IBC – Tax Challenges

Training Presentation

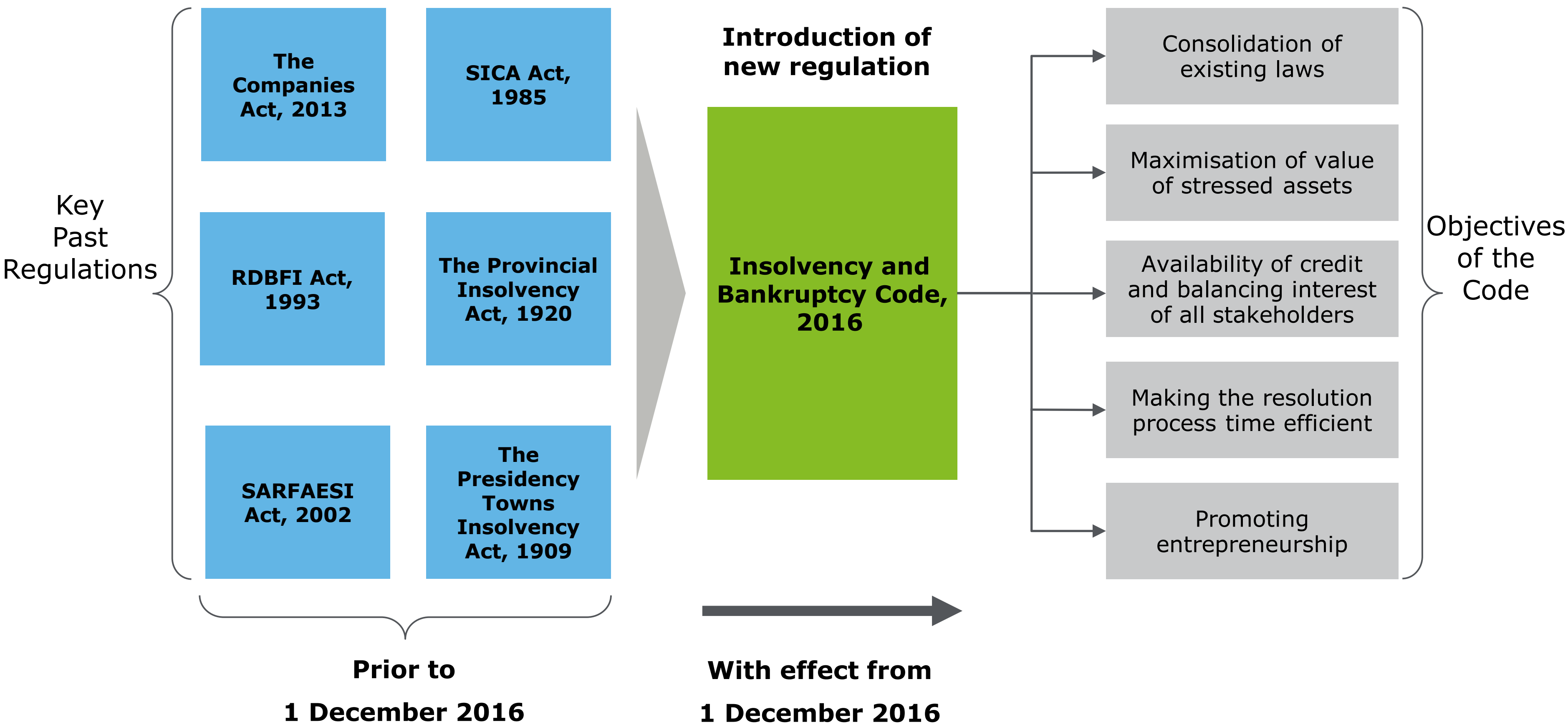
15 June 2019

Contents

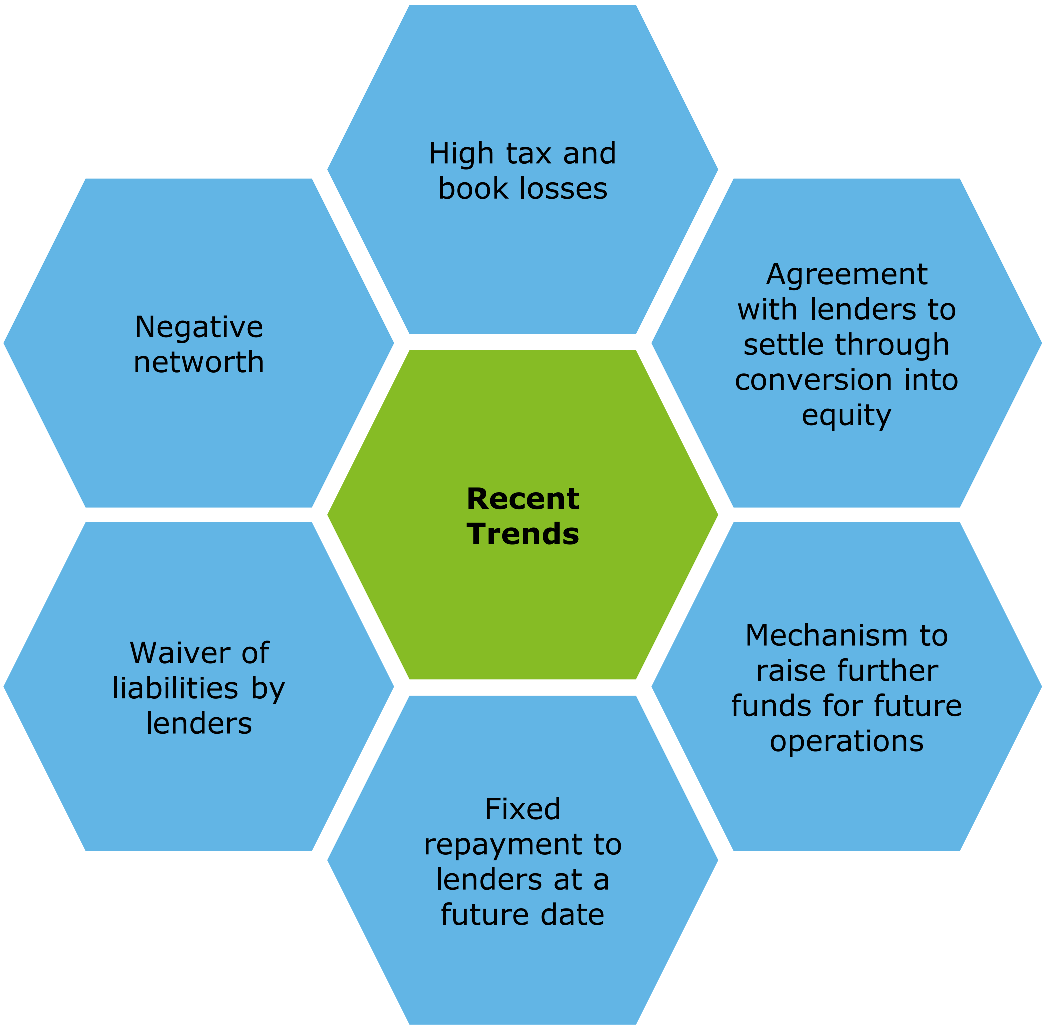
Background

Background: Objectives

The Code aims to consolidate all the existing insolvency related laws and amend multiple legislations, including the Companies Act. As per Section 238 of the Code, it has an overriding effect on all other laws related to insolvency and bankruptcy.



Recent trends in companies admitted under IBC



IBC – Tax and regulatory amendments

Direct Tax

- Non applicability of Section 79 of ITA where a change in shareholding takes place in a previous year pursuant to a resolution plan approved under the IBC
- Eligibility to claim aggregate of brought forward business losses and UAD for MAT purposes
- IBC to overrule provisions of Section 178 (liquidation of companies under the ITA). Thus, for cases where IBC applies, liquidator is not required to retain assets for tax payable

Companies Act

- A company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan
- Every valuation under the IBC shall be conducted by a registered valuer, i.e., a valuer registered with the IBBI

ECB Policy

- Resolution applicants are allowed to raise ECBs from the recognised lenders, except the branches/overseas subsidiaries of Indian banks, for repayment of Rupee term loans of the CD under the approval route

Prudential Framework for Resolution of Stressed Assets

- Complete discretion to lenders with regard to design and implementation of RPs subject to the specified timeline and independent credit evaluation
- Additional provisioning for delay in implementation of RP or initiation of insolvency proceedings

IBC – Tax and regulatory amendments

Securities and Exchange Board of India (SEBI) Regulations

- SEBI (Delisting of Equity shares) Regulations, 2009:
  - Relaxation from provisions of delisting, if resolution plan provides for:
    - Specific procedure for delisting; or
    - Exit option to public at a specified price

- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011:
  - Specific exemption for acquisition pursuant to resolution plan approved under Section 31 of the IBC, 2016 from an obligation to maintain minimum public shareholding

- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009:
  - Exemption from provisions related to preferential issue of specified securities except lock-in

- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2009:
- Relaxation from requirements in relation to:
  - Disposal of shares in a material subsidiary resulting in reduction of shareholding less than 50 percent
  - Material related party transactions
  - Re-classification of promoter to public
  - Scheme of arrangement process

Tax considerations

Tax Considerations

Tax issues in connection with IBC

- Waiver of debt: IT/MAT
- Conversion of debt into equity
- Transfer of assets
- Issue of shares on premium/discount
- Transfer of accumulated tax losses and UAD
- Transfer of tax holiday benefits
- General Anti Avoidance Rule
- Implications on slump sale/ itemized sale under a resolution plan
- No objection certificate from income-tax department
- Tax proceedings during resolution proceedings and post dissolution

Tax Considerations: Miscellaneous issues

Section 281
"Certain transfers to be void"

- Section 281 states that Income Tax Department has the right to recover outstanding tax dues by treating the transfer of assets (including securities) as void
- Exceptions to provision:
- buyer is a bonafide purchaser without notice; or
- where a no-objection is obtained from the Income Tax Department
- Obtaining NOC is a time consuming process

Stamp duty implications

- Transfer of assets of a stressed company is not free from stamp duty implications
- In the insolvency resolution case of Monnet Ispat, NCLT rejected its plea for exemption from stamp duty provisions on transfer of asset pursuant to the resolution plan
- In the insolvency resolution case of Synergies Dooray, stamp duty exemptions were demanded. However, NCLT did not provide any direct observation on this matter

Liability of directors for payment of taxes

- As per Section 179, every director is jointly and severally liable for payment of tax dues in case of private companies undergoing liquidation
- Exception to this is that the director proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part

Tax Considerations: Miscellaneous issues (cont.)

Section 194A
TDS on interest payment

- Any person other than individual or HUF, who is liable to pay interest (other than interest on securities) to a resident, shall deduct TDS at the time of payment or credit, whichever is earlier
- Non-compliance of section 194A results in assessee being treated as "Assesse in default" and penalty under section 221
- TDS not required to be deducted when interest payable to bank, banking cooperative society, financial corporation, LIC, UTI, insurance company or insurance cooperative society
- In liquidation issues, assesse may decide not to deposit TDS on the interest liability recognised in its books of accounts. This would result into a default in TDS provisions and interest, and penalties would arise upon the assesse

Applicability of GAAR

- An arrangement under IBC may have the risk of being considered as an impermissible avoidance agreement and tax consequences may arise if the arrangement leads to significant tax benefits
- As per a CBDT circular, GAAR will not apply to such an arrangement where a Court or NCLT has explicitly and adequately considered the tax implication, while sanctioning an arrangement

Overriding effect on Income tax act

- Pursuant to Section 238 of IBC, provisions of IBC are regarded as a complete code in itself and would have an overriding effect over other legislations
- Supreme Court in case of Monet Ispat also laid down that IBC shall override anything inconsistent contained in any other enactment, including Income tax act

Tax Considerations: Miscellaneous issues (cont.)

Deductibility of insolvency resolution process costs

- Section 5(13) of IBC defines "insolvency resolution process costs" as costs of interim finance, fees of RP, costs incurred by RP in running day-to-day business, and costs incurred to facilitate resolution process
- Insolvency resolution process costs include costs on restructuring and costs incurred in running day-to-day business
- As per Section 35DD, costs incurred on amalgamation or demerger are allowed as deduction over fiver years
- As per judicial precedents, restructuring costs are to be treated as revenue expenditure under section 37
- No clarifications issued by CBDT till date as to whether it should be accounted as a revenue expenditure or a capital expenditure
- Clarifications also required for treatment of insolvency resolution costs incurred by Acquirer

Applicability of the moratorium period extends to the income tax proceedings

- Moratorium is a period during which judicial proceedings for recovery, enforcement of security interest, sale or transfer of assets or termination of essential contracts cannot take place against the debtor
- This order of moratorium remains in effect till the completion of the CIRP or earlier, if NCLT approves a resolution plan or passes an order for liquidation of the corporate debtor
- In the case of Monnet Ispat, SC upheld that moratorium under the provisions of IBC shall apply to the orders of ITAT in respect to the tax liabilities of the assessee
- In case of Kitply Industries Ltd., the NCLT Guwahati Bench has upheld that continuation of a proceeding by ITD during the moratorium is in operation is illegal

Tax Considerations: Miscellaneous issues (cont.)

