



The Insolvency & Bankruptcy Code, 2016
Direct Tax Aspects

29 June 2019

Agenda

Section 1

Introduction to the Code

Section 2

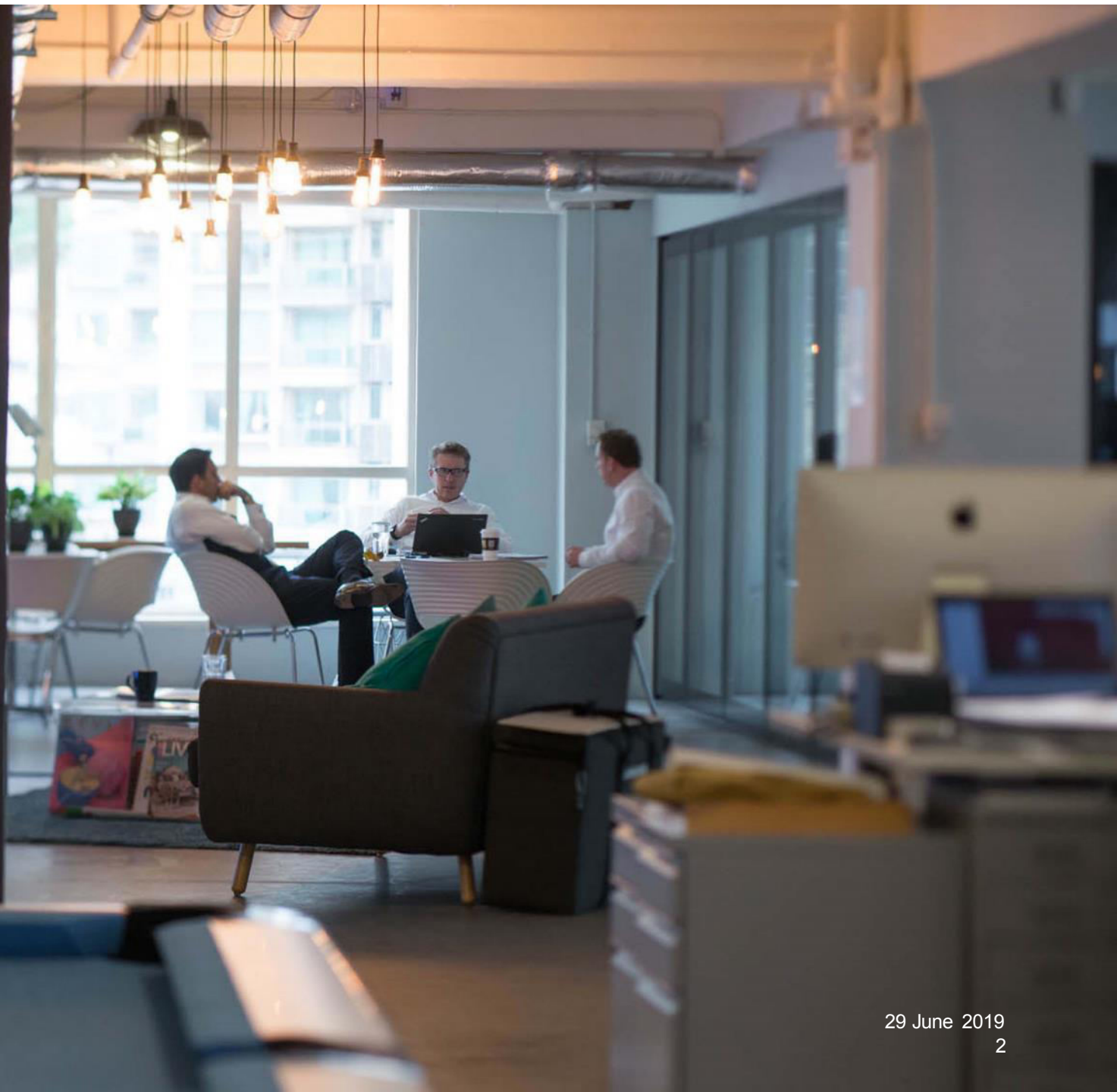
Direct Tax Aspects

Section 3

Regulatory Aspects

Section 4

Annexures



01 Section

Introduction to the Code



Object of the Code

To consolidate and amend laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals

Time bound process

Maximisation of value of assets

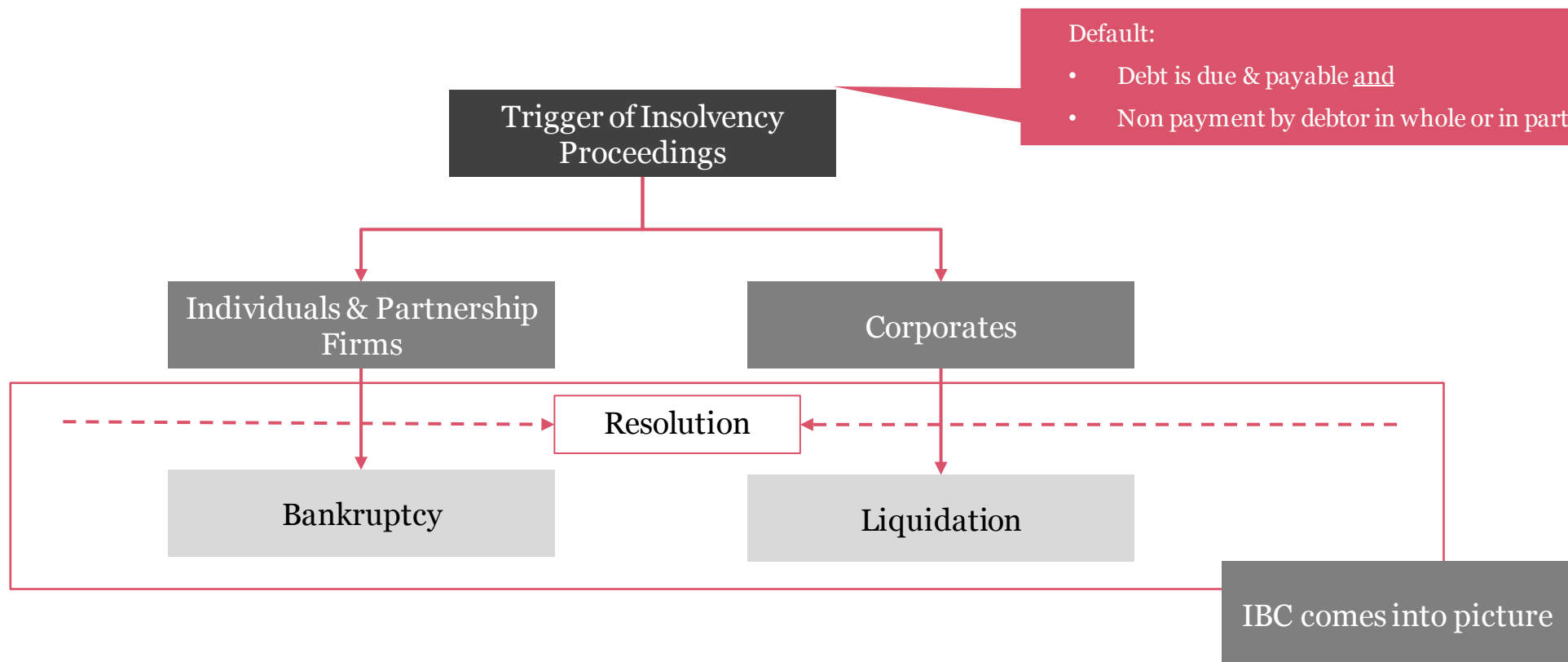
Promote entrepreneurship

Availability of credit

Balance the interests of all stakeholders including alteration in the order of priority of payment of Government dues



Insolvency under IBC regime



Application of the Code

Applicability

- Companies incorporated under the Companies Act
- Companies governed by any special Act
- LLPs
- Such bodies (incorporated under any law) as notified by CG
- Personal guarantors to corporate debtors
- Partnership Firms and Proprietorship firms
- Individuals

Non-applicability

- Financial service provider
- Example – Banks, Financial Institutions, Insurance Company, Asset Reconstruction Company, Mutual Funds, Collective Investment Schemes or Pension Funds

Default limits

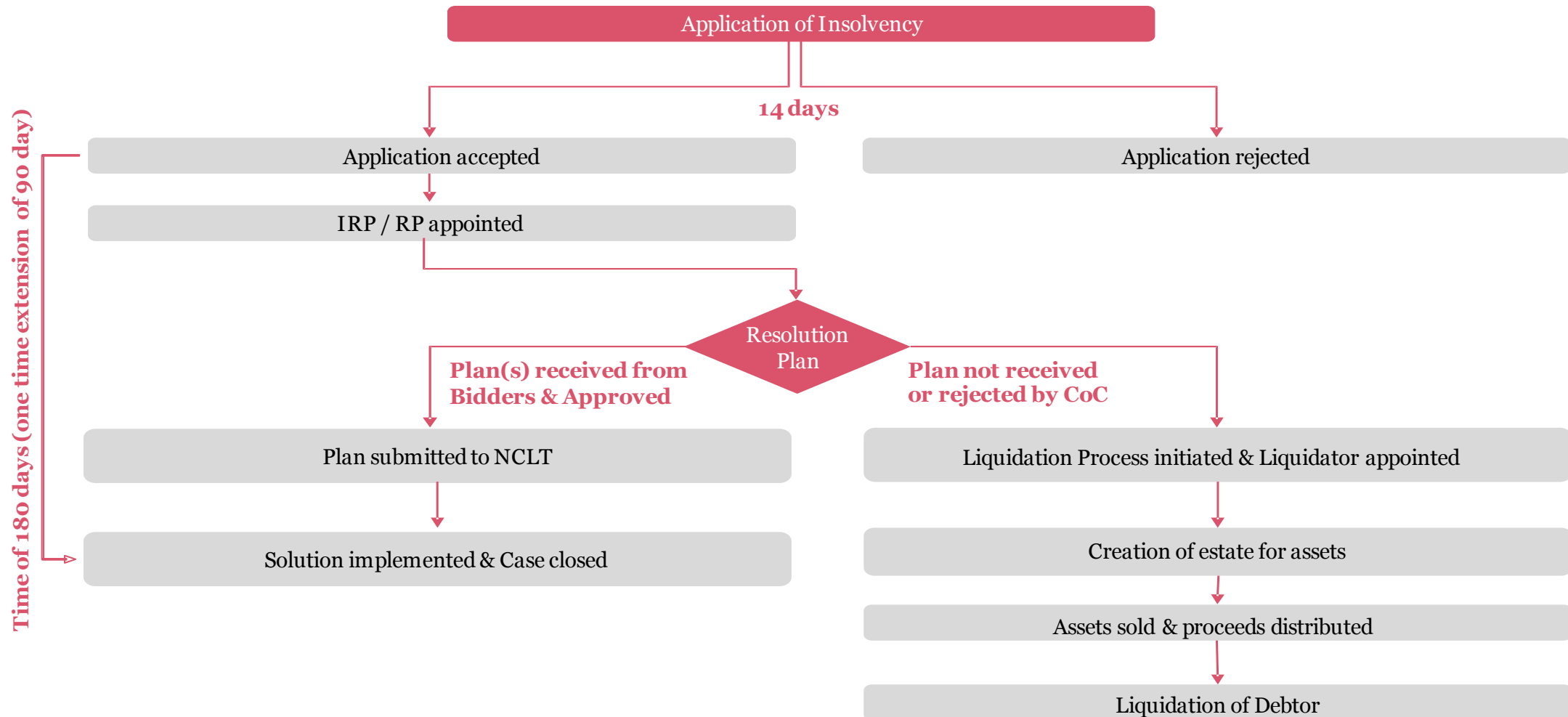
- For Corporates – INR 1 lakh [CG can notify higher value not exceeding INR 1 crore]
- For Individuals & Partnership Firms – INR 1,000 [CG can notify higher value not exceeding INR 1 lakh]

Who can file an application for insolvency?

