



A. Introduction

In today's volatile economic climate, distressed businesses are increasingly becoming focal points of strategic investment and financial restructuring. Across Asia, and particularly in financial centres like Singapore, companies under financial pressure are turning to legal and restructuring frameworks to manage debt, protect value, and avoid liquidation. These distressed businesses often present unique opportunities for investors seeking to acquire undervalued assets, enter new markets, or consolidate their positions through timely and well-structured acquisitions. When approached with thorough due diligence and sound legal safeguards, investing in or acquiring distressed businesses can serve both as a recovery path for the company and a value-creating move for the investor.

B. Key Indicators of a Distressed Business and/or Assets

Financial Indicators

Understanding the signs of financial distress is critical for investors, lenders, and stakeholders seeking to assess the risks associated with a company or asset. The first and most fundamental step involves a close review of financial statements -namely, the balance sheet, income statement, and cash flow statement. These documents provide vital insight into a company's operational stability and financial viability. Warning signs may include declining revenue, shrinking profit margins, and increasing interest expenses, all of which may suggest that a company is struggling to generate sustainable income. A negative cash flow also indicates short-term liquidity problems. Key financial ratios such as a low assets-to-liabilities ratio, high debt-to-equity ratio, and weakening profitability or interest coverage ratios further highlight a company's deteriorating financial health and limited ability to pay its debts as they fall due.

Non-financial Indicators

In addition to financial data, several non-financial indicators may signal a distressed asset. Operational shortcomings, such as mismanagement or lack of internal controls, can quickly undermine a company's performance. Broader market forces, including sector-specific downturns or negative investor sentiment, can also impact a company's outlook. Credit rating downgrades serve as a formal warning

that a firm’s creditworthiness is in decline, often leading to a rise in bond yields as investors demand greater compensation for increased risk. Legal developments, such as insolvency filings or creditor actions, are among the most definitive signs of distress and often mark the beginning of restructuring or liquidation processes. Together, these financial and non-financial indicators provide a comprehensive framework for identifying distressed assets and anticipating potential recovery or risk mitigation strategies.

C. Refinancing of Distressed Assets

Asset Sale

Acquiring assets from a financially distressed yet not formally insolvent company can present a compelling opportunity for buyers. Such transactions may allow acquirers to obtain valuable assets that would otherwise be inaccessible, either to enhance their existing operations or to enter new markets. However, caution is essential. If the purchase is made for less than fair market value, it may later be challenged as a "transaction at undervalue," particularly if the seller enters formal insolvency proceedings. In such cases, the law may permit the transaction to be reversed in order to protect the interests of creditors. Moreover, the acquired assets may be subject to existing encumbrances, such as liens or other claims. To mitigate these risks, comprehensive due diligence is critical before finalizing any asset acquisition, ensuring that the buyer is fully informed about the asset’s legal and financial status.

Share Sale

A share sale is often seen as more straightforward in structure, involving the direct purchase of shares from the current owners of a company. This approach offers the advantage of maintaining the continuity of the business, including its contracts, licenses, and operations. However, it also carries a unique set of risks. By acquiring shares, the buyer inherits not only the company’s assets but also its liabilities—some of which may be undisclosed or unfavourable. As such, thorough due diligence is essential prior to completion. This includes a full review of the company’s financial condition, legal obligations, and operational viability. Additionally, while an injection of capital from the buyer may temporarily stabilize the business, it may not be sufficient for long-term sustainability if underlying structural issues are not addressed.

Asset Sale vs. Share Sale

Aspect	Asset Sale	Share Sale
Definition	Purchase of specific assets (e.g., equipment, inventory, IP) from a business.	Purchase of ownership (shares) in the entire company.
Transaction Structure	Buyer acquires selected assets and may assume certain liabilities.	Buyer acquires all assets and liabilities by owning the company outright.
Control Over Liabilities	Buyer can choose which liabilities to assume.	Buyer assumes all existing liabilities, including hidden or contingent ones.

Due Diligence Focus	Asset ownership, encumbrances, title, and valuation.	Company's financial health, legal compliance, contracts, and contingent risks.
Risk of Clawback	High, especially if the seller later enters insolvency and the sale was undervalued.	Moderate, depending on the sale price and whether it impacts creditors.
Continuity of Business	May require new contracts, licenses, and employee transfers.	Business continues as-is, with minimal disruption.
Complexity of Execution	Potentially more complex; multiple asset classes and consents may be involved.	Generally simpler; shares are transferred under a single agreement.
Regulatory Considerations	Must check for compliance with asset transfer laws and encumbrances.	Must comply with corporate and securities regulations.
Tax Implications	May trigger capital gains tax (if applicable) and sales tax on individual assets; less favourable to seller.	Typically more tax-efficient for sellers; buyer inherits company's tax position.
Strategic Use	Suitable for acquiring specific assets or parts of a business.	Ideal for full acquisition and long-term control of the company.

