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Recharacterization of Intra-Group Financial Instruments under the Insolvency and Bankruptcy Code, 2016: Towards an Identity of Interest Test

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ABSTRACT

The Insolvency and Bankruptcy Code, 2016 creates a sharp divide between financial creditors and equity holders, and that divide shapes the entire course of a company's insolvency. Financial creditors are given significant powers: they sit on the Committee of Creditors, vote on resolution plans, and recover their dues ahead of most other unsecured claimants in liquidation. Equity holders are placed at the very bottom of the recovery waterfall under Section 53, which in practice means that shareholders almost never recover anything once insolvency begins. This imbalance has encouraged controlling groups to recharacterize equity contributions as loans to subsidiaries, moving from the last position in recovery to one of the first. The Supreme Court has relied on the commercial effect of borrowing test to decide whether a transaction counts as financial debt, yet that test focuses only on the form of the transaction and does not ask whether the form was shaped by genuine negotiation or by strategic manipulation within a group. The 2025 Amendment Bill, enacted as the Insolvency and Bankruptcy Code (Amendment) Act, 2026, introduces group insolvency procedures but leaves this classification problem unresolved. This paper proposes an Identity of Interest Test, which examines the origin of the capital, governance behaviour, risk profile and the timing of recharacterization, and argues that the test should be added to Section 5(8) of the Code with the burden placed on the entity claiming financial creditor status.

Keywords: *Insolvency and Bankruptcy Code, financial debt, recharacterization, group insolvency, intra-group financial instruments, Section 5(8), substantive consolidation, related party, Committee of Creditors, identity of interest test*

I. INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (the "IBC" or "the Code") introduced a creditor-led resolution architecture premised on the separation of financial creditors, who govern the

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corporate insolvency resolution process ("CIRP"), from equity shareholders, who bear residual risk and occupy the last position in the distribution hierarchy. This separation reflects a coherent economic logic that runs through the Code as a whole. Those who lend at arm's length price the risk of default into the interest rate they charge, receive a fixed return capped by their principal and interest, and are given governance authority over the resolution process because they bear the primary economic exposure to the debtor's failure. Equity holders invest in the expectation of unlimited upside, accept the risk of total loss, and are excluded from resolution governance precisely because their incentives in an insolvency may not align with a value-maximizing resolution.

This logic breaks down in a corporate group where the person who controls both the lender and the borrower is able to decide, unilaterally and without any opposing interest, what form their financial relationship will take. An inter-corporate advance from a holding company to a subsidiary carries the legal label of a loan and, if structured to satisfy the formal requirements of Section 5(8) of the Code, will qualify as financial debt. The economic substance of the relationship may nonetheless be indistinguishable from an equity subscription. The holding company bears the same downside risk as an equity holder, controls the subsidiary through its shareholding rather than through any creditor right, and has no independent recourse to enforce repayment against itself. But the formal label, if accepted at face value, moves the holding company from the last position in the Section 53 waterfall into the ranks of recognized financial creditors.

This paper examines whether Indian insolvency law, as it currently stands and as it has been amended by the Insolvency and Bankruptcy Code (Amendment) Act, 2026, provides adequate tools to detect and resist this kind of strategic recharacterization. It situates the problem within the distributional architecture that the Code establishes and examines the limits of the separate legal entity doctrine as an analytical tool for group insolvency problems. It then analyses the Section 5(8) classification test and identifies its structural blind spot in the group insolvency context. Finally, it analyses the new group insolvency framework and argues that, while procedurally significant, that framework does not address the classification problem and may intensify the incentive for recharacterization.

II. The IBC framework and the distributional stakes of financial creditor classification

The Code restructured India's approach to corporate insolvency by replacing debtor-controlled restructuring mechanisms with a creditor-led resolution architecture. Under the Code, when a corporate debtor commits a default exceeding the prescribed threshold, a financial creditor or an operational creditor may approach the National Company Law Tribunal ("NCLT") to initiate a CIRP. The admission of such an application triggers a moratorium under Section 14 of the Code that freezes the corporate debtor's assets and prevents enforcement action by individual creditors for the duration of the resolution period.[1]

Governance of the CIRP passes to a Committee of Creditors ("CoC") composed exclusively of the corporate debtor's financial creditors.[2] Section 5(7) of the Code defines a financial creditor as any person to whom a financial debt is owed,[3] and Section 5(8) defines financial debt as a debt disbursed against the consideration for the time value of money.[4] Whether a claim falls within or outside this definition determines whether the claimant enters the CoC with full voting rights or is excluded from resolution governance as an operational creditor. The Supreme Court clarified in *Pioneer Urban Land & Infrastructure Ltd. v. Union of India* that the Section 5(8) definition was intended to be read purposively and broadly, extending to any transaction that carries the commercial effect of borrowing money against a return, including instruments not conventionally described as loans.[5] The breadth of this construction has itself attracted academic criticism for diluting the significance of the time-value-of-money requirement.[6]

The distributional consequences of financial creditor classification become most significant when a corporate debtor proceeds to liquidation. Section 53 prescribes a mandatory waterfall that governs the order of distribution from the liquidation estate.[7] Insolvency resolution process costs and liquidation costs rank first; workmen's dues for the twenty-four months preceding the liquidation commencement date rank next, equally with the debts of secured creditors who have relinquished their security; then come the wages and unpaid dues of other employees for the preceding twelve months; then financial debts owed to unsecured creditors; then government dues and any unpaid balance owed to secured creditors who enforced their security; then any remaining debts and dues; then preference shareholders; and last of all equity shareholders or partners. Equity therefore receives a distribution only after every creditor class has been paid in full. The Supreme Court in *Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta*