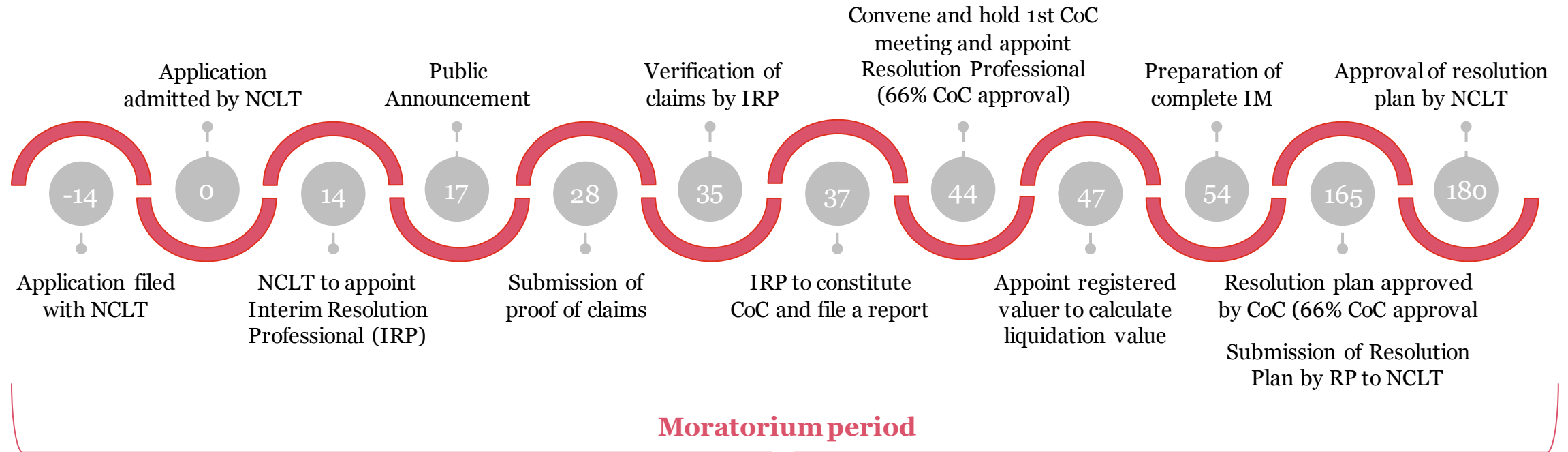
- Financial Creditor
- Operational Creditor
- Corporate Debtor itself

The Code has overriding effect over other laws – Section 238

Process of Corporate Insolvency – Key steps

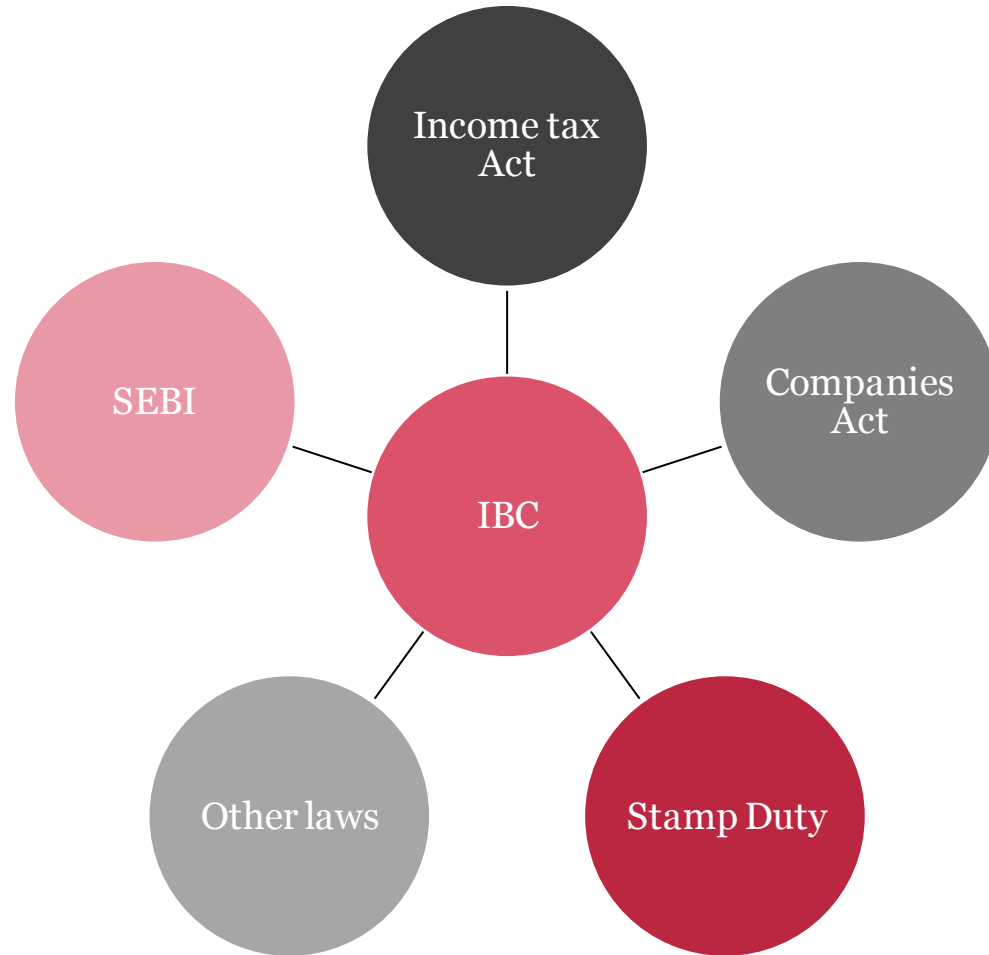


Process of Corporate Insolvency - Timelines



Process of Insolvency to be completed within 180 days. NCLT can grant extension of additional 90 days.

