

Insolvency and Bankruptcy code: Tax Issues & Structuring Aspects

December 2019

Strictly Private and Confidential
www.pwc.in



Background

India Inc. lagged a robust insolvency resolution process since independence. Earlier, India had attempted many legislations dealing with Insolvency & Bankruptcy resolution (SICA, SARFAESI Act, etc.). However, none of them yielded results as expected by the stakeholders.



In 2016, the Insolvency and Bankruptcy Code was introduced paving the path for a single regularized insolvency regime mainly with the objective of:

- *Maximization of value of assets of insolvent persons*
- *To promote entrepreneurship & availability of credit*
- *To balance the interests of all the stakeholders*



Recent resolutions under IBC

Tata Steel completes Rs 35,200 crore purchase of bankrupt Bhushan Steel

Tata Steel said Rs 1,200 crore will be paid to operational creditors of BSL over a period of 1 year as per their admitted claims and terms of resolution plan.

By [Sangita Mehta](#), ET Bureau | Updated: May 19, 2018, 08.07 AM IST

Supreme Court paves way for ArcelorMittal's takeover of Essar Steel in ₹42,000 crore deal

3 min read . Updated: 15 Nov 2019, 02:54 PM IST

All-clear for Vedanta to acquire Electrosteel

Electrosteel failed to repay more than Rs 13,000 crore bank loans.

By [Saikat Das](#), ET Bureau | Aug 10, 2018, 05.30 PM IST

NCLAT Approves UltraTech's Revised Bid of ₹7,950 crore for Binani Cement

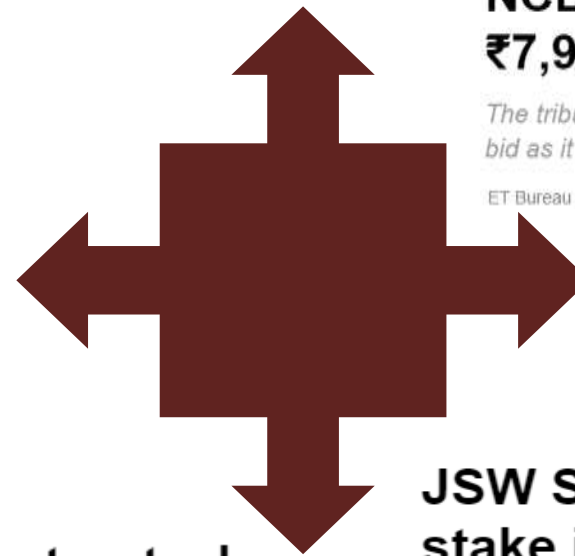
The tribunal rejected Dalmia Group's plea challenging the validity of UltraTech's revised bid as it termed it in violation of Section 29A of the IBC.

ET Bureau | Updated: Nov 15, 2018, 08.01 AM IST

JSW Steel, promoters acquire around 88% stake in Monnet Ispat

MIEL had recently said the insolvency resolution plan approved by NCLT was completed under which JSW Steel provided a working capital advance of Rs 125 crore.

PTI | Sep 04, 2018, 11.24 PM IST



Contents

- | | |
|----|------------------------------------|
| 1. | Background of Corporate insolvency |
|----|------------------------------------|

Section A

- | | |
|----|----------------------|
| 2. | Tax issues under IBC |
|----|----------------------|

- | | |
|----|-------------------------------|
| 3. | Possible Modes of acquisition |
|----|-------------------------------|

Section B

- | | |
|----|---|
| 4. | Resolution Plan – Key Considerations and exemptions |
|----|---|



Background of Corporate Insolvency Process



Background of Corporate Insolvency

01 When can it be initiated?

Insolvency of corporate debtor can be initiated on default of minimum INR 1 Lac by the Corporate debtor

02 Who can initiate?

1. Operational Creditors
2. Financial Creditors
3. Corporate Debtor

03 When can it be initiated?

Initiator to make an application to the NCLT along with records substantiating that a default has happened

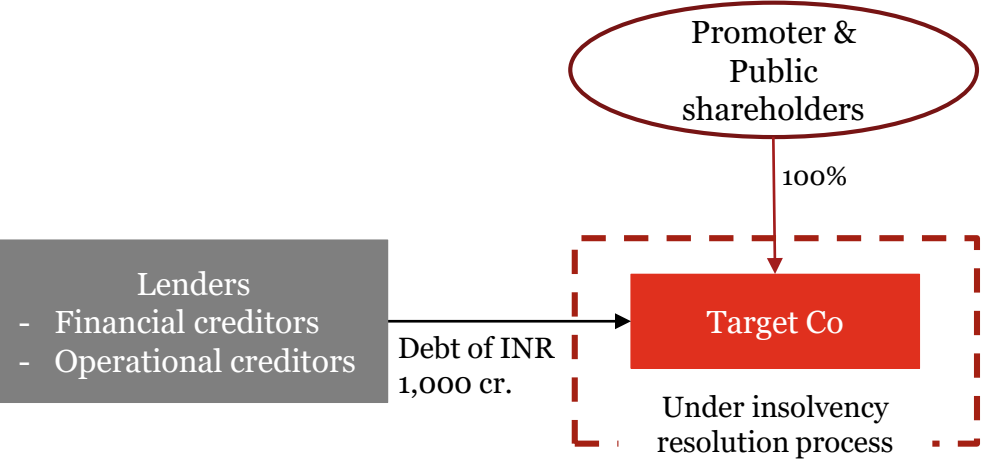
04 Role of NCLT

NCLT may either accept or reject the application for insolvency. In case NCLT accepts the application, CIRP commences



