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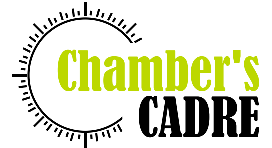

THE CHAMBER'S JOURNAL

Your Monthly Companion on Tax & Allied Subjects

Vol. XI | No. 7 | April 2023

CORPORATE RESTRUCTURING

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Covering important Amendments to Finance Bill 2023

The Chamber of Tax Consultants

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The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre-eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.

Unveiled by **Shri S. E. Dastur,** Senior Advocate on 30th January, 2008.

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ज्ञानं परमं बलम्

Vol. XI | No. 7 | April – 2023

Contents

Editorial — *Vipul K. Choksi* 5

From the President — *Parag S. Ved* 7

SPECIAL STORY — CORPORATE RESTRUCTURING

Issues under Income tax pertaining to Mergers/Amalgamation
— Ketan Dalal & Deep Chandan 9

De-merger controversies under Direct Taxes
— Deepa Dalal, Heenal Satra, Kirti Patodia & Komal Oza 17

Slump Sale/Itemised Sale
— Nilesh Vichare & Arijit Jain 27

Conversion of Company into LLP - Tax Implications — Uday Ved, N. Krishna & Wrutuja Soni 36

Income-tax issues involved in various Share Driven Transactions — Kumarmangalam Vijay & Surajkumar Shetty 50

Do's and don'ts of takeover under IBC from Income Tax perspective — Mehul Bheda & Drishti Kankariya 58

Overview of Cross Border Merger and De-merger — Shruti Lohia & Vansh Vermani 67

Overview of NCLT process for Merger and Demerger – Scope of Dispensation of Meetings/ Consents from Shareholders and Creditors
— Akanaksha Mota 78

Merger and Amalgamation under Section 233 of the Companies Act, 2013 — Nitin Gutka 88

Steps to be taken for implementation of Merger/Demerger, post NCLT approval — Rajesh Thakkar & Radhika Bhangdia 93

Closure of Companies — Vaishakh Kapadia 99

Stamp Duty Implications relating to Business Restructuring — Zulfiqar Shivji 109

HOT SPOT

Finance Act, 2023 – Amendments relevant to the Financial Services Sector
— Anish Thacker 117

Direct Tax Amendments to the Finance Bill 2023 - Other than amendments relating to Financial Services sector
— Vinay Deshmane & Urvi Shah 125

DIRECT TAXES

Supreme Court — Keshav Bhujle 131

High Court — Jitendra Singh, Radha Halbe & Harsh Shah 133

Tribunal — Tanmay Phadke, Viraj Mehta & Kinjal Bhuta 139

INDIRECT TAXES

GST – Recent Judgments & Advance Rulings — Naresh Sheth & Jinesh Shah 145

Service Tax – Case Law Update — Rajiv Luthia & Keval Shah 154

CORPORATE LAWS

Case Law Update — Makarand Joshi 157

OTHER LAWS

FEMA Update & Analysis
— Hardik Mehta & Tanvi Vora 174

Best of The Rest
— Rahul Hakani & Niyati Mankad 178

The Chamber News
— Vijay Bhatt & Mehul Sheth 185

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Editorial

Dear Readers,

India is one of the fastest growing economies and despite turmoil in different parts of the world, our economy is quite stable. Surprisingly, the World Happiness Report, which was released recently has ranked India 126 out of 137 countries and thereby assessing India as one of the least happy countries in the world.

The World Happiness Report is a publication of the Sustainable Development Solutions Network powered by the Gallup World Poll data. The report, which is in its tenth year, uses global survey data to report on how people evaluate their own lives, besides economic and social parameters. The rankings are based on average data of a three-year period of 2020-2022, in which respondents were asked to evaluate their quality of life. Six factors – gross domestic product, life expectancy, generosity, social support, freedom, and corruption – were factored to contribute to happiness index

Although India improved its position to 126 in the list compared to last year rank of 136, it ranks lower than our neighbours such as China, Sri Lanka, Nepal and Pakistan. Both Russia and Ukraine reported higher levels of happiness in the latest report despite the escalation of the conflict between the two countries since February 2022. According to the index, Russia's ranking improved from 80 in 2022 to 70 this year, while Ukraine's ranking improved from 98 to 92.

These findings, make one think whether, the information collected under these criteria, set to determine happiness is realistic. How can our ranking be lower than some of our neighbouring countries which are economically not doing well as we are and have multiple problems far more serious than those in our country? It is understood that the sample size for the poll was restricted to 500 to 2000 people. In a country of the size of India with population of close to 1.5 billion, the sample population considered for poll is not at all adequate and representative to judge the happiness index of the citizens of our country.

India is a land of celebrations. Events throughout a person's life are celebrated, be they be birth of a child, be it wedding in the family, celebration of number of festivals or for that matter getting embroiled in the enjoying of sports, especially cricket ! The makers of the report seem to be ignorant about some of the important factors like how often old people meet their kids in the west versus India ! The deep bonds between grandparents and grandchildren! The number of depression cases as a percentage of population etc. The six factors considered are not adequate

to properly evaluate the happiness index of a country. Our Country has its own challenges but its one of the most stable and 'happening' economies, a fact endorsed by scores of foreigners from all places coming here to attain peace and enlightenment. The low rank in the happiness index is therefore clearly not indicative of the factual position .

Another important subject which is the talk of the town these days is Artificial Intelligence (AI) and its perceived threat to the human race. ChatGPT and other bots based on AI have become very popular because of their ability to come up apparently with well written content on any topic whatsoever. These are fantastic tools which can be of immense help. As seen however, at the same time they are also prone to make serious mistakes and can also be misused. Wil AI really impact the life of professionals in future is a question that remains open today but still assume higher significance in the years to come.

One of the most significant effects of AI on professionals is automated solutions, which could lead to some job loss. However, automation should also create new opportunities for professionals to work alongside AI, using their unique skills and expertise to guide and oversee the applied technology.

Another effect of AI on professionals is the need for acquiring new skills. As AI becomes more prevalent, professionals will need to develop a better understanding of how it works and how to use it effectively. A few of these are learning to program AI systems, analysing data generated by AI, and understanding the ethical implications of using AI in their work.

As AI becomes more prevalent, professionals will need to adapt to these changes and develop new skills to stay relevant in the AI-powered workplaces of the future.

Human brain has the ability to think which AI doesn't have and as long as we use AI as our supplicant and not get overawed by its ability, only the methodology of work would change, nothing else.

This issue of the Journal is on Corporate Restructuring, a very important area from the perspective of all stakeholders including us professionals. The Journal Committee is doing a commendable job in bringing out issues on the subjects which are most relevant for professionals .My sincere gratitude to the authors for sharing their expert knowledge and sparing their valuable time to write the articles for this issue.

Let me end with the quotes that help us to realise what we need to in the era of AI

"Real Risk with AI is not malice, but competence"-

—Stephen Hawking

"I can be changed by what happens to me. But I refuse to be reduced by it."

— Maya Angelou

VIPUL K. CHOKSI
Editor

From the President

Dear Members,

Lok Sabha passed the finance bill 2023 with Key amendments in the last week of March. The bill was passed with 46 changes, that too without having any discussion or debate. A total of 20 more Sections have been added to the amendments. The important substantial amendment brought in, without any public debate or discussion, is related to removal of the tax benefits on long-term investment in debt mutual funds (MFs with over 35 per cent allocation to debt securities). Now, gains from such funds, irrespective of the holding period and indexation benefit would be taxed at slab rates. Now, Royalty/FTS pay-outs shall be taxable @ 20% plus surcharge and cess under domestic tax provisions. It also offered marginal relief to taxpayer under the new income tax regime. It also raised the securities transaction tax rate by 25% on futures and options.

Artificial intelligence (AI) has already started to revolutionize the way businesses operate, and the tax industry is no exception. ChatGPT has the potential to bring significant benefits to tax professionals. It can provide quick access to information, offer personalized support and help professionals keep up with changes in tax laws and regulations. However, it has its own drawbacks when it comes to Tax Professionals, such as accuracy, lack of context, limited scope, lack of human interaction and data privacy concerns. We may use ChatGPT as a tool to augment their expertise and not as a substitute for professional judgement. As technology continues to evolve, it is likely that ChatGPT and AI will play an increasingly important role in the tax profession. We learnt by crushing data, looking for the latest court cases, and confirming sources and information. This helped us beef up our critical eye and structure our expertise. The question arises what will happen when this is done by AI. The Juniors in the Profession should be extremely careful with conclusions and analysis they draw from the tool. CTC is not behind in embracing technology. We have recently done live webinar on Linkedin on the subject of ChatGPT. We are also planning another program on the subject.

I congratulate Chairman Direct tax committee for successful RRC at Indore in first week of March. Apart from study, delegates visited Shree Mahakaleshwar Temple and took blessings of lord Shiva.

Chamber had excellent participation on webinar series on foreign countries Taxation laws organized by International Taxation Committee. I congratulate Chairman Student committee for organizing five days (two hour) unique programme for CA Student which has become our regular annual event. It was undoubtedly very well-structured program with excellent speakers attended by more than 80 participants. Students Committee has rolled out Dastur Essay Competition. I would request members to encourage their students to participate in the competition.

The International Taxation Committee has organized 16th RRC at Coimbatore which is scheduled to take place from 15.06.2023 to 18.06.2023. I request you all to attend the programme in good number and make it successful.

The current issue of Journal is on the subject of 'CORPORATE RESTRUCTURING'. I thank Adv Dharan Gandhi for designing the Special story. I also thank all the authors for giving their article on the subject and sparing their valuable time for the Chamber.

I conclude with best wishes to all the readers.

Jai Hind

PARAG S. VED
President

CA Ketan Dalal CA Deep Chandan

Issues under Income Tax pertaining to Mergers/Amalgamation

Mergers and acquisitions (M&A) activity in India has been dynamic, with both domestic and cross-border transactions gaining momentum. In the past, M&A activity in India has been dominated by acquisitions, but mergers are gaining traction as a means of consolidation and expansion.

Mergers can be of unrelated parties (non-group) or within the group. Cases of such external/non-group mergers are often a case of coming together either as competitors or for forward or backward integration/synergy or a combination of the two or indeed for any other reason. Recent examples of non-group mergers are Sony and Zee in the media sector, Inox and PVR in the multiplex space and of course a semi group merger is the one of HDFC and HDFC Bank where the original promoting parent is folding up into the bank. There are many cases of course, of mergers within the group such as Grasim Industries and Aditya Birla Nuvo, Tata Steel merging its seven subsidiaries, including four listed entities (Tata Steel Long Products, TRF, Tata Metaliks and Tinplate Company) with itself, but in these cases also, given external stakeholders, these are closer to external mergers.

The government's push towards privatization and consolidation is also likely to create need/opportunities for mergers in sectors such as banking, insurance, and infrastructure. In the technology and e-commerce sector, mergers could be a means of consolidation and creating synergies. In the pharma space, consolidation is likely to be driven by scale and need for R&D spend. At a broad level, as companies continue to expand their offerings and seek to gain market share, mergers could help them to streamline operations and offer more integrated services to customers.

However, mergers can be complex and challenging, with cultural, financial, regulatory and tax hurdles to overcome. The success of a mergers depends on several factors, including a clear strategic rationale, compatibility of business models, and effective integration of operations.

In this article we have sought to deal with tax issues relating to mergers under the Income-tax Act, 1961 (IT Act).

Tax neutrality

The term 'merger' typically indicates unification of two entities into a single entity. Section 2(1B) of the IT Act defines 'Amalgamation' as the merger of one or more

companies with another company or the merger of two or more companies to form a new company in such a manner that:

1. All the properties and liabilities of the amalgamating company become the properties and liabilities of the amalgamated company by virtue of the amalgamation; and

2. Shareholders holding at least 75% in value of the shares in the amalgamating company (other than shares already held immediately before the amalgamation by the amalgamated company(s) or its subsidiary or its nominee) become shareholders of the amalgamated company by virtue of the amalgamation.

It is only when a merger satisfies the above conditions, that the merger will be considered as an 'Amalgamation' for the purposes of the IT Act. Where a merger qualifies as an amalgamation, subject to fulfilling certain additional criteria, the Amalgamation would be regarded as tax neutral; and exempt from capital gains tax in the hands of the amalgamating company and its shareholders.

Income-tax implications in the hands of the Amalgamating Company

Section 47 of the IT Act specifically exempts, *inter alia*, the following from liability to capital gains tax.

1. Transfer of capital assets by an amalgamating company to the amalgamated company if the amalgamated company is an Indian company; there are judicial precedents to the effect that business undertaking is also a 'Capital Asset'[1].

2. Transfer of shares in an Indian company by an amalgamating foreign company to the amalgamated foreign company if both the criteria below are satisfied:

   - At least 25% of the shareholders of the amalgamating company continue to remain shareholders of the amalgamated company;

   - Such transfer does not attract capital gains tax in the amalgamating company's country of incorporation.

   - However, where a wholly-owned subsidiary company amalgamates into its holding company, the transfer shall be exempt from capital gains tax though the above condition is not satisfied[2].

3. Transfer of shares in a foreign company in an amalgamation between two foreign companies, where such transfer results in an indirect transfer of shares an Indian company. The criteria to be satisfied to avail this exemption are the same as above.

Income-tax implications for shareholders of the Amalgamating Company

Section 47 of the IT Act also provides an exemption from capital gains tax for transfer of shares in the amalgamating Company, if the shareholders receive shares in the amalgamated company as a consideration and the amalgamated company is an Indian

1. *Cooper vs. Union of India [1970] 40 Comp Cas 325 (SC)*
2. *DIT vs. Hoechst GMBH [2007] 208 CTR 197 (AAR)*

company. For such shareholders, the cost of acquisition of shares of the amalgamated company will be deemed to be the cost at which the shares of the amalgamating company were acquired by the shareholder and the period of holding of shares of the amalgamated company will include the period for which the shares in the amalgamating company were held by the shareholder (Explanation to Section 2(42A).

Income-tax implications in the hands of the Amalgamated Company

There is an express exception provided for the amalgamated company under section 56(2)(x) of the IT Act in relation to the receipt of any sum of money or any property on amalgamation. Accordingly, there would be no adverse tax implications under normal provisions of the IT Act in the hands of amalgamated company on receipt of property pursuant to amalgamation. Section 56(2)(x) originally intended for bogus gifts and the like, has been extended far its original remit, and the fact that such an exception is needed is an indication of the tax exposure in case of non-tax neutral amalgamation.

Issue of Preference Shares as a consideration for Amalgamation

Section 2(1B) of the IT Act requires shareholders holding at least 75% in value of the shares in the amalgamating company (other than shares already held immediately before the amalgamation by the amalgamated company(s) or its subsidiary or its nominee) to become "shareholders" of the amalgamated company. The requirement is to become "shareholder" of the amalgamated company and it can be either by way of issue of equity or preference shares by the amalgamated company; hence, if the equity shareholders of the amalgamating company are issued only (or partly) preference shares in the amalgamated company, then the conditions of Section 2(1B) should be considered as complied with. In this context, the Gujarat High Court[3] has held that an exemption from capital gains tax would apply only when the consideration is received by the shareholders in the form of shares and not combination of shares, bonds, debentures or cash. It may also be pointed out that a short tenure preference shares issued as a consideration for merger may have a GAAR exposure.

Cost Inflation Index for the shares received upon Amalgamation

There may arise a question with respect to indexation benefit for computing capital gains on sale of shares received upon amalgamation, as to whether the Cost Inflation Index (CII) for the year in which the amalgamated company issued shares is to be considered or CII for the year of acquisition of shares of the amalgamating company is to be considered. In this regard, it may be noted that the Bombay High Court[4], on the issue of gift of shares held that CII of the year of acquisition of shares by previous owner has to be considered. Extending the same analogy, CII of the year in which shares were acquired in amalgamating company should be considered in case of receipt of shares on amalgamation.

3. *CIT vs. Gautam Sarabhai Trust [1988] 173 ITR 216 (Guj)*
4. *CIT vs. Manjula Shah (2011) 16 taxmann 42 (Bom)*

Merger of step-down wholly owned subsidiary (2nd level WOS) directly with ultimate parent – whether satisfies Section 2(1B) conditions and tax neutral?

A question may arise whether merger of wholly-owned step-down subsidiary with ultimate parent is covered within the ambit of tax neutral "Amalgamation" u/s 2(1B) of the IT Act? As discussed above, Section 2(1B) of the IT Act requires, in order for merger to qualify as tax neutral (and thereby availing various exemption available under the IT Act for tax neutral merger including capital gains exemptions u/s 47(vi) and 47(vii) of the IT Act), that the shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies **(other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or <u>its subsidiary</u>)** become shareholders of the amalgamated company by virtue of the amalgamation. The carve-out provided for non-issuance of shares by the amalgamated company u/s 2(1B) refers to shares held in amalgamating company by the amalgamated company **<u>or its subsidiary</u>**. Hence, the merger of step-down wholly owned subsidiary should satisfy the conditions stipulated u/s 2(1B) of the IT Act and hence, such merger should be tax neutral under the IT Act.

A question may also arise whether merger of step-down wholly owned subsidiary (2nd level WOS) directly with ultimate parent can be regarded as an indirect/deemed distribution of assets or accumulated profits by 1st level wholly owned subsidiary? The provisions of sections 2(22) of the IT Act are deeming provisions and must therefore, be subject to a strict interpretation. The CBDT vide its Circular NO. 5-P, dated 9-10-1967 has clarified that neither the provisions of section 2(22)(a) of the IT Act (pertaining to distribution by a company of accumulated profits to its shareholders) nor section 2(22)(c) of the IT Act (pertaining to distribution made to the shareholders of a company on its liquidation to the extent of its accumulated profits) are attracted in a case where a company merges with another company in a scheme of amalgamation. In view of this, said merger should not partake the character of deemed dividend from 1st level wholly owned subsidiary to ultimate parent. However, there needs to be adequate commercial rationale for merger of step-down wholly owned subsidiary (2nd level WOS) directly with ultimate parent from a GAAR perspective.

Carry forward and set-off losses of Amalgamating Company

The provisions of section 72A of the IT Act, allows the carry forward and set off of the accumulated losses and the unabsorbed depreciation of the amalgamating company by the amalgamated company as the loss of the year in which the amalgamation was effected. The specified companies eligible for the purpose of section 72A of the IT Act are as under:

- A company owning an "industrial undertaking" or a ship or a hotel,
- A banking company;
- One or more public sector companies engaged in operations of aircraft

Further, "Industrial undertaking" is defined to mean an undertaking engaged in manufacture or processing of goods, manufacture of computer software, generation or distribution of power or provision of telecom services.

Also, transition of accumulated losses and the unabsorbed depreciation of the amalgamating company in the hands of the amalgamated

company is subject to the following conditions prescribed under section 72A(2) of the IT Act read with Rule 9C of the Income-tax Rules, 1962.

- Amalgamating company is engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for at least 3 years;
- Amalgamating company continuously holds as on the date of amalgamation at least 75% of the book value of the fixed assets held by it 2 years prior to the date of amalgamation;
- Amalgamated company continuously holds at least 75% of the book value of the fixed assets and continues the business of the amalgamating company for a minimum period of 5 years;
- Amalgamated company to furnish certificate in Form 62, to the Assessing Officer; and
- Amalgamated company owning an industrial undertaking should achieve the level of production of at least 50% of the installed capacity within 4 years of amalgamation and continue to maintain the same up to 5 years from amalgamation.

Amalgamated company can carry forward and set-off the accumulated business losses of the amalgamating company for a period of 8 years from the year in which amalgamation takes place i.e. amalgamated company gets a fresh lease of 8 years basis the language of the provision[5].

In case said conditions are breached, the benefits claimed (i.e. accumulated business losses/unabsorbed depreciation utilised by the amalgamated company), would be taxed in the hands of the amalgamated company in the year of default.

There are several issues arising out of the above

(i) It is strange that there is a conditionality of industrial undertaking; this seems to be a relic of the past, in the sense that the assumption seems to be that service companies are unlikely to have losses. However, one has seen financial services companies such as broking companies having substantial losses and the same is the case with NBFCs having substantial NPAs or indeed companies in e-commerce sector. The restricted definition of industrial undertaking is a serious constraint to consolidation and hence, this condition needs to be dropped.

(ii) The conditionality of achieving at least 50% installed capacity is subjective interpretation and is adding serious complexity. Recently, Delhi NCLT in the case of Minda TG Rubber[6] rejected a scheme of amalgamation seeking carry forward of losses u/s 72A upon objection raised by Income-tax department that while the losses were sought to be carried forward to the amalgamated company, there was no provision in the

5. *Supreme Industries vs.. DCIT (2007) 17 SOT 476 (Mumbai ITAT)*
6. NCLT Delhi Bench in the matter of Minda TG Rubber Pvt. Ltd. in CP (CAA) 118/ND/2021

scheme for compliance to conditions prescribed under Section 72A. Many of these conditions are subsequent conditions and as the Supreme Court recently held in the case of Reliance Jio[7], the tax department is free to examine tax implications of the Scheme during the course of regular assessment, but to reject a scheme on this basis appears to be an incorrect interpretation of law.

(iii) Reverse merger (profit making company merging into a loss making company) can be explored, but issues such as capital structure, perception and indeed, GAAR issues need to be borne in mind. On the GAAR aspect, the key question is whether the merger is commercially driven or only devised for tax benefit? If the answer is tilted towards the first aspect, the GAAR exposure may be defensible.

(iv) Applicability of Section 79 in a merger scenario can be an issue as well; for example., When Company A (a profit making company) merges with Company B (a loss making company) and as a result of a merger, there is a change in shareholding of Company B by more than 51%, does losses of Company B lapse? This seems debatable. On the other hand, if Company B (a loss making company) merges into Company A (a profit making company), subject to conditionalities of Section 72A, the loss should remain intact, especially in light of non-obstante clause of Section 72A.

Lapse of Capital Losses and Availability of MAT Credit in the hands of Amalgamated Company

In the absence of any specific provision under the IT Act, capital losses (short-term as well as long-term) of the amalgamating company are not available for carry forward and set-off in the hands of the amalgamated company.

W.r.t MAT credit, basis judicial precedents[8], MAT credit pertaining to amalgamating company may be allowed to be carried forward and set-off by the amalgamated company for the remaining number of years.

Merger of Listed Company with another Listed Company – Availability of Grandfathered Price (31st January 2018)?

The Finance Act, 2018 withdrew exemption u/s 10(38) for LTCG arising from transfer of listed securities on or after 1 April 2018 and introduced Section 112A of the IT Act which provides for taxation of LTCG arising from transfer of listed securities (exceeding Rs 100,000) at the rate of 10% without giving any indexation benefit. The investors who bought listed equity shares before 1st February 2018 were exempted to pay 10% tax on gains made upto 31st January 2018. In other words, capital gains accrued until 31st January 2018 were “grandfathered”. However, in case of merger of listed company with another listed company, in the absence of any specific

7. *JCIT (OSD), Circle-3(3),1, Mumbai vs. Reliance Jio Infocomm Ltd.* [Civil Diary No. 16409 of 2021 dated September 9, 2022

8. Mumbai ITAT decision in the case of *Skol Breweries Ltd. vs. ACIT* [IT Appeal No. 2313 of 2017] and Ambuja Cements Limited (179 ITD 436) (2019);

Ahmedabad ITAT decision in the case of *Adani Gas Ltd, Ahmedabad vs. ACIT (ITA Nos. 2241 & 2516/Ahd/2011) (2016)*;

provision, there is an ambiguity as whether grandfathering applies in such a scenario; the language of the Section 55(2)(ac) uses the words "**acquired** before the 1st day of February, 2018" and hence, availability of grandfathering to the shares of amalgamated listed company (received as a consideration for merger of amalgamating listed company) could be subject to litigation.

This is very unfortunate since the date of acquisition and the cost of acquisition under section 49 and section 2(42C) relates back to the original date; the term "acquired" should be clarified as the date when the shares of the amalgamating company were originally acquired. The absence of this clarity in spite of several representations over the years, ever since the provision was introduced is becoming a serious deterrent in mergers activity.

Issue of shares to Mauritius/Singapore shareholders by Amalgamated Company – Availability of Capital Gains exemption under India-Mauritius DTAA and India-Singapore DTAA

Article 13 of India – Mauritius DTAA was amended vide protocol dated 10th May 2016 and New Paragraph 3A was inserted to provide that gains from the alienation of shares **acquired on or after 1st April 2017** in a company which is resident of a Contracting State (i.e. Mauritius) may be taxed in that State (i.e. Mauritius).

Similarly, Article 13 of India – Singapore DTAA was also amended vide Protocol dated 30 December 2016 and new paragraph 4A was inserted to provide that gains from the alienation of shares **acquired before 1 April 2017** in a company which is a resident of a Contracting State (i.e. Singapore) shall be taxable only in the Contracting State in which the alienator is a resident (i.e. Singapore).

Currently it is not clear whether grandfathering provisions under the protocol will extend to a swap in case of a merger, where the amalgamated Indian company issues its own equity shares after 31 March 2017 as consideration to an existing Mauritius/ Singapore shareholder of an amalgamating Indian company who acquired such shares prior to 31 March 2017.

The situation is the same as the one stated in the preceding paragraph and it is imperative for the Government to clarify this in the interest of clarity of law and indeed "Ease of Doing Business".

Merger of Unlisted Company with Listed Company – LTCG tax rate of 10% u/s 112A of the IT Act available?

The Finance Act, 2018 withdrew the exemption under section 10(38) for LTCG arising from transfer of listed securities on or after 1 April 2018 and introduced Section 112A of the IT Act which provides for taxation of LTCG arising from transfer of listed securities (exceeding Rs 100,000) at the rate of 10% without giving any indexation benefit. Section 112A of the IT Act applies if STT has been paid on acquisition and transfer of equity shares.

In this regard, the Government has issued a notification u/s 112A(4) dated 01st Oct 2018 providing certain situations wherein Section 112A of the IT Act will continue to be applicable, even if STT is not paid at the time of acquisition. The said notification covers situation wherein shares are issued by a listed company as a consideration for merger of an unlisted company into listed company and hence, the requirement of payment of STT at the time of acquisition of shares shall not apply in such a case and long-term capital gains shall be taxable @10% u/s 112A of the IT Act. Kindly note that, in such a situation, for the purpose of computing capital gains in

the hands of shareholders of unlisted company (post-merger and listing), original cost of acquisition of unlisted shares indexed upto FY 2017-18 shall be considered to be the cost of acquisition as per Section 55(2)(ac) of the IT Act.

Inbound Mergers

Under section 47(vi) of the IT Act, exemption has been provided to amalgamating company (i.e., Foreign Company) for any transfer of capital assets to Indian amalgamated company pursuant to Scheme of amalgamation.

A similar tax exemption has also been provided to the shareholders of the amalgamating company under Section 47(vii) of IT Act where shares of the amalgamating company are transferred in consideration for the issue of shares in the Indian amalgamated company.

However, one of the critical consideration for an inbound merger is amalgamating foreign company's country of incorporation needs to permit outbound merger under the local laws; for example, Mauritius, Luxembourg, etc. permit outbound merger whereas Singapore, Australia, Hong Kong do not permit outbound merger. In absence of allowability of outbound merger under local laws, a liquidation of foreign company may be considered to facilitate inbound merger in India. However, income-tax implications may differ.

Outbound Mergers

Under IT Act, there are no specific provisions providing exemption in case of merger of Indian amalgamating company with Foreign amalgamated company. Consequently, the capital gains arising from these mergers may result in tax liabilities in the hands of the Indian amalgamating company and its shareholders.

Outbound mergers may be ideal in cases where Indian amalgamating company is asset light and non-manufacturing. However, while the Indian regulatory framework permits outbound mergers, in the absence of specific exemption, uncertainty around income-tax implications is likely to be a barrier – a classic case of unaligned laws!

Key takeaways

The conditionalities of tax neutral amalgamation are relatively benign as compared to demerger. However, even in the case of amalgamation, there are several issues which have created, and are creating substantial uncertainty and have become serious constraint. As an example, the point regarding grandfathering vis-à-vis 31st January 2018 price and indeed the India-Mauritius and India-Singapore treaties vis-à-vis the date of 31st March 2017 needs to be urgently clarified in the interest of clarity of law and indeed Ease of Doing Business. Another example is the restrictive definition of industrial undertaking u/s 72A which needs to be dropped or may be extended to other sectors as well.

As a parting thought, it is important to bear in mind that amalgamations/mergers need to be commercially driven, and usually are. In most cases, they are operationally disruptive, and can be resorted to when the potential benefits are likely to override the pain and cost of disruption. Additionally, regulatory issues (including time and costs involved such as stamp duty, etc.) and accounting issues (under Ind-AS 103, 109, etc.) need to be factored in, to take an integrated and holistic view, as opposed to looking through a narrow tax lens only.

CA Deepa Dalal CA Heenal Satra CA Kirti Patodia CA Komal Ojha

De-merger controversies under Direct Taxes

Background

- A demerger is a form of restructuring whereby one or more business 'undertaking(s)' of a company (**'Demerged Company'**) are transferred to another company (**'Resulting Company'**) and in consideration, generally Resulting Company issues its own shares to the shareholders of the Demerged Company. Demerger is usually undertaken to split businesses/undertakings to achieve improved strategic focus on the core operations, value unlocking for the shareholders and to attract investments for specific business segments.

- Demerger can have significant tax and regulatory implications (major one being capital gains tax exposure) in the hands of both the Demerged Company and shareholders of the Demerged Company. However, Section 47(vib) and Section 47(vid) read with Section 2(19AA) of the Income Tax Act, 1961 ("Act") provides exemption from capital gains tax subject to satisfaction of certain conditions. Section 2(19AA) defines demerger as:

    a. Undertaking criteria: there should be transfer of undertaking/(s) wherein all assets and liabilities of the undertaking are transferred at the book values by the Demerged Company to the Resulting Company, by virtue of the demerger;

    b. Consideration criteria: Pursuant to demerger, the Resulting Company shall issue its shares to the shareholders of the Demerged Company on a proportionate basis. Further, the shareholders holding at least 75% in value of the shares in the Demerged Company shall become shareholders of the Resulting Company or companies by virtue of the demerger;

    c. Going concern criteria: the transfer of the undertaking should be on a going concern basis.

- Section 47(vib) exempts the demerged company from capital gains tax liability on transfer of capital assets to the resulting company as part of demerger if the resulting company is an Indian company.

- Section 47(vid) provides an exemption to the shareholders of the demerged company if they receive shares of the

resulting company in consideration of the demerger.

- This article seeks to analyze certain direct tax controversies that can arise in case of a demerger.

Controversies under the Act

A. Demerged (Transferor) company perspective

1. Whether investment activities (investment in shares, mutual funds, etc.) qualify as an 'undertaking'?

- Tax neutrality or otherwise of demerger of investment business has been subject matter of litigation under the Act.

- The following two conditions that need to be satisfied to assess whether assets and liabilities transferred satisfy 'undertaking' criteria:

  – It includes any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole; and

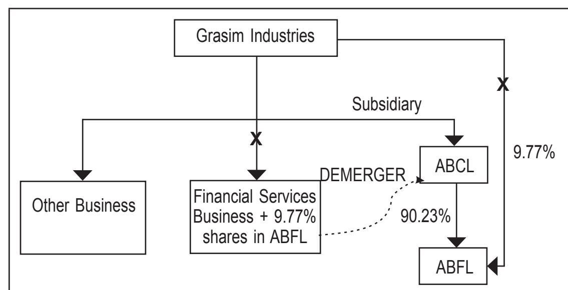
  – It does not include individual assets or liabilities or any combination thereof not constituting a business activity.

- Recently, the Hon'ble Income Tax Appellate Tribunal, Mumbai (**"Tribunal"**) in the case of Grasim Industries Limited[1] (**'GIL'** / **'Assessee'**) has passed order in favour of the Assessee wherein transfer of financial service business (**'FSB'**) has been regarded as transfer of an 'undertaking'.

The brief facts of the case are as follows:

- A composite scheme of merger of Aditya Birla Nuvo Limited ("ABNL") with GIL followed by demerger of FSB along with investment in Aditya Birla Finance Limited (**"ABFL"**) from merged GIL into Aditya Birla Financial Services Limited (**"ABFSL"**) [later renamed as Aditya Birla Capital Limited (ABCL)] was approved by National Company Law Tribunal (**"NCLT"**).

- Relevant pictorial structure of the case is as follows:



- Tax Authority held that demerger was not tax neutral as FSB does not amount to 'undertaking' under Section 2(19AA) of the Act broadly on the following grounds:

  a. Assessee was not carrying on FSB, as it was only holding shares of companies which are allegedly into FSB;

  b. Substantial value of FSB undertaking was derived from

1. (ITA No. 1935/Mum/2020) / [2022] 145 taxmann.com 289 (Mumbai - Trib.)

single investment (i.e., shares of ABFL); and

c. All other assets and liabilities so transferred along with investment in ABFL (in the form of FSB undertaking) did not constitute 'business activity' in itself.

- Therefore, the Tax Authority alleged that, in substance, the transaction was of transfer of investment in ABFL by GIL for consideration in kind (i.e., shares of ABCL) which in-turn was distributed to its shareholders and hence Assessee was liable to pay Dividend Distribution Tax (**"DDT"**).

- The Tribunal held that on the facts of the case, the demerger was tax neutral, and FSB satisfies the undertaking criteria as required under Section 2(19AA) of the Act on the following grounds:

  a. tax audit report of Assessee contained detailed description of the businesses which recognized FSB as a one of the businesses of the Assessee;

  b. interest income arising from the lending business in the form of intercorporate deposits have been offered as a business income and was accepted by Tax Authorities; and

  c. GIL (i.e., merged entity) was holding financial assets of ~ INR 5,800 crores and the magnitude of the assets shows that there was FSB carried out by ABNL.

  d. The Assessee had not transferred singular asset as an 'undertaking' but transferred all other assets and liabilities (such as fixed assets, other investments, fund-based lending in the form of intercorporate deposits, deposits with regulatory authorities, contracts, litigations, borrowings, current liabilities, deferred tax liability, etc.) which forms part of FSB.

  e. FSB was a business activity which can be run independently for the foreseeable future.

- Thus, detailed evaluation of facts of each case needs to be undertaken to assess whether financial business activity would satisfy 'undertaking' criteria or not.

2. *Issue of shares by immediate holding company of Resulting Company*

- While it is fairly common in a demerger transaction that consideration is discharged by the parent company of the Resulting Company on behalf of its wholly subsidiary company by issue of its own shares instead of share issuance by its wholly owned subsidiary company. Tax neutrality of such demerger under the provisions of the Act is not free from ambiguity.

- Following two interpretations can be drawn in such cases:

  a. Reference to "including a wholly owned subsidiary thereof" in Section 2(41A) of the Act could be interpreted as enabling language

which suggests that more than one company can be the Resulting Company and the undertaking could be transferred to a company other than the company issuing the shares. Further, as per section 47(vib) of the Act, the Demerged Company is not liable to capital gains tax if it transfers its undertaking to a resulting Indian company. Thus, the transfer of undertaking should be to an Indian company. There is no specific requirement of issue of consideration also by such resulting Indian company.

b. Accordingly, strict reading of the above phrase could imply that a wholly owned subsidiary of a company to which the undertaking is demerged is proposed to be included as a Resulting Company.

3. Issues around transfer of loans or borrowings relatable to the undertaking

- The Scheme of demerger must cover takeover of all liabilities related to the undertaking by the Resulting Company. The Act provides that the liabilities referred in the conditions laid down in 2(19AA) includes the following:

  a. The liabilities that arise out of the operations of the undertaking.

  b. Specific loans or borrowings (including debentures) raised and utilized solely for the operations of the undertaking.

  c. The general or multi-purpose borrowings of the Demerged Company to be transferred in the same proportion in which the value of assets transferred in a demerger bears to the total value of assets of such Demerged Company before Demerger.

- As per the above provisions, both raising, and utilization of funds should have been for the purpose of the undertaking. However, practically, there could be different scenarios:

  o that the loan was originally raised for general purposes but is in fact utilized for the business of demerged undertaking; or

  o loan raised for the operations of demerged undertaking but was utilized for general purposes. In such cases, bifurcation of liability as per provision of the Act may lead to incorrect bifurcation of liabilities.

- Accordingly, adjustments in respect of above may need to be considered.

- Some other issues surrounding general or multipurpose borrowings, as per the formula prescribed in the law that may pose some practical challenges are as follows:

  o Question arises whether the split of general or multi-purpose borrowings should be considered:

    a. each liability wise individually, or

    b. head wise classification (egs. Non-convertible debentures as a whole) or

    c. by general or multi-purpose borrowings as a whole

- Of the above, split of general or multi-purpose borrowings could be basis the

general or multi-purpose borrowings taken as a whole.

- The term used in the formula prescribed is assets which is not described under the Act and thus the questions that arise as follows:
  - o Whether assets include only fixed assets of all the assets and if it includes all assets whether gross value to be considered or net value – considering, the literal interpretation of the term asset and from a commercial perspective the view may be that all assets to be included and not just fixed asset. Further a strict interpretation could indicate that assets must be considered at a gross value and not net
  - o Whether deferred tax asset to be excluded in computing the value of assets – considering that there is no specific carve out, a view may be taken to include deferred tax asset for computing total value of asset.

B. Resulting (Transferee) company perspective

4. Carry forward of unabsorbed capital loss

- Section 72A(4) of the Act provides for carry forward and set off of accumulated business losses and unabsorbed depreciation of the Demerged Company. This provision does not deal with carry forward and set off of other types of unabsorbed losses of the Demerged Company.
- The issue that arises is whether any other type of unabsorbed loss of Demerged Company (say, capital loss) can be transferred to the Resulting Company or not.
- Section 74 of the Act deals with provisions relating to set-off and carry forward of losses under the head "Capital gains". It does not provide for the situation and the condition under which such a capital loss of Demerged Company is allowed to be set-off and carried forward in the case of demerger in the hands of the Resulting Company.
- Further, Section 72A was inserted to specifically provide for manner of carry forward and set off of business losses in case of amalgamation and demerger.
- Considering the above, one could argue that if the intention of the legislature was to allow set-off and carry forward of unabsorbed capital losses in case of demerger, it could have specifically provided for in Section 72A of the Act.
- In absence of a specific enabling provision, it could be interpreted that the Resulting Company would not be eligible to any losses except for losses specifically provided for under Section 72A of the Act.
- The above view has been upheld by Mumbai Tribunal in the case of ***Clariant Chemicals (I) Ltd. vs. ACIT***[2] in relation to amalgamation.
- However, as against amalgamation wherein the loss other than specified

2. [2015] 53 taxmann.com 39 (Mumbai ITAT)

loss may lapse, in case of demerger, the Demerged Company may still be eligible to carry forward and set off such capital loss against its own gains as per the provisions of Section 74 of the Act.

5. ***Section 72A vs. Section 79 of the Act:***

- A company (other than a company in which the public are substantially interested and an eligible start-up company) is not eligible to carry forward and set off the loss incurred in any year prior year against the income of the previous year, unless on the last day of the previous year, the shares of the company carrying not less than 51% of the voting power is beneficially held by persons who beneficially held shares of the company carrying not less than 51% of the voting power on the last day of the year/s in which the loss was incurred in terms of Section 79 of the Act.
- As per the provisions of Section 72A(4) of the Act, the Resulting Company would be eligible to carry forward and set off the accumulated business losses and unabsorbed depreciation of the Demerged Company as provided therein. Thus, such losses become the losses of the Resulting Company pursuant to the demerger.
- Where there is a change in beneficial shareholding of more than 49% of the voting power of the Resulting Company during the year in which demerger is effected, the question that arises is whether the Resulting Company would be eligible to carry forward and set off the accumulated business losses and unabsorbed depreciation of the Demerged Company transferred pursuant to the demerger
- Both Section 79 and Section 72A(4) of the Act starts with a non-obstante provision. While the former applies notwithstanding anything contained in Chapter VI[3] of the Act, the latter applies notwithstanding anything contained in any other provisions of the Act.
- Basically, Section 79 of the Act has an overriding effect only over Chapter VI of the Act whereas, Section 72A(4) of the Act has an overriding effect over any other provisions of the Act.
- Further, Section 72A(4) of the Act, is a specific provision dealing with carry forward and set off of accumulated losses and unabsorbed depreciation in case of demerger. Accordingly, the same should have an overriding effect on Section 79 of the Act.
- Thus, the provisions of Section 79 of the Act should not apply, and the Resulting Company should be eligible to carry forward and set off the accumulated business losses and unabsorbed depreciation of the Demerged Company transferred pursuant to the demerger.

3. Aggregation of income and set off or carry forward of loss

- This principle has been upheld by the Mumbai Tribunal in the case of ***Aegis Limited vs. ACIT***[4].

- However, it is worthwhile to note that if there are any existing losses of the Resulting Company and the change in shareholding of Resulting Company exceeds 49% consequent to issue of shares to shareholders of Demerged Company pursuant to demerger, there is no shelter available under 72A(4) and the losses may no longer be eligible for carryforward and set off in terms of Section 79.

6. Permissibility of claim of deduction under section 43B to Resulting Company in respect of the amount disallowed in the hands of the Demerged Company

- Section 43B begins with a non-obstante clause and provides for deduction of certain expenditure specified therein only in the year of actual payment of such expenditure, irrespective of the method of accounting regularly followed by the assessee. However, the payment is to be made on or before the "due date" for furnishing return of income.

- The issue that arises is which company would be entitled to claim deduction under section 43B in respect of the amount disallowed in the hands of the Demerged Company where the liability relating thereto is transferred to the Resulting Company and payment pertaining to such liability is made by the Resulting Company.

- Section 43B was introduced in the Act w.e.f. A.Y. 1984-85 with a view to disallow expenses to taxpayers that do not discharge their statutory liability in respect of indirect taxes, employer's contribution to provident fund, Employees' State Insurance Scheme, etc., for long periods of time, however for the purpose of their income-tax computation, the aforementioned liability was claimed as deduction on the ground that they maintain accounts on mercantile or accrual basis. To curb this practice, it was proposed to provide that deduction for any sum payable by the assessee by way of tax or duty under any law for the time being in force shall be allowed only in computing the income of that previous year in which such sum is actually paid by the taxpayer

- Section 41(1)(b) specifically provides that where a successor in business obtains any amount or any benefit in respect of loss or expenditure incurred by the predecessor, such amount or value of benefit accruing to the successor shall be deemed to be profits and gains of business chargeable to tax in the hands of the successor. For this purpose, "successor in business" includes a Resulting Company in case of a demerger.

- However, Section 43B does not specifically deal with a scenario where the liability incurred by the Demerged Company and disallowed under Section 43B is transferred to the Resulting

4. [2015] ITA No. 1213/Mum/2014 (Mum ITAT)

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Company pursuant to a demerger and paid thereafter by the Resulting Company.

- A view can be taken that it should be available in the books of the Resulting Company.

7. Allowability of deduction for bad debts to Resulting Company

- The demerged undertaking could have bad debts for which provisions may have been created in past and such provisions were disallowed in the books of the Demerged Company while computing the taxable income for such year. Allowability of such bad debts in the hands of Resulting Company is not specifically dealt with under the provisions of the Act.

- Supreme Court has held that successor firm should get the deduction for the bad debts since the debt had been taken into account in computing the income of the predecessor firm and had subsequently been written off in the books of the successor firm as irrecoverable[5].

- Though the decision was in context of a firm but the rationale behind it could apply in context of demerger of an undertaking.

C. Shareholder of Demerged Company perspective

8. Computation of "Net book value of assets" for the purpose of arriving at cost basis of shares of Resulting Company

- As per the provisions of section 49(2C), the cost of acquisition of the shares in the Resulting Company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the Demerged Company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the Demerged Company immediately before such demerger.

- The cost of acquisition of shares of the Resulting Company needs to be worked out as under:

<table>
<tr><td rowspan="2">Cost of acquisition of shares of the Demerged Company</td><td rowspan="2">X</td><td>Net book value of assets transferred</td></tr>
<tr><td>Net worth</td></tr>
</table>

- For above purpose, "net worth" means the aggregate of the paid-up share capital and general reserves as appearing in the books of account of the Demerged Company immediately before the demerger. Further, the aggregate of the paid-up share capital and general reserves should generally be equal to the book value of assets less liabilities. Thus, the amount of liabilities of the Demerged Company are reduced while calculating the "net worth".

5. *CIT vs. T Veerbhadra Rao K Koteswara Rai & Co. (1985) 155 ITR 152 (SC)*

- For the purpose of calculating "net book value of assets transferred", a plain reading of this term suggests that it would mean gross value of the assets less depreciation thereon. However, where the amount of liabilities is ignored for the purpose of above calculation, it may lead to an absurd result in certain scenarios. E.g., in a case where the assets of the demerged undertaking are substantially financed by corresponding loans related to such assets, considering the gross value of assets (instead of net value of the assets) would result in higher cost of acquisition of shares of the Resulting Company, despite the intrinsic value of such shares being much lower on account of the liabilities transferred.

- Furthermore, for the purpose of arriving at "net worth" in above calculation, net assets (i.e., assets less liabilities) is considered. Accordingly, for the purpose of calculating the numerator as well, comparison needs to be made in a like manner. Thus, the amount of net assets (i.e., assets less liabilities) should be considered.

- Considering, the Act has mentioned the term as "book value of net assets", instead of "net book value of the assets", there is an ambiguity on whether or not liability should be included in the numeration for arriving at the cost of acquisition of shares of the Resulting Company.

- Considering above, a view that the amount of net assets (i.e., assets less liabilities) should be considered appears to be more logical.

