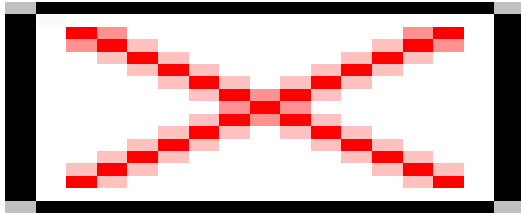


Vaccine shot for stressed companies

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THE

countdown for Union Budget 2021 has begun. The Finance Minister who shall be presenting her third Budget on 1 February 2021, has promised a Budget ***"like never before"***.

This has resulted in huge expectations from various industries and businesses which were severely impacted by the COVID-19 global pandemic.

Some key expectations from the viewpoint of revival of stressed companies are as under:

Recipient Taxation provisions

Finance Act, 2017 introduced the recipient taxation provisions [viz. section 56(2)(x) and section 50CA] under the Income-Tax Act, 1961 ('the Act'). These were anti-abuse provisions intended to discourage tax avoidance transactions and to stem generation of black money.

As a result of the COVID-19 global pandemic, many industries / businesses have taken a hit, thereby impacting the valuations of the business / assets. As a result, there is an apprehension that many companies shall be under pressure and either may be subjected to Insolvency and Bankruptcy ('IBC') proceedings or shall be required to dispose off certain businesses for their survival.

In case of revival of stressed companies, typically the shares / business is transferred at a price lower than the value determined as per prescribed income-tax rules. Further, in cases involving severe stress, companies may also need to raise equity funding from promoters / investors as part of the Resolution Plan ('RP'). In the event the shares are issued by an unlisted company at a price exceeding the Fair Market Value ('FMV') as prescribed for tax purposes or shares are issued by a company (irrespective of whether listed or unlisted) at a significant discount to the FMV as prescribed, gift tax implications shall arise.

In light of the current scenario, it is quintessential that following exclusions are provided from gift tax provisions, since the value of the shares / business have significantly declined due to the ongoing pandemic:

- Sale of shares of stressed companies;
- Issue of shares by stressed companies as part of RP, wherein funds are raised for survival or mobilising capital.

This benefit could be provided vide the following mechanisms:

- Introducing a form for applications which can be made by the sellers to the tax authorities, highlighting inter alia, the details of the asset to be sold and the reason for sale of the asset at a price below FMV;

- Prescribing a higher tolerance range wherein downward variation in the consideration received as compared to the stamp duty value or FMV, will be acceptable.

Carry forward of losses

Section 79 of the Act restricts carry forward of losses where there is change in shareholding of an entity by more than 49%. Finance (No. 2) Act, 2019 provided exceptions to this section inter-alia to companies where change in shareholding takes place under IBC.

Section 79 is an anti-abusive provision and was inserted with an intent to curb the taxpayers' attempts at acquiring a loss-making company and claim / enjoy the tax benefits of such losses while conducting profitable business.

In the current scenario, most share transfers would be distressed sales and not with an intent to claim tax advantage. Accordingly, it is recommended that there should be some clarification / exception and the above relief should also be extended to 'stressed companies' who have not pursued the IBC route while putting adequate safeguards.

This shall give much-needed impetus to crisis-ridden entities, which have

been finding it difficult to scout for buyers. Also, it can act as a push for those companies who venture to acquire and turnaround such stressed companies.

Impact of change in shareholding of subsidiary of stressed companies under IBC should also be outside the purview of Section 79.

Write-back of loans

Where any outstanding liability, in respect of the entity for which the resolution plan is approved (i.e. corporate debtor), is waived in accordance with the approved resolution plan, such waiver / write-back, especially liability in respect of operational creditors, may be subject to tax under both normal and Minimum Alternate Tax (MAT) provisions. The MAT liability could be mitigated by electing into the newly introduced concessional tax regime, or by a set-off of brought-forward losses. However, no specific exemptions are provided for normal tax in respect of companies under the IBC.

Where a past deduction was allowed in respect of any operational debt, write-back of this would be taxable subject to relief if any, on account of brought-forward tax losses. As regard write-back of financial debt, companies need to rely on certain judicial precedents to claim exemption from taxation.

Accordingly, it is recommended that in case of stressed companies, waiver of loan (operational / financial) along-with interest should be made exempt under the Act.

Concluding remarks:

The proactive efforts of the government in reviving the economy from the hazards of this global pandemic have been applauded across the globe. With the vaccination drive already underway to mitigate the spread of this pandemic, vaccine shot for struggling stressed companies in the form of relaxations by government will boost the Indian economy and send a positive message to the world about the country's bold efforts in reviving the economy.

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