Section 80
Submission of return of losses

- Section 80 provides that if a taxpayer fails to file ROI within the specified due date, the losses of the relevant previous year shall lapse and not be allowed to be carried forward
- As per amendment made to section 140 by Finance Act 2018, for companies under IBC, IRP would have the right to sign the return
- Difficulties may arise for companies undergoing insolvency resolution proceedings for filing of ROI within the statutory due dates

Right of Income tax department to claim preferential treatment in the event of liquidation

- Income tax department is not treated as a secured creditor under IBC
- Section 53 of IBC provides order of priority for distribution of assets and dues to CG or SG comes fifth in the order of priority
- Section 178(6) provides that a liquidator of a company under IBC is not required to set aside assets for payment of outstanding tax dues
- No provision in IBC that gives a right to the department to claim preferential treatment
- In the case of Leo Edibles and Fats, Hyderabad, High Court upheld that income tax department cannot claim any priority only because the order of attachment issued by it was prior to the initiation of liquidation proceedings under the code

Whether amendments to section 79 and 115JB would apply for perpetuity

- Amendment to section 79 provides for exemption where change in the shareholding takes place pursuant to an approved resolution plan
- Amendment to Section 115JB provides for exemption to a company which has been admitted in CIRP by NCLT
- Clarification is required regarding whether these exemptions would be available for perpetuity or not

Tax Considerations: Miscellaneous issues (cont.)

Possibility of obtaining waiver of income tax under the provisions of Section 31 of the IBC

- As per Section 31 of the IBC, if the Adjudicating Authority is satisfied that the resolution plan as approved by CoC complies with the law, it shall by order approve the resolution plan that shall bind the stakeholders involved in the resolution plan
- Creditors are defined as to include an Operational Creditor
- Operational debt is defined as to include a debt in respect of repayment of any dues arising under any law and payable to the CG, SG, or local authority
- Stakeholder is not defined in the Code
- Operational creditor or stakeholder can be interpreted to include tax authorities basis following jurisprudence:
    - Akshay Jhunjhunwala vs. Unoin of India (Calcutta High Court)
    - Synergies Dooray Autromotive Ltd (Hyderabad NCLT)
- If such an interpretation is valid, a question arises whether it may be possible to obtain waiver of income tax by including the same in the final resolution plan – Asahi Infrastructure & Project (Mumbai NCLT)
- Under the SICA regime, CBDT had accepted that if a restructuring scheme sanctioned as per section 17(3) of SICA includes exemption/waiver from tax obligations, then such scheme would have an overriding effect over the provisions of the Income-tax Act
- Whereas under the IBC regime, in some of the insolvency resolution cases, NCLT rejected the proposal included in the resolution plan on waivers of liabilities, which may arise due to ongoing tax litigations
    - Amit Spinning (New Delhi NCLT)
    - Agro Industries (Allahabad NCLT)

Tax Considerations: Miscellaneous issues (cont.)

Failure to submit the claim with the proof within the time stipulated

- As per Section 18, the IRP is required to prepare a list of assets and liabilities as on the initiation date
- The IRP is also required to receive and collate all the claims submitted by creditors to him, pursuant to the public announcement made
    - As per the Regulation 40A, the creditors need to submit the claim within 90 days of commencement of CIRP
- In this regard, a question arises whether the RP can reject the claims submitted beyond 90 days by the creditors
- The NCLT Bench of New Delhi in case of ARGL allowed the claims made by the Central Board of Indirect Taxes and Customs which was rejected by the RP for filing of the claim belatedly. Thus, while a timeline for submission of claims has been prescribed, liabilities apparent from the books of accounts need to be considered by the IRP/ RP