D. Others

9. General Anti Avoidance Rules ("GAAR") vis-à-vis Compromises or Arrangements under Companies Act, 2013

- The Indian tax authorities are empowered to invoke GAAR provisions where an arrangement (or any step therein) has been entered into with the main objective of obtaining a "tax benefit" and following conditions are satisfied:

  a. It creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

  b. It results, directly or indirectly, in the misuse, or abuse, of provisions of the IT Act;

  c. It lacks commercial substance or is deemed to lack commercial substance, in whole or in part; or

  d. It is entered into, or carried out, by means, or in a manner, which are not normally employed for bona fide purposes.

- Section 230(5) of Companies Act, 2013 stipulates that a notice with all the prescribed documents must be sent to the regulatory authorities including the Income-tax Authorities, sectoral regulators etc. and seek their representations to be made on the proposed scheme.

- The representations received from above authorities are taken on record before proceeding with the sanction or rejection of the scheme.

- In certain cases, it is observed that the Income Tax Department invoked

GAAR provisions to raise objections on the Scheme alleging doubt on the genuineness of the scheme of demerger and there could be loss to the revenue authorities if the NCLT sanctions the scheme.

- A question arises that in case where schemes lack commercial rationale, can the provisions of GAAR be invoked by tax Authorities based on 'substance over form' principle.
- By invoking GAAR, in addition to denying benefit of carry forwards of business losses and unabsorbed depreciation, there is a risk of entire transaction being considered as void for tax purposes if there is no business reason underlying the transaction, or if the transaction is given a legal form which does not correspond to its actual character.
- Also, can GAAR provisions be invoked by tax Authorities even if the scheme is duly sanctioned by Hon'ble Tribunal?
- In this regard, the Central Board of Direct Taxes vide its circular[6] has clarified that GAAR provisions will not apply to scheme if the Hon'ble Tribunal has explicitly and adequately considered the tax implications while sanctioning a Scheme.
- However, the terms 'explicitly' and 'adequately' have not been defined in the said circular and in the absence of judicial precedent / guidelines on interpretation of the above terms, NCLT approval on scheme may not protect against invocation of GAAR by tax Authorities.
- Resorting to GAAR, the Income-tax Department in certain cases have raised objections to the proposed schemes before the NCLT.
- The NCLT have agreed to the contentions raised by the Income-tax Department and have rejected the scheme.
- However, in certain matters, the scheme was approved though the department claimed that there is a tax avoidance, and the scheme cannot be sanctioned.
- The real question that arises for determination is, to what extent the NCLT is required to consider the objections raised by the Income-tax Department and in what circumstances, such objections can be based upon, and the proposed scheme can be rejected.
- Accordingly, commercial rationale is a must and a scheme cannot be just to achieve tax benefits

Conclusion

All the above issues have led to more confusion, complexity, and uncertainty amongst taxpayers. A clarification in respect of the open issues may be a welcome step for taxpayers to seamlessly carry out strategic restructuring activities and avoid unwarranted litigations.

6. Circular No. 7 of 2017 dated 27 January 2017.

CA Nilesh Vichare CA Arijit Jain

Slump Sale/Itemised Sale

Slump Sale

Background

The provisions for taxation of slump sale found its place in the Income Tax Act, 1961 ("IT Act") for the very first time vide Finance Act, 1999 wherein section 50B was introduced. The said section was introduced due to the decision of Hon'ble Supreme Court in the case of PNB Finance Ltd.[1] which held that transfer of a business undertaking for a lumpsum consideration did not trigger capital gains tax as there was no manner provided in the IT Act to compute the cost of acquisition of such business undertaking. Correspondingly, provision of section 2(42C) was also incorporation in the IT Act to define slump sale.

Slump sale means transfer of an entire business undertaking (including contracts, employees, contingent liabilities, goodwill, customer base, etc) on a going concern basis for a lumpsum consideration. It can also be said that the lock, stock, and barrel of an undertaking needs to be transferred. The definition of slump sale as per section 2(42C) of IT Act is as under:

*"slump sale" means the **transfer** of one or more **undertakings, by any means,** for a **lump sum consideration** without values being assigned to the individual assets and liabilities in such transfer."*

Transfer shall qualify as slump sale only if all of the below constituents are satisfied

Undertaking

Explanation 1 of section 2(19AA) defines "undertaking" as:

"Undertaking shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole but does not include individual assets or liabilities or any combination thereof not constituting a business activity."

The question which needs consideration is whether all the assets and liabilities needs to be transferred or the transferor can cherry pick the assets and liabilities that it proposes to transfer as part of business undertaking.

In this regard, Punjab and Haryana High Court in the case of Max India Ltd.[2] held that the assets and liabilities transferred should be

1. 307 ITR 75
2. 319 ITR 68

capable of running the business undertaking as a going concern without any interruption in the hands of the Transferee in order to qualify as slump sale. High court upheld the ruling of the tribunal which held as under:

"From the above, it is evident that for a sale to be termed as a 'slump sale', it is not essential that all the assets and liabilities must be transferred. Even if some assets and liabilities are retained by the transferor, the sale would not lose the character of being a slump sale, if the transfer is of a going concern, on that basis and the transferee is in a position to carry on the business without any interruption."

Similarly, Delhi High Court in the case of Triune Projects Pvt. Ltd.[3] upheld the position that buyer is well within his rights to exclude defunct assets or property from a business transfer which will cause inconvenience or some kind of trouble for the buyer and the remaining assets and liabilities would still qualify as a slump sale and be eligible for treat of tax under Section 50B of the Income Tax Act, 1961.

Further, Calcutta High Court in the case of AKZO Noble India Ltd.[4] upheld the findings of the tribunal that merely because two assets have been excluded from the assets transferred, it cannot be said that it is not the transfer of the undertaking as a going concern. In the instant case, all the assets comprising of land, building, plant and machinery, raw material, industrial licences, technology, trademark have been transferred whereas current liabilities relating to the business were also transferred along with the employees working in the particular business.

Therefore, the court have consistently applied the test that as long as the business undertaking transferred is able to run independently without any interruption in the hands of the transferee, even if certain assets or liabilities are retained by the Transferor, it shall still constitute an undertaking.

Though the section does not require the transfer of business undertaking has to be on a going concern basis, the Memorandum to the Finance Bill, 1999 states that the intention is to cover taxability of the transfer of business undertaking on a going concern basis. Further, if a business is discontented and non-operational, it would be a challenge to qualify the same as a business activity. Therefore, going concern assumption is implicit in transfer of business undertaking to qualify as slump sale. As long as the assets or liabilities retained by the Transferor does not affect the going concern assumption of the business undertaking, it shall not jeopardize the definition of slump sale.

Transfer

Vide Finance Act 2021, the provisions of section 2(42C) were amended to include the words 'transfer' as against 'sale'. The amendment was primarily aimed to nullify the effect of the decision of Hon'ble Bombay High Court in the case of Bharat Bijlee Ltd.[5] which held that the transaction of slump exchange would fall outside the purview of section 50B as the definition of slump sale earlier only included the transaction of sale.

In the case of Bharat Bijlee, the assessee transferred the lift business undertaking to another entity in lieu of preference shares of

3. 291 CTR 268
4. 276 Taxman 259
5. 365 ITR 258

the transferee entity. There was no monetary consideration explicitly determined between the transferor and the transferee entity in the transaction document. Hence, on literal interpretation of the wordings in the section, the court held that the transaction of exchange would not fall within the ambit of s. 2(42C) and therefore, would not be taxable under the provisions of section 50B. However, post the recent amendment of s. 2(42C), transfer would include slump exchange transactions as well and hence, would now fall within the purview of taxation of section 50B.

Lump sum consideration

The section explicitly mentions that for the transaction to qualify as slump sale, there should not be any value which should be assigned to individual assets and liabilities. The business undertaking as a whole should be transferred for a lumpsum consideration.

Further, Explanation 2 to section 2(42C) carves out an exception that where any value is assigned to any specific asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees, it shall not be regarded as assignment of values to individual assets or liabilities.

Computation mechanism as it stands today under the provisions of section 50B of IT Act

Particulars	*Amount*
Full value of consideration on sale of an undertaking (As per Rule 11UAE)	XX
Less: Expenses in relation to transfer of undertaking	(XX)
Net consideration	XX
Less: Cost of acquisition/ Net worth (As per Explanation 1 & 2 to section 50B)	(XX)
Capital Gain	XX

Key aspects from the perspective of Transferor i.e Seller

Full Value of consideration as per Rule 11UAE

By insertion of Rule 11UAE, the legislature has introduced a concept of deemed consideration in the hands of the transferor. Provisions of Rule 11UAE prescribes the method for calculation of fair market value of the undertaking which shall be deemed to be the full value of consideration in case of slump sale.

Rules prescribes two methods for determination of fair market value, namely, FMV1 and FMV2. The higher of both shall be deemed to be the fair market value of the business undertaking.

FMV1 is defined to include the fair value of assets and liabilities comprised in the business undertaking which the transferor proposes to transfer under the slump sale. The calculation under FMV1 shall be as under:

FMV 1 = A + B + C + D – L, where

A = Book value of assets transferred excluding jewellery, artistic work, shares, securities, and immovable properties

B = Open market value of jewellery and artisti c work basis valuation report

C = Fair market value of shares as per Rule 11UA(1)

D = Stamp duty value of immovable properties

L = Book value of liabilities transferred

FMV2 is defined to include the fair market value of the consideration that is received in lieu of transfer of business undertaking. The calculation under FMV2 shall be as under:

FMV 2 = E + F + G + H, where

E = Cash or value of monetary consideration

F = Fair value of non-monetary consideration such as jewellery, archaeological collections, drawings, paintings, sculptures, work of art, shares, and securities as per Rule 11UA(1) basis valuation report

G = Fair value of non-monetary consideration represented by property other than as mentioned above and immovable property basis valuation report

H = Stamp duty value of immovable properties

Rule 11UAE defines deemed consideration be higher of adjusted book value (FMV1) or actual consideration received on transfer of business undertaking (FMV2). However, Rule 11UAE does not take into consideration the actual commercial fair market value of the business or the fair market value as defined u/s. 2(22B) of IT Act. Therefore, a question may arise where the commercial fair value of business undertaking is more than the deemed consideration as determined under Rule 11UAE, can tax authorities substitute the commercial fair market value as deemed consideration in case where provisions of transfer pricing are not applicable. A view is possible that since specific methodology has been prescribed under the provisions of law in form of Rule 11UAE, it shall not be open to tax authorities to substitute commercial fair value instead of deemed consideration as determined under Rule 11UAE.

Whether provisions of section 50C shall apply?

As per s. 50C of IT Act, if the consideration for transfer of capital asset being land or building or both is less than the stamp duty value, the stamp duty value shall deem to be considered for transfer of said asset.

The question that arises is whether provisions of s. 50C of IT Act shall apply in case where land or building or both is part of the business undertaking proposed to be transferred as slump sale.

In this regard, considering that the transfer is of entire business undertaking (including land or building or both), provisions of section s. 50B of IT Act shall apply. Further, it can also be argued that business undertaking is a separate and district asset as compared to the individual assets (including land or building or both) and given that s. 50C of IT Act applies only on transfer of land or building or both, it can be contended that provisions of s. 50C of IT Act shall not apply in case of transfer of business undertaking via slump sale.

Cost of acquisition

Cost of acquisition and cost of improvement in case of slump sale shall be deemed to be the "net worth" of the business undertaking. Explanation 1 to section 50B defines net-worth as aggregate value of total assets of the undertaking as reduced by the value of liabilities of such undertaking as appearing in its books of account. Further it also states that revaluation of any assets shall be ignored while computing net worth.

Explanation 2 to section 50B lays down the mechanism to compute aggregate value of assets which is as under:

i. Depreciable assets - written down value of block of assets determined in accordance with provisions of section 43(6)(c)(i)(C)

ii. Self-generated goodwill - Nil

iii. Capital assets for which whole expenditure is allowed or allowable as deduction u/s. 35AD - Nil

iv. In case of other assets, the book value of such asset

Negative net worth

There may be instances where the value of liabilities proposed to be transferred as part of the business undertaking are in excess of the value of assets which shall result in negative net worth. Therefore, 2 views are possible w.r.t. dealing with negative net worth while computing capital gains:

View 1: Consider the negative net-worth and add the same to the amount of sale consideration to arrive at capital gains

View 2: Consider the cost of acquisition as zero

While there are judicial precedents[6] in favour of view 1, Hon'ble Special Bench of Mumbai Tribunal in the case of Summit Securities[7] has held that where net worth is negative figure, deduction of negative figure amounts to addition of amount to the full value of consideration.

Period of holding

First proviso to section 50B of IT Act provides that any capital gains arising on transfer of business undertaking via slump sale shall be taxable as long-term capital gains if the business undertaking is owned and held by the taxpayer for a period of at least more than 36 months immediately preceding the date of transfer.

Compliance

Transferor shall be required to furnish Form 3CEA i.e., a report of a chartered accountant indicating the computation of net worth of the business undertaking and certifying that the net worth has been accurately arrived at in accordance with the provisions of s. 50B of IT Act.

Transfer of business losses and unabsorbed depreciation

There are no specific provisions in the IT Act which enable transfer of business losses and unabsorbed depreciation with regards to transfer of business undertaking via slump sale.

Key aspects from the perspective of Transferee i.e Buyer

Purchase price allocation

The Transferee would have paid a lumpsum consideration for the acquisition of entire business undertaking. However, for accounting and tax purposes, transferee will have to recognize each individual assets as also liabilities which are purchased as part of business undertaking. In order to do so, the Transferee can either get the same done from the internal team or approach a third party external valuer.

Practically, transferee undertakes a purchase price allocation report from an external valuer who shall basis his best estimates, allocate the consideration paid to different assets.

Deduction in respect of certain expenses

As per provisions of s. 43B of IT Act, deduction of certain expenses/payments are allowed only once the actual payment is made. Similarly, as per provisions of

6. *Zuari Industries Ltd. vs. ACIT (298 ITR 97) (Mum. Trib.)*

7. 132 ITD 1

s. 40(a), deduction of expenses is allowed only where appropriate taxes have been withheld and deposited with the government on said payments.

Therefore, there can be instances where such expenses for which deduction has not been claimed by the Transferor are transferred as part of business undertaking on a going concern basis. Question arises as to whether the deduction on fulfilment of the condition prescribed can be claimed by the Transferee entity.

Given that the deduction can be claimed by the person who has incurred the expenditure, it may be difficult to claim the deduction in the hands of the Transferee entity.

Alternatively, even on payment made by the Transferee entity, a view can be adopted that the Transferor entity be allowed with the deduction for such expenses.

Succession Risk

As per provisions of s. 170 of IT Act, where a person (predecessor) carrying on business is succeeded (other than by death) by another person (successor) who continues to carry on that business and the predecessor cannot be found then the tax authorities can assess the successor in respect of income of the predecessor for the financial year in which the succession took place, up to the date of succession, as well as the year immediately preceding that year.

Tax Clearance Certificate

S. 281 of IT Act stated that any charge created over an asset or transfer of an assets at a time when there are pending proceedings under the IT Act, the charge or transfer shall be void if any tax or amount becomes payable at the conclusion of such proceedings and the seller will continue to be liable to pay the relevant dues.

However, the proviso states that the transfer shall not be void if it is made for an adequate consideration and the seller is not aware about any pending proceedings or notice of any tax payable. Further, the transaction shall not be void even if the seller obtains a tax clearance certificate from the tax authorities.

Section also defines the term assets to include land, building, machinery, plant, shares, securities, and fixed deposits in banks, to the extent to which any of the assets aforesaid does not form part of the stock-in-trade of the business. Hence, where seller parts away with an asset which does not fall within the definition of asset, provisions of s. 281 of IT Act shall not be applicable.

Whether transfer of business undertaking which consist of assets specified above would be required to comply with provisions of s. 281 of IT Act is open to debate. However, in practical scenario, in order to avoid any scope of litigation in future, the buyer would insist the seller to provide the Tax Clearance Certificate.

Whether Tax Clearance Certificate u/s. 281 of IT Act absolves the buyer of succession risk u/s 170 of IT Act?

S. 281 and S. 170 of IT Act are independent section and are mutually exclusive. Obtaining a tax clearance certificate u/s. 281 of IT Act would not absolve the buyer of the liability that may arise u/s. 170 of IT Act. Even if Tax Clearance Certificate has been obtained under the provisions of s. 281 of IT Act, if at all any liability arises u/s. 170 of IT Act, the buyer would not be absolved of the same.

Applicability of gift tax provisions

As per s. 56(2)(x) of IT Act, where any person receives certain specified property without consideration or for an inadequate consideration in comparison to the fair market value, the difference between the fair market

value and the consideration shall be taxable in the hands of the recipient.

The term "property" has been defined to include immovable property being land or building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or bullion.

However, as can be seen that a business undertaking is not a specified property under the aforesaid definition. Thus, a question would arise whether receipt of specified property as defined above which are received as part of business undertaking for less than fair market value would be subject to gift tax implications in the hands of the recipient.

Though this issue has both the views possible, it would be interesting to see how the courts view the said matter in years to come.

Indirect tax implications on slump sale

GST on transfer of business undertaking

GST is applicable on 'supply' of goods or services or both. Slump sale as a concept is not defined under GST law. However, in common parlance it is understood to be sale of the business undertaking on a going concern basis. S. 7(1) of Central Goods and Services Tax Act, 2017 ("CGST Act") defines supply to, inter alia, include all forms of supply of goods or services or both such as sale, transfer, barter, exchange, license, rental, lease, or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business. Under the GST law, supply by way of transfer of a business undertaking on a going concern, as a whole or an independent part thereof are specifically exempt from payment of GST.

Therefore, no GST is payable if the business undertaking is transferred on a going concern basis.

However, what would constitute transfer of business undertaking on a going concern basis has not been defined under the GST law rather it does not law down the elements that need to be present to satisfy to claim the exemption from payment of GST on transfer of business undertaking. Court have taken a view under the erstwhile Indirect tax laws i.e., VAT regime that following key element could be considered essential for a transaction to qualify as slump sale:

a. Sale should be of entire business as a going concern i.e., "lock, stock and barrel" wherein all assets, liabilities, employees, subsisting licenses and contracts of the business are transferred to the buyer;

b. Business undertaking to be transferred should be operationally and functionally independent;

c. No right in relation to the business being transferred is retained by the seller;

d. No assets or liabilities related to the business being transferred are retained by the seller; and

e. There should be a lump-sum consideration for the transfer of business without allocation to individual assets

Furthermore, the transferee entity needs to amend its GST registration or obtain fresh GST registration in respect of the business undertaking that it acquired. GST registration held by the Transferor entity in respect of business undertaking shall not be transferred to the Transferee entity.

Transfer of Input Tax Credit

S. 18 (3) of CGST Act, 2017 states that where there is a change in constitution of the business on account of sale, merger, demerger, amalgamation, lease, or transfer of

the business with the specific provisions for transfer of liabilities, the transferor is allowed to transfer the input tax credit which remains unutilised.

Further, as per Rule 41 of Central Goods and Service Tax Rules, 2017, the transferor and transferee entity need to fulfil certain conditions for the purpose of transfer of ITC which, *inter alia*, includes electronic filing of Form GST ITC-02.

ITEMISED SALE

As against the concept of slump sale, where individual assets are transferred and value is ascribed to each asset, it shall be treated as itemised sale. Even in case of transfer of business undertaking, where specific value is ascertained for each asset, it would lose the characteristics of slump sale and would be considered as itemised sale of individual assets.

Computation mechanism as it stands today w.r.t. non-depreciable assets under the provisions of section 48 of IT Act

Particulars	***Amount***
Full value of consideration	XX
Less: Expenses incurred wholly and exclusively in connection with transfer of such capital asset	(XX)
Net consideration	XX
Less: Cost of acquisition (As per s. 55(2) or s. 49)	(XX)
Less: Cost of improvement (As per s. 55(1)(b)	(XX)
Capital Gain	XX

Key aspects

Full Value of Consideration

The term full value of consideration is not specifically defined under the provisions of IT Act. However, Hon'ble Supreme Court in the case of George Henderson and Co. Ltd.[8] under the erstwhile IT Act held as under:

"…we are of the opinion that the expression "full value of the consideration" cannot be construed as the market value but as the price bargained for by the parties to the sale. The dictionary meaning of the word "full" is "whole or entire, or complete" (Shorter Oxford English Dictionary). The word "full" has been used in this section in contrast to "a part of the price". Consequently, the words "full price" means "the whole price". Clause (2) of section 12B itself clearly suggests that if no deductions are made as mentioned in sub-clause (ii) thereof, then that amount represents the full value of the consideration or the full price. In other words, when deductions are made as specified in sub-clauses (i) and (ii), then that amount does not represent the full value. The expression "full value" means the whole price without any deduction whatsoever and it cannot refer to the adequacy or inadequacy of the price bargained for. Nor has it any necessary reference to the market value of the capital asset which is the subject-matter of the transfer."

8. 66 ITR 622

Applicability of s. 50C, 50CA and 50D

There are specific provisions under the IT Act which lays down that the even if the capital asset is transferred for an agreed consideration below the fair market value as prescribed under the said provisions, the fair market value shall be deemed to be the consideration for transfer of such assets.

S. 50C of IT Act provides that in case the consideration for transfer of land or building or both is less than the stamp duty value, the stamp duty value shall be the deemed consideration for transfer of such asset.

Similarly, s. 50CA of IT Act provides that in case the consideration for transfer of unquoted share is less than the fair value as determined in terms of Rule 11UA, the fair value shall be the deemed consideration for transfer of such shares.

S. 50D prescribed that where the consideration on transfer of capital asset is not ascertainable or cannot be determined, the fair market value of such capital asset as on the date of transfer shall be deemed to be the full value of consideration.

Cost of acquisition

The term cost of acquisition has been defined under the provisions of s. 55(2) of IT Act. Further, where the asset has been acquired by certain specific modes of transfer which are exempt under the provisions of s. 47, in such situation, provisions of s. 49 determines what shall be the cost of acquisition.

Cost of improvement

Provisions of s. 55(1)(b) of IT Act deals with the manner for computation of cost of improvement.

Provisions of s. 50 of IT Act deal with the capital gains on transfer of depreciable assets

On transfer of capital asset forming part of block of assets[9], the consideration received shall be reduced from the relevant block of asset. In case the sale proceeds exceed the written down value of the relevant block of asset, the excess amount shall be considered as short-term capital gains u/s. 50 of IT Act. Further, if the sale consideration is not in excess of the written down value of block of asset but all the assets in the relevant block cease to exist, then the difference would be deemed to be short-term capital loss.

If the block of asset has a positive written down value (post deduction of consideration as well) and there are assets in the relevant block of asset, then the seller would be eligible for depreciation on the reduced written down value of the block of asset.

Cost of asset in the hands of Transferee

The cost of assets for the transferee shall be the actual cost at which the capital asset is acquired by the transferee.

Indirect tax implications on itemised sale

In case of itemised sale of individual assets or in case where values are assigned to each asset in case of transfer of business undertaking, it would amount to 'supply' under GST law. However, it would be essential to identify the nature of asset transferred and place of supply in order to examine the exact GST implications. The rate of GST would be dependent on the nature of asset.

9. As defined under s. 2(11) of IT Act

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Conversion of Company into LLP - Tax Implications

Introduction

Business exigencies and corporate structures have been evolving around the world, whereby several countries have accommodated hybrid structures such as Limited Liability Corporation, Limited Partnerships, etc. and there was a need for the Indian Government to facilitate a structure which would provide benefits of a corporate structure while at the same time providing flexibility and benefits of partnership firms as well. This led to the legislation of 'Limited Liability Partnership' in the year 2008.

The legislation was targeted towards corporatization of small businessmen/ professionals, who were carrying out business in the form of sole proprietorships or partnerships. While companies with relatively low turnover were also considering conversion into LLPs, the activity was mostly restricted to domestic companies as Foreign Direct Investment ('FDI') was not permissible in LLPs in the initial years. However, gradually, the norms for FDI were relaxed for LLPs and with the inherent tax advantage available to LLPs (as the profit distributions were tax-free), more and more companies started considering converting into LLPs.

On account of the rising popularity of the LLPs, several tax and regulatory issues have surged which have been addressed in this article.

Company vs. LLP

Considering the existing tax rates, an LLP (taxed at 30%) will generally be a better vehicle vis-à-vis a company (taxed at 22% or 25% as the case may be), primarily due to there being no tax on profit distributions in case of a LLP and the effective tax rate would be lower in case of an LLP (where profit is sought to be distributed to the partners) although the headline tax rate would be lower in case of a company. Also, in case of an eligible new manufacturing company, a further reduced tax rate of 15% would be applicable which would make the comparison a more detailed exercise considering the relevant facts of the case.

For instance, an LLP would be entitled to claim other tax benefits such as additional depreciation, Chapter VI -A benefits, etc. which a company with concessional tax regime is not entitled to. Although LLPs are subject to an Alternate Minimum Tax of 18.5%, LLPs may still be beneficial considering tax-free distribution.

Further, sale of a company's share depends on valuation under income-tax provisions and could lead to unfavorable tax consequences in case the valuation norms are not met. Section 50CA of the Income-tax Act, 1961 ('the Act') deals with valuation in case of sale of a company's share, and section 56(2)(x) of the Act deals with valuation in case of receipt of a company's shares. This leads to adverse consequences in case the Company is distressed and the actual valuation is much lower than its asset valuation. There are no such valuation norms in the case of an LLP.

LLPs provide greater operational flexibility as compared to companies as in certain cases requiring urgent decisions. The same could be taken by partners without there being any need for convening Extraordinary General Meetings, giving notices in advance, etc.

All the above aspects are benefits available to LLP vis-à-vis a company. Certain disadvantages of LLP could be non-availability of weighted deduction for in-house R&D. In case of companies, only substantial change in shareholding will lead to the losses getting lapsed. Further non-tax factors such as strong governance in case of companies, certain performance linked conditions restriction of FDI in LLP as compared to that of the Company, etc. are some of the aspects wherein the LLP lag the Company structure. External investors (mainly foreign investors) generally prefer a company compared to LLP due to governance and other business considerations.

Though prima facie it appears as though LLP scores over the Company structure, both have their pros and cons based on the business needs and strategies around the formal structure.

In this context, we have covered certain important aspects in this article along with the judicial precedents relevant in the context of conversion of Company into LLP.

Conversion of Company Into LLP

The Finance Act 2009 introduced taxation of LLPs on similar lines as applicable to partnership firms. However, no specific provisions were inserted with respect to conversion to LLP. This was addressed by Finance Act 2010 by amending section 47 of the Act through insertion of clause (xiiib) prescribing conditions, on satisfaction of which, the conversion of a Company into LLP would not constitute as a taxable transfer.

The Limited Liability Partnership Act, 2008 contains enabling provisions under section 56 read with Schedule III and Rule 39 of the Limited Liability Partnership Rules, 2009 confirming to which a private company or unlisted public company (incorporated under Companies Act, 1956 or Companies Act, 2013) would be able to convert themselves into LLPs.

Rationale for Businesses Converting from Company to LLP

- One of the benefit for converting company into the LLP is to facilitate tax efficient cash extraction which is ideal for owners anticipating profit upstreaming at regular intervals. Absence of profit distribution tax equivalent to dividend tax plays a key role in this regard.
- For small and medium scale businesses, to comply with various compliances which are mandatory for a company under the Company law is not cost effective. The LLP structure is advisable if the operational benefits from the LLP are greater and there is no legal binding for a corporate governing structure like

a private limited company or public limited company. Further, it provides flexibility and efficiency to partners to manage commercial affairs based on LLP deed and cash flow.

- Similarly, in case of professionals such as Chartered Accountants in practice, operating a company is not permitted by the Institute of Chartered Accountants of India ('ICAI'), whereas an LLP structure is permitted by ICAI.
- Setting up, re-organize and wind up is relatively easier for a LLP. Further, there are thresholds of turnover less than INR 40 lakhs or contribution less than INR 25 lakhs for statutory audit, therefore for start-ups and small-scale businesses, focus can be maintained on business operations rather than undertaking mandatory compliances.

Non-Taxable Transfer u/s 47(xiiib)

Section 47(xiiib) of the Act was introduced vide Finance Act, 2010. The legislative intent was to tax LLPs at par with that of partnership firms. Therefore, conversion of the Company into LLP would attract a levy of capital gains tax and similarly, carry forward of business losses and unabsorbed depreciation would not be available to the successor LLP. Therefore, it was proposed to introduce a new sub-clause to section 47of the Act. The Memorandum to Finance Bill, 2010 explicitly concluded that the conversion of a private limited company or unlisted public company into LLP would not be considered as a taxable transfer subject to fulfillment of certain conditions.

The aforesaid provision clearly brings out mandatory cumulative conditions for tax exemption for the Company and its shareholders on the conversion of the Company into LLP –

- **All assets and liabilities** immediately before conversion should become the assets and liabilities of the LLP.
- **All the shareholders to become partners of** the LLP and contribution and profit-sharing ratio (**'PSR'**) to be in the same proportion as their shareholding in the Company.
- **Aggregate of PSR** of the shareholders of the Company in the LLP shall be **at least 50%** at any time during the period of **5 years** from the date of conversion.
- In the **3 preceding years**:
  - o Total **sales or turnover** or gross receipts of the Company is **less than or equal to 60 lakhs**.
  - o Total value of assets of the Company is **less than or equal to 5 crores**.
- **No other consideration** is paid to the shareholders except by way of PSR and capital contribution.
- **No amount is paid** to the partners of LLP, directly or indirectly, out of accumulated profit of the Company as of the date of conversion for a period of 3 years from the date of conversion.

(Emphasis supplied)

Thus, the conversion from a company to LLP would not be regarded as a transfer only if all the above conditions are cumulatively satisfied, i.e., if any condition is not satisfied, then it will amount to taxable transfer and Company and shareholders would be taxed for such conversion.

Key considerations in the above context are –

- In case of a company being converted into the LLP, Capital gains will be

exempt from tax on fulfilment of the above conditions laid down under section 47(xiiib) of the Act.

- The LLP which acquires the assets and liabilities on conversion will record the actual cost of the block of assets at the written down value of the block of assets in the hands of the company on the date of conversion.
- Further, in the year of conversion, the aggregate depreciation allowable to the Company and LLP shall not exceed the depreciation calculated at the prescribed rates as if the conversion had not occurred. Furthermore, the cost of acquisition of the capital asset for the LLP shall be equal to the cost for which the Company acquired it and indexation benefit will be available for resident shareholders having long term capital asset consequent to such conversion.
- In case of Partners of LLP (shareholders of the Company), capital gains will be exempt from tax on fulfilment of conditions and cost of acquisition of a capital asset being rights of a partner in successor LLP, shall be equal to the cost of acquisition of the shares in the Company immediately before its conversion.

If in case the aforesaid conditions are not complied with post claiming exemption u/s 47(xiiib) of the Act, the sub-section 4 to section 47A of the Act lays down the provisions to address this issue which has been reproduced as under -

….Where any of the conditions laid down in the proviso to clause (xiiib) of section 47 are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible assets or share or shares not charged under section 45 by virtue of conditions laid down in the said proviso shall be ***deemed to be the profits and gains chargeable to tax of the successor limited liability partnership or the shareholder of the predecessor company, as the case may be****, for the previous year in which the requirements of the said proviso are not complied with.*

(Emphasis supplied)

Therefore, if any of the conditions mentioned above are not complied with, the exemption granted above will be withdrawn, and the amount of profits or gains arising from the transfer of such capital asset or intangible assets or share or shares shall be chargeable to tax. Further, such amount shall be deemed to be the profits and gains chargeable to tax in the hands of LLP or the shareholder of the Company, as the case may be, for the previous year in which the conditions prescribed u/s 47(xiiib) of Act are violated.

Key Issues

The above withdrawal provisions caused taxpayers to raise the moot question before the judiciary for consideration as to whether the exemption may be withdrawn in the same financial year in which conversion has taken place on account of not fulfilling any one or more conditions mentioned in the proviso to section 47(xiiib) of the Act.

The issue has been discussed in the case of ***ACIT vs. Celerity Power LLP***[1] wherein, the entire business of the Company including all its assets and liabilities were transferred to the

1. *ACIT vs. Celerity Power LLP [2019] 174 ITD 433 (Mumbai)*

resultant LLP and assessee's contention was that conversion of the Company into LLP did not involve any transfer of property, liabilities, assets, etc. and therefore, capital gains, if any, could be brought to tax only in the hands of the erstwhile company. However, the Assessing Officer ('AO') argued that the benefit availed by the Company was to be deemed as profits and gains of the successor LLP as per provisions of section 47A (4) of the Act and therefore, taxable in the hands of the LLP.

Some of the principal aspects of the ruling covering arguments of the Assessee and the Revenue are as under:

a) Whether conversion of company into LLP without adhering to the conditions mentioned in section 47(xiiib) of the Act, is regarded as transfer.

There have been arguments wherein questions were raised as to whether the conversion of equity shares held by shareholders in a private limited company into partnership interest in the LLP consequent upon the conversion would be regarded as a transfer under section 2(47) of the Act. The shares held by the shareholders in the company will no longer exist on conversion and the partnership interest in the LLP in return could not be considered independent of its shareholding in the company. On conversion of company into LLP, the company is dissolved, and shareholding replaces with partnership interest. The definition of transfer u/s 2(47) is inclusive and therefore it extends to disposing or parting with an asset or any interest therein i.e., extinguishment of shareholder's interest on conversion.

The contention is that to be regarded as transfer and chargeable as capital gains, there have to exist two parties at a time was not accepted by the Bombay High Court decision in case of ***Texspin Engg. & Mfg. Works***[2]. It was further held that the Act does not require the existence of a counterparty for taxation purposes. Further, in case of AAR ruling on the decision of the Supreme Court in case of ***Grace Collis***[3], it was observed that the expression extinguishment of any rights as occurring in section 2(47) of the Act extends to mean extinguishment of rights independent of or otherwise than on account of transfer.

In the case of ***CADD Centre***[4] and ***Unity Care and Health Services***[5], the issue involved was the conversion of partnership firm into company. It was held that the word 'transfer' presupposes existence of transferor and transferee simultaneously. Further, if the firm was held to be the transferor, then, the transferee company was not in existence on that date. But, on the other hand, if the transferee was the company which came into existence on certain date, then the firm i.e., the transferor was not in existence as on the said date. It was accordingly concluded that conversion of partnership firm into a company was not a case of transfer by one person to another and that it was a mere change

2. *CIT vs. Texspin Engg. & Mfg. Works, [2003] 263 ITR 345 (Bombay)*
3. *CIT vs. Grace Collis [2011] 115 taxmann 326 (SC)*
4. *CADD Centre vs. ACIT, City Circle – II, Chennai [2016] 65 taxmann.com 291(Madras)*
5. *ACIT, Circle -2 (1), Mangalore vs. Unity Care & Health Services [2006] 103 ITD 53 (BANG.)*

under the relevant Act under which the persons are registered to carry on the business.

Referring to the case of ***Domino Printing Science Plc.***[6], the assessee raised substantial arguments with regard to various limbs of transfer under the Act before the AAR –

- There cannot be 'sale' or 'exchange' of shares of Indian company since the same person cannot sell or exchange the shares with itself.
- The percentage of holding in the Indian company remains same as that of partnership interest in the LLP in the same proportion which should not be regarded as extinguishment of right in shares in Indian company.

In the context of the above, the tax authorities further argued that the transaction should be considered an 'exchange' as two separate persons i.e., a Private limited company and the LLP, are involved in the arrangement, and shares of Indian company have been exchanged by Indian company for interest in the LLP. Also, since Indian company would be deemed to be dissolved on conversion into LLP, it will be regarded as extinguishment of rights in shares of Indian company. Wherein the AAR distinguished the Bombay High Court decision of Texspin where it was held that the conversion of a partnership firm into a company does not amount to 'transfer'. However, in respect of section 47(xiiib) of the Act, the AAR relied on the decisions of the Mumbai Tribunal in case of ***Celerity Power LLP*** and ***Aravali Polymers***[7] where it was observed that conversion of a company into LLP which does not satisfy the conditions of exemption was to be treated as 'transfer' of capital assets.

Although the AAR ruling is not binding on other assessees and does have persuasive value in a court of law, the tax authorities are more likely to take support of the ruling and apply it in pending tax litigations in similar circumstances. Whilst the concerned taxpayer could challenge the ruling before higher forums, it plays a pivotal role. It casts uncertainty of tax litigation where companies seek to convert themselves into LLPs without complying with conditions for explicit exemption.

b) Whether transaction of conversion of the Company into LLP is taxable transfer or not

Section 47 of the Act commences with –

"Nothing contained in section 45 shall apply to the following transfers …"

(Emphasis supplied)

Therefore, section 47 covers transactions **that are transfers** but are not considered as a taxable transfer subject to fulfilment of certain conditions mentioned in the said section. Therefore, it could

6. *Domino Printing Science Plc. [2021] 433 ITR 215 (AAR – New Delhi)*
7. *Aravali Polymers LLP vs. JCIT [2014] 65 SOT 11 (Kolkata ITAT) - Appeal No. 242/CIT(A)-xx/Range 34 Dt. 10.04.2014*

be argued, without going into the merits of the case, that conversion of the Company into LLP is a transfer. However, whether the same is subject to tax depends on the fulfillment of conditions mentioned in the respective sub-sections.

The arguments and subsequent ruling of the Hon'ble ITAT emphasize the intention of the provisions laid down and held that the purpose and intent behind enactment of section 47(xiiib) of the Act were that since the 'transfer' of assets on conversion of the Company into LLP resulted in levy of capital gains tax, the sub-section was proposed to be introduced to exempt such conversion subject to fulfillment of certain conditions.

Without prejudice to the above, one may consider the definition of the term 'convert' as mentioned in Clause 1(b) of the Third Schedule of the LLP Act, 2008, which stipulated that the conversion of a private company into LLP involves transfer of property, assets, etc. and the term 'transfer' has to be read only in context of provisions of the Act. Further, conversion of the Company into LLP is differently placed as in comparison to succession of a partnership firm by a company under Part – IX of the Companies Act, 1956.

In the light of above discussions, it could be inferred that the conversion of Company into LLP is to be regarded as involving transfer of capital assets.

c) Whether transaction of conversion of a Company into LLP involves any capital gain or not

Since conversion of a Company into LLP is to be considered a transfer, the next question which arises is whether conversion of the Company into LLP involves any capital gain.

Basis the first condition laid down in proviso section 47(xiiib) of the Act that the conversion of the Company into LLP shall take place at 'book value'. During the process of conversion, the entire 'undertaking' of the erstwhile company transferred into LLP and therefore, 'book value' was the only cost attributable to the individual assets and liabilities. Therefore, there is no need to determine fair market value of such assets and the provisions of section 50C, section 50CA, section 50D and section 56(2)(x) of the Act which refers to the fair market value to compute the taxable income, do not stand while transferring such assets and liabilities to the LLP on conversion. The total value of assets appearing in the books of account of predecessor company would become value of assets in the books of the successor LLP.

If in case, the transfer of assets and liabilities is contemplated not at a book value but at fair market value computed basis provisions of section 50D of the Act, then one of the conditions mentioned in the proviso to section 47(xiiib) of the Act will not be complied which result into withdrawal of such exemption available to the Company and its shareholders.

Some of the essential principles placed in above rulings including Celerity Power LLP, such as charging section and computation section, have to be read together as both would constitute one package. The consideration for transfer of capital asset is what the transferor receives in lieu of the assets he parts with, in the form of cash or

kind. Therefore, the asset transferred or parted with cannot be considered for the transfer, meaning that the expression full value of consideration cannot be construed as having reference to market value of the asset transferred. It was further observed and held that the expression full value of consideration as per provisions of section 48 of the Act could be construed as the market value of the asset on the date of transfer. The meaning of full value of consideration was cited by the Hon'ble Apex court as the price bargained for by the parties to the transaction[8].

Thus, as the assets and liabilities of the erstwhile company had got vested in the LLP at their 'book values', hence such 'book value' could only be regarded as the 'full value of consideration' for the purpose of computation of 'capital gains' under section 48 of the Act.

d) Entitlement to carry forward losses and unabsorbed depreciation: –

We refer to provisions of section 72A(6A) of the Act relating to carrying forward and setting off accumulated loss and unabsorbed depreciation allowance in case of business reorganization which inter alia provides as under -

…Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, ***the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected*** *and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly:*

Provided that if any of the conditions laid down in the proviso to clause (xiiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with….

(Emphasis supplied)

On a plain reading of the above provision, wherein a private company or an unlisted public company is converted into LLP fulfilling all the conditions mentioned in the proviso to section 47(xiiib) of the Act, then accumulated losses and unabsorbed depreciation of the predecessor company shall be deemed to be accumulated losses and unabsorbed depreciation of the successor LLP from the previous year in which such conversion took place to the extent of conditions are fulfilled, if not, the said loss would be regarded as deemed income of the LLP in the

8. (i) *CIT vs. George Henderson and Co. Ltd., [1967] 66 ITR 622 (SC)* and (ii) *CIT vs. Gillanders Arbuthnot and Co. [1973] 87 ITR 407 (SC).*

previous year in which conditions are not complied with.

However, the arguments were raised in view of provisions of section 58(4) of the LLP Act, 2008 where sub-section (b) of section 58(4) states that –

.....(b) all tangible (movable or immovable) and intangible property vested in the firm or the Company, as the case may be, all assets, interests, rights, privileges, liabilities, obligations relating to the firm or the Company, as the case may be, and the whole of the undertaking of the firm or the Company, as the case may be, ***shall be transferred to and shall vest in the limited liability partnership*** *without further assurance, act or deed...*

(Emphasis supplied)

The above arguments held between section 58(4) of the LLP Act and section 72A(6A) of the Act have been reviewed by judicial precedents wherein the Hon'ble ITAT ruled that section 58(4) of the LLP Act is only in the context of tangible and intangible property, interests, rights, etc. and has got nothing to do with the carry forward of losses and the same is a part of the Act.

Thus, section 72A(6A) of the Act is clear and loud in terms of precondition by a statutory requirement that the assessee should have complied with the conditions of the proviso to section 47(xiiib) of the Act.

e) The conversion of equity interest of shareholder in the Company into partnership interest in the LLP to be considered as a transfer

As discussed above paras, the definition of 'transfer' as per section 2(47) of the Act is an 'inclusive' definition. It, therefore, extends to events and transactions that may not otherwise be transferred according to their ordinary, popular and natural sense. Thus, preliminary view could be adopted that the extinguishing shareholder's interest in the Company in lieu of partnership interest in the LLP would be regarded as transfer u/s 2(47) of the Act on account of conversion of Company into LLP.

The transfer includes disposing of or parting with an asset or any interest therein or creating any interest in any asset in any manner whatsoever. On conversion of the Company into LLP, all tangible and intangible property vesting in the Company to be transferred and vested in the resultant LLP. Therefore, on such vesting, not only the share capital, but also the shareholder's interest in shares of the Company gets extinguished. Relying on various judicial precedents[9] and also the AAR in the case of ***Domino Printing Science Plc., Authority for Advance Rulings, New Delhi*** ruling held that the expression 'extinguishment of any rights therein' as occurring in section 2(47)(ii) extends to mean extinguishment of rights independent of or otherwise on account

9. *CIT vs. Grace Collis [2001] 248 ITR 323 (SC), Kartikeya V. Sarabhai vs. CIT [1997] 94 Taxman 164 (SC)* and *Anarkali Sarabhai vs. CIT [1997] 90 Taxman 509 (SC).*

of transfer and both should be looked at independently and not united.

However, the extinguishment of shareholder's interest in the Company in lieu of partnership interest in the LLP is one of the conditions for claiming exemption as mentioned in the proviso to section 47(xiiib) of the Act. Though, extinguishment of equity interest into partnership interest is to be regarded as a transfer within the meaning of section 2(47) of the Act, the same is not taxable as laid down in section 47(xiiib) of the Act.

f) *The computation mechanism provided in section 48 of the Act is workable and is capable of being implemented or not*

On conversion of company into LLP, the value of the partnership interest in the LLP may not be equal to value of shareholders' interest in the Company and therefore, value of partnership interest in LLP cannot be taken as the cost of acquisition of shares. Further, the full value of consideration of the shares foregone would be equivalent to value of partnership interest in LLP.

The computation mechanism encompasses a situation that may be tax neutral. However, the same cannot be considered as rendering provisions of section 48 of the Act unworkable and not capable of being implemented even though the amount considered for the partnership interest in the LLP has been derived by the book value of assets and liabilities of the LLP. Thus, based on the above reasonings, computation provisions laid down in section 48 is workable and capable of being implemented at the time of transfer of partnership interest in the LLP by partners at the time of exit.

g) *What constitutes turnover/sales/gross receipts for the purpose of section 47(xiiib) of the Act*

Per CBDT Circular 1/2011 – explanatory notes to the provisions of the Finance Act, 2010 clarifies that the sales/gross receipts/turnover of the business which is taxable under the head 'Profits and gains of business or profession' shall be considered as turnover or sales or gross receipts to compute the threshold of INR 60 lakhs to comply with the conditions of section 47(xiiib) of the Act.

h) *Allowability of Minimum Alternate Tax ('MAT') credit to resultant LLP*

One of the important questions raised by the shareholders of the Company was whether the resultant LLP would be eligible to claim MAT credit of the Company post conversion. In this regard, section 115JAA(7) of the Act wherein sub-section 7 of the said section addresses such issue by clarifying that –

...In case of conversion of a private company or unlisted public company into a limited liability partnership under the Limited Liability Partnership Act, 2008 (6 of 2009), the provisions of this section shall not apply to the successor limited liability partnership.

Therefore, basis provisions of the Act, the LLP cannot utilize accumulated MAT credit of company post conversion.

i) ***Whether is it necessary to remove charge on the assets of the Company prior to conversion into LLP and whether the LLP has to re-negotiate existing contracts with customers and vendors***

As per Third Schedule to LLP Act, 2008 a company may apply for conversion provided, no security interest in its asset is subsisting or in force at the time of application for conversion from the Company into LLP with the Registrar of Companies. Further, the reference to the Company shall be substituted with reference to the LLP as if such LLP was a party to the agreement.

