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**COMPARATIVE STUDY OF BANKRUPTCY AND INSOLVENCY LAWS  
IN INDIA AND USA**

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**Abstract**

Financial distress can occur in the form of individual or business insolvency. It occurs when a company cannot fulfil its financial commitments to creditors or lenders. When bankruptcy procedures are initiated, a creditor who has not received their due payment may sue a company or a person who is incapable of repaying their debts. A business files for Bankruptcy when it cannot fulfil its financial obligations or pay its creditors. All the Company's outstanding obligations are calculated and paid off from the Company's assets in a court petition. *Bankruptcy filing* is a legal course undertaken by the Company to free itself from debt obligations. This Article compares the Bankruptcy and Insolvency Laws in the USA and India. This paper compares the variations in the processes of the two nation's bankruptcy procedures. It provides a thorough explanation, including the effect of the laws on business dealings between the two nations, their interactions, and the international bankruptcy process. This Article examines the evolution of Bankruptcy Law in the United States of America and India. It details the requirements and process for the USA and India Resolution Process. This study compares the Bankruptcy and insolvency laws of the United States and India from the perspectives of individuals and corporations and analyses the legislative structure. This analysis demonstrates major replacements and adjustments enacted in earlier linked acts to bring the new bankruptcy legislation into effect with procedures for liquidation and insolvency settlement along with the bankruptcy history.

**Keywords:** Insolvency, Bankruptcy, U.S. Bankruptcy Code, and Bankruptcy.

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## Introduction

Insolvency refers to the inability to repay the debt. It includes the incapability of an individual and a corporation to repay the debt or the liability due to them. Insolvency occurs when an individual or a corporation's assets or other resources are insufficient for repaying the obligations within a specified period. In insolvency, legal actions could be taken against a person or corporation where their assets are liquidated to repay the debts or obligations. Corporate insolvency is of two types – "cash flow insolvency" and "balance sheet insolvency."<sup>3</sup> When an organisation cannot make the demands for payments when they become due, they become "cash flow insolvent." The business may have sufficient assets to cover the amount owed, but it lacks the necessary funds, or cash, to do so. They might not have enough time to sell the assets or raise money against them. In this sense, a business experiencing cash flow insolvency issues may be asset-rich but cash-poor. The corporation will frequently have insufficient assets to cover its debts. When a company's liabilities exceed its assets, it becomes "balance sheet insolvent" and cannot pay its debts on time. This also accounts for future and contingent liabilities, including postponed payments.

Bankruptcy refers to the legal proceedings when a person or a business organisation cannot pay off their debts or liabilities. Bankruptcy is a process for the fresh start of the insolvent individual or corporation and for the debt repayment to the creditors. The bankruptcy process starts with the insolvent or the creditors filing a petition in court. Here, all the assets of the insolvent are measured and calculated, which are then liquidated to pay off the creditors. This process not only guarantees repayment of the debt but also ensures a fresh start for the insolvent person or the corporation by forgiving them certain amounts of debts which they could not pay off or when their assets are deficient in paying such debts. However, such a process on the part of a corporation becomes more complex as such proceedings are primarily kept in records, making it hard for the businesses to borrow in future.<sup>4</sup>

## History of Insolvency and Bankruptcy Laws in India and USA

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<sup>3</sup>Cash Flow and Balance Sheet Insolvency – What is the difference?, *available at*: <https://myliquidation.co.uk/cash-flow-balance-sheet-insolvency-whats-the-difference/> (last visited on January 20, 2024).

<sup>4</sup>Bankruptcy Explained: Types and How it Works, *available at*: <https://www.investopedia.com/terms/b/bankruptcy.asp> (last visited on January 20, 2024).

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**INDIA** – The emergence of the Insolvency and Bankruptcy laws in India originates from the British Government. The Britishers were the first to realise the need for insolvency laws in India. The Britishers set up the first insolvency courts in the three Presidency towns – Bombay, Madras and Calcutta- where they primarily traded. These courts were established in 1828 with the passing of Statute 9 (Geo IV c. 73), which could be the beginning of special insolvency legislation in India.<sup>5</sup> Sections 23 and 24 of the Government of India Act, 1800, The Indian Insolvency Act, 1848, The Presidency-towns Insolvency Act, 1909 and The Provincial Insolvency Act, 1920 were the first insolvency regulations in India, formed under the British Government.<sup>6</sup> The Act of 1800 conferred the insolvency jurisdiction on the Supreme Court of Madras and the Recorder's Court at Bombay. They were also empowered to make rules and regulations for relief to insolvent debtors per the Lord's Act of 1759 provisions. In essence, the courts were established to support bankrupt debtors. Alongside private courts, they were also courts of records. Anyone whose tranquillity is disturbed by the court's ruling may file a petition or go directly to the Supreme Court.

