

# Insolvency & Bankruptcy Code – Key Tax Issues

CA Saumya Sheth

**BGSS & Associates**

Chartered Accountants

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# Introduction

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# Insolvency Regulations in India

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## Erstwhile law on Insolvency in India

- Insolvency resolution and liquidation in India was governed by a plethora of legislations like:
  - SARFAESI Act, 2002
  - Recovery of Debt Due to Banks and Financial Institutions Act, 1993
  - SICA Act, 1985 ( Now Repealed)
  - The Presidency Towns Insolvency Act, 1909 (Now Repealed)
  - The Provincial Insolvency Act, 1920 (Now Repealed)
  - Companies Act, 2013
- Such multiple legislations lead to immense confusion in the legal system

## Introduction of IBC

- Insolvency and Bankruptcy Code, 2016 (IBC) was introduced w.e.f 28 May, 2016 consolidating existing laws relating to insolvency in a single legislation thereby facilitating a time bound resolution of stressed businesses

# Intent & Applicability of IBC Code

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**Consolidation of various insolvency laws into a single legislation**

**Maximization of Asset Value**

**Promote Entrepreneurship**

**Availability of Credit**

**Balance interests of all stakeholders**

**IBC Code applies to  
Companies, Partnership Firms,  
LLP, Proprietary Concerns and  
Individuals**

**IBC Code does not apply to:  
NBFC, Investment companies and  
Finance Companies**

# IBC Framework

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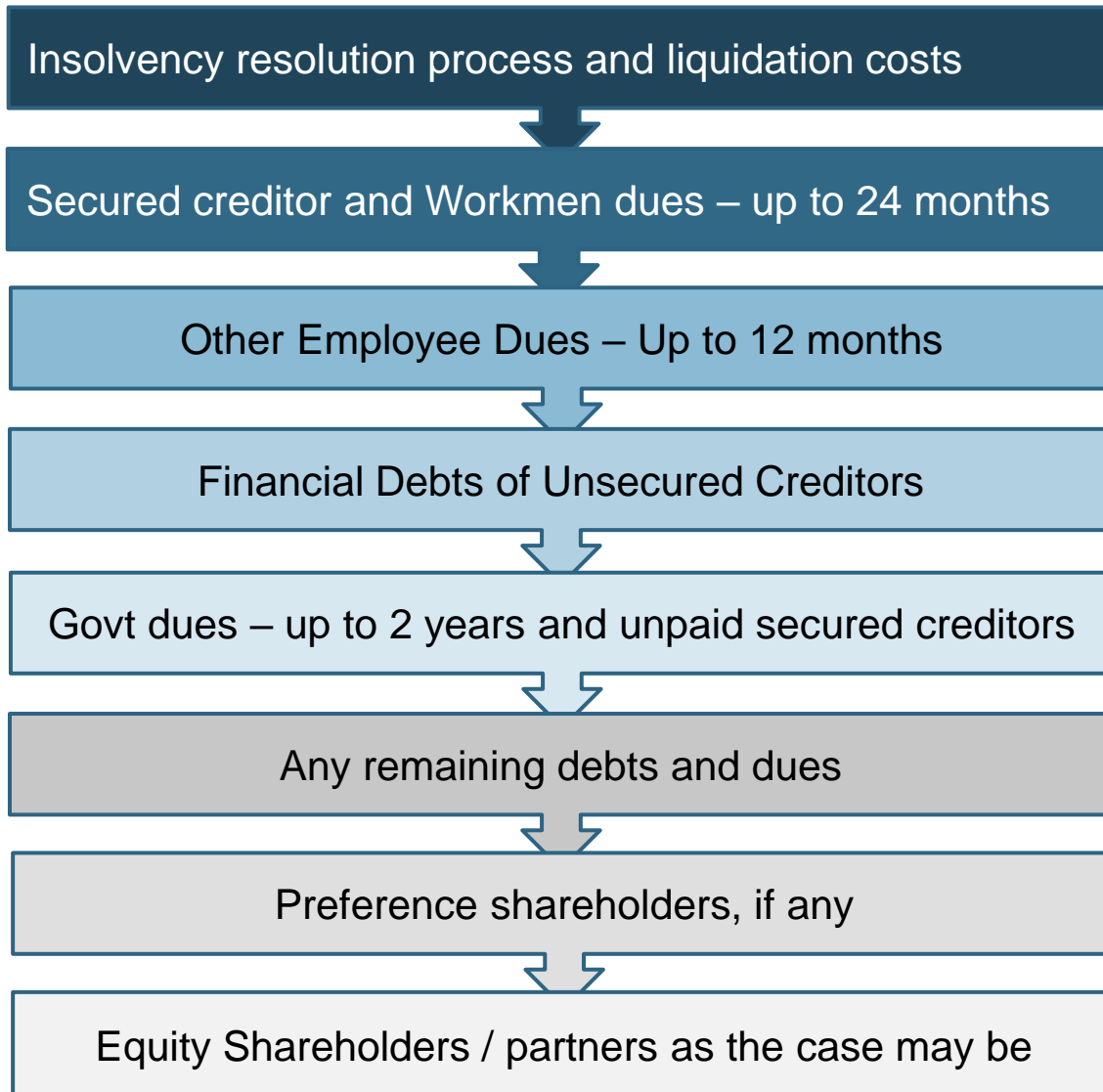
IBC Code is divided into 5 parts consisting of 225 sections:

<b>Part I</b>	Preliminary – <b>Definitions</b> of General Terms
<b>Part II</b>	Insolvency Resolution and Liquidation for <b>Corporate Persons</b>
<b>Part III</b>	Insolvency Resolution and Bankruptcy for <b>Individuals and Partnership Firms</b>
<b>Part IV</b>	Regulation of <b>Insolvency Professionals, Agencies and Information Utilities</b>
<b>Part V</b>	Miscellaneous

**IBC Code has an over riding effect over all other laws - Section 238**

# Waterfall Mechanism

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**Intent of IBC is to negotiate possibility of restructuring of debt between creditor the debtor and assess the viability of debtor's business as a going concern rather than liquidation or winding up**

# Erstwhile regulations v/s IBC

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<b>Erstwhile Insolvency Regulations</b>	<b>IBC</b>
<b>Legislations:</b> <ul style="list-style-type: none"><li>✓ Plethora of Legislations giving rise to confusion and delay in resolution process</li></ul>	<ul style="list-style-type: none"><li>✓ Existing laws amended and consolidated into a Single Legislation</li></ul>
<b>Timelines :</b> <ul style="list-style-type: none"><li>✓ No Specific Timelines</li></ul>	<ul style="list-style-type: none"><li>✓ Resolution of Insolvency Process within 180 days</li></ul>
<b>Control:</b> <ul style="list-style-type: none"><li>✓ Operational control in the hands of promoters / debtors leading to possibilities of misappropriation of funds</li></ul>	<ul style="list-style-type: none"><li>✓ Operational Control in the hands of Resolution Professional to be appointed by Committee of Creditors</li></ul>
<b>Insolvency Professionals</b> <ul style="list-style-type: none"><li>✓ Lack of Insolvency Professionals</li></ul>	<ul style="list-style-type: none"><li>✓ Appointment of Insolvency Professional mandatory</li></ul>