Case Study

Indicative Target's Structure



Facts of Target Co

- Target Co is an Indian Co with an outstanding debt of INR 1,000 cr.
- Target Co is undergoing Corporate Insolvency Resolution Process under IBC
- Target Co prepares its accounts under Ind AS

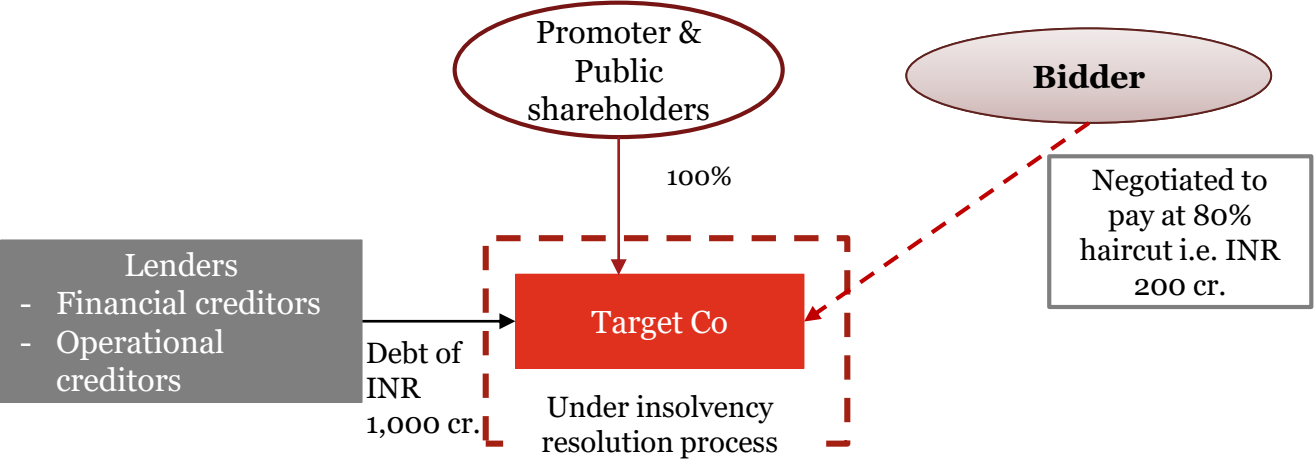
Indicative Balance Sheet of Target Co (in INR cr.)

<i>Equity & Liabilities</i>	<i>Amount</i>	<i>Assets</i>	<i>Amount</i>
Share Capital	100	Assets	800
Other Equity	(300)		
Long Term Liabilities	1,000		
	800		800



Case Study (cont'd)

Post transaction Structure



Proposed Transaction

- Bid Co is contemplating to acquire Target Co for its revival from insolvency and expansion of business in India under IBC process
- Lenders (i.e. Banks) have agreed for a 80% haircut on their debt i.e. receive INR 200 cr. (negotiated consideration/ fair value) in full settlement of their dues of INR 1,000 cr.

Section A – Tax issues under IBC



Key Tax Issues under IBC

01

Normal tax on write back of debt & interest of:

- *Financial creditors*
- *Operational creditors*

Normal Tax

Tax Attributes

03

Preservation of tax attributes of Target

- *Tax Losses*
- *Tax depreciation*
- *Tax cost base of depreciable assets*
- *MAT Net-Operating losses/ depreciation (MAT NOLs)*



Tax issues under IBC



02

Minimum Alternate Tax (MAT) on write back of debt

MAT

Recipient Taxation

04

Recipient Taxation – Infusion of equity in the listed entity where listed price much higher than the fair value of the company



Tax amendments post introduction of IBC



MAT

Both Unabsorbed book losses & unabsorbed book depreciation allowed to be set off for the companies under IBC process

- *However, not much relief to companies as unabsorbed book losses & unabsorbed book depreciation are typically lower than the haircut on principal debt*

Unabsorbed book losses (100) & depreciation (200)	300
Total Debt	1000
Debt Settlement	200
Debt written back	800
Profits for MAT purposes due to debt written back (A)	800
Less: unabsorbed book losses & depreciation (B)	300
MAT payable on (A) – (B)	500

MAT regime to not apply to companies opting for Concessional Tax Regime



Other regulatory amendments



Tax losses

Losses of companies under IBC process not to lapse in case of change in shareholding pursuant to a resolution plan approved under IBC

- *However, this relaxation is subject to affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.*

Does it require a pre-clearance from tax authority? Who shall be responsible to serve notice to tax authority?