Interplay between IBC and other regulations



Direct Tax Issues



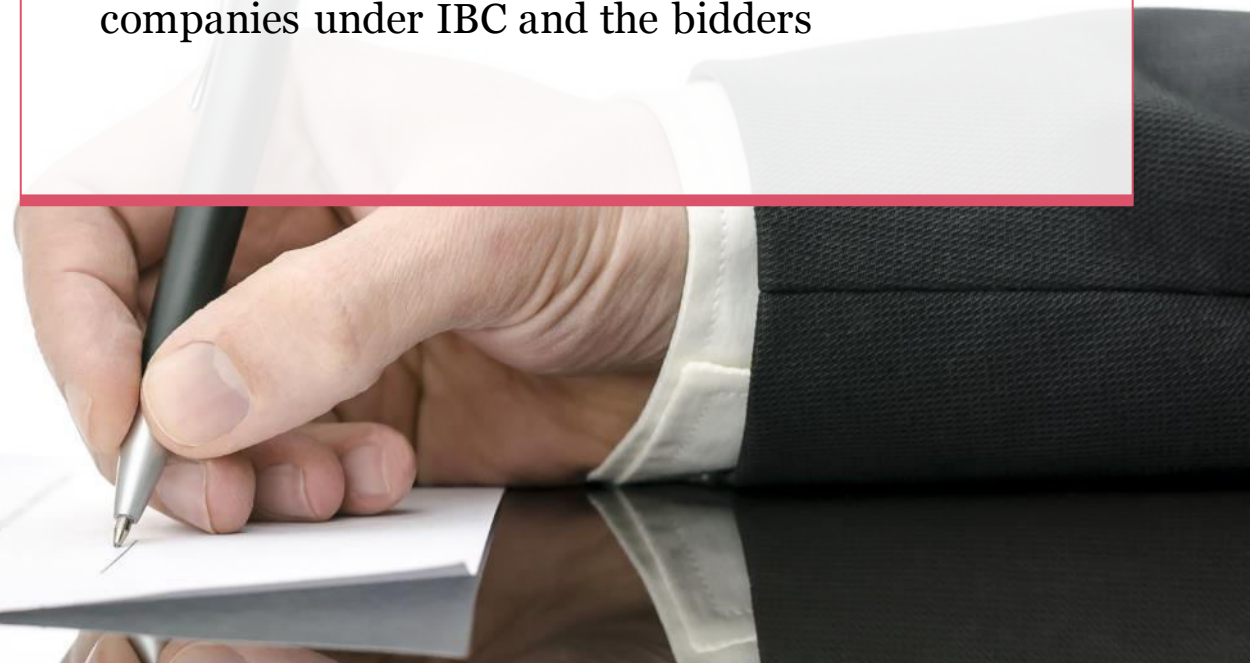
An Overview

Write back of loans:

- Section 41(1) and Section 28(iv)- Taxability of write back of loans
- Section 115JB- Applicability of MAT provisions for companies registered under IBC

Acquisition issues:

- Section 79- Carry forward of tax losses in case of change in shareholding of certain companies
- Section 56 and Section 50CA- Implications for the companies under IBC and the bidders



Section 41(1) and Section 28(iv)

Provisions of Sec 41(1)

- Section 41(1) of the Act provides that remission or cessation of any trading liability which has been claimed as a deduction in any previous assessment year is taxable in the year in which such remission or cessation took place

Provisions of Sec 28(iv)

- Section 28(iv) of the Act states that value of any benefit or perquisite (whether convertible into money or not) arising from the business or the exercise of a profession shall be chargeable to tax as income from business or profession

Issue

- Taxability of waiver of loan of a corporate debtor under IBC

Write back of loan – Case Study

Position of liabilities of A Ltd. (under IBC)

Particulars	Amount of loan outstanding	Amount proposed to be repaid under the resolution plan	Write back
Long term loan	6000	2000	4000
Operational Creditors	8000	3000	5000

Question:

What would be the tax implications of the said write backs?

Since the write back of 4000 is a result of write off of non-current liabilities, a view can be taken that this amount is not taxable under section 41(1) and section 28(iv) of the Act

The write back of 5000 is a result of write off of operational creditors i.e. a trading liability . Hence, the amount would be taxable under section 41(1) of the Act

Write back of loans – Summary

Trading Liabilities

- Trade creditors, operational creditors
- Taxable u/s 41(1) since cessation of trading liability

Financial Liabilities

- Financial borrowings for capital assets
- Not taxable u/s 28(iv) as waiver of loan in nature of cash or money
- Not taxable u/s 41(1) since not a cessation of trading liability & no deduction is claimed
- Above held by the Supreme Court in Mahindra and Mahindra Ltd (Refer Annexure 2)



Section 115JB

Minimum Alternate Tax

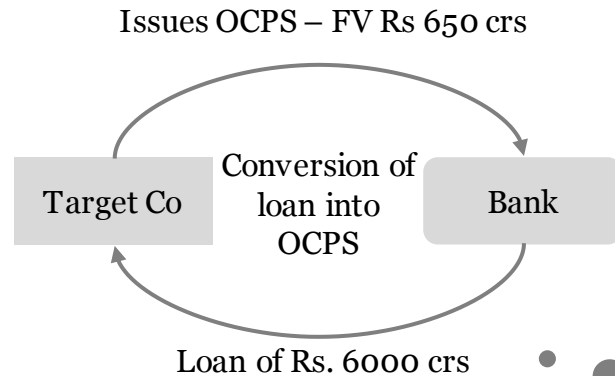
- 01** As per section 115JB of the Act, if the tax payable by any company on its taxable profits is less than an amount of 18.50% of the book profits of the company computed in accordance with that section, then MAT @ 18.50% on the book profits of the company is payable as tax by the company for that assessment year
- 02** Initially, there was no carve out from the provisions of this section for companies registered under the IBC. Later on, vide a press release, a deduction of the total amount of book loss brought forward (including unabsorbed depreciation) was allowed from the book profits of the company under IBC
- 03** IBC has superseded the erstwhile SICA. As per the provisions of the Act, a deduction from book profits is available for the amounts of profits earned by a sick industrial unit until the company's net worth becomes positive. However, there is no corresponding provision for companies under IBC

No blanket exemption from MAT provisions for companies under IBC



Write back of loan - MAT Implications

Proposed Arrangement*



*Vide Resolution Plan – Loan to be converted to OCPS (redeemable at par)

Derecognition of Financial Liability – IndAS 109:

In the event of derecognition of financial liability, the difference between the carrying amount of a financial liability extinguished and new financial liability assumed shall be recognized in **profit or loss account**.

Particulars	Debit	Credit
Loan	6000	
OCPS		650
Profit & Loss		5350

Securities Premium? Whether it can be said Company law overrides accounting standard?

