

SC order on personal guarantors thorn in the side of biz families

Lack of clarity between legitimate succession planning and evasion is a worry, say experts

SUBMITO DEY
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Business families that have undertaken estate planning over the past two-three years are a worried lot.

Following last week's Supreme Court (SC) order on personal guarantors under the Insolvency and Bankruptcy Code (IBC), emboldened lenders are expected to enhance scrutiny of any recent estate planning measures by debt-laden promoter groups, including those by personal guarantors, said legal experts.

Over the past few years, there have been increasing number of instances of business families taking steps to ring-fence personal assets from business risks.

Legal experts pointed out that moving sizeable personal assets into family-controlled trusts — as part of the estate and succession planning measures — have been the most popular.

"Unfortunately, this judgment will bring legitimate structures into question

and paint every movement of assets into trusts with a bad faith brush," said Rishabh Shroff, partner at law firm, Cyril Amarchand Mangaldas.

The SC judgment points out that under the Code, the personal guarantor's liability is joint and co-extensive with the principal borrower, unless specifically stated otherwise in the guarantor documents.

Even after a company is taken over, sold or transferred to a new entity through the IBC process, the guarantor continues to be liable for the entire debt of the company, unless specifically discharged by the committee of creditors in the settlement scheme.

Any recent transfer of personal assets by promoter groups, or promoters who gave guarantee, could come under increased scrutiny for malfeasance, added legal experts.

However, more legal clarity is required to draw the line between legitimate succession planning and evasion. There is need for clarity on what actions, intentions, series of steps taken



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prove these charges, said lawyers. "The guarantor's liability today is very precarious. A person should give guarantee, even for his own enterprise, after fully understanding the implications," said Rajesh Narain Gupta, managing partner, SNG & Partners.

This becomes all the more pertinent amid the second pandemic wave that has led to financial stress across businesses.

Mitra Dixit, a family business advisor, and a director on the boards of several companies, is optimistic that lenders will use this apex court judgment judiciously, maybe on a case-by-case basis. The mechanism to identify the 'genuineness' of the case will be a sensible call, she added.

For promoters and guarantors looking to ring-fence their personal wealth from business risks, Shroff's advice is to make sure that any transfer of assets is done after carefully ensuring all necessary approvals and consent, as needed, have been sought and obtained prior to the transfer. This will help negate any subsequent legal challenges

posed by lenders. "The other important aspect is to ensure the whole exercise is properly documented and structured.

"It will be crucial to demonstrate substance in the exercise, to objectively say the approach is for legitimate succession planning purposes," said Shroff.

The timing for estate and succession planning becomes all the more crucial following the apex court order. Gupta pointed out that the pandemic has made many business families realise it is best to put in place succession planning measures and create bankruptcy remote structures during good times, when there are no demands for repayment by lenders.

"Unfortunately, the boundary between legitimate succession planning and evasion is not a bright-line test, and unless done with proper advice, life may become tough," said Shroff.

As a result, the role of family business advisors for preparing successors and planning long-term strategies is set to increase, added Dixit.