Case Studies

Direct Tax Considerations
Case study: Waiver of debt

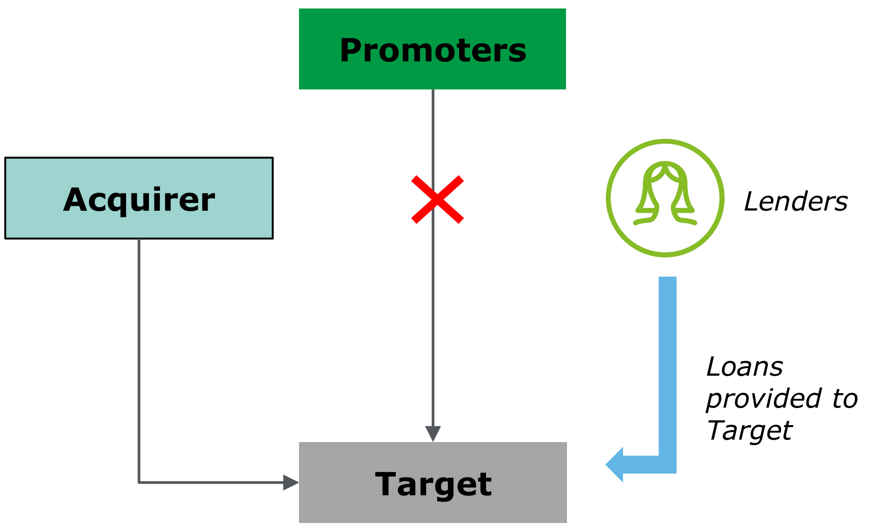
Background

- Target is an entity undergoing resolution proceedings under IBC. It has the following liabilities:
  - Term Loan for purchase of Capital Assets,
  - Loan for working capital purposes,
  - Interest on such loans
- Lenders have agreed to waive off the liability by 70 percent pursuant to the resolution plan

Key Considerations for Target

- Taxability on waiver of principal amount and interest on loan under:
  - Section 41(1): Taxability of any benefit received in respect of a trading liability by way of remission or cessation
  - Section 28(iv): Tax on the value of any benefit or perquisite, whether convertible into money or not, arising from the business
  - Section 2(24)(xviii): Income to include any assistance in the form of subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement by the Central Government or a State Government or any authority or body or agency

Relevant Structure



Direct Tax Considerations
Case study: Waiver of debt (cont.)

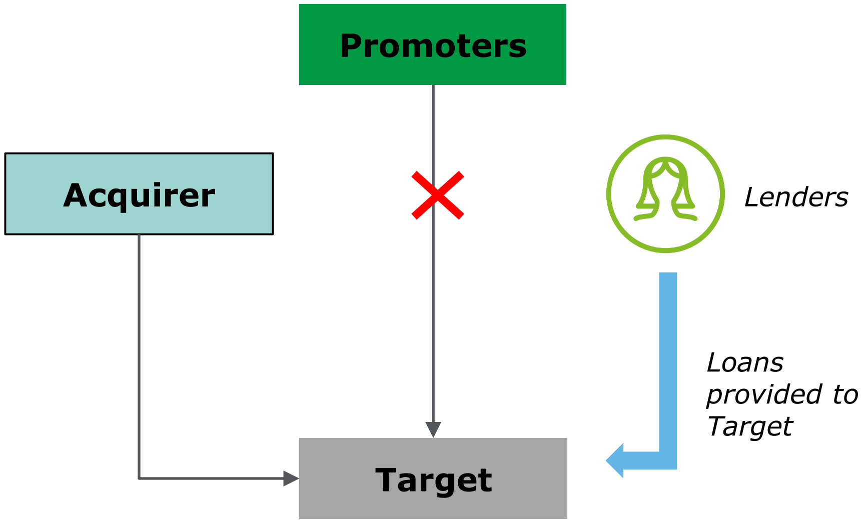
Key Considerations for Target

- Section 56(2)(x): A promise by the Target to repay the loan in a particular manner can be construed as a consideration for the settlement agreement. Hence, it can be said that Section 56(2)(x) shall not apply. However, litigation cannot be ruled out.

- Implications under MAT provisions:
  - If lender is a substantial shareholder: Possibility of recognising the amount of waiver through "Other equity", and hence tax implications under MAT may not arise
  - If lender is not a substantial shareholder: Possibility of recognising the amount of waiver through Profit and Loss, and hence tax implications under MAT may arise

- Possible risk of applicability of anti-abuse provisions if grant and waiver is treated as a single transaction