Computation of book profit u/s 115JB

Finance Act 2018 Amendment

Aggregate deduction of brought forward losses and unabsorbed depreciation for computing book profits in case of a company against whom **application has been admitted by NCLT** under IBC

Scenario 1

Feb'18 – Application admitted

Benefit in FY18? - *Yes*

Sept'18 – Resolution Plan approved by CoC

Will the benefit continue in FY19? - *Yes*

Dec'18 – Approved by NCLT

Can benefit be claimed post FY19?
- Once the order is approved, no claim can be made

Scenario 2

Feb'18 – Application admitted

Benefit in FY18? - *Yes*

Jun'18 – Application withdrawn (90% CoC)

Will the benefit continue FY19 onwards?
- *No since the application is withdrawn*
- *Possibility of withdrawal of FY18 benefit cannot be ruled out – more likely if application was filed by corporate debtor.*

Scenario 3

Feb'18 – Application admitted

Benefit in FY18? - *Yes*

Jun'18 – Resolution plan rejected by CoC & Company undergoes liquidation

Will the benefit continue FY19 onwards?
- *No since the resolution plan is rejected*
- *Possibility of withdrawal of FY18 benefit cannot be ruled out.*

Section 79

Provisions of Sec 79

- Section 79 of the Income-tax Act, 1961 (the Act) provides that any change in the shareholding of a closely held company beyond 49% in the financial year vis-à-vis the shareholding on the last day of the previous year in which the loss was first incurred would lead to lapse of tax losses relating to that previous year.

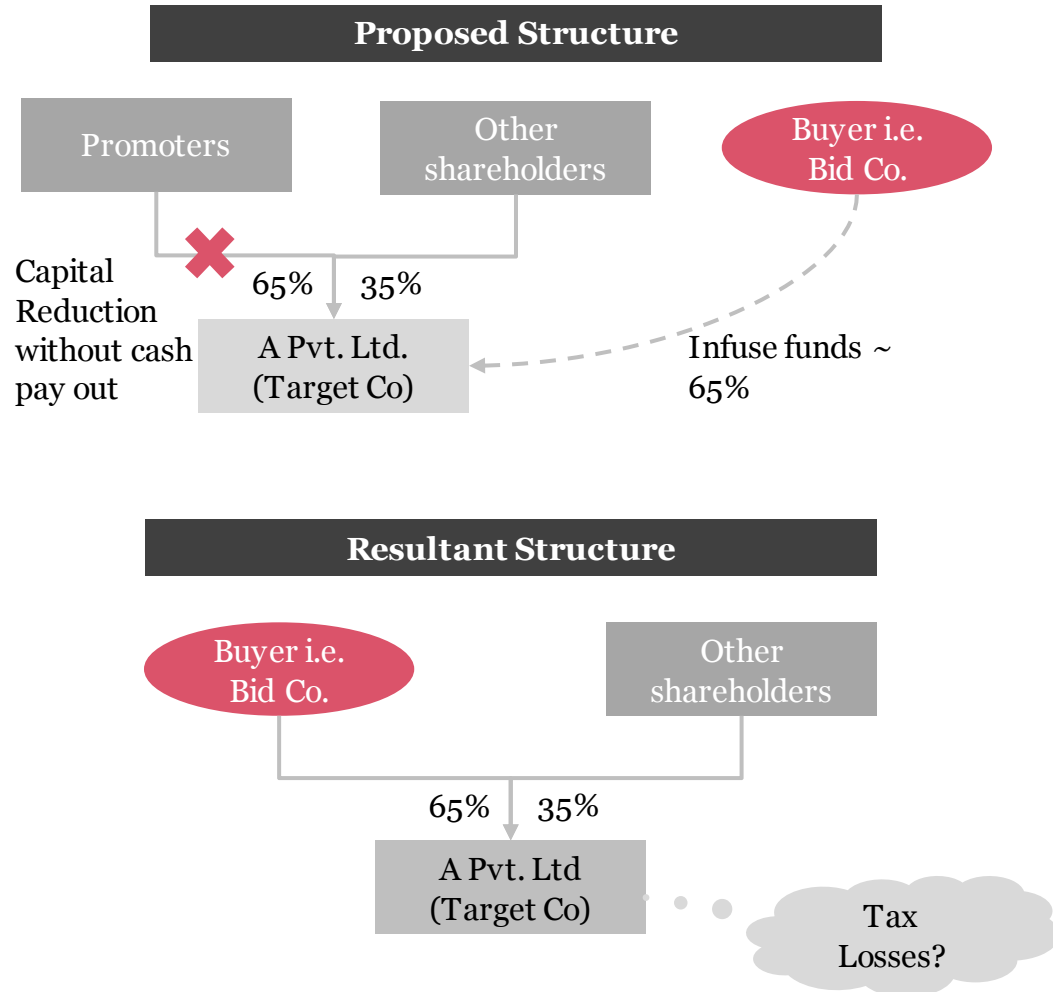
Amendment to the section

- Section not to apply to any change in shareholding of a company, pursuant to a resolution plan approved by the Code.
- However, a reasonable opportunity of being heard has to be given to the Jurisdictional Principal Commissioner of Income Tax or Commissioner of Income Tax.

Issues

- For plans approved before F.Y. 2017-18, where no opportunity of being heard has been given to Principal Commissioner of Income Tax or Commissioner of Income Tax, will the tax losses lapse?

Carry forward and set off of losses – Case Study I



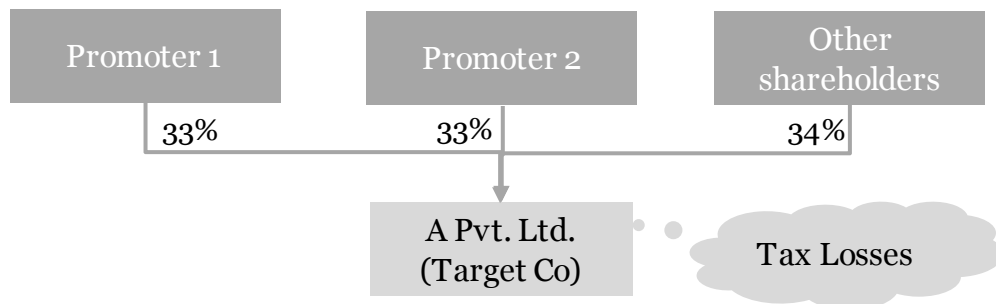
Question:

Whether the carry forward and set off of losses of A Pvt. Ltd. shall be permissible subsequent to change in shareholding pattern pursuant to resolution plan under IBC?

