

## SIMPLIFYING VOLUNTARY LIQUIDATION PROCESS: IMPROVING EASE OF EXIT IN INDIA

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**T**he ease of doing business is not only about seamless starts or how smooth the journey turns out to be – it is also about the freedom to exit, as and when needed. It is an equally essential aspect of the ease of doing business, as much as entry into business. A sound framework for exit, therefore, is essential for all businesses irrespective of whether or not they are insolvent.

Liquidation can be involuntary as in the case of insolvency or bankruptcy; or voluntary which could be due to personal reasons, subsidiaries being merged, and changes in technology or regulations. An important point to note here is that a company may decide to voluntarily close its operation even when it's viable. In order to improve the overall ease of doing business, there is a need to streamline the process for exit of companies-both voluntary and involuntary. Most of the debate over exit is dominated by insolvency and bankruptcy cases, but this article deals with issues related to voluntary liquidation.

The issue of ease of exit is not new. Several committees, including Goswami Committee (1993)<sup>2</sup>, Eradi Committee (2000)<sup>3</sup>, and Irani Committee (2005)<sup>4</sup> pointed out loopholes in processes concerning exit of companies, time taken due to pendency of court approvals and lags in the process.<sup>5</sup> Almost all the committees, however, focused mostly on involuntary liquidation processes and found that exit is an inordinately lengthy and costly affair. Even the Economic Survey 2015-16<sup>6</sup> notes that

India has made great strides in removing the barriers to the entry of firms, talent, and technology into the Indian economy. Less progress has been made in relation to exit. Thus, over the course of six decades, the Indian economy moved from 'socialism with limited entry to 'marketism' without exit'.

While the reference in the Economic Survey is meant for insolvency and involuntary liquidation cases, this holds true in case of voluntary liquidation as well.

There has been an overhaul in the winding up process due to insolvency/bankruptcy regime in India with the introduction of the Insolvency and Bankruptcy Code, 2016 (Code/IBC). In fact, after the institution of IBC, India's ranking under the 'Resolving Insolvency' head in the World Bank Group's Doing Business report has improved sharply from 136 to 52.<sup>7</sup> However, the procedure of voluntary exit of business still needs to be simplified radically. Economic Survey 2020-21 briefly touched upon this issue.

In the current scenario, there are two prominent methods of voluntary liquidation, one is under the IBC and another is through the Registrar of Companies (RoC) under section 248 of the Companies Act, 2013 (Companies Act). In this article, the authors explore the issues in the regulations and processes for voluntary liquidation under both ways and discuss possible solutions.

## VOLUNTARY LIQUIDATION PROCESS UNDER THE COMPANIES ACT

Section 248(2) of the Companies Act is currently the most popular way to voluntarily close a company. A company may, after extinguishing all its liabilities, by a special resolution or consent of 75% members in terms of paid-up share capital, file an application in a prescribed manner to the RoC. There must not be any pending litigations against the company. This is considered to be a faster winding up process. However, as per the data available from Ministry of Corporate Affairs (MCA), out of the 28,536 pending cases (as on June 13, 2021), nearly 10% are pending from more than 1000 days and 54% cases (15,310) are pending for more than one year.

### Process of voluntary liquidation under section 248(2)

**Step 1:** Company has to convene a board meeting to approve closure of bank account, pay off all the pending liabilities, and prepare the latest financial statement of the company after closure of bank account.

**Step 2:** Company files a STK-2 form with the respective RoC.

**Step 3:** Director shall furnish declaration in the e-form stating that the company does not have any dues towards any government department. This has to be certified by a Chartered Accountant/Cost Accountant/Company Secretary.

**Step 4:** RoC issues a public notice in a prescribed manner in (i) MCA website; (ii) Official Gazette; (iii) Largest circulating newspaper, one in English and other one in vernacular language giving 30 days' notice time for any claims and objections to be raised. If the company applying for winding up is regulated under Special Act (under section 8), approval of the concerned Regulatory body is required, otherwise not required.

**Step 5:** After expiry of notice period, RoC may strike off company's name and publish dissolution notice in Official Gazette.

### Issues in the voluntary liquidation process

(a) There is no strict timeline in place to be followed by RoC leading to uncertainty among companies applying for liquidation. The companies that file under this section do not have any pending litigations etc., still almost half of the cases take more than a year for processing.

(b) RoC takes a lot of time to publish the final notice of strike off in newspapers. RoCs have to give notice in two leading newspapers – one in English and other one in vernacular language. These notices may run upto five to ten full size pages. Since the cost of publication of notice in leading newspapers are high, RoCs generally wait for accumulation of processing of more STK-2 forms, and once they get substantial number of cases (e.g. 1000 cases) publication of notice in newspapers is done in one go. This is entirely unnecessary in the digital age.