Relevant Structure



Direct Tax Considerations
Case study: Change in shareholding

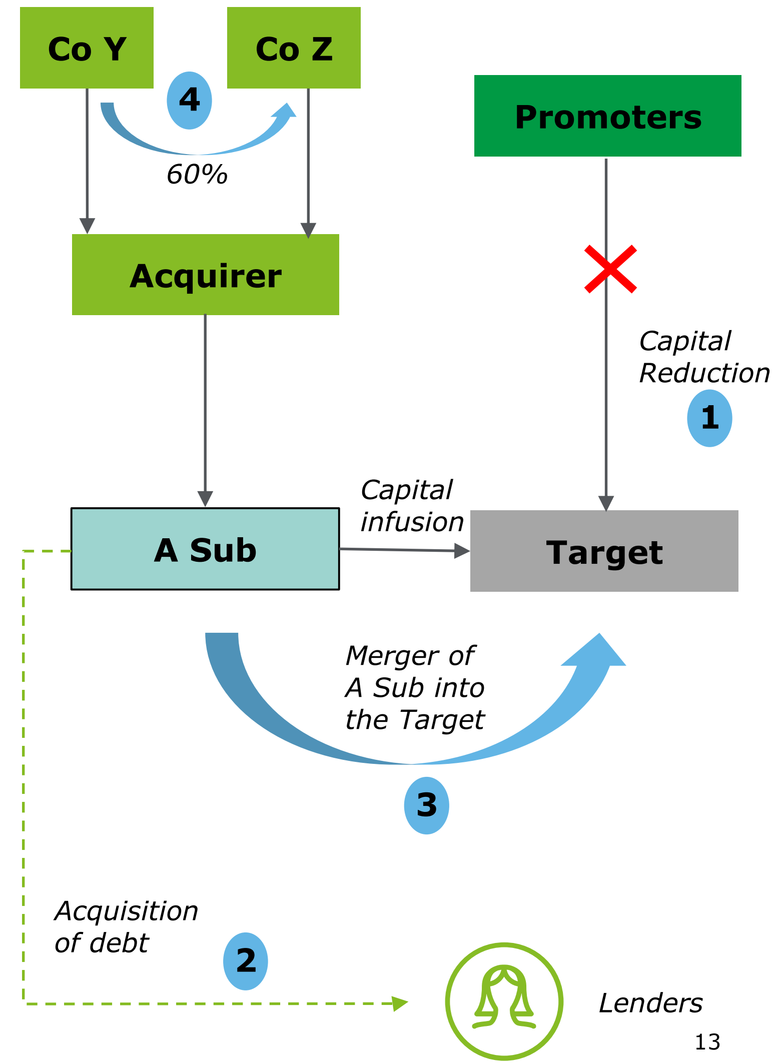
Background

- Target is an entity undergoing resolution proceedings under IBC
- Acquirer is a wholly owned subsidiary of Co Y
- The Acquirer proposes the resolution plan with the following steps:
  - Equity infusion into the Target by Acquirer through A Sub and capital reduction of promoters capital
  - Acquisition of debt by Sub A from the lenders (70% waived off)
  - Merger of A Sub into the Target
  - Transfer of a part of shareholding of Acquirer from Co Y to Co Z

Key Considerations for Target

- Availability of relaxation under proviso to Section 79 in case of companies undergoing change in shareholding pursuant to a resolution plan
  - Change in ownership from Promoters to A Sub
  - Change in ownership from A Sub to Acquirer
  - Change in part-ownership from Co Y to Co Z
- Merger should be part of resolution plan?

Relevant Structure



Direct Tax Considerations

Case study: Issue of equity to lenders and buyout by Promoters at a later date

Background

Stage 1

- Target is an entity with a loan of INR 100
- Target has agreed to issue equity shares at face value to the Lenders as consideration against the loan