However, laws relating to insolvency were not prevalent in the non-presidency towns until the "Presidency Towns Insolvency Act, 1909" and the "Provincial Insolvency Act, 1920" were enacted by repealing the earlier "Indian Insolvency Act, 1848" which was found to be inadequate to meet the changing conditions. While the 1909 Act prevailed in the Presidency towns of Calcutta, Bombay, and Madras dealing with the insolvency of individuals, partnerships, and association of individuals, a "Provincial Insolvency Act, 1907" was enacted for the non-presidency areas, which was later replaced by the Act of 1920 with applicability in all the provinces of India, dealing with the insolvency of the individuals including individuals as proprietors.<sup>7</sup>

Later, these two Acts and the Acts prevailing in the presidential towns were repealed. A new Code, "Insolvency and Bankruptcy Code, 2016", was adopted, which consists of provisions of all the earlier repealed Acts. The Constitution of India, which was adopted in the year 1950, consists of the expression 'Bankruptcy and Insolvency' in Entry 9 List-III of the 7th Schedule, that is, the

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<sup>5</sup>Law Commission of India, "Twenty-Sixth Report on Insolvency Laws" (February, 1964).

<sup>6</sup>A historical evaluation of Insolvency and Bankruptcy Laws in India, *available at*: <https://lawbhoomi.com/a-historical-evaluation-of-insolvency-and-bankruptcy-laws-in-india/> (last visited on January 20, 2024).

<sup>7</sup>Shraddha Khandhadia, Dr. Amin Kumar Singh, Prof. (Dr.) Mrityunjai Pandey, "The Evolution of Insolvency Laws in India" 8 *Journal of Emerging Technologies and Innovative Research* 551 (2021).

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Concurrent List under Article 246, making it a subject with the right of both the Centre and the State to make laws relating to it.<sup>8</sup> However, the provisions relating to the incorporation, command and liquidation of companies are provided in the Union List.<sup>9</sup> This constitutional provision gave Parliament the power to enact the – "Companies Act of 1956" which dealt with all the provisions relating to the incorporation of a company, its dissolution, and the winding-up process.

However, the major disadvantage of this Act was that it consisted of no provisions relating to the expression of insolvency and Bankruptcy or its proceedings but dealt only with the payment of debts. Nevertheless, this Act was the only legislation that dealt with the corporation's insolvency until 1985 when the Parliament enacted the "Sick Industrial Companies Act 1985". This Act was enacted to deal with sick companies and or enterprises suffering from financial loss with debt more than or equal to their net worth. By the early 1980s, the problem of sickness had spread to all industrial firms. Between 1981 and 1985, sick industrial units rose from 26,758 to 119,60. To address this issue, the Tiwari committee was established in 1980 to provide recommendations for resolving the industrial disease problem. The SICA legislation of 1985 was enacted because of the formation of this Committee.

Recognising the industry's "sickness" and restoring them to their rightful place was the goal underlying the adoption of this Act. The "Board of Industrial and Financial Reconstruction" (BIFR) and the "Appellate Authority for Industrial and Financial Reconstruction" (AAIFR) were two new legal forums created with the passage of this Act.<sup>10</sup> SICA was the first Act with a sole focus on corporate reorganisation. As per the Act, the Board of the Company is responsible for disclosing the Company's sickness. The Act provided that all litigation, claims, and procedures against the Company would automatically be suspended upon disclosure of sickness. This procedure differed from the one provided under the Companies Act, which allowed the High Court to decide whether to grant a stay rather than do so automatically.

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<sup>8</sup>Company Secretaries of India, "Insolvency – Law and Practice" (December 2019).

<sup>9</sup>Hritika Sharma, Evolution of the Insolvency and Bankruptcy Laws in India, *available at*: <https://ibclaw.in/wp-content/uploads/2021/05/EVOLUTION-OF-INSOLVENCY-AND-BANKRUPTCY.pdf> (last visited on January 25, 2024).

<sup>10</sup>Jatin Jadwani, Pulkit Dua, "The Evolution of Insolvency and Bankruptcy Laws in India" 3 *International Journal of Advanced Legal Research* (2023).