(c) Despite submission of an affidavit and an indemnity bond regarding no pending litigation in the affidavit, sometimes objections are raised by RoC. In many cases, RoC demands that the documents need to be resubmitted for any inconsistency in the notarisation and apostalisation, leading to delays. This is because there is no standard format of affidavit or bond decided by the RoC.

### Recommended solutions

First, there is a need to put in place a strict timeline for RoC to follow.

Second, requirement of RoC to publish the final notice of strike-off in newspapers may be dropped and the regulations should allow for notice to be published on the website of MCA.

Third, there should be a standard format of affidavits with clear language that should be displayed on the website of MCA so that there are no rejections or requirements of changes at a later stage. Further, all the documents required to be submitted along with affidavit and forms should be clearly displayed.

## VOLUNTARY LIQUIDATION PROCESS UNDER IBC

Section 59 of IBC states that '*A corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings under this chapter*'. This is a relatively newly introduced path for voluntary liquidation, and, in theory, it should be an important process. However, as on March, 2021, 907 cases have been filed under this scheme so far and out of them, 7 have been withdrawn. Out of the total, final reports have been received for 400 cases, however, the final order of dissolution has been passed in 226 cases. 500 cases are ongoing.<sup>8</sup>

## Process of voluntary liquidation

Section 59 of IBC together with the Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017 (Voluntary Liquidation Regulations) provide the mechanism for voluntary liquidation of a corporate person. The major steps for voluntary liquidation process under section 59 of IBC are as follows:

**Step 1:** Board meeting is held approving the voluntary liquidation. Section 59(3) (a) of the Code provides that majority of the directors of the company shall pass declaration regarding solvency and that the company is not being liquidated to defraud any person. Such declaration is to be accompanied with (a) audited financial statements and record of business operations of the company for the previous two years or since its incorporation, whichever is later and (b) a report of the valuation of assets of the company, if any, prepared by a Registered Valuer.

**Step 2:** Passing of shareholder's resolution and appointing a Liquidator. Section 59 (3) (c) of the Code provides that there shall be a resolution / special resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily and appointing an Insolvency Professional to act as the Liquidator. Further, creditors representing two-thirds in value of the debt of the company shall approve the said resolution within seven days of such resolution.

**Step 3:** Liquidator files the resolution to Insolvency and Bankruptcy Board of India (IBBI) and RoC within seven days as per section 59(4) of the Code and regulation 3 (2) of Voluntary Liquidation Regulations. Regulation 14 of Voluntary Liquidation Regulations requires to make public announcement (in English and regional newspapers) within five days calling stakeholders to submit claims within 30 days (section 38 (1) of IBC).

**Step 4:** Opening a designated bank account for cash and liquid funds and closure of existing bank account(s) and transfer of funds to designated bank account.

**Step 5:** Apply for No Objection Certificate (NOC) in Central Board of Direct Taxes, Central Board of Indirect Taxes and Custom, Employee Provident Fund Organisation and sectoral regulators. It is important to note that these compliances are not explicitly mentioned in the Code but these compliances are implied.

**Step 6:** Liquidator gives final remittance to shareholders and deposits applicable withholding taxes and then closes the bank account.

**Step 7:** Liquidator then submits a final report to shareholders, RoC, IBBI and National Company Law Tribunal (NCLT).

**Step 8:** Order is passed by NCLT.

**Step 9:** File copy of order for dissolution of corporate debtor (CD) with RoC vide Form INC 28 and RoC to strike-off the name of CD from RoC. This is also not specified under the Code; however, this task is also implied.

## Issues in voluntary liquidation process

As on March 2021<sup>9</sup>, out of the 907 cases filed for voluntary liquidation under IBC, 674 cases have not yet been closed. Of the 500 cases where closure report has not been filed, nearly 30% (144 cases) have been ongoing for more than two years. Therefore, the procedure for voluntary liquidation needs to be streamlined. Some major issues are listed below:

(a) The Code does not specifically mention the need for taking NOCs from departments, however, it is implied to be taken. It is implied that NOCs from various departments including the Central Board of Direct Taxes, the Central Board of Indirect Taxes and Custom, Employee Provident Fund Organisation and other sectoral regulators needs to be taken. However, it is not explicitly mentioned in the Code. This leads to confusion regarding the procedure to be followed among the departments, Liquidators etc. as to the exact procedure to be followed.

(b) There are no Standard Operating Procedures (SoPs) in the departments for granting NOCs. The departments have no well-defined SoPs to grant NOCs for the voluntary liquidation applications. As per the current practice, the Liquidators write a letter to the head of the departments asking for any claims that the department has on the company and to grant NOCs. The department then assesses the application and responds. Since there are no SoPs, the claims raised by the departments come with a lag and not within stipulated time period.