Consequences where exempt Transfer Conditions are not Satsified

Section 47A(4) of the Act provides that if any of the conditions specified in proviso to section 47(xiiib) of the Act are not complied with, the exemption granted on such conversion will be withdrawn and the amount of profits or gains arising from the transfer of such capital asset or intangible assets or share or shares shall be chargeable as deemed income in the hands of the LLP or the shareholder of the Company, as the case may be, for the previous year in which the conditions prescribed u/s 47(xiiib) of Act are violated.

The conditions aim to ensure the continuity of the same business by the same shareholders on a going concern basis.

Certain key issues arise on withdrawal of the benefit of exempt transfer as contemplated under section 47(xiiib) of the Act which has been discussed hereunder:

a) ***if capital gains are not chargeable under section 45 of the Act, whether the same can be taxed under section 47A of the Act***

The above question was raised before the AAR and then upheld by the Bombay High Court in case of ***Umicore Finance***[10] wherein it was held that in order to bring chargeability of capital assets under section 47A of the Act, there should be profit/gains arising from the transfer of such capital asset under section 45 of the Act. The deeming provisions in section 47A(3) of the Act are not absolute. The principle discussed in the said decision is that if the taxpayer did not have the benefit of capital gains accrued under section 47(xiiib) of the Act at the time of conversion and even if there is non-compliance, the provisions of section 47A (4) of the Act will not apply.

In order to determine whether the pre-requisite of section 47(4) of the Act to charge profits and gains resulting from transfer of capital assets is fulfilled or not, the basic provisions of section 45(1) of the Act and section 48 of the Act need to be referred. Section 47A (4) of the Act cannot be read on a standalone basis.

On the contrary, as observed in case of ***Aravali Polymers LLP*** wherein the LLP post conversion has provided interest

10. *Umicore Finance Luxembourg [2010] (323 ITR 25) (AAR-New Delhi)* and *CIT vs. M/s Umicore Finance (2016) 76 taxmann.com 32 (Bombay HC).*

free loan facility to partners out of reserves and surplus before conversion, thereby, violating the proviso (f) of section 47(xiiib) of the Act. The Kolkata ITAT held that since one of the conditions stipulated in section 47(xiiib) of the Act was not fulfilled, it would not be entitled to the benefit of exemption and revoked capital gain exemption claimed on conversion and remanded for re-computation of capital gains u/s 45 of the Act.

Further, the AAR, in case of ***Domino Printing Science Plc.*** ('Domino India'), ruling held that the provision of section 47A (4) of the Act stipulates for charging capital gains tax on failure to comply with the conditions prescribed in section 47(xiiib) of the Act. In the instant case, the requirement of the proviso to section 47(xiiib) was not complied in the year of conversion of the company into LLP itself. Therefore, the profit or gain arising in the hand of the shareholder on sale of shares of Domino India was chargeable to capital gains tax by deducting from the full value of consideration of the shares in the transfer pursuant to conversion and also the cost of acquisition of those shares in the year of conversion of the company into LLP.

In the light of above views, the issue is still debated and on the plain reading of section 47A(4) of the Act, a position could be adopted that if any of the conditions are not satisfied as mentioned in section 47(xiiib) of the Act, the exemption will be withdrawn and profits and gains on transfer of assets on account of conversion of the Company into LLP will be chargeable as deemed income in the hands of successor LLP and shareholders of the Company.

b) Sale consideration of transfer of shares by shareholders of the Company and transfer of assets by the Company into LLP on conversion for computation of capital gains under section 48 of the Act

The AAR in case of ***Domino Printing Science Plc.*** held that the shareholders acquire partnership interest as consideration for relinquishing shares in the Company. In such case, the full value of consideration for section 48 of the Act would be the value of partnership interest in LLP. Therefore, the incidence of capital gains tax in the hands of shareholders on transfer of shares, pursuant to conversion, cannot be ruled out.

In case the value of consideration is not ascertainable, section 50D of the Act provides the fair market value to be deemed as the full value of consideration.

However, the impact of DTAA would have to be considered where the shares of the Company have been acquired by a non-resident residing in Singapore/ Mauritius and acquired or purchased shares of Indian Company prior to April 01, 2017. Article 13 of India - Singapore DTAA and India – Mauritius DTAA, had provided that capital gains arising on transfer of shares in an Indian Company which have been acquired prior to April 01, 2017, shall not be taxable in India. Similarly, applicable DTAA should be reviewed to explore potential benefits compared to the Act's provisions.

c) ***Capital gains involved in transfer of capital assets on conversion of private limited company to LLP, would be subject to liability of assessee LLP (as a successor entity) under section 170 of the Act***

Section 170(1)(b) of the Act, a 'successor entity' which continues to carry on the business of the person who has been succeeded (predecessor) shall be liable to be assessed only in respect of the income of the previous year after the date of succession. However, the said liability of a successor entity is subject to an exception carved out in section 170(2), as per which, where the predecessor cannot be found, there is the assessment of the income of the previous year in which the succession took place up to the date of succession, and of the previous year preceding that year shall be made on the successor in the like manner and to the same extent as it would have been made on the predecessor, and all the provisions of this Act shall, so far as may be, apply accordingly.

Thus, in terms of the aforesaid provision, it can be inferred that though the Capital gains, if any, involved in the transfer of the capital assets on conversion of the private limited company to the assessee LLP, de hors applicability of section 47A(4) of the Act, would not be liable to be assessed in the hands of the LLP as per section 45 read with section 5 of the Act, however, the same would be subject to the liability of the assessee LLP (as a successor entity) under section 170 of the Act.

d) ***Recognition of goodwill in the books of the LLP post conversion, not forming part of block of asset for income-tax purposes would not amount to violation of condition prescribed under section 47(xiiib) of the Act***

It is pertinent to note that the conditions stipulated under the Act should be strictly construed and adhered to. Further, no new words can be incorporated into the statute which/can give unintended interpretation against the spirit of the law.

The Mumbai ITAT in the case of ***Brizeal Realtors and Developers LLP***[11] s held that if the shareholders of the Company have not received any thing more than their share capital in the LLP on the date of conversion and if the accumulated profits did not include the amount of Goodwill in the books of the predecessor company, there cannot be said to be any violation of clause (f) of section 47 (xiiib) of the Act. Further, the conversion of the Company into LLP as per the provisions of the LLP Act, 2008 and commercial decisions taken after such conversion cannot be seen as a colourable device.

e) ***Where the LLP fails to satisfy conditions laid down in proviso to section 47(xiiib) of the Act, whether 'carry forward' of losses would be declined of the erstwhile company by the LLP.***

Section 72A(6A) of the Act entitles the LLP to carry forward business losses of the erstwhile private limited company for the balance number of financial

11. *ITO vs. Brizeal Realtors and Developers LLP [2023] 146 taxmann.com 109 (Mumbai - Trib.).*

years and the unabsorbed depreciation of the private limited company would be allowed to be set off for the indefinite period by the successor LLP. In clear and loud terms, it is preconditioned by a statutory requirement that LLP should have complied with conditions of proviso to section 47(xiiib) of the Act.

It is inferred in the case law of Celerity Power LLP that the claim of the LLP as regards carry forward of the loss of the erstwhile private limited company, de hors satisfaction of the conditions laid down in the proviso to section 47(xiiib) of the Act, clearly militates against the statutory provision, thus, the right to claim such carry forward of business losses and unabsorbed depreciation of the erstwhile company by the LLP will be denied.

GAAR Implications on Account of Conversion

Today, the focus of legislators is anti-avoidance and economic substance. In many instances, courts have primarily held that the legal form of a transaction has to be respected (cases such as ***Vodafone International Holdings B.V. vs. Union of India (2012)***, and ***CIT vs. High Entergy Batteries (India) Ltd. (2012))*** to achieve tax efficiency, whereas, in certain transactions, courts have applied GAAR principles to disregard the transaction or to deny tax benefits (cases such as ***Mc Dowell & Co. Ltd. vs. CTO (1985),*** and A***janta Pharma Mumbai, NCLT (2018)).***

GAAR should be made applicable to arrangements **where the main purpose (and not one of the main purposes** provided in Finance Act 2012) is to obtain tax benefit and there should be an **intent and purpose** of tax avoidance and the same should be backed by an element of repercussions that are often a result of such tax avoidance arrangement.

Reorganization of structure i.e., conversion from the Company into LLP is generally driven by commercial considerations and not by the motive to obtain a tax benefit. Therefore, the arrangement should be looked at in a holistic manner and not in a dissecting manner. The corporate veil may be lifted if facts and circumstances reveal that the arrangement or corporate structure is a sham intended to evade taxes. The onus is on the Company/owners to demonstrate with adequate documentation as to why any arrangement/ reorganization of the Company should not be treated as IAA.

It is required to understand the intention of promoters to convert the Company into a LLP. If the intention of the promoters to convert the Company into LLP in the financial year to make such conversion tax neutral, it could be considered as a colourable arrangement in absence of commercial justification. The Income-tax authorities may raise objections/ questions to test the arrangement as an IAA that the intention of promoters to convert Company into LLP is to obtain tax-free share of profit in future vis-à-vis dividend/bonus pay-outs which would be chargeable to tax.

Parting Thoughts

With the trend of conversion of the Company into LLP booming where such restructuring and reorganization are surpassing all records, it is essential for the owners to look at the commercial substance and intention behind such conversion. Corporates need to assess whether the conditions laid out under Section 47(xiiib) of the Act could be complied with by them upon conversion of the company to an LLP. If not, then the tax cost accruing as a result of conversion needs to be weighed against other benefits that the businesses sought to achieve through such restructuring in order to make a rational decision.

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Income-tax issues involved in various Share Driven Transactions

In general, most transactions and investments made by investors both domestic and foreign are into shares of companies. These companies could be listed or unlisted. The nuances involved in either of these transactions would depend on the specific facts of each case.

While there are a myriad set of laws applicable at the time of investments into or acquiring shares, we have focussed on some of the income tax aspects of certain modes of divestments, i.e. sale of shares, capital reduction, and buyback of shares. For the purposes of this article, we have restricted the discussion to shares held as 'capital assets' in the books of the taxpayers. Please note that this article is not meant to be used as an 'advice' and while we have dealt with some of the important aspects of these transactions based on our experience, this is not meant to be a complete guide on the taxability of share transactions.

I. Sale of shares

- ***Nature of income***

As per Section 45 of the Income-tax Act, 1961 (**"IT Act"**), any income arising from the 'transfer' of a 'capital asset' is taxable in the hands of the transferor of such asset as 'capital gains'.

Section 2(14) of the IT Act defines the term 'capital asset' while the term 'transfer' is defined in section 2(47) of the IT Act. Amongst other assets, assets such as shares and securities (as defined in the Securities Contract Regulation Act, 1956) are included within the purview of 'capital assets' unless such assets are held as 'stock-in-trade'. Accordingly, any income arising from the transfer of shares is taxed as 'capital gains'.

- ***Period of holding***

Shares that are listed on a recognized stock exchange in India are regarded as 'long-term capital assets' if they are held for more than 12 months, else such shares are regarded as 'short-term capital assets' if they are held for a period of 12 months or less. Shares that are not listed on a recognized stock exchange in India are regarded as 'long-term capital assets' if they are held for more than 24 months, else such shares are regarded as 'short-term capital assets' if they are held for a period of 24 months or less.

The categorization as 'long-term capital assets' or 'short-term capital assets' is relevant from the perspective of determining the tax liability at the time of transfer of such shares. Gains arising from the transfer of 'long-term capital assets' are taxable as 'long-term capital gains' ("LTCG") and gains arising from the transfer of 'short-term capital assets' are taxable as 'short-term capital gains' ("STCG").

• ***Tax rates***

Section 111A, Section 112 and Section 112A of the IT Act provide the tax rates that are applicable in the case of capital gains arising from the transfer of shares. STCG generally forms part of the regular income of the transferor/seller and hence, is chargeable to tax at normal tax rates as applicable in the case of a taxpayer unless otherwise provided for. In the case of individuals, the tax rate applicable to STCG is as per the slabs which are relevant to each such individual. In the case of the corporates, such rate would be the applicable corporate tax rate. In the case of non-resident companies, this rate is 40% (plus applicable surcharge and cess).

STCG arising from the transfer of securities being equity shares listed on a recognised stock exchange is chargeable to tax at the rate of 15% (plus applicable surcharge and cess) under Section 111A of the IT Act if Securities Transaction Tax (**"STT"**) is paid at the time of transfer of such securities.

LTCG is generally charged to capital gains tax at the rate of 20% (plus applicable surcharge and cess). Resident taxpayer is also eligible to claim the benefit of indexation while computing the quantum of LTCG. However, a taxpayer has the option to pay tax either at the rate of 20% (after indexation) or 10% (without indexation) where the LTCG arises from the transfer of listed shares. A non resident taxpayer is subject to tax on LTCG derived on sale of a company in which public is not substanatially interested at the rate of 10% without indexation or without considering effect of depreciation in foreign currency.

LTCG arising from the sale of listed equity shares was previously exempted from capital gains tax. However, post an amendment made by the Finance Act, 2018, LTCG arising from the transfer of listed equity shares is now chargeable to tax under Section 112A of the IT Act at the rate of 10% (plus applicable surcharge and cess) on capital gains in excess of INR 100,000 (i.e. INR 0.1 million). This rate of tax will only apply if the STT is paid at the time of acquisition and transfer of such securities.

• ***Foreign exchange fluctuation***

Non-resident investors are also eligible to claim the benefit of any foreign exchange fluctuations on their investments in India. As per the first proviso to Section 48 of the IT Act, capital gains arising to a non-resident investor shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with the transfer of shares, and the full value of the consideration (i.e. sales consideration) into the same foreign currency as was initially utilized for making the investment. Once the quantum of capital gains has been determined as above, then, the gains would be re-converted into Indian Rupees for determination of the tax to be paid on the same. Rule 115A of the Income Tax Rules, 1962 (**"IT Rules"**) deals with the rules prescribed for the conversion of foreign currency into Indian Rupees and vice-versa. This benefit is not available on the transfer of shares that are listed on a recognized stock exchange in India and STT is paid on such a transfer i.e., where the benefit of the

concessional tax rate of 10% (plus applicable surcharge and cess) is availed.

- ***Cost of acquisition in some cases***

— *Listed shares*

Section 55(2)(ac) of the IT Act provides that the cost of acquisition in the case of a long-term capital asset (being an equity share in a company or other assets referred to in section 112A of the IT Act) which are acquired before 1 February 2018, shall be higher of;

(i) The actual cost of acquisition of such asset; and

(ii) lower of—

 (A) the 'fair market value' of such asset; and

 (B) the full value of the consideration received or accruing as a result of the transfer of the capital asset.

'Fair market value' as a concept is widely used in the IT Act. However, the rules for determining such fair market value differ depending on the provisions. In the present context, 'fair market value' is defined to mean:

(i) In a case where the capital asset is listed on any recognized stock exchange as on 31 January 2018, the 'fair market value' would be the highest price of the capital asset quoted on such exchange on the said date. However, in a case where there is no trading in such asset on such exchange on 31 January 2018, the 'fair market value' would be the highest price of such asset on such exchange on a date immediately preceding 31 January 2018 when such asset was traded on such exchange.

(ii) The 'fair market value' in the following cases would be deemed to be an amount that bears to the cost of acquisition the same proportion as the Cost Inflation Index for the financial year 2017-18 bears to the Cost Inflation Index for the first year in which the asset was held by the taxpayer or for the year beginning on the first day of April 2001, whichever is later, in a case where the capital asset is an equity share in a company which is:

 (A) not listed on a recognized stock exchange as on 31 January 2018 but is listed on such exchange on the date of transfer (e.g. cases where the initial public offering has taken place post 31 January 2018); or

 (B) listed on a recognized stock exchange on the date of transfer and which became the property of the taxpayer in consideration of a share that is not listed on such exchange as on 31 January 2018 by way of transaction not regarded as transfer under Section 47 of the IT Act (e.g. due to amalgamation, demerger, etc.),

In other words, where the share being transferred on a stock exchange was not listed as of 31 January 2018, the taxpayer would be allowed the benefit of indexation on the original cost of acquisition of such shares.

— *Shares received in lieu of holding other shares/assets*

As per Section 55(2)(aa) of the IT Act, where the taxpayer becomes entitled to subscribe to any additional financial asset or is allotted any additional financial asset without any payment

by virtue of holding a capital asset, being a share or any other security, then, the cost of acquisition of the new share/asset would be:

(i) In relation to the original financial asset, on the basis of which the taxpayer becomes entitled to any additional financial asset, the cost of acquisition would mean the amount paid for acquiring the original financial asset.

(ii) The cost of acquisition in relation to any right to renounce the entitlement to subscribe to the new financial asset shall be taken to be 'nil' when such right is renounced by the taxpayer in favour of any person.

(iii) The cost of acquisition in relation to the financial asset, to which the taxpayer has subscribed on the basis of the said entitlement would be taken to mean the amount actually paid by him for acquiring such asset.

(iv) The cost of acquisition in relation to the financial asset allotted to the taxpayer without any payment and on the basis of holding of any other financial asset, shall be taken to be nil in the case of such taxpayer.

(v) The cost of acquisition in relation to any financial asset purchased by any person in whose favour the right to subscribe to such asset has been renounced, means the aggregate of the amount of the purchase price paid by him to the person renouncing such right and the amount paid by him to the company or institution, as the case may be, for acquiring such financial asset.

— *Shares received as a result of certain corporate actions*

Further, where the capital asset, being a share or a stock of a company, became the property of the taxpayer on account of any of the following corporate actions, then the cost of acquisition as per Section 55(2)(b) of the IT Act would mean the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived:

(i) the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares,

(ii) the conversion of any shares of the company into stock,

(iii) the re-conversion of any stock of the company into shares,

(iv) the sub-division of any of the shares of the company into shares of smaller amount, or

(v) the conversion of one kind of shares of the company into another kind.

Similarly, there are specific provisions that deal with determining the cost of acquisition in the case of tax-neutral reorganizations such as mergers and demergers.

As per Section 49(2) of the IT Act, where the capital asset being a share or shares in an amalgamated Indian company becomes the property of the taxpayer in consideration of a tax-neutral amalgamation under the IT Act, the cost of acquisition of the new share in the amalgamated entity is deemed to be the cost of acquisition in the hands of such taxpayer of the share or shares in the amalgamating

company. For example, if Mr. A bought shares of PQR Ltd at INR 100, and PQR Ltd merges with XYZ Ltd where XYZ Ltd is the surviving entity then, the cost of acquisition of shares of XYZ Ltd received by Mr. A pursuant to the merger would be INR 100.

Section 49(2C) and Section 49(2D) of the IT Act deal with the provisions relating to shares received pursuant to a tax-neutral demerger. The cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the taxpayer in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger. The cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the cost of acquisition of shares of the resulting company.

- ***Tax deduction at source/withholding tax***

As per the provisions of Section 195 of the IT Act, any person (including a non-resident) who is responsible for paying any taxable income to a non-resident is required to withhold appropriate taxes from such payments. Accordingly, any person who is acquiring shares from a non-resident is required to withhold appropriate taxes at the time of making payments to such non-resident. Failure to withhold taxes attracts interest liability for the payer under Section 201 of the IT Act and a potential penal liability under Section 271C of the IT Act.

The Finance Act, 2021 has also introduced provisions for the deduction of tax at source on certain payments made to resident taxpayers for the purchase of goods. Any person, being a buyer who is responsible for making any payment to a resident seller for the purchase of goods is required to deduct an amount equal to 0.1% of such sum exceeding INR 50 lakh (i.e. INR 5 million) as income-tax. This provision applies if the aggregate value of such goods exceeds INR 50 lakh (i.e. INR 5 million) in the relevant financial year and the purchaser's total sales, gross receipts or turnover from the business carried on by him exceed INR 10 crores during the financial year immediately preceding the relevant financial year in which the purchase of goods is carried out.

- ***Issues faced by non-residents***

Section 90(2) of the IT Act provides that in case of a taxpayer who is a resident of a country with which the Government of India has entered into a Double Taxation Avoidance Agreement (**"DTAA"**), the provisions of the IT Act or the applicable DTAA, whichever is more beneficial, may be applied. Thus, if a non-resident taxpayer is eligible to claim the benefits of the DTAA, then such provisions shall apply unless the provisions of the IT Act are more beneficial to the taxpayer.

In the context of India-Mauritius DTAA, Circular 789 dated 13 April 2000, issued by the Central Board of Direct Taxes and upheld by the Hon'ble Supreme Court of India in the case of ***Azadi Bachao Andolan ([2003] 132 Taxman 373 (SC))*** linked beneficial ownership for applying the benefit of the DTAA to tax residency certificate (**"TRC"**) issued to the Mauritius resident by the Mauritius tax authorities. Various Indian courts from time and time ruled that holding a valid TRC would be sufficient proof of the residential status and beneficial ownership of shares for granting the benefit of the DTAA.

In the case of ***Bid Services Division (Mauritius) Limited ([2023] 148 taxmann.***

com 215 (Bombay)), the Hon'ble High Court of Bombay has recently remanded the matter back to the Authority for Advance Rulings (**"AAR"**) for a fresh determination of whether a Mauritian taxpayer is entitled to the benefits of the India-Mauritius DTAA. The AAR in this case had held that the taxpayer was a sham or a shell or a conduit entity that was incorporated only for the purposes of evading tax in India or as a device to avoid taxation.

II. Capital reduction

- ***Dividend income***

As per Section 2(22)(d) of the IT Act, any distribution of accumulated profits by a company to its shareholders on the reduction of its capital is regarded as 'dividend' income in the hands of the shareholders.

Previously, the dividend income was subjected to Dividend Distribution Tax (**"DDT"**) which was payable by the company distributing such dividends and such dividend was exempt in the hands of the shareholders. However, post an amendment made by Finance Act, 2020, dividend income is now subject to tax in the hands of shareholders as 'other income' (assuming shares are held as a capital asset) at the regular tax rates applicable to them. Further, as per Section 194, for dividends distributed, declared, or paid on or after 1 April 2020 by an Indian company to the shareholder, the Indian company shall deduct tax at the rate of 10% on the dividend distributed to the resident shareholders. As per Section 115A and Section 115AD of the IT Act, the dividend income of a non-resident person (including foreign portfolio investors), is taxable at the rate of 20% (plus applicable surcharge and cess) without providing for deduction under any provisions of the IT Act. However, as per Section 115AD of the IT Act dividend income of a 'specified fund' as defined in clause (c) of the Explanation to Section 10(4D) of the IT Act is taxable at the rate of 10% (plus surcharge and cess).

- ***Capital gains***

Any income distributed to the shareholders over and above the accumulated profits of the company (i.e. income treated as a dividend as explained above), would be regarded as the 'full value consideration' received by the shareholders at the time of capital reduction. Any gains arising on such a transaction, in other words, the positive difference between such full value consideration and the cost of acquisition of the shares, is regarded as 'capital gains' in the hands of the shareholders and is taxed accordingly.

- ***Some issues***

The Mumbai Bench of the Income Tax Appellate Tribunal (**"ITAT"**) in the case of Carestream Health (ITA No. 826/Mum/2016) decided on the issue of allowability of loss incurred in case of a capital reduction and whether such loss can be carried forward to subsequent years. The taxpayer received consideration from its Indian subsidiary as a part of a capital reduction scheme. The total consideration received by the taxpayer up to the extent of accumulated profits of the Indian subsidiary was subjected to DDT as it was considered to be deemed dividend while the balance portion was regarded as sale consideration, and capital loss was calculated on the same after availing indexation benefit under the IT Act.

The ITAT allowed the carry forward of loss by holding that even though the share of the taxpayer after extinguishment/cancellation of shares on capital reduction remained the same, it would still qualify as a transfer under the provisions of the IT Act. Further, it was also held that it is possible to compute the

capital gains as the cost of acquisition and sale consideration received thereon was available.

III. Buy-back of shares

- ***Taxability of the company undertaking the buy-back***

Under Section 115QA of the IT Act, any domestic company which buys back its shares is liable to pay additional income tax on the 'distributed income' at the rate of 20% (plus applicable surcharge and cess).

The term 'buy back' is defined to mean "purchase by a company of its shares in accordance with the provisions of any law for the time being in force relating to companies".

The term 'distributed income' has been defined to mean "the consideration paid by the company on buy-back of shares as reduced by the amount, which was received by the company for issue of such shares, determined in the manner as may be prescribed".

For the purposes of Section 115QA, the amount received by a company in respect of the shares issued by it shall be determined in accordance with Rule 40BB of the IT Rules. This Rule deals with certain scenarios where the amount received by a company is to be determined. We have listed some examples:

(i) Where the share has been issued by a company to any person by way of subscription, the amount actually received by the company in respect of such share including any amount actually received by way of premium shall be the amount received by the company for the issue of such share.

(ii) Where the company had at any time, prior to the buy-back of the share, returned any sum out of the amount received in respect of such share the amount as reduced by the sum so returned shall be the amount received by the company for issue of said share.

(iii) Where the share has been issued by a company under any plan or scheme under which an employees' stock option has been granted or as part of sweat equity shares, the fair market value of the share as computed in accordance with Rule 3(8) of the IT Rules (i.e. rule for determining value of shares to be taxed as perquisite), to the extent credited to the share capital and share premium account by the company shall be deemed to be the amount received by the company for issue of said share.

(iv) Where the share has been issued by a company being an amalgamated company, under a scheme of amalgamation, in lieu of the share or shares of an amalgamating company, then, the amount received by the amalgamating company in respect of such share or shares determined in accordance with this rule, shall be deemed to be the amount received by the amalgamated company in respect of the share so issued by it.

(v) The amount received by a company, being a resulting company in respect of shares issued by it under a scheme of demerger, shall be the amount which bears the amount received by the demerged company in respect of the original shares determined in accordance with this rule in the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger. The amount received by the demerged company in respect of the original

shares in the demerged company shall be deemed to have been reduced by such an amount.

- ***Taxability of shareholders***

Once the company undertaking the buy-back of its shares has paid the buy-back tax as per Section 115QA, shareholders receiving such amounts are not further taxed on the same amount. This exemption is provided under Section 10(34A) of the IT Act.

- ***Applicability of Section 46A of the IT Act***

Section 46A of the IT Act provides that shareholder or a holder of other 'specified securities' receives any consideration from any company for purchase of its own shares or other specified securities held by such shareholder or holder of other specified securities, then the difference between the cost of acquisition and the value of consideration received by the shareholder or the holder of other specified securities, as the case may be, shall be deemed to be the capital gains arising to such shareholder or the holder of other specified securities in the year in which such shares or other specified securities were purchased by the company. Therefore, prior to introduction of Section 115QA, any buy-back of shares resulted in capital gains income for the shareholder where the difference between the cost of acquisition and the consideration received for such a buy-back resulted in any gains for such shareholder.

However, Section 115QA begins with a non-obstante clause, i.e. it overrides the other provisions of the IT Act to the extent that the other provisions are not consistent with the operation of Section 115QA. Therefore, in the case of buy-back of shares by an Indian company (whether listed or unlisted) the provisions of Section 115QA overrides the provisions of Section 46A and will be applicable in such cases.

Section 46A would remain applicable in cases where the buy-back of shares is undertaken by a foreign company and the shareholder is subjected to Indian tax by reason of his residential status or the source of such income being in India.

Closing remarks

As can be seen from the above discussion, the taxability of share transactions (especially those involving non-residents) can contain various nuances and issues which need to be treated carefully. The ever-changing tax laws and evolving judgments in these matters need to be borne in mind while advising clients and helping them navigate these issues.

"If money help a man to do good to others, it is of some value; but if not, it is simply a mass of evil, and the sooner it is got rid of, the better."

— *Swami Vivekananda*

CA Mehul Bheda CA Drishti Kankariya

Do's and don'ts of takeover under IBC from income tax perspective

1. Introduction

1.1. The Insolvency and Bankruptcy Code, 2016 ('IBC' or 'the Code') is the bankruptcy law of India which was introduced as a consolidated single law for dealing with insolvency and bankruptcy cases in India in a time bound and efficient manner. The Code aims at maximizing the value of the assets of a debtor and to promote entrepreneurship and availability of credit.

1.2. The Code empowers any creditor of a corporate debtor having outstanding due of more than INR 1 Crore[1] to file for insolvency against such corporate debtor with the adjudicating authority, which is National Company Law Tribunal (NCLT) for corporate persons. The threshold for filing application includes outstanding principal debt as well as interest[2]. Also, a group of creditors jointly crossing the threshold are also eligible to file for insolvency[3].

1.3. The aim of the Code is to shift the control of such companies to the creditors. Accordingly, in case of corporate debtors, once any claim of a creditor has been admitted by NCLT, Corporate Insolvency Resolution Process (CIRP) is initiated on appointment of an Interim Resolution Professional who helps set up a committee of creditors (COC). The COC then appoints a Resolution Professional (RP), and along with the help of the RP, COC is responsible for inviting bids from interested parties (bidders) for taking over and reviving the company under IBC ('IBC Company'). All bidders are required to submit a resolution plan to the COC which will lay down the bid amount, mechanics of the acquisition and payment of liabilities.

1.4. The COC will finally select a resolution plan that they think will be the most beneficial to all the stakeholders involved. Such resolution plan is then presented to the NCLT for approval.

1. The threshold has been increased from INR 1 lakh to INR 1 Crore vide Notification No. S.O. 1205(E), dated 24.03.2020 with effect from the date of this notification
2. *Prashat Agarwal vs. Vikash Parasrampuria (NCLAT Mumbai) [Company Appeal (AT) (Ins) No. 690 of 2022]*
3. *Vishnu Oil Mill (P.) Ltd. vs. Union of India [2022] 141 taxmann.com 408 (Rajasthan)*

If the NCLT sanctions the approved resolution plan, then the same becomes binding on the corporate debtor, bidder and all the stakeholders involved. The successful bidder ('Acquirer') of the IBC Company then proceeds with implementation of the resolution plan.

1.5. It is interesting to note that since the inception of the IBC in December 2016, a total of 6199 CIRPs have commenced. Of these, 4199 have been closed. Of the CIRPs closed, the corporate debtor was rescued in 2298 cases, of which 894 have been closed on appeal or review or settled; 793 have been withdrawn; and 611 cases have ended in approval of resolution plans; while 1901 have ended in orders for liquidation[4].

1.6. Some of the successful acquisitions that have taken place through the IBC are acquisition of Bhushan Steel Ltd. by Tata Steel Ltd., Monnet Ispat and Energy Ltd. by JSW Steel Ltd., Uttam Galva Steel by joint venture of Arcelor Mittal and Nippon Steel.

1.7. The bid amount for acquisition of companies under IBC is usually subdued, given that the companies are under financial stress and the realizable value of the assets may not be sufficient to pay off the creditors. Hence, there is usually a substantial haircut to the dues of the creditors.

1.8. Section 53 of the Code lays down the order of priority in which the bid amount is to be distributed. Popularly known as the 'Waterfall Mechanism', it provides that the Insolvency and liquidation costs are the first in the priority of payment, followed by secured creditors and employee dues. Unsecured and operational creditors come later in the order of priority. Hence, if the bid amount is insufficient to discharge even the secured creditors and employee dues, then nothing may be paid at all to the unsecured and operational creditors.

1.9. Accordingly, there would be a write back of such loans and liabilities in the books of the IBC Company. The Acquirer will need to be mindful of the tax implications on write back of outstanding loans/liabilities in the hands of such IBC company, and whether it would result in any tax outflow.

2. Taxability on write back of liabilities

For the purpose of evaluating the taxability on write-back of outstanding loans/liabilities, including accrued interest, the following sections of the Income-tax Act, 1961 ('the IT Act') will need to be specifically analysed:

2.1. Tax under section 41(1) of the IT Act

Section 41(1) of the IT Act provides that where deduction has been claimed in the past for any trading liability and subsequently any benefit is received in respect of such trading liability by way of remission or cessation, then the value of any benefit accruing shall be deemed to be profits and gains arising from business or profession. Accordingly, any loan/liability, including interest, which has earlier been claimed as a deduction for tax purposes, and is subsequently

4. Volume 25 of the Quarterly newsletter of the Insolvency and Bankruptcy Board of India – October – December 2022

waived off, would be subjected to tax under section 41(1) of the IT Act.

The Supreme Court in the case of Mahindra and Mahindra Ltd[5] has held that any loans which have not been claimed as a deduction earlier, will not be subjected to tax under section 41(1) of the IT Act. Also, any interest which was disallowed due to non-payment, under section 43B of the IT Act, will not be subjected to tax under section 41(1) of the IT Act on write back since no deduction was claimed earlier[6].

2.2. Tax under section 28(iv) of the IT Act

Section 28(iv) of the IT Act seeks to tax any benefit or perquisite received, whether convertible into money or not, arising from business or the exercise of a profession.

The Supreme Court in the case of Mahindra and Mahindra Ltd. has held that the provisions of Section 28(iv) of the IT Act are applicable only for non-monetary benefits, and waiver of loan or interest should be treated as cash receipt in the hands of the debtor, hence would fall outside the purview of Section 28(iv) of the IT Act.

However, the Finance Bill, 2023 proposes to expand the definition of Section 28(iv) of the IT Act to include even cash benefits arising from business or exercise of profession. Hence, it will now need to be evaluated if write back of loan/interest could be taxed within the ambit of section 28(iv) of the IT Act.

2.3. Tax under section 28(i) of the IT Act

Section 28(i) of the IT Act seeks to tax any profits or gains arising from business or profession which was carried on by the assessee at any time during the previous year under the head 'Profits and gains of business or profession'.

One will need to evaluate if waiver of loans could be subjected to tax under section 28(i) of the IT Act, especially of an entity that is not engaged in the business of raising and giving loans. One may also need to evaluate whether a waiver of loan could be considered as a capital receipt which cannot be taxed under 28(i) of the IT Act[6].

2.4. Tax under section 56(2)(x) of the IT Act

Section 56(2)(x)(a) of the IT Act provides that where any person receives any sum of money, without consideration, the whole of the aggregate value of such sum shall be deemed as income chargeable under the head 'Income from other sources'.

The above-mentioned Supreme Court decision in the case of Mahindra and Mahindra Ltd. has held that waiver of loan is a cash receipt, hence it becomes important to analyse if any tax could arise under section 56(2)(x)(a) of the IT Act.

5. *CIT vs. Mahindra and Mahindra Ltd. [2018] 404 ITR 1 (SC)*
6. *ACIT vs. Spel Semiconductor Ltd. [2013] 59 SOT 114 (Chennai - Tribunal)*
7. *Bombay Gas Co. Ltd. vs. Addl. CIT [2012] 54 SOT 13 (Mumbai - Tribunal), Jai Pal Gaba vs. ITO [2019] 178 ITD 357 (Chandigarh - Tribunal)*

The Chandigarh Bench of the Income-tax Appellate Tribunal[8] has held that waiver of loan for one time settlement is not without consideration, hence, there will be no 56(2)(viia) implications (now 56(2)(x)).

Another argument for non-applicability of section 56(2)(x) of the IT Act could be that waiver of loan is a constructive receipt and there would not be any actual receipt of cash, hence section 56(2)(x) of the IT Act should not apply.

2.5. Set-off of taxable income against tax losses

Even if write back of liabilities gets taxed under the IT Act, there may not be any tax outflow due to availability of tax losses in the IBC Company. In most cases, IBC Companies will have huge brought forward tax losses. Accordingly, any tax liability arising on write back can be set off against brought forward business losses and unabsorbed depreciation. Brought forward business losses are available for a period of 8 years for set off against any income under the head profits and gains from business and profession. Unabsorbed depreciation can be set off against any income and are available infinitely. Accordingly, the Acquirer will need to evaluate the position of tax losses in the IBC Company which are actually available for utilization, after taking into consideration the outstanding tax demands and litigation status. It is also important to keep in mind that for claiming tax losses, the income-tax return needs to be filed within the due date prescribed under the IT Act. In case the return is not filed within the prescribed due dates, losses incurred for that year may not be permitted to be carried forward. For companies under IBC, the RP has been authorized under the IT Act to sign returns. Hence, it should be ensured that during the resolution process, returns are filed within the due dates so that fresh losses incurred are available for utilisation.

2.6. Tax under MAT provisions

Write back of loans could be credited to the profit and loss account based on the applicable accounting standards. Accordingly, there could be MAT liability on loan write backs, in absence of any specific carve out for an IBC Company. However, for companies against whom CIRP has been initiated, the MAT provisions under section 115JB of the IT Act permit deduction of aggregate of book losses and unabsorbed depreciation from the book profits, for arriving at the taxable book profit for MAT purposes. Accordingly, there may not be any MAT liability if sufficient books losses are available. The other option to mitigate MAT liability is to opt for the new tax regime under section 115BAA of the Act wherein MAT provisions are not applicable.

2.7. Tax withholding under section 194R of the IT Act

The Finance Act, 2022 has introduced section 194R of the IT Act, which provides deduction of tax at source by any person who provides to a resident, any benefit or perquisite, whether convertible into money or not, arising

8. *Jai Pal Gaba vs. ITO [2019] 178 ITD 357 (Chandigarh - Tribunal)*

from business or the exercise of a profession.

CBDT Circulars[9] issued on section 194R of the IT Act state that waiver or settlement of a loan would constitute benefit. However, waiver of loans by certain specified lenders which inter-alia includes banks, specified non-banking financial institution and Asset Reconstruction Companies are not required to withhold tax under section 194R of the IT Act. Accordingly, in case of loan waived off by any other creditor, they may withhold tax under section 194R of the IT Act, credit of which will be available to the IBC Company.

3. Conducting tax due diligence on the IBC Company

All the bidders looking at acquiring an IBC Company would need to conduct a thorough due diligence on such company to understand its financial health before submitting its bid. The bidders must also conduct a due diligence from tax perspective to identify all outstanding tax liabilities and evaluate the tax litigation status. The tax due diligence will also help in understanding the tax loss position of the IBC Company. This will also help in the valuation exercise to arrive at the bid amount.

4. Acquisition structuring from tax perspective

4.1. Takeover of a company under the IBC process requires the bidders to carefully structure the acquisition in order to lower or mitigate any tax exposure as well as to ensure compliance with regulatory laws.

4.2. Typically, the Acquirer or the consortium formed of bidders will acquire the IBC Company through a special purpose vehicle (SPV). The SPV is funded with the bid amount through a mix of debt, equity and hybrid instruments. Although the funding instrument is decided based on the commercial requirement of the Acquirer, it must be mindful of the tax leakages of each funding instrument. The SPV then funds the IBC Company so that the creditors can be paid off as per the approved Resolution Plan.

4.3. Typically, the SPV's fund the IBC Company by primary infusion of equity or hybrid instruments (such as compulsory/optionally convertible debentures or preference shares). The Acquirer will need to evaluate if infusion of funds results in any tax liability in its hands. Under the deemed gift tax provisions of section 56(2)(x) of the IT Act, if any person receives any shares or securities for inadequate consideration, computed as per Rule 11UA of the Income-tax Rules, 1962, exceeding INR 50,000, then the difference between the Rule 11UA value and the consideration paid shall be taxable in the hands of the recipient. No exemption has been given for acquisition/infusion in a company which is under IBC. Accordingly, say in a scenario where the IBC Company is listed on stock exchanges in India where it is frequently traded and the

9. CBDT Circular no. 12 of 2022 dated 16th June 2022 and CBDT Circular No 18 of 2022 dated 13th September 2022

quoted price is higher than the price agreed for infusion, then there could be deemed gift tax in the hands of the Acquirer under section 56(2)(x) of the IT Act. The acquisition amount for a IBC Company is usually at substantial discount and could even be very nominal given that the equity value of the company may have no value. Hence, the Acquirer must restructure the acquisition appropriately keeping in mind the deemed gift tax provisions.

4.4. The SPV can also fund the IBC Company through merger of the SPV and the IBC Company. In several successfully completed IBC bids, merger route has been opted for acquisition (for example, in the case of acquisition of Monnet Ispat & Energy Limited) or merger has been done post the acquisition (for example, in the case of acquisition of Bhushan Steel Ltd. by Tata Steel Ltd.).

4.5. The Acquirer will also have to evaluate the direction of the merger that results in least possible tax and other costs. On merger, the Acquirer or the consortium formed will get a direct stake in the IBC Company. Merger is tax neutral under the IT Act for all parties involved only on satisfaction of conditions provided therein. Hence, in case of merger, it will have to be evaluated if those conditions are satisfied.

4.6. There are also companies under IBC where bidding is done for each or only one of the business of such a company. For example, in the case of the ongoing Reliance Capital bid, parties could bid for each business cluster separately. Also, in the case of Murli Industries Limited, the resolution plan approved revival of only one business and proposed sale of the remaining businesses. In case of acquisition of only one or more of the businesses, the Acquirer will have to evaluate structures for acquisition of business such as, demerger or slump sale. While demerger is tax neutral under the IT Act for all parties involved on satisfaction of certain conditions, slump sale is subjected to tax.

4.7. The Acquirer must also consider the impact on the tax losses of the IBC Company due to acquisition/infusion or any restructuring steps such as merger. As per Section 79 of the IT Act, tax business losses of a company in which public are not substantially interested lapses in case of change in shareholding by 51% or more. However, the Finance Act, 2018 has provided relaxation for continuity of such tax losses in case of change in shareholding pursuant to a resolution plan approved under IBC after affording reasonable opportunity of being heard to the jurisdictional Principal commissioner. Hence, it is important to ensure that the RP serves notice to such commissioner intimating about the carry forward of losses inspite of change in shareholding and affording him an opportunity to raise his concerns, if any. The Acquirer must also ensure that the continuity of tax losses is appropriately captured in the Resolution Plan.

4.8. In case of merger of IBC Company with the SPV, provisions of section 72A of the IT Act will need to be evaluated for carry forward of tax losses pursuant to merger. Unlike section 79 of the IT Act, there is no relaxation under section 72A of the IT Act for an IBC Company.

4.9. As part of the restructuring, the Acquirer will also need to provide the mechanism for providing exit to the existing promoters in the Resolution Plan. Exit is typically provided by purchasing shares from the existing promoters or by undertaking a capital reduction without consideration. The Acquirer will need to evaluate the tax implications of providing exit. In case of purchase of shares without consideration, deemed gift tax implications under section 56(2)(x) of the IT Act, as discussed above, will need to be evaluated. In case of capital reduction without consideration, there may not be any tax liability on the IBC Company.

4.10. Another important restructuring aspect in the resolution plan pertains to the debt restructuring. The Acquirer may agree to convert some of the outstanding debt of the lenders into equity or any other security, which could be bought back at a later date a pre agreed price. Accordingly, the tax implications on conversion of debt into equity/security as well as purchase of such shares at a later date will need to be evaluated.

5. Tax deduction of IBC related costs

5.1. The Acquirer will incur several costs for acquiring the IBC Company in the course of the resolution process, including the costs to be incurred by the IBC Company as per the Code. The Acquirer will need to evaluate whether the costs incurred by it as well as IBC Company would be available as a deduction for income-tax purposes. Under the IBC process, insolvency resolution process costs has been defined to include interim finance, fees payable to resolution professional, costs incurred to run the business and facilitate the resolution process.

5.2. Costs incurred to run the business will be available as a deduction under section 37 of the IT Act, being connected to the business. Section 35DD of the IT Act permits deduction of costs incurred for amalgamation or demerger over a period of 5 years. However, there is no precedent on availability of deduction of IBC related costs under section 37 of the IT Act.

6. Moratorium on tax proceedings

The Acquirer will also need to keep in mind that moratorium period under IBC extends to income-tax proceedings[10]. Moratorium is the period during which judicial proceedings for recovery, enforcement of security interest, sale or transfer of assets cannot take place. The order of moratorium remains in effect till the completion of the resolution process. Accordingly, till the completion of the resolution process, all tax litigations against the IBC Company are suspended.

7. Waiver of tax dues

7.1. While formulating the resolution plan, the Acquirer will also need to evaluate whether waiver can be claimed for all outstanding tax demands. It is pertinent to note that the provisions of section 238 of the Code have an overriding effect on anything inconsistent contained in any other law. The Supreme Court in the case

10. *PCIT vs. Monnet Ispat & Energy Ltd. [2019] ITA Nos. 533 / 2017*

of Monnet Ispat & Energy Ltd.[11] has upheld that IBC shall override anything inconsistent contained in any other enactment, including Income-tax Act. Also, several judicial precedents[12] have upheld that tax dues are operational creditors, and hence they fall later in the order of priority of payment after financial creditors and employee dues. Accordingly, waiver can be sought in the resolution plan for any outstanding tax liabilities, especially if in the order of priority of payment, no amount is paid to operational creditors. However, whether waiver will be granted for tax pertaining to ongoing matters where tax dues have not crystallised prior to approval of the resolution plan is an open question. NCLT is certain cases[13] has mandated obtaining approval of the relevant authorities in case of such waivers.

7.2. Recently, the Supreme Court in the case of Rainbow Papers Ltd[14] held that the Gujarat VAT authorities, whose dues were outstanding, to be secured creditors since the Gujarat VAT Act provided for first charge on the assets of the company for outstanding demand. Relying on this Supreme Court decision, recently the NCLAT, in the case of Assam Company India Ltd.[15], wherein the Income-tax authority had attached the bank account, held that government dues are secured creditors and remanded the matter back to the NCLT for consideration. These recent judicial pronouncements have unsettled the position of tax dues being considered as operational creditors. The Acquirer will need to be mindful whether any attachment order has been issued by the tax authorities that could result in tax demands being considered as secured creditor and having priority in payment.

7.3. The Acquirer must be mindful that all the outstanding tax demands, as appearing in the books of accounts, need to be considered as claims by the RP. Also, if the tax authorities submit their outstanding dues to the RP, within the stipulated time period, the same will have to be considered in the Resolution Plan.