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Furthermore, even after SICA was deemed ill, it granted the debtor organisation complete control over its assets and operational processes. However, due to the shortcomings or the failure of the SICA, 1985 and the Companies Act, 1956 in regulating the insolvency resolution process, the Parliament legislated the "Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI)" to speed up the insolvency resolution process. Under this Act, the 'Debt Recovery Tribunal (DRT)' was formed. However, as DRT started to get overburdened with workload, the Parliament enacted the "Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act, 2002)" to safeguard the interest of secured creditors under the recommendations of the Narasimham Committee – I.<sup>11</sup> The IBC was adopted in the year 2016 with the recommendations of the Vishwanathan Committee, 2014 which, in its interim report brought out in the year 2015, proposed to establish the 'Insolvency and Bankruptcy Board of India (IBBI)', recommended the repealing of all the earlier Acts relating to Insolvency in India and proposed two tribunals – 'National Company Law Tribunal (NCLT)' and the 'Debt Recovery Tribunal (DRT)' for dealing with insolvency resolution process of the companies, LLP's and the individuals respectively.<sup>12</sup>

**USA** – There was no formal legislation on insolvency in the United States of America until the Constitution of the USA was adopted in the year 1787, which, in its Article I, Sec 8, empowered Congress to legislate a uniform Bankruptcy Law.<sup>13</sup> In response, the first federal bankruptcy law was passed in the USA in 1800 as the "Bankruptcy Act, 1800". This Act dealt with merchant debtors, the cases against whom creditors mostly initiated. This Act allowed the discharge of the debtors only if two-thirds of creditors agreed to the debtor's discharge from tier liabilities. This Act was, however, repealed, and a new "Bankruptcy Act, 1841" was enacted, which granted the district court's jurisdiction over all matters of insolvency and Bankruptcy. This Act was repealed in 1843, and again, a new "Bankruptcy Act, 1867" was enacted, which granted original jurisdiction to all the district courts to deal with all the cases relating to Bankruptcy. However, this Act was also repealed in 1878, and another Act was enacted as the "Bankruptcy Act of 1898.

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<sup>11</sup>Saket Hishikar, "A Concise History of Bankruptcy, Insolvency, and Debt Restructuring Laws in India" 45 *Vikalpa* 116 (2020).

<sup>12</sup>*Supra* note 6 at 4.

<sup>13</sup>The Evolution of U.S. Bankruptcy Law – A Time Line, available at: [https://www.rib.uscourts.gov/newhome/docs/the\\_evolution\\_of\\_bankruptcy\\_law.pdf](https://www.rib.uscourts.gov/newhome/docs/the_evolution_of_bankruptcy_law.pdf) (last visited on January 27, 2024).

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This Act is also known as the 'Nelson Act', and it became the first modern Bankruptcy Act in the nation.

This Act remained in force for 80 years until it was superseded by the "Bankruptcy Reform Act of 1978", which established bankruptcy courts in each district with separate bankruptcy judges, dealing with all cases relating to Bankruptcy. This Act also introduced two new chapters, 'Chapter 11 and Chapter 13', dealing with easy filing and reorganisation and offering a super discharge for businesses and individuals.<sup>14</sup> Currently, the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005" is the new law on Bankruptcy prevailing in the United States of America, which was enacted by amending the "Bankruptcy Reform Act of 1978".

### **Insolvency Resolution Process of India and USA**

**INDIA** – In India, the Insolvency and Bankruptcy Code, 2016 deals with the insolvency resolution process for – i) Corporate persons and ii) Individuals and Partnership Firms. The Insolvency resolution process for corporate persons is called "Insolvency Resolution and Liquidation for Corporate Persons" and individuals and partnership firms "Insolvency Resolution and Bankruptcy for Individuals and Partnership Firms." The provisions for corporate persons are provided under section 4 – 77 and for individuals and partnership firms under section 78 – 187. According to section 4 of the Act, the insolvency resolution process for corporate persons could begin only if the minimum amount of default is not less than one lakh rupees, the higher amount of which shall not be more than one crore rupees, whereas, according to section 78 of the Act, the insolvency resolution for individuals and partnership firms could begin only if the amount of default is not less than one thousand rupees, the higher amount of which shall not be more than one lakh rupees.<sup>15</sup> The insolvency resolution proceedings are reviewed by the 'Insolvency and Bankruptcy Board of India (IBBI) constituted under this Act.

