

Financial stress in corporates

- Tax and structuring aspects

2 May 2020

Outline of presentation



Economic scenario



Lifecycle of a stressed business



Resolution – RBI framework



Resolution - IBC framework



Tax and structuring issues



Concluding thoughts

Economic scenario

Economic scenario

Economy was already in slow lane...

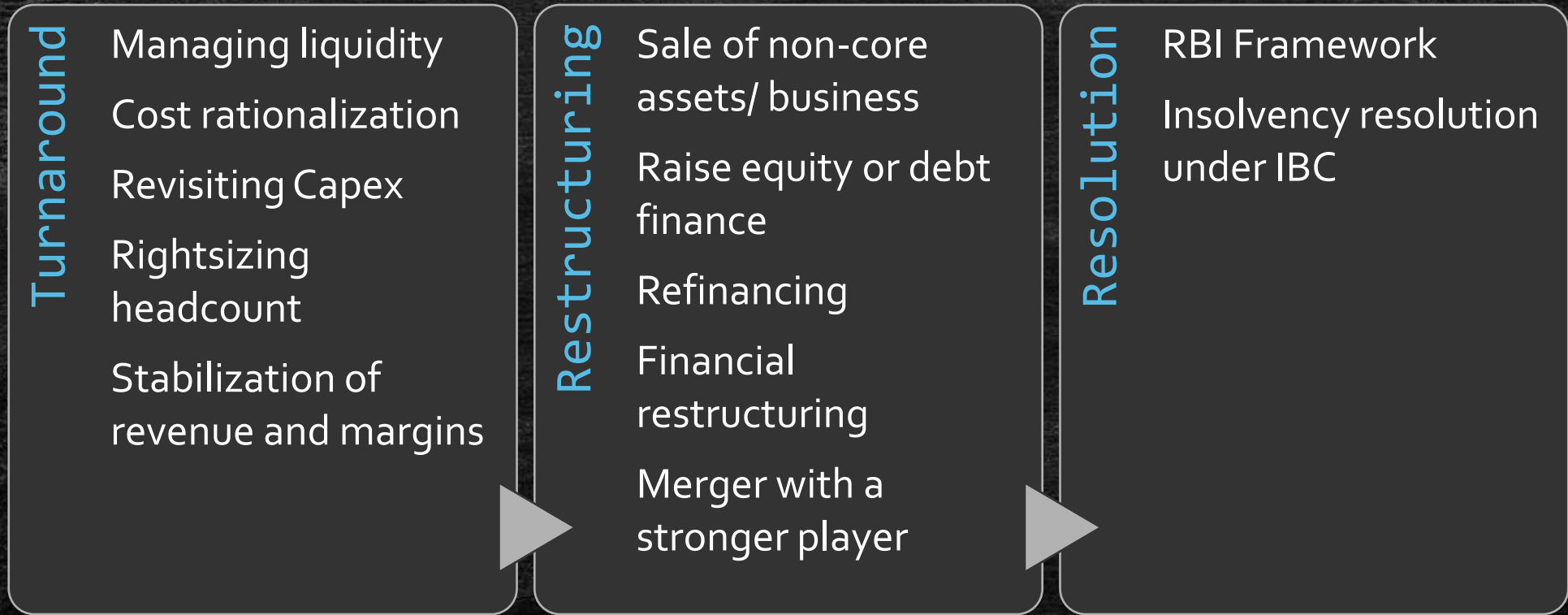
- Decline in GDP growth to 4.7% in Q3 FY 20
- Corporate profitability at a record low of 2.8% of GDP
- GNPA ratio remains elevated at 9.3%
- Twin balance sheet problem transformed into a Four balance sheet problem

...then came Covid-19

- Lock down to have severe economic consequences
- GDP may remain flat (or may even shrink)
- Many (new) sectors to see long-term impact
 - Hospitality
 - Air travel
 - White goods
 - Leisure/ Entertainment