Summary Do's and Don't's

The Acquirer should keep in mind the following from a tax perspective while acquiring an IBC Company:

- Tax impact in the hands of the IBC Company on write back of loan/ liabilities and whether there would be any tax outflow;

11. *PCIT vs. Monnet Ispat & Energy Ltd. [2019] 107 taxmann.com 481 (SC)*
12. *PCIT vs. Synergies Dooray Automotive Ltd. [2019] 153 SCL 77 (NCL-AT), RMS Employees Welfare Trust vs. Anil Goel [2019] 109 taxmann.com 169 (NCL-AT),*
13. *Parveen Bansal vs. Amit Spinning Industries Limited C.A. 360 (PB) 2018 in C.P. No. (IB)-131(PB)/2017, Tata Capital Financial Services Limited vs. M/s Ciscon Projects Private Limited IA No. 763/2019 in C.P. (IB) No. 158/7/HDB/2018*
14. *State Tax Officer vs. Rainbow Papers Ltd [2022] 174 SCL 250 (SC)*
15. *PCIT vs. M/s Assam Company India Ltd. (NCL-AT PB, Company Appeal No. 242 of 2022)*

- Conducting tax due diligence on the IBC Company to identify tax demands, litigation status and tax loss status;
- On acquisition, to ensure continuity of the tax losses of the IBC Company (which is not widely held), it should be ensured that intimation is made to the tax commissioner that tax losses are intended to be carried forward inspite of change in shareholding;
- On acquisition/conversion, deemed gift tax implications under section 56(2)(x) of the IT Act should be evaluated;
- In case of acquisition through merger, tax neutrality under the IT Act should be ensured;
- There will be moratorium on tax proceedings till completion of the resolution process under IBC;
- Tax dues should be treated as Operational creditors and should be treated as per the Waterfall Mechanism under section 53 of the Code;
- During the pendency of the resolution process, filing of Income-tax returns and all other compliances should be done within due dates to avoid any penalties as well as to ensure eligibility of fresh tax losses

IBC is still at a nascent stage in India and tax jurisprudence on the subject is an evolving area. It is essential for stakeholders involved in IBC to duly examine the transactions with regard to its implications from tax perspective to avoid any unnecessary tax liability or dispute, and to ensure proper compliance with the applicable tax laws and regulations.

"Never think there is anything impossible for the soul. It is the greatest heresy to think so. If there is sin, this is the only sin; to say that you are weak, or others are weak."

— *Swami Vivekananda*

"I should love to satisfy all, if I possibly can; but in trying to satisfy all, I may be able to satisfy none. I have, therefore, arrived at the conclusion that the best course is to satisfy one's own conscience and leave the world to form its own judgment, favorable or otherwise."

Mahatma Gandhi

Shruti Lohia
Advocate

Vansh Vermani
Advocate

Overview of Cross Border Merger and De-merger

Globally, corporations are reorganising their operations through mergers and acquisitions at an unprecedented rate in order to tackle the problems posed by globalisation. One of the most notable characteristics of the current M&A landscape is the prevalence of cross-border transactions, which is an easier method of internationalisation compared to the greenfield mode of entry. In this regard India's economy has grown significantly to become one of the largest economies in the world. Despite the COVID-19 pandemic, the foreign direct investment (FDI) inflow in India stood at its highest ever at a whopping USD 84.8 billion in Financial Year (FY) 2022-23[1].

India, being an emerging market with remarkable business opportunity, has emerged as a focal point of the deal street in the recent years. With a robust economic system and continued focus of the Government on ease of doing business, the M&A statistics in India have started to witness a significant uptrend. The FDI inflows in India have increased from USD 59.83 bn in FY 2020 to USD 83.57 bn in FY 2021.

There is no doubt that cross-border FDI is a vital driver of the Indian economy notwithstanding global circumstances such as the global financial crisis, global recession, conflict between Russia and Ukraine and rising oil prices. India recorded a soaring high number of USD 171 bn in M&A activity in FY 2022[2], which is the highest ever in the 75-year history of India.

During the year, there were 11 transactions worth more than a billion dollars, totalling USD 82.5 bn, and 97 transactions worth between USD 100mn to USD 999 mn, totalling USD 26.2 bn. While domestic consolidation was the most prevalent form of M&A activity, registering 355 deals with a total value of USD 70.7 bn, record deal values for outbound M&A activity totalling USD 18 bn across 61 deals have been seen to date.

The government has recently made numerous efforts and undertaken key initiatives including easing FDI regulations in various industries, PSUs, oil refineries, telecom and defence. Given the significant transactions in the

1. Economic Survey 2022-23, Page 35
2. https://www.businesstoday.in/latest/corporate/story/ma-activity-with-an-india-angle-hit-a-record-171-billion-in-2022-358825-2023-01-04

technology and health sectors, multinational companies (MNCs) have pursued strategic collaborations with top domestic business groups, fuelling an increase in cross-border M&A of 83% (year on year) to USD 27 bn[3].

A cross border M&A maybe undertaken for several reasons such as simplification of group holding structure, consolidation of business, unlocking business value, externalising the holding structure, reduction in effective tax rate of the group, restructuring the debt and shifting of intangibles.

Historically, mergers and share purchases were the standard mode of effecting M&A transactions, but as businesses evolved and regulatory restrictions emboldened, new and innovative ways of structuring cross-border deals have been rampant such as use of put and call options, use of convertible or hybrid instruments and use of transaction structures like slump exchange and debt push-down.

A variety of legal complexities related to M&A transactions need to be addressed while undertaking any M&A transaction. Thus in addition to understanding and agreeing upon the transaction's financial components, the resultant legal, regulatory, and tax issues must also be understood and agreed upon by the parties. This becomes even more eminent for cross-border transactions, which typically include multiple jurisdictions. It is important to thoroughly review the tax and other regulatory features of each jurisdiction involved in order to effectuate a transaction within the parameters of the law.

In an Indian context, the laws which will need to be considered in a cross-border M&A transaction are:

- Companies Act, 2013 and rules thereunder;
- Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder;
- Income-tax Act, 1961, rules made thereunder and relevant tax treaties;
- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015; SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 if the Indian company is listed on any stock exchange
- Other laws such as stamp duty, prior permission if any required from Competition Commission of India, etc

CROSS BORDER MERGER

Regulatory provisions

The Indian regulatory landscape is coming of age to appreciate and facilitate the unlocking of potential of Indian entrepreneurship. Section 394 of the erstwhile Companies Act, 1956 permitted the merger of a foreign company with an Indian company (i.e. Inbound merger); however, no specific guidelines were issued by the Reserve Bank of India (RBI) in this regard. Further, outbound mergers (i.e. merger of Indian company with foreign company) were not permitted within purview of the statutory framework. However, in 2017, the Ministry of Corporate Affairs and the RBI introduced a framework for enabling cross border M&A within the regulatory framework through enactment of section 234 in the Companies Act, 2013 (Companies Act) read with Rule 25A to permit the inbound-

3. https://www.ibef.org/economy/foreign-direct-investment

outbound mergers. Pursuant to above, on 20 March 2018, the RBI notified the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 (CBM Regulations).

Section 234 of the Companies Act read with the Rules permit the merger of a foreign company with an Indian company and the merger of an Indian company with a foreign company incorporated in specified jurisdictions after obtaining prior approval of the RBI and in compliance with the provisions of sections 230 to 232 of the Companies Act (requirements applicable to domestic merger). This will include procedural requirements such as filing an application before the jurisdictional National Company Law Tribunal (NCLT), conducting meetings of shareholders/creditors, notification to income-tax authorities, other sectoral regulators and publication of advertisement in respect of the merger. Section 234 amongst other terms and conditions for the scheme of merger also provides, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts. The transferee company/surviving entity is required to ensure valuation by a valuer who is a member of a recognized professional body in its jurisdiction and in accordance with internationally accepted principles on accounting and valuation. In this regard, a declaration is required to be submitted by the transferee company along with the application to the RBI for obtaining its approval for the merger.

The CBM Regulations lay down conditions for cross-border mergers from an exchange control law perspective. Cross-border merger has been defined to mean any merger, amalgamation or arrangement between an Indian company and foreign company in accordance with the Rules notified under the Companies Act. It includes both inbound and outbound merger. Inbound merger means a cross-border merger where the resultant company is an Indian company. Outbound merger means a cross-border merger where the resultant company is a foreign company.

The CBM Regulations provide for 'deemed approval of RBI' wherein any cross-border merger undertaken in accordance with the conditions specified are adhered to and no separate approval is required under the Companies Act. In this regard, the following conditions for deemed RBI approval are notable:

- In case of Inbound Mergers, the issuance or transfer of Indian/resultant company's securities to a person resident outside India must be in consonance with the conditions in the Foreign Direct Investment (FDI) Regulations
- In case of Inbound Mergers, the guarantees or borrowings from outside sources inherited by a resultant Indian company must conform to the external commercial borrowing (ECB) norms or trade credit norms, as the case may be, laid down under regulations under the Foreign Exchange Management Act, 2000, (FEMA) within two years of such merger
- In case of Outbound Mergers, the acquisition/holding of securities in foreign/resultant company by an Indian resident must be in consonance with the Foreign Exchange Management (Transfer or issue of Foreign Security) Regulations, 2000 or the provisions of the Liberalized Remittance Scheme, as applicable
- In case of Outbound Mergers, the guarantees or borrowings of the Indian

company which become the liabilities of the resultant company foreign shall be repaid as per the scheme sanctioned by the NCLT in terms of the Rules;

- Assets which are not permitted to be held by the resultant company (Indian or foreign) under India's foreign exchange regulations, as a consequence of the merger, must be disposed of within two years of the sanction of the scheme of amalgamation by the NCLT and the proceeds must be repatriated to India or outside India, as applicable, immediately;

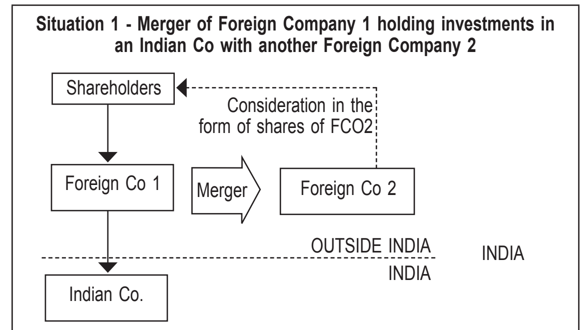
- An office in India of the Indian/ transferor company, in the case of an Outbound Merger, and an office outside India of the foreign/transferor company, in case of an Inbound Merger, shall be deemed to be a branch office (i) of a foreign company, inside India, and (ii) of an Indian company, outside India, respectively and must satisfy applicable respective regulations under FEMA.

- The resultant company may open a bank account in foreign currency in the overseas jurisdiction for transactions incidental to the cross-border merger for a maximum period of two years from the date of sanction of the Scheme.

Tax provisions

To understand the tax implications that could arise in the context of cross border merger, a few typical forms of cross border merger are discussed below.

Situation 1 - Merger of Foreign Company 1 holding investments in an Indian Co with another Foreign Company



Tax implications

- As per section 47(via) of the Income-tax Act, 1961 (Act) transfer of shares of India Co. to Foreign Co 2 pursuant to the merger of Foreign Co 1 with Foreign Co 2 will not be subject to capital gains tax under the following circumstances:

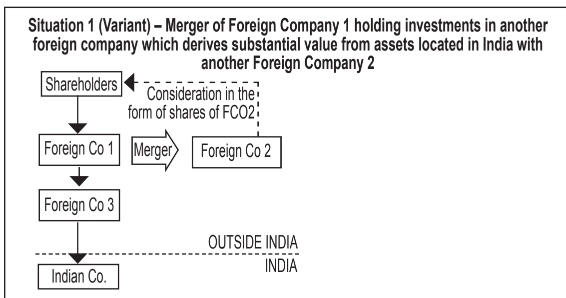
    - o At least 25 percent of Foreign Co 1's shareholders are shareholders of Foreign Co 2.

    - o Such a transfer does not attract capital gains tax in the country where Foreign Co 1 is located.

- Section 56(2)(x) of the Act provides for taxation in the hands of the recipient on receipt of property for inadequate or Nil consideration. This section would also not be applicable on receipt of investments in Indian Co by the Foreign Co 2, given the specific exclusion provided in the said section for mergers which are not regarded as transfer under section 47(via) of the Act.

- No tax neutrality is provided in the hands of the shareholders of the Foreign Co 1. Accordingly, pursuant to merger where the shareholder extinguishes its rights in the shares of Foreign Co 1, and if the Foreign Co 1 derives substantial value from assets located in India, (as provided under section 9) then the resultant capital gains will be taxable in the hands of the shareholder. One could check for relief if any available under applicable tax treaty with India.

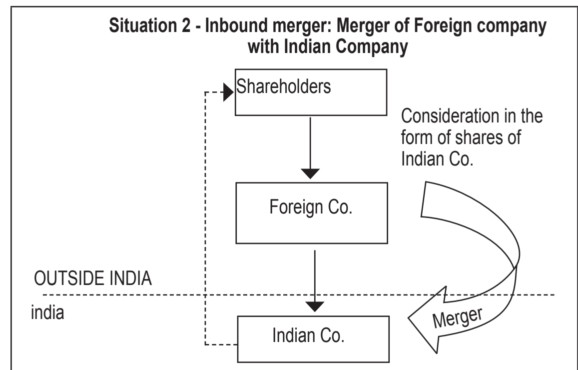
Situation 1 (variant): Merger of one foreign company (F Co 1) into another foreign company (F Co 2) which derives substantial value from assets located in India



Tax implications

- In this situation an indirect transfer as envisaged under section 9 of the Act is triggered both in the hands of the foreign amalgamating company (i.e. F Co 1) and in the hands of the shareholders of F Co 1.
- The tax implications under this variant are similar as Situation 1. Tax neutrality is provided by section 47(viab) of the Act to the amalgamating foreign company (i.e. F Co 1) in respect of the indirect transfer of shares of Indian Co pursuant to amalgamation of F Co. 1 with F Co 1 subject to fulfilment of following conditions:
    - o At least 25 percent of F Co 1's shareholders are shareholders of F Co 2;
    - o Such a transfer does not attract capital gains tax in the country where F Co. 1 is located.
- No specific exclusion has been provided under section 56(2)(x) of the Act in the hands of the amalgamated foreign company (F Co 2) on receipt of shares of F Co 3 which derives substantial value from Indian assets. However, one could argue that given F Co 2 will issue its shares to the shareholders of F Co 1 as consideration for merger, it has not received assets for inadequate consideration.
- No tax neutrality is provided in the hands of the shareholders of F Co 1. Accordingly, pursuant to merger where the shareholder extinguishes its rights in the shares of F Co 1, and if F Co 1 derives substantial value from assets located in India (as provided under section 9) then the resultant capital gains will be taxable in the hands of the shareholder. One could check for relief if any available under applicable tax treaty with India.

Situation 2: Merger of Foreign company into Indian company



Tax implications

- Section 47(vi) of the Act provides for capital gain exemption on transfer of capital assets by the amalgamating company (Foreign Co) to the amalgamated company (Indian Co), if the amalgamated company is an Indian company.

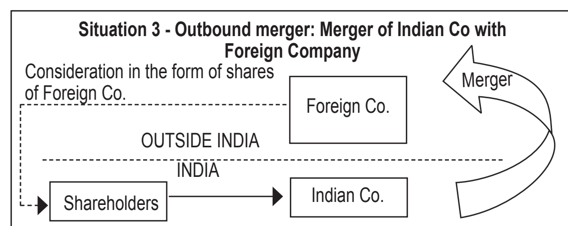
- Similarly, section 47(vii) of the Act provides for capital gain exemption in the hands of the shareholders for transfer of shares of the amalgamating company (Foreign Co), provided the transfer is made in consideration of allotment of shares in the amalgamated company (Indian Co) being an Indian company.

  - o However, in this context it will be worthwhile to note that while the Companies Act provides a flexibility of discharging consideration by way of cash or depository receipts to the shareholders, the Act needs to be realigned to provide exemption to shareholders where the consideration is in the form of cash. Depository receipts could arguably be considered as shares and thus the shareholders may be able to seek exemption where the consideration is discharged by the amalgamated company in the form of issue of its depository receipts.

- Rigours of section 56(2)(x) would not be applicable on receipt of assets of Foreign Co by Indian Co, given the specific exclusion provided in the said section for mergers which are not regarded as transfer under section 47(vi) of the Act.

- Effective April 1, 2023 where the value of the undertaking or assets received by the Indian Co from the foreign company is more than the fair value of shares issued by the Indian Co as discharge of consideration, there could be tax implications in the hands of the Indian company under section 56(2)(viib) of the Act.

Situation 3 - Outbound merger involving merger of Indian company with the foreign company



Tax implications

- No tax neutrality is provided in the Act for outbound merger. Thus there could be capital gains implication in the hands of the shareholders of the amalgamating company (Indian Co) on receipt of shares of Foreign Co in exchange of its shareholding in the Indian company. Similarly, there could be tax implications in the hands of the Foreign Company on receipt of assets of Indian company under the head capital gains and/or income from other sources.

- The Indian amalgamating company may be able to defend taxability by relying on following arguments:

  - o Pursuant to merger the Indian company would be wound up without liquidation. Accordingly, there would be no realization of assets or distribution of assets by Indian Co in favour of its shareholders.

- o By placing reliance on Circular No. 5P dated 9 October 1967, one can argue that the Indian company effects no distribution of dividend.
- o The Indian company would not be entitled to receive any consideration for transfer of its assets and liabilities to the foreign company. Accordingly, the Indian company should not trigger any capital gains tax liability including in terms of Section 50D of the Act.

Unless the provisions for granting a tax-neutrality for an outbound merger are introduced in the Act, the resultant capital gains tax will in itself be a huge deterrent for Foreign Companies to even consider such a cross border merger.

CROSS BORDER DEMERGER

Regulatory provisions

Section 234 of the Companies Act refers only to cross border mergers and amalgamations and it does not specifically refer to demergers or any other arrangements. Accordingly, permissibility of cross border demerger is a conundrum, existing since the notification of the said section. In this regard, the divergent view taken by the Ahmedabad NCLT while dealing with inbound and outbound demerger in the case of Sun Pharmaceutical Industries Limited (Sun Pharma) is notable.

In 2018[4], Sun Pharma made an application to the Tribunal for the sanction of the demerger of an undertaking of one of its group entities in the United Arab Emirates in itself i.e. an inbound demerger into the parent listed company. The NCLT approved the Scheme in favour of the Petitioner contending that Section 234 of the Companies Act, 2013 squarely covers within its ambit demergers too.

Then in 2019[5], subsequently after sanction of the inbound demerger, Sun Pharma made an application for sanction of an outbound demerger. As a part of its group restructuring plan, Sun Pharma was to demerge two of its investment undertakings into its Dutch and American holding companies. However, this time, the NCLT took a contrary view and refrained from granting its approval to the arrangement. The NCLT while rejecting the scheme of demerger stated as below:

"Therefore, it may be noted that although the doors have now been opened for Indian companies for outbound mergers, the law is still silent on cross border demergers. While it was possible for a foreign company to transfer its undertaking/business to an Indian company under the 1956 Act, as Section 394 applied to demergers as well as mergers, Section 234 of the Act only refers to "mergers and amalgamations" without any express mention of demergers"

Unlike inbound demergers, the provisions akin to those under FDI Regulations have not been prescribed under the Overseas Direct Investment Guidelines of the RBI. Non-existence of concurrent enabling provisions under the ODI Guidelines further supports the proposition of the NCLT. However, the NCLT has unleashed a Pandora's box by completely restricting outbound demergers. Clarity on

4. CP(CAA) 90/230-232/2018 in CA(CAA) No. 18/NCLT/AHM/2018
5. CP(CAA) No. 79 of 2019 in CA(CAA) No. 338/AHM/NCLT/2019

this matter can only be provided by further exposition to interpretation of the provisions by Tribunals and Courts.

Tax provisions

The tax provisions applicable in case of cross border demerger are similar to situations discussed under cross border mergers. However, given the lack of clarity of permissibility of undertaking cross border demergers, the same have not been discussed.

Other Key issues arising on account of Inbound Merger

- Section 72A of the Act provides for carry forward and set off of accumulated loss in certain cases of amalgamation for companies which fall within the ambit of 'Industrial undertaking'. Currently, there is no mechanism under the Act to subsume the foreign tax losses of the foreign amalgamating company post-merger with the resulting Indian amalgamated company.

- As discussed under the regulatory provisions, the office of the foreign company outside India shall be deemed to be the branch/office of the Indian Company. Thus where an overseas manufacturing company is merged with an Indian company, the factories of the overseas manufacturing company would deem to become the branch or office of the Indian company outside India. Assuming that post-merger, the manufacturing activities are intended to continue, this will lead to establishing a place of business outside India which could have Permanent Establishment (PE) implications for the Indian company in the foreign country. Further the ongoing commercial liabilities and employees' contracts, would form part of the branch liabilities and expose the Indian Holding Company directly to such a commercial reality. Given these consequences, it is unlikely that Indian companies will choose to amalgamate its WOS/JV engaged in manufacturing activities with its Indian Holding Company.

- On merger of an operating overseas company into Indian company, its employees will shift to the payrolls of the amalgamated Indian company and accordingly, the Indian company will be responsible for bearing the employee costs and other social security aspects. Since post-merger the business operations subsist, the employees and the overseas branch will form a place of business outside India and will constitute a PE.

- Pursuant to an inbound merger, the loans taken by the overseas company will need to be taken over by the Indian amalgamated company. These overseas loans if not in compliance with ECB guidelines would need to be repaid by the Indian company within the transition period of two years.

Other Key issues arising on account of Outbound Merger

- Post an outbound merger, the office of the Indian amalgamating company shall be deemed to be the Branch office of the Foreign Amalgamated Company. Under FEMA regulations a branch of a Foreign Company is permitted to undertake only specified activities which does not include manufacturing activities. Accordingly, in case the Indian amalgamating company is engaged in manufacturing activities pre-merger, the resultant branch will not be permitted

to continue such activities post-merger. Further the ongoing commercial liabilities and employees' contracts, would forming part of the branch liabilities will become the liabilities of the Foreign Company. The resultant Branch may not be permitted to service such liabilities directly. Due to such reasons, it is unlikely that a Foreign Company will choose to amalgamate its manufacturing arms/units in India.

- The PE risk as discussed above in the context of inbound merger would equally be applicable in the context of outbound merger. Since the business of the Indian amalgamating company would continue through the branch office, such place of business in India would have a potential exposure of it being considered as Fixed Place PE of the Foreign amalgamated company. In such cases, the profits attributable on account of Indian operations to the Indian branch of the Foreign Company, may be taxable at a higher rate of 40% (plus surcharge and cess).

- Similarly on merger of an operating Indian company into overseas company, the employees of the Indian company will need to be shifted to the payrolls of the amalgamated foreign company. Such employees may face taxation not only in India but also in the jurisdiction of the Foreign Company, thereby leading to double taxation (subject to availability of foreign tax credit) on the salaries and emoluments earned. The overseas amalgamated company being the employer of Indian resident employees would also be liable to deduct and pay the taxes withheld on any salary payments as also comply with other employee specific obligations such as contribution to Provident fund, Gratuity fund, etc.

Due to the aforementioned problems, it appears that inbound or outbound mergers would be feasible only where the amalgamating company is a holding company having limited assets or has a very small-scale setup in the commerce or service sectors. In other situations, it appears exceedingly improbable.

Interplay of General Anti-Avoidance Rules (GAAR) and Scheme of Cross border mergers/ demergers

As with any tax planning measure, the applicability of GAAR as enshrined under the Act is equally pertinent to a Scheme of cross border merger/demerger, especially where the main purpose of undertaking the arrangement was to obtain a tax benefit. For instance, merger of an overseas foreign company holding surplus cash into Indian company could be driven with the main object to facilitate cash repatriation into India in a tax neutral manner. Such a scheme of inbound merger may attract GAAR implications.

Two pertinent questions arise in this case:

(1) Whether a Scheme can be rejected by the NCLT on grounds of applicability of GAAR?

(2) Whether a Scheme passed by the NCLT can be subject to GAAR?

According to the Companies Act, all transactions in India including compromises and agreements need approval of NCLT. As part of the NCLT approval process a copy of the notice of the Scheme is required to be given to the income-tax authorities in accordance with section 230(5) of the Companies Act, and the NCLT must consider

any comments received before sanctioning the Scheme.

With respect to the question whether a Scheme can be rejected by the NCLT on grounds of applicability of GAAR, the following decisions are notable:

The Mumbai bench of the NCLT rejected a scheme of amalgamation between Ajanta Pharma Limited and Gabs Investment Private Limited [CSP Nos. 995, 996 of 2017 in CSA Nos. 791 and 792 of 2017] on the ground that the scheme was designed purely for the avoidance of tax and was not in public interest.

Contrary to the aforesaid ruling is the Delhi NCLT's ruling, in the case of PIPL Business Advisors & Ors. with NIIT Technologies Limited [Company Petition No.CAA-385(ND)/2017]. Herein the income-tax department very avidly raised arguments against the Scheme that *"The intention of the applicant companies is not simplification of the shareholding structure as claimed by it but to avoid income tax liability as on date and in future as well, and the companies cannot be allowed to use dubious means for tax evasion and that a duty is cast upon the income tax department to lift the corporate veil to identify the true transaction"*. The Delhi Bench sanctioned the Scheme on the grounds that the income-tax department failed to convincingly demonstrate tax evasion as alleged in the representations made. However, it should be noted that while granting sanction to the Scheme, the NCLT protected the right of the income-tax department to initiate subsequent proceedings by holding that "the Department is entitled to take out appropriate proceedings for recovery of any statutorily dues from the transferor or transferee or any other person who is liable for payment of such tax dues the said protection be afforded is granted".

Another notable ruling is the recent NCLT Chandigarh bench's ruling in the case of Panasonic India Private Limited and Panasonic Life Solutions India Private Limited in [CP (CAA) NO.8/CHD/HRY/2021]. In this case, the Income-tax department had objected to amalgamation of transferor company having carried forward losses of Rs. 364 Crore with the transferee company on grounds of potential loss of revenue. The NCLT, Chandigarh while approving the scheme of amalgamation made the following observation:

"7.15 We emphasize that the treatment of carrying forward and set off of accumulated loss and unabsorbed depreciation allowance in amalgamation or demerger etc. of companies are clearly spelt out under Section 72A of the Income Tax Act, 1961 read with Rule 9(C) of the Rules. Further conditions regarding carrying forward and set off losses in cases of certain companies are equally clearly spelt out in Section 79 of the Income Tax Act, 1961. These provisions, in our opinion, are sufficient to protect the interest of revenue in any case of amalgamation or demerger etc. Even if a proposal of a Scheme of Amalgamation has been approved by the Adjudicating Authority, it is clarified that no provision of such a Scheme can override the existing provisions of the Income Tax Act. In any case, the above issues will come up for the consideration of the Assessing Officer at the time of assessment of the petitioner companies, and the Department can analyze the Scheme and is entitled to take any decision as per the provisions of the Income Tax Act on any issues including those discussed above. The Transferee Company has already submitted an undertaking in the form of an affidavit that it would extend its complete

> *cooperation to the income tax authorities in any proceedings that exist/may arise post the sanction of the Scheme of Amalgamation by this Adjudicating Authority.* ***As regards the provision of GAAR, the Income Tax Department is at liberty to invoke the provisions if the Assessing Officer during the course of assessment or reassessment proceedings, believes that GAAR should be invoked but the case will have to be referred to the Principal Commissioner or Commissioner of Income Tax, who in turn has to refer the matter to an Approving Panel in accordance with the provisions of Section 144BA of the Act.***

As regards the second question whether a Scheme passed by the NCLT can be subject to GAAR, reference can be drawn to the Circular No. 7 of 2017 dated 27th January, 2017 issued by the Central Board of Direct Taxes wherein vide Question 8 it has been clarified as follows:

"Question no. 8: Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial precedents etc.?

Answer: Where the Court has explicitly and adequately considered the tax implications while sanctioning an arrangement, GAAR will not apply to such arrangement."

These decisions of the NCLT read with the CBDT Circular provide significant relief to the industry, particularly in cases where the Scheme is proposed for legitimate and bonafide commercial reasons and not undertaken with the main purpose of obtaining a tax benefit. Having said that the taxpayer must be prepared to defend applicability of GAAR during the assessment stage especially where the NCLT has not deliberately dealt with it while sanctioning the Scheme. From practical experience, the NCLT rarely questions the commercial wisdom of the parties or the tax evasions, if any, being undertaken under the garb of the Scheme. These tax issues are left to be dealt with by the income-tax department during the stage of assessment.

Conclusion

Tax and the surrounding regulatory provisions have long been key factors governing and guiding the shape of India-focused M&A. India has come a long way in opening up the legislative and tax environment for cross border M&A transactions, yet several finer aspects need to be addressed for their effective and smooth implementation.

"When you step beyond thought and intellect and all reasoning, then you have made the first step towards God; and that is the beginning of life."

— *Swami Vivekananda*

CS Akanksha Mota

Overview of NCLT process for Merger and Demerger – Scope of Dispensation of Meetings/Consents from Shareholders and Creditors

Introduction

In this era of globalization, competition and an interconnected world, we observe significant business decisions being taken by corporate houses to grow big and gain a competitive advantage over others. When a company decides to boost its corporate performance and dominate the market sector in which it conducts its business, the thought of merging or acquiring a company that benefits both corporations can be extraordinarily pleasing.

A 'Merger' is a combination of two or more entities into one; a merger essentially means an arrangement whereby one or more existing companies merge their identity into another to form a new and a different entity which may or may not be one of those existing entities. Mergers and acquisitions are used as instruments of momentous growth and are increasingly getting accepted by Indian businesses as a critical tool of business strategy.

Merger and demerger are like two sides of the same coin. The word 'Demerger' denotes the act of disjoining a part or a unit of a company to incorporate a brand-new company completely separate from the original company. A demerger aims at a more specific and smoother functioning of the units. The new company may not necessarily be a subsidiary of the parent company after the split. In other words, a demerger is a corporate partition of a company into smaller undertakings, where one separated undertaking is retained by the parent company while others are either acquired by others, work independently, are liquidated, or are sold.

Some of the high-value mergers that have occurred during recent years are PVR and INOX, the merger of HDFC Ltd and HDFC Bank, proposed merger of Air India with Vistara. There have been several popular demergers in India, a few of them being demerger of Vedanta Limited, Piramal Enterprises, Dhampur Sugar Mills, ICICI Lombard General Insurance Company Limited, etc.

The Regulatory framework of mergers, arrangements or compromise covers:

1. The Companies Act, 2013, Companies (Compromise, Arrangements and Amalgamations) Rules, 2016

2. National Company Law Tribunal Rules, 2016.
3. Income Tax Act, 1961
4. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
5. Competition Act, 2002
6. Indian Stamp Act, 1899

Sections 230-234 of the Companies Act, 2013 deal with merger provisions, which outline the schemes of arrangement or compromise between a company, its shareholders, and/or its creditors. The Companies (Compromises, Arrangements, and Amalgamations) Rules 2016 read with National Company Law Tribunal Rules, 2016 provide for the manner and the documents to be submitted by the company at the time of making the application and during the process of proceedings for a merger.

In pursuance of promoting ease of business in India, the Companies Act, 2013 has provided exemption from NCLT approval for the merger/amalgamation between small companies or holding company and its wholly owned subsidiary company or such other class or classes of companies, as may be prescribed in Section 233 of the Act. However, in this Article, we will have an overview of the NCLT process for merger and demerger and also the scope of the dispensation of meetings of shareholders and creditors.

Procedure for Merger/Demerger through NCLT is detailed as under:

1. Memorandum of association to authorise merger/demerger:

The Memorandum of Association of most of the companies contains provisions in their objects clause, authorising amalgamation, merger, demerger, absorption, take-over and other similar strategies of corporate restructuring. If the memorandum of a company does not have such a provision in its objects clause, the company should alter the objects clause, for which the company is required to hold a general meeting of its shareholders, pass a special resolution and file along with a certified copy of the special resolution along with a copy of the explanatory statement and Memorandum of Association & Articles of Association and a copy of the agreement with the concerned Registrar of Companies and the prescribed filing fee. However, Courts under the Companies Act 1956 held even in absence of the explicit provisions in the memorandum of a Company, Courts have the power to sanction a scheme [Refer *Maneckchowk & Ahmedabad Mfg. Co. Ltd., In re [1970] 40 Comp. Cas. 819 (Guj.), PMP Auto Industries Ltd., In re, S.S. Miranda Ltd., In re, Morarjee Goculdas Spg. & Wvg. Co. Ltd., In re [1994] 80 Comp. Cas. 289 (Bom.), In re Liqui Box India (P.) Ltd. [2006] 131 COMP CASE 645 (Punjab & Haryana)*]. However, in order to avoid litigation it is advisable to have provisions.

2. Drafting scheme of merger/demerger:

Drafting of a scheme is the most critical part of the merger process. The company shall prepare a draft scheme which will act as a binding agreement between the Transferor Company and the Transferee Company. Any model scheme of amalgamation should include the following:

- Appointed Date or Transfer Date: This is usually the first day of the financial year preceding the financial year for which audited accounts are available with the companies. In other words, this is a cut-off date from which all the movable and immovable properties including all rights, powers, privileges of every kind, nature and description

of the transferor-company shall be transferred or deemed to be transferred without any further act, deed or thing to the transferee company. However, considering the situation appointed date can also be any date other than April 1. However, if the 'appointed date' is significantly ante-dated beyond a year from the date of filing, the justification for the same would have to be specifically brought out in the scheme and it should not be against public interest - MCA General Circular No. 09/2019.

- Effective Date: This is the date on which the transfer and vesting of the undertaking of the transferor company shall take effect i.e., all the requisite approvals would have been obtained, i.e., the date of filing of NCLT order with ROC.
- Arrangement with secured and unsecured creditors including debenture-holders.
- Arrangement with shareholders (equity and preference): This refers to the exchange ratio, which will have to be worked out based on the valuation of shares of the respective companies as per the audited accounts and accepted methods and valuation guidelines.
- Cancellation of share capital/reduction of share capital: This will be necessitated when the shares of the transferor-company(ies) are held by the transferee-company and/or its subsidiary(ies) or vice versa. Pending receipt of the requisite approvals to the amalgamation, the transferor-company(ies) possesses the property to be transferred and to carry on the business for and on behalf and in trust for the transferee-company.

The Scheme should suitably provide for:

1. Brief details of transferor and transferee companies.
2. Appointed date.
3. Main terms of transfer of assets and liabilities from the transferor to the transferee, with power to execute on behalf or for the transferee, the deed/ documents being given to the transferee.
4. Effective date of the scheme.
5. Details of happenings and consequences of the scheme coming into effect on the effective date.
6. The terms of carrying on the business activities by the transferor between the 'appointed date' and the 'effective date'.
7. Details of the share capital of the transferor and transferee company.
8. Proposed share exchange ratio, conditions attached thereto, fractional certificates to be issued to transferee company, approvals and consent required etc.
9. Conditions about payment of dividends, ranking of equity shares, prorata dividend declaration and distribution.
10. Status of employees of transferor companies and various schemes or funds created for their benefit, from the effective date.
11. Agreement between transferor and transferee companies towards making applications/petitions under Sections 230 to 232 (Companies Act 1956 - under section 391 and 394 and other provisions to the respective High Courts.)

12. Impact of various provisions covering income tax dues, contingencies and other accounting entries deserving attention.

13. Statement to bear costs, expenses etc. in connection with the scheme by the transferee company.

14. Qualifications attached to the Scheme, requiring various approvals and sanctions etc.

15. Enhancement of borrowing limits of the transferee company upon the scheme coming into effect.

16. Surrender of shares by the shareholder of the transferor company for exchange into new share certificates.

3. Convening a Board Meeting

A Board Meeting is to be convened and held to consider and approve in principle, merger/demerger. First, the notice for a meeting to discuss the merger needs to be sent at least 7 days before the date of the meeting as per section 173(3) of the Companies Act, 2013. Once the board meeting of both the transferor and transferee company is held, it is eminent for a resolution consenting to the merger to be passed. After this is done, the draft of the scheme will be considered for approval. Besides approving the merger, the resolution should also authorize a director/ Company secretary to make an application to the Tribunal. This step will also involve the appointment of an independent registered valuer for valuing the shares to determine the share exchange ratio.

4. Filing of an Application

The company shall apply for a merger/ demerger through NCLT by submitting an application in Form No. NCLT-1 along with prescribed fees. The Application shall be accompanied by the necessary documents which includes:

1. Notice of Admission in Form No. NCLT-2

2. Affidavit in Form No. NCLT-6

3. Copy of Scheme of Merger/demerger.

4. NOCs from both creditors and shareholders (seeking dispensing of meetings of shareholders and creditors, by way of affidavit)

5. A certificate from the Auditor of the Company to the effect that the accounting treatment in the Scheme of Merger is in conformity with the accounting standards prescribed under Section 133.

Hon'ble High Court observed that having regard to the relevant clauses of the proposed scheme and particularly the provision whereby no new shares are sought to be issued to the members of the transferor-company by the transferee-company, the scheme will not affect the members of the transferee-company. The creditors of the transferee-company are not likely to be affected by the scheme given the financial position of the transferee-company. In the affidavit in support of the company application, the financial position of the transferor and transferee-companies have been set out and which would show that the transferor-company and the transferee-companies have an excess of assets over liabilities. Accordingly, it was held that the filing of a separate petition for sanction by transferee-company was unnecessary - Mahaamba Investments Ltd. v. IDI Ltd. [2001] 44 CLA 152 (Bombay)

5. Submission of Declaration with Form

Section 230 (1) of the act states that certain

disclosures shall be made while submitting the affidavit in Form no. NCLT-6 which shall include:

1. Latest financial statements
2. Last auditor's report
3. Information regarding the pendency of any proceedings or investigation
4. Information on the reduction of capital
5. Scheme of corporate debt restructuring consented by not less than 75% of the secured creditors.

6. Calling of Meeting by the Tribunal

According to Rule 5 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016., upon hearing the application under sub-section (1) of section 230 of the Act, the Tribunal shall give directions as it may think necessary in respect of the following matters:

1. determining the members/creditors whose meeting or meetings have to be held for considering the proposed scheme of merger or amalgamation;
2. fixing time and place for such meetings;
3. appointing a chairman or chairmen for the meetings;
4. fixing quorum and procedure to be followed at the meetings including voting by proxy;
5. determining the values of the members/ creditors, whose meetings have to be held;
6. notice to be given of the meetings and the advertisement of such notice; and
7. the time within which the chairman of the meeting or chairmen of the meetings are to report to the Court the result of the meeting or meetings as the case may be.
8. Such other matters as the Tribunal may deem necessary.

7. Advertisement of Notice

Generally, the Tribunal directs that the notice of meeting of the creditors and members or any class of them be given through newspapers advertisements also. Where the Tribunal has directed that the notice of the meetings should also be given by newspaper advertisements, such notices are required to be given in the prescribed Form and published in an English newspaper and in the regional language of the state in which the registered office of the company is situated. Moreover, the notice of the meeting shall be placed on the website of company in at least 30 days before the meeting date.

8. Affidavit of Service by Chairperson

The chairperson appointed for the meeting of the company or other person directed to issue the advertisement and the notices of the meeting shall file an affidavit before the Tribunal not less than seven days before the date fixed for the meeting or date of the first of the meetings, as the case may be, stating that the directions regarding the issue of notices and the advertisement have been duly complied with.

9. Convening the meeting

At the General Meeting convened by the Tribunal, a resolution will be passed approving the scheme of amalgamation with such modification as may be proposed and agreed to at the meeting.

The following points of difference relating to the holding and conducting of the meeting convened by the Tribunal may be noted:

1. Proxies are counted for the purpose of quorum;
2. Proxies are allowed to speak;
3. The vote must be put on poll [Rule 13 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016].

In terms of Section 230(1), the resolution relating to the approval of amalgamation has to be approved by a majority of members representing three-fourths in value of the creditors or class of creditors or members or class of members as the case may be present and voting either in person or by proxy. The resolution will be passed only if both the criteria namely, majority in number and three fourth in value vote for the resolution. The minutes of the meeting should be finalised in consultation with the Chairman of the meeting and should be signed by him once it is finalised and approved.

10. Reporting of the results by the Chairman

The chairman of the meeting will submit a report of the meeting indicating the results to the concerned Tribunal in Form No. CAA-4 of the said Rules within the time fixed by the Tribunal, or where no time has been fixed, within three days after the conclusion of the meeting. The Report must state accurately:

1. the number of creditors or class of creditors or the number of members or class of members, as the case may be, who were present at the meeting;
2. the number of creditors or class of creditors or the number of members or class of members, as the case may be, who voted at the meeting either in person or by proxy;
3. their individual values; and
4. the way they voted.

11. Petition for confirming compromise or arrangement

Where the proposed compromise or arrangement is agreed to by the members or creditors or both as the case maybe with or without modification, the company (or its liquidator), shall, within seven days of the filing of the report by the chairperson, present a petition to the tribunal in Form No.CAA.5 for sanction of the scheme of compromise or arrangement. Where the company fails to present the petition for confirmation of the compromise or arrangement as aforesaid, it shall be open to any creditor or member as the case may be, with the leave of the tribunal, to present the petition and the company shall be liable for the cost thereof.

12. Date and Notice of Hearing

On hearing the petition, the Tribunal shall fix a date for the hearing of petition, and notice of the hearing shall be advertised in the same newspaper in which the notice of the meeting was advertised, or in such other newspaper as the Tribunal may direct, not less than ten days before the date fixed for the hearing. The Tribunal also directs that notices of petition be sent to the objectors or to their representatives under sub-section (4) of section 230 of the Act and to the Central Government and other authorities who have made representation under rule 8 and have desired to be heard in their representation.

13. Sanction of the Scheme

After examining all the documents, the tribunal may sanction the merger scheme by order in Form No. CAA 6 and may also further order for the modifications of the scheme, if required.

14. Filing of order with ROC

In the final stage of the procedure of merger through NCLT, according to the provisions of Section 230(8) of the Companies Act, a certified copy of the order passed by the NCLT is required to be filed in form INC-28 with the concerned Registrar of Companies within 30 days from the date of receipt of the order.

Copies of the order of the Tribunal are required to be affixed to all copies of the Memorandum and Articles of Association of the transferee company issued after the certified copy has been filed as aforesaid.

The above sets out briefly the procedure relating to merger and amalgamation in India. It will be obvious from the foregoing that a considerable amount of paperwork and documents are required to be prepared during the course of the process of the merger. Since the law requires approval of the shareholders both in the majority in number and three-fourth in value, it has to be ensured that an adequate number of shareholders, whether in person or by proxy attend the meeting so that the resolution can be passed by the requisite majority as mentioned above. Normally the time frame for such a merger will depend on the opposition, if any, to the proposed merger from shareholders or creditors but in normal cases, it may take anything between six months to one year to complete the merger from the time the Board approves the scheme of amalgamation till the merger becomes effective on the filing of the certified copies of the Court's Order.

The time required for the whole merger proceedings can be reduced considerably when a dispensation is granted from convening the meeting of the shareholders and creditors. If 90% by value of creditors/members agree by way of affidavit then a meeting of creditors/ members can be dispensed with by the approval of NCLT.

However, there has been a lot of unclarity regarding NCLT's jurisdiction to grant dispensation of the meetings of shareholders and creditors in an arrangement or amalgamation, especially in a scenario where the 'majority' of the aforementioned stakeholders have given their written consent to such dispensation. This was due to the conflicting decisions rendered by different benches of NCLT. There was no 'settled' position of law that 'consent' can be a vital factor for the dispensation of meetings. The origins of this confusion can be traced back to the erstwhile Companies Act of 1956 and the accompanying Company (Court) Rules, 1959 which did not have any particular provision that empowered the judicial authority to dispense with the meetings for considering the scheme of arrangement. In the past, High Courts have usually dispensed with the meetings of shareholders and creditors in cases where a majority of members had granted their consent in writing.

There have been conflicting decisions rendered by different benches of the NCLT on this specific issue. While some benches had dispensed with shareholder and creditor meetings in situations where consent affidavits were submitted, other benches disagreed with this position of law and have held the opposite, thereby denying themselves the jurisdiction to dispense with such meetings even in a scenario where 100% written consents were obtained from the concerned members and creditors.

Provisions of Law regarding the dispensation of a meeting of creditors

Section 230(9) of the Companies Act, 2013 provides for provision for dispensation of

meetings as it states that the NCLT in its discretion may dispense the meeting of creditors or any class of creditors when the creditors or any class of them having 90% of value agree and confirm to the scheme of compromise or arrangement by way of an affidavit. Additionally, Rule 5 of Companies (Compromises, Arrangements and Amalgamation) Rules, 2016 states that NCLT after hearing the application under section 230(1) of the Companies Act, 2013 may dismiss such application if it thinks fit or give directions in respect to determining the class or classes of shareholders or members whose meetings have to be held for approval of the proposed scheme; or dispensing the meeting of classes or class of creditors referred in subsection 9 of section 230 of the Companies Act, 2013.

The following are the landmark cases which deal with the ambiguity of the authority of NCLT on the dispensation of meetings:

1. **In re, JVA Trading Private Limited [2017] 77 taxmann.com 210 (NCLT - New Delhi)**

Facts

JVA Trading Private Limited (Transferor Company) and C & S Electric Limited (Transferee Company) filed a joint application under section 230 to 232 of the Companies Act, 2013 read with CAA Rules before the NCLT Principal Bench, New Delhi in connection to the proposed scheme of amalgamation between both the companies. The Transferor company had only 4 shareholders and all of them had given their 100% consent to the proposed scheme of amalgamation. Whereas, the Transferee had unsecured creditors to whom the company owed Rs 2,00,000 and they constituted less than 3% in value of the amount owed to unsecured creditors. The representation was made before the NCLT that they are creditors in supplies who will not be prejudiced by the approval of the scheme of amalgamation. The scheme of amalgamation does not in any way seeks to extinguish their liabilities and hence, the company prayed for dispensing with the requirement of sending notices to individual unsecured creditors. Therefore, in the application, it had prayed for dispensation with the meeting of members and creditors.