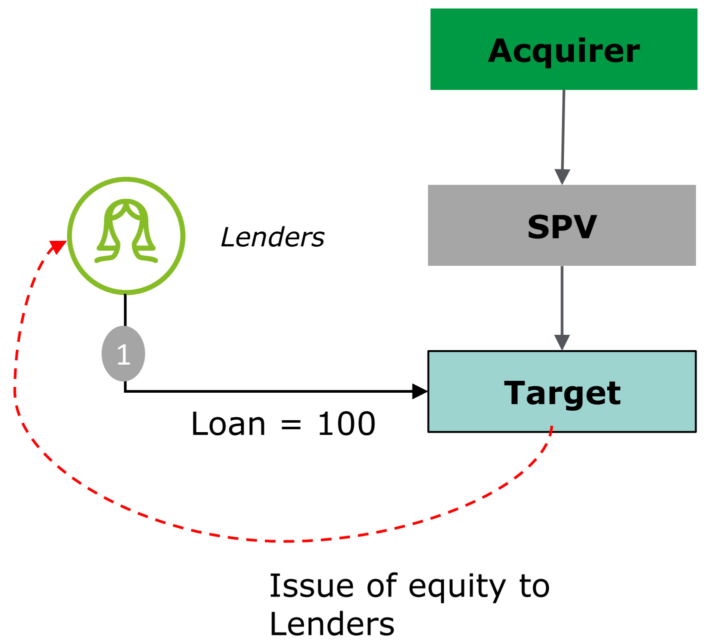
Stage 2

- SPV (of the Acquirer) will acquire the shares of Target from the Lenders at a later date (say 3 years) for a pre-determined price
- Book value per share of the Target is expected to increase in the coming years

Key Consideration for Promoters

- Potential taxability under section 56(2)(x) in the hands of SPV on acquiring the shares of Target from the Lenders after 3 years

Relevant Structure



Direct Tax Considerations
Case study: Slump sale

Background

- Target is an entity undergoing resolution proceedings under IBC
- Acquirer proposes acquisition of the Target through slump sale

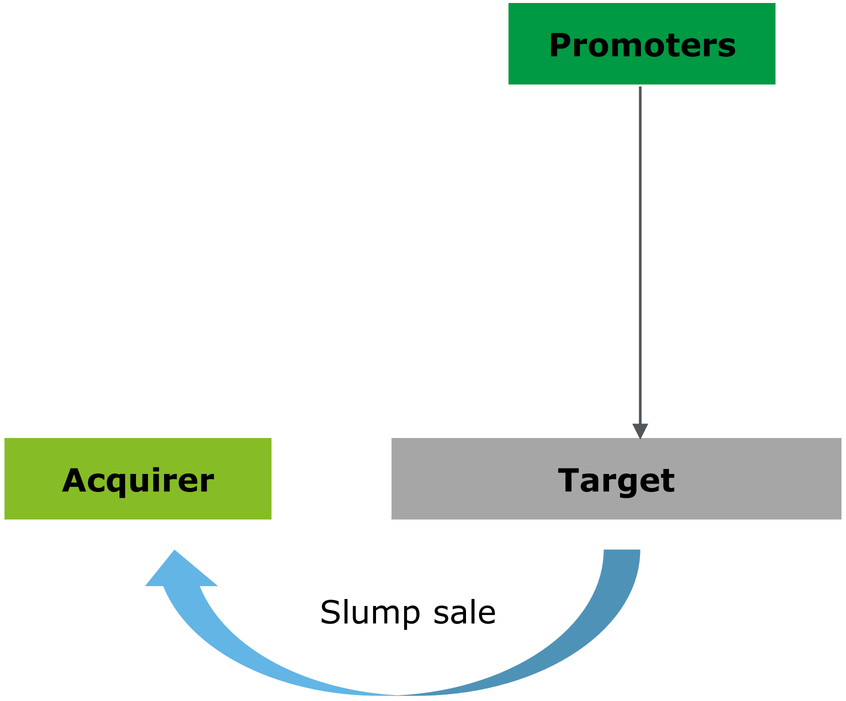
Key Considerations for Target

- Capital gains in the hands of the Target under Section 50B (requirement of fair valuation due to possible applicability of GAAR provisions)

Key Considerations for Acquirer

- Possibility of recognising goodwill and claiming depreciation is a litigious issue
- Non-transfer of tax losses due to non-applicability of Section 72A
- Availability of tax holiday benefits despite the limitations imposed by Section 80-IA
- Obtaining "No Objection" certificate under Section 281, considering the risk of highlighting such transaction to tax authorities

Relevant Structure



Glossary

Abbreviations	Particulars
CCP	Compulsory Convertible Preference Share
CD	Corporate Debtor
CIRP	Corporate Insolvency Resolution Professional
COC	Committee of Creditors
Code/IBC	Insolvency and Bankruptcy Code
ECB	External Commercial Borrowings
GAAR	General Ant-avoidance Rules
GST	Goods And Service Tax
IBC	Insolvency and Bankruptcy Code, 2016
ITA	The Income Tax Act,1961
MAT	Minimum Alternate Tax
NCLT	National Company Law Tribunal
OCP	Optionally Convertible Preference Share
SEBI	Securities and Exchange Board of India
SICA	Sick Industrial Companies Act
UAD	Unabsorbed Depreciation

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