



Insolvency and Bankruptcy Code (IBC)

Conflict with Income-tax law

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IBC: Process in brief

- A financial/operation creditor or a corporate debtor itself may apply for initiation of insolvency resolution proceedings before NCLT.
- On admission by NCLT, an insolvency professional is appointed, who invites claims of all stake holders/creditors.
- Thereafter, invites resolution plans from potential bidders/investors.
- With the approval of creditors committee, put up the best “Resolution Plan” for approval of the NCLT.
- Total time limit for insolvency resolution process is 180 days (may be extended up to 270 days).
- If no resolution plan is made/approved, the corporate debtor goes into liquidation.
- The company is liquidated.

IBC: Scope of Insolvency Proceedings

- Resolution Plan is defined as :

"resolution plan" means a plan proposed by any person for insolvency resolution of the **corporate debtor as a going concern** in accordance with Part II"

- It means resolution as a going concern.
- **Asset sale, slump sale, demerger, merger out of the scope.**

- A resolution plan needs to *inter-alia* confirm following [S.30]:

- provides for the management of the affairs of the Corporate debtor after approval of the resolution plan;
- the implementation and supervision of the resolution plan;
- does not contravene any of the provisions of the law for the time being in force
- **No power to override any provision of law including income-tax Act.**

- Only power : NCLT shall by order approve the resolution plan which shall be **binding** on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan. [S.31]



IBC: Issues with Income-tax law

- **Can existing tax demand as on the date of approval of Insolvency Plan be waived?**
 - Tax demands are at par with unsecured creditors, hence deemed written off as per order of the NCLT like any other unsecured creditor.
 - It may be argued that such a direction in Resolution Plan would not be compliant with the extant law, and may be declared void.
- **Can the tax liability of the period up to the date of approval of Insolvency Plan but crystallized afterwards be waived?**
 - No, as such liability was never a part of the Insolvency Process.
 - It does fall in the definition of debt as not due.
- **Can the tax liability arising on implementation of the Resolution Plan be waived?**
 - Write off of debt would be subject to MAT as well as normal tax liability.
 - No power to NCLT to waive such taxation.
 - CBDT announcement of some relaxation under MAT is inadequate.

Insolvency Resolution Process: An example

- Financials of a corporate debtor ABC Ltd under insolvency

	Rs in Cr		Rs in Cr
Capital (1 cr share)	100	Assets	30,100
Reserves	(20,000)		
Bank loans	50,000		

- ABC Ltd is a listed company and it is traded at Rs 2 per share
- Fair market value of all its assets/enterprise is only Rs 5,000 cr.
- ABC has carry forward tax losses of Rs 20,000 cr.
- A potential investor XYZ Ltd is ready to invest Rs 5,000 cr considering fair value of assets of the corporate debtor.

Resolution Plan Options

- **Option 1:** Slump sale/demerger of the assets/enterprise to XYZ Ltd for Rs 5000 cr, which is paid to banks and balance debt is written off
 - Not feasible as sale of assets/enterprise is out of scope.
 - As per section 170 of Income-tax Act, the successor in business is liable for tax of the predecessor company.
- **Option 2:** XYZ infuses capital of Rs 5000 cr; pays off bank loan, balance Rs 45,000 cr is written of.
 - XYZ would be required to infuse capital at face value (as per Company Law) though net-worth is negative and trading price is only Rs 2.
 - Tax risks of existing, hidden as well as arising on implementation (e.g. MAT).
 - As per SEBI regulations, XYZ cannot have more than 75% shares of a listed company though open offer is waived
- **Option 3:** Bank loans are converted into 25000 cr equity shares @ Rs 2 per share; XYZ buys these shares for Rs 5000 cr @ Rs 0.20 per share.
 - Financial creditors are allowed to be issued shares at a discount under insolvency process as per the latest amendments.
 - As per SEBI regulations, XYZ cannot have more than 75% shares of a listed company though open offer is waived.
 - Tax risk of existing as well as hidden risks.
 - Biggest tax exposure u/s 56(2)(x) i.e. deemed gift on difference between FMV and transaction price (Rs 45,000 cr); further uncertainty as FMV is to be taken on the date of implementation.



THANK YOU