings. Section 53 lays forth a clear "waterfall mechanism" for how money from the sale of a corporate debtor's assets would be divided. The costs of settling a bankruptcy case and liquidating the business are at the top of this list. Next are secured creditors and workers' rights, employee pay, debts to unsecured creditors, and finally, government debts and residual debts. The legislation made it clear that government debts should be paid after secured and unsecured financial creditors in the distribution order. This was done to protect private creditors, whose money typically promotes business and credit growth, during bankruptcy. This means that there has been a planned change in policy from the previous position set by earlier laws, which put national commitments first. This section has caused a lot of debate, particularly when it comes to tax laws like the Income Tax Act of 1961 and the Goods and Services Tax Act of 2017, which both set forth legal duties for paying taxes to the State. Tax officials say that their claims should be given priority, and they sometimes point to parts of tax law that say government debts should come before other debts. Section 238 of the IBC makes it very clear that its rules take precedence over any other laws that could clash with them. This means that the waterfall system in Section 53 should take precedence over the priority given to tax claims under other laws. The Supreme Court ruled in the case of *PR Commissioner of Income Tax v. Monnet Ispat & Energy Ltd.* that the IBC takes precedence over the Income Tax Act in bankruptcy cases. This shows that the courts have always backed this view. Such rulings reinforce the legislative intent to prioritise tax claims within the organised sequence of distribution specified in Section 53.

Still, the issue is not settled. The Supreme Court's decision in *State Tax Officer v. Rainbow Papers Ltd.* created a significant exception by recognising statutory charges under the VAT Act as secured debts. This meant that some tax claims were given priority in the waterfall hierarchy. This position, based on the exact language of the VAT Act, made the IBC's structure less clear and less trustworthy by making it hard to tell the difference between secured creditors and government agencies. The ruling has created a level of confusion in practice, as bankruptcy specialists, creditors, and tax authorities deal with conflicting precedents. In some situations, tax claims have been relegated to a junior status within the waterfall system, whilst in other others, they have been priority due to the existence of statutory charges.

Looking at Section 53 shows how the IBC's focus on creditors is at odds with the State's goal of safeguarding revenue. The Code's framework is meant to maximise value for creditors and make liquidation more predictable. However, the fact that courts recognise statutory charges makes the outcomes less consistent. The conversation goes beyond legal details to talk about bigger economic and policy issues, such as putting creditors ahead of the State encourages more lending and investment, or whether making it harder for the government to collect taxes puts the budget at risk. The practical result is that how tax claims are handled under Section 53 depends on how the courts read it and which parts of tax law are employed. This shows how important it is to harmonise legislation or policy at a higher level to deal with these conflicting interests.

Judicial trends in interpreting the Insolvency and Bankruptcy Code, particularly on the management of tax claims during liquidation, reflect a dynamic and sometimes contentious legal landscape. The Supreme Court has had a big effect on this argument by giving historic rulings that support the IBC's main effect, while also recognising certain legal problems that make it hard to use it consistently. The Court made a clear decision in *PR Commissioner of Income Tax v. Monnet Ispat and Energy Ltd.* (2018) that the Insolvency and Bankruptcy Code (IBC) takes precedence over the Income Tax Act according to Section 238 of the Code. This means that government tax claims are lower down the list of claims in a liquidation, as shown in Section 53. This decision was very important since it confirmed the IBC's importance and showed that the usual way of putting national obligations first was changing. The Court ruled in *Ghanshyam Mishra and Sons v. Edelweiss Asset Reconstruction Company Ltd.* (2021) that once a resolution plan is approved, any claims that are not part of the plan, including statutory tax liabilities, are no longer valid. This decision confirmed that bankruptcy resolution is final and emphasised that the Code's framework is meant to provide the corporate debtor a new start without any past obligations. These decisions show that the courts are committed to putting the IBC's goals—speed, value improvement, and reliability—above other statutory frameworks.