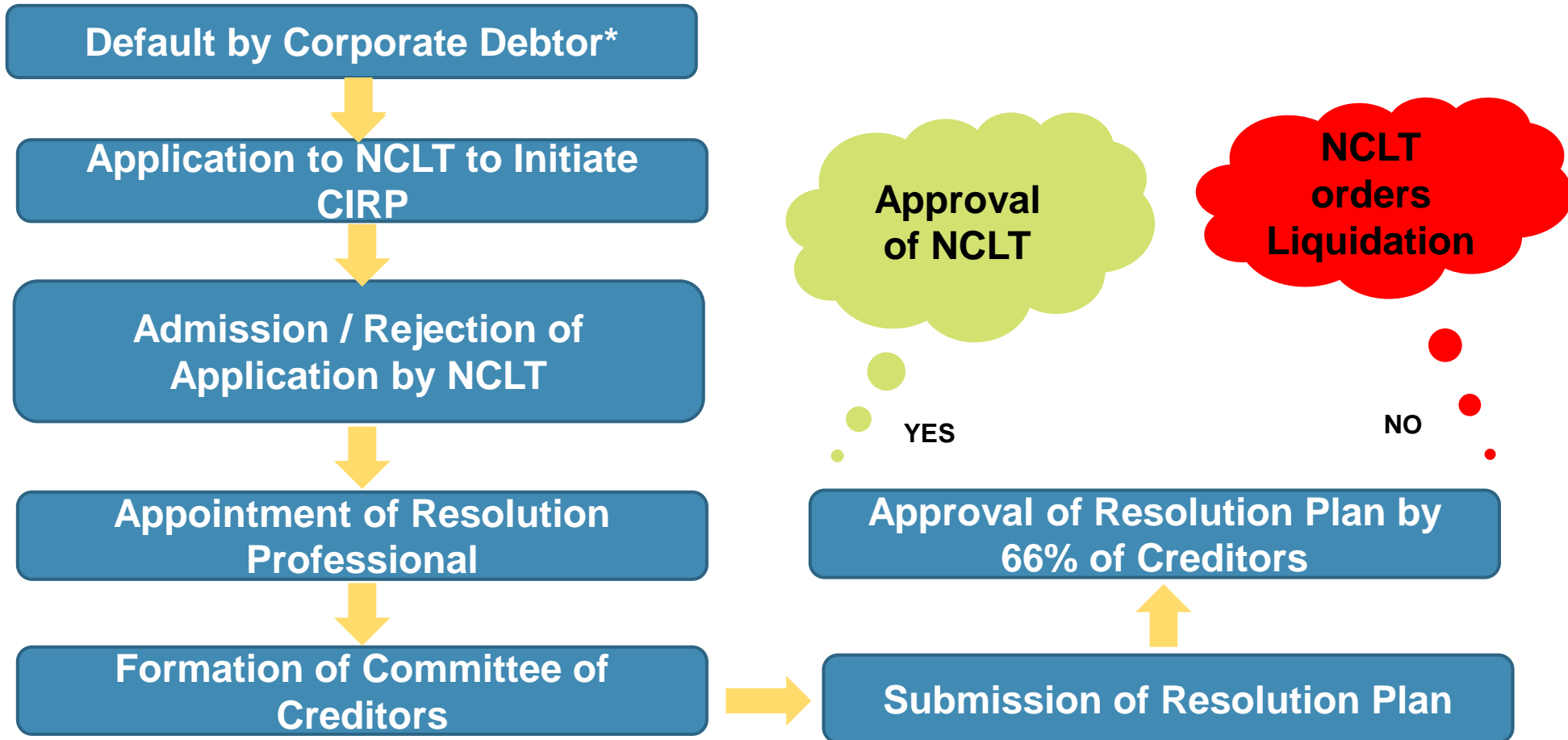
# Erstwhile regulations v/s IBC

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Erstwhile Insolvency Regulations	IBC
<b>Waterfall Mechanism</b> ✓ Unclear Waterfall Mechanism for payment of debt	✓ Well Defined Waterfall Mechanism
<b>Information Utilities</b> ✓ No Specific Timelines	✓ Resolution of Insolvency Process within 180 days
<b>Assessment of Insolvency</b> ✓ Net Worth Based Approach	✓ Cash Flow Based Assessment