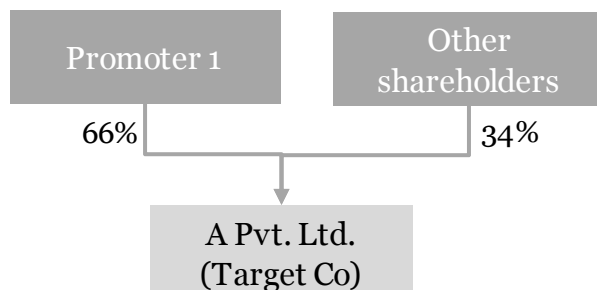
As amended by Finance Act 2018, the provisions of section 79 shall not apply to a company where a change in the shareholding takes place in a previous year pursuant to a resolution plan approved under the IBC

Carry forward and set off of losses – Case Study II

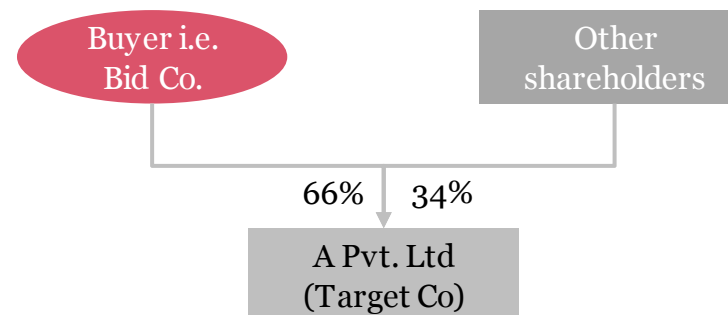
FY 2016



FY 2017



FY 2018 – Pursuant to resolution plan



Question:

Whether the carry forward and set off of losses shall be available in FY 2018?

2 views

- Tax losses available since the provisions of section 79 not applicable where change in shareholding is pursuant to resolution plan approved under IBC
- Tax losses should not be available since change in shareholding pursuant to resolution plan is only 33% and remaining 33% change is due to internal transfer from Promoter 1 to Promoter 2

Section 56 and Section 50CA

Provisions of Sec 56(2)(viib)

- Triggered when a closely held company issues shares at an amount exceeding its fair market value computed in accordance with Rule 11UA of the Income-tax Rules, 1962.
- Provides for taxation in the hands of the company issuing the shares
- The difference between the fair market value of the shares and the amount at which they are issued is charged to tax

Provisions of section 56(2)(x)

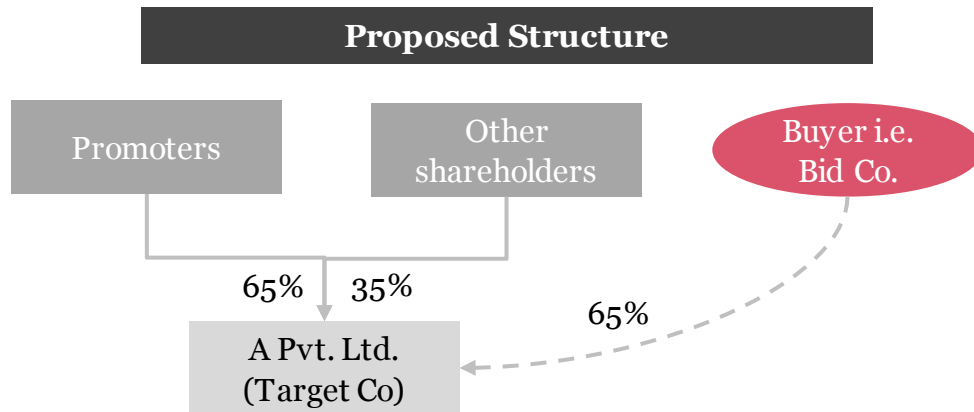
- Triggered when no consideration is paid for property or consideration paid for property is less than the prescribed fair market value
- Provides for taxation in the hands of the recipient of property
- The term property includes shares
- Amount to be taxed
 - The fair market value – if no consideration paid
 - Difference between the fair market value and consideration – if consideration paid

Provisions of section 50CA

- Triggered where transfer of unlisted shares is at less than its fair market value
- Provides for taxation in the hands of the transferor
- The fair market value of the property is deemed to be the full value of consideration for the purpose of computing capital gains tax

No carve out for companies registered under IBC and their shareholders/ investors under these provisions

Case Study I



Under the resolution plan, the Target Company will issue shares to the buyer of face value Rs. 10/- at a premium of Rs. 15/- per share which will give the buyer 65% stake in the Target Co. The data is as under:

Particulars	Value per share
Fair Market Value as per Rule 11UA	11
Face Value of each share	10
Value at which shares are to be issued	25

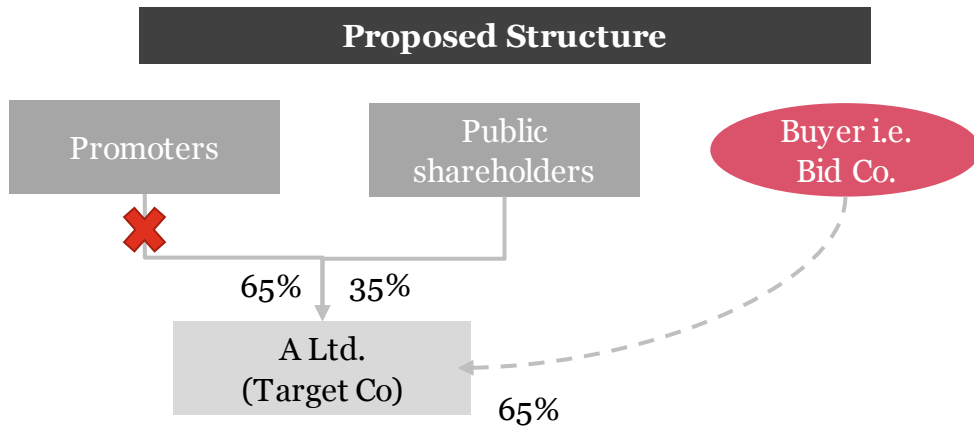
Question:

What will be tax implications of this transaction?

Yes. As there is no specific exemption to companies registered under IBC, the Target Co. will be liable to pay tax on the difference between the issue price and fair market value of shares i.e. Rs. 14/- per share u/s 56(2)(viib)

What if the fair value is Re. 1 and issue price is Rs. 10?