1. Insolvency Resolution and Liquidation Process - Section 6 of the Act provides for a 'Corporate Insolvency Resolution Process (CIRP)'. This section provides that the insolvency resolution process for the corporate person could be initiated by a financial

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<sup>14</sup>*Supra* note 11.

<sup>15</sup>The Insolvency and Bankruptcy Code, 2016, available at: <https://www.mca.gov.in/Ministry/pdf/TheInsolvencyandBankruptcyofIndia.pdf> (last visited on January 28, 2024).

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creditor (sec 7), an operational creditor (sec 8), and the corporate debtor (sec 10). The National Company Law Tribunal (NCLT), the adjudicating authority, is to admit the application within 14 days and, if rejected, shall notify the applicant within seven days of receipt of the application to rectify any defaults. The insolvency resolution process shall be completed within 180 days. It could be extended to another period of 90 days if instructed to do so by a resolution passed at a meeting of the Committee of Creditors by a vote of 75 per cent.<sup>16</sup> The adjudicating authority appoints the 'interim resolution professional' within 14 days from the date of commencement of the insolvency resolution process.

2. It shall declare a moratorium, i.e., prevent others from instituting suits against the corporate debtor, prevent the debtor from transferring, disposing, or alienating any assets or prevent any person from recovering any property which is in possession of the debtor. The Act consists of provisions for the 'Committee of Creditors' and the liquidation of a Company. In case of a liquidation order passed by the adjudicating authority NCLT, the interim resolution professional appointed for the corporate insolvency resolution process shall act as the liquidator who shall deal with or have custody of all the assets, property, etc., of the corporate debtor. The Act also provides for the provisions of the 'Fast Track Corporate Insolvency Resolution Process' and 'Voluntary Liquidation of Corporate Persons' under sections 55 – 58 and 59, respectively, and provisions for corporate offences and penalties under sections 68 - 77.
1. **Insolvency Resolution and Bankruptcy Process:** Section 80 of the Act provides provisions for the 'Fresh Start Process', and Section 94 provides the 'Insolvency Resolution Process' of an individual debtor or a partnership firm. The fresh start process could be initiated by the debtor (sec 81) or the debtor through a resolution professional by applying to the adjudicating authority (sec 82). In the former case, an interim moratorium commences from the date of the application, which ceases the acceptance or rejection of the application. In the latter case, the adjudicating authority 'Debt Recovery Tribunal' will direct the 'Insolvency and Bankruptcy Board of India (IBBI)' about the receipt of the

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<sup>16</sup>The Insolvency and Bankruptcy Code, 2016, available at: <https://www.mca.gov.in/Ministry/pdf/TheInsolvencyandBankruptcyofIndia.pdf> (last visited on January 28, 2024).

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application and shall require the Board to provide confirmation relating to the disciplinary proceedings against the resolution professional if any. The resolution professional must apply within ten days before the adjudicating authority recommends accepting or rejecting it. Within 14 days of receiving such a recommendation from the resolution professional, the adjudicating authority shall pass an order either accepting or rejecting the application.<sup>17</sup> The moratorium period starts from the date of application acceptance, preventing any legal action or proceedings against such debtor by creditors, including the pending actions. In the case of 'Insolvency Resolution Process' (sec 94), a debtor personally or through a resolution professional and a creditor personally or jointly with other debtors or through a resolution professional could apply to the adjudicating authority (DRT) for initiation of the insolvency resolution process (sec 95). The Act provides provisions for bankruptcy orders for individuals and partnership firms under Section 121 – 148.

**USA** – In the USA, the 'Bankruptcy Reform Act 1978' is the ruling modern law called the "U.S. Bankruptcy Code, 1978", also known as "Title 11". Chapter 11 of the Code provides for the insolvency framework.<sup>18</sup> Under Title 11, the Code is divided into six chapters, i.e., Chapters 7, 9, 11, 12, 13 and 15. U.S. insolvency law aims to maximise return to the debtor's creditors (and, if possible, equity holders) to preserve employment and realise the going concern surplus of reorganisation value over liquidation value. Accordingly, business debtors should be reorganised rather than liquidated.<sup>19</sup>

1. Chapter 7 - Chapter 7 of the U.S. Bankruptcy Reform Act, 1978 deals with the Insolvency Resolution and Liquidation process for Individuals, Corporations and Partnerships.<sup>20</sup> However, the discharge is available only to individual debtors, not corporations or partnerships. Under this Chapter, an individual debtor could file for insolvency irrespective of the debtor's debt or whether the debtor is solvent or insolvent.

