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SUPREME COURT CLARIFIES PURCHASER'S RESPONSIBILITY FOR PRE-CLOSING LIABILITIES

12 January 2023

Background

On 15 December 2022, the Supreme Court, in its recent judgement in Wave Industries Private Limited v State of Uttar Pradesh, provided clarity on the responsibility of a purchaser for pre-closing liabilities. This is an interesting and important precedent towards purchaser liability in a business purchase transaction. Usually, a business purchase or asset purchase is done in order to circumscribe other seller liabilities as compared to acquiring a company.

Facts and description

In this case, the seller / respondent was the Uttar Pradesh State Sugar Corporation which sold a loss-making sugar mill (Amroha unit) to the purchaser M/S Wave Industries Private Limited in 2010, through a bid process.

The seller had followed a public advertisement process to invite bidders and the transaction was conducted on a slump sale basis (documented by a slump sale agreement), i.e., for a lumpsum consideration rather than an asset-by-asset consideration. From the facts narrated in the judgment, it appears that the transaction was conducted on an as-is-where-is basis along with all assets and liabilities of the Amroha unit except certain "*excluded liabilities*". This term "*excluded liabilities*" was defined to mean liabilities "*claimed till Signing Date which are being retained/settled by the Seller*". The slump sale agreement also clarified that contingent liabilities and pending legal proceedings against the seller in relation to the unit would stand transferred to the purchaser. The purchaser was also responsible for transactional tax liabilities (i.e., those arising pursuant to the transaction), and tax and other liabilities "*pertaining to the operations and activities of the Unit pertaining to the period after the Signing Date*," and "*arising from or in respect of the operations and activities of the Unit of the Seller after the Signing Date*".

In furtherance of the slump sale agreement, the parties entered into a property sale deed for transfer of the Amroha unit. This deed carried a confirmation from the seller that all taxes and dues relating to the Amroha unit "*due upto*" the signing date had been settled by the seller, and also a clarification that the seller shall be liable for taxes "*of whatsoever nature relating or pertaining to the Unit up to the Signing Date and thereafter, the same shall be the liability of the Purchaser*".

Subsequently, a dispute arose on which party should discharge certain outstanding liabilities of unpaid duty, penalty, and interest aggregating to INR 5,68,797 which related to the pre-signing period. The purchaser claimed that the seller ought to pay the unpaid amount as these amounts had accrued pre-signing. The Allahabad High

Court on writ referred the matter to the State Government for hearing and resolution, and the State Government concluded that since "Excluded Liabilities" did not expressly cover tax liabilities and contingent liabilities were transferred to the purchaser post signing, these outstanding liabilities would be the purchaser's responsibility.

The Supreme Court on appeal held that the tax liabilities had arisen pre-closing when the onus of discharging liabilities was on the seller, and therefore could not be fastened on the purchaser. The Hon'ble Supreme Court interpreted the slump sale agreement and the property sale deed together, to hold that the tax related provisions of the sale deed clarified that pre-signing taxes would be the seller's responsibility and the tax provisions in the slump sale agreement made the purchaser responsible for post-signing taxes. Therefore, these specific provisions related to tax liabilities would prevail over the general liability transfer provisions under the slump sale agreement.

Notably, the Hon'ble Supreme Court, while taking cognizance of the underlying sales taxes demand, also read the extant value added tax laws in favor of the appellant / purchaser to conclude that it was not a 'dealer' thereunder, prior to purchasing the Amroha Unit. As such, it was the seller/ respondent who accrued the liability under the extant laws.

Comment

It is noteworthy that under the slump sale agreement, "*excluded liabilities*" was not defined broadly as is often done in similar transactions and it was limited to "*liabilities …. which are being retained/settled by the Seller*" thereby leaving it linked to specific identification between the parties. It is also fairly common for purchasers to consider obtaining an indemnification for any excluded liabilities that may befall the purchaser – subject of course to parties' ability to negotiate this.

While in the facts of this case, the Hon'ble Supreme Court referred to the subsequent property deed, and held that the seller shall be liable for all assessments and taxes up to the signing date and the liability of the purchaser would commence only after this period, one wonders whether the same interpretation would have held good for any other business or other liabilities of the Amroha unit if they would have fallen upon the purchaser.

Also, while the purchaser may have gotten relief in this instance, it is noteworthy that they had to litigate the matter all the way to the Supreme Court, and therefore, this is a good precedent of the importance of clearly defining what assets and liabilities are being inherited by the purchaser of a business.

From a taxation standpoint, this judgement is pertinent as it recognizes and upholds the idea of excluding liabilities, especially when the slump sale qualification is hinged on the philosophy of business transfer on going concern basis along with all assets and liabilities. Historically, the tax departments in multiple instances have disputed such liability limitations / exclusions to deny the slump sale status and demand tax by treating the transaction as asset sale.

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