Case Study II



A Ltd. is a listed company whose shares are suspended from trading. Under the resolution plan, the buyer intends to acquire the shares of A Ltd. at a price of Rs. 2 per share. The relevant data is as under:

Particulars	Value per share
Fair Market Value as per books of accounts	11
Last available stock price	8
Value at which shares are to be transferred	2

Question:

What will be the tax implications of the said transaction?

As there is no specific exemption to companies registered under IBC, the Bid Co. will be liable to tax on the difference between the issue price and fair market value of shares as income from other sources u/s 56(2)(x)

Further, as per section 50CA, the fair market value will be the full value of consideration while computing capital gains tax in the hands of the promoter

As per Rule 11UA, a quoted share is a share which is quoted on any recognized stock exchange with regularity from time to time, Hence, for computation of fair market value under Rule 11UA- will shares of A Ltd. be considered as quoted or unquoted?

Regulatory Aspects



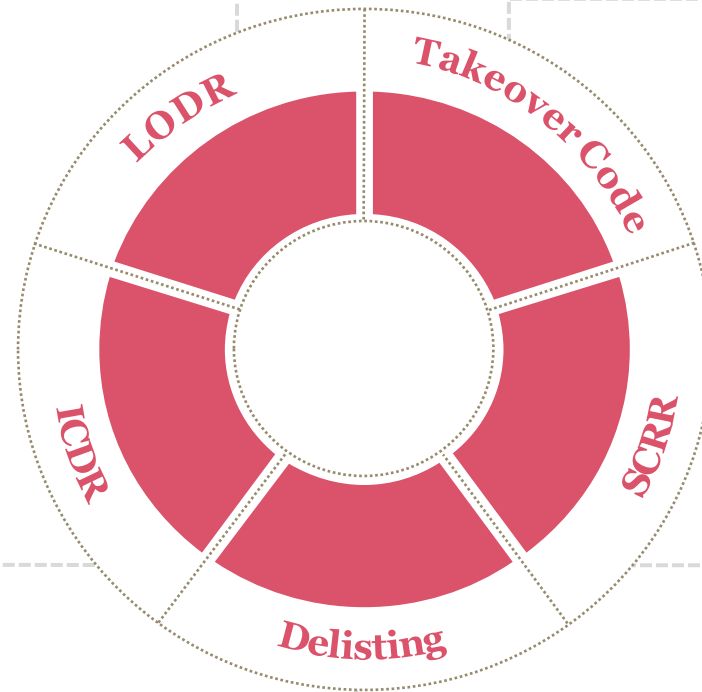
SEBI Regulations

LODR

- Role & responsibilities of BoD with IRP or RP
- Shareholders' approval for transactions with related parties or for disposal of material subsidiary done away with if disclosed to stock exchanges
- Relaxation from reclassification of existing promoter or promoter group
- Schemes not to require SEBI & stock exchanges approval

Listed entities with approved resolution plans:

- Exemption from preferential issue procedure for equity shares and convertible securities
- Lock-in restrictions still apply



Acquisition pursuant to resolution plan:

- Exemption from open offer
- Acquirer can hold more 75% in a listed entity

Due to implementation of resolution plan, if public shareholding falls:

- Below 25%: Increase to 25% within 3 years
- Below 10%: Increase to at least 10% within 18 months

Listed entities with approved resolution plans:

- Exemption from delisting regulations if specific procedure for delisting is laid and exit option to existing public shareholders at a price not less than liquidation price
- No tenure restriction to re-apply for listing

Companies Act

Section 53 – Prohibition on issue of shares at discount

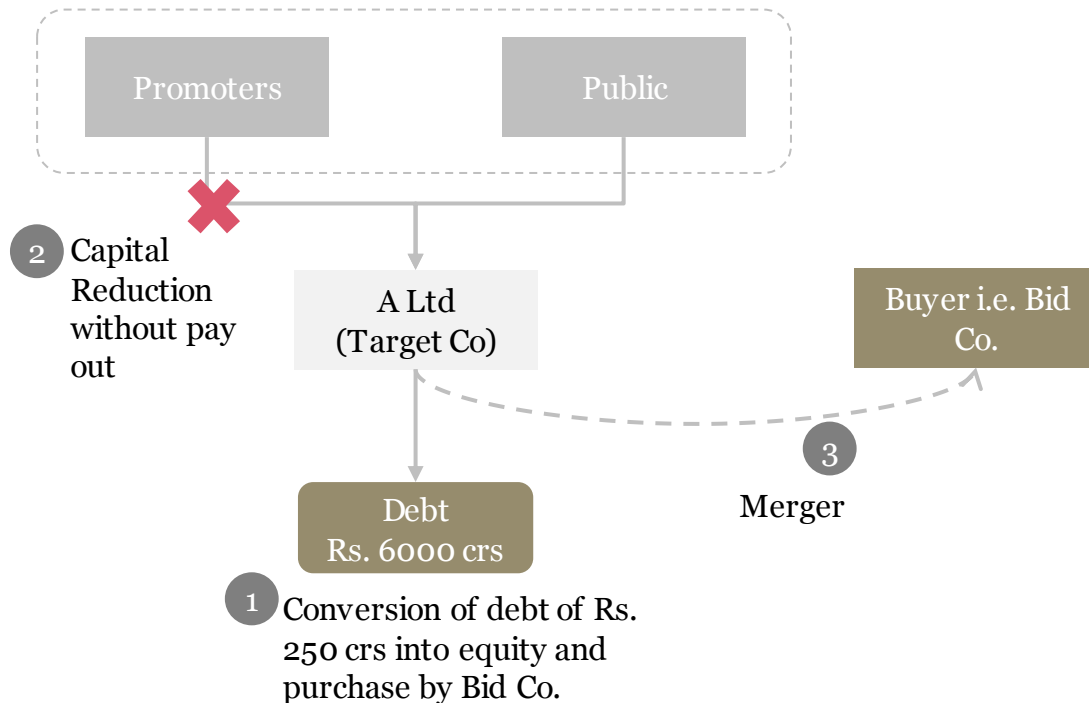
- Section 53 of the Companies Act, 2013 prohibits a company to issue shares at a discount
- However, an exemption has been provided in this respect when shares are issued to creditors at a discount, on conversion of their debt into shares in pursuance of any statutory resolution plan or debt restructuring scheme specified by RBI or specified under the Banking (Regulation) Act, 1949

MCA circular for deemed shareholders approval - dated 25 Oct 2017

- Approval of shareholders/ members for implementation of resolution plan deemed to be received on approval by NCLT

Companies Act

Resolution plan approved by NCLT



Question:

Whether Company Law process to be complied with for implementation of proposed restructuring? OL, RD, ROC approval?