Other regulatory amendments



Other regulations

- Open Offer Exemption: Exemption from SEBI (Substantial Acquisition of shares and Takeover) Regulations to acquirer under IBC
- Preferential Issue Exemption: Exemption from SEBI (ICDR) Regulations on Preferential Issue of equity shares by Company under IBC
- Delisting Regulations Exemption: Exemption from SEBI (Delisting of Equity Shares) Regulations to Company under IBC
- Deemed Shareholder Approval: Any approval of shareholders required under the Companies Act, 2013 or any other law for implementation of actions under the resolution plan shall be deemed to have been given



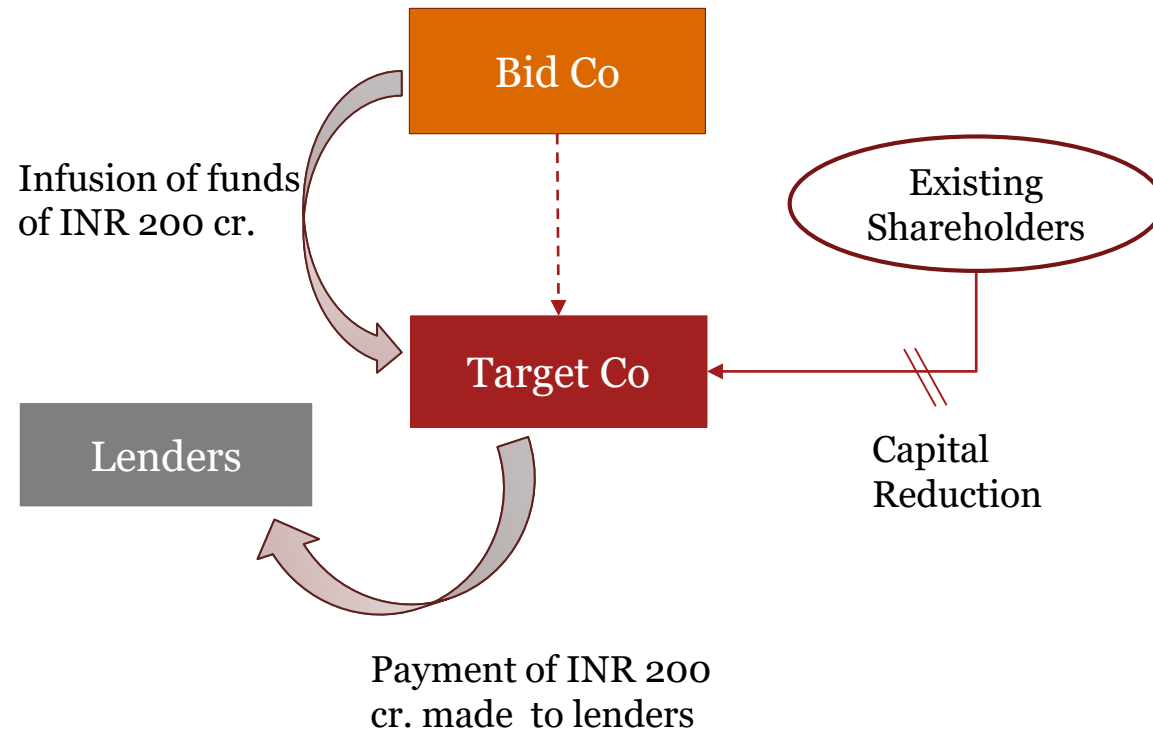
Tax on write back of Debts/ Interest

Normal Tax	
Debt obtained for Capex/ Working capital purposes	<p>Section 28(i) – No tax implications unless Assessee is engaged in the business of lending / factoring</p> <p>Section 28(iv) – Attracted only when the benefit received is in some form other than cash and since waiver of loan results in a receipt in the nature of cash, no taxability should arise (CIT vs Mahindra and Mahindra)*</p> <p>Section 41(1) – No taxability u/s 41(1) as no deduction claimed</p>
Trade Payables/ creditors	<p>Write back is taxable as business income under the normal income tax provisions to the extent of deduction claimed</p> <p>- Tax deduction admissible only when appropriate tax withholding is deducted and paid</p> <p><i>Such tax exposure on account of write back of trade payables/ creditors would be mitigated to the extent of unabsorbed tax losses and depreciation.</i></p>
Write back of O/S Interest	<p>Tax deduction for interest payable to certain financial institutions/ banks is allowed only in the year of its actual payment. Since no deduction would have been claimed at the time of accrual, no taxability would typically arise on waiver of such interest liability</p>
Minimum Alternate Tax	
MAT	<p>Potential acquisition tax –MAT exposure on write back of such debts / interest after adjusting MAT NOLs</p>