# Corporate Insolvency Resolution Process



**CIRP process is required to be completed within a period of 180 / 270 days failing which NCLT orders liquidation**

\*For an amount exceeding Rs. 100,000

# Four Large Accounts under IBC\*

Amount in Crores of Rupees

<b>Name of Corporate Debtor</b>	<b>Resolution Applicant</b>	<b>Claim of Financial Creditors</b>	<b>Amount Realized</b>
Electrosteel Steels Limited	Vedanta Ltd.	13,175	5,320
Bhushan Steel Ltd.	Tata Steel Ltd	56,022	35,571
Monnet Ispat & Energy Ltd.	Consortium of JSW Steel and AION Investments Pvt. Ltd.	11,015	2,892
Amtek Auto Ltd	Liberty House PTE	12,605	4,334

\* Based on quarterly newsletter released by IBBI for July – Sept, 2018

# SEBI Regulations for IBC companies

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# SEBI v/s IBC

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**Several SEBI Regulations were amended w.e.f. 1 June, 2018 to facilitate insolvency resolution plan for listed entities under the IBC Code**

## **Amendment to SEBI Takeover Regulations**

- ✓ Acquirer holding 25% or more of shares or voting rights in a listed company may acquire shares more than the prescribed maximum non-public shareholding i.e. 75% subject to and in accordance with the resolution plan approved by the NCLT
- ✓ Thus, Acquirer may now infuse funds by way of equity capital without triggering the takeover regulations
- ✓ However, such acquirer would need to comply with minimum public shareholding requirement of 25% within a period of one year from the date of acquisition of shares

## **Amendments to SEBI ICDR Regulations**

- ✓ Equity and convertible instruments issued pursuant to NCLT approved resolution plan would be exempt from compliances in relation to preferential allotment of securities (like pricing, shareholders resolution, disclosures etc.)
- ✓ However requirement of Lock-in pursuant to preferential issue needs to be complied with

# SEBI v/s IBC

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## Amendment to SEBI Delisting Regulations

- ✓ Delisting of a Company undergoing Insolvency resolution proceedings would not be required to comply with the onerous requirements of delisting such as bidding/ reverse book building process, fixation of the floor price, prior approval of stock exchanges etc.
- ✓ However, the above exemption would be available only once the NCLT Approved Resolution Plan lays down specific procedure for delisting or provides an exit option to existing public shareholders at a price specified in the resolution plan

## Amendments to SEBI LODR Regulations

- ✓ Specific disclosures in relation to the resolution application and resolution plan to be made to stock exchanges within one day of resolution plan being approved. No further compliances (like fairness opinion, valuation report, majority approval of minority) required
- ✓ Erstwhile promoters may be reclassified as Public Shareholders, if such promoters have no control over the Listed Company
- ✓ Resolution Professional appointed under IBC Code, shall step into the shoes of the Board of Directors and various Committees
- ✓ No shareholder approval required for material related party transactions or any actions taken as part of the Resolution Plan approved by NCLT

# Key Income tax implications under IBC

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# Income Tax implications under IBC