[1] The Insolvency and Bankruptcy Code, 2016, § 14.
[2] *Swiss Ribbons Pvt. Ltd. v. Union of India*, (2019) 4 SCC 17 (holding that financial creditors are engaged from the inception in assessing the viability of the corporate debtor, which justifies their exclusive presence on the Committee of Creditors).
[3] The Insolvency and Bankruptcy Code, 2016, § 5(7).
[4] The Insolvency and Bankruptcy Code, 2016, § 5(8).
[5] *Pioneer Urban Land & Infrastructure Ltd. v. Union of India*, (2019) 8 SCC 416.
[6] Saurabh Gupta, *The Supreme Court Ruling in Pioneer: The Curious Case of Allottees under the IBC*, INDIACORPLAW (Jan. 11, 2020), https://indiacorplaw.in/2020/01/11/supreme-court-ruling-pioneer-curious-case-allottees-ibc/ (last visited June 13, 2026).
[7] The Insolvency and Bankruptcy Code, 2016, § 53(1).

set aside the appellate tribunal's direction that financial and operational creditors be treated on an equal footing, holding that differential treatment reflecting the priority of claims and the value of security interests is a matter for the commercial wisdom of the CoC and is not to be displaced by an adjudicating authority.[8] Whatever latitude a resolution plan enjoys, the position of equity at the foot of the statutory waterfall is not among the variables the CoC may reorder in its own favour.

The gap in distributional outcomes between a financial creditor and an equity shareholder is therefore not a technical formality but a variable with decisive economic consequences.[9] A financial creditor participates in the CoC, negotiates the terms on which a resolution plan is accepted and, in a liquidation, receives a distribution that may represent meaningful recovery depending on the value of the estate. An equity holder has no vote on the resolution plan, no right to challenge the commercial decisions of the CoC and no realistic expectation of recovery once the liquidation estate is distributed. This gap creates a powerful and predictable incentive for any controlling group entity that holds, or can recharacterize, an intercompany instrument as financial debt rather than as an equity contribution. A holder who moves an instrument from the last rung of the Section 53 waterfall into the ranks of recognized financial creditors gains a structural advantage that survives the corporate debtor's insolvency regardless of the economic substance of the original transaction. The question this paper examines is whether the Section 5(8) classification framework provides adequate tools to detect and resist such a recharacterization when it is driven by distributional positioning rather than by any genuine change in the nature of the intercompany relationship.

III. The separate legal entity doctrine and its limitations in group insolvency

The separate legal entity doctrine holds that a company, once incorporated, exists as a legal person entirely distinct from the individuals or entities that own or control its shares. The principle was established in English common law by the House of Lords in *Salomon v. A Salomon & Co. Ltd.* and was received into Indian company law as a foundational rule that courts disturb only with considerable caution.[10] In applying the doctrine to group structures, the Supreme Court in *Life Insurance Corporation of India v. Escorts Ltd.* confirmed that a company

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[8] *Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta*, (2020) 8 SCC 531 (setting aside the appellate tribunal's direction that financial and operational creditors be paid on an equal footing, and holding that differential treatment of classes of creditors, having regard to the priority of their claims and the value of their security interests, lies within the commercial wisdom of the Committee of Creditors).

[9] Mark J. Roe & Michael Simkovic, *Absolute Priority, Relative Priority, and Valuation Uncertainty in Bankruptcy*, 173 U. Pa. L. Rev. 389 (2025).

[10] *Salomon v. A Salomon & Co. Ltd.*, [1897] AC 22 (HL).

retains its separate legal personality even where a single promoter exercises practical control over several related entities within a common group.[11] Courts have recognized exceptions to this default, accepting that the corporate form may be disregarded where it has been used as a vehicle for fraud, where maintaining the fiction of separate personality would allow a party to evade an existing legal obligation, or where the arrangement was designed to defeat the evident purpose of a statutory provision.[12] These exceptions are demanding and require considerably more than a transaction that merely exploits the formal separateness of related entities for financial advantage.

Equity-to-debt recharacterization in a group setting does not fit comfortably within either the default rule or its recognized exceptions. The parties to such a transaction never dispute that the holding company and the subsidiary are separate legal persons, and no one asks for the corporate veil to be lifted or for the two entities to be treated as one. The claim is rather that an instrument created and labelled by a common controller should be evaluated as though it were the product of negotiation between independent parties, and that its formal characterization should be treated as conclusive of its legal nature. That is a different kind of argument from anything the separate legal entity doctrine was designed to address, because the doctrine was developed to protect creditors and third parties from misuse of the corporate form and not to extend uncritical deference to intra-group characterization decisions made by a controlling promoter.