D. Critical Role of Due Diligence

As outlined above, it is critical for any prospective buyer to undertake comprehensive legal due diligence prior to proceeding with either an asset sale or a share sale, this is especially true when the potential target is in distress. This process ensures the buyer is fully informed of any potential risks, liabilities, or legal complications associated with the transaction. Beyond the legal ownership and financial aspects, due diligence should also extend to the company's governance structures and operational processes. This is particularly important in the context of distressed businesses, where poor management or neglected internal controls may have contributed to the company's current state.

Engaging an independent valuer is a prudent step in such transactions. A professional valuation covering both tangible and intangible assets not only helps ensure the buyer is paying a fair price but also provides a safeguard against future claims that the transaction was conducted at undervalue. By taking these precautions, a buyer significantly reduces the risk of inheriting unforeseen issues and enhances the likelihood of a successful and sustainable acquisition.

E. Tax Implications of Distressed Asset Transactions

Buy-Side Tax Considerations

When buying distressed assets, it's crucial to consider the tax impact of how the transaction is structured, whether as an asset sale or a share purchase. In an asset sale, the buyer may benefit from

a "step-up" in the tax basis of the assets, allowing for depreciation deductions that can reduce future tax bills. In contrast, a share purchase may preserve the company's existing tax attributes, like loss carry forwards, but could also bring potential liabilities.

Buyers may also use debt financing to fund the acquisition, and this can have tax advantages, as interest payments on the debt are often tax-deductible. However, if the transaction involves multiple entities, transfer pricing rules must be carefully considered to ensure that the pricing of intercompany transactions is in line with tax regulations.

Distressed assets may also come with accumulated tax losses or debt, which can be advantageous for buyers looking to "restructure" the company. These tax losses can be used to offset future income, providing valuable savings in the long term.

Sell-Side Tax Considerations

For sellers, the tax treatment of distressed asset disposals depends on the structure of the sale. In an asset sale, the seller may have to pay taxes on the profits from selling the assets, which could be subject to capital gains tax or ordinary income tax, depending on the type of assets sold.

Capital gains tax generally has a lower rate than ordinary income tax, so it is usually more favourable. However, certain assets, like inventory or depreciable property, may not qualify for capital gains tax treatment and could be taxed at higher ordinary income rates. Sellers should also consider the timing of the sale—selling assets at a loss could help offset other gains and reduce taxes in that year.

Before selling, sellers may also consider tax restructuring options like spin-offs or write-offs to minimize their tax liability. Proper planning is essential to ensure the transaction is structured in the most tax-efficient way possible.

F. Singapore as a Platform

Singapore's corporate and banking system provide comprehensive tools to help businesses successfully restructure. The Insolvency, Restructuring and Dissolution Act offers a range of options to businesses facing difficulties, starting with the ability to apply for a moratorium. This temporary legal protection stops creditors from taking action, giving the distressed business a chance to reorganize without the pressure of lawsuits or claims.

One of the major benefits of Singapore's restructuring laws is that distressed businesses can continue to operate under the debtor-in-possession model. This means that the company's existing management can stay in control during the restructuring process, rather than bringing in an external manager. This approach encourages the distressed business to take responsibility for its recovery while getting the necessary support.

For distressed business that already have a plan and approval from creditors, Singapore also allows for a pre-packaged restructuring plan. This allows the distressed business to quickly implement a solution without lengthy court proceedings. In more challenging cases, a company can turn to judicial

management, where a court-appointed manager takes over the business with the goal of turning it around, ultimately helping secure a better outcome for everyone involved.

Another significant advantage is the ability for distressed business to access “super-priority” financing. This type of funding allows companies to get financial support during the restructuring process, even ahead of existing creditors, helping them stay afloat while working on their recovery. In addition, distressed businesses may benefit from favourable tax treatment, such as reduced or deferred tax liabilities, which can ease short-term financial burdens and improve cash flow during the turnaround period.

For distressed business with operations outside Singapore, the law also supports cross-border restructuring, making it easier for businesses with international reach to manage their financial difficulties across different countries.

Further information

Should you have any questions on how this article may affect you or your business, please get in touch with the following people:

Papon Charoenpao

Partner

paponc@pdlegal.com.sg

T Dinesh

Counsel

tdinesh@pdlegal.com.sg

Lester Kuo

Associate

lesterk@pdlegal.com.sg

© PDLegal LLC

This article is intended to provide general information only and does not constitute legal advice. It should not be used as a substitute for professional legal consultation. We recommend seeking legal advice before making any decisions based on the information available in this article. PDLegal fully disclaims responsibility for any loss or damage which may result from relying on this article.