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## Type of creditors

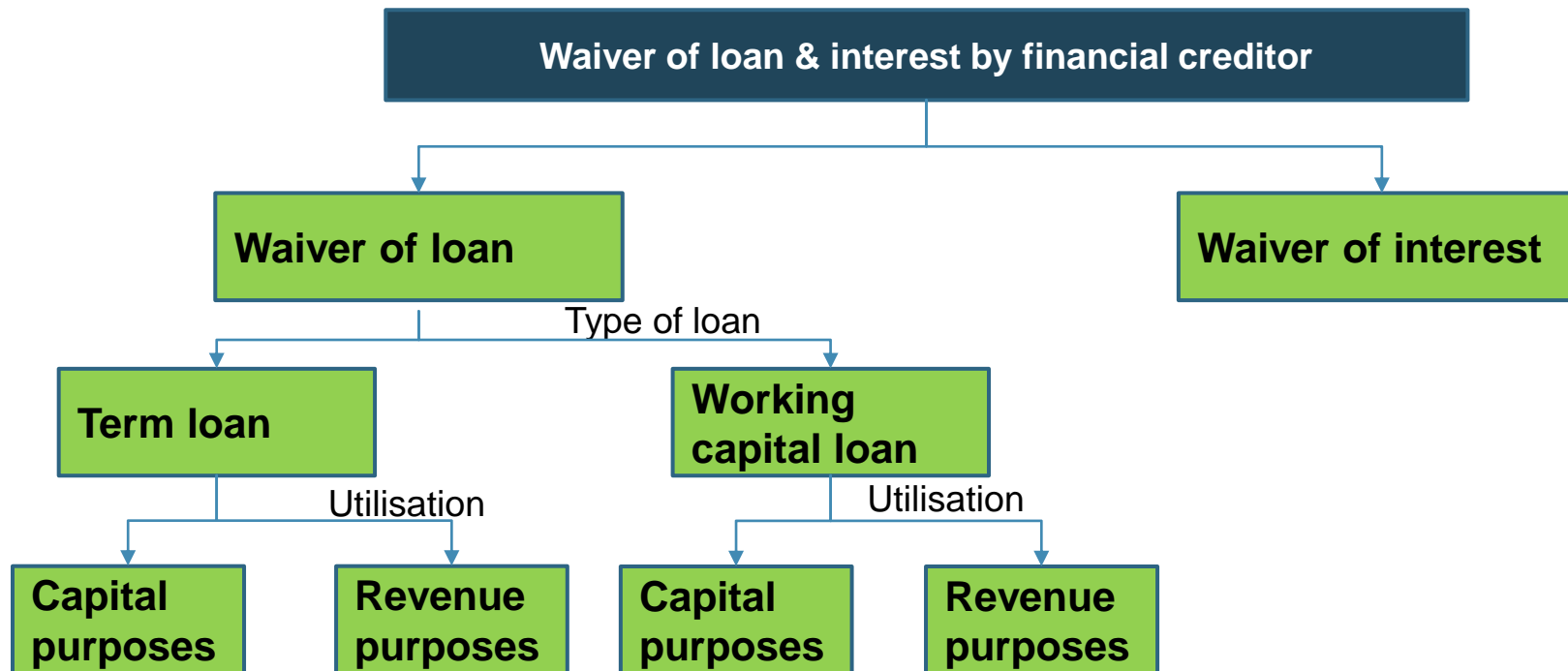
- Under IBC, there are two categories of creditors, viz. Financial creditor & Operational creditor
- **Financial Creditor** – sec 5(7) of IBC - a person to whom financial debt is owed (including a person to whom debt has been legally assigned or transferred)
- **Financial Debt** – sec 5(8) of IBC - debt along with interest disbursed against consideration for time value of money and includes specified borrowings. List of specified borrowings is given in **Annexure 1**
- In common parlance, financial creditor can be understood to mean person from whom loan is received and would therefore, include banks & other financial institutions
- **Operational Creditor** – sec 5(20) of IBC - a person to whom operational debt is owed (including a person to whom debt has been legally assigned or transferred)
- **Operational Debt** – sec 5(21) of IBC - claim in respect of goods or services, including employment, or debt arising under any law and payable to Central Government / State Government / local authority
- Hence, normal creditors for goods and services, including government dues would be covered under the category of operational creditor

# Income Tax implications under IBC – Loan waiver

## Tax Implications on waiver of loans and other liabilities:

The first step under resolution plan approved by NCLT, would generally involve waiver of loans and other liabilities of the corporate debtor, which is subject to IBC proceedings

Tax implications on waiver of loans can be bifurcated based on type of loan & end use as under:





# Income Tax implications under IBC – Interest waiver

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## Waiver of interest amount – Implications under normal tax provisions

