



INSOLVENCY & BANKRUPTCY

Statutory Tax Charges and the IBC Waterfall: The Madras High Court Ruling in Avenue Realty

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PUBLISHED 26 May 2026

The interplay between insolvency law and tax recovery has generated considerable judicial debate, particularly after the Supreme Court's decision in *State Tax Officer v. Rainbow Papers Limited*. The Madras High Court, in *Avenue Realty v. Assistant Commissioner, Srirangam (GST Circle) and Others* (W.A.(MD) No.2662 of 2025 and C.M.P.(MD) No.15106 of 2025, decided on 17 April 2026 by Justice N. Sathish Kumar and Justice M. Jothiraman), has advanced this discourse by distinguishing corporate insolvency resolution from liquidation, and by giving effect to the retrospective clarificatory amendment to Section 3(31) of the Insolvency and Bankruptcy Code, 2016.

The subject property belonged to RLS Alloys Private Limited, the corporate debtor. Upon an application by M/s. Foseco India Limited, an operational creditor, the National Company Law Tribunal ordered the company into liquidation on 14 June 2019, as no resolution plan materialised. The liquidator conducted a public auction on 24 October 2024, in which the appellant, Avenue Realty, emerged as the successful bidder. However, the first respondent, the Assistant Commissioner, Srirangam (GST Circle), had attached the property on 3 February 2016 for tax arrears under the Tamil Nadu Value Added Tax Act, 2006, and this encumbrance was reflected in the Encumbrance Certificate.

The appellant filed a Writ Petition before the learned Single Judge seeking quashing of the attachment. The Single Judge dismissed the petition, holding that the Commercial Taxes Department was a "secured creditor" under Section 3(30) of the IBC and directing the appellant to recover the amount from the liquidation proceeds. Avenue Realty then preferred the present Writ Appeal.

The procedural history before the insolvency authorities reveals defaults by the tax department. On 10 August 2020, the first respondent wrote to the Resolution Professional requesting settlement of dues. The Official Liquidator rejected the claim as time-barred and asked the department to approach the NCLT. The liquidator himself filed I.A. No.932 of 2020 before the NCLT for removal of the attachment, which was dismissed on 15 July 2022. The first respondent's subsequent application was dismissed for non-prosecution on 8 January 2024. Thus, at the time of the auction and writ proceedings, the tax claim had never been admitted in the liquidation process.

The appellant, represented by Senior Counsel, contended that the Single Judge had erroneously applied *Rainbow Papers* without appreciating that subsequent Supreme Court decisions had confined that ruling to its specific factual context. It was emphasised that *Rainbow Papers* arose during the Corporate Insolvency Resolution Process under the unamended Regulation 12 of the IBBI Regulations, which merely required creditors to submit proof of claim, whereas the present case arose after the 2018 amendment to Regulation 12, which mandates that a creditor shall submit a claim with proof. The appellant further relied upon the Insolvency and Bankruptcy Code (Amendment) Act, 2025, which received Presidential assent on 6 April 2026 and inserted an Explanation to Section 3(31) of the IBC clarifying that a security interest exists only when created by an agreement or arrangement between parties, and not merely by operation of law. This clarificatory amendment, it was argued, applied retrospectively and negated the Single Judge's conclusion. The appellant also stressed that once liquidation is ordered, Section 53 of the IBC, the waterfall mechanism, governs distribution exclusively, and Section 238 of the IBC precludes parallel recovery under the TNVAT Act.

The respondents, represented by the Additional Government Pleader and Special Government Pleader, countered that Section 42 of the TNVAT Act, 2006 creates a first charge on the property, and that this statutory charge constitutes a security interest under the IBC, rendering the Department a secured creditor. They relied upon *Rainbow Papers* and a Division Bench judgment in W.P. No.26362 of 2024. They further contended that there was no provision under the Registration Act enabling deletion of an existing encumbrance entry.