(c) There are conflicting timelines between Income Tax Act and IBBI regulations. There are some timelines in the Code which conflict with other existing laws. One such example is section 14(2) of Voluntary Liquidation Regulation which mentions that 'last date for submission of claims, which shall be 30 days from the liquidation commencement date', whereas section 178(2) of the Income Tax Act provides that the assessing officer shall within three months from receipt of notice of appointment from the Liquidator provide details of any tax arrears.

(d) There is a lack of standard guidelines on requirements by NCLT bench. Discussion with market participants shows that certain benches of the NCLT specifically require an NOC from the relevant RoC to be submitted before taking the application for dissolution on record, even though this requirement does not emanate from regulations. This leads to lags in the processes as the company has to then go back to take the specified clearances.

(e) There is hesitancy in the banks for closure of existing bank accounts and also for opening of the new liquidation bank account by the Liquidator which is a mandatory step in the liquidation proceedings. The bank employees are not fully aware of the requirements leading to hesitancy among them.

## Recommended solutions

First, the requirements of taking NOCs from various departments should be explicitly mentioned in the Code.

Second, there is a need to create well-defined SOPs with clear timelines in each department. There should be a standard form to apply for NOCs which should be available on the website of IBBI and MCA. If no response is received from the concerned department within specified time period, then it shall be deemed that the department has no objection and no pending claims. SoPs should be properly disseminated to the field officers/ assessing officers and clearly displayed on the website of each department. There should be a senior level nodal officer for making sure that the process is followed.

Third, there is a need to work on making the timelines in IBC consistent with the other existing laws.

Fourth, consistent SoPs in the form of documents, checklists, etc. required across NCLT benches should be issued. This is important for clarity among relevant stakeholders, i.e., registry, Liquidators and claimants regarding documentation. Another option that may be considered is that in ordinary cases where there are no pending litigations, there may be no need for the liquidation process to involve NCLT and the case may directly go to an Adjudicating Authority, maybe IBBI. This process is followed in some countries, including, UK, Singapore, Hong Kong and Malaysia.

Fifth, there is a need to issue guidelines to banks making them aware about the liquidation process, and powers of Liquidator for opening of liquidation accounts and closure of existing accounts. Department of Financial Services (in Ministry of Finance) may issue an internal checklist to the banks clearly specifying the list of items required for closure of accounts/opening of bank accounts of companies under voluntary liquidation and undertakings required for account closure and opening up.

## CONCLUSION

There is a case for simplifying the voluntary liquidation process to improve the ease of exit for businesses in India, both under the IBC and under section 248(2) of the Companies Act.

Most importantly, there is a need for creation of a 'single window' for the entire process of voluntary liquidation. A portal should be created which combines all the steps of the liquidation process. Companies should be able to apply and submit all the forms on the portal and departments can process the applications and update it on the portal accordingly. This will help in fast-tracking and streamlining the entire process.

In the process under section 248(2) of the Companies Act, there is a need to put in place a strict timeline for RoC. The requirement of publishing the final notice in newspaper by RoC that creates

a lot of delays needs to be dropped and replaced by publishing notice on the website instead. MCA along with RoC should decide and come up with standard format of affidavits, and also deliberate on whether declarations can replace affidavits to make the process faster by avoiding the step of notarisation.

In the IBC process, there is a need to explicitly list down taking of NOCs as a part of the process. Further, well-defined SoPs with clear timelines for all departments to grant NOCs as well as for NCLT should be in place. The SoPs should detail out all the required documents, checklists etc. and should be displayed clearly on the website of departments and IBBI. A nodal officer from each department should be appointed to ensure that this is followed. There is a need to move away from Liquidators writing letters to all relevant departments for getting NOCs to having standard forms to be filled to apply for NOCs.

Overall, slight procedural changes to the voluntary liquidation process will go a long way in improving ease of doing business in India by facilitating the voluntary exit process.

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## Notes

<sup>1</sup> Opinions expressed in the article are personal and do not necessarily reflect those of the Ministry of Finance, Government of India.

<sup>2</sup> Report of the Committee on Industrial Sickness and Corporate Restructuring, Ministry of Corporate Affairs, July, 1993.

<sup>3</sup> Report of the High-Level Committee on Law relating to Insolvency and Winding up of Companies, Ministry of Corporate Affairs, 2000.

<sup>4</sup> Report of the Expert Committee on Company Law, Ministry of Corporate Affairs, 2005.

<sup>5</sup> Bansal S. and Mittal M. (2020), "Ease of exit for businesses in India", Chartered Secretary, The Institute of Company Secretaries of India, Vol. 50, pp. 63-67.

<sup>6</sup> Economic Survey 2015-16, Ministry of Finance Vol. I, p. 37.

<sup>7</sup> Doing Business Report 2020, World Bank.

<sup>8</sup> IBBI Quarterly Newsletter, January-March, 2021.

<sup>9</sup> *Ibid.*