Possible modes of acquisition



Option 1 – Infusion of funds into Target Co by Bid Co

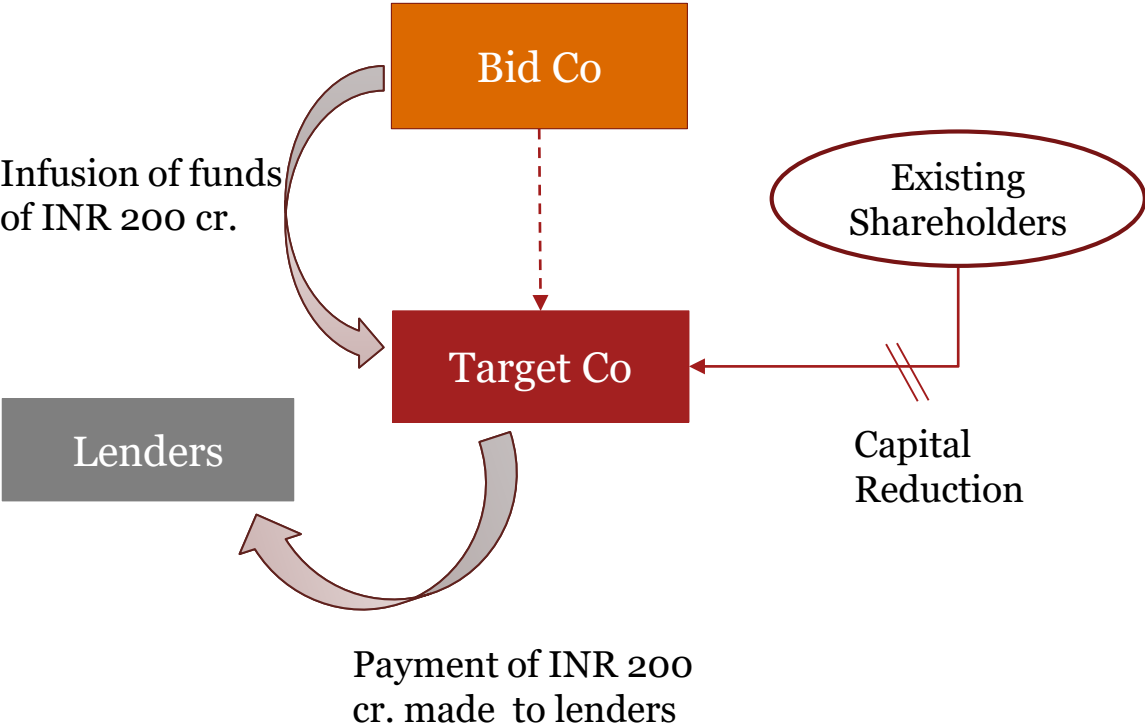


Mechanics

- Bid Co to infuse funds (i.e. INR 200 cr.) into Target Co by way of Equity/ CCD or Debt at fair value
- Funds infused to be used to discharge debts of lenders
- Target Co to undertake reduction of capital of existing shareholders