Indian insolvency practice has developed a functional approach to group structures that occupies a middle ground between treating entities as fully separate and treating them as fully consolidated. Tribunals have shown a willingness to examine the economic reality of group arrangements for specific insolvency purposes, particularly the coordination of related proceedings, without abandoning separate legal personality as a general principle. This functional approach draws support from the single economic entity reasoning traceable in English jurisprudence to Lord Denning's judgment in *DHN Food Distributors Ltd. v. Tower Hamlets London Borough Council*, where the court treated a group of companies as one undertaking for a particular statutory purpose without collapsing their formal distinctness across the board.[13] The most direct Indian illustration is the consolidation of thirteen of the fifteen domestic Videocon group entities into a single CIRP, where the NCLT's order of 8 August 2019 rested on a finding that the relevant entities operated as one undertaking in practice, sharing

[11] *Life Insurance Corporation of India v. Escorts Ltd.*, (1986) 1 SCC 264.
[12] John H. Matheson, *The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context*, 87 N.C. L. REV. 1091 (2009), cited in Varsha Yogish, *Staggered Lifting of the Corporate Veil: A Case for Group Insolvency Norms*, INDIA CORPORATE LAW (Oct. 21, 2019), https://corporate.cyrilamarchandblogs.com/2019/10/group-insolvency-norms/ (last visited June 3, 2026).
[13] *DHN Food Distributors Ltd. v. Tower Hamlets London Borough Council*, [1976] 1 WLR 852 (CA).

management, financing and business operations, while each entity retained its separate legal personality for all other purposes.[14,15]

Neither the Videocon consolidation nor the broader functional approach addresses the narrower question of instrument characterization with which this paper is concerned. That body of doctrine deals with the prior question of identifying which entities belong together in the same insolvency group. It says nothing about how the character of a specific financial claim between two members of an identified group ought to be assessed, or whether Section 5(8) of the Code allows a resolution professional or an adjudicating authority to look past the formal label attached to an instrument and examine its economic substance. That is the question the following section addresses.

IV. The Section 5(8) classification test and its structural blind spot in group insolvency

The classification of an intra-group financial instrument as financial debt or as equity carries decisive consequences under the Code. A holding company that qualifies as a financial creditor of its subsidiary is admitted as such at the threshold, and in liquidation recovers proportionately ahead of equity. One that does not is pushed to the last position in the Section 53 waterfall and receives nothing until every creditor class has been paid in full. Whether a promoter can engineer this difference through instrument design, and whether Section 5(8) provides any defence against it, is the question this section addresses.

Section 5(8) defines financial debt as a debt disbursed against the consideration for the time value of money.[16] The Supreme Court in *Pioneer Urban Land & Infrastructure Ltd. v. Union of India* interpreted that definition with deliberate breadth.[17] Disbursal requires a real movement of funds from the lender to the borrower, placing the money in the borrower's control. Consideration for the time value of money means compensation for the period during which the money remains with the borrower, whether expressed as interest, as a discount or through a comparable return mechanism. Section 5(8)(f), which covers any transaction having the commercial effect of a borrowing, extends the definition beyond conventionally labelled instruments to capture arrangements that replicate the economics of lending regardless of their

[14] *State Bank of India v. Videocon Industries Ltd.*, MA 1306/2018 in CP No. 02/2018 (NCLT Mumbai, Aug. 8, 2019).
[15] *Videocon Case: The Doctrine of Substantial Consolidation*, IndiaCorpLaw (Aug. 2019), https://indiacorplaw.in/2019/08/videocon-case-doctrine-substantial-consolidation.html (last visited June 30, 2026).
[16] The Insolvency and Bankruptcy Code, 2016, § 5(8).
[17] *Pioneer Urban Land & Infrastructure Ltd.*, *supra* note 5.

formal description. The Supreme Court confirmed in *Phoenix ARC Pvt. Ltd. v. Spade Financial Services Pvt. Ltd.* that both elements must be genuinely present and not merely apparent from the face of the document.[18]

This test works well in arm's length transactions. When a bank and a borrower negotiate a facility, opposing interests discipline the form of the instrument and the resulting document tends to reflect the underlying economics. Courts that give formal deference to instruments negotiated on this footing are therefore standing on solid analytical ground. The problem arises when the same test is applied to a financial instrument between a holding company and its subsidiary under common control. In that setting there is no opposing interest, no external pricing mechanism and no independent counterparty with whom to negotiate. The form of the instrument is decided unilaterally by whoever controls both entities, with full knowledge of how each characterization behaves in insolvency. Section 5(8) contains no provision for examining whether that choice was made honestly or strategically.

Phoenix ARC is the closest Indian authority to a substance-over-form inquiry in this context. The Supreme Court there found that the inter-corporate deposit claims were collusive and therefore did not satisfy the Section 5(8) test, but the finding turned on evidence of deliberate mis-documentation and diversion of funds. It does not address the quieter problem of a controlling promoter who chooses, without any fraud, to structure a capital contribution as an inter-corporate loan specifically because that label improves the holding company's distributional position if the subsidiary becomes insolvent. The underlying transaction in such a case remains genuine in every commercial sense. Only the choice of form is strategic, and that strategic choice is invisible to the Section 5(8) test as it currently stands.

This doctrinal gap finds a clear and instructive referent in comparative law. The United States Court of Appeals for the Sixth Circuit in *In re AutoStyle Plastics, Inc.* applied an eleven-factor test to determine whether advances from a controlling shareholder should be recharacterized as equity despite their debt label, proceeding from the recognition that a controlling shareholder who chooses the form of an instrument with no counterparty to constrain that choice cannot have the chosen form taken at face value.[19] Indian insolvency law has no equivalent framework. The Section 5(8) test accepts the label of an intra-group instrument with the same formal deference it accords a negotiated bank facility, while the conditions that justify such deference in the bank facility context are wholly absent.[20]

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[18] *Phoenix ARC Pvt. Ltd. v. Spade Financial Services Pvt. Ltd.*, 2021 SCC OnLine SC 51.

[19] *In re AutoStyle Plastics, Inc.*, 269 F.3d 726 (6th Cir. 2001).