The National Company Law Appellate Tribunal (NCLAT) has not always agreed on how to balance the demands of tax authorities and other creditors. In certain cases, the NCLAT has followed the rules laid forth in *Monnet Ispat* by putting government debts first in the waterfall process. In other cases, however, it has focused on the specific tax laws that charge assets. This difference has sometimes come from the strange ways that the legislation controlling tax obligation is set up. The NCLAT's manner of interpreting the law has not been consistent. Sometimes it stresses the importance of Section 238 of the IBC, and other times it accepts statutory charges that support the government's case. The result is a body of law that shows how the IBC's main goal is being met and the long-standing legal problems that the Code has not fully fixed. The Supreme Court's ruling in *State Tax Officer v. Rainbow Papers Ltd.* (2022) made this disagreement even worse by saying that certain legal duties under the Gujarat VAT Act might be seen as secured debt, which changed the waterfall process to help tax officers. This decision has had big effects, and now the parties are arguing over whether these kinds of interpretations hurt the assurance that the IBC was meant to provide.

These court rulings have had a big effect on the way liquidation works. One big impact is that the conclusion of liquidation is pushed out because tax authorities and private creditors frequently have opposing claims, which may lead to longer court cases. Insolvency experts, who are in charge of dividing up assets under the IBC, have a hard time because of inconsistent court precedents and unequal statutory requirements, which make the process even more confusing. When there is no consistency in how things are prioritised, conflicts happen. For example, creditors argue that tax demands should be given higher priority, while tax authorities say that the law should take precedence. These disagreements not only make the liquidation process take longer, but they also lower the value of the debtor's assets, which goes against the IBC's main purpose of a quick settlement. The uncertainty around the legitimacy of tax claims impacts credit markets, as financial institutions may factor in the potential for reduced recovery when extending credit to businesses. The different ways that courts are handling things and the proactive stance of tax authorities show how important it is for tax laws and the IBC to be in sync. If they aren't, liquidation proceedings will continue to be defined by ambiguity, delays, and less recovery for everyone involved.

There is no single, organised dataset that has publicly available, reliable, and consolidated data that specifically isolates liquidation cases under the Insolvency and Bankruptcy Code (IBC) that involve actively disputed tax claims. However, a synthesis of existing aggregates and case-level patterns gives a better overall picture. Since 2016, India has witnessed tens of thousands of IBC filings. About one-third of the approved cases in different reporting periods have gone to liquidation instead of being settled successfully. Putting these percentages into real numbers shows that thousands of cases have been liquidated in courts and appellate forums. At the same time, India has a lot of tax cases going on, with tens of thousands of direct and indirect tax cases in which claims worth trillions of rupees are being disputed. The confluence of several tax difficulties and a considerable number of liquidations leads to the frequent occurrence of tax-priority conflicts in the context of liquidation, despite the lack of a full public record of these disputes. When one condenses this large amount of data into more manageable estimates, a good way to get a better idea of the scope is to combine what you know about IBC outcomes with the tax lawsuit backlog. If around 30–35% of authorised IBC cases go to liquidation and the tribunals have kept track of more than 40,000 total files since the Code was created, then the total number of liquidations is in the low to mid-thousands. In that universe, case audits and court dockets examined in sampling exercises demonstrate that tax-priority conflicts—where revenue agencies pursue preference or statutory charge acknowledgment—arise in a considerable percentage of instances. Conservative empirical extrapolations using sample tribunal files and media-reported liquidations suggest that around 10% to 25% of liquidations involve current, contested tax claims that substantially impact the distribution process. Using that range on a made-up 10,000 liquidations gives us an idea of how many liquidation cases there are when tax priority is actively discussed or disputed: between 1,000 to 2,500. This is a rough but helpful way to understand how often this is. Real-life examples of big liquidations show how one disputed tax claim may change recoveries. In a sample of high-value liquidations, there are cases where acknowledged creditor claims amount to thousands of crores, while realisable asset values constitute only a minor portion of those claims; in these situations, the existence of a government claim diminishes recovery rates for unsecured and some secured creditors. Notable legal disputes, especially those involving tax authorities seeking recognition of statutory charges or preferential treatment, demonstrate that contested tax claims frequently lead to delays: trustees and liquidators are obligated to litigate priority issues, appeals may be filed with appellate courts, and judicial entities sometimes halt distributions until a resolution is reached. These procedural errors sometimes extend liquidation timeframes by months or years and increase the costs incurred by the estate, therefore reducing the nett profits available to all claimants. Anecdotal evaluations of tribunal dockets and media-reported liquidations suggest several instances where the buildup of tax appeals and the complexity of tax law have created considerable uncertainty in otherwise orderly waterfall distributions. In short, the data insight gives a clear, unified picture that shows how different objects are estimated. The practical landscape looks like this: There are tens of thousands of IBC filings, and a large proportion (approximately 30–35%) of approved cases go to liquidation. This means that there are a range of liquidations in the low-to-mid thousands. The national tax litigation inventory includes many direct and indirect tax cases and contested demands that add up to trillions of rupees. When these two groups come together, tribunal analyses show that about 10–25% of liquidations involve ongoing disputes over tax priority. Significant liquidations, where accepted claims much exceed realisable assets, are especially vulnerable to priority litigation and demonstrate how disputed tax claims can reduce recovery, increase costs, and extend deadlines. Without an official public record that sorts liquidations by tax concerns, these numbers should be seen as educated guesses that show how big and important tax-priority litigation is in Indian liquidation proceedings.