Option 1 – Infusion of funds into Target Co by Bid Co

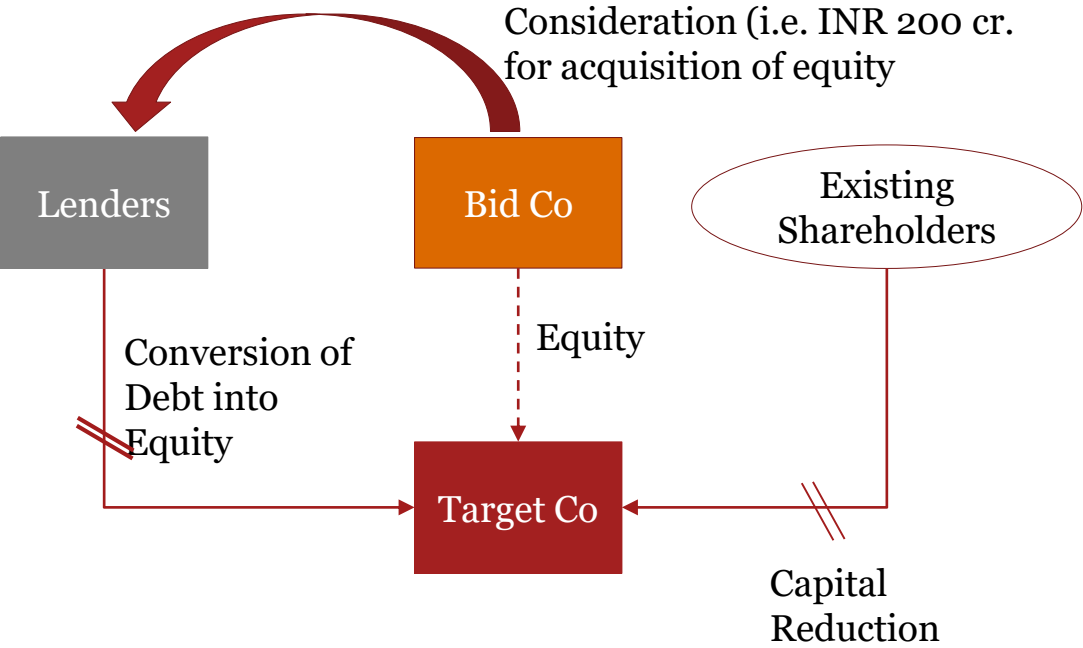


Key Considerations	
MAT on discharge of debt	×
<u>Accounting entry (in Target Co books)</u>	
Debt	Dr. 1,000
To Cash	200
To P&L A/C	800
Recipient taxation u/s 56	✓
Normal Tax on write back of debt/ interest	✓
Preservation of tax losses/ depreciation	✓
Preservation of tax cost base of depreciable assets	✓
Preservation of MAT NOLs	× (Adjusted against aforesaid debt write back)



Option 2 – Conversion of Existing debt into Equity[^] by Lenders

Indicative structure:



Mechanics

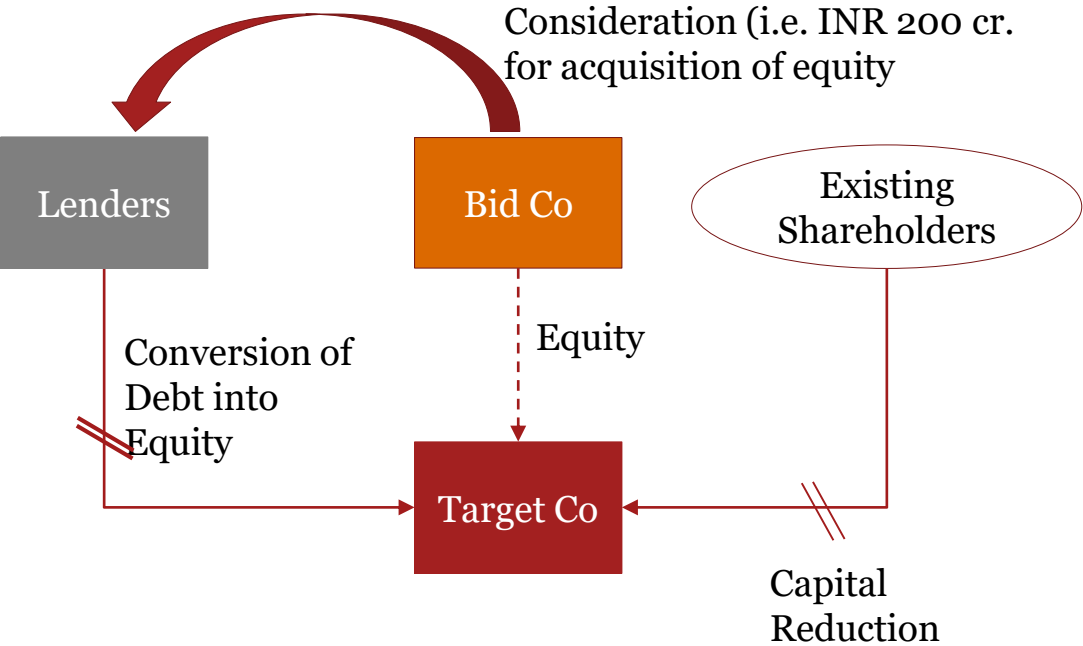
- Lenders to convert debt of Target Co into Equity[^] at fair value (i.e. INR 200 crore)
- Bid Co to purchase shares of Target Co from lenders at INR 200 cr.
- Target Co to undertake reduction of capital of existing shareholders

[^] or any other instrument



Option 2 – Conversion of Existing debt into Equity^ by Lenders

Indicative structure:



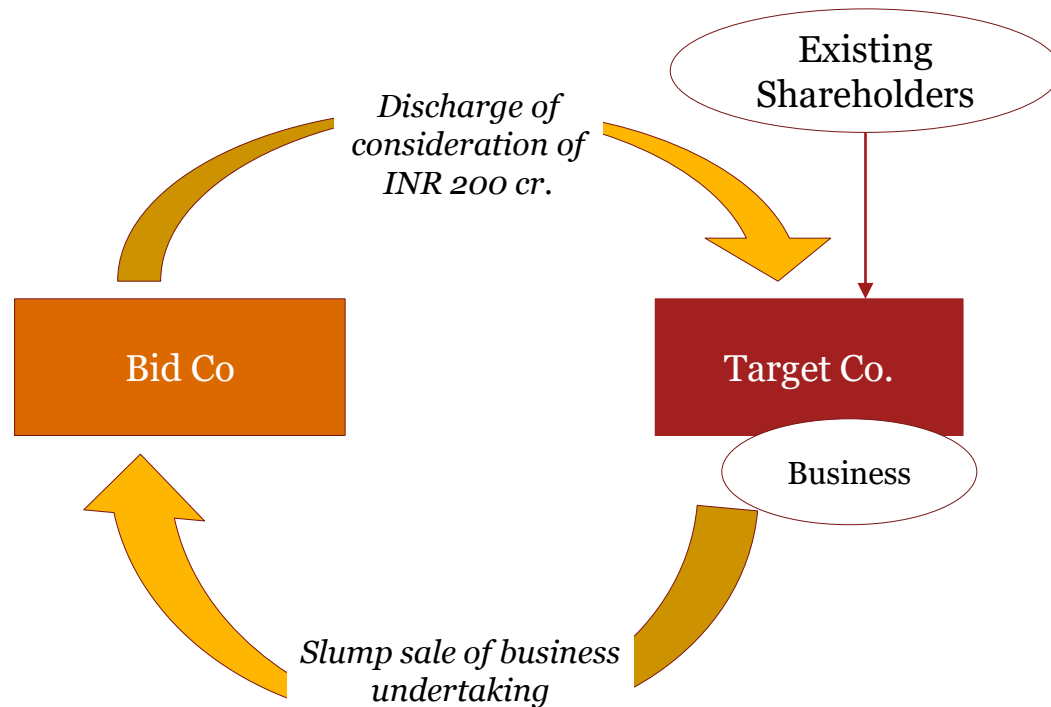
^ or any other instrument

Key Considerations	
MAT* on conversion of debt <u>Accounting entry</u> Debt Dr. 1,000 To Equity 200 (<i>Equity to be credited with the fair value of debts issued</i>) <u>To P&L A/C 800</u>	×
Recipient taxation u/s 56	× (to be analysed on facts)
Normal Tax on conversion of debt/ interest	✓
Preservation of tax losses/ depreciation	✓
Preservation of tax cost base of depreciable assets	✓
Preservation of MAT NOLs	× (Adjusted against aforesaid debt write back)



Option 3 – Acquisition through Slump Sale

Indicative structure:



Mechanics

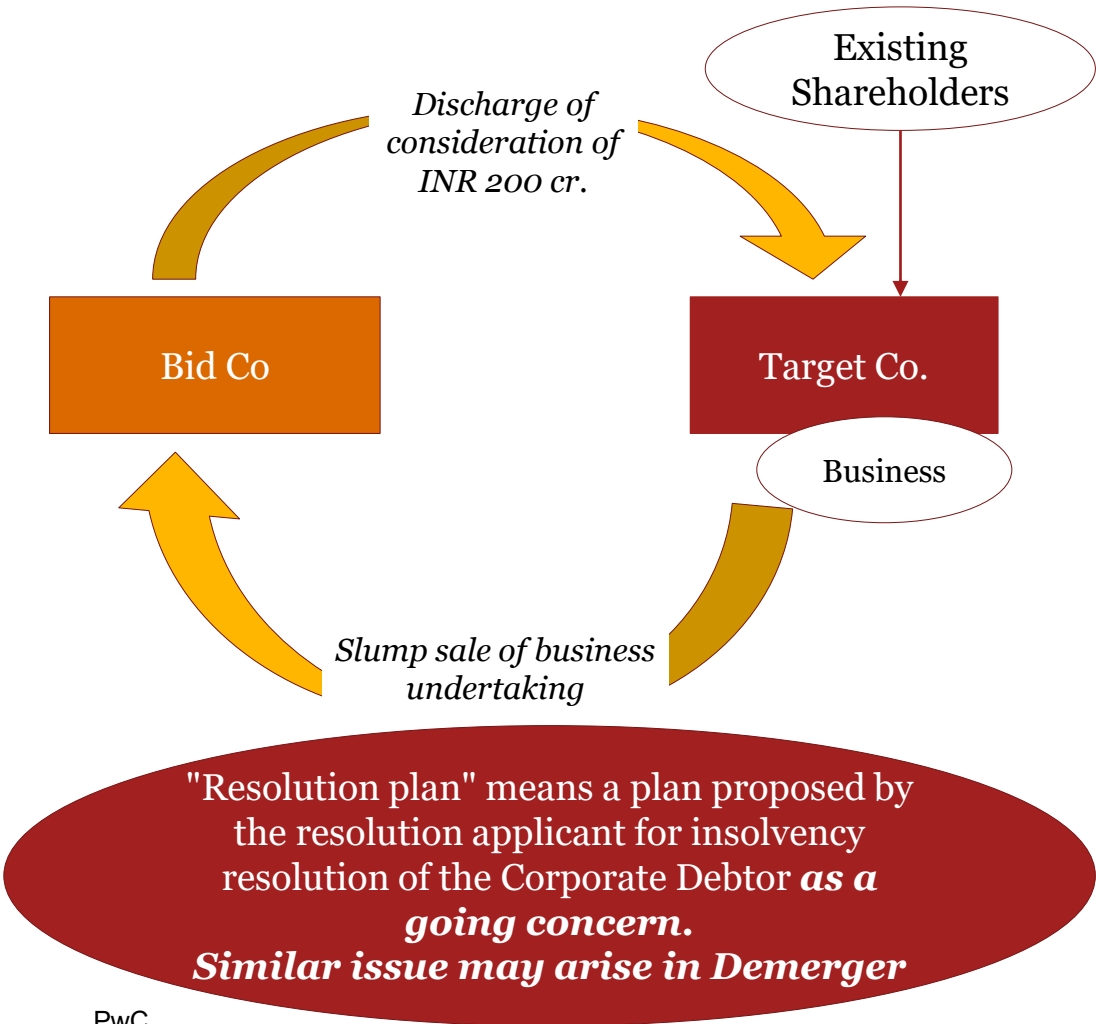
- Target Co to Slump sale its business to Bid Co
- Bid Co to raise funds from its shareholders and discharge consideration of INR 200 cr. to Target Co for the business purchased
- Target Co to discharge its debts and subsequently liquidated
- Business of Target to be carried on by Bid Co