[20] Deborah J. Enea & Loren A. Flath, *Bankruptcy Court Recharacterizes Alleged Loan as Equity Under Delaware Law*, TROUTMAN PEPPER LOCKE INSIGHTS (2025), https://www.troutman.com/insights/bankruptcy-court-

V. The Insolvency and Bankruptcy Code (Amendment) Act, 2026: Procedural Progress and Substantive Silence

The Insolvency and Bankruptcy Code (Amendment) Bill, 2025, passed by the Lok Sabha on 30 March 2026 and enacted as the Insolvency and Bankruptcy Code (Amendment) Act, 2026 on receiving Presidential assent on 6 April 2026, represents the most significant legislative intervention in India's corporate insolvency architecture since the Code's enactment. By inserting Chapter V-A into the principal Act, it creates an enabling framework for the coordinated resolution of corporate groups, addressing a structural gap that Indian tribunals had been filling through equitable reasoning for nearly seven years. The procedural architecture marks genuine progress and deserves to be taken seriously on its own terms. It deserves careful analysis, however, not only for what it does but for what it conspicuously leaves undone. This section argues that the new framework, while resolving the coordination problem, does not address the instrument classification problem identified above, and that it may intensify the incentive for recharacterization rather than diminish it.

Chapter V-A operates through an enabling mechanism rather than through self-executing substantive rules. The new Section 59A empowers the Central Government to make rules providing for a common bench to hear insolvency proceedings against corporate debtors belonging to the same group, for coordination between separate proceedings and between their committees of creditors and insolvency professionals, for the appointment of a common insolvency professional as coordinator, for the formation of a committee comprising the committees of creditors of the group companies, and for binding coordination agreements.[21] These provisions reflect, in statutory form, the procedural arrangements that the NCLT had improvised in the Videocon proceedings and that the Working Group on Group Insolvency constituted by the Insolvency and Bankruptcy Board of India had recommended in its report of September 2019. The Working Group identified four facets of a comprehensive group insolvency framework: procedural coordination among stakeholders, substantive consolidation in limited circumstances, rules to address perverse behaviour within corporate groups, and clear criteria for determining group interconnection.[22] It recommended that the first phase of

recharacterizes-alleged-loan-as-equity-under-delaware-law/ (last visited June 4, 2026) (describing the eleven-factor *AutoStyle* test as applied by the Third, Fourth, Sixth and Tenth Circuits and the Southern District of New York).

[21] The Insolvency and Bankruptcy Code, 2016, § 59A, as inserted by the Insolvency and Bankruptcy Code (Amendment) Act, 2026.

[22] Insolvency and Bankruptcy Board of India, *Report of the Working Group on Group Insolvency* (Sept. 23, 2019), https://ibbi.gov.in/uploads/whatsnew/2019-10-12-004043-ep0vq-d2b41342411e65d9558a8c0d8bb6c666.pdf (last visited June 23, 2026) (identifying procedural coordination among stakeholders, substantive consolidation in limited circumstances, rules against perverse behaviour within

implementation carry both procedural coordination and rules against perverse behaviour, reserving substantive consolidation and cross-border group insolvency for a later stage. What Chapter V-A enacts is the procedural limb alone. The rules against perverse behaviour, the only facet that could have addressed intra-group instrument characterization directly, and which the Working Group had placed in the same first phase, do not appear in the enacted text.

The legislative history explains how this omission arose without ever being decided upon. The Insolvency Law Committee, reporting in March 2018, acknowledged that the treatment of group companies within insolvency law is a complicated subject, observed that the system was then too new to absorb it, and recommended that the issue be revisited in the long term once the basic framework had been tested in practice.[23] The Working Group returned to the question in 2019 and proposed the phased framework described above. The Amendment adopts the phasing but not the content of the first phase in full, and it announces no timeline for what remains. The perverse behaviour limb, which would have required rules governing the assertion of financial creditor status by related parties within a group, has been deferred without any stated mechanism for its eventual implementation.[24]

The restriction on related-party participation in the CoC is the provision most likely to be cited as an answer to the problem this paper identifies. That restriction, however, is not new and owes nothing to Chapter V-A. The first proviso to Section 21(2) of the Code already denies a financial creditor that is a related party of the corporate debtor any right of representation, participation or voting in a meeting of the CoC, and *Phoenix ARC* extended that bar purposively to an entity that sheds the related-party label in order to circumvent it. The proviso is a significant safeguard, but it is a safeguard against influence rather than against classification. It says nothing about whether the claim is a financial debt at all. A group entity whose recharacterized instrument satisfies the formal requirements of Section 5(8) is admitted as a financial creditor even though it may not sit in the CoC, and that admission fixes its rank in the Section 53 waterfall and its standing to be dealt with as a financial creditor under a resolution plan. The classification inquiry under Section 5(8) occurs at the Section 7 admission stage, before the CoC is

corporate groups, and criteria for determining group interconnection as the facets of a comprehensive framework, and recommending that the first phase carry procedural coordination and rules against perverse behaviour, with substantive consolidation and cross-border group insolvency deferred).

[23] INSOLVENCY LAW COMMITTEE, *Report* 83 (Mar. 2018) (recording the view that "the treatment of group companies within insolvency laws is a complicated subject" and that it "may be too soon to introduce a complex subject, like the present issue").

[24] Saptadip Nandi Chowdhury, *Untangling the Corporate Web: India's Leap Towards Group Insolvency*, IBC LAWS (2025), https://ibclaw.in/untangling-the-corporate-web-indias-leap-towards-group-insolvency-evaluating-the-proposed-chapter-v-a-of-the-insolvency-and-bankruptcy-amendment-bill-2025-by-saptadip-nandi-chowdhury/ (last visited June 15, 2026) (analysing the open-ended treatment of intra-group financial claims under the 2025 Bill).

constituted, and it is at that stage, not in the conduct of the CoC, that the distributional advantage is won.