Decision

NCLT relying on the above-mentioned provisions of law held that the provisions do not provide NCLT with the power to grant dispensation of meeting in relation to the shareholders/members. It only empowers the NCLT to dispense the meeting of creditors, if creditors having at least 90% of the credit value have given their consent to the proposed scheme of amalgamation.

The aforesaid stance was followed by Mumbai bench of NCLT in the scheme of amalgamation involving Basis Point Commodities Private Limited, where, in its order dated January 20, 2017, the following was observed that keeping in view the provisions of Section 230 of the Companies Act, 2013, dispensation of meeting of members cannot be granted and following directions are issued in relation to the calling, convening and holding of the meeting of the equity shareholders and preference shareholders

2. **In re, Jupiter Alloys Steel India Limited [TA No. 11 of 2017, dated 17-5-2017**

Facts

In this matter, Jupiter Alloys Steel India (Amalgamating Company) and Jupiter Wagons Limited (Amalgamated Company) filed a joint application before NCLT, Kolkata bench under section 230 to 232 of the Companies Act, 2013 read with CAA Rules for seeking

dispensation of the meeting of shareholders. The shareholders of both Amalgamating and Amalgamated company had given their consent to the scheme of amalgamation by way of an affidavit.

Decision

It was held in the matter that NCLT is empowered to dispense the meeting of shareholder by virtue of its inherent powers vested in NCLT by Rule 11 of the NCLT Rules, 2016. In the judgement NCLT, Kolkata bench also made an observation that High Courts used to exercise their discretion to dispense the meeting of shareholders under the Companies Act, 2013 and such decisions cannot be ignored.

3. Coffee Day Overseas Private Limited with Coffee Day Enterprises Limited (2017)

Facts

In this matter, Coffee Day Overseas Private Limited (Transferor Company) and Coffee Day Enterprises Limited (Transferee Company) filed a joint application before NCLT, Bengaluru bench under section 230 to 232 of the Companies Act, 2013 read with CAA Rules for seeking dispensation of the meeting of shareholders and creditors. The shareholders of both Transferor and Transferee company and two unsecured creditors had given their consent to the scheme of amalgamation by way of an affidavit.

Decision

The Bengaluru bench granted dispensation for holding of meetings of shareholders and creditors without going into the merit of whether NCLT had such power to dispense.

The Bengaluru bench of NCLT in two separate cases for approving the scheme of amalgamation involving Altair Engineering India Private Limited and Altisource Business Solutions Private Limited continued to dispense with the meeting of shareholders and creditors.

In the matter of scheme of amalgamation between Apollo Pipes Limited (Transferor Company) and Amulya Leasing and Finance Limited (Transferee Company), the principal bench of NCLT dispensed the holding of meetings of equity shareholders of the Transferor company and meetings of secured and unsecured creditors of Transferee Company whereas meetings of secured and unsecured creditors of the Transferor Company and equity shareholders of the transferee company were directed to be convened.

4. DLF Phase IV Commercial Developer and Ors. (Company Appeal (AT) No. 180 of 2019, dated 19-8-2019)

Facts

In this matter scheme of arrangement was proposed between DLF Phase IV Commercial Developers Limited, DLF Real Estate Builder Limited, DLF Residential Builders Limited, the transferor companies, DLF Utilities Limited, the demerged company and DLF Limited, the transferee Company. The demerged company and the transferor companies were wholly-owned subsidiaries of the transferee company. The companies had filed an application before the NCLT Chandigarh bench for dispensation of meetings of shareholders, secured and unsecured creditors. The companies in their application had relied on the judgement of Jupiter Alloys Steel India Limited and Jupiter Wagons Limited for the above relief.

However, the NCLT Chandigarh bench rejected the relief and held that the Companies Act, 2013 does not permit dispensation of meetings either in the case of shareholders, secured or

unsecured creditors. In the matter consent affidavits of unsecured creditors with respect to the demerged company, and of equity shareholder, secured and unsecured creditors with respect to transferee company had not been obtained. Therefore, even when the scheme is proposed between holding company and wholly-owned subsidiaries, it cannot be ground for dispensation of meetings of shareholder, secured and unsecured creditors. Subsequently, the above companies filed an appeal before the NCLAT.

Judgement

The NCLAT held that the NCLT Chandigarh bench should have followed the judgement passed by the coordinate or larger benches and dispensed the meetings of shareholder, secured and unsecured creditors in the present matter by taking into consideration that there shall be positive net worth and creditors will not be compromised. Therefore, the order of the NCLT Chandigarh bench was set aside within the purview of per incuriam and sent back for fresh consideration.

Other

Relying on the Judgements of Tribunal in the matter of *Ambuja Cements Ltd., In re [2021] 128 taxmann.com 320/168 SCL 307 (NCL-AT), MohitAgroCommoditiesProcessing (P.) Ltd., In re [Company Appeal (AT) No. 59 of 2021, dated 28-6-2021]*, NCLAT has held that as the merger is of a Wholly Owned Subsidiary Company into its holding Company, no shares would be allotted as consideration under the merger; the proposed Scheme will not result in any dilution in the Shareholding of the Shareholders of the 'Transferee Company', the net worth of the 'Transferee Company' is positive, and accordingly meeting of the Shareholders was dispensed off.

Through, the above-mentioned judicial decisions, it can be concluded that NCLT has the jurisdiction to grant dispensation with respect to the meetings of creditors and members if the written consent of all the members and creditors is obtained or in a scenario where the scheme is proposed between a wholly-owned subsidiary and holding company.

Conclusion

The Companies Act, 2013 has ensured provisions that provide for a single consolidated forum in the form of the NCLT, for all the merger and de-merger schemes. This ensures a smooth and quick mode of executing mergers. Having NCLT look after mergers also guarantees a level of transparency which is important in today's times where mergers and de-mergers are a sought-after panacea for corporate turbulence. Having a proper procedure also gives impetus to foreign companies in exploring business relationships in India, thus opening up a gateway for more foreign investments. NCLT is an important part of the regulatory framework that revolves around these corporate tools. The procedure involved is very simple and to the point, it also upholds the true spirit of rule of law by ensuring that all stakeholders are made aware of the scheme and that any rising contentions are given a stage.

CA Nitin Gutka

Merger and Amalgamation under Section 233 of The Companies Act, 2013
(Fast Track Merger)

Introduction

The term merger and amalgamation have not been defined under the Companies Act, 2013 but in commercial terms, merger mean a combination of two or more existing companies which merge their identities to form a new company and amalgamation means the undertaking of one company is transferred into the existing company. While the practice of merger and amalgamation having being expanded and seen exponential growth, certain advancements in this field have not been explored to the best of their potential. Fast Track Merger is one such measure that was introduced with the objective of promoting the ease of doing business in India. The concept of fast track merger was introduced under the Companies Act, 2013. Section 233 of the Companies Act, 2013 (**"the Act"**) read with Rule 25 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 (**"the Rules"**) offer a certain class of companies with alternative option of merger with lesser compliance and less complicated procedure and quicker registration process. It is simple and swifter to implement. The significance of fast track merger process is that it does not require tribunal intervention — i. e., the mandatory approval of the National Company Law Tribunal (**NCLT**). This provision is an alternative to the lengthy and time-consuming process of NCLT for certain class of companies. The aim of this article is to highlight the procedure of a FastTrack Merger and understand the intricacies involved therein.

Applicability of Fast Track Merger

The scheme of a merger or amalgamation can be entered into between:

(a) Two or more small companies

(b) Holding Company and its wholly-owned subsidiary company.

(c) Such other class or classes of companies as may be prescribed.*

Section 2(85) of the Companies Act, 2013 defines a small company to mean a company other than a public company :-

(i) **paid up share capital which does not exceeds rupees four crores and

(ii) ** turnover of which does not exceed rupees forty crores

Provided nothing in this clause shall apply to

(a) holding company or subsidiary company

(b) A company registered under section 8 or

(c) A company or body corporate governed by any special Act.

Therefore, the said definition shall not be applicable to companies or body corporates which are being governed (that should ideally also entail regulated) under any special Act.

** two or more start-up companies or one or more start-up company with one or more small company inserted by Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2021 w.e.f 1-02-2021*

*** amended vide notification dated 15th September, 2022 as per Companies (Specifications of definition details)* Amendment Rules, 2022

Interestingly, while Section 1(4) of the Companies Act,2013 specifically mentions that the provisions shall be applicable to every company incorporated under the Act or the erstwhile Act whereas Section 2(85) categorically bars companies which are being governed under any special Act. Thus both the Sections are inconsistent and contradicts to each other

Benefits of Fast Track Merger

No Mandatory approval of NCLT required.	No NCLT Convened Meeting required.	Public advertisement for convening meeting of shareholders and creditors not required.
Less Administrative Burden.	No Special Audit required.	Cost effective mechanism and time saving.
Less Legal Requirements.	Quicker approval and registration process.	Registration of scheme shall deemed to have effect of dissolution of transferor companies without process of winding up

Procedure under Fast Track Merger

Conduct a Board Meeting of both the Companies to approve Draft Scheme, Share Exchange ratio report and accounting treatment certificate and also authorize the Board for filings	
Notice to Registrar of Companies (ROC), Official Liquidator(OL), Income Tax authorities where the registered office of the Companies are situated or other person affected by the Scheme, for inviting objections and suggestions within 30 days from the date of notice	Form CAA-9
File form GNL-1 attaching copy of Form CAA-9	Form No GNL-1

Submission of copy of notice filed (Form No CCA-9) with ROC, OL Income Tax authorities or other person affected by the Scheme with Regional Director	
Receipt of objections or suggestions from ROC, OL, Income Tax authorities or other person affected by the Scheme within period of 30 days from the date of filing of Form CAA-9	
Conduct Board Meetings for considering suggestions of ROC, OL, Income Tax authorities or other persons affected by the Scheme and incorporating in the scheme, approving the draft of the Declaration of Insolvency form and EOGM formalities.	
Declaration of Solvency is filed with respective ROC.	Form. CAA-10
File form GNL-2 to be filed by Companies attaching Form CAA-10.	Form GNL-2
Dispatch of Notice of Meeting along with statement referred to in section 230(3) of the Companies Act, 2013 to shareholders and Creditors	
If a meeting of the creditors are not convened then obtain consent of creditors based on the certificate issued by Chartered Accountants clearly specifying their dissent or assent	
File Mgt-14 for the results of the meetings of shareholders and creditors within 15 days	
Transferee Company to file the Scheme as agreed by the shareholders and creditors within 7 days of the conclusion of the meetings of shareholders or creditors with RD, ROC,OL	Form CAA-11
Transferee Company to File Form RD-1 & GNL-1 attaching Form CAA-11 and other documents.	Form RD-1 and GNL-1
Where objections or suggestions are received. RD after considering the objections or suggestions shall register the Scheme and issue a confirmation to the companies or if no communication is received from ROC & OL within 30 days of the filing of the Scheme in Form CAA-11 it will be presumed that they have no objection then RD shall register the Scheme and issue a confirmation to the companies.	Form CAA-12
If RD after receiving the objections or suggestions or for any reason is of the opinion that such a scheme is not in the public interest or not in the interest of the creditors then RD may file an application before the Tribunal within 60 days of the receipt of the scheme stating its objections and requesting Tribunal to consider the scheme under Section 232.	Form CAA-13
On receipt of the application from RD or from any person ,if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per procedure laid down in section 232 of the Companies Act,2013, the tribunal may direct accordingly or it may confirm the scheme by passing such orders as it deems fit, subject to observations of RD	

A copy of order confirming the scheme shall be communicated to the Companies by RD	

Issues and Challenges in Implementation of Fast Track Merger

Whether convening meeting of shareholders compulsory along with approval of shareholders or class of shareholders holding at least 90% in number of shares
• Based on plain reading of Section 233 of the Companies Act ,2013 it appears that there is no discretion to the company to obtain the consent of shareholders
The meeting/consent of creditors to be taken of those outstanding as on last audited financial statements or based on latest financial position? Whether creditors would include statutory dues
• While there is a no straight answer to this; In the current NCLT scenario, notices are issued to all the statutory authorities while contingent creditors are not considered
Is there any scope for merger of more than 2 companies under Fast Track in one scheme?
• Section 233(1) of the Companies Act, 2013 provides that a scheme of merger or amalgamation may be entered into between two or more small companies.
Can Regional Director suggest any changes in the scheme?
• On plain reading of Section 233(4) of the Companies Act, 2013; it appers that ROC and OL has power to make any suggestions or objections to the scheme and RD has to consider such objections or suggestion while confirming the Scheme without any further changes.
Can the appointed date be changed after filing of CAA 11?
• Appointed date can be changed by following procedure laid-down
Is there a scope of scheme of demerger or compromise under fast track?
• Section 233(12) of the Companies Act,2013 also applies to a company specified in sub-section (1) for a compromise or arrangement referred to in section 230 or division or transfer of a company subject to Section 232
Whether Regional Director has any power to reject the scheme?
• On a plain reading of Section 233(5), Regional Director may not have power to reject the Scheme; however, Regional Director may seek necessary directions from NCLT to this effect.

Precedences of Listed Companies using Fast Track

1. Western Hospitals Corporation Private Limited and Apollo Home Healthcare (India) Limited with Apollo Hospitals Enterprise Limited.

2. IDFC Alternative Limited and IDFC Trustee Company Limited and IDFC Projects Limited with IDFC Limited

   This scheme was rejected by Regional Director on the ground that the Transferee Company has failed to comply the provision of section 233(1)(b). The NCLT Bench Chennai on an application made by the Companies allowed the Scheme under section 230 (6) of the Companies Act,2013.

3. Yuflow Engineering Private Limited with Yuken India Limited.

   The Regional Director returned back the application with a request to approach NCLT. The Company approached NCLT Bengaluru Bench with a same scheme under section 230-232 of the Companies Act, 2013 and the same was sanctioned by NCLT Bengaluru Bench on 20th February, 2023

4. Ensure Support Services (India) Limited and Computer Factory (India) Private Limited with ACCEL Limited

   This scheme was rejected by Regional Director on the ground that the Transferor Companies have not conducted EGM as required under Section 233(1)(b) of the Companies Act, 2013 and the Companies has failed to comply with the provision of section 233(1)(d) by not obtaining consent of creditors of more than 9/10th in value. The NCLT Bench Chennai on an application made by the Companies allowed the Scheme under section 230(6) of the Companies Act,2013.

5. Best Safety Private Limited with Mallcom (India) Limited

Conclusion

The introduction of fast-track merger and subsequent amendments to expand its scope have provided much-needed relief to small companies and startups intending to going in for restructuring. However, the mechanism still needs clarity for smooth implementation. Section 233 of the Act does not specifically prescribe whether a step-down subsidiary can fall under the ambit of fast-track merger. Further, in the absence of any definition of wholly owned subsidiary, the interpretation is driven from other statutes and judicial pronouncements, which causes ambiguity.

The framework governing the merger and amalgamation of companies has been simplified and has been made facilitative with the introduction of the concept of fast track merger. The erstwhile legal framework, with respect to merger and amalgamation, require the intervention of court and was a long drawn and expensive procedure. However, the inability of the regulators to adhere to the timeline of 30 days prescribed under Section 233 of CA, 2013 and lack of consensus, misinterpretations of Section 233 by different RDs may make the fast track merger and amalgamation unattractive as due to which the time taken for a merger under fast track route is at times similar to the time taken by NCLTs under Section 232 of the C.A. 2013.

CA Rajesh Thakkar CA Radhika Bhangdia

Steps to be taken for implementation of Merger/Demerger, Post NCLT approval

1. Introduction

1.1 Merger & Acquisitions (M&As) is the path that businesses take to achieve exponential growth and therefore continues to generate interest. The Indian M&A landscape is no different. M&As have become an integral part of the Indian economy and daily headlines. M&As are often seen as key strategic moves for companies looking to grow, unlock value and improve their competitive position in the market. However, the success of these corporate transactions doesn't end when the ink dries on the deal documents.

1.2 Mergers/demergers is one of the path to achieving M&A. Mergers/Demergers tend to find favour amongst the stakeholders largely due to its tax neutrality. However, the flip side is the time period involved in complying with the provisions of Sections 230-232 of the Companies Act, 2013 (anywhere upwards of 6 months). While third party M&A transactions are time sensitive and merger/demerger may not be the best way to culminate a M&A transaction, in case of internal restructuring, largely corporates adopt mergers/demergers to realign their objectives.

1.3 When we talk of merger/demerger, the general understanding is that approval of the National Company Law Tribunal (NCLT) is in itself the final step to the exercise. While this is partially correct, the post-merger/demerger compliance can be just as critical, if not more so, for the long-term success of any transaction. During this phase, companies must navigate a complex web of legal and regulatory requirements to ensure that they remain in compliance with all applicable laws and regulations.

1.4 While there are many elaborate discussions and articles around compliances required before mergers/ demergers are panned out, very little is discovered yet about the post-completion process. It is pertinent to note that transactions of this nature are highly sensitive and in order to achieve the benefits of a successful arrangement, companies must be aware of and adhere to post transactions compliances (and the after-effects) as well.

1.5 In this article, we have delved into the intricacies of post-merger and demerger compliances, exploring the various legal and regulatory issues that companies need to consider during this

period. We'll discuss the importance of compliance, the potential risks of non-compliance and the steps that companies can take to ensure a smooth transition. By understanding the key compliance issues that arise after a merger or demerger, companies can better navigate this challenging period and position themselves for long-term success.

1.6 In this article, we shall briefly discuss some of the most important post-merger and demerger compliances from the perspective of–

- Foreign Direct investment (FDI)
- Stamp duty implications
- Income tax Act/Goods & Service Tax Act/Foreign Exchange Management Act
- Companies Act, 2013
- Accounting aspects
- Listing Agreement/SEBI
- Other aspects

2. Foreign Direct Investment

2.1 The liberalization of FDI regime and opening of almost all the sectors of the economy for complete foreign ownership has transformed India into one of the most open economies of the world and has led to increased entry of multinationals in various capital-intensive sectors such as infrastructure, insurance, power and pharmaceuticals.

2.2 In mergers/demergers, it is important to be mindful of the FDI sectoral cap, which refers to the maximum percentage of foreign ownership allowed in a particular sector. In case of any merger/demerger involving companies in these sectors, one may need to evaluate whether the approval of the Government of India is required.

2.3 To obtain government approval, the concerned parties can apply on the Foreign Investment Facilitation Portal (FIFP) of the Department for Promotion of Industry and Internal Trade (DPIIT), which is responsible for facilitating and promoting foreign investment in India. The FIFP portal provides a single-window clearance mechanism for foreign investors and businesses to apply for various regulatory approvals, including approvals related to FDI.

2.4 For example, in case of merger involving two or more pharmaceutical companies approved by NCLT, an application would need to be filed with the Ministry of Pharmaceuticals for approval of the merger, through the FIFP portal. The Scheme will become effective only after the approval of FIFP is received.

2.5 The application would need to provide details about the merger, including the foreign shareholding post-merger and such other information/data that may be sought be the Ministry of Pharmaceuticals to grant its approval. The application is filed online through the FIFP portal on www.nsws.gov.in.

3. Stamp Duty

3.1 As per Section 232 of the Companies Act, 2013, when an order sanctioning merger/demerger passed by the NCLT provides for transfer of any assets and/or liabilities, then, by virtue of that order, the assets shall be transferred to and vest in, and those liabilities shall be transferred to and become liabilities of, the transferee/resulting company.

3.2 Even though the merger/demerger order is not specifically mentioned as an instrument requiring stamping under the Indian Stamp Act, 1899, various States have included an article in their respective Stamp Acts to treat a Court order as a 'Conveyance Instrument'. To illustrate, Maharashtra, Karnataka and Gujarat are some of the States that have a specific entry to levy stamp duty on Court orders approving merger/demerger. Further there is also a monetary penalty where the application for stamp duty adjudication is filed beyond the stipulated time period defined by the respective States.

3.3 Even in States where there is no specific entry to levy stamp duty on Court orders, it may be prudent to file an application with the appropriate authority considering the order of the Supreme Court of India that has ruled that the merger/demerger order is subject to payment of stamp duty.

3.4 The Hon'ble Supreme Court of India in case of ***'Hindustan Lever & Anr. vs. State Of Maharashtra & Anr.' (18 November, 2003) Supreme Court, Appeal (civil) 8231, 8232, 9237 and 10208*** of 1996 made the following observations:

"… the amalgamation scheme sanctioned by the Court would be an "instrument". By the said "instrument" the properties are transferred from the transferor company to the transferee company, the basis of which is the compromise or arrangement arrived at between the two companies."

3.5 The Hon'ble Supreme Court of India finally held that the definition of "Conveyance" in the Indian Stamp Act was an inclusive definition and includes within its ambit an order of the High Court and therefore it attracts stamp duty."

3.6 Thus, an order of merger/demerger is subject to stamp duty in India. Stamp duty is payable on the NCLT order approving the merger/demerger in the State where the registered offices of the companies are located. It is also relevant to note that in case stamp duty is not paid on the NCLT order, the title to an immovable property transferred pursuant to a scheme, may be defective.

3.7 Lastly, in addition to paying stamp duty on NCLT order, stamp duty is also payable on allotment of shares issued by the transferee/resultant company to the shareholders of the transferor/demerged company.

4. Income tax Act/Goods & Service Tax Act/Foreign Exchange Management Act

4.1 Income Tax Act

4.1.1 For the purpose of Income tax Act, the merger/demerger becomes effective from the Appointed Date which is generally a retrospective date [***Marshall Sons & Co. (India) Ltd. vs. ITO [1997] 233 ITR 809 (SC)***]. Lets take an example where the Board of Directors of Co A and Co B have approved a Scheme of Amalgamation in their Board Meeting on October 15, 2021 with an Appointed Date of April 1, 2021. The Scheme was sanctioned by the NCLT on March 15, 2022 and the NCLT order was filed with the Ministry of Corporate Affairs on March 31, 2022 (Effective Date). From the perspective of Income tax Act, Co B is deemed to have merged with Co A with effect from April 1, 2021.

4.1.2 Since Co B ceases to exist, it would need to cancel its Permanent Account

Number (PAN) and Tax Deduction Account Number (TAN) by filing the requisite intimation with the tax authorities. The transferee company would also need to file revised TDS Returns in respect of the period between the Appointed Date and the Effective Date. Lastly, where the Effective Date is after the due date of filing the Return of Income (ROI), for example November 15, 2022, the transferee company would need to file revised ROI for AY 22-23.

4.1.3 Unlike in case of a merger, where the transferor company ceases to exist, in case of demerger, the demerged company continues to operate, less the undertaking that has been demerged into the resulting company. In such event, while the demerged company is not required to cancel its PAN and TAN, both the companies would however, need to revise their TDS return and ROI, if applicable, to give effect to the demerger.

4.2 Goods & Service Tax Act

4.2.1 While in case of Income tax, the merger/demerger is effective from retrospective date i.e. Appointed Date, in case of Goods & Service Tax, the law recognizes the Effective Date as the date from which the scheme can be implemented.

4.2.2 In case of merger, the transferor company would need to apply for cancellation of its registrations in terms of Section 87 of the GST Act. Likewise, the transferee company will need to seek registrations in all States where the transferor company has its registration unless the transferee company already has the registrations. In addition, the transferee company would also need to take necessary steps to avail input tax credit of the transferor company in terms of Section 18(3) of the GST Act.

4.2.3 In case of demerger as well, the resulting company may need to evaluate the need of either obtaining a fresh registration or modifying its existing registration, depending on the facts. Likewise, input tax credit in respect of the demerged undertaking shall also be allowed to be transferred to the resulting company (Rule 41 of the CGST Rules).

4.3 Foreign Exchange Management Act

In case there are non-resident shareholders in the transferor company to whom shares would be allotted pursuant to the merger/demerger, the transferee/resulting company would need to report such allotment (within 30 days) through Form FC-GPR on the online FIRMS portal on the Reserve Bank of India website.

5. Companies Act, 2013

5.1 Within 30 days of receipt of certified copy of the merger/demerger order, transferor and transferee companies are required to file the NCLT order on the Ministry of Corporate Affairs portal through Form INC-28. Generally, this is the Effective Date of the Scheme, unless approval of regulatory authority such as IRDA, TRAI, etc is needed. Upon approval of the Form INC-28, the status of the Transferor Company on the portal shall be updated to 'Amalgamated' (only in case of merger).

5.2 Form SH-7 needs to be filed within 30 days of allotment of shares to the shareholders of transferor company.

6. Accounting Aspects

6.1 Post the Effective Date, the transferor company would account for the merger/demerger in its books of account in line with the Accounting Treatment specified in the Scheme.

7. Listing Agreement/SEBI

In case of merger/demerger involving a listed company, the listed company is required to comply with various post-merger regulations issued by the Securities and Exchange Board of India (SEBI), primarily revolving around shares issued that are proposed to be listed on the stock exchange. Some of the action points are narrated hereunder:

7.1 Certified copy of the merger/demerger order issued by the NCLT along with other documents to be filed with the Stock Exchange.

7.2 The listed company to pay a fee to SEBI at the rate of 0.1% of the paid-up share capital of the listed/transferee/ resulting company, whichever is higher, post sanction of the proposed scheme, subject to a cap of ₹ 5,00,000.

7.3 Intimations to be given to Stock exchange for following matters:

- For the Scheme being made effective
- Record Date for identification of shareholders entitled to be allotted shares pursuant to the scheme.
- Formation of committee of Board of Directors authorizing them to take all necessary steps for issue, allot and listing of shares issued pursuant to the Scheme.

7.4 Shareholding pattern to be filed within 10 days of any capital restructuring of the listed company resulting in a change exceeding 2% of the total paid-up share capital.

7.5 Application to stock exchange for obtaining the "final listing approval" for new shares along with prescribed fees.

7.6 On receipt of final listing approval, intimations to be sent to new shareholders regarding the corporate action. On final credit of shares by R&T agents, obtain confirmation letters from the depositories for the credit of new shares in the shareholders account (in case of demat).

7.7 In cases where listed company is getting merged with an unlisted company, unlisted company at its option can get its shares listed on a stock exchange. For this, unlisted company will have to make an application to stock exchange thereby seeking relaxation from the strict enforcement rules for listing of its equity shares on a recognized Stock Exchange without making an initial public offer, if it satisfies the following conditions:

- The equity shares sought to be listed are proposed to be allotted by the unlisted transferee company to the holders of securities of a listed transferor company pursuant to a scheme of merger sanctioned by NCLT.
- Atleast 25% of the post scheme paid up share capital of the transferee company shall comprise of shares allotted to the public shareholders in the transferor company.
- The transferee company will not issue/reissue any shares, not covered under the scheme of merger.
- Where an unlisted company is proposed to list its equity shares pursuant to a Scheme of Arrangement, the unlisted

company is required to comply with the provisions of Master Circular no. SEBI/HO/CFD/DIL1/CIR/P/2021/0000000665 dated November 23, 2021 issued by SEBI.

- It may be noted here that the stock exchange will not permit listing of new shares issued pursuant to a scheme, unless past non-compliances are made good by a listed company.

8. Other Aspects to be considered:

Apart from specific compliance requirements related to regulators such as FDI, RBI, ROC, SEBI, Stamp Duty, accounting, etc, there are several general aspects to be considered post-merger.

8.1 Intimation to Vendors/Customers: The transferee company should notify vendors/customers of the transferor company and update their contracts with vendors/customers.

8.2 Revision of Employment Contracts: The transferee company would be required to revise the employment contracts of the transferor company's employees as mentioned in the scheme of merger to reflect the changes resulting from the merger/demerger. Similarly, the Provident Fund balance and other retirement benefits of the employees of the transferor company would need consideration by the transferee company.

8.3 Updating licenses and permits: The transferee company should update its business licenses and permits to reflect the changes resulting from the merger/demerger.

8.4 Updating bank accounts: The transferee company would need to update the banking partners of the transferor company to reflect the changes resulting from the merger/demerger.

8.5 Assignment of Legal Contracts such as leasehold premises, litigation cases, etc would need to be evaluated and assigned to the transferee/resulting company.

9. Conclusion

9.1 While the compliance of Sections 230-232 of the Companies Act, 2013 is a very standard process, what is really critical is the compliance of the post merger/demerger compliances and integration. Any default in any of these areas can cause undue hardship and financial implication for a company.

9.2 Once the merger/demerger has been completed it is important for the transferee/resulting company to focus on integrating its operations, systems and culture to ensure a smooth transition and achieve the desired synergies.

9.3 The integration process can involve combining and streamlining operations, consolidating staff and resources, and implementing new policies and procedures. The goal is to eliminate redundancies, optimize efficiencies and create a unified and cohesive organization.

9.4 Effective communication and leadership are critical during this period to ensure that employees, customers and other stakeholders are informed and engaged in the integration process. It is also essential to manage any cultural differences that may arise between the merging companies to ensure a successful integration.

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Closure of Companies

The Companies Act, 2013 ("Act") and Insolvency and Bankruptcy Code, 2016 ("IBC") and the rules made thereunder provide certain options to companies to close the entity, subject to certain compliances and procedural filings. A company may be closed either by strike off or alternatively by voluntary winding-up.

A. Strike Off

The Ministry of Corporate Affairs ("MCA") has notified Sections 248 to 252 of the Act and Companies (Removal of Names of Companies from the Register of Companies) Rules, 2016.

The Act read with the Rules set out the procedure for strike-off of the name of a company.

(1) Eligibility and Non-eligibility

A company may apply for strike off to the Registrar of Companies if:

(a) it has failed to commence its business within one year of its incorporation; or

(b) it is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company; or

(c) the subscribers to the memorandum have not paid the subscription which they had undertaken to pay at the time of incorporation of a company and a declaration to this effect has not been filed within one hundred eighty days of its incorporation; or

(d) the company is not carrying on any business or operations, as revealed after the physical verification.

The Register of Companies shall not remove the names of the following companies:

(a) Listed companies;

(b) Delisted companies due to non-compliance of listing regulations;

(c) Vanishing companies. A company would be deemed to be a vanishing company, if it is has:

   (i) Failed to file returns with Registrar of Companies ("ROC") for two years;

(ii) Failed to file returns with the stock exchange for two years (if it continues to be a listed company);

(iii) It is not maintaining the registered office of the company at the address notified with the ROC/Stock Exchange; and

(iv) None of its Directors are traceable.

- All the conditions mentioned above would have to be satisfied before a listed company is declared as a vanishing company;
- The conditions mentioned at (i), (iii) & (iv) would suffice to declare a company as vanishing if such company has been de-listed from the Stock Exchange.;

(d) Companies under inspection or investigation are ordered and being carried out or actions on such order are yet to be taken up or were completed but prosecutions arising out of such inspection or investigation are pending in the Court;

(e) Companies against which any prosecution is pending or an application for compounding of offences is pending;

(f) Companies which have defaulted in repayment of public deposit;

(g) Companies having charges pending for satisfaction;

(h) Companies registered under Section 8 of the Companies Act, 2013 or Section 25 of the Companies Act, 1956 (Formation of companies with charitable objects).

Further, a company shall not make an application for removal of name, if at any time in previous three months, it has:

(a) Changed its name or shifted its registered office from one state to another;

(b) Disposed of any property or rights held before cesser of trade or otherwise carrying on business;

(c) Has engaged in any other activity except the one which is necessary or expedient for the purpose of making an application for strike-off, or deciding whether to do so or concluding the affairs of the company, or complying with any statutory requirement;

(d) Made an application to the National Company Law Tribunal (“NCLT”) for sanctioning the scheme of compromise or arrangement; and the same is pending before the NCLT.

(e) Companies under winding up process under the Insolvency and Bankruptcy Code.

(2) Procedure

A Company may suo-moto file an application for strike off to the ROC for removing the name of the company from the ROC. A Company may, after extinguishing all its liabilities, by a special resolution or consent of 75% members in terms of paid-up share capital, file an application to the ROC

on all or any of grounds stated above for removing the name of the company from the register of companies. When the company files an application for strike off, the company has to file inter alia director's indemnity bond indemnifying any claimants for all lawful claims against the company arising in future after the striking off the name of the Company, statement of accounts containing assets and liabilities of the company made up to a day of the application, not more than thirty days before the date of application and certified by a Chartered Accountant; an affidavit in Form STK 4 by every director of the company along with;

(a) A copy of the special resolution duly certified by each of the directors of the company or consent of 75 per cent of the members as on the date of application;

(b) A statement regarding pending litigations, if any, involving the company;

(c) No Objection Certificate (NOC) from appropriate Regulatory Authority, as applicable.

No application shall be filed by a company unless it has filed overdue returns up to the end of the financial year in which the company ceased to carry its business operations. The Registrar shall, on receipt of such application, cause a public notice to be issued.

The ROC may, if it deems fit, shall send a notice to all the directors of the company containing reasons for removal of name of the company and seeking representations along with copies of the relevant documents, if any, against the proposed action of strike off, within a period of thirty days from the date of notice.

The ROC shall:

- publish the notice in Form STK 5 (when ROC has proposes to strike off the name of the company) or STK 6 (when the company suo moto made the application for strike off) as the case may be, which should be placed on MCA website, published in the Official Gazette and also in an English and vernacular newspaper both having wide circulation in the State in which the registered office of the company is situated.
- simultaneously intimate the concerned regulatory authorities having jurisdiction, seeking their objections, if any within thirty days from the date of issue of letter of intimation and if no objections are received within thirty days from the respective authority, it shall be presumed that they have no objections to the proposed action of striking off or removal of name.

The ROC thereafter shall after due consideration strike-off/remove the name of the company from the register of companies and publish a notice of dissolution of company in the Official Gazette and the said notice shall also be placed on the MCA website.

If a company files an application with an object of evading the liabilities of the company or with an intention to deceive or defraud any creditor or other person, then the person in charge of the management shall be liable to such

person or creditor who incurred loss or damage and such person shall be punishable for fraud.

(3) Penalty

If a company files a strike off application in violation of the restrictions mentioned below, it shall be punishable with fine which may extend to Rs. One lakh:

(a) it has failed to commence its business within one year of its incorporation; or

(b) it is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company; or

(c) the subscribers to the memorandum have not paid the subscription which they had undertaken to pay at the time of incorporation of a company and a declaration to this effect has not been filed within one hundred eighty days of its incorporation; or

(d) the company is not carrying on any business or operations, as revealed after the physical verification.

(4) Appeal to the NCLT

Any person aggrieved by an order of the ROC, notifying a company as dissolved under Section 248, may file an appeal to the NCLT within a period of three years from the date of the order of the ROC and if the NCLT is of the opinion that the removal of the name of the company from the register of companies is not justified in view of the absence of any of the grounds on which the order was passed by the Registrar, it may order restoration of the name of the company in the register of companies.

The ROC may also make an appeal to the NCLT within a period of three years from the date of the order under Section 248 if he is satisfied that name has been struck off either inadvertently or on the basis of incorrect information.

The NCLT may also order the restoration of name of the company on the application made by any member or creditor or workman before the expiry of twenty years from the publication of strike off notice in the Official Gazette.

(5) Advantages and Disadvantages

The advantages of strike off are that it is a simpler procedure than winding up. It is normally the preferred option for defunct companies or companies with nil or very limited liabilities. Most importantly it is far cheaper than the voluntary winding up option.

The disadvantages of strike off are that, at times when the company decides to proceed with the strike off option it may have to wait for a period of two years to show that it is not doing business. During these two years it would be required to continue with all the filings and compliances. This can make the process very cumbersome.

B. Voluntary Winding-up

Any corporate person who intends to liquidate itself voluntarily may initiate voluntary liquidation proceedings under the provisions of Section 59 of the Insolvency and Bankruptcy Code, 2016 (**"IBC"**). The Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations,

2017 (**"Liquidation Regulations"**) apply to the voluntary liquidation of corporate persons.

The IBC defines a '*corporate person*' as, a company incorporated under the Companies Act, 2013, a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008, any other person incorporated with limited liability under any law. It is clarified that a corporate person does not include a financial service provider.

(1) Eligibility and Non-eligibility

In order to be eligible to apply for voluntary liquidation, the company:

- should not have made any defaults as defined by the IBC.
- should not have any debt or be such that it will be able to pay its debts in full; from the proceeds of assets to be sold in the voluntary liquidation.
- should not be liquidated in order to defraud a person.
- should be solvent.

(2) Procedure

The corporate person should obtain a Valuation Report for the company from a Registered Valuer. For this purpose, at least three years' financial statements of the Company would be required.

Thereafter, the company shall conduct a meeting of the Board of Directors to discuss and approve the following:

(a) voluntary winding up of the company;

(b) recommendation of the liquidator/ insolvency professional to be appointed by the shareholders;

(c) declaration of solvency and affidavits by each of the directors stating that:

- they have made a full inquiry into the affairs of the company and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full; from the proceeds of assets to be sold in the voluntary liquidation; and
- the company is not being liquidated to defraud any person.

(d) fixing the day, date, time and venue for the General Meeting of the shareholders (not later than four weeks from the date of the declaration stated above); and

(e) identifying the creditors of the Company, if any.

For this purpose, the audited financial statements and record of business operations of the company for the previous two years, a report of the valuation of the assets of the company, if any, prepared by a Registered Valuer and the list of Shareholders and Creditors of the Company.

Once the Board Meeting is held the Company shall hold a General Meeting in order to pass a Special Resolution to:

(a) to liquidate the Company voluntarily;

(b) to appoint an Insolvency Professional to act as the liquidator and decide terms and conditions of appointment i.e. remuneration etc.

The Company shall also obtain the consent from the creditors of the company representing two-thirds in value of the debt of the Company for the resolution passed by the Members within seven days of such resolution passed by the Members. The certified true copy of the resolution passed by the Members and the consent letter from the Creditors has to be obtained.

The Form MGT 14 has to be filed with the ROC and Insolvency and Bankruptcy Board of India ("IBBI") has to be informed within seven days of passing of the resolution of Members or the subsequent approval by the creditors, as the case may be.

One must take note that subject to approval of the creditors, the voluntary liquidation proceedings in respect of a Company shall be deemed to have commenced from the date of passing of the Special Resolution by the Members of the Company.

Please mention about the public announcement to be made in the english and regional newspaper as per IBBI Regulation 14 of Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017 covered below in Actions to be taken by the Liquidator since all publications are mentioned below together.

(3) Preliminary Report

Thereafter the liquidator shall submit a Preliminary Report to the Company within forty-five days from the liquidation commencement date. The term '*liquidation commencement date*' in defined in the Liquidation Regulations as the date on which the proceedings for voluntary liquidation commence as per section 59(5) of the IBC (date of passing member's resolution) and Regulation 3(4) of the Liquidation Regulations (date of passing partner or contributories' resolution).

This Preliminary Report shall set out-

(a) the capital structure of the corporate person;

(b) the estimates of its assets and liabilities as on the liquidation commencement date based on the books of the corporate person. If the liquidator has reasons to believe (which reasons shall be recorded in writing) that the books of the corporate person are not reliable, the liquidator shall also provide such estimates based on reliable records and data otherwise available to him)

(c) whether the liquidator intends to make any further inquiry in to any matter relating to the promotion, formation or failure of the company or the conduct of the business thereof; and

(d) the proposed plan of action for carrying out the liquidation, including the timeline within which he proposes to carry it out and the estimated liquidation costs.

(4) Verification of Claims

The liquidator shall verify the claims (of the Operational Creditors, Financial Creditors, Workmen and Employees, Other Stakeholders) submitted within thirty days from the last date for receipt of claims and may either admit or reject the claim, in whole or in part, as the case may be. The liquidator shall record in writing the reasons for rejection and

communicate his decision of admission or rejection of claims to the creditor and corporate debtor within seven days of such admission or rejection of claims. In case a creditor is aggrieved with the decision of the liquidator he may appeal to the Adjudicating Authority against the decision of the liquidator.

The liquidator shall prepare a list of stakeholders on the basis of proofs of claims submitted and accepted with:

(a) the amounts of claim admitted, if applicable,

(b) the extent to which the debts or dues are secured or unsecured, if applicable,

(c) the details of the stakeholders, and

(d) the proofs admitted or rejected in part, and the proofs wholly rejected.

The list of stakeholders shall be available for inspection by (a) the persons who submitted proofs of claim and (b) members, partners, directors and guarantors of the Company. The said list will also be displayed on the website, if any, (a) of the Company and (b) designated by the IBBI for this purpose. This list shall be made available Within 45 (forty- five) days from the last date for receipt of claims.

The liquidator shall (a) value and sell the assets of the Company, (b) recover all the monies due to the Company, in a time-bound manner and realise uncalled capital or unpaid capital contribution, if any. The Liquidator shall open a bank account in the name of the corporate person followed by the words 'in voluntary liquidation', in a scheduled bank, for the receipt of all moneys due to the corporate person. The liquidator shall deposit into the bank account all the realizations made without any deduction not later than the next working day.

The liquidator shall distribute the proceeds from realization to the stakeholders within thirty days from the receipt of the amount. The liquidation costs shall be deducted before such distribution is made.

The liquidator shall endeavor to complete the process within two hundred and seventy days from the liquidation commencement date where the creditors have approved the resolution and ninety days from the liquidation commencement date in all other cases.

(5) Annual Status Report

In the event that the liquidation process continues for more than twelve months from the liquidation commencement date; then within fifteen days from the end of the said twelve months and at the end every succeeding twelve months till dissolution of the corporate person, the liquidator shall hold a meeting of the contributories of the Company and shall present an Annual Status Report indicating progress in liquidation, including-

(i) settlement of list of stakeholders,

(ii) details of any assets that remains to be sold and realized,

(iii) distribution made to the stakeholders,

(iv) distribution of unsold assets made to the stakeholders;

(v) developments in any material litigation, by or against the Company; and

(vi) filing of, and developments in applications for avoidance of transactions, if any.

The Annual Status Report shall enclose the audited accounts of the liquidation showing the receipts and payments pertaining to liquidation since the liquidation commencement date. This Report along with compliance certificate shall be sent to the ROC, IBBI and the NCLT.

(6) Final Report

Once the Company has been completely wound up, and its assets completely liquidated, the liquidator shall submit the final report for the dissolution to the IBBI, ROC and the Adjudicating Authority.

The Final Report shall consist of:

(a) Audited accounts of the liquidation, showing receipts and payments pertaining to liquidation since the liquidation commencement date;

(b) A statement demonstrating that-

- (i) The assets of the corporate person have been disposed of;
- (ii) The debt of the corporate person has been discharged to the satisfaction of the creditors;
- (iii) No litigation is pending against the corporate person or sufficient provision has been made to meet the obligations arising from any pending litigation.

(c) A sale statement in respect of all assets containing -

- (i) The realized value;
- (ii) Cost of realization, if any;
- (iii) The manner and mode of sale;
- (iv) An explanation for the shortfall, if the value realized is less than the value assigned by the registered valuer in the report of the valuation of assets;
- (v) The person to whom the sale is made; and
- (vi) any other relevant details of the sale.

The NCLT shall on an application filed by the liquidator and on hearing the matter, pass an order that the Company shall be dissolved from the date of that order and the Company shall be dissolved accordingly. Once the order is passed within fourteen days from the date of such order; it shall be forwarded to the ROC with which the Company is registered.

The Company shall from the liquidation commencement date cease to carry on its business except as far as required for the beneficial winding up of its business.

However, the Company shall continue to exist until it is dissolved by an order of the NCLT. The remuneration payable to the liquidator shall form part of the liquidation cost. The liquidator shall maintain the Registers and Books of Accounts of the Company and will also have them completed and brought up-to-date.

The liquidator shall preserve a physical or an electronic copy of the reports, registers and books of account for at least eight years and a physical copy of records for a minimum period of three years after the dissolution of the corporate person.

(7) Eligibility for appointment as Liquidator

Regulation 6 of the Liquidation Regulations provides that an insolvency professional shall be eligible to be appointed as a liquidator if he, and every partner or director of the insolvency professional entity of which he is a partner or director is independent of the Companycorporate person;

A person shall be considered independent of the corporate person, if he-

(a) is eligible to be appointed as an independent director on the board of the corporate person under the Act, where the corporate person is a company;

(b) is not a related party of the corporate person; or

(c) has not been an employee or proprietor or a partner-

 (i) of a firm of auditors or secretarial auditors or cost auditors of the corporate person; or

 (ii) of a legal or a consulting firm, that has or had any transaction with the corporate person contributing ten per cent or more of the gross turnover of such firm,

 at any time in the last three years.

An insolvency professional shall not be eligible to be appointed as a liquidator if he, or the insolvency professional entity of which he is a partner or director is under a restraint order of the Board;

A liquidator shall disclose the existence of any pecuniary or personal relationship with the concerned company or any of its stakeholders as soon as he becomes aware of it, to the IBBI and the Registrar;

An insolvency professional shall not continue as a liquidator if the insolvency professional entity of which he is a director or partner, or any other partner or director of such insolvency professional entity represents any other stakeholder in the same liquidation.

- Actions to be undertaken by the Liquidator
- Public Announcement

The liquidator shall make public announcement within five days of his appointment:

(a) Calling upon stakeholders to submit their claims as on the liquidation commencement date; and

(b) Provide the last date for submission of claim, which shall be thirty days from the liquidation commencement date.

The liquidator shall make this publication :

(a) in one english and one regional language newspaper with wide circulation at the location of the registered office and principal office, if any, of the company

and any other location where in the opinion of the liquidator, the company conducts material business operations;

(b) on the website, if any, of the company; and

(c) on the website, if any, designated by the IBBI for this purpose.

- ***Maintenance of Registers and Books of Accounts***

  (a) Where the books of accounts of the company are incomplete on the liquidation commencement date, the liquidator shall have them completed and brought up-to-date the books of accounts, at all convenient speed.