- Ideally the corporate debtor would have claimed deduction of interest on loan in previous years
- Hence, waiver of interest amount would constitute income and be taxable under section 41(1) of the Act
- However, if interest amount claimed was disallowed under section 43B in earlier years, court\* has taken a view that said waiver is not taxable under section 41(1)
- Further, court\* has also taken a view that said waiver cannot be taxable under section 28(iv)

**Waiver of interest – Taxable under section 41(1) if deduction claimed in earlier years**

\*See 35 taxmann.com 304

# Income Tax implications under IBC – Loan waiver

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## Waiver of loan amount – Implications under normal tax provisions

- Tax implications on waiver of loan is dependent on its utilisation, viz. capital purposes & working capital loan
- Supreme Court\* has now settled the position and held that write back of loan which has been utilised for capital purposes would not be taxable either under section 28(iv) or under section 41(1)
- With regards to loan utilised for working capital, High Courts\*\* have taken a view that waiver of such loans would be taxable under section 28(iv)
- Hence, with respect to waiver of loan utilised for working capital purposes, there seems to be potential tax implications in hands of corporate debtor

**Write back of loan utilized for capital purposes – Not taxable**  
**Write back of loan utilized for revenue purposes - May be taxable**

\*Refer Mahindra & Mahindra Ltd. - 93 taxmann.com 32

\*\*Refer Ramaniyam Homes (Madras HC) 384 ITR 530, Solid Containers Ltd. (308 ITR 417)  
(Bombay HC)

# Income Tax implications under IBC – Loan waiver

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## Applicability of MAT provisions to IBC companies

- Under Explanation 1 to section 115JB(2) of the Act, MAT is not applicable on profits earned by sick companies commencing from the year company is sick company under Section 17 of SICA and ending in the year in which entire net worth of company becomes positive
- However, no specific exemption is available for IBC companies
- Hence, any write back of loan / interest if credited to P&L A/c can create potential MAT liability

## Accounting implications on write back

- Indian Accounting Standard (“Ind AS”) 109 stipulates that upon waiver of a loan, the difference between the carrying amount of the loan and the consideration actually paid towards such waiver would be routed through profit and loss account.
- Therefore, if a financial liability (being a loan) is extinguished without paying any consideration, the entire extinguished liability would be treated as part of income in the profit and loss statement of the debtor, thus attracting MAT provisions.

# Income Tax implications under IBC – Loan waiver

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## Loan and interest waiver – MAT implications

- Once loan and interest waiver is credited to P&L Account as per accounting treatment being followed, it may be subject to MAT
- No specific exclusion in 115JB to exclude such waiver of loan
- However, based on particular facts in following rulings, it was held that waiver of loan is capital receipt and hence, not an income, even if credited to P&L Account. Hence, MAT does not apply:
  - JSW Steel Ltd. v. Asst. CIT (Mumbai ITAT) (82 taxmann.com 210)
- Similarly in following rulings, based on general principles, it was held that if an item is not an income under the Act, MAT does not apply:
  - Shivalik Venture (P) Ltd. vs. DCIT (Mumbai ITAT) (173 TTJ 238)
  - Shree Cement Ltd. vs. ACIT (Jaipur ITAT) (152 ITD 561)

# Income Tax implications under IBC – Loan waiver

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## Loan and interest waiver – MAT implications

- However, contrary rulings are also present which state that if an amount is credited to P&L A/c, MAT is applicable:
  - B & B Infotech Ltd. v. ITO (Bangalore ITAT) (130 TTJ 213)
  - Duke Offshore Ltd. v. DCIT (Mumbai ITAT) (45 SOT 399)
- However, if based on accounting principles, if loan and interest waiver is not credited to P&L A/c, MAT may not apply to such waiver

## Conversion of loans into equity – Tax implications under section 269T

- Section 269T mandates that loan / deposit above specified sum has to be repaid by account payee cheque or electronic clearing system
- The issue which arises for determination is whether conversion of loan into equity can be said to be in contravention of provisions of section 269T of the Act
- Courts\* have taken a view that such conversion, although strictly speaking is in violation of section 269T of the Act, there exists a reasonable cause and hence, penalty u/s 271E should not apply