Lifecycle of a stressed business

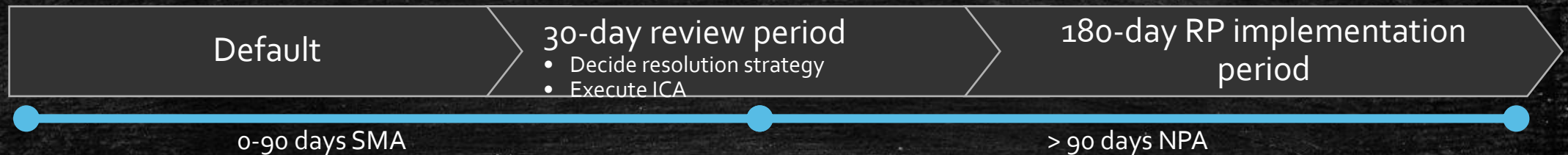
Lifecycle of a stressed business



Resolution – RBI framework

Resolution – RBI framework

- RBI framework contained in Resolution of Stressed Assets Directions 2019 dt June 7, 2019
- Applies to Banks, FIs, SFBs, NBFC-ND-SI and NBFC-D
- Extant resolution mechanisms such as CDR, SDR, S4A etc. withdrawn
- Time-lines and classification



- Resolution plan
 - Can provide a variety of steps/ structuring mechanism

Resolution – RBI framework

- Issue of shares to lenders on conversion of loan
 - Exemption to banks for acquisition
 - SEBI's preferential issue guidelines not applicable subject to conditions
 - Exemption from making an open offer under the SEBI takeover code
 - Exemption under the Companies Act for issue of shares at a discount on conversion of debt into equity under the resolution plan
- SEBI's consultation paper released for ease of fund raising by stressed companies under the preferential issue guidelines
- ECB Regulation
 - ECB for repayment of INR loan for Capex in Infra and Manufacturing sectors under OTS
 - Banks also permitted to assign their loans to eligible ECB lenders

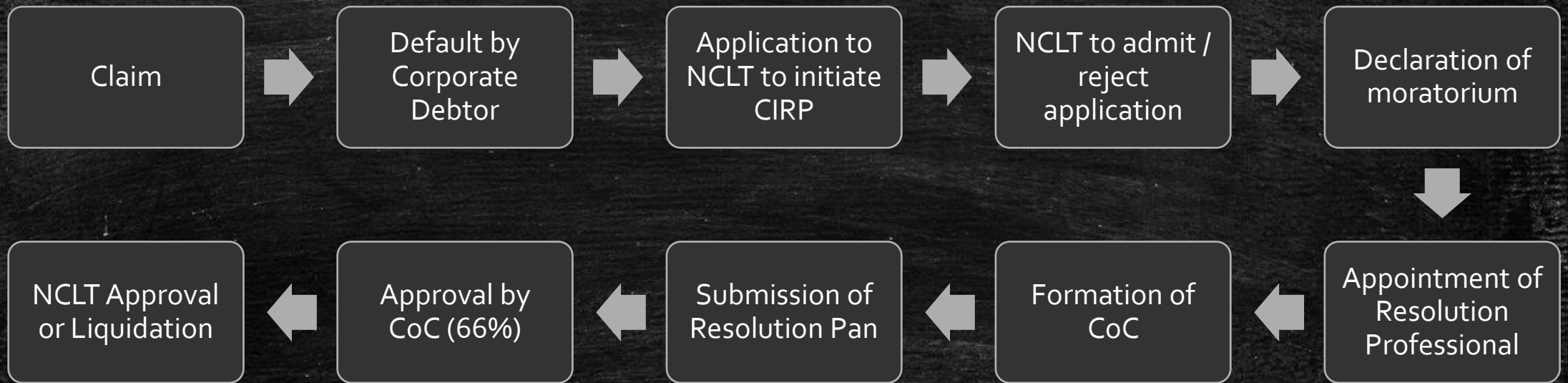
Resolution – IBC framework

Resolution – IBC framework

- Single insolvency and bankruptcy framework
 - Code has an overriding effect over any inconsistency in other laws
 - NBFCs / HFCs with assets > 500 Crs covered
- Time-bound resolution process
- Process can be initiated as soon as a default occurs
 - Cash-flow based approach v Balance-sheet based approach
 - Threshold for minimum amount of default raised to INR 1 Crs from INR 1 Lakh
- Allows lenders to come together and control the borrower to maximize recovery
 - Most actions require 66% approval
- Provides moratorium during the resolution process
- Clear priority of distribution
 - Government dues rank lower than those of secured creditors and unsecured financial creditors