The prospect of pooling under Chapter V-A creates a further concern that the legislative commentary has not examined. Section 59A is an enabling provision, and the framework it contemplates is one of procedural coordination; it does not itself authorize substantive consolidation, which the Working Group expressly reserved for a later phase. But tribunals have ordered substantive consolidation in exercise of their equitable jurisdiction, as the Videocon proceedings show, and rules made under Section 59A may in time extend further. Wherever the assets and liabilities of related corporate debtors are in fact pooled, the estate against which financial creditors assert their claims expands to include the assets of every entity in the consolidated group. A group entity holding recharacterized instruments against several subsidiaries may then assert financial creditor status against the enlarged estate, multiplying the distributional advantage that a single successful recharacterization would have produced in a standalone CIRP. A mechanism designed to protect genuine creditors by pooling assets for maximum recovery thus creates a larger arena in which strategic recharacterization produces larger gains. The Amendment builds the arena without examining the players who enter it.

This legislative silence stands in instructive contrast to the position that India's own tribunals had developed before the Amendment. The NCLT's order of 8 August 2019 in *State Bank of India v. Videocon Industries Ltd.* identified fourteen factors to be examined before ordering consolidation, among them common control, common directors, common assets, interlacing of finance, inter-looping of debts and singleness of economics of units.[25] Those factors constitute an implicit substance-over-form inquiry into the economic reality of the group.[26] They are applied at the point of deciding whether to consolidate proceedings, not at the point of classifying instruments within them. The Amendment converts this judicial practice into a statutory framework but inherits its limitation: it tells courts how to coordinate the proceedings of related entities without telling resolution professionals or adjudicating authorities how to evaluate the financial claims that those entities assert against one another within the coordinated process. Whether a group entity's financial claim is a genuine debt obligation or a strategically labelled equity contribution remains entirely outside the Amendment's scope.

[25] *State Bank of India v. Videocon Industries Ltd.*, *supra* note 14 (setting out fourteen factors relevant to substantive consolidation, including common control, common directors, common assets, common liabilities, inter-dependence, interlacing of finance, pooling of resources, co-existence for survival, inter-looping of debts and singleness of economics of units).

[26] *SBI v. Videocon Case: Doctrine of Substantial Consolidation*, SCC ONLINE BLOG (Jan. 9, 2021), https://www.scconline.com/blog/post/2021/01/09/sbi-v-videocon-case-doctrine-of-substantial-consolidation/ (last visited June 30, 2026).

VI. Comparative analysis: substance over form in United States and United Kingdom law

The problem of distinguishing genuine debt from strategically labelled equity in the insolvency of a corporate group is not unique to India. Both the United States and the United Kingdom have developed doctrinal tools that conduct a substance-over-form inquiry into the economic reality of intra-group financial relationships. Neither system transplants directly into the Indian CIRP framework, for reasons this section identifies. But both share an intellectual core, a preparedness to look past the formal label of a financial instrument and examine the conditions under which that label was applied, on which the Identity of Interest Test proposed below draws.

The United States doctrine of substantive consolidation empowers bankruptcy courts to pool the assets and liabilities of two or more related entities and satisfy all claims from the consolidated pool. The doctrine was developed by courts exercising their general equitable jurisdiction in bankruptcy, without express statutory authorization. The Second Circuit's judgment in *In re Augie/Restivo Baking Co.* established that the sole purpose of substantive consolidation is to ensure the equitable treatment of all creditors, and reduced the various factors the courts had used to two critical questions: whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit, and whether the affairs of the debtors are so entangled that consolidation will benefit all creditors.[27] The court in *Augie/Restivo* reversed the courts below and denied consolidation precisely because the evidence showed that one creditor had lent money on the strength of the borrowing entity's individual financial condition alone, had no knowledge of the other entity, and had proceeded throughout on the assumption that it was dealing with separate legal persons.[28] Consolidation, had it been ordered, would have rendered that creditor's secured loan subordinate to the other entity's administrative debt, a result the court found irreconcilable with the creditor's reasonable expectations at the time of contracting. The principle that emerges is that the economic reality of how the parties actually dealt with one another, and not the formal corporate structure, governs the consolidation inquiry.

The Eleventh Circuit's judgment in *Eastgroup Properties, Inc. v. Southern Motel Associates, Ltd.* added structural precision to this inquiry.[29] The court held that the proponent of consolidation must establish two things: first, that there is substantial identity between the

[27] *In re Augie/Restivo Baking Co.*, 860 F.2d 515, 518 (2d Cir. 1988).

[28] *Augie/Restivo*, *supra* note 27. See also *First Impressions: 9th Circuit Rules That Notice of Proposed Substantive Consolidation Must Be Given to Creditors of Non-Debtor*, Jones Day Insights (Dec. 2019), https://www.jonesday.com/en/insights/2019/12/first-impressions-9th-circuit-rules (last visited June 7, 2026).

[29] *Eastgroup Properties, Inc. v. Southern Motel Associates, Ltd.*, 935 F.2d 245, 249 (11th Cir. 1991).

entities to be consolidated, meaning that they operated as a single economic unit and did not maintain genuine economic separateness; and second, that consolidation is necessary to avoid some harm or to realize some benefit. Once these elements are established, a presumption arises that creditors did not rely solely on the credit of one of the entities involved.[30] The burden then shifts to any objecting creditor to demonstrate actual reliance on the separate identity of the entity with whose estate it does not wish to be consolidated, and to show that it will be prejudiced by consolidation. *Eastgroup* also confirmed that even where an objecting creditor establishes such reliance, consolidation may still be ordered if the demonstrated benefits heavily outweigh the harm to the objecting party. Together, *Augie/Restivo* and *Eastgroup* establish a framework that is explicitly consequentialist in structure: it asks what the economic reality of the group relationship was, whose expectations were formed in reliance on that reality, and whether the remedy of consolidation serves the interest of the creditor body as a whole.