\*Refer illustratively, Triumph International Finance (I) Ltd. (Bom HC) (345 ITR 270) & Arkit Vincom Pvt. Ltd (Kol ITAT)

# Income Tax implications under IBC – Losses

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## Brought forward losses under MAT

- As per amendment made in section 115JB by Finance Act 2018, for companies which have been admitted by NCLT under IBC, total of brought forward losses and unabsorbed depreciation as per books of accounts has to be reduced
- Hence, as against lower of brought forward losses or unabsorbed depreciation for rest of the companies, substantial relaxation is provided for companies under IBC
- Whether, said provision would continue even after CIRP proceedings have been completed?

## Carry forward of losses on change in shareholding under section 79

- Section 79 provides that if there is change in shareholding by more than 51% in a company (in which public is not substantially interested), losses would not be carried forward
- In case of companies referred to in IBC, there would be change in shareholding resulting into lapses of losses as per tax provisions
- Hence, specific exemption provided under section 79 to IBC companies by Finance Act, 2018 if the resolution plan is approved by IBC and **reasonable opportunity of being heard** is provided to **jurisdictional Commissioner / Principal Comm**

# Tax implications under IBC - Losses

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## **Carry forward of losses upon merger / demerger – Section 72A**

- Section 72A provides for conditions to be fulfilled by amalgamated company / resulting company for carry forward of losses incurred in amalgamating company / demerged company
- In the erstwhile SICA regime, while passing orders, BIFR used to relax conditions under section 72A
- However, no specific amendment made in section 72A for companies covered under IBC

## **Carry forward of losses – Section 80**

- Section 80 specifies that loss would be carried forward only if return of income is filed before the due date
- No specific amendment for companies and hence, it may be possible that due to ongoing CIRP proceedings, return of income may be filed beyond due date resulting into losses being lapsed

## **Filing of return by RP for IBC companies**

- Filing of IBC companies would be undertaken by RP as per amendment made in section 140 by Finance Act, 2018

# Tax implications under IBC – FMV of assets

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## Applicability of section 56(2)(x) / 50CA

- No specific exemption provided for IBC companies
- Section 56(2)(x) / section 50CA refers to fair market value of shares to be determined as per Rule 11UA which is mainly Net Asset Value after substituting following values:
  - Immovable property – Stamp duty value;
  - Jewellery or artistic work – Based on valuation report obtained from registered valuer;
  - Investment in equity shares – Based on value determined as per Rule 11UA
- In case of IBC companies, possible that real fair market value of equity shares is much lower than FMV compute as per above rules
- In such cases, possibility of tax litigation would arise



# Tax implications under IBC – Tax dues

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## Tax department's claim on assets of companies under IBC

- Sec 178 relating to appointment of liquidator amended to provide that it would be subject to IBC provisions
- Post amendment by IBC, tax department is not a secured creditor and hence, liquidation would be as per section 53 of IBC
- Recently, Andhra Pradesh High court held\* that despite charge of tax authorities on assets of the company by virtue of initiating attachment proceedings, charge would need to be lifted as tax department is not a secured creditor

## Proceedings during moratorium period

- Section 14 of IBC provides that all existing / pending suits / recovery proceedings would be stalled during the moratorium period imposed by NCLT
- Does it also apply to ongoing income tax proceedings ?