Resolution – IBC framework

- Insolvency resolution process – an overview



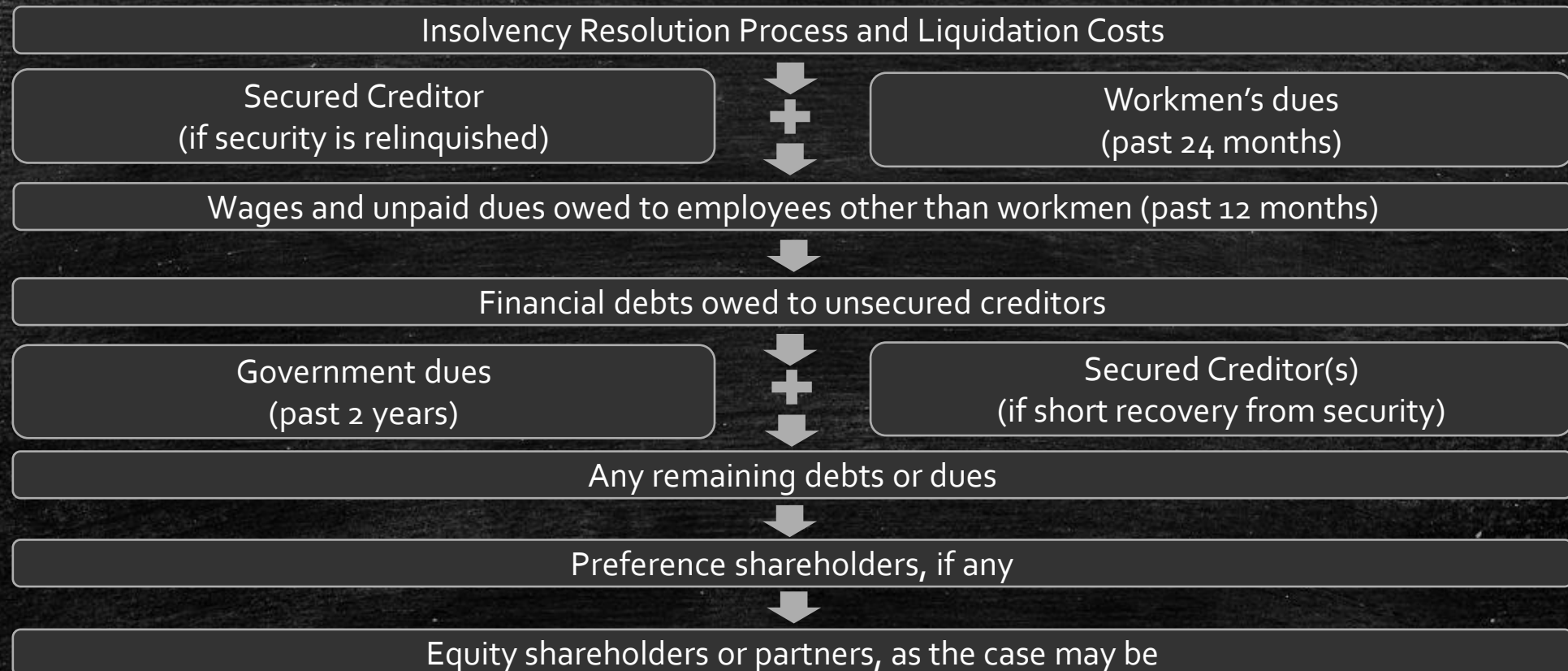
CIRP process to be completed in **180 days** + extension of **90 days** possible with the approval of CoC (66%)
Overall time limit of **330 days** (including time taken for litigation)