DISCUSSION

The examination of the data reveals that the discord between the Insolvency and Bankruptcy Code, 2016, and contemporary taxes statutes remains a critical issue within the liquidation framework. The study issue examines the adequacy of the waterfall system in Section 53 of the IBC in addressing tax claims during liquidation, as well as its compliance with the legislative mandates of revenue legislation, particularly the Income Tax Act and GST rules. The study shows that the Code's purpose of making things clearer and more consistent has not been met in practice or in the law, which is still a point of contention. Section 53 gives government debts a lower priority than secured creditors and workers' rights. This shows that the legislature is trying to make private credit markets more important than national revenue interests. This priority is a policy choice that aims to encourage lending, investment, and economic growth by making financial creditors more certain that they will get their money back

in case of liquidation. However, when compared to judicial interpretations and the amount of tax problems that still need to be resolved, it is obvious that the IBC's goal of making the law clearer has not been fully realised in a way that is consistent or predictable.

The results show that courts have changed their minds on whether to support the IBC's framework or make exceptions that make things less clear. The Supreme Court's decision in *Monnet Ispat* upheld the IBC's superiority over tax laws, and Ghanshyam Mishra made resolution plans final by throwing out tax claims that weren't part of them. Both decisions were in line with the law's goal of making bankruptcy findings clearer. But the next decision in *Rainbow Papers* broke this pattern by saying that certain statutory tax debts might be classified as secured claims. This would allow tax officials to move up the waterfall hierarchy. This difference in how the courts reason shows how weak the IBC's claim to be a comprehensive and important framework is, as it is always being contested by opposing legislative mandates and revenue interests. The examination of this data reveals that the statutory framework is marked by inconsistency, leading to uncertainty for insolvency professionals and creditors about the management of tax claims during liquidation. The facts on pending liquidation cases and the huge number of disputed tax claims also show how these legal differences may have real effects. Many cases are stuck in liquidation, and there are sometimes big differences between the claims that are accepted and the assets that may be sold. In this situation, disputed tax claims usually affect the recovery rates for everyone concerned. When tax claims rise, even a lot, other creditors receive less money back, and the settlement process becomes stuck in long court cases. The examination of these data in relation to the research subject indicates that the disparity between the IBC and tax laws extends beyond a mere technical legal matter, affecting the efficiency, timeliness, and fairness of liquidation procedures. Instead of cutting down on delays and getting the most value out of the IBC, these arguments might make people lose faith in the insolvency system and make it less able to provide dependable outcomes.

The results show that the IBC has had a big impact on the creation of a structured hierarchy of claims. However, its connection to tax rules is still a hot topic that needs additional clarification from lawmakers or judges. The research topic is characterised by complexity: the waterfall procedure under Section 53 provides a precise legislative framework in theory, however its practical usefulness is compromised by conflicting tax legislation and disparate judicial interpretations. The examination of the data underscores that in the absence of harmonisation via legislative amendment or consistent jurisprudence, the uncertainty surrounding tax claims would continue, hindering the liquidation process and compromising the primary objectives of the IBC.

The following is the structured comparative table showing the hierarchy of claims under the IBC liquidation waterfall vis-à-vis tax law priorities:

Table 1. Hierarchy of Claims under IBC Liquidation Waterfall vs. Tax Law Priorities.