The transplantability of this framework to India is constrained by two structural differences between proceedings under Chapter 11 of the United States Bankruptcy Code and the Indian CIRP. First, substantive consolidation is a remedy for hopelessly entangled entities whose affairs cannot be separated without consuming the assets. The *Augie/Restivo* court took the view that consolidation on the entanglement ground is appropriate only where the time and expense of attempting to unscramble the debtors' affairs would themselves threaten the realization of any net assets for the creditors.[31] That is a remedy of last resort, calibrated to an extreme case of economic commingling. India's recharacterization problem does not require commingled assets or impossible entanglement; it arises whenever a controlling entity makes a unilateral characterization decision about a financial instrument, whether or not the broader group is economically integrated. Second, Chapter 11 proceedings are restructuring-oriented and give courts extensive flexibility in approving plans that distribute value equitably. The CIRP is more rigid and time-constrained, and gives the adjudicating authority a narrower supervisory role. An open-ended balancing exercise of the kind *Eastgroup* permits, in which a court weighs the benefits of consolidation against prejudice to particular creditors, is procedurally unsuitable for a process designed to be completed within a fixed period. What the United States framework contributes to the present analysis is not its remedy but its intellectual discipline: courts in that

[30] *The ABC's of Substantive Consolidation, Part II*, ANDERSON KILL P.C. INSIGHTS, https://andersonkill.com/article/the-abcs-of-substantive-consolidation-part-ii/ (last visited June 12, 2026) (summarising the *Auto-Train* burden-shifting framework adopted in *Eastgroup* and the requirement that the demonstrated benefits of consolidation heavily outweigh the harm to objecting creditors).

[31] *Augie/Restivo*, *supra* note 27, at 518.

system ask what the economic relationship between the parties actually was, and they answer by examining the conduct of the parties rather than the label attached to their transaction.

The United Kingdom's cross-class cram-down mechanism, introduced through Part 26A of the Companies Act 2006, operates through a different doctrinal channel but reflects the same underlying principle. Section 901G allows a restructuring plan to bind a dissenting class of creditors if the court is satisfied that no member of that class would be any worse off than in the relevant alternative, which is typically the insolvency scenario that would follow if the plan were not approved. To apply this test the court must assess what each creditor class would actually receive in the relevant alternative, which requires examining the economic substance of each creditor's claim. The English High Court's judgment in *Re Virgin Active Holdings Ltd.* was the first occasion on which the mechanism was used to cram down classes that had actively opposed the plan, and Snowden J. assessed what each dissenting class would receive in the relevant alternative as compared with the proposed plan, attaching little weight to the objections of classes that would be out of the money in that alternative.[32] Where a creditor's formal contractual priority rests on a characterization that does not reflect the economic substance of the underlying relationship, the relevant alternative analysis may produce a different result from the one the creditor expects.[33] The court is therefore required, at least implicitly, to examine whether the formal label of a financial instrument corresponds to its economic substance.

The common thread between the United States and United Kingdom approaches is a shared commitment to examining what the economic relationship between the parties actually was, as evidenced by their conduct, rather than what their documents say it was. Neither system permits a party to select the legal label for its financial relationship with a related entity by reference to that label's distributional consequences in insolvency, and then insist that the chosen label be treated as conclusive. Both recognize that the conditions which justify treating a formal label as conclusive in an arm's length context, namely the presence of opposing interests, independent negotiation and market pricing discipline, are absent in an intra-group context where the same controller sits on both sides of the transaction. The Identity of Interest Test proposed below draws on this shared foundation while addressing the structural features of the Indian CIRP that preclude direct adoption of either approach.

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[32] *Re Virgin Active Holdings Ltd.*, [2021] EWHC 1246 (Ch) (Snowden J.). The cross-class cram-down power had first been exercised in *Re DeepOcean 1 UK Ltd.*, [2021] EWHC 138 (Ch).

[33] *English Court Sanctions Virgin Active's Restructuring Plans, Following Major Challenge from Landlords*, KIRKLAND & ELLIS LLP PUBLICATIONS (2021), https://www.kirkland.com/publications/kirkland-alert/2021/05/virgin-active-restructuring-plan-sanctioned (last visited June 10, 2026) (discussing the "relevant alternative" test as applied by Snowden J.).

VII. The identity of interest test: a proposed framework for Section 5(8)

The analysis in the preceding sections establishes that Section 5(8) of the Code, as currently interpreted, accepts the formal label of an intra-group financial instrument without any mechanism for examining whether that label was chosen honestly or strategically. The Amendment does not address this gap in any of the provisions it enacts. Comparative law in the United States and the United Kingdom shows that both systems conduct a substance-over-form inquiry in analogous situations, asking what the economic reality of the intra-group relationship was rather than what the documents say it is. This section proposes the Identity of Interest Test as a statutory framework to supply what the current law lacks.