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<sup>17</sup>The Insolvency and Bankruptcy Code, 2016, available at: <https://www.mca.gov.in/Ministry/pdf/TheInsolvencyandBankruptcyofIndia.pdf> (last visited on January 28, 2024).

<sup>18</sup>Sharen Joel, "Comparative study of Insolvency and Bankruptcy Code of India and USA" 2 *Journal of Legal Research and Juridical Sciences* 590.

<sup>19</sup>Davis Polk, Wardwell LLP, "In review: insolvency law, policy and procedure in USA" *Lexology* 2 (2024).

<sup>20</sup>Chapter 7 – Bankruptcy Basics <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics> (last visited on January 28, 2024).

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This Chapter's main aim is to ensure the debtor's assets are liquidated quickly, efficiently, and orderly so that the creditors and equity holders can get their share. Chapter 7 prohibits companies from reorganising.<sup>21</sup>

2. Chapter 9 – Chapter 9 deals with bankruptcy proceedings of municipal corporations, which refer to government agencies. This Chapter provides the financially distressed municipalities protection from the creditors by helping them enter negotiations.<sup>22</sup> This Chapter, however, consists of no legal proceedings for liquidation.
3. Chapters 11, 12 and 13 – These three chapters wholly deal with the concept of 'reorganisation' of the debtor's assets.<sup>23</sup> Chapter 11 is for businesses, whether sole ownership, partnership, or corporation. Here, the debtor or creditors could voluntarily file a bankruptcy petition with the Bankruptcy Court.<sup>24</sup> A proposed reorganisation plan is put to a vote by concerned creditors, and if it receives the necessary votes and meets specific legal requirements, the court may confirm the plan. Chapter 12 of this Code is related to family farmers or family fishermen with regular annual income, allowing them an opportunity to plan a way to pay their debts.<sup>25</sup> Chapter 13 provides for the adjustment of debts of an individual with regular income.<sup>26</sup> It helps wage earners create a strategy for paying off all or some of their debt. In this Chapter, debtors offer creditors a repayment plan consisting of instalment payments spread over three to five years.
4. Chapter 15 – This Chapter deals with Ancillary and other Cross-Border Cases. This Chapter is based on the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law ("UNCITRAL") in 1997. The main objective of this Chapter is to attempt to offer efficient procedures for handling

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<sup>21</sup>*Supra* note 18 at 3.

<sup>22</sup>Chapter 9: what it means, how it works, example, *available at: <https://www.investopedia.com/terms/c/chapter9.asp>* (last visited on January 28, 2024).

<sup>23</sup>Md Rashid Shamim, "Bankruptcy Laws: A Comparative Study of India and USA" 6 *Journal of Management* 249 (2019).

<sup>24</sup>Chapter 11 – Bankruptcy Basics, *available at: <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>* (last visited on January 30, 2024).

<sup>25</sup>Chapter 12 – Bankruptcy Basics, *available at: <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-12-bankruptcy-basics>* (last visited on January 30, 2024).

<sup>26</sup>Chapter 13 – Bankruptcy Basics, *available at: <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-13-bankruptcy-basics>* (last visited on January 30, 2024).

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situations of insolvency involving debtors, assets, claims, and other interested parties from many countries.<sup>27</sup>

## Conclusion

Before introducing the Insolvency and Bankruptcy Code in 2016, India had no specific law governing insolvency procedures, which the Companies Act, Securitization and Reconstruction of Financial Assets, and Enforcement of Security Interest, Sick Industrial Companies Act of 2002 governed. However, the United States was far ahead of the curve. In the year 1800, it passed its first insolvency law. Even though several adjustments were made and introduced, the statute of 1800 was later repealed. The current law is relatively old, but the provisions are broad and incorporate innovative ideas such as debtors in possession and processes for municipal insolvency and cross-border Bankruptcy. India still has a long way to go, and as a developing country, India requires assistance to make significant modifications to the law.

The Insolvency and Bankruptcy Code, 2016, compared to the U.S. Bankruptcy Reform Act of 1978, is an exhaustive legislation encompassing various provisions for the granting of relief to creditors and discharge to debtors. This Act has provided India's financial sector with a gateway to resolve matters relating to insolvency through adequate provisions and measures.

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<sup>27</sup>Chapter 15 - Bankruptcy Basics, available at: <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-15-bankruptcy-basics> (last visited on January 30, 2024).

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