"Resolution plan" means a plan proposed by the resolution applicant for insolvency resolution of the Corporate Debtor **as a going concern.**
Similar issue may arise in Demerger



Option 3 – Acquisition through Slump Sale

Indicative structure:

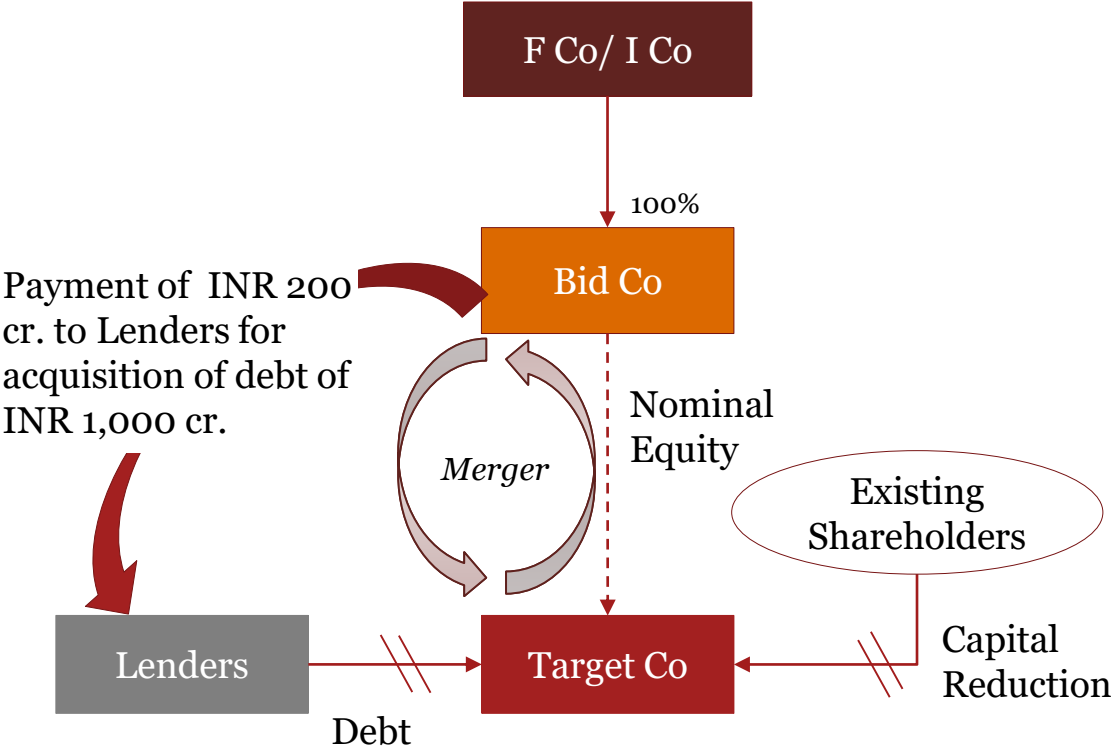


Key Considerations	
MAT on discharge of debt	✓
Accounting entry	Since adjusted against loss on slump sale and applies to Target Co
Debt Dr. 1,000	
To Cash 200 (Cash received on slump sale used to discharge debt by Target Co)	
To P&L A/C 800	
Normal Tax on write back of debt/ interest	✓
Preservation of tax losses/ depreciation	✗
Preservation of cost base of depreciable assets	✗
Preservation of MAT NOLs	✗



Option 4 – Merger of Bid Co and Target Co

Indicative structure:



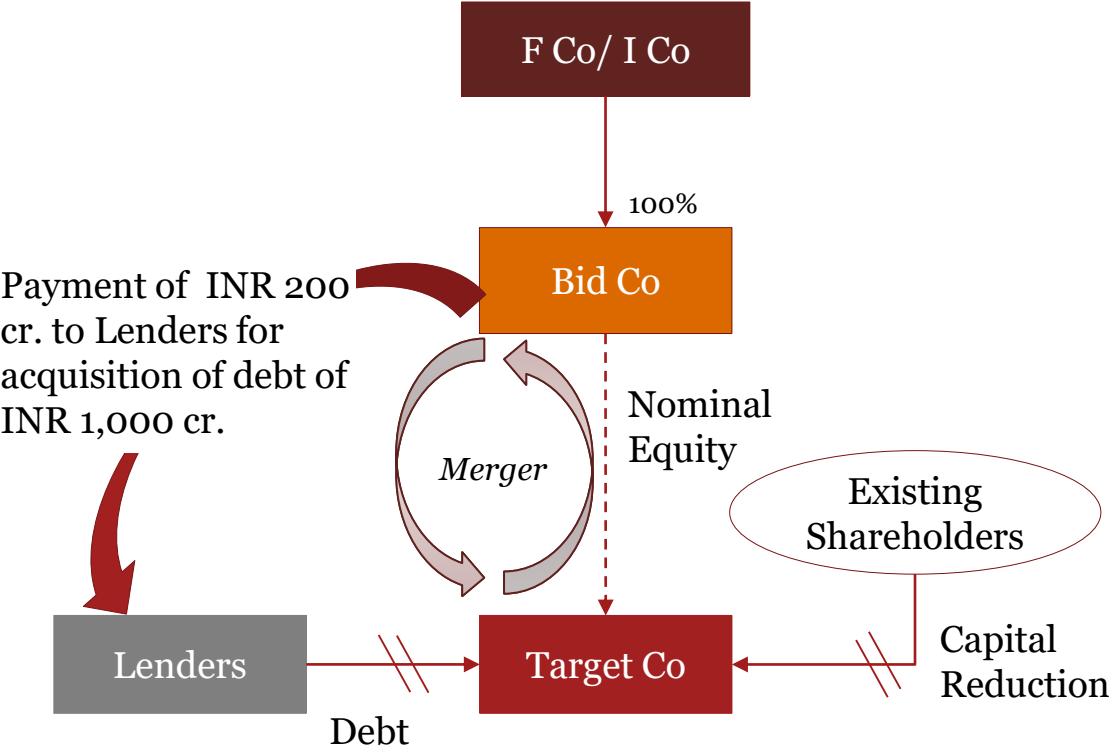
Mechanics

- Bid Co to infuse nominal equity into Target Co at fair value
- Bid Co to acquire debt of INR 1,000 cr. from the lenders at negotiated/ fair value i.e. INR 200 cr.
- Target Co to undertake reduction of capital of existing shareholders
- Bid Co and Target Co to merge



Option 4 – Merger of Bid Co and Target Co

Indicative structure:



Key Considerations	
<u>MAT on write back of debt</u>	
<ul style="list-style-type: none">Acquisition method of accounting to be followed on merger – Fair valuation of all assets & liabilities of Target Co on mergerAny difference between carrying value and fair value to be recognized as goodwill/ capital reserveNo credit to P&L A/C- no MAT implication	✓
Recipient taxation u/s 56	✓
Preservation of tax losses/ depreciation	✓
Preservation of tax cost base of depreciable assets	✓
Preservation of MAT NOLs	x



Amalgamated Co may pay taxes under MAT going forward – Accordingly, debt maybe infused in the Amalgamated Co and tax break on interest shall be available

Section B

Resolution Plan – considerations and exemptions



Resolution plan – considerations & exemptions

- 1** → Requirement of obtaining NOC u/s 281 of the Income-tax Act not applicable
- 2** → All outstanding tax litigations whether contingent / non-contingent or assessed / non-assessed or recorded / unrecorded etc., till Resolution date to be absolved on approval of Resolution plan
- 3** → Provisions of taking over predecessor's Tax liability under section 170 of Income Tax Act not applicable
- 4** → Waiver of non-compliances of taxes prior to acquisition date
- 5** → Relief from payment of stamp duty on amalgamation etc.
- 6** → Transfer of permits & licenses of Target Co to Bid Co in case of merger (if envisaged)
- 7** → No right of subrogation to Promoters against the Target Co



Any Questions?

Annexures



Annexure 1: Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate persons) regulations, 2016

37. Resolution plan.

A resolution plan shall provide for the measures, as may be necessary, for insolvency resolution of the corporate debtor for maximization of value of its assets, including but not limited to the following:-

- a) transfer of **all or part** of the assets of the corporate debtor to one or more persons;
- b) sale of all or part of the assets whether subject to any security interest or not;
- c) the substantial acquisition of shares of the corporate debtor, or the **merger or consolidation of the corporate debtor** with one or more persons;
- (ca) cancellation or delisting of any shares of the corporate debtor, if applicable