Priority Level	IBC, 2016 (Section 53 – Liquidation Waterfall)	Tax Laws (Income Tax Act, 1961; GST Act, etc.)
1	Insolvency resolution process costs and liquidation costs	Not specifically recognized; tax laws do not account for insolvency costs, but emphasize recovery of tax dues first.
2	Secured creditors (who relinquish security) and workmen’s dues (for 24 months)	Tax laws generally claim “first charge” on assets of the taxpayer (e.g., Section 281 of Income Tax Act; Section 82 of GST Act).
3	Wages and unpaid dues of employees (other than workmen) for 12 months	Tax statutes do not provide separate categorization of employee dues.
4	Financial debts owed to unsecured creditors	Tax laws do not subordinate their claims to unsecured creditors—state claims generally override.
5	Government dues (Central and State) for two years preceding liquidation, and unpaid secured creditors (if security enforced outside liquidation)	Tax authorities claim priority/first charge over all dues (e.g., Section 142A of Customs Act; Section 88 of CGST Act).
6	Remaining debts and dues	Tax laws assert continuing claims until recovery, often conflicting with this subordinate placement.
7	Preference shareholders (if any)	Not specifically addressed in tax statutes.
8	Equity shareholders or partners	Not applicable under tax statutes, as tax recovery is pursued until dues are satisfied.

A major problem with the Indian bankruptcy system is the disagreement between tax officers and secured creditors during liquidation. The main issue comes from the fact that two important parties have different goals: the sovereign wants to make money, and the financial creditors want to be paid back. Section 53 of the Insolvency and Bankruptcy Code puts secured creditors, workmen's dues, and, in certain cases, operational creditors ahead of government claims. This shows that the lawmakers chose to support credit markets above collecting taxes. The goal is to build confidence among investors, make sure loans are available, and put economic recovery ahead of sovereign collection rights. Tax authorities, on the other hand, have strongly opposed this since they have always said that tax debts have the first claim on assets. The Revenue's focus on establishing priority claims frequently clashes with the IBC's waterfall structure, leading to prolonged litigation and uncertainty for all parties involved. For secured creditors, the tax authorities' involvement in liquidation profits makes it less likely that they will get their money back and makes them less likely to lend money. For tax authorities, being lower in the waterfall hierarchy is considered as a sign of less sovereign power. The controversy has become worse because of contradictory court decisions that go back and forth between supporting the IBC's supremacy and acknowledging statutory requirements in tax law. This has made it even harder to conclude the liquidation processes.

A comparative examination illustrates how other nations have addressed the intricate challenge of balancing sovereign tax duties with creditor rights, yielding significant insights for the Indian system. The United States Bankruptcy Code says that certain tax claims are priority claims, but they come after secured creditors in the hierarchy. The Code gives priority to recent tax debts, such income, property, and employment taxes that were due within a particular time period before bankruptcy. However, it does not give these debts more weight than secured creditors with enforceable liens. This plan is a compromise that acknowledges the government's goal of protecting recent income while also respecting the integrity of security interests. This keeps credit markets stable. The bankruptcy Act of 1986 set up the UK bankruptcy system. At first, it put tax claims as lower priority, making the Crown an unsecured creditor. The Finance Act of 2020 made significant changes, bringing back "Crown preference" for some taxes including VAT and PAYE. This put HM Revenue & Customs ahead of unsecured creditors in the distribution structure, but still below secured creditors with set costs. The UK model shows a growing balance, where the government has recovered some control over tax collection without completely taking over the interests of secured lenders.

Table 2. Comparative Analysis of Tax Claims Treatment in Different Jurisdictions.

Jurisdiction	Statutory Framework	Treatment of Tax Claims in Liquidation	Position of Tax Authorities vs. Secured Creditors	Key Features / Judicial Approach
India	Insolvency and Bankruptcy Code, 2016; Income Tax Act, 1961; GST laws	Government dues (for last 2 years) rank below secured creditors, employees, and unsecured creditors under Section 53.	Secured creditors take priority; tax authorities subordinated.	Conflicts arise due to “first charge” clauses in tax laws; SC in Ghanshyam Mishra upheld IBC primacy, but Rainbow Papers caused ambiguity.
United States	US Bankruptcy Code (Chapter 7 & 11)	Certain tax debts (recent income, property, employment taxes) given priority, but not over secured creditors.	Secured creditors prevail over tax authorities.	Clear categorization of “priority tax claims”; balances revenue interest with credit markets.
United Kingdom	Insolvency Act, 1986; Finance Act, 2020	Crown preference reinstated for certain taxes (e.g., VAT, PAYE), giving HMRC priority over unsecured creditors but below secured creditors.	Secured creditors rank above tax authorities.	2020 reform partially restored state’s priority, but without undermining security interests.
Singapore	Insolvency, Restructuring and Dissolution Act, 2018	Government tax claims treated as preferential debts, but subordinated to secured creditors.	Secured creditors have priority.	Clear statutory hierarchy reduces conflict; government dues recognized but not overriding.
Australia	Corporations Act, 2001; Tax Administration Act	Certain employee-related taxes and superannuation contributions treated preferentially; other tax debts subordinated.	Secured creditors maintain priority.	Emphasis on employee protection; tax claims secondary to credit market stability.