Resolution – IBC framework

- Resolution Plan – key aspects
 - Resolution as a “going concern” – mergers/ demergers permissible
 - Should not contravene provisions of other laws
 - Binds all stakeholders including the Government
 - Superior rights of financial creditors
 - Operational creditors entitled to a minimum of liquidation value or amount as per s.53 waterfall
 - CoC can commercially decide on the distribution of resolution proceeds

Resolution – IBC framework

- Waterfall mechanism (section 53)



Resolution – IBC framework

- Companies Act
 - Issue of shares at discount
 - No separate approval of shareholders
- ECB Regulations
 - ECB for repayment of INR term loan – approval route
- SEBI
 - De-listing regulations
 - Exemption under preferential issue guidelines
 - Exemptions under takeover code

Tax and structuring issues

Tax and structuring issues

Normal tax

- Write-back of principal amount of loan (term v. working capital)
- Write-back of o/s interest
- Write-back of operational creditors
- Write-off of assets (depreciable v. non-depreciable)
- Conversion of debt / o/s interest into equity

MAT

- Write-back of liabilities / Write-off of assets
- Impairment provision
- Fair valuation on restructuring of debt
- Fair valuation on debt-to-equity conversion

Existing v. concessional tax regime u/s 115BAA

Tax and structuring issues

Tax attributes

- Availability and preservation of tax attributes
- Tax losses, UAD and MAT losses
- Tax holiday

Deemed gift tax

- Funds infusion by way of shares / securities
- Conversion of debt into equity
- Write-back of creditors and loans

IBC v. Outside IBC

- Relief for o/s tax dues
- Sum of business loss + UAD for MAT
- Continuity of tax losses (s.t. opportunity of being heard)