  (b) He shall maintain the registers and books of accounts of the company, as may be applicable and as may be necessary to account for transactions entered into by him in relation to the company; for example: cash book, ledger, bank ledger, register of fixed assets and inventories, securities and investment register, register of book debts and outstanding debts, etc.

  (c) The liquidator shall keep receipts for all payments made or expenses incurred by him.

- ***Distribution***

  The liquidator shall distribute the proceeds from realization within thirty days of the receipt of the amount to the stakeholders.

  The liquidation costs shall be deducted before the distribution is made.

  The liquidator may, with the approval of the corporate person, distribute amongst the stakeholders an asset that cannot be readily or advantageously sold due to its peculiar nature or other special circumstances.

(8) Advantages and Disadvantages

The advantages of voluntary winding up are that even a solvent company can opt for winding up. Further, the directors' personal liability to any future debt/ demand also comes to an end through this process.

The disadvantages of winding-up are that the process is very costly as it involves additional fees in respect of the liquidator, court/tribunal fees, etc. Further, this process can be very time consuming and lengthy process.

"What is now wanted is a combination of the greatest heart with the highest intellectuality, of infinite love with infinite knowledge."

— *Swami Vivekananda*

CA Zulfiqar Shivji

Stamp Duty Implications relating to Business Restructuring

Stamp Duty is a state subject in India. While some of the States in India have enacted their own Stamp Acts, others have adopted the Indian Stamp Act, 1899 with their State specific amendments.

Chargeability of Stamp Duty

The underlying principle with regard to stamp duty is that stamp duty is always charged with reference to the instrument and not on a transaction. Indian Stamp Act, 1899 is the umbrella law under which stamp duty is levied. Section 2(14) of the Indian Stamp Act, 1899 defines instrument as –*"Instrument includes every document by which any right or liability is, or purports to be, created, transferred, limited, extended, extinguished or recorded;"*. To elaborate the meaning of an instrument in simplified terms, an instrument is a written legal document that records the formal execution of legally enforceable acts or agreements, and secures their associated legal rights, obligations, and duties. One such act is the act of "Conveyance" which refers to transfer of the ownership of the property whether movable or immovable in nature from the seller to the buyer. Accordingly, a "Conveyance deed" is an instrument which serves as an ultimate proof that the ownership of the property has been transferred from one person/entity to another.

Businesses are always looking for inorganic growth, mergers & acquisition, restructuring to derive synergies, and such other advantages. In this process, many times companies are amalgamated, merged, demerged, converted into LLP, Business Transfer Agreement/ Share Transfer Agreement being executed or internal group restructuring being done. The Companies Act, 2013 has made provisions under sections 230 to 233 (section 391 to 394 under the erstwhile Companies Act, 1956) for enabling companies to carry out the process of amalgamation, merger and demerger. Companies have to approach the National Company Law Tribunal (jurisdictional High Court under section 391 to 394 of the erstwhile Companies Act, 1956) of the State where the registered office of the Company/ies are located for sanctioning of the scheme of amalgamation, merger and demerger.

While there are several exemptions/concessions under the Income tax Act, 1961 with regard to the aforesaid merger/demerger, the levy of stamp duty becomes a cost for the transactions especially where there is transfer of immovable property as a part of the restructuring process.

Amalgamation/Merger/Demerger

The procedure commences with the preparation of the Scheme of Amalgamation/

Merger/Demerger ('Scheme') and filing the same with the jurisdictional National Company Law Tribunal ('NCLT'). Upon the Scheme being sanctioned, all the movable and immovable properties of the Transferor/ Demerged Company (ies) will be transferred to the Transferee Company. This transfer of the property attracts stamp duty as per the definition of 'Conveyance' introduced by various State Governments. In the past, before the provisions with regard to stamp duty on a Scheme were settled, there were ambiguities as to whether the Scheme per se or the order of the NCLT (High Court under the erstwhile Companies Act, 1956) constitutes an instrument of Conveyance chargeable to stamp duty.

The following observations were made in some important judicial pronouncements in this connection –

Hindustan Lever vs. State of Maharashtra (Supreme Court)[1]

The word "Instrument" is defined to mean every document by which any right or liability is, or purports to be created, transferred, limited, extended, extinguished or recorded, but does not include bill of exchange, cheque, promissory note, bill of lading, letter of credit, policy of insurance, transfer of shares, etc. The recital in the Scheme as well as the order of the High Court (which was the jurisdictional authority for sanctioning the Scheme), declares, that upon such order of High Court, the undertaking of the transferor company shall stand transferred to the transferee company with all its movable, immovable assets and liabilities without any further act or deed. Thus the Scheme sanctioned by the High Court would be an instrument. By the said "instrument", the properties are transferred from the transferor company to the transferee company, the basis of which is compromise or arrangement arrived at between the two companies. This judgement became the landmark judgement which set into motion several states in India to include within the definition of Conveyance, orders of the High Court on restructuring of companies pursuant to which movable/immovable property passes from the transferor to the transferee.

Li Taka Pharmaceuticals Ltd. vs. State of Maharashtra (Bombay High Court)[2]

An order under section 394 is founded or based upon compromise or arrangement between the two companies of transferring assets & liabilities of one company to another company and that order is an "instrument" as defined under the Bombay Stamp Act (Maharashtra Stamp Act) which includes every document by which any right or liability is transferred.

Chief Controlling Revenue Authority vs. Reliance Industries Limited (Bombay High Court)[3]

The Court held that a scheme settled by two companies has no effect or force until the scheme it is sanctioned by the High Court and hence the Scheme per se is not a document chargeable to stamp duty but the order passed by the High Court sanctioning the said scheme under section 394 of the Companies Act, 1956 (Section 232 of the Companies Act, 2013) is an instrument chargeable to stamp duty.

1. 9 SCC 438 (2004)
2. AIR 1997 Bom 7
3. AIR 2016 Bom 108

By relying on the decision of the Supreme Court in Hindustan Lever[1] and Bombay High Court in Li Taka Pharmaceuticals[2], it held that the taxable event is the execution of the instrument and not the transaction as such. It also held that in cases where the Registered Offices of the transferor and transferee company (ies) are situated in different states which requires sanctioning of the Scheme by different jurisdictional High Courts, the order passed by each High Court will be treated as separate instrument chargeable to stamp duty. Hence, stamp duty paid pursuant to an order passed by one High Court cannot be claimed as set-off/remission/deduction against the stamp duty payable on order passed by the other High Court.

However, section 19 of the Maharashtra Stamp Act, 1958 provides that, if any instrument is executed outside the state of Maharashtra and subsequently such instrument or a copy of the instrument is received in the State, the stamp duty payable on such instrument shall be the duty chargeable as per schedules to the aforesaid Act less the amount of duty, if any, already paid under any law in force on the execution of the same instrument. To this argument, the above ruling of Reliance Industries Ltd held that the scheme was sanctioned by both the High Courts in both the States, meaning there were two independent instruments executed in two separate states and it was not the case wherein one instrument was executed in one State was received in other State. The decision in the case of Reliance Industries Ltd has been further appealed before the Hon'ble Supreme Court and is pending hearing.

State specific stamp duty provisions on amalgamation/merger/demerger

As mentioned earlier, the levy of stamp duty is matter of each State's consideration and hence, many States have enacted their own stamp duty acts with the Indian Stamp Act, 1899 as basis. The States such as Maharashtra, Gujarat, Karnataka, Rajasthan, Andhra Pradesh, Chhattisgarh, Goa, Haryana, Jammu & Kashmir, Kerala, Madhya Pradesh, Telangana, Uttar Pradesh, Tamil Nadu and West Bengal have enacted specific provisions to include the payment of Stamp Duty on the Order of the High Court issued pursuant to amalgamation/reconstruction in their Acts/ Schedules. However, only some of the States like Maharashtra, Karnataka, Gujarat, Kerala, Rajasthan and Uttar Pradesh have their own Stamp Duty Acts. Rest other States such as Madhya Pradesh, Andhra Pradesh, have adopted the Indian Stamp Act, 1899 after making State specific amendments to it for levy Stamp Duty on the High Court Order on amalgamation/merger/demerger. Most of the States have also made amendment pursuant to the change of the jurisdictional authority for sanctioning of Schemes by NCLT under sections 230 to 233 of the Companies Act, 2013.

For ready reference, relevant section/clause of the Stamp Act of some of the States are summarized below –

(I) Gujarat Stamp Act, 1958

As per Article 20(d) of the Schedule IA:

Higher of –

a. 1% of market value of the shares issued as consideration; OR

b. 1% of the true market value of the immovable property transferred and situated in Gujarat.

However, there is upper limit for the stamp duty payable under this clause – INR 25 Crores.

(II) Maharashtra Stamp Act, 1958

As per Article 25(da) of Schedule I – 10% of the market value of the shares issued;

But should be restricted to higher of –

I. 5% of market value of immovable property transferred and located in Maharashtra; OR

II. 0.7% of the market value of the shares issued.

The upper cap of stamp duty under the Maharashtra Stamp Act has been recently increased from INR 25 Crores to INR 50 Crores.

(III) Karnataka Stamp Act, 1957

As per Article 20(4) of the Schedule I:

Higher of –

a. 1% of the market value of the shares issued as consideration or shares merged/cancelled in case of merger of subsidiary with its parent company; OR

b. 3% of the true market value of the immovable property transferred and situated in Karnataka.

States with no specific entry for stamp duty on Schemes

For States which do not have their own Stamp Duty Act or inspite of having their own State specific acts, and no specific entry/ amendments have been made/incorporated with regard to stamp duty payable on Schemes, the subject still remains a grey area. Some companies voluntarily discharge the stamp duty by paying off at the general rates prevalent in their State for Conveyance of properties in order to avoid any future litigation on the legality of the Scheme.

Considering Delhi which has no specific stamp duty provisions in place for conveyance pursuant to Schemes, the Delhi High Court in the case of ***Delhi Towers Ltd vs. G.N.C.T. of Delhi***[4] ruled that stamp duty was required to be paid on an order of the court approving a scheme of amalgamation as it qualifies as conveyance. Delhi Towers refuted the above reasoning of the court on the ground that since an order under section 394 of the Companies Act has not been included in the definition of "conveyance", the legislative intent, therefore, is to exclude it from the purview of stamp duty payment. The company further contended that placing reliance on the Hindustan Lever case is unjustified as it dealt with the Bombay Stamp Act, 1958, which was amended to explicitly include an order approving a scheme of amalgamation under the definition of "conveyance". The Court observed that the definition of "conveyance" under the Indian Stamp Act is an inclusive definition of wide import which cannot be confined to specific instruments mentioned in the statute.

Having said that, the inclusive definition of conveyance under the main law – Indian Stamp Act, 1899 includes the Order of the High Court even in the absence of a specific inclusion. The next step comes the computation mechanism and the rate of stamp duty on the amalgamation/merger/demerger. Although, the Court held that stamp duty is leviable, the applicable rate of duty still remains a matter which is not well specified in the law.

4. CA No. 466/2008 in Company Petition No. 50/2003

Set-off of stamp duty paid for Schemes having registered offices/assets in more than one State

While most of the State adopted stamp duty acts provide for set-off of stamp duty paid in one State against that in another State, however, detailed guidance has not been laid down. For example, if a scheme is passed by two different NCLTs in different States and as per the formula for computing stamp duty on Schemes, in one State the higher of the two parameters works out as per immovable property being transferred in that State and in the other State, it works out as per value of shares issued pursuant to the Scheme; in such a situation would set-off be available. Another example is in case where the stamp duty payable on the Scheme works out to the maximum stamp duty payable in one State and it is worked out as per prescribed formula in another State; in such a situation, would set-off be available.

Internal Group Transfers

The Ministry of Finance vide a Notification dated December 25, 1937 exempted the payment of stamp duty on instrument evidencing transfer of property between companies, which are more or less under the same ownership. The companies wishing to obtain relief from stamp duty must satisfy the authorities that the deal sought to be exempted evidences the transfer of properties between the two companies, one of which is the beneficial owner of at least 90% of the issued share capital of the other or if the transfer takes place between parent and its subsidiary. Provided in this case a certificate is obtained by the parties from the officer appointed in this behalf by the local Government concerned that the conditions prescribed in the notification are fulfilled. The claim for exemption under the Notification came up for consideration before the Punjab High Court in the case of ***Associated Clothiers vs. Union of India AIR 1957 P H 261 (Punjab),*** where, while upholding the validity of the Notification the Court held that the notification was designed to facilitate reconstruction of a company or amalgamation of two companies which are more or less under the same ownership so that they should be able to rearrange their affairs without being saddled with liability for payment of stamp duties.

Moreover, when a wholly owned subsidiary ('WOS') merges into its holding company, no shares are issued as consideration and simply the share capital as standing in the books of the WOS gets cancelled against the investment standing in the books of the holding company. Having said that, in Maharashtra as per Article 25(da) of Schedule I, stamp duty on a scheme is capped at 10% of the market value of the shares issued. In the absence of any shares issued, no stamp duty is leviable on the same in Maharashtra. However, in case the WOS has immovable properties in States other than Maharashtra, stamp duty implications for such properties being transferred as a part of the Scheme will need to be considered. Similarly, on merger of WOS in Karnataka where no shares are issued, one may have to consider payment of stamp duty at the rate of 1% of the shares cancelled.

Transfer of shares

Where the shares are in physical form, share transfer deed as prescribed under the Companies Act, 2013 needs to be duly completed and submitted to the concerned company whose shares are being transferred to effect the transfer. In the case of shares being in dematerialised form, the transfer of shares is effected pursuant to DP instructions. It is however an accepted practice to enter into

Share Purchase Agreement recording the terms and conditions of the proposed purchase/sale of shares leaving no ambiguity therein as well as determining the consequent rights and obligations of the parties, the stamp duty on which is prescribed at rate of 0.2% of the agreement value as per Article 5(h)(A)(iv) of the Maharashtra Stamp Act. However, in case of transfer of shares only through transfer deed (without entering into a detailed SPA), the rate of stamp duty on the same is governed by the Indian Stamp Act, 1899 as applicable for the State of Maharashtra which is 0.015% (for both if transferred in dematerialised form or physical mode). The stamp duty payable on transfer of shares under this Article is payable on the prescribed share transfer deed and the rate is computed on the value of shares, i.e. normally on the purchase/sale value entered under the transfer deed. This is so irrespective of where the company is registered or where the parties to the transfer are located.

Business Transfer Agreement ('BTA')/Slump Sale Agreement

A slump sale contemplates transfer of a business undertaking as a whole on a going concern basis and without assigning values to the respective assets or liabilities. Section 2(42C) of the Income Tax Act, 1961 defines "Slump Sale" to mean the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. Explanation 2 of the same clause further states that, the determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities. Slump sale could involve transfer of both immovable and movable property. Transfer of movable property can be made by handing over/physical delivery/novation/waiver of such movable property by obtaining a suitable receipt to that effect recording and/or acknowledging the passage of title in movables from one party to the other. Such a transfer of movables physical delivery does not require registration or stamping. With respect to immovable properties, a separate conveyance deed would have to be executed and registered and the appropriate stamp duty and registration charges paid. It is vital to ensure that the immovable property is not transferred under the slump sale agreement but the same is conveyed through a separate sale deed. Such sale deed/conveyance would be stamped as per the stamp duty rates prevailing in the respective states where the immovable properties are being transferred. The slump sale agreement would have to be stamped under Article 5 of the Schedule I of the Maharashtra Stamp Act. Article 5(h)(A) contained in Schedule I to the same act is relevant in this case. This Article generally seeks to bring in all instruments/contracts which have monetary value and have not been covered under any other specific Article. A contract which creates any obligation, right or interest having monetary value is liable to be stamped in accordance with the Article 5(h)(A)(iv) at the rate of 0.2% on the consideration for the slump sale. Additional stamp duty would also be paid for indemnity, etc provided in the BTA. With regard to stamp duty on transfer of intangible assets including patents/trademarks as part of the slump sale, case to case specific positions will need to be taken.

Supreme Court in the case of ***Dunccans Industries Ltd. vs. State of UP and others (AIR 2000 SC pg. 355),*** held that when there is an intention to transfer the entire business undertaking on an as-is-where-is basis including plant, machinery and other assets, the machinery which formed the fertilizer

plant were permanently embedded to the earth with an intention of running the fertilizer factory. It further held that, the machinery was not embedded to the earth with an ultimate intention to dismantle the same for the purpose of sale as part of the machinery or scrap. Therefore, the machinery is to be treated as "immovable property". The Court also held that it cannot be said that the plant and machinery could have been transferred by manual delivery of possession on any date prior to the date of conveyance of title to the land. Stamp duty as conveyance of immovable property was directed to be paid.

Conversion into LLP

The Limited Liability Partnership Act, 2008 contains provisions under sections 55 to 58 for conversion of firms and companies into a Limited Liability Partnership ('LLP'). Section 58(4) of the LLP Act, 2008 which deals with the registration and effect of conversion, states that –

"Notwithstanding anything contained in any other law for the time being in force, on and from the date of registration specified in the certificate of registration issued under the Second Schedule, the Third Schedule or the Fourth Schedule, as the case may be,—

(a) …

(b) all tangible (movable or immovable) and intangible property vested in the firm or the company, as the case may be, all assets, interests, rights, privileges, liabilities, obligations relating to the firm or the company, as the case may be, and the whole of the undertaking of the firm or the company, as the case may be, ***shall be transferred to and shall vest in the limited liability partnership without further assurance, act or deed;***

(c) …"

Hence, as per clause (b) above, all the properties vest and stand transferred without any further assurance, act or deed. The Act itself states that when any Company or Firm is converted into a LLP and it holds any property which is registered with any authority, then such LLP is required to notify these authorities regarding the conversion. The property of the Company or firm automatically vests with the LLP and no Conveyance Deed is required to be executed separately for such transfer. In fact there is no consideration or buyer/seller in the entire transaction and the ultimate beneficiaries remain the same post conversion too. This a case of succession from a private limited company into a LLP. Therefore, there should be no levy of stamp duty on such conversion. This interpretation finds support from the following rulings wherein it was held that no stamp duty is required to be paid in the event of vesting of property by law and not by conveyance –

1. ***Rama Sundary Roy vs. Syamendra Lal Ray - ILR (1947) 2 Cal 1;***

2. ***Vali Pattabhirama Rao vs. Sri Ramanuja Ginning and Factory P. Ltd. - 60 Company Cases 568 (APDB)***

The Ministry of Corporate Affairs with respect to the question that whether there was stamp duty exemption in case of conversion of business structures, has clarified through an FAQ that since stamp duty is the subject reserved for the States, the LLP Act does not contain any provision for treatment of stamp duty issues and that the stamp duty payable will depend upon the relevant Stamp Act prescribed by the State Government/Union Territory. This clarification has certainly caused anxiety amongst various stakeholders and left it open for each State to take a position on this.

Conversion into Company

Section 367, Part XXI of the Companies Act, 2013 provides that all property, movable and immovable (including actionable claim), belonging to or vested in a company at the date of its registration in pursuant to this Part, shall, on such registration, pass to and vest in the company as incorporated under this Act for all the estate and interest of the company therein. This is quite similar to the provisions relating to vesting of properties upon conversion of a firm or company into an LLP as under the LLP Act, albeit the LLP Act emphasizes that such transfer and vesting will be without any further assurance, act or deed. The vesting of properties upon conversion to a company under and as per the Companies Act would amount to a succession and all the justifications discussed above with regard to conversion into LLP would be relatable in this case too. Infact, conversion of firm to private limited has existed much before the provisions with regard to conversion of firm/private limited into LLP came into force. There have been judicial pronouncements with regard to stamp duty on conversion from firm to private limited company.

Valuation for Stamp Duty Adjudication

In relation to the transferee company, whose shares are listed and quoted for trading on a stock exchange means the market value of shares on the appointed day mentioned in the Scheme of Amalgamation or when the appointed date is not fixed, the date of the order of the High Court. In relation to the transferee company whose shares are not listed on the stock exchange, means the market value of the shares issued or allotted with reference to the market value of the shares of the transferor company or as determined by the Collector after giving the transferee company an opportunity of being heard. The number of shares issued or allotted in exchange or otherwise shall mean, the number of shares of the transferor company accounted as per exchange ratio as on the appointed date. The adjudication authorities would review the exchange ratio workings to satisfy themselves on the value of consideration being issued. Each State may have their respective way of working out/accepting the valuation as presented for adjudicating of stamp duty on the basis of shares issued pursuant to a Scheme.

Conclusion

Prevalence of differential stamp duty regimes/ practices in different States has created a confusion in the arena of Mergers & Acquisitions involving business restructuring, unification/streamlining. Moreover, businesses would prefer to have a more predictable and standard regulations with regard to stamp duty on business restructuring including having a centralized Act. One of the matters that can be settled to avoid disputes/litigations on stamp duty would be to provide clarity on the mechanism for set-off of stamp duty for Schemes that involve multiple States. May be the formula and rates for stamp duty in case of Schemes can be unified/aligned. With regard to group/internal restructuring, a more simplified/concessional stamp duty cost can be prescribed.

CA Anish Thacker

HOT SPOT
FINANCE ACT, 2023 – AMENDMENTS RELEVANT TO THE FINANCIAL SERVICES SECTOR

1 Introduction

The Finance Bill, 2023 (FB 2023 or Bill) was presented by the Hon'ble Finance Minister (FM) Nirmala Sitharaman on 1 February 2023[1]. While moving the Bill for approval by the Lok Sabha[2] on 24 March 2023, the FM introduced amendments to FB 2023 (Amended FB 2023). The Bill has been passed by both houses of the Parliament without discussion whatsoever, and has also received presidential assent. Some of the key amendments which impact the Financial Services sector, are discussed below. These are divided into the International Financial Services Centre (IFSC) related amendments and the other amendments. The IFSC related amendments are first discussed below.

It may be noted that this article does not cover all amendments made between the tabling of the Finance Bill before Parliament and the moving of the Bill for discussion. Only selected amendments have been covered in this article.

2 IFSC Related Amendments

2.1 *Tax exemption for non-resident on distribution of income from Offshore Derivative Instruments (ODIs) issued by an IFSC Banking Unite (IBU)*

- The endeavor of the provision of exemption under section 10(4D) of the Income-tax Act, 1961(the Act) Hs been to provide parity in tax treatment to IFSC Funds as compared to Funds in offshore jurisdictions (of course . The overseas funds typically issue ODIs, popularly called P Notes or participatory notes to offshore investors. These notes are contracts

1. Refer our consolidated tax and policy alerts on tax and policy amendments "Budget Connect 2023" series released on 2 February 2023
2. The lower house of parliament

which allow investors a synthetic exposure to income from Indian securities. To hedge the exposure that the funds take on, the funds typically hold the said securities on their own books. The same also applies to an IFSC fund including IFSC Banking units (IBUs). The discussion below is in the context of the IBUs.

- Under the ODI contract, the IBU makes investment in permissible Indian securities. Such income may be taxable/ exempt in the hands of IBU as per the provisions of the ACT. The IBU would pass on such income to the ODI holders.
- Presently, the income of non-residents on transfer of ODIs entered with IBU is exempt under the Act. However, there is no similar exemption on the distribution of income to the non-resident ODI holders. Resultantly, such distributed income may be taxed twice in India i.e., first when received by the IBU, and second, when the same income is distributed to non-resident ODI holders.
- In order to remove double taxation, the Finance Bill, 2023 (FB 2023) proposed exemption to any income distributed on ODI entered with an IBU provided that the same is chargeable to tax in the hands of the IBU.
- The condition of chargeability of such income to tax in the hands of IBU could have resulted in practical difficulties for non-residents to claim the exemption. Considering the various representations made on this aspect, the Amended FB 2023 addresses this anomaly by removing the said condition.

2.2 *Concessional tax rate on dividend income received by a non-resident from an unit in IFSC*

- Presently, dividend income received by a non-resident from a unit in IFSC is taxable at the rate of 20%[3] under the ACT. In order to encourage investments from outside India into IFSC, the Amended FB 2023 reduces the tax rate under the ACT on such dividend income to 10%[3].

2.3 *Tax rate of 9%[3] on interest on bonds listed on IFSC Stock Exchange on or after 1 July 2023*

- Presently, interest in respect of monies borrowed from a source outside India by way of issuance of any long-term bond or rupee denominated bond (before 30 June 2023) which are listed on recognized stock exchange located

3. Being a fund established in India which has been granted a certificate of registration as Category I or II AIF and is regulated by Securities and Exchange Board of India ('SEBI') or IFSC Authority

in IFSC is taxable under the ACT at a concessional rate of 4%[3].

- FB 2023 did not extend the concessional tax regime on interest income earned by non-residents on specified bonds covered under section 194LC of the ACT.
- The Amended FB 2023 provides for a 9%[3] tax rate on interest under the ACT with respect to the bonds issued by an Indian Company and listed on recognized stock exchanges in IFSC on or after 1 July 2023. Bonds listed on IFSC exchange on or before 30 June 2023 would continue to enjoy the concessional tax rate of 4%[3].

2.4 Conditional tax exemption to Non-residents maintaining a bank account with an IBU

- Presently, a non-resident is liable to tax in India with respect to any income which is: (a) received or deemed to be received in India and (b) accrues or arises or is deemed to accrue or arise in India.
- Recently, non-resident entities (inter-alia having an Indian connection) have opened / are considering opening a bank account with an IBU in IFSC for their global business operations.
- In order to encourage the growth of IBUs in IFSC as well as to limit the undue tax incidence on non-residents who merely have a bank account with an IBU in IFSC, the Amended FB 2023 provides an enabling provision to exempt non-residents who are maintaining a bank account with an IBU in IFSC to the extent such income accrues or arises outside India and is not deemed to accrue or arise in India. A Notification to enable this would need to be introduced by the Central Board of Direct Taxes (CBDT).

2.5 Non-applicability of surcharge and cess on income from securities earned by Category III AIFs and investment banking division of an OBU (i.e. "Specified Fund" as per section 10(4D) of the ACT)

- The Amended FB 2023 intends to remove the burden of surcharge and cess on income from securities earned by a Specified Fund. Under the ACT, Specified Fund is inter alia defined to mean a Category III AIFs (which meets specified conditions) and investment banking division of an OBU (meeting specified conditions). In this context, a fact specific evaluation may be required considering the nature of technical amendments.
- The objective of the amendment appears to be to bring the taxation of Specified Fund in IFSC at par with the tax regime applicable for Fund investing from a jurisdiction with which Indian has a Tax Treaty.

2.6 Extension of 100% tax holiday/s 80LA of the Act to OBUs

- Presently, section 80 LA of the Act provides a 100% tax deduction for initial 5 assessment years and 50%

tax deduction for the subsequent 5 assessment years with respect to the income earned by an OBU in a Special Economic Zone.

- Further, the Act also provides for a 100% tax deduction for a consecutive period of 10 out of 15 years with respect to the income earned by a unit in IFSC from its approved business.
- With respect to the former provision, the Amended FB 2023 increases the tax deduction to 100% during the subsequent tax years i.e., year 6 to year 10.

2.7 *Relocation of an off-shore Fund - Expansion of the definition of 'Original Fund'*

- Presently, the ct provides for a tax neutral relocation of offshore Funds to IFSC [i.e., assets of the Original Fund, or of its wholly owned special purpose vehicle, to a resultant Fund in IFSC] for promoting the Fund Management ecosystem in IFSC.
- The definition of 'Original Fund' under the ACT is now expanded to include:
- an investment vehicle, in which Abu Dhabi Investment Authority (ADIA) is the direct or indirect sole shareholder or unit holder or beneficiary or interest holder and such investment vehicle is wholly owned and controlled, directly or indirectly, by ADIA or the Government of Abu Dhabi, or
- a Fund notified by the Central Government in the Official Gazette (subject to such conditions as may be specified).

2.8 *Shares issued by a private company to specified fund located in IFSC will not be subjected to angel taxation*

- Prior to the FB 2023, shares issued by a closely held company to non-resident in excess of the company's prescribed fair market value was not liable to tax in the hands of the closely held company issuing the shares under section 56(2)(viib) of the Act (angel tax). Additionally, angel tax did not apply to with respect to (i) shares issued to a resident being a venture capital fund or a specified fund[3]; or (ii) shares issued by a notified start-up.
- The FB 2023 extended the provisions of "angel tax" in respect of shares issued by closely held companies to non-residents also with effect from Financial Year 2023-24. The amended FB 2023 does not change this position.
- However, considering that a specified fund located in IFSC is now governed by the International Financial Services Centre Authority (Fund Management) Regulations, 2022, Amended FB 2023 provides that shares issued by closely held companies to specified fund located in IFSC governed by said Regulations, 2022 will not be subject to "angel tax".

3 Other amendments

3.1 Gains from transfer, redemption or maturity of units of specified mutual fund (SMF) also to be taxed as short-term capital gains

- The FB 2023 introduced a special tax regime to tax the gains on transfer, redemption or maturity of Market Linked Debentures (MLDs) as short-term capital gains (STCG), irrespective of the period for which the MLDs are held.

- Such gains are to be computed by reducing the cost of acquisition of such debentures and also any expenses incurred in connection with the transfer. However, the benefit of indexation is not available while computing such gains.

- The amended FB 2023 extends the scope of the special tax regime to unit of a Specified Mutual Fund (SMF). A SMF is defined to mean a mutual fund of which not more than 35% of total proceeds are invested in the equity shares of domestic companies. The percentage of holding in equity shares of domestic companies is to be computed by using the annual average of the daily averages of the holdings unlike in the case of Equity Oriented Funds where the annual average of the monthly averages has to be used.

- Considering the judicial precedents[4] in the context of capital gains arising on depreciable assets under a comparable provision, it is possible to take view that the new provision merely modifies the method of computation of gains (by denying indexation benefit in case of SMF units) and does not change the long term character of the asset (MLD or SMF units) for other purposes like lower rate of tax on long term capital gains or roll over capital gains exemption and set off of losses.

3.2 Amendments relating to business trusts (REITs/ InvITs) and its unit holders

- Computation of certain distribution to be taxed as "other income" in the hands of business trust unit holders:

- The Act accords partial 'pass-through' status to business trusts in terms of which certain specific incomes (i.e., interest, dividend and rent) are taxed in the hands of the unit holders on distribution by the business trusts[5] whereas other incomes are taxed in the hands of business trust.

- The FB 2023 proposed to introduce a new provision whereby any other distributions (such as repayment of debt) by business trusts that presently do not suffer taxation

4. Illustratively, *CIT vs. V. S. Dempo Co. Ltd (2016)(387 ITR 354)(SC), Smita Conductors vs. DCIT (2015)(152 ITD 417)(Mum)*
5. Comprising REITs and InvITs

either in the hands of business trust or in the hands of unit holders, will henceforth be taxed as "other income" in the hands of unit holders.

- Further, where such distribution is made on redemption of units by business trusts, then the distribution received shall be reduced by the cost of acquisition of the unit(s) to the extent such cost does not exceed the distribution so received.
- Stakeholders represented for reconsideration of the proposal – more particularly, in respect of treatment of redemption proceeds as normal income instead of capital gains.
- The amended FB 2023, provides a revamped version of the new provision. The revamped provisions provide the manner of computing the distribution which is taxable as "other income" in the hands of unit holders (referred to as "specified sum"). As per this computation, the "specified sum" shall be the result of 'A – B - C', where:

'A'	Aggregate sum distributed by the business trust during the current TY or past TY(s), w.r.t. the unit held by the current unit holder or the old unit holder. However, the following sum shall not be included in 'A': - Interest or dividend income from the SPV - Rental income - Any sum chargeable to tax in the hands of business trusts
'B'	Issue price of the units
'C'	Amount charged to tax under this new provision in any past TY(s).

If the result of the above is negative (i.e. where 'B' + 'C' is more than 'A'), the "specified sum" shall be deemed to be zero.

- The above computation mechanism indicates that specified sum is to be computed by taking into account the distribution made in the past TY(s), including the distribution made to the old unit holders who were holding units prior to the current distribution date. Thus, while the levy as per the revamped provision applies prospectively w.e.f. TY 2023-24, the provision has a retroactive impact since it factors the distributions made prior to TY 2023-24.
- Furthermore, the Amended FB 2023 omits the proposal of FB 2023 to reduce the cost of acquisition of units by the amount of distribution for computing "other income".
- ***Notified sovereign wealth fund (SWF) and pension fund to be exempted from the above revamp provision:***

- The provides exemption to notified SWF and pension fund, in respect of certain incomes including distribution received from business trusts.
- The amended FB 2023 extends the exemption in respect to "other income" received by notified SWF and pension fund as per the revamped business trust taxation provision above.

- ***Computation of cost of acquisition of units in business trusts:***
  - The amended FB 2023 introduces provision to determine the cost of acquisition of units in business trust. In determining the cost of acquisition any sum received by unit holder from business trust w.r.t. such units, is to be reduced, except the following sums:
    - — Interest or dividend income from the SPV
    - — Rental income
    - — Any sum not chargeable to tax in the hands of business trusts
    - — Any sum not chargeable to tax in the hands of unit holders under revamped provision.
  - Furthermore, it provides that where units are received by way of transaction not considered as transfer for capital gains, the cost of acquisition of such unit shall be computed by reducing the sum received from business trust (as explained above), whether such sum is received before or after such transaction.
  - The above provision requires reduction of all sums received from the business trust even prior to 1 April 2023, and to this extent, the provisions have a retroactive impact.

- ***Exemption from withholding of tax from interest payment by special purpose vehicle (SPV) to business trust:***
  - Prior to the FB 2023, interest (other than interest on securities) paid by SPV to business trust was not liable for withholding. However, there was no exemption for withholding on interest on securities paid by SPV to business trust.
  - As per the amended FB 2023, interest on securities paid by SPV to business trust is specifically exempted from withholding with effect from 1 April 2023.

- ***Exemption on swap of interest in JV held by public sector company with shares of foreign company***
  - The amended FB 2023 introduces a new provision for exempting any transfer of a capital asset being an interest in a JV, held by a public sector company, in exchange of shares of a company incorporated outside India by a foreign government,

in accordance with laws of that foreign government, from capital gains. For this purpose, a JV shall mean a business entity, as may be notified by the Central Government.

- A consequential amendment is also made to provide that cost of acquisition of such shares shall be deemed to be cost of acquisition of the interest in JV. However, there is no consequential amendment to include the holding period of interest in JV in the holding period of such shares.
- The amendment shall apply from TY 2022-23.
- The amendment is likely to benefit ONGC Videsh Limited (OVL) whose interest in JV in Russia having production sharing agreement with Russian Government in respect of certain oil fields was recently swapped with shares of new Russian company in accordance with decree issued by the Russian President. The swap was made to address difficulties arising out of existing operator being unable to operate the oilfields due to sanctions on Russia after outbreak of war with Ukraine.

4 Conclusion

The financial services sector, an in particular, the IFSC continue to be the the key focus areas of the Government as we move to the next phase of amrit kaal. The fact that the Government wants to remove the arbitrage opportunities available to high net worth taxpayers is also not something that one can question. One sincere request to the Ho. Fm and the drafters of the Finance Bill would be to consult stakeholders much prior to moving amendments and try and avoid a situation where multiple corrections or amendments have tto be made at the time of moving of the Bill for discussion. As mentioned earlier, no discussion happened in the passing of the Bill this year so no voice of the stakeholders could reach the Government. This is avoidable in a vibrant democracy where consensus should be prevalent.

"Work for work's sake. There are some who are really the salt of the earth in every country and who work for work's sake, who do not care for name, or fame, or even to go to heaven."

— *Swami Vivekananda*

CA Vinay Deshmane CA Urvi Shah

HOT SPOT
Direct Tax Amendments to The Finance Bill 2023 - Other than Amendments relating to Financial Services Sector

The Finance Bill, 2023 ('Finance Bill') was introduced at the time of presentation of the Union Budget for the Financial Year ('FY') 2023-24 by the Hon'ble Finance Minister on 1 February 2023. Subsequently, certain amendments were proposed to the provisions of the Finance Bill through a Notice of Amendments tabled in the Lok Sabha. The Finance Bill with amendments ('amended Finance Bill') has been passed by both the houses of the Parliament and received assent of the Hon'ble President on 31 March 2023.

The Direct Tax amendments to the Finance Bill 2023 other than amendments relating to Financial Services sector are discussed below.

1. The tax rate on payment to non-residents towards royalty and Fees for Technical Services ('FTS') increased from the existing rate of 10% to 20% [Section 115A] [with effect from ('w.e.f.') 1 April 2024]

Non-residents are taxable on income that accrues or arises or is deemed to accrue or arise in India or is received or deemed to be received in India. Income in nature of royalty or FTS is deemed to accrue arise in India and hence taxable in hands of non-residents in India.

Section 115A of the Income Tax Act, 1961 ('the Act') provides the rate at which different streams of income are taxable in hands of non-residents. Section 115A was amended by the Finance Act, 2015 to reduce the rate of tax on royalty and FTS in hands of non-residents from 25% to 10% (excluding applicable surcharge and cess).

The Finance Act 2023 has amended the tax for royalty and FTS income earned by non-residents from 10% to 20% (excluding applicable surcharge and cess). This change was not proposed in the Finance Bill introduced on 1 February 2023.

With this amendment, the maximum effective tax rate on royalty and FTS would increase to 21.84% including surcharge and cess.

As per section 90(2) of the Act, a non-resident can choose to be taxed as per the provisions of Double Tax Avoidance Agreement ('DTAA') entered into between India and the country of residence of the non-resident or the Act, whichever is more beneficial. To avail the beneficial rate prescribed under the DTAA, the non-resident would be required to provide prescribed documentation, which includes a Tax Residency Certificate ('TRC') issued by the country of residence and Form-10F

(especially where the prescribed details are not mentioned in the TRC) to be submitted online, which would, in turn, require Permanent Account Number ('PAN'). The requirement of online filing of Form 10F (for non-resident taxpayer who are not having PAN and not required to have PAN) was relaxed till 31 March 2023, which has been further extended to 30 September 2023 (vide Notification dated 28 March 2023).

Prior to this amendment, the tax rate of 10% (excluding applicable surcharge and cess) provided in section 115A was at par with certain DTAAs[1] concluded by India. This rate, if compared to the hitherto Act rate (effective rate of 10.92% including surcharge and cess) provided marginal relief making DTAA benefit less lucrative considering the onerous documentation requirements to claim the benefit. Pursuant to this change, non-residents may take benefit of lower tax rate under relevant DTAAs. This may increase compliance burden on non-residents who were simply paying taxes as per tax rate provided in the Act[2] earlier.

Some DTAAs[3] provide for a 15% rate on Royalty and FTS. Taxpayers which claimed the benefit of lower rate of 10% (excluding applicable surcharge and cess) under the provisions of the Act without taking recourse to the DTAA, would be adversely affected. Firstly, the need to obtain the necessary documents, which were hitherto not required in absence of the need to avail the benefit of the DTAA and secondly, the additional tax levy of 5% (effectively 4.08%).

It is pertinent to note that section 115A exempts non-residents from filing income-tax returns in India provided that:

(i) such non-resident had income from dividend/interest/royalty/FTS from India and

(ii) tax has been deducted at source from such income at a rate which is not lower to the rate provided under section 115A.

With the increase in tax rate under section 115A, TDS on royalty and FTS payments to non-residents may be made at a lower rate as per applicable DTAA. Therefore, non-residents may no longer be exempt from filing income-tax return. This would again increase the compliance burden on non-residents including the requirement to obtain PAN and furnish Form 10F.

2. Extension of scope of rebate in case of resident individuals covered under new regime under section 115BAC(1A) [Section 87A] [w.e.f. AY 2024-25]

Hitherto, section 87A provided rebate to resident individual where total income does not exceed INR 5 lacs. The amount of rebate is lower of the tax liability or INR 12,500. Considering the said rebate, resident individuals having net taxable income up to INR 5 lacs were not required to pay any tax.

The Finance Bill 2023 proposed to insert a proviso to section 87A of the Act to allow a higher rebate to the resident individual opting for the new Concessional Tax Regime ('CTR')

1. For example, DTAA with Singapore, France, Germany, Netherlands, Ireland provide for 10% tax rate on royalty and FTS.
2. If a non-resident payee is not having PAN, higher TDS rate (higher of 20%, rate as per the Act and rate as per DTAA or Finance Act) would be applicable as per section 206AA of the Act. In case where non-resident is having income in the nature of royalty, FTS, capital gains and interest and provides TRC, then lower rate as per the Act can be applied even in the if such non-resident does not have PAN.
3. Like USA, UK, Mauritius (for royalty) etc.

under section 115BAC(1A) of the Act. A rebate under section 87A is available if total income of resident individual during the FY does not exceed INR 7 lacs. The amount of rebate is lower of the tax liability or INR 25,000. In other words, if the total income of a resident individual is up to INR 7 lacs, there would not be any tax liability on opting for CTR under section 115BAC(1A) of the Act.

The amended Finance Bill further provides for marginal relief to resident individuals whose net taxable income exceeds INR 7 lacs and incremental income tax liability is higher than incremental income above INR 7 lacs. Marginal relief will be provided to the extent incremental income tax liability exceeds incremental income in excess of INR 7 lacs. This is explained by way of following example:

Particulars	***Scenario – I – Income up to INR 7 lacs***	***Scenario – II – Income exceeding INR 7 lacs***
	Amount (INR)	***Amount (INR)***
Net total income	7,00,000	7,20,000
Tax as per new CTR	25,000	27,000
Less: Rebate	25,000	7,000 [27,000 (incremental tax) – 20,000 (incremental income)]
Total income tax	Nil	20,000

The above marginal relief shall not be applicable to resident individuals opting for old tax regime.

3. Higher rate of TCS under certain circumstances not to exceed 20% [Section 206CC and 206CCA] [w.e.f. 1 July 2023]

Presently, section 206CC and 206CCA of the Act provide for TCS at a higher rate of 5% or twice the rate prescribed under the Act in following scenarios:

— where a person responsible for making a payment on which TCS is leviable, does not furnish his PAN to the person who is responsible to collect such TCS (section 206CC).

— where a person responsible for making a payment on which TCS is leviable, has not filed his tax return for the year preceding the year in which TCS is leviable for which the time limit for furnishing the return of income has expired and the aggregate of TDS/TCS for such person is INR 50,000 or more in such preceding year (section 206CCA).

The Finance Bill 2023 had proposed to increase rate of TCS for remittances made under Liberalized Remittance Scheme ('LRS') and payments for overseas tour packages from 5% to 20%. With increase in TCS rate on LRS to 20%, the higher rate for TCS (computed at twice the rate as per section 206CCA) would be 40%, which is higher than the slab rates for individuals.

In order to rectify the above anomaly, the Finance Bill has been amended to cap the highest rate of TCS at 20%.

4. Amendment in provision of TCS on remittance under LRS [Section 206C(1G)] [w.e.f. 1 July 2023]

Finance Act, 2020 had introduced TCS @ 5% on foreign remittances made by a resident under the LRS, provided the aggregate amount

of remittance during any financial year exceeds INR 7 lacs.

The Finance Bill 2023 increased rate of TCS on certain foreign remittances and on sale of overseas tour packages as summarized below.

Sr. no.	*Type of remittance*	*Present rate*	*Proposed rate*
1.	For the purpose of any education, if the amount being remitted out is a loan obtained from any specified financial institution	0.5% in excess of INR 7 lacs	No change
2.	For the purpose of education, other than (1) or for the purpose of medical treatment.	5% in excess of INR 7 lacs	No change
3.	Overseas tour package	5% without any threshold	20% without any threshold
4.	Any other case	5% in excess of INR 7 lacs	20% without any threshold

The Finance Bill has been amended to provide that TCS shall be collected in case of remittance under LRS even if remittance is not made out of India.

5. Change in effective date for TDS on winnings from lottery, crossword puzzle etc. [Section 194B] [w.e.f. 1 April 2023]

The Finance Bill proposed to amend section 194B of the Act to provide that TDS shall be applicable where the amount/the aggregate of amount of winnings from any lottery or crossword puzzle or card game and other game of any sort during the FY exceeds INR 10,000.

Further, the scope of section 194B of the Act was proposed to be widened by including, income from gambling or betting of any form or nature, within its ambit. These amendments were proposed to come into effect from 1 April 2023.

Moreover, 2nd proviso in section 194B was proposed to be inserted w.e.f. 1 July 2023 to clarify that section 194B of the Act shall not apply to winnings from any online games in view of specific provisions proposed to be introduced vide section 194BA.

The effective date of amendment proposed by the Finance Bill in 2nd proviso to section 194B of the Act has been changed to 1 April 2023 instead of 1 July 2023.

6. Change in effective date of TDS on net winnings from online games [Section 194BA] [w.e.f. 1 April 2023]

The Finance Bill proposed to introduce a new section 115BBJ whereby any income by way of net winnings from any online games during the financial year, computed in the prescribed manner, included in the total Income, is to be taxed @ 30%. The aforesaid amendments were proposed to come into effect from 1 April 2023.

Consequently, the Finance Bill also proposed to introduce a new section 194BA for levy of TDS on income by way of winnings from any online games taxable under the newly inserted section 115BBJ during the FY. This provision was proposed to be effective from 1 July 2023.

The effective date for TDS applicability under section 194BA has been moved to 1 April 2023 from 1 July 2023.

7. Section 206AB of the Act not to apply in respect of TDS on winning from online games [w.e.f. 1 April 2023]

Section 206AB of the Act provides that where a person fails to furnish his return of income for the specified period and TDS during that period exceeds the specified limit, the deductor shall deduct the tax at rates higher of the following:

(i) at twice the rate specified in the relevant provision of the Act; or

(ii) at twice the rate or rates in force; or

(iii) at the rate of 5%.

This provision does not apply where the tax is required to be deducted under the specified provisions where TDS rate is the maximum rate of 30%.

While section 194BA dealing with TDS on net winnings from online games requires tax to be deducted @ 30%, the Finance Bill did not propose to include the said section in list of sections excluded from the provisions of section 206AB. This could have resulted in higher TDS of 60% in case of online game winnings.