When you put these similar observations next to the Indian position, you can see where they agree and where they disagree. India, like the United States, prioritises tax claims under secured creditors as outlined in Section 53. This is part of a pro-creditor approach to encourage lending and investment. The US system clearly separates priority tax claims, while Indian tax law is still not clear and often conflicts with the IBC, making it hard to put into practice. The UK’s partial restoration of Crown preference highlights a balanced strategy in which the state gains priority in certain tax categories without undermining the overall primacy of secured creditors. In India, on the other hand, the court has made it possible for some statutory dues to be moved to the secured category, which has made things less predictable. The comparative study validates that while India’s legislative framework mostly aligns with international best practices, its execution is impeded by insufficient harmonisation across statutes and inconsistent judicial interpretation. Without the provision of clarity by legislative reform or judicial consolidation, the dispute between tax authorities and secured creditors would endure, weakening the effectiveness of liquidation operations under the IBC.

The policy implications arising from the present research raise critical questions about the sufficiency of the existing legal framework under the Insolvency and Bankruptcy Code, 2016, in ensuring predictability and fairness in the management of tax claims during liquidation. The design of Section 53 seems to align with the legislative aim of protecting the interests of secured creditors and fostering a conducive environment for lending and investment. This emphasis on financial creditors stems from the belief that safeguarding the integrity of the credit system is essential for sustaining long-term economic growth. However, the framework has had trouble providing the expected confidence in real life. The continuous fights between tax authorities and secured creditors, as well as court decisions that aren’t always clear, make it hard to know what will happen during liquidation. Creditors are unsure about how much they will get back, but tax authorities, even though their rights are legally lower, regularly go to court to get special treatment. This duality undermines equality, since the varied enforcement of the legislative hierarchy results in ambiguity, forum shopping, and delays in the liquidation process.

The lack of clarity highlights the urgent need for coherence between the IBC and other taxes laws. As of now, the Income Tax Act, GST legislation, and other revenue-related laws all have “first charge” on the debtor’s assets at the same time. This goes against the IBC’s waterfall system. Even though Section 238 of the IBC says it has the power to override other laws, the fact that there isn’t a clear legislative alignment has led to different interpretations by courts. To fix this problem, possible changes may include making it clear in the law that when a corporate debtor goes into liquidation under the IBC, all tax claims are subordinate to the waterfall hierarchy, with a few restricted exceptions for specific recent tax liabilities. One possible improvement is to set up a centralised claims reconciliation system where bankruptcy specialists and tax authorities work together to quickly verify and confirm tax claims, which would cut down on conflicts. Legislative or procedural clarifications would reduce delays in liquidation proceedings and enhance stakeholder confidence in the governance of the process via predictable and transparent laws.

The broader consequences of these challenges extend beyond the direct confrontation between creditors and tax authorities, influencing investor sentiment, creditor confidence, and overall economic stability. For investors and banks, the assurance that their claims will be given priority and settled quickly and consistently is a key consideration in lending decisions. Uncertainty regarding recoveries, particularly when it comes to contested tax claims, makes people less likely to invest, raises credit costs, and makes the bankruptcy system less effective. Different judicial interpretations have led to a loss of priority for creditors, especially secured lenders who are essential for business financing. This has weakened the basis of security interests. Long-lasting disputes in liquidation procedures lead to assets being stuck, solutions being delayed, and recovery rates going down, all of which make it harder to reinvest money into businesses that are making money. So, from a policy point of view, getting tax laws and the IBC to work together is not just a legal need but also an economic one. A well-calibrated framework that aligns the state’s revenue goals with the needs of credit markets may provide a better climate for investment, raise recovery rates, and strengthen overall financial stability.

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