GAAR – Commercial rationale

Tax and structuring issues

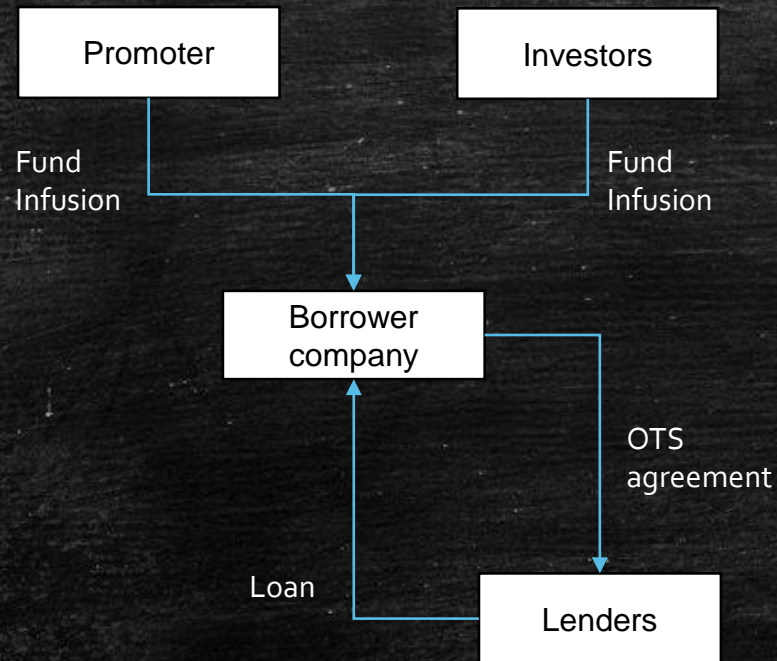
Stamp duty

NBFC/CIC

FEMA

Competition Laws

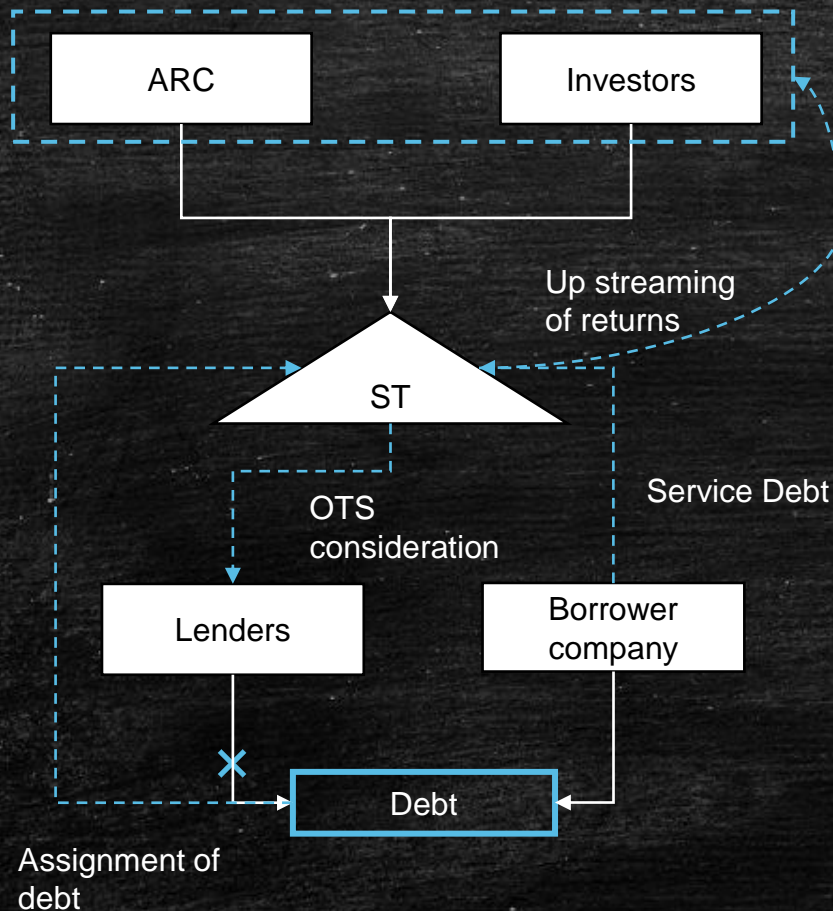
Case study 1 – One-time settlement



Mechanics

- Borrower company to enter into OTS with the Lenders
- Borrower company to raise funds required for repayment under OTS from :
 - Promoter
 - Investors