To rectify the aforesaid anomaly, the amended Finance Bill adds section 194BA to this list with effect from 1 April 2023.

8. Amendment to the definition of 'rates in force' in section 2(37A) to include reference to withholding provisions on income by way of winnings from online games

Section 194BA provides that the person responsible for paying the winning from online games shall deduct tax at the rates in force.

The term "rate or rates in force" is defined under section 2(37A) of the Act. Sub-clause (ii) of section 2(37A) of the Act lists down certain provisions of TDS (such as TDS on income from winnings from lotteries and crossword puzzles etc.), for which the expression "rates in force" shall mean the rates of income-tax specified on this behalf in the Finance Act of the relevant year.

In case of TDS provisions on net winnings from online games, rates provided in TDS rate schedule of Finance Bill provided for 30% rate. However, no amendment was proposed in the Finance Bill to the definition of "rates in force" to include reference to section 194BA.

To rectify such anomaly, the Finance Act 2023 provides to add reference to section 194BA in section 2(37A).

9. Exemption from capital gains on transfer of interest in a Joint Venture held by a Public sector company in exchange of shares of a foreign company [Section 47 and Section 49] [w.e.f. 1 April 2023]

A new clause (xx) has been inserted in section 47 of the Act to provide exemption in relation to transfer of a capital asset, being an interest in a joint venture, held by a public sector company, in exchange of shares of a company incorporated outside India by the Government of a foreign State, in accordance with the laws of that foreign State.

The term 'joint venture' is defined to mean 'a business entity, as may be notified by the Central Government in the Official Gazette'.

Further, sub-section (2AI) has been inserted in section 49 of the Act to provide that the cost of the interest in joint venture shall be deemed to be cost of shares of the foreign company received in exchange by the public sector company.

However, no consequential amendment has been made to include the holding period of interest in joint venture in the holding period of such shares.

10. Amendment in section 11(7) of the Act for extending exemption under section 10(23EC) to Charitable Trusts [Section 11(7)] [w.e.f. 1 April 2024]

Section 11(7) of the Act provides that if a trust or institution is registered under section 12AA/12AB of the Act, then it cannot claim exemption under other provisions of section 10 except section 10(23C), section 10(46) and section 10(1).

The Finance Bill proposed to amend section 11(7) to allow trusts registered under section 12AA/12AB to claim exemption for newly inserted section 10(46A) i.e. exemption of income arising to a specified body, authority, board, trust or commission.

The Finance Bill has been amended to also allow exemption under section 10(23EC) to such Trusts registered under section 12AA/12AB. Section 10(23EC) exempts income received by the notified Investor Protection Fund, established jointly or separately by commodity exchanges in India, through contributions made by the exchanges and their members.

11. Scope of tax exemption for Sikkimese individuals expanded [Section 10(26AAA)][with retrospective effect from 1 April 1990]

Section 10(26AAA) of the Act provides exemption to Sikkimese individuals on account of any income from any source in the state of Sikkim and dividend or interest on securities. Such exemption specifically excludes Sikkimese woman who, on or after 1 April 2008, marries an individual who is not a Sikkimese.

Constitutional validity of the above provision was challenged before the Hon'ble Supreme Court[4]. The Hon'ble Supreme Court allowed the benefit to be extended to such individuals and directed to amend provisions of the Act in this regard.

Accordingly, the Finance Bill was amended to substitute clause (26AAA) of section 10 of the Act to widen the meaning of the term "Sikkimese" and include individuals:

- whose name does not appear in the Register of Sikkim Subjects but it is established that such individual was domiciled in Sikkim on or before 26 April 1975; or
- who was not domiciled in Sikkim on or before 26 April 1975 but it is established beyond doubt that such individual's father or husband or paternal grandfather or own brother was domiciled in Sikkim on or before 26 April 1975.

Further, proviso to section 10(26AAA) denying exemption to Sikkimese woman who married a non-Sikkimese individual on or after 1 April 2008, is removed to allow exemption to such woman.

The amendment takes effect retrospectively from 1 April 1990, when this provision was first introduced.

4. *Association of Old Settlers of Sikkim v. Union of India [2023] 146 taxmann.com 271 (SC).*

Keshav B. Bhujle
Advocate

DIRECT TAXES
Supreme Court

1 ***CIT(Exemptions) vs. Sant Girdhar Anand Parmhans Sant Ashram; [2023] 452 ITR 52 (SC): Dated 28/02/2023:***

Donations to charitable institutions — Special deduction u/s. 80G of ITA 1961 — Requirements to be satisfied separately — That assessee registered u/s. 12AA not sufficient — Whether assessee invites disqualification for spending more than 5 per cent. of receipts for religious purposes — Details of assessee's activities and accounts not on record — Matter to be considered afresh by Commissioner (exemption) in light of assessee's contentions including fact that assessee held approval for subsequent periods:

The assessee-trust's objects included, inter alia, spiritual awakening of the common masses, spreading teachings of great Indian saints, organising gatherings of people desirous to be benefited from spiritual preachings, publicising such preachings and philosophies of great saints and extending financial assistance to the poor, destitute, etc. The assessee filed an application for grant of approval u/s. 80G(5)(vi) of the Income-tax Act, 1961. The Commissioner (Exemptions) denied the approval on the ground that the assessee had spent more than 5 per cent. of the total receipts for religious purposes such as pooja expenses and telecast expenses.

The Tribunal allowed the assessee's appeal, in view of the fact that the assessee had been granted exemption u/s. 12AA on November 30, 2015 itself which was still in existence and if there was any violation, that would have been subject to variation or withdrawal by the Commissioner (Exemptions).

Punjab and Haryana High Court dismissed the appeal filed by the Revenue and held as under:

"i) The Commissioner (Exemptions) had granted approval to the assessee u/s. 12AA on the same date as his order denying the approval to the assessee. Taking note of the objects and aims of the assessee it was recorded by the Tribunal that there was no logic in denying approval u/s. 80G(5)(vi) and

that the assessee had demonstrated that spending more than 5 per cent. of the total receipts for religious purposes as pooja expenses and telecast expenses was justified. If, in subsequent years, the Department was satisfied that the activities of the assessee were not qualified for charitable purposes, it would be open to the Department to initiate action for cancellation of registration u/s. 12AA of the Act.

ii) The Department had not been able to controvert the findings recorded by the Tribunal warranting interference. No question of law arose."

On appeal by the Revenue, the Supreme Court held as under:

"i) Neither the order of refusal of the certificate u/s. 80G(5B) nor the subsequent order of the Tribunal dealt with essential facts as to the quantum of receipts and the expenditure incurred. While the assessee claimed to continue to hold exemption u/s. 12AA of the Act, never the less, for the benefit u/s. 80G(5B), the requirements of that provision have to be satisfied separately.

ii) In view of the fact that the Commissioner's order as well as the order of the Tribunal were bereft of any factual details as to the nature of activities which the assessee carried on and the accounts involved, the matter required to be considered afresh by the Commissioner (Exemption) in the light of the contentions to be urged on behalf of the assessee.

iii) It was open to the assessee to rely on the fact that it was recipient of the benefit u/s. 80G(5B) for subsequent periods (A. Ys. 2022-23 to 2026-27)."

■●■

"Never forget the glory of human nature! We are the greatest god.. Christs and Buddhas are but waves in the boundless ocean which I AM."

– Swami Vivekananda

"The greatness of a nation and its moral progress can be judged by the way its animals are treated. I hold that the more helpless a creature the more entitled it is to protection by man from the cruelty of humankind."

– Mahatma Ghandi

Jitendra Singh
Advocate

Radha Halbe
Advocate

Harsh Shah
Advocate

DIRECT TAXES

High Court

Transfer pricing - Section 92C of the Income-tax Act, 1961 - Computation of arm's length price - Assessee outsourcing its manufacturing activity is legally on the same pedestal as that of a manufacturer - Accordingly, no transfer pricing adjustment on account of Advertisement, Marketing and Promotion expenses ought to be made. [Section 92B]

1. The Transfer Pricing Officer had made an adjustment on account of advertisement, marketing and promotion expenses incurred by the Assessee. While making the adjustment the Transfer Pricing Officer distinguished the decision of Hon'ble Delhi High Court in the case of ***Maruti Suzuki India Ltd. vs. CIT (2015) 381 ITR 117 (Del.)*** holding that the Assessee was not a manufacturing company and was only a distribution company. The adjustment proposed by the Transfer Pricing Officer was upheld by the Hon'ble Dispute Resolution Panel.

2. The assessee being aggrieved by the order of the DRP challenged the same before the Hon'ble Income Tax Appellate Tribunal. Hon'ble Appellate Tribunal after analysing the facts of the assessee's case observed that the Assessee outsourced its entire production requirements to toll manufacturers/ contract manufacturers on a licence basis. The assessee procured the raw materials and got it converted from the third-party toll manufacturers. The financial statements demonstrated the manufacturing and the consumption of raw materials, sales of finished goods, inventory of finished goods etc. Hon'ble Appellate Tribunal, further, observed that from the financials it can be seen that the products manufactured were either of its own or through contract manufacturers and they are subjected to levy of Central Excise Duty. Therefore, on facts, the Tribunal held that the revenue had taken an incorrect stand that the assessee was not a manufacturer and only a distributor *simplicitor*.

3. The Tribunal also noted that mere use of a foreign word "Organon", i.e., the name of an associate enterprise, was irrelevant and its use would not automatically bring the transaction in the ambit of an "international transaction". What is relevant is the examination of whether the assessee was promoting any of the brands of

the associate enterprise in India. On examination the Tribunal found that the revenue had only assumed that the Assessee had promoted the brand of the associated enterprise by incurring AMP expenditure in India thereby warranting any compensation. The Assessee had not paid any royalty or trade-mark fee to its associated enterprises and had benefited in terms of the excess premium return in the price of goods.

4. Furthermore, the Tribunal found that AMP expenditure is duly factored into the pricing fixed by the associated enterprises for purchase of raw materials, purchase of finished goods, sale of finished goods and recovery of expenses. These transactions were duly accepted to be at arm's length.

5. In addition to the above, the Tribunal had thoroughly examined the AMP expenses and found that the revenue had erred in including in its ambit certain selling expenses, i.e., expenses that are purely related to products of the assessee and not for any brand. In conclusion the Tribunal rejected the contentions raised by the revenue and the transfer pricing adjustment was deleted.

6. The department being aggrieved by the decision of Appellate Tribunal, preferred an appeal before the Hon'ble High Court at Kolkata. Hon'ble High Court was pleased to reject the appeal of the revenue by observing that the Appellate Tribunal has examined the facts of the case of the Assessee in detail and had granted relief. Therefore, in the absence of any perversity in the order passed by the learned Tribunal, there were no grounds to interfere with the same.

PCIT – 4, Kolkata vs. Organon India Pvt. Ltd. [ITAT/16/2020, order dated 13th March 2023]

Reopening of assessment - Section 148 of the Income Tax Act, 1961 – Reassessment notice issued for assessment year 2014-15 on 30 June 2021 is barred by limitation [Sections 147, 148, 148A, 149 and 151 of the Act]

Facts:

1. The Assessing Officer has issued notice dated 30.06.2021 under section 148 of the Act seeking to reopen the assessment of the assessee for the Assessment Year 2014-15. The said notice was issued relying on the provisions of TOLRA and Notification No.38 of 2021 dated 27.04.2021 whereby the time limit was extended till 30.06.2021 without appreciating the fact that the Finance Act, 2021 has amended sections 147 to 151 of the Act which came into force with effect from 01.04.2021.

2. The department has also issued similar notices to various assessee's relying upon the explanation to the aforesaid notification whereby the time limit was extended. The said notices became subject matter of challenge before different High Courts. The Notifications issued for extension of time were prayed to be declared ultra vires. However, Hon'ble Supreme Court in the case of ***Union of India vs. Ashish Agarwal [(2022) 444 ITR 1 (SC)***], striking balance between the notices issued by the Department under the old regime and the provisions brought into force under the new regime held that all notices issued under Section 148 of the Act between 01.04.2021 to 30.06.2021 shall be deemed to have been issued under

section 148A of the Act to be treated as show-cause notices under section 148A(b) of the Act.

3. The Assessing Officer relying upon the above decision of the Hon'ble Supreme Court treated the notice dated 30.06.2021 issued under section 148 of the Act as show cause notice under section 148A(b) of the Act and thereupon, the order dated 21.07.2022 under section 148A(d) was passed.

4. The assessee being aggrieved by the said order challenged the same before the Hon'ble Gujarat High Court being violative of the scheme of reassessment as amended by the Finance Act, 2021.

Decision of Hon'ble Gujarat High Court

5. Hon'ble High Court held that all original notices under section 148 of the Act referable to the old regime and issued between 01.04.2021 to 30.06.2021 would stand beyond the prescribed permissible timeline of six years from the end of Assessment Year 2013-14 and Assessment Year 2014-15. Therefore, all such notices when they would relate to Assessment Year 2013-14 or Assessment Year 2014-15 would be time barred as per the provisions of the Act as applicable in the old regime prior to 01.04.2021. Furthermore, these notices could not be issued as per the amended provision of the Act.

6. Hon'ble High Court relied upon its recent decision in ***Keenara Industries Private Limited vs. ITO [R/Special Civil Application No. 17321 of 2022]***, and held that the Taxation and Other Laws Act, 2020 was viewed to be a secondary legislation and secondary legislation would not override the principal legislation i.e., the Finance Act, 2021.

7. The Hon'ble High Court accordingly set aside the notices deciding the Petition in assessee's favour.

Sunny Rashikbhai Laheri vs. ITO [R/SPECIAL CIVIL APPLICATION NO. 22494 of 2022, Date of Order: 21/03/2023] (Gujarat High Court)

Approval - Section 153D of the Income Tax Act, 1961 - Assessment - Search and seizure - Assessment order passed without obtaining the prior approval as mandated in the section 153D of the Act is bad in law.

Facts

1. A search and seizure operation under Section 132 of the Act was conducted in the case of the Assessee and various persons and concerns. Assessment orders were passed under Section 143(3)/144/153A of the Act making various additions/disallowances. The Assessee, being aggrieved, filed appeals before the CIT (A). One of the grounds for challenge was the non-compliance with Section 153D of the Act which requires prior approval of the Additional Commissioner of Income Tax (Additional CIT) where the AO is below the rank of a Joint Commissioner. The CIT (A) partly allowed the appeals holding that it was not necessary that the fact of approval of the Additional CIT was required to be mentioned in the body of the assessment order.

2. The Assessee challenged the order passed by the CIT(A) before the Income Tax Appellate Tribunal, Cuttack Bench,

Cuttack. Before the Appellate Tribunal the assessee argued that the guidelines contained in Circular No.3 of 2008 dated 12th March 2008 issued by the Central Board of Direct Taxes (CBDT) had not been followed which referred to the various changes in the Finance Act, 2007 and inter alia also to the change brought about by the insertion of a new Section 153D of the Act. The Appellate Tribunal after considering the arguments and relevant provisions of the Act, allowed the appeal of the assessee and quashed the assessment order passed without taking prior approval from the Additional CIT as mandated by the provisions of section 153D of the Act.

The department being aggrieved by the order of the Appellate Tribunal, filed an appeal before the Hon'ble Orissa High Court as per the provisions of section 260A of the Act.

Arguments of the Assessee

3. The assessee contended that the conditions of section 153D were not fulfilled as there was no mention of any sanction or approval being taken before passing of the assessment order. Alternatively, the so-called approval of the Additional CIT under Section 153D of the Act had been granted in a mechanical manner without application of mind.

Department's arguments

4. The revenue contended that the approval was a mere administrative order and not open to challenge before a court of law. Granting an opportunity of hearing was not mandatory and was therefore not given. The revenue further argued that mere irregularity in granting approval was not fatal to the assessment order. Lastly, it was submitted that even if there had been a violation of the principles of natural justice, unless prejudice were shown by the Assessee, no interference with the assessment orders was warranted.

Decision of Hon'ble Orissa High Court

5. Hon'ble Orissa High Court was pleased to dismiss the appeal of the department by observing that it is it abundantly clear that the legislative intent behind introduction of Section 153D was to be obtaining of "prior approval" by the AO when he is below the rank of a Joint Commissioner, before he passes an assessment order or reassessment order under Section 153A(1)(b) or 153B(2)(b) of the Act. Such an approval of a superior officer cannot be a mechanical exercise has been emphasized in several decisions. Where the approval is granted mechanically, it would vitiate the assessment order itself.

6. Hon'ble High Court has further observed that while elaborate reasons need not be given, there has to be some indication that the approving authority has examined the draft orders and finds that it meets the requirement of the law. Mere repeating of the words of the statute, or mere "rubber stamping" of the letter seeking sanction by using similar words like 'see' or 'approved' will not satisfy the requirement of the law.

ACIT, Circle-1(2), Bhubaneswar vs. M/s. Serajuddin & Co. Kolkata [I.T.A. Nos. 39, 40, 41, 42, 43, 44 & 45 of 2022, Date of Order: 15.03.2023] (Orissa High Court)

Penalty - Bar of limitation - Section 275 of the Income Tax Act, 1961 - notice under Section 274 issued nine years after the end of the relevant assessment year and ten years from the date of the relevant financial year is woefully barred by limitation and liable to be quashed.

Facts

1. The Assessee filed its return of income for AY 2007-08 on 31st October 2007 declaring an income of ₹ 47,39,42,143/-. The return was revised on 31st March 2009 declaring an income of ₹ 47,14,28,736/-. In the revised return, the Assessee had added back certain expenses amounting to ₹ 84,62,03,987/- by way of abundant caution, having regard to the provisions of Section 40(a)(ia) of the Act. The same was claimed as an expense in AY 2008-09 in the return filed on 30th September 2009.

2. The Assessee's return for AY 2007-08 was subjected to scrutiny and an assessment order under Section 143(3) of the Act was passed on 28th October 2011 determining the total income at ₹ 102,06,71,340/-.

3. After the passage of more than six years, the Assessing Officer issued a show cause notice dated 9th November 2017 to the Assessee seeking its explanation as to why penalty should not to be imposed under Section 271C of the Act for failure to deduct TDS for AY 2007-08.

4. In reply to the said notice, the Assessee raised an objection on 19th December 2017 that the proceedings initiated to levy penalty under section 271C of the Act is barred by limitation. Since no response was received, the Assessee sent a reminder on 22nd January 2018. However, without dealing with the limitation issue, the Assessing Officer fixed the matter for hearing. Accordingly, the Assessee filed a Writ Petition with the Delhi High Court. Hon'ble Delhi High Court relegated the Assessee back to the Assessing Officer with a direction that the Assessing Officer would consider Assessee's all submissions/contentions, including the contention that no penalty could have been imposed without declaring it as an assessee-in-default.

5. As per the directions of the Hon'ble Delhi High Court, the Assessing Officer passed an order on 14th June 2018 on the preliminary objections and issued a show cause notice dated 27th June 2018 seeking the Assessee's response on levy of penalty. The Assessee, being aggrieved, challenged both, the order dated 14th June 2018 as well as notice dated 27th June 2018 before the Hon'ble Delhi High Court.

Arguments of the Assessee

6. Before the Hon'ble Delhi High Court, the Assessee argued that the show cause notice dated 9th November 2017 was woefully delayed. The notice was issued nine years after the end of the relevant assessment year and ten years from the date of the relevant financial year.

7. Relying on the provisions of Section 275(1)(c) of the Act, the assessee contended that although a limitation period is prescribed for completion of proceedings, nothing is stated as to when the proceedings would commence i.e., be considered as having been initiated. The argument that the

limitation period starts to run only after proceedings are initiated would not only cause endless delays but also cause grave injustice to Assessee's.

Department's arguments

8. The department argued that penalty proceedings are distinct and aren't related to any other proceedings. Since, the legislature had not provided any trigger point for completion of proceedings under Section 271C, the date of commencement can only be that date when the show cause notice was issued under Section 274 of the Act.

Decision of Hon'ble Delhi High Court

9. Hon'ble Delhi High Court allowed the Writ Petition filed by the assessee by observing that there were two limbs of limitation:

   (i) As per the first limb, period of limitation is fixed for a situation when penalty is sought to be imposed as fallout of action taken in another proceeding.

   (ii) The second limb fixed the period of limitation, where initiation of action of imposition of penalty was taken on a stand-alone basis i.e., not because of action taken in another proceeding.

10. Hon'ble court has further observed that the assessment order for AY 2007-08 was passed on 28th October 2011 and the issue concerning limitation of penalty was flagged as far back on 9th September 2013 and in an internal communication dated 11th July 2014. However, no steps were taken for issuance of a show cause notice, and the same was issued only on 9th November 2017. Thus, the delay was inexcusable, especially as there were no reasons available on record for not issuing the show cause notice in 2013-14. In-fact there was explanation for not issuing the show cause notice even during the period commencing from the passing of the assessment order (28th October 2011) and the internal communication dated 9th September 2013.

11. Hon'ble Delhi High Court, therefore, concluded that even if they were to take an indulgent view of the matter, i.e., if the limitation period began to run only from 2013 or 2014, then too since the show cause notice dated 9th November 2017, it was woefully delayed and deserved to be quashed.

Clix Capital Services Private Limited vs. JCIT Range, 74 [W.P.(C) 7326/2018 order dated 16th February 2023, Delhi High Court]

"Anything that brings spiritual, mental, or physical weakness, touch it not with the toes of your feet."

— *Swami Vivekananda*

Tanmay Phadke
Advocate

CA Viraj Mehta

CA Kinjal Bhuta

DIRECT TAXES

Tribunal

1 *Trinity education trust vs. ITO (ITA : 669/SRT/2018) (AY 2014-15)*

Section 11 and Form 10B: Benefit of section 11 cannot be denied merely on the ground that the Form 10B is not filed with the return

Facts

The assessee is a charitable trust and filed its return of income for the AY 2014-15 declaring the total income at Rs. 24,48,705/-. As the income of the assessee exceeded the basic amount not chargeable to tax, the assessee was required to file the audit report in Form 10B along with return which remained to be filed. The CPC denied the benefit of section 11. The assessee filed a rectification application u/s 154 of the act and submitted the audit report. The said rectification was rejected on the observation that no error existed in the intimation. Being aggrieved, the assessee filed an appeal but did not succeed. Thereafter, the Assessee approached the ITAT.

Held

The ITAT noticed that the omission to file the Form 10B was on account of oversight. The ITAT perused the decisions of jurisdiction High Cour in cases "***CIT vs. Kalavani Mandal (P) Ltd (2014) 41 Taxmann.com 184*** and ***Sarvoday Charitable Trust vs. ITO" (2021) 125 Taxmann.com 75*** and observed that the jurisdictional High Court has held that if a charitable trust substantially satisfies the conditions for seeking an exemption u/s 11 of the Act, the benefit cannot be denied merely on the ground of delay in filing form 10B. The ITAT observed that the Form 10B was available with the CIT(A) and the benefit of section 11 ought to have been granted by him. The ITAT allowed the appeal of the Assessee.

2 *Jetkool Exports India vs. NEAC ITA No. 2596/Mum/2022*

Section 40(b)(v)- Remuneration to partners cannot be disallowed in the hands of a partnership firm merely on the reason that supplementary deed providing for higher remuneration is entered into subsequently with retrospective effect

Facts

The assessee had paid a remuneration of ₹ 2,70,60,662/- to the partners during the year and had furnished the deed of partnership in support of its claim. The A.O. relied on

the clause 7 of the deed and reached the conclusion that the remuneration payable to the partners was not in accordance with the terms of deed of partnership dated 01.08.2005. However, the assessee in its submission had stated that the remuneration was in accordance to the supplementary deed dated 16.03.2021 and the said deed was w.e.f. 01.04.2010 which had calculated the remuneration of the partners in accordance with the amended provision of section 40(b)(v) of the Act vide Finance Act (No.2) 2009. The AO rejected the same by considering it as afterthought. The CIT(A) confirmed the disallowance. Being aggrieved, the assessee approached the ITAT.

Held

The ITAT observed that the assessee vide registered partnership deed dated 01.08.2005 was entitled to deduction with regard to the remuneration payable to partners. Sec. 40(b)(v) got amended and the amended provision provided for higher remuneration. The assessee would get the benefit of the amended provision for higher remuneration from 01.04.2010. However, the only lacuna was the supplementary deed was executed subsequently on 16.03.2021 but with a retrospective effect. The ITAT referred to the decision of the Allahabad High Court in ***CIT vs. Alison Singh & Co. [2013] 358 ITR 458*** wherein it has been held that as the subsequent deed is executed in accordance with the primary deed, there would be no objection in giving retrospective effect to the subsequent deed. The ITAT also observed that the said claim was allowed in the earlier years without change in facts. On the observation, the ITAT allowed the appeal of the assessee.

3 *Emgee Integrated Logistics Private Limited vs. ACIT [ITA No. 982/Chny/2022]*

Section 68: No addition can be made on account of cash deposits, if the AO cannot prove why the explanations offered by assessee are incorrect

Facts

The case of the assessee was selected for scrutiny by CASS. On perusal, of details submitted, the Assessing Officer found cash deposits of ₹ 1,05,55,000/- during the demonetization period. The assessee submitted that the cash deposit was actually the cash which withdraw before two months of demonetisation for purchase of land. The AO was of the opinion that payment for purchase of land can be done only after the clearance of various tests, also payment of not more than ₹ 2,00,000/- can be done at a time. These facts were undisputed; however, the cash deposit amount was added as unexplained cash credit u/s. 68.

Held

The assessee has shown withdrawals for cash deposits during demonetization period and discharged the burden cast upon him. If at all, the AO doubted the source for the cash deposits, he should have found through detailed enquiry that the withdrawals are not deposited in the same bank of the assessee. However, in this case, no such enquiry has been carried out and moreover; the AO has not doubted the genuineness of the transactions. It was held that, the assessee had explained the source of cash deposits sufficiently and addition is to be deleted as AO cannot prove why the explanations offered by assessee are incorrect.

4 *Prakash Gems vs. DCIT [ITA No. 7332/Mum/2018 dt. 30/01/2023 (Mum) (Trib.) (AY 2014-2015)*

Section 68 – Search Proceedings - No Addition can be made on rough draft agreement found on whatsapp – Sales consideration as per registered sale agreement is correct and is accepted as actual sales consideration

Facts

During the course of search proceedings, a copy of draft agreement on the whatsapp of the mobile of Shri Alkesh Patel the partner in the assese firm was found pertaining to sale of office for consideration of ₹ 2,38,12,236/- In assessment, the AO noticed that assese has given working of capital gain after adopting sale value of ₹ 88,34,300/- as against the amount shown in the draft agreement found on the whatsapp to the amount of ₹ 2,38,12,236/-. It was explained that proposed amount of ₹ 2,38,12,236/- was only shown as proposal on the rough draft agreement found on the whatsapp of mobile phone. A.O did not agree with the submission of the assese and computed the capital gain on the basis of rough draft agreement of the sold property found on the whatsapp of Shri Alkesh Patel partner of the assese firm. CIT(A) sustained the order of AO. Being aggrieved with the same, appeal before ITAT is filed.

Held

The decision of the P & H High Court in the case of ***Navneet Jhamb vs. ACIT (2020) 422 ITR ITR 332 (P&H HC)*** pertained to the issue that there was no statement of the seller regarding obtaining the money and therefore the addition was not sustained. Nowhere it was submitted that actual amount had been received as per the draft proposal. Draft proposal was made on 14.01.2013 whereas the property was actually sold on 30.07.2013. Draft proposal was only prepared by the broker. ITAT held that A.O had not brought on record any other material to confront that sale was made as per the draft proposal. The A.O has also not made any inquiry to prove contrary to the claim of the assese that actually the property was sold at ₹ 88,34,000/- . During the course of assessment the assese has also submitted a copy of registered sale agreement and copy of the purchase agreement of the office premises sold. The A.O has not supported his finding with any corroborative and conclusive evidence in spite of the fact that on mobile whatsapp it was stated that same was a rough draft proposal. Neither any independent verification from the broker, buyers Nor AO has obtained any valuation report from the independent sources i.e DVO. On the said basis ITAT held that lower authorities was not justified in making addition on the basis of rough draft agreement found on the mobile.

5 *DCIT vs. Heaven Associates: (ITA. No.245/Ahd/2017)*

Section 132/153C/143: In case of concluded assessment, addition can only be made on the basis of an incriminating material

Facts

The search action had taken place in the Bafna Panchal group of cases including the assessee, on 7.1.2014. Thereafter the notice under section 153A was issued on 3.7.2014 and the assessee filed return of income on 27.11.2014 declaring income of ₹ 4,47,520/- for the AY 2012-13 which was the income as shown in the original return of income. In

in the assessment, the AO made addition on account of unexplained deposits/unsecured loans from M/s.Zeelan Infrastructure P.Ltd. amounting to ₹ 50.00 lakhs, disallowed interest paid on the unexplained deposits amounting to ₹ 1,46,427/- and made addition on account of unrecorded sales receipt (on-money) of ₹ 2,13,14,769/-. Being aggrieved, the assessee filed an appeal before the CIT(A). It was contended that the additions did not pertain to any incriminating material which was accepted by the CIT(A). Thereafter, the Revenue filed an appeal before the ITAT. After hearing both the sides, the ITAT held as under:

Held

The ITAT held that there was no perversity in the finding of the CIT(A) and noted the fact that the time limit to issue a notice u/s 143(2) had expired. The ITAT also observed that in the case of ***PCIT vs. Saumya Construction P.Ltd. (2016) 387 ITR 0529 (Guj),*** the High Court has held that in the case of search, the concluded assessment could be disturbed only to the extent of incriminating material. The ITAT noticed that the revenue has not showed as to how the additions made by the AO and deleted by the CIT(A) were based on the incriminating material except mentioning the revenue has not accepted the decision of the Gujarat High Court. On the observation, the ITAT dismissed the appeal of the revenue.

6 ***Navodaya Logistics Pvt Ltd vs. ITO [ITA No. 621/Mum/2022 dt.20/01/2023 (Mum)(Trib.)(AY 2013–2014)***

Section 147: Reassessment – No addition made relating to reasons for reopening – No other addition can be made – Reassessment quashed

Facts

Reassessment made on the basis that information received from DIT that assessee is one of the beneficiary of bogus entries on account of short term capital loss. AO and CIT(A) disregarded the submissions of the assessee and made addition.

Held

ITAT held that case was reopened on the basis that assessee has entered into selling script of 'Rutron Int'. Addition was made by lower authorities on the basis of sale of share of M/s Tumni Textile Mills Ltd. It was seen that there was no sale of share of Rutron Int entered into by the assessee in AY 13-14 infact shares were sold in the year AY 14-15. AO and CIT(A) in the impugned order has not even whispered for sale of scrips of RUTRON INT, being a penny stock and to further claim STCL qua the same. It is settled principle of law that when addition has been made on the basis of allegations made in the "reasons recorded", no addition on the basis of any other issue is sustainable in the eyes of law. When the AO has voluntarily waived off his right to examine the sale of scrip of RUTRON INT share and has claimed STCL thereon during the assessment proceedings the entire initiation of reopening falls flat. On the said basis reopening is quashed.

7 *Trikaal Mediinfotech Pvt. Ltd. vs. DCIT (ITA No: 5989/Mum/2019)*

Section 199- Once the TDS has been deducted on a particular income, the assessee should get credit even if the income is not directly offered for tax

Facts

The assessee had developed a customised software in field of medical prescription data. The development of the software was completed during the year under consideration. During the process of development of software, some software patches were developed on which some revenue was earned and tax was deducted thereon by the parties from whom such revenue was received. The assessee used to reduce revenue so received from cost incurred to develop and claimed credit in those year when it was deducted. However, TDS credit was denied in the earlier assessment years because revenue was reduced from capitalised cost. Therefore, entire TDS credit was claimed in the current AY when the software was complete. The entire capitalised cost net of revenue was transferred to intangible assets. The lower authorities did not allow TDS on the ground that assessee should follow AS 7 and revenue should be recognised on percentage completion method.

Held

It is not in dispute that TDS was deducted in respect of sale of software patches and that credit has not been allowed in the earlier assessment years. As per section 199 of the Act, tax deducted at source and paid to government exchequer is treated as payment of tax on behalf of the person for whom TDS was made. Rule 37BA(3) further clarifies that credit for TDS shall be given for assessment year for which such income is assessable. The ITAT relied upon the decision of Chennai ITAT case in case of Supreme Renewable Energy which had based its rationale on SC decision of Karnal Co-op Sugar Mills Ltd (243 ITR 2), where it was held that, when an income is not directly liable for tax as the same is incidental to the cost or to the installation and acquisition of an asset, the tax deducted on such income shall be refunded to the assessee or is entitled to take credit of the same. Government cannot benefit itself from the taking advantage of legal technicalities. Reducing the income from the cost of the asset is indirectly offering the same for assessment and taxation. Accordingly, the appeal was allowed in favour of the assessee by allowing the due TDS credit.

8 *Dura Line India Private Ltd. vs. ACIT [ITA No. 1757/Del/2020]*

Section 250(6): In case of failure of assessee to reply to any notices, the CIT(A) is dutybound to adjudicate on available data instead of dismissal of appeal

Facts

The assessee did not reply to any appeal notices issued by the CIT(A). The CIT(A) in turn dismissed the appeal of the assessee on the grounds of non-prosecution of appeal by the assessee. The assessee filed appeal arguing that the actions of CIT(A) of dismissing the appeal ex-parte qua the assessee without adjudicating the grounds of appeal filed in Form 35 and the submissions is violation of principles of natural justice.

Held

It was held, that in case CIT(A) proceeds to adjudicate the appeal on non-compliance by the assessee, the CIT(A) is still duty bound to adjudicate on all grounds of appeal by taking into consideration the assessment order as well as evidences and explanations filed by the assessee before the AO during the assessment proceedings. Dismissing the appeal in a cryptic manner without considering material on record, is a case of not giving opportunity of hearing to the assessee and against the natural justice. The appeal was restored back to the file of CIT(A) for denovo consideration without being influenced by the first CIT(A) order.

9 ***Adhar Nagri Sahakari Patpedhi vs. CIT - [ITA No. 702/Mum/2022 dt. 06/01/2023 (Mum)(Trib.) (AY 2017-18)]***

Section 263 – Whether order is erroneous and prejudicial to the interest of the Revenue – Assessment u/s 143(3) was completed and return filed was accepted – 263 order was passed to examine the applicability of Section 69A wrt. 115BBE on cash deposits and provisions of Section 80P(2)(d) & 269SS – Section 263 jurisdiction cannot be exercised - on inadequacy of enquiry or when two plausible views are available

Facts

The assessee is a registered co-operative society and is into accepting deposits from members and lending advances to them as well as reinvesting money. Assessment was made u/s 143(3) and return filed was accepted as it is. CIT invoked the provision of section 263 on the ground that the assessment order is prejudicial and erroneous to the interest of the Revenue and set aside the assessment order with the direction to examine the applicability of the provision of section 69A of the Act r.w.s. 115BBE on the cash deposits made by the assessee, to examine the applicability of the provisions of section 80P(2)(d) of the Act and u/s. 269SS of the Act and also to verify the applicability of the deduction u/s. 80P of the Act on 'other income'. Thereby, order u/s 263 was challenged before ITAT.

Held

The ITAT perused the facts and held that A.O. has sought for details pertaining to all the issues raised by the ld. PCIT during the assessment proceedings. Assessee has submitted adequate reply by way of written submission and documentary evidences to substantiate its claim. It can be inferred that there was no lack of enquiry pertaining to the issues raised. It is observed that the A.O. has enquired into the details of the cash deposits during demonetization period and there is no infirmity in the conclusion arrived at by the A.O. For the issue pertaining to the deduction u/s. 80P it is held that there are divergent views in relation to interest received from the deposits made in co-operative banks, the A.O. is said to have taken one of the view possible. There are no latches and mistakes committed by the A.O. while passing assessment order. Therefore, exercise of power u/s. 263 of the Act was not in accordance with the law.

CA Naresh Sheth CA Jinesh Shah

INDIRECT TAXES
GST – Recent Judgments and Advance Rulings

A. DECISIONS BY HIGH COURT

1 *Pinstar Automotive India Private Limited – Madras High Court - [W.P. No. 8493 of 2023]*

Facts and issue involved

Petitioner has procured goods or services from various suppliers for which they have made payment of entire amount including tax. GST Registration of such suppliers has been cancelled and tax collected by them has not been remitted to the department. Petitioner received notice from GST authorities directing reversal of ITC availed by it where tax on the same has not been deposited to the government by the supplier. Adjudicating authority adjudicated the said show cause notice and confirmed the demand vide order in original dated 27.07.2022. In response to the said adjudication order, petitioner preferred rectification application on the grounds that adjudicating authority had not considered various judicial precedents on the subject matter.

Petitioner's submissions

The petitioner presented proof for payment of consideration to supplier within a period of 180 days and therefore, they are eligible to avail ITC.

The petitioner filed an application for rectification of errors apparent on the face of the record under Section 161 of the Act on the ground that GST authority failed to refer to following relevant decisions while passing order:

- ***Arise India Limited vs. Commissioner of Trade and Taxes [TS-314-HC 2017 (Del) – VAT];***
- ***Shri Ranganathar Valves Private Limited vs. Assistant Commissioner [2020-TIOL-1611-HC-Mad-VAT];***
- ***CC & CCE vs. M/s. Juhi Alloys Limited [Excise Appeal No. 3625 3627 of 2010-Ex (SM), CESTAT, Delhi, dated 01.07.2013]; and***
- *Commissioner of Central Excise, Jalandhar vs. M/s. Kay Kay Industries [AIT-2013-147-SC].*

Observations and Discussion by Court

Three suppliers of the petitioner had uploaded the invoices in GSTR-1, but no tax had been remitted by them in Form GSTR-3B. Section 16 of CGST Act lays down eligibility conditions for taking Input tax credit.

One of the conditions is that the tax charged in respect of such supply has been actually paid to the Government in cash or through utilization of ITC in respect of such supply. Hence, there is a mandate cast on the claimant of ITC to ensure compliance with the provision or else it will not be entitled to such ITC. Section 16 of CGST Act needs to be observed strictly so that there is no jeopardy to the interests of the revenue.

However, where the tax liability has been met by way of reversal of ITC and similarly recovery is effected from the supplier as well, this would amount to a double benefit to the revenue.

ITC reversed by recipient should be restored to it if the GST liability is recovered by department from the supplier. The substantive liability falls on the supplier and the protective liability upon the purchaser.

Decision of High Court

GST authorities should restore the ITC reversed by the claimant if the liability is made good by the supplier.

2 ***Shiva Jyoti Construction vs. Chairperson, CBEC and Others – Odisha High Court [W.P.(C) NO. 18216 OF 2017]***

Facts and issue involved

Petitioner has erroneously furnished the details of supplies made to M/s. Odisha Construction Corporation Limited ('OCCL') under B2C category instead of B2B category of Form GSTR-1. The last date for filing GSTR-1 was 31.03.2019 and the date by which the rectification should have been carried out was 12.04.2019. The error came to be noticed after the OCCL held up the legitimate running bill amount of the petitioner by informing them about the above error on 21.01.2020. Thereafter, it has been making requests to GST department to permit it to correct the GSTR-1 forms filed by them but to no avail. The stand taken by GST department is that once the deadline for rectification of forms was crossed, then no further indulgence could be granted to the petitioner.

Hence, petitioner preferred the present writ.

Discussions by and observations of High Court

By permitting the petitioner to rectify the above error, there will be no loss whatsoever caused to the department. It is not as if there will be any escape of tax. This is only about the ITC benefit which in any event has to be given to the petitioner.

On the contrary, if it is not permitted, then the petitioner will unnecessarily be prejudiced. Reliance is placed on Hon'ble Madras High Court's decision in case of ***M/s. Sun Dye Chem vs. The Assistant Commissioner ST [WP No. 29676 of 2019].***

Decision of High Court

Court permitted the petitioner to resubmit the corrected Form GSTR-1 under B2B category. Court issued directions to the department to receive corrected Form GSTR-1 manually and facilitate the uploading of those details on the web portal.

3 *M/S. Balaji Exim vs. Commissioner, Cgst And Other – Delhi High Court [W.P.(C) 10407/2022 & W.P.(C) 10423/2022]*

Facts and issue involved

Petitioner had filed two refund applications for seeking refund of the unutilized ITC pertaining to export of goods. Said refund applications were not processed as the supplier (i.e. M/s. Shruti Exports) from whom the petitioner had purchased the goods had allegedly received fake invoices from its suppliers. On being summoned, petitioner appeared before the Superintendent, Anti-Evasion branch and furnished the required documents.

Notwithstanding the submissions made by petitioner refund applications were rejected on the ground that petitioner was a part of a supply chain involving fake ITC. On appeal against the said order, appellate authority held that although petitioner was in possession of the tax invoices, it could not be said that the petitioner had received the goods. Therefore one of the conditions of Section 16(2) of CGST Act was not satisfied.

Petitioner has assailed the said appeal rejection order before Hon'ble High court.

Petitioner's submissions

Petitioner is not concerned with any allegation against its supplier M/s Shruti Exports (proprietor Vijander Kumar Goel) as the purchases made by them were genuine and against genuine invoices. GST law does not mandate to examine the affairs of supplying dealer.

Observations and Discussion by Court

Petitioner's refund applications were rejected on a mere apprehension that its supplier had issued fake invoices. There is no conclusive finding on the basis of any cogent material that the invoices issued by M/s. Shruti Exports to the petitioner are fake invoices.

Invoices issued by M/s. Shruti Exports were reflected in AIO system and there is no dispute that M/s. Shruti Exports had issued said invoices. It is also clear that said supplier is a registered dealer in GST. There is no allegation that invoices raised by M/s. Shruti Exports were not paid by the petitioner. There are no allegations that goods in question were not exported overseas. Thus, the petitioner has established not only the fact that the goods have been exported but that it had paid for the same including IGST and cess charged thereon. Thus, petitioner's refund applications cannot be rejected.

There is merit on petitioner's submission that it is not required to examine the affairs of its supplying dealer. The allegations of any fake credit availed by petitioner's supplier M/s. Shruti Exports cannot be a ground for rejecting petitioner's refund application unless it is established that petitioner has not received the goods or paid for them. Court placed reliance on the decision of Delhi High Court in case of ***Ltd. vs. Government of NCT of Delhi & Other [2017 SCC Online Del 11286].***

Decision of High Court

Petitioner would be entitled to the refund of the ITC on goods that have been exported by it. In the event, department is able to find material to establish the allegations regarding non-supply of any goods by M/s Shruti Exports to the petitioner, it would be open for them to initiate such action as may be warranted in accordance with law.

B. RULINGS BY AUTHORITY OF ADVANCE RULING

1 *Karnani Fnb Specialities Llp – West Bengal AAR [2023-TIOL-30-AAR-GST]*

Facts and Issue involved

Applicant is engaged in the business of providing restaurant services from its lounge. It also provides catering services as well as banquet renting services. Along with such supplies, the applicant is also engaged in selling/serving of alcoholic liquor for human consumption to its customers.

Applicant has sought an advance ruling as to whether it is obliged to reverse Input tax Credit ('ITC') u/s 17(2) of the CGST Act r.w. Rule 42 of the CGST Act in respect of alcoholic liquor sold by it at its premises?

Applicant's submissions

CGST Act permits utilization of ITC to the extent of input tax paid on inputs and input services that are used towards making supplies on which tax is payable. ITC attributable to 'exempt supplies' is to be reversed as per the formula prescribed under Rule 42.

Section 2(47) of CGST Act defines 'exempt supply' to mean supply of goods or services or both which:

- either attracts nil rate of tax; or
- is wholly exempt from tax u/s 11 of CGST Act; or
- is a non-taxable supply as defined u/s 2(78) of CGST Act.

Sale of alcoholic liquor for human consumption is not a 'supply of goods' as alcohol is outside the realm of GST itself. Further, it is neither subject to nil rate of tax nor is exempt under any notification issued u/s 11 of CGST Act.

Further, non-taxable supply is defined u/s 2(78) of CGST Act to mean a supply of goods or services which is not leviable to tax under CGST Act. Article 366(12A) of the Constitution, the very fountainhead of GST, determines the scope of the tax by way of defining "Goods and Services Tax" as 'any tax on supply of goods, or services or both, except for taxes on the supply of the alcoholic liquor for human consumption." Thus, by virtue of Article 366 (12A), the scope of GST has been restricted, under the Constitution of India, to specifically exclude sale of alcoholic liquor for human consumption. Therefore, selling 'alcoholic liquor for human consumption' cannot even be treated as a 'supply' as envisaged under the Act.

The scope of 'non-taxable supply' thus, must necessarily be limited to those supplies over which the legislature can exercise its legislative competence and impose tax such as supply of petroleum crude, high speed diesel, motor spirit, natural gas and aviation turbine fuel- which at present is 'not leviable to tax' under GST law and can be brought under such levy with effect from date as may be notified by the Government on the recommendations of the Council.

Therefore, the scope of 'non-taxable supply' is limited to those activities which would ordinarily attract the levy of GST but which have deliberately been kept outside the purview thereof and not those supplies for which the legislature lacks the necessary constitutional mandate.

The legislature did not even intend to include sale of alcoholic liquor as "not leviable”. Hence it does not fall under ‘non-taxable supply’.

In a situation where supply of alcohol is treated as a non-taxable or exempt supply requiring reversal of ITC, then it will result into discharging of GST liability on output supply of alcoholic liquor by way of reversal of ITC. CGST Act ought not to be interpreted in a manner where a taxpayer has to bear tax on such activity in an indirect manner where it is directly and expressly excluded from the scope of the statute.

Department’s submissions

Section 7(1) of the GST Act, 2017 define the term "supply" which includes all form of supply of goods or services or both such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made for a consideration by a person in course of furtherance of business. Supply of liquor for human consumption is also a supply as per definition given in section 7(1) of the GST Act, 2017.