\* In the case of Leo Edibles and Fats Limited v. TRO, (Writ Petition No 8560 of 2018)

# Tax implications under IBC – Tax dues & stamp duty

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## **NOC from income tax department required – Section 281**

- Section 281 provides that no objection certificate to be obtained from tax authorities before transferring any asset
- Implications under IBC code

## **Stamp duty on transfer of property under IBC**

- No specific exemptions on payment of stamp duty upon transfer of properties of IBC companies

# Our Offices

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## AHMEDABAD

209, Balaji Heights, Near IDBI Bank, C.G. Road,  
Ahmedabad – 380 009

Email : [saumya@bgss.co.in](mailto:saumya@bgss.co.in)

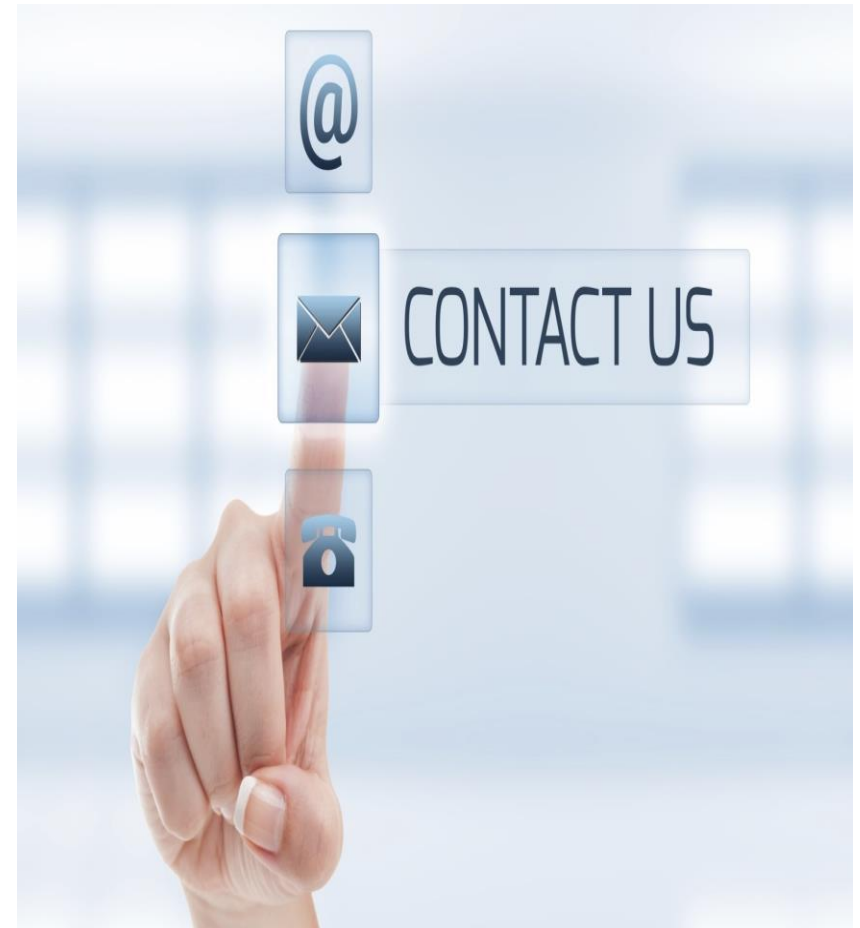
Mobile No: +91 90999 27783

## MUMBAI

605, Zee Nayak, M.G. Road, Vile Parle (East),  
Mumbai – 400 057

Email : [bhaumik@bgss.co.in](mailto:bhaumik@bgss.co.in)

Mobile No: +91 98339 15583



*Thank You*

# Annexure 1 – Definition of Financial Debt under IBC

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## Section 5(8) of Part II of IBC – Definition of financial debt

*"financial debt" means a debt alongwith interest, if any, which is disbursed against the consideration for the time value of money and includes—*

*(a) money borrowed against the payment of interest;*

*(b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent;*

*(c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;*

*(d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;*

*(e) receivables sold or discounted other than any receivables sold on non-recourse basis;*

*(f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing.*

*Explanation.—For the purposes of this sub-clause,—*

*(i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and*

*(ii) the expressions, "allottee" and "real estate project" shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (16 of 2016);]*

*(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;*

*(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;*

*(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause;”*