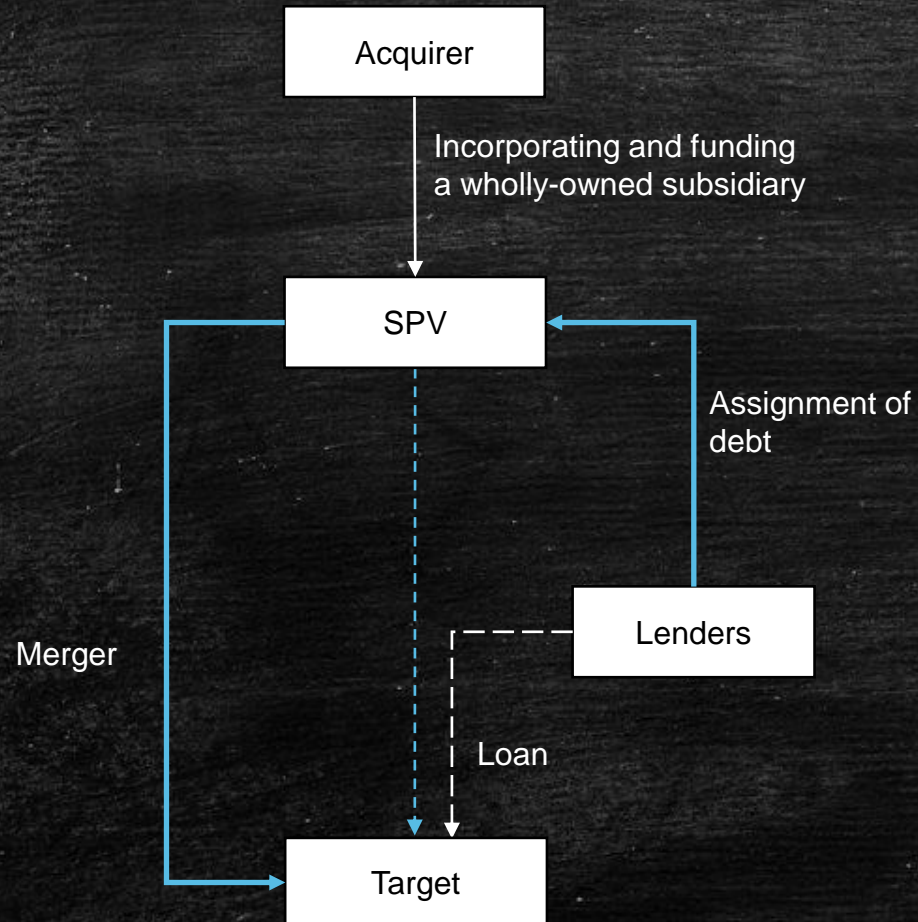
Case study 2 – ARC Structure



Mechanics

- Lenders to assign debt to ST under OTS
- ST pays the consideration to lenders
- Borrower company to service loan
- ST to upstream income to the investors and ARC

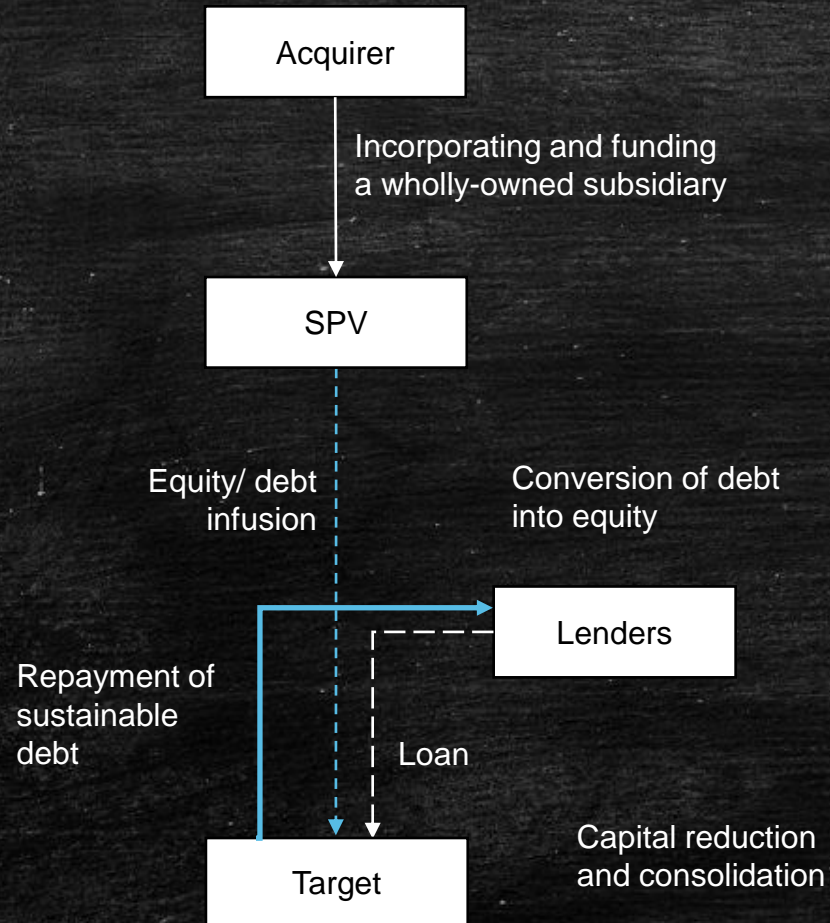
Case study 3 – Assignment of debt (IBC)



Mechanics

- Incorporate SPV
- Assignment of debt
- Merger of SPV into Target

Case study 4 – Capital reduction (IBC)



Mechanics

- Acquirer to incorporate an SPV
- Conversion of debt into equity
- Capital reduction and consolidation
- Repayment of sustainable debt

Concluding thoughts

Concluding thoughts

- Several businesses in a variety of sectors may undergo restructuring or resolution due to **Covid-19** related stress
- IBC v. **Outside IBC**
 - Fear of losing valuable assets
- Need for a **'pre-pack'** insolvency regime under IBC
 - Flexibility of pre-agreed restructuring plan
 - Protection of IBC process
- Need to strengthen **scheme of arrangement** provisions under the Companies Act

Questions



Thank **You!**

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