The test rests on a single organizing question: at the time the capital was originally deployed, was the economic relationship between the deploying entity and the receiving entity one of creditor and debtor, or one of owner and owned? That question is prior to the commercial effect of borrowing inquiry applied in *Anuj Jain*.[34] The commercial effect of borrowing test asks whether the present form of the transaction looks like a loan. The Identity of Interest Test asks whether the relationship from which the transaction originated was ever a genuine lending relationship, or whether the instrument's debt characterization is a label applied after the event to capital that was economically indistinguishable from equity from the moment it was deployed. Only if the identity of interest inquiry produces an answer consistent with a genuine creditor-debtor relationship should the transaction proceed to the Section 5(8) commercial effect of borrowing analysis. The proposed test comprises four factors.

The first factor is the origin of the capital itself. The adjudicating authority should examine whether the capital was disbursed as debt from the moment of deployment, that is, whether there was a contemporaneous and enforceable obligation to repay a fixed principal amount on a defined schedule with interest accruing from the date of disbursement. Where interest was added retrospectively to an advance previously treated in the accounts as an equity contribution, where no repayment schedule existed at the time of deployment, or where the characterization of the instrument as debt was effected by amendment of an existing equity arrangement rather than by a fresh disbursement, the origin of the capital is inconsistent with a genuine lending relationship. The significance of this factor draws support from the NCLT's observation in the Videocon proceedings that the inter-looping of debts and the commingling of financial accounts

[34] *Anuj Jain, Interim Resolution Professional for Jaypee Infratech Ltd. v. Axis Bank Ltd.*, (2020) 8 SCC 401.

evidenced the single economic unit that the group actually constituted.[35] Where the financial accounts of the related entities treated the deployment as an equity contribution for a material period before the insolvency, that treatment is contemporaneous evidence of the parties' own understanding of the nature of the capital.

The second factor concerns the pattern of control and governance behaviour displayed by the parties. A genuine creditor exercises creditor-type rights: it stipulates repayment terms, takes security where appropriate, monitors the borrower's financial condition, and enforces its rights on default. A shareholder exercises owner-type rights: it appoints directors, receives dividends, approves major transactions and directs strategy. Where the entity asserting financial creditor status exercised governance rights over the corporate debtor that are characteristic of ownership rather than of arm's length lending, and where it did not exercise or could not have exercised the enforcement rights a genuine creditor would hold, the governance pattern is inconsistent with the creditor characterization now asserted. This factor draws on the same analytical discipline that the Sixth Circuit applied in *In re AutoStyle Plastics, Inc.*, where the presence or absence of creditor-type protections, including security for the advances and the extent of their subordination to outside creditors, formed part of the eleven-factor inquiry into whether a controlling shareholder's advances should be treated as equity. The court in that case ultimately declined to recharacterize the advances, but the factors it identified remain the leading articulation of the inquiry.[36,37]

The third factor is the risk profile of the instrument at the time of deployment. Genuine debt carries a fixed-return profile: the lender is entitled to its principal and agreed interest regardless of the borrower's commercial performance, and holds rights enforceable against the borrower's assets. Equity capital carries a variable-return profile: the contributor participates in profits if the entity performs well and bears the full risk of loss if it does not. Where the instrument carried no fixed maturity, where repayment was contingent on the corporate debtor's financial performance or exercisable at the option of the corporate debtor rather than of the alleged creditor, or where the instrument was subordinated to all third-party creditors in a manner that replicates the economic position of equity, the risk profile is inconsistent with the debt characterization asserted. This factor reflects the reasoning in *Pepper v. Litton*, where the United States Supreme Court held that the equitable powers of a bankruptcy court are exercised so that

[35] *State Bank of India v. Videocon Industries Ltd.*, *supra* note 14.

[36] *In re AutoStyle Plastics, Inc.*, *supra* note 19, at 749-50 (setting out the eleven factors and affirming the refusal to recharacterize the advances as equity).

[37] *Subordination of Shareholder Loans between Creditor Protection Devices: A Comparative Analysis*, AMICUS CURIAE, https://journals.sas.ac.uk/lawreview/article/download/5335/5136/9403 (last visited June 30, 2026) (analysing the eleven-factor *AutoStyle* test and the role of undercapitalization in recharacterization analysis).

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substance will not give way to form, and that the dealings of a dominant shareholder with its controlled company must be examined for their substance rather than accepted on the label the dominant party chose.[38]

The fourth factor concerns the timing of the recharacterization relative to the onset of financial distress. Where an equity instrument was converted into a debt instrument within twenty-four months before the date on which the corporate debtor's CIRP commenced, a rebuttable presumption should arise that the recharacterization was effected to improve the converting entity's distributional position in the anticipated insolvency rather than to reflect any genuine change in the economic relationship between the parties. This presumption is modelled on the look-back period that Section 43 of the Code already applies to preferential transactions, which prescribes a two-year look-back where the beneficiary is a related party and one year in other cases.[39] The same policy logic that justifies the Section 43 look-back applies with equal force here. A related party that converts its equity position into a debt claim within two years of insolvency has made a characterization decision in conditions where the risk of the subsidiary's insolvency was, or should have been, visible to it. The presumption is rebuttable on evidence that the recharacterization was effected for a genuine commercial reason unrelated to insolvency positioning, such as a restructuring of the group's financing required by an independent lender or a regulatory requirement imposed on the group by a competent authority.