No separate approval required.

The aforementioned restructuring proposed under Resolution Plan has been approved by NCLT vide order under IBC

Stamp duty implications

Facts:

The Resolution Plan provided for restructuring of the Corporate Debtor in a manner that the Buyer (Bid Co.) would acquire the management and control of the Corporate Debtor by way of Merger. The same has been approved by NCLT by passing an order.

Which Article under the relevant State Stamp Act to be considered?

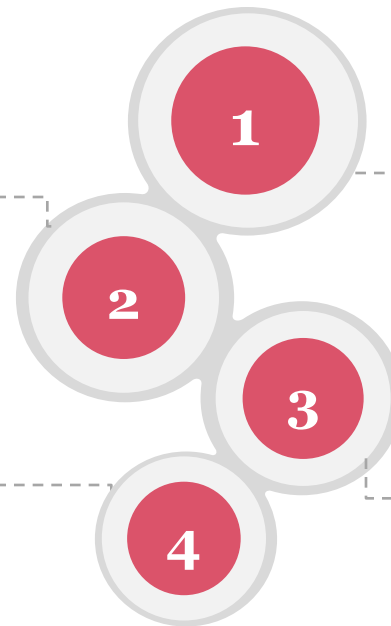
Scenario - II: On Conveyance?

- Whether covered as transfer of assets? – Stamp duty under ‘Conveyance’ article
- **Stamp duty payable based on respective entry in State Stamp Act**

Scenario - IV: Exemption from Stamp Duty?

No exemption provided

- Hyderabad NCLT – In the matter of **Synergies Dooray Automotive Limited**
- Mumbai NCLT - In the matter of **Monnet Ispat & Energy Limited**



Scenario - I: On NCLT order?

- Article relating to NCLT order exists
- However, on reading Article 25(da) [in Maharashtra] – Stamp duty is payable on order of NCLT in relation amalgamation u/s 230-232
- **No entry for order under IBC**

Scenario - III: No stamp duty?

- No entry for order under IBC
- Transfer of assets vide NCLT order and hence no conveyance deed
- **Whether stamp duty payable?**

Annexures



Top 12 Insolvency Cases - Status

Company	Bidder(s)	Approx. Debt (INR Cr)	Status
Amtek Auto	Liberty House UK	14,074	Matter under consideration in NCLAT
Bhushan Steel	Tata Steel	44,478	Successful
Electrosteel Steels	Vedanta	10,273	Successful
Jyoti Structures	Sharad Sanghi	5,165	Supreme Court approved resolution plan for the Company
Monnet Ispat & Energy	JSW - AION	12,115	Successful
ABG Shipyard	Liberty House UK	6,953	Headed for liquidation
Alok industries	JM Financial –RIL	22,075	GAIL has opposed the resolution plan submitted by the bidder, matter is under consideration in NCLT
Bhushan Power and Steel	Tata Steel, JSW Steel, Liberty House UK	37,248	NCLT has reserved its judgement on the approval of JSW Steel's resolution plan
Era Infra Engineering	NA	10,065	Admitted on 8 th May, 2018 after a number of hearings by NCLT
Essar Steel	Numetal-JSW, ArcelorMittal-Nippon Steel, Vedanta	37,284	NCLAT order awaited for Arcelor Mittal bid
Jaypee Infratech	Adani Group, Jaypee Group Lakshdeep Investments, NBCC	9,635	NCLAT order awaited for Adani Group and Jaypee Group bids
Lanco Infratech	Thriveni Earthmovers	44,364	Headed for liquidation since CoC refused bids of Thriveni Earthmovers

Source: Public Domain [Updated as on 27th June, 2019]

Summary of the Mahindra and Mahindra Limited judgement*

Facts of the case

- The assessee wanted to expand his product line for which it entered into an agreement with an American company A Co. for supply of tooling and other equipment through its subsidiary SA Co.
- To procure the tooling, A Co. agreed to provide a loan to the assessee
- Later on, B Co. took over A Co. subsequent to which B Co. agreed to waive off the principle amount of loan advanced by A Co. to the assessee
- The tax officer opined that waiver of loan represented income and not liability and hence, held the same to be taxable under section 28(iv) of the Act
- On appeal, the CIT(A) taxed such waiver under section 41(1) rather than section 28(iv) of the Act
- The Income tax Appellate Tribunal set aside the order of CIT (A) and deleted the addition made by the Tax Officer
- The matter was then contested before the Supreme Court

Decision

- On the applicability of section 28 of the Act it was held that income to be taxed under clause (iv) should have been in some form other than money.
- The waiver of loan resulted in extra cash in the hands of the debtor and the condition of benefit received in form other than money was not satisfied. Hence, provisions of section 28(iv) of the Act did not apply.
- The assessee was paying interest but did not claim deduction under section 36(1)(iii) of the Act for such interest payments, as the equipment purchased were capital assets in the hands of the assessee and was not debited to its Profit and Loss account. Therefore, they could not be classified as a trading liability.
- Section 41(1) of the Act deals with the remission/cessation of trading liability, whereas the waiver of loan amounts to cessation of liability other than trading liability. Hence, the provisions of section 41(1) of the Act shall not be applicable.
- Therefore, neither does section 28(iv) of the Act, nor does section 41(1) of the Act applies to waiver of the principal portion of the loan taken on capital assets.

Key Abbreviations

Abbreviations used	Particulars
RP	Resolution Professional
IRP	Interim Resolution Professional
CoC	Committee of Creditors
IBC	The Insolvency and Bankruptcy Code, 2016
NCLT	National Company Law Tribunal
SICA	Sick Industrial Companies (Special Provisions) Act, 1985
MAT	Minimum Alternate Tax
CIT(A)	Commissioner of Income Tax (Appeals)
RBI	Reserve Bank of India

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