The Division Bench framed the central issue as whether a charge created by operation of law under Section 42 of the TNVAT Act qualifies as a "security interest" under Section 3(31) of the IBC, and whether tax authorities are "secured creditors" within Section 3(30). The Court also examined whether an auction purchaser in liquidation can seek removal of a pre-existing tax attachment, and whether *Rainbow Papers* applies to liquidation proceedings as distinguished from resolution.

In its analysis, the Court drew a sharp distinction between the CIRP stage and the liquidation stage. It noted that *Rainbow Papers* arose during the resolution process where the State Tax Officer had raised its claim before the Committee of Creditors, and the Supreme Court found fault with the rejection because the unamended Regulation 12 did not require a separate claim to be filed. The present case was at the liquidation stage, governed by Section 53 of the IBC. The Court relied upon *Paschimanchal Vidyut Vitran Nigam Limited v. Raman Ispat (P) Limited*, (2023) 10 SCC 60, where the Supreme Court held that *Rainbow Papers* did not notice the waterfall mechanism under Section 53 and was to be confined to its own facts.

The Court observed that the Single Judge had overlooked the critical 2018 amendment to Regulation 12, which changed the requirement from “submit proof of claim” to “submit claim with proof.” The first respondent had filed a belated claim, rejected by the liquidator and dismissed for non-prosecution by the NCLT. The Court held that the doors were closed on the VAT authorities due to their own default, and the orders rejecting their claims could not be collaterally revived in writ proceedings.

Turning to the substantive question, the Court analysed Section 3(31) of the IBC in light of the 2026 Amendment. The newly inserted Explanation clarifies that a security interest shall exist only if created pursuant to an agreement or arrangement by the act of two or more parties, and shall not include an interest created merely by operation of law. The Court held this to be a clarificatory and retrospective amendment, explicitly undoing the consequences of Rainbow Papers. The Court cited the Statement of Objects and Reasons and the Standing Committee’s observations to confirm that Parliament intended “security interest” to cover only consensual transactions. The Court also relied upon *Moti Lal v. Karrabuldin* and *Dattatreya Shanker Mote v. Anand Chintaman Datar* to reiterate that attachment prevents alienation but does not confer title.

The Court further placed reliance upon *Ghanashyam Mishra & Sons (P) Limited v. Edelweiss Asset Reconstruction Company Limited*, (2021) 9 SCC 657, which held that statutory dues stand extinguished if not part of the resolution plan, and upon *JSW Steel Limited v. Pratishtha Thakur Haritwal*, (2025) 9 SCC 673, which distinguished Rainbow Papers where no claim was raised before the Committee of Creditors. The Court reaffirmed that Section 238 of the IBC contains a non-obstante clause giving primacy to the waterfall mechanism, and that once liquidation is ordered, assets must be dealt with exclusively under Section 53.

In its final decision, the Division Bench allowed the Writ Appeal and set aside the order of attachment. The Court held that the first respondent was not a secured creditor under the IBC, as the charge under the TNVAT Act was created by operation of law and not by a consensual transaction. The Court further held that the validity of the auction sale could not be questioned, particularly since the first respondent had given no-objection for the sale. The Registering Authority was directed to make an appropriate contra entry in the Encumbrance Certificate, clarifying that the earlier attachment would not operate as a bar for the appellant to deal with the property free from encumbrance. The Court made it clear that its orders would be subject to the outcome of any pending proceedings before the NCLAT or higher forums. There shall be no order as to costs.

The judgment in *Avenue Realty* represents a significant reaffirmation of the primacy of the IBC’s liquidation framework over parallel tax recovery mechanisms. By giving retrospective effect to the 2026 clarificatory amendment and by confining Rainbow Papers to the resolution process, the Madras High Court has restored the distinction between consensual security interests and statutory tax charges. The decision highlights that tax authorities cannot bypass the IBC’s procedural rigours and claim secured status for statutory dues created by operation of law, thereby protecting the integrity of liquidation sales and the rights of bona fide auction purchasers.

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