The procedural design of the test matters as much as its substantive content. The test should operate at the Section 7 admission stage, before the CoC is constituted.[40] Once a group entity has been admitted as a financial creditor, its claim is fixed in the distributional hierarchy and it acquires standing to be dealt with as a financial creditor in the resolution process, including standing to resist the very challenge the test is designed to enable. The resolution professional, or any creditor with standing to object to the admission of a claim, should be entitled to invoke the Identity of Interest Test by raising a challenge before the adjudicating authority at the time the claim is admitted or the CoC is constituted. On such a challenge, the burden of establishing all four factors should lie with the entity asserting financial creditor status. This allocation of the burden reflects the asymmetry of information in the intra-group context: the entity asserting creditor status is the same entity that controlled the instrument's characterization, and it alone

[38] *Pepper v. Litton*, 308 U.S. 295, 306 (1939).
[39] The Insolvency and Bankruptcy Code, 2016, § 43(4).
[40] Vidushi Puri, *Distinction in Treatment of Financial Creditors vs. Operational Creditors under IBC*, IBC LAWS (2024), https://ibclaw.in/distinction-in-treatment-of-financial-creditors-vs-operational-creditors-by-vidushi-puri/ (last visited June 30, 2026) (discussing the significance of admission at the Section 7 stage as distinct from downstream Committee of Creditors participation rights).

has full access to the records and the decision-making that explain why the instrument took the form it did.

The test requires statutory expression to be fully effective in practice. The current Section 5(8) framework gives the adjudicating authority no explicit basis for inquiring into the origin of an instrument's characterization. The following proviso is proposed for insertion after Section 5(8)(i) of the Code.[41]

Provided that where an entity claiming to be a financial creditor is a related party of the corporate debtor, as defined in Section 5(24), the adjudicating authority shall, before admitting the application or including the claim in the computation of the Committee of Creditors, satisfy itself that the alleged financial debt was, at the time of its original deployment:

(a) disbursed as a debt obligation with a contemporaneous and enforceable repayment schedule and interest accruing from the date of disbursement;

(b) held by the claimant in the capacity of a creditor exercising creditor-type rights and not in the capacity of a shareholder exercising governance rights over the corporate debtor; and

(c) structured to carry the risk profile of a fixed-return instrument and not the risk profile of equity capital.

Provided further that where the conversion of an equity instrument into a debt instrument occurred within a period of twenty-four months prior to the date of commencement of the corporate insolvency resolution process, it shall be presumed, unless the contrary is shown, that such conversion was effected for the purpose of improving the claimant's distributional position in the insolvency of the corporate debtor.

This formulation gives the adjudicating authority a structured basis for inquiry while preserving the rebuttable nature of the presumption and avoiding the categorical exclusion of all related-party financial claims. A related party that deployed genuine debt capital on arm's length terms, exercised creditor-type rights throughout the relationship and made no strategic recharacterization in anticipation of insolvency will satisfy the test and be admitted as a financial creditor on the same basis as any other. The test targets only what it should target: the entity that chose its instrument's label with full knowledge of the consequences of that label in insolvency, and with no counterparty to discipline the choice.

[41] The Insolvency and Bankruptcy Code, 2016, § 5(24).

VIII. Conclusion

This paper has argued that the Section 5(8) definition of financial debt, as currently interpreted, contains a structural blind spot that enables controlling group entities to recharacterize equity contributions as financial debt in anticipation of a subsidiary's insolvency, and thereby to convert a claim that would rank last in the Section 53 waterfall into one that ranks among the first. The mechanism is straightforward: a common controller facing no opposing interest on either side of the intra-group transaction selects the label that produces the most favourable distributional outcome in insolvency and structures the instrument accordingly. The commercial effect of borrowing test, which examines the present form of the transaction rather than the conditions under which that form was chosen, has no tools for detecting such a choice.

The Insolvency and Bankruptcy Code (Amendment) Act, 2026 introduces procedural coordination mechanisms for group insolvency that are genuinely significant and that reflect recommendations developed over several years by the Insolvency Law Committee and the Working Group on Group Insolvency. It does not, however, address the instrument classification problem identified in this paper. To the extent that pooling of assets follows from coordinated proceedings or from an order for substantive consolidation, the Amendment may increase the distributional advantage available to a group entity that has successfully recharacterized its equity as debt, because that entity's claim then reaches across a larger pool of assets. The first proviso to Section 21(2) bars a related-party financial creditor from representation, participation and voting in the CoC, and so addresses the influence such an entity might otherwise exercise. It does not address the anterior classification question, which determines the rank the claim takes in the distribution of value.

Comparative analysis of United States and United Kingdom law shows that both systems have developed, through different doctrinal channels, a shared commitment to examining the economic reality of intra-group financial relationships rather than the formal label of the instrument. Both deny the entity that made the characterization decision the benefit of treating that decision as conclusive. The Identity of Interest Test proposed here draws on that comparative material while adapting it to the structural features of the Indian CIRP: it operates at the Section 7 admission stage rather than as a remedy for hopelessly entangled estates, it uses a four-factor inquiry calibrated to the conditions that distinguish genuine debt from strategic equity labelling, and it allocates the burden of proof to the party that controlled the characterization decision.

The test requires statutory implementation through a targeted amendment to Section 5(8) of the Code. The proposed proviso gives the adjudicating authority an explicit basis for the inquiry, defines the four factors with sufficient precision to guide resolution professionals and practitioners, and creates a rebuttable presumption for conversions occurring within twenty-four months of the commencement of the CIRP that is consistent with the look-back logic already present in Section 43. Together with the procedural coordination framework of Chapter V-A, the Identity of Interest Test would give Indian insolvency law both the architecture for managing group proceedings and the tools for evaluating the financial claims asserted within them. The Amendment has, in this sense, built the arena in which group insolvencies will be resolved. The proposed test would ensure that only genuine creditors, and not strategically relabelled shareholders, may enter it.

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