Section 2(78) of the GST Act defines non-taxable supply as supply of any goods or services or both which is not leviable to tax under this Act or under the IGST Act. The definition given here is in consonance of article 366(12A) which only empowers to levy tax. So definition of non-taxable supply as per section 2(78) is complete, cannot be restricted, and conditioned invoking article 366(12A) of Constitution. Hence, supply of liquor is non-taxable supply and thereby exempt supply requiring ITC reversal u/r 42 of CGST Rules.

Discussions by and observations of AAR

Section 17 of CGST Act allows a registered person to utilize input tax credit, to the extent of its eligibility, for making payment of output tax.

Sale of alcoholic liquor for human consumption for consideration by the applicant in the course or furtherance of business comes under the purview of supply as defined in section 7 of the GST Act.

Article 366(12A) of the Constitution of India defines ‘Goods and Services Tax‘ to mean tax on supply goods or services or both, except taxes on the supply of alcoholic liquor for human consumption. The specific exclusion delineates that tax shall not be levied on supply of alcoholic liquor for human consumption. Accordingly, section 9 of the GST Act which deals with 'Levy and collection' excludes levy of tax on the 'supply of alcoholic liquor for human consumption'.

It follows from above that sale of alcoholic liquor for human consumption is a supply under the GST Act on which tax is not leviable. A supply of goods or services or both which is not leviable to tax is defined as 'Non-taxable supply' in clause (78) of section 2 of the GST Act.

Since activities of selling of alcoholic liquor for human consumption by the applicant would be treated as 'non-taxable supply', it will be 'exempt supply' under the GST Act. Applicant is required to reverse input tax credit attributable to such exempt supply under section 17(2) of the GST Act read with rule 42 of the GST Rules.

Ruling of AAR

Applicant is required to reverse input tax credit ('ITC') in terms of section 17(2) of

the CGST Act read with Rule 42 of the GST Rules.

2 *Pico2femto Semiconductor Services Pvt Ltd – Karnataka AAR [Advance Ruling No. KAR ADRG 12/2023 dated 20.03.2023]*

Facts and Issue involved

Applicant is engaged in business of providing engineering services primarily relating to semi-conductor services. Applicant has two independent verticals viz. research and development of semi-conductor chips; and staffing business.

Applicant has entered into business transfer agreement dated 27.06.2022 with M/s Tessolve Semiconductor Private Limited for transfer of staffing business along with all the assets and liabilities.

Applicant has sought advance ruling in respect of following questions:

1. Whether the transaction of transfer/ sale of one of the independent running business divisions of the applicant constitutes a transaction of "supply" u/s 7 of the CGST Act?

2. Whether the transaction constitutes supply of taxable goods or taxable services or both? And would be the time of supply, value of supply and rate of tax applicable to such supply?

3. Whether the recipient i.e., the purchaser/ transferee of the business as a whole is entitled to claim the credit of the "input tax" paid on the said transaction?

4. Whether the GST rate mentioned in Sr.No. 2 of the Notification No.12/2017 - CT(Rate) dated 28.06.2017 is applicable i.e. whether the transaction is is exempted from GST?

Applicant's submissions

The transaction of transfer / sale of one of the independent running business (viz. staffing business) as a whole, along with all the assets and liabilities for a lump sum consideration, is a slump sale in terms of section 50B of Income Tax Act,1961 read with Section 2(42C) thereof. Further, such sale of running business as a whole is not in regular course of business of the applicant and hence, it is not a transaction of supply of goods or services or both as per Section 7 of the CGST Act.

Further, entry 2 of the Notification No. 12/2017 – CT(R) dated 28.06.2017 provides that the services of transfer of a going concern, as a whole or independent part thereof, is exempted from the purview of GST. Such transfer of business even if it is accepted to be treated as supply, it amounts to services by way of transfer as a going concern, as a whole or an independent part thereof which is squarely covered under entry 2 of the exemption Notification No. 12/2017 – CT(R) dated 28 June 2017.

Discussions by and observations of AAR

For any activity to qualify as supply u/s 7 of CGST Act, it should satisfy following three limbs:

- It should either be a supply of goods or services or both;
- It should be made or agreed to be made for a consideration by a person; and
- It should be in the course or furtherance of business.

Transfer of staffing business, being one of the forms of supply of goods or services, is

admittedly for a consideration and in course or furtherance of applicant's business. Since all the above three limbs are fulfilled, activity of applicant amounts to supply as defined u/s 7 of the CGST Act.

Further, the staffing business of the applicant is not a movable property and thus the said supply cannot be treated as supply of goods. Anything other than goods is services and hence, impugned transaction is a supply of service as also provided under entry 4(c)(i) of Schedule II to CGST Act.

The time of supply of the impugned transaction should be determined by the applicant in terms of Section 13 of the CGST Act 2017 and the value of impugned supply shall be the transaction value, which is the price actually paid or payable. Above transaction, being a financial service, is covered under SAC 9979119 and GST rate applicable thereon is 18%.

As regards credit of input tax charged on transaction is concerned, the question pertains to entitlement of recipient and not supplier. Thus, the question is beyond jurisdiction and cannot be answered.

Applicant has not furnished any certificate from the qualified auditor to the extent that the staffing division business is a going concern. Hence, the benefit of Sr. No. 2 of exemption notification which prescribes that the 'services by way of transfer of a going concern, as a whole or an independent part thereof' is exempt will be applicable subject to fulfilment of the conditions of a going concern.

Ruling of AAR

1. The transaction of transfer/sale of one of the independent running business as a whole along with all the assets and liabilities of the independent business division constitutes a supply u/s 7 of the CGST Act.
2. Time of supply has to be determined in terms of Section 13 of the CGST Act and value of supply need to be determined in terms of Section 15(1) of the CGST Act. The rate of GST applicable on the transaction is 18%.
3. The question about entitlement of the input tax credit by the recipient of the service cannot be answered as it is beyond jurisdiction.
4. The benefit of entry number 2 of the Notification No.12/2017 - CT(R) dated 28.06.2017 is applicable subject to fulfilment of the condition/s of going concern.

3 *Marubeni India Private Limited – Karnataka AAR [Advance Ruling No.: KAR ADRG 14/2023 dt. 20-03-2023]*

Facts and Issues involved

Applicant is engaged in trading of imported as well as domestic goods. They intend to enter into a new business transaction wherein the applicant would be engaged in supplying domestically procured goods to overseas customer. Applicant has been approached by an overseas customer for supply of domestically procured goods. Overseas customer will issue purchase order in the name of applicant who in turn will place back to back purchase order on the Indian manufacturer. For logistics convenience, applicant instructs Indian manufacturer to directly ship the goods from their premises

to the location of foreign customer. The goods will not be physically delievered to the applicant.

Indian manufacturer shall be responsible for undertaking the customs compliance such as documenatation for outbound customs clearnace as exporter and filing of bill of lading for transportation of goods to the overseas customer on the direction of applicant.

Applicant raises invoice on overseas customer for sale of goods to them. Overseas customer shall pay the consideration in converitble foreign exchange duly supported by Bank Realization Certificates. Indian manufacturer shall raise invoice on applicant for sale of goods. Applicant shall make payment of consideration to the Indian manufacturer in foreign currency from foreign currency account maintained in India. Alternatively, foreign customer will open transferable LC in foreign currency in favour of the applicant, in which case the applicant would partially transfer the same LC in favour of Indian manufacturer. Such transactions are permitted under RBI and FEMA guidelines.

Transaction between applicant and Indian manufacturer will be accounted as purchase of goods in the books of account of Applicant. Transaction between applicant and overseas customer will be accounted as sale of goods in the books of account of applicant. Indian manufacturer shall be responsible for arranging logistics till customs port and shall also file shipping bill for export of goods with following details:

- Exporter of goods – Indian manufacturer;
- Consignee – Overseas customer; and
- Buyer - Applicant

Invoice raised by Indian manufacturer shall indictae following details thereon:

- Supplier – Indian manufacturer;
- Ship to – Overseas customer along with its complete address; and
- Bill to – Applicant

Applicant shall raise invoice on overseas customer with following details thereon:

- Supplier – Applicant;
- Bill tio / Ship to – Overseas customer along with its complete address; and
- Bill from – Indian manufacturer's location

Applicant would hand over the bill of lading and GST invoice to the overseas customer so as to allow them to receive the shipment from Oversea customer's port. Indian manufacturer, in the above transaction, would not, at any point, be issuing any invoice to the overseas customer nor be communicating directly / indirectly with the oberseas customer.

Applicant has sought advance ruling on whether the supply of goods by them to the overseas customer is taxable under GST as zero rated supply or not?

Applicant's submissions

Indian manufacturer is undertaking the customs clearnace as an exporter and undertaking issuance of bill of lading for transfer of title of goods. Such bill of lading is transferred to applicant from India manufacturer for transfering of ownership of the goods once goods reach at the port of export beyond the customs frontier.

Though the customs clearance is undertaken by Indian manufacturer, but

goods are actually being taken outside India by applicant. Hence, supply of goods by applicant to overseas customer qualify as export of goods and hence zero-rated supply in accordance to section 16 of IGST Act.

Alternatively, if Indian manufacturer is regarded as exporter of goods, place of supply for supply undertaken by Indian manufacturer shall be determined u/s 11 of IGST Act i.e. place outside India.

Consequently, supply undertaken by applicant to overseas customer will be regarded as 'supply of goods from a place in non-taxable territory to another place in non-taxable territory without such goods entering into India' which is neither supply of goods nor supply of services as per Entry 7 of Schedule III r.w. section 7(2)(a) of CGST Act.

Discussions by and observations of AAR

Exporter is defined u/s 2(20) of Customs Act, 1962 to mean owner of the goods, beneficial owners of the goods or any person holding himself out to be an exporter of goods.

Bill of lading is defined by United Nations Conference on Trade and Development ('UNCTAD'), Geneva in its report of 1971 to include a document of title of goods which enables the consignee to take delivery of the goods at their destination or to dispose of them by the endorsement and delivery of the bill of lading.

Exporter is owner of the goods and bill of lading is the proof of title of goods when the goods are handed over to the shipper. Since Indian manufacturer files shipping bill as exporter and also gets bill of lading issued to him, he is the owner of the goods and holds title of goods till they cross customs frontier of India. In effect Indian manufacturer takes the goods out of India to a place outside India while he is holding ownership and title of the goods. Thus, Indian mnaufacturer is the exporter of goods and hence place of supply for transaction between Indian manufacturer and applicant is outside India as per section 11(b) of IGST Act.

In respect of second transaction between applicant and overseas customer, involving same goods, it is observed that goods are supplied from a location outside India to a location outside India and hence is covered by Entry 7 of Schedule III to CGST Act and shall be treated neither supply of goods nor supply of services.

Ruling of AAR

Supply of goods by applicant to overseas customer shall neither be treated as supply of goods nor supply of services.

"We may talk and reason all our lives, but we shall not understand a word of truth, until we experience it ourselves."

— *Swami Vivekananda*

CA Rajiv Luthia

CA Keval Shah

INDIRECT TAXES

Service Tax – Case Law Update

1 *M/s Ratnawat Infra Construction Company LLP, Jaipur vs. Commissioner, Central Excise And CGST, Jaipur 2023-TIOL-262-CESTAT-DEL*

Background and Facts of the Case

- The Appellant i.e, M/s Ratnawat Infra Construction Company (LLP), Jaipur is engaged in rendering the services of construction of residential complex, registered with the Service Tax Department.
- The appellant had entered into an 'Agreement of Sale' of flats during the period prior to 30.06.2017 and the proposed buyers had given advance payments for the same. Due to delay in the construction, the buyers of 7 flats proceeded to cancel the bookings. The buyers were refunded the entire booking amount along with the service tax which was collected from them and paid. This was reflected in the ST-3 return for the period April 2017 – June 2017.
- Since the flats were booked in the Service Tax Regime and cancellation thereof was effected in the year 2019, the appellants could not take credit of Service Tax paid already on flats which were subsequently not sold in view of Rule 6(3) of the Service Tax Rules, 1994.
- Consequently, the appellants filed a refund claim on 30.09.2020 in view of Section 142 of the CGST Act, 2017 which was rejected on the grounds of limitation as well as unjust enrichment. The appellants filed an appeal which was again rejected on the ground that the appellants have raised a demand note on the buyer in 2017 and the refund is filed in 2020 hence, time barred. Also, it was categorically stated that the unjust enrichment bar was also not satisfied by the appellants.
- Aggrieved by the said Order, the appeal stood before the Hon'ble Tribunal on the said issue.

Arguments put forth

The Appellants submitted as under:

- The Ld. Counsel for the appellants submitted various documents such as demand notes/ invoice copies, booking agreement, cancellation agreement, ledger accounts, bank statements etc. wherein it is clear that the booking amounts received along with interest were refunded to the buyers along with the Service Tax.

- They argued that the amount of service tax remained as a deposit with the department and that there is no time limit for claiming the same.

- As per Circular No. 151/2000-2012-ST, investment amount shall be treated as consideration paid in advance for the construction services to be provided by the developer/builder to the investor and the said amount would be subject to Service Tax and where the investor exits from the project before/after the issuance of completion certificate, the builder/ developer is entitled to credit under Rule 6(3) of The Service Tax Rules, 1994 provided he has refunded the original amount.

- The board have clarified that the builder/developer is entitled to Service Tax credit on cancellation of bookings, wherein the said builder/developer have refunded the amount of booking including service tax to the buyer of the flat and also the retention of amount of Service Tax without there being tax liability as the facts/circumstances also hit by Article 265 of the Constitution Of India.

The Respondents Submitted as under:

- The respondent relies on the contention of the revenue and the impugned order.

Decision

- The Hon'ble CESTAT appreciated the arguments made by the appellant and held that the appellant is entitled to refund, in view of the CENVAT credit no longer available, in spite of being entitled to the same under Rule (6)(3) of Service Tax Rules, the appellant is entitled to refund of such amount u/s 142(3) of CGST Act.

- The Adjudicating Authority was directed to grant the refund of the said amount along with interest as per rules within 45 days from receipt/service of this order.

2 *Commissioner of Service Tax, Ahmedabad vs. Torrent Pharmaceuticals Limited 2023 (3) TMI 1127 – CESTAT, Ahmedabad*

Background and Facts of the Case

- The appellants being revenue in this case raises the issue whether the Commissioner (Appeals) has the power to remand the matter to Adjudicating Authority.

Arguments put forth

The Appellants submitted as under:

- The Ld. Deputy Commissioner (AR) appearing on behalf of the Revenue reiterates the grounds] of appeal.

- The Ld. Deputy Commissioner appearing on the behalf of the appellant submits that per the Section 35 A of Central Excise Act, 1944 / Section 128 A (3) of the Customs Act, 1962 with effect from the 11.05.2001 after amendment in the said section the Commissioner (Appeals) has no power to remand the matter to

the Adjudicating Authority. Therefore, he erred in remanding the matter to the Adjudicating Authority.

The Respondents Submitted as under:

- The Learned Counsel appearing on behalf of the Respondent submits that the issue is no longer res-integra as held by the Jurisdiction High Court in the case of Associated Hotels Limited- 2015 (37)STR 723 (Gujarat), followed by this Tribunal in Final Order No. A/10860 -10864/2020 dated 18.03.2020 in the case ***CCE vs. Adani Power Limited that the Commissioner (Appeals)*** indeed has power to remand the matter to the Adjudicating Authority.

Decision

- As regards the issue that whether Commissioner (Appeals) has power to remand the matter to Adjudicating Authority, we find that this being a case of refund of service tax, clearly covered by the ratio of Hon'ble Gujarat High Court judgment in the case of Associated Hotels Limited (supra). In the said judgment, the Hon'ble High Court has also referred to the judgments of Hon'ble Supreme Court in the case of ***Mil India Limited vs. CCE, Noida - 2007 (210) ELT 188 (SC).***
- The Honourable CESTAT is of the view that the learned Commissioner (Appeals) has power to remand the matter to the Adjudicating Authority, therefore, on this count also, Revenue's appeal does not sustain.
- The Revenue's appeal is dismissed thereof.

"Be not afraid, for all great power throughout the history of humanity has been with the people. From out of their ranks have come all the greatest geniuses of the world, and history can only repeat itself. Be not afraid of anything. You will do marvelous work."

– Swami Vivekananda

"We but mirror the world. All the tendencies present in the outer world are to be found in the world of our body. If we could change ourselves, the tendencies in the world would also change. As a man changes his own nature, so does the attitude of the world change towards him. This is the divine mystery supreme. A wonderful thing it is and the source of our happiness. We need not wait to see what others do."

– Mahatma Ghandi

CS Makarand Joshi

CORPORATE LAWS
Case Law Update

Companies Act

1. In the Matter of Anbronica Technologies Private Limited. Adjudication Order dated 1st March 2023, ROC (Delhi)

Facts of the case

- Anbronica Technologies Private Limited (hereinafter referred to as "subject company") approached Tyke Platform (owned and operated by Tyke Technologies Private Limited) which is engaged in the business of running a technology-based community platform under the brand name "Tyke." This network is created through registration on Tyke platform and includes individuals from the business industry, corporate executives and professionals who are part of the start-up ecosystem.

- Further, the Tyke platform also provides various services, including but not limited to, the facilitation of setting up of escrow bank account for accepting the investment in the separate subscription bank account, identity verification of proposed investors (KYC Verification) using Aadhar authentication and PAN verification, and assistance in completing the compliance procedures of private placement as provided under Companies Act, 2013.

- As per published terms of use including the Privacy Policy, and Risks ("Terms of Use") to govern the use of the website of Tyke platform includes an internal mechanism to restrict the number of Investors that view the detailed profile to 200 by default thereby making it compliant with the applicable laws. However, it shall be the company's responsibility to comply with the provisions of applicable laws including the Companies Act, 2013 and the private placement rules thereunder.

- Further, it is also stated that Tyke is neither acting as an intermediary to offer nor inviting the public to subscribe to securities of any company and is merely collecting investment interests from its community of members. Also, the Tyke platform is not acting as an agent of the company to inform the public at large about any private placement offer.

- The subject company had issued its Compulsorily Convertible Debentures (hereinafter referred to as "CCDs") using the website of Tyke.

- Tyke platform organized an online pitching session (referred to as "AMA" or "Ask Me Anything") for the subject company, after which, the members of Tyke showed interest in investing in the company. Out of these interested members, the company identified 28 members who were willing to invest in the subject company and the board passed a resolution in the Board meeting held on 10th July 2021 to issue 1,25,000, 0.01% CCDs having a face value of ₹ 10 each at par for a total consideration of ₹ 12,50,000 subjects to the approval of the members. The members passed a special resolution as on 2nd August 2021 to approve private placement. MGT-14 to the said effect was filed with ROC and the private placement offer letter was circulated and allotment happened.

- ROC considered this private placement in violation of section 42(7) under Companies Act, 2013 and issued a show cause notice dated 27th December 2022 to the company asking therein the reasons for not imposing penalty on the subject company under section 42(10) under Companies Act, 2013.

Observation of ROC in Show Cause Notice

- The campaign for raising fund closed on 25th July, 2021, the subject company had already received a Board approval of identified persons on 10th July, 2021.

- The CCDs were oversubscribed, as was displayed on the website of Tyke.

- The details of the banking transactions enclosed by the subject company suggested that the money in the virtual escrow account of the subject company was received from the investors at different dates ranging from 15th July, 2021 to 28th July, 2021 in the virtual escrow account, whereas the approval of members in the EGM was received only on 2nd August, 2021.

- It was also not clear as to whether Tyke was collecting any commission or service fees.

- Whether engaging the services of Tyke amounted to violation of sub-section (7) of Section 42 of the Companies Act, 2013.

Reply on the part of subject company

The opportunity of being heard was also provided to representative/officer of Tyke. While appearing the director of the Tyke gave detailed submission on working of Tyke platform. The relevant submissions are as under:

- Tyke charges a fee (on-boarding fees from the subject company) for accessing the Tyke platform.

- Tykes allows the company to display the pitching information in the Tyke's website and organises AMA sessions which are accessible to all the community members which are approximately 1.5 lacs.

- Community members can communicate their intention to invest by parking the proposed investment amount in their own virtual escrow account. Tyke charges fee on the amount transferred in the escrow account by the community members.

- Tyke can access list of members anytime who have parked their money in their own virtual escrow account. The number of community members at this stage can exceed 200.

- In case the community members who have shown interest to invest exceed

200 or the investment commitment has exceeded the amount sought by the company, this is termed as, `over-subscription'. On the basis of this information, the company finalises the list of identified persons to whom private placement offer is made.

- The company thereafter passes a board resolution with such identified group of people to initiate the private placement process and also, calls for an EGM to take necessary approvals. A form PAS-4 is circulated by the company to such identified group of people using the Tyke platform via hosting it on the profile of the user and at times over email as well. Also, the Company enters into investment Agreements with each of the identified people, individually.
- Upon compliance with private placement offer requirements the proposed investment amount is remitted by the escrow account agent to the company's separate bank account.
- Thereafter, the company allots the securities through a Board Resolution and the same is filed via e-Form PAS -3 with the Registrar of Company and thereafter issues the security certificates to each investor. Tyke charges the company a Service fees which is calculated as a percentage of the amount raised from the investors.

Contentions of the subject company

The authorised representative of the company on behalf of subject company argued as follows:

- The subject company has only availed value added services in the form of facilitation of connecting like-minded people community with start-ups. Tyke also provides the verification of KYC and identification of KYC of people who have shown interest to invest in the subject company.
- Mere availing of the value added services from Tyke platform will not amount to issue of public advertisements and company has complied section 42(7) of the Companies Act, 2013 while issuing of CCDs.
- The subject company connected with persons who showed the interest in their business on Tyke. The company availed the services of Tyke and entered into the agreement with Tyke. CCDs were issued to the investors identified by Board.

Held

- Section 42 of the Companies Act, 2013 clearly provides that the private placement shall be made to a select group of persons who have been identified by the Board. The number of such persons cannot exceed 200 as prescribed in the rules.
- The Explanation I to section 42(3) of the Companies Act, 2013 makes it very clear that the process of "private placement" covers:
  - — the offer, or
  - — invitation to subscribe, or
  - — issue of securities
- The provision requires a company to adhere to the limit of 200 persons not just with respect to the number of persons who ultimately subscribe to the securities of the company, but also the said number, i.e. 200, cannot be exceeded at the time of making an offer or invitation to offer of the securities of the company.

- Thus section 42(7) of the Companies Act, 2013 provides that no company issuing securities under this section shall release any public advertisement or utilize any media, marketing or distribution channels or agents to inform the public at large about such issue.
- Even if it is assumed that the pitch related information is visible to the members of the Tyke platform, such number is around 1.5 lakhs. Also, while explaining the issue of over-subscription for fund campaign on its website, the representative of Tyke admitted that community members showing interest in the company can exceed 200. Therefore, the "Terms of Use" of Tyke which was quoted by the subject company that the platform restricts the number of investors to 200 is clearly not true.
- In this present case, the website of Tyke has been clearly used by a company as a media/marketing/distribution channel/agent to inform the public at large about the issue of securities.
- Tyke has collected its fees/commission at various stages from the company. Moreover, Tyke based on its own submissions has also collected money from the investors who have used the platform for investing in different companies. Thus, the role of Tyke cannot be relegated to mere "generation of interest in the company". Instead, it is an active facilitator for allowing the companies to raise investments through its portal and it is providing end-to-end services, either by itself or through its agents/partners.
- In view of the above facts and circumstances, it has been found that the company and its promoters/directors are liable for penalty for violation of section 42(7) of the Companies Act, 2013.
- The nature of the present violation on the part of the subject company is serious. Whereas, under the of the Companies Act, 2013, the subject companies fulfil the requirements of a small company. Thus, the penalty on the subject company would be governed by Section 446B of the of the Companies Act, 2013.
- The penalty levied on the subject company is ₹ 2 lakhs and on officer in default ₹ 1 lakh each on 2 directors of the subject company.
- Further, it is noted that as the provisions of Section 42 of the Companies Act, 2013 does not allow adjudication officer to impose penalty on Tyke which has clearly facilitated the subject company in the act of commission of default of sub-section (7) of Section 42 of the Companies Act, 2013.

2. In the matter of *Surendra Kumar Singhi (Petitioner) vs. Registrar of Companies, West Bengal (Respondent)* Calcutta high court order dated 20th January 2023.

Facts of the case

- M/s Mani Square Limited (the "Company") was incorporated on 30th October, 1959 under the Companies Act, 1956 with paid up share capital of ₹ 66,28,000/.
- According to the provisions of Section 217(3) of the Companies Act, 1956, the Board of the company was bound to give fullest information and explanation in its report on every reservation, qualification or adverse remark contained in Auditor's report.

- Upon scrutiny of the Balance-sheet and other documents as on 31st March, 2014 it was found that the Board of Directors of Company did not furnish fullest information and explanation in their Director's report with respect to the remarks of Auditors in their report on Balance Sheet for the year ending on 31st March, 2014.
- This has resulted in violation of provisions of Section 217(3) of Companies Act, 1956. The said violation was pointed out to the directors vide show cause notice.
- Reply on the part of the Company was not satisfactory and hence issued instructions to launch prosecution for the aforesaid violation.
- Considering this as non-compliance of section 217(3) of the Companies act 1956, the ROC West Bengal (hereafter called as "Respondent"), filed a complaint against the Company and all its directors before Chief Metropolitan Magistrate of Calcutta
- Rest of the accused directors of the Company i.e., other than the Petitioner recorded a plea of guilty before the learned magistrate and were convicted and sentenced to pay a fine of ₹ 10,000/- only each, and were directed to undergo simple imprisonment for 15 days.
- The Petitioner was appointed as an independent director of the Company w.e.f. 2nd June, 2014 as the petitioner did not have any connection with the Company prior to 2nd June, 2014. The Petitioner being absolutely innocent and having no connection with the alleged circumstances of the instant case, chose not to take the course adopted by the rest of the accused persons and prayed for discharge by filing a petition before the Learned Metropolitan Magistrate.
- But the Magistrate rejected the petition and refused to discharge the Petitioner from the complaint.
- Aggrieved by the initiation and continuation of the impugned proceedings the Petitioner preferred a revision petition before the High Court, praying to quash the proceedings against him.

Petitioner's contentions

Learned Advocate for the Petitioner has submitted that:-

- The Petitioner was requested to join the Board of Directors of the company as an "independent director" on 2nd May, 2014.
- The Petitioner gave his consent to join as an "independent director" of the Company on 6th May, 2014 and the formal consent in the prescribed form, DIR-2 was given to act as an independent director on 17th May, 2014.
- The Petitioner joined as an independent director on the Board of the Company since 2nd June, 2014 and prescribed Form DIR-12 was duly filed with the Registrar of Companies on 8th June, 2014.
- The Petitioner resigned from the Board of the Company on 31st December, 2016 by submitting Form DIR-11 evidencing such resignation.
- The alleged violation mentioned in the impugned petition of complaint pertained to the financial year ending on 31st March, 2014 and the Petitioner was not director of the company as

on 31st March, 2014 and therefore, under no stretch of imagination, the prosecution could be allowed to be continued against the petitioner.

- Further learned advocated quoted general circular dated 2nd March 2020 issued by MCA, wherein it has been directed by appropriate authority of government that unnecessary criminal proceedings should not be initiated against the independent directors and non-executive directors.
- The Learned Magistrate failed to consider the aforesaid submissions in proper perspective and rejected the petition mechanically by simply stating that he has no authority to direct discharge of the petitioner.
- It is further submitted that it has been held by the Hon'ble Supreme Court of India by interpreting provisions of other statutes which are pari material to the penal provisions for which the Petitioner is being prosecuted, that liability is attracted against a person/director
- For any violation committed by a Company until such person is conclusively found to be a director on the date of offence.
- A director of a company doesn't ipso facto by holding position of director become responsible for the conduct of the business of the company or any commission or omission of the company; before or after the date on which the said director, was inducted into or had resigned from the company.
- All the persons including the company secretary and managing directors who are involved in day to day affairs of the company and are responsible for violations have pleaded guilty and were convicted and sentenced.
- The complaint has been mechanically filed against all directors picking up the list from the website of MCA on the date of filing of the complaint including the petitioner.
- The Petitioner was an independent director and that he had given his consent to only act as an independent director of the board.
- Section 161 of Companies Act, 2013 clearly states that any person appointed by the Board of Directors should always be appointed as an additional director. It is only the shareholders in the general meeting who can appoint a regular director irrespective of the director being an independent director/ alternate director/any other Director, the appointment can only be as an additional director.
- Hence, the interpretation of the Respondent that the Petitioner was additional and not Independent Director is wrong and misinterpreted.
- The said DIR 12 under the column designation it is stated "Additional Director" because this is the requirement of the Companies Act, 1956 that any director appointed by the Board has to be appointed as Additional Director, however, the next column below the said column designation i.e. category, states in the said form DIR 12 as "independent". The ROC had deliberately withheld from mentioning in its report in the second column category which establishes the fact that the Petitioner has been appointed as Independent Director only.

- The Petitioner was not present during the meeting in which the report of the Board was considered and are in dispute. The Petitioner had also not signed the said report, and was not the part of the Board which considered approval of the report, hence can't be held liable for any shortcomings of disclosure in the said report.

Respondent's contentions

Learned advocate for the Respondent, had argued that:

- Upon scrutiny of Balance Sheet and other related documents in the XBRL format as at 31.03.2014, it was found that Board of Directors did not furnish fullest information and explanation in the Directors' report with respect to the Auditor's remarks in their report on Balance Sheet. Therefore, leading to violation of Section 217 (2A) of the Companies Act, 1956
- As per records from the MCA portal, date of signing of board report for financial year 2013-2014 was 5th September 2014. This falls well within the period of directorship of the petitioner being from 2nd June, 2014 till 31st December, 2016.
- The attachment to the DIR 12 Form on behalf of Company where Petitioner joined as director, clearly states in its resolution dated 2nd June, 2014 that Petitioner was appointed as an Additional Director and not as Independent Director.
- As per Board's Report along with balance sheet for financial year 2013-2014, it has been mentioned that the Petitioner has been appointed as Additional Director with effect from 2nd June, 2014. Therefore, at time of scrutiny of Balance Sheet of the Company, the Petitioner's name was reflected as additional director of the Company as per records fetched from MCA portal website.
- For prosecution under Section 217(3) of Companies Act, 1956, all members of the Board at that point of time ought to have exercised due diligence when the balance sheet was approved.
- Whether the absence of the petitioner from Board's meeting would be falling within the exceptions provided in Section 217(5) of 1956 Act or whether his case is covered under exceptions as mentioned in General Circular 1 of 2020 is essentially a mixed question of fact and law which requires judicial decision by the Trial Court.

Held

On hearing the learned Advocates for both the parties and considering the materials on record including the documents relied upon, the court noted that,

- The invitation to the petitioner dated 02.05.2014 clearly showed that the Petitioner was invited to join the board of directors of the company as a Director and the Petitioner's reply dated 6th May, 2014 thereto stated that he had given his consent to act as an Independent Director on the board of the company.
- Form DIR-12 showed that the petitioner had been holding the designation of "Additional Director" and category "independent".
- Form no. DIR-11 is a notice of resignation of a director to the registrar and it is shown in the said form that

the Petitioner was a "director" of Mani Square Limited from 30th September, 2014 to 31st December, 2016.

- As seen from the MCA portal, the Petitioner was an "Additional Director" from 02.06.2014 to 30.09.2014. Thereafter, the designated partner details in the Ministry of Corporate Affairs showed the petitioner as a "Director" of Mani Square Limited
- In spite of being shown on the portal as "Additional Director /Director" the Petitioner did not lodge any complaint with the Ministry about the alleged wrong information. There is no case that the Petitioner had filed any objection to the said wrong information (as alleged) on the portal.
- Though appointed on a temporary basis, an additional director is vested with the same powers of a director. Moreover, they are subject to all obligations and limitations of a director.
- The additional director must utilize his/her powers in the best interest of the Company and the shareholders.
- The Petitioner as seen from the documents was an Additional Director on the date the board report was filed. To counter the same evidence is required to be adduced during the trial so also to decide whether the Petitioner at the relevant time of filing the report was a Director, Additional Director or an Independent Director.
- The responsibility of an Additional Director is the same as that of a director (but different from an independent director) they remain responsible, as the statute provides for the same.
- Thus, to quash the proceedings by exercising the courts inherent powers would amount to an abuse of the process of court and would also amount to serious miscarriage of justice.
- The revision petition was thus dismissed.

SEBI

Order of the Adjudicating Officer of SEBI read with Order of the Hon'ble Securities Appellate Tribunal.

Name of the Case: Adjudication order and order of Hon'ble Securities Appellate Tribunal (SAT) in the matter of Quasar India Limited.

Facts of the case

1. Quasar India Limited (hereinafter, referred to as "**Noticee-1**"/"**QIL**") made a preferential allotment on January 31, 2014 by allotting 51,05,000 equity shares of ₹ 10/- each at par to promoter and non-promoter entities aggregating to ₹ 5.10 Cr. Bombay Stock exchange (hereinafter, referred to as "**BSE**") had carried out preliminary examination of the utilisation of funds raised by QIL through preferential allotment.

2. BSE on investigation found that the objects of preferential allotments, as presented by the Noticee-1 to the shareholders *vide* Notice of Extra Ordinary General Meeting ("EGM") of the members of QIL dated December 16, 2013 for the EGM to be held on January 15, 2014, was to augment the working capital requirements of QIL and to fund the proposed business expansion plans of the company. BSE further observed that the aforesaid resolution for the preferential allotment was passed by the members, and there has been no

mention about any modification made to the 'Objects of the preferential issue' as set out in the Notice of the EGM dated December 16, 2013. On further examination carried out by BSE, of the utilization of funds raised by QIL, based on observation of BSE's Auditor Committee and Disciplinary Action Committee, it was observed that QIL had utilized the issue proceeds for granting loan and advances to various entities, which did not adhere to the objects of the issue.

3. In this regard, details were further sought from QIL with respect to utilisation of proceeds of preferential issue. Under preliminary examination BSE sought details regarding utilisation of funds by the Noticee-1. QIL submitted same vide letter dated January 31, 2016. On investigation, BSE found that Noticee-1 had given ₹ 4,67,00,000 as loans to certain entities and ₹ 45,10,400 as payment to creditors. BSE further sought details from Noticee -1 with respect to loans given and payment made to creditors. On replies by QIL, BSE observed that in certain cases the loans were given without interest. BSE, in this regard, further sought clarification from QIL with respect to giving of interest free loans. BSE then stated that QIL changed its earlier stand and intimated that funds were given as business advances for different purposes such as buying of premises, purchases of fabric, setting of power projects, acquisition of sick company, buying office premises etc., and therefore no interest was charged.

4. Further the matter was referred to SEBI and SEBI, as part of its investigation and examination, vide its letter dated November 28, 2019 advised QIL to provide the details of utilization of funds of the allotment dated January 31, 2014 along with reasons/purpose/transaction/agreement in details along with all relevant documentary evidence. Vide letter dated December 31, 2019, QIL provided the details of utilization of funds raised through the preferential issue. QIL had submitted a copy of its bank account statement highlighting the aforesaid payments/transactions. It was observed from the details of utilization of funds submitted by QIL that the same did not match with the utilization details as submitted by QIL to BSE vide letter dated January 31, 2016. On seeking clarification, *vide* letter dated December 16, 2020, QIL had submitted that there might have been a clerical error in the submission of data to BSE. Also, it was observed from the bank account statement of QIL, where the preferential issue proceeds were credited, that the fund flow did not match with the deployment of proceeds as provided by QIL. So QIL was asked to provide comments on how the details of funds utilization submitted by them did not match with actual fund flow as observed from its bank statement of QIL submitted that the fund utilization provided was true and correct to the best of their knowledge and belief and depicts the final position of the funds' utilization.

5. SEBI thus stated that investigation, *prima facie*, revealed that Noticee-1 had mis-utilized the issue proceeds by not deploying funds for the stated objects of the preferential issue. It was also observed that the said fraudulent act of deviating and mis-utilising the preferential issue proceeds was done by QIL with the knowledge of its directors

i.e. Ankit Agarwal, Ganesh Prasad Gupta and Yogesh Bansal (hereinafter referred to as **Noticees-2 to 4** respectively).

Charge

Section 12A(a), (b), (c) of SEBI Act, 1992 read with Regulations 3(a), (b), (c), (d), 4(1), 4(2)(f) and (r) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (hereinafter referred to as "**PFUTP Regulations**"). Non-disclosure under clause 43 of the erstwhile Listing Agreement read with section 21 of Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as "**SCRA**, **1956**") in respect of variation or deviation in the utilization of preferential allotment proceeds and therefore it was alleged that QIL violated the said provisions.

Arguments by QIL

1. **Company Utilised the proceeds of preferential allotment for the objects as specified in the explanatory statement to EGM**

A. QIL stated that amounts that were raised were advanced to several parties for meeting the business requirements / working capital needs of the Company. They were not diverted or utilised for any other purpose as contended by the Audit Committee of the BSE. QIL further submitted that they have advanced ₹ 278 lacs as loan and has received interest on them as well. It was further stated that the amount was advanced as it was lying idle and they intended to earn some income on the same. QIL further stated that the contents of the main objects permit the business of investing in shares. Further, clause 6 of the Main Objects permits QIL to engage in any lawful activity as may be permitted by the law of the land for the time being in force. This proves that QIL had not done any activity which is not permitted by its Memorandum of Association. QIL further submitted a certificate from Ms V N Purohit & Co., Chartered Accountants confirming the utilisation of the proceeds in accordance with the objects stated. QIL further affirmed that pending utilisation of the funds, they had provided short-term advances to certain entities, which have been returned to QIL. QIL further stated that the details provided by QIL regarding the utilisation of the funds is true and correct and depicts the final position regarding the utilisation of funds.

B. Ratification of utilisation of funds done: QIL further stated that BSE directed them to ratify the utilisation of funds by way of a shareholder resolution vide notice no: 20180613-29 dated 13.06. 2018 in the year 2018. They confirmed that the ratification was done in January 2019 as that was the earliest Shareholders Meeting after the direction of the BSE. QIL also submitted that they believed that there was no mis-utilisation of funds and they deny that they have mis-utilized the funds or committed a fraud and violated the provisions of Section 12 of the SEBI Act, 1992 read with Regulations 3(a), (b), (c), (d), 4(I), 4(2)(f), and 4(2)(r) of PFUTP Regulations, 2003. QIL further stated that Noticees 2 to 4 have carried out all duties assigned to them as per the provisions of applicable laws.

C. QIL further specifically stated as follows with respect to certain contracts:

i. **Neeru Bansal:** QIL confirmed that an amount of ₹ 50,00,000 was paid as advance to Ms Neeru Bansal

on September 10, 2013 towards the office space that was proposed to be purchased from her. Since, she could not deliver as per the commitment made, the amount given to her was returned by her to QIL.

ii. **Taxus Infrastructure:** With regard to the allegation in Paragraph 9(b) regarding the payment of ₹ 96,00,000 made to Taxus Infrastructure ('Taxus') on September 12, 2013, September 27, 2013 and November 07, 2013, QIL denied that the amount advanced was not in accordance with the objects of the issue. One of the objects was to finance fund the expansion propositions of QIL. QIL had accordingly identified investment in the power project of Taxus Infrastructure as it appeared to be lucrative and accordingly advanced ₹ 90,00,000 towards the subscription to the equity capital of Taxus. Remaining ₹ 6,00,000 was a penalty imposed on Taxus opportunity loss caused due to failure of the investment. However, the same was returned to Taxus after they made a request to QIL to refund the penalty amount.

iii. **Madhu Vashist:** Amount of ₹ l,00,000 was paid to Ms Madhu Vashist, as advance towards purchase of fabric.

iv. **Sandeep Gupta:** It is submitted that amount was provided as an advance to Mr Sandeep Gupta so that he could identify certain takeover targets, particularly companies which were sick. Mr Sandeep Gupta however could not complete the transaction and hence the amount advanced to him were refunded by him to QIL on March 10, 2014, March 11, 2014 and March 26, 2014.

v. **Munish Bajaj & Sons HUF:** With regard to the payment made to Munish Bajaj & Sons HUF, QIL denied all the allegations made in the Notice. The amount of ₹ 17,00,000 was advanced to purchase property. The deal was however cancelled as Munish Bajaj & Sons HUF was unable to handover the possession of the property.

vi. **Josh Impex Pvt Ltd:** With regard to the amount of ₹ 30,00,000 paid to Josh Impex Private Limited, QIL denied all the allegations made in the Notice, The amount was advanced towards purchase of Blended Woven Fabric, which is part of the business in which we operate. This was in accordance with the objects of the issue as well. However, QIL was forced to cancel the order due to change in the import Policy of the Government of India and continuing with the order would not have helped QIL's business.

vii. **Signature Builders Private Ltd:** With regard to the payment to Signature Builders Private Limited, QIL confirmed that same was advanced towards the purchase of 2 Bedroom Guest House. QIL had provided the necessary correspondence in this regard. It can be seen from the notice that it was Signature Builders which had changed its submission and not

QIL. QIL had advanced ₹ 90,00,000 towards the same and the amount was returned by Signature Builders Private Limited as they did not keep up their commitments.

viii. **Rekha Malhotra:** QIL denied the allegations made in the Notice with regard to the payments made to Ms Rekha Malhotra. QIL said it would like to reiterate the amount of ₹ 6,00,000 was made towards purchase of fabric and the order was cancelled due to the non-matching of the final product with the sample and the unethical behaviour of Ms Rekha Malhotra.

ix. **Chanson Shipping and Packaging Company Private Ltd:** QIL denied the allegations regarding payment made to Chanson Shipping and Packing Company Private Limited. The same was for the purchase of warehouse, which they did not deliver on time and hence had to be cancelled. The amount of ₹ 50,00,000 advance was towards purchase of warehouse and not interest free loan as alleged in the Notice. QIL denied that they didn't have the intent of recovering the amounts advanced to the parties. The agreements may not have been entered on a stamp paper, but to receive the amounts advanced as loan or given as advance towards the purchase of fabric, office property, warehouse etc., was with good intent. If the intent to recover the amount was not there, QIL would not have received all the amounts given to the parties mentioned above, except for the amount of ₹ 12,00,000 advanced to Pun Films Private Limited.

Arguments by SEBI

1. **Company Utilised the proceeds of preferential allotment for the objects as specified in the explanatory statement to EGM:** SEBI initially countered the arguments pertaining to each contract as follows:

    a. **Neeru Bansal:** The contention of Quasar India that ₹ 50,00,000 was paid to Neeru Bansal for purchase of office space does not seem tenable. No details/documents regarding the purchase property was available with QIL. Further, submitting different documents to BSE and SEBI clearly shows that the reason given by QIL that the amount was utilized for purchase of office space was an afterthought. Since the amount was returned back by Neeru Bansal without paying any interest, SEBI concluded that the amount paid to Neeru Bansal was actually an interest-free loan.

    b. **Taxus Infra and Power Projects Ltd:** SEBI stated that the contention of Quasar India that ₹ 90,00,000 was paid to Taxus Infrastructure and Power Projects Pvt. Ltd. in accordance with objects of the issue is not tenable. No details/documents regarding how the payment made to Taxus in in accordance with the objects of the preferential issue was available with QIL. As per information memorandum submitted by QIL to BSE dated June 9, 2014, the business activity of QIL was fabric/textile trading. It is not clear as to how participation in power projects would benefit QIL engaged in fabrics. Further, submitting different

documents to BSE and SEBI clearly shows that the reason given by QIL that the amount was utilized in accordance with the objects of the issue was an afterthought. Since the amount was returned back by Taxus Infrastructure and Power Projects Pvt. Ltd. without paying any interest, SEBI concluded that the amount paid to Taxus Infrastructure and Power Projects Pvt. Ltd. was actually an interest-free loan.

c. **Madhu Vashist:** The contention of Quasar India that ₹ 10,00,000 was paid to Madhu Vashisht for purchase of fabric is not tenable. No valid legal documents regarding the purchase of fabric is available with QIL or the counterparty. Further, submitting different documents to BSE and SEBI clearly shows that the reason given by QIL that the amount was utilized for purchase of fabric was an afterthought. In view of the above, SEBI concluded that the amount paid to Madhu Vashisht was actually an interest-free loan.

d. **Sandeep Gupta:** The contention of Quasar India that ₹ 10,00,000 was paid to Sandeep Gupta for buyout of a sick company with similar business objectives is not convincing and is not tenable. No valid legal documents/agreements regarding the deal is available with QIL. The counterparty entity had denied the existence of any such agreement. Further, it is observed that submitting different documents to BSE and SEBI clearly shows that the reason given by the Company that the amount was utilized for identifying a sick company with similar business objectives was nothing but an afterthought. In view of the above, SEBI concluded that the amount paid to Sandeep Gupta was actually an interest-free loan.

e. **Munish Bajaj & Sons HUF:** The contention of Quasar India that ₹ 17,00,000 was paid to Munish Bajaj & Sons HUF in accordance with objects of the issue is not tenable. No details/documents regarding the property was available with the Company. Since the amount was returned back by Munish Bajaj & Sons HUF without paying any interest, SEBI concluded that the amount paid to Munish Bajaj & Sons HUF was an interest-free loan.

f. **Josh Impex Pvt Ltd:** It is difficult to accept the contention of Quasar India that ₹ 30,00,000 was paid to Josh Impex Pvt. Ltd. for purchase of fabric. No valid legal documents regarding the purchase of fabric is available with QIL. Further, submitting different documents to BSE and SEBI clearly shows that the reason given by QIL that the amount was utilized for purchase of fabric was an afterthought. In view of the above, SEBI concluded that the amount paid Josh Impex Pvt. Ltd. was actually an interest-free loan.

g. **Signature Builders Private Ltd:** It is difficult to accept the contention of Quasar India that ₹ 90,00,000 was paid to Signature Builders Pvt. Ltd. to take 2BHK flat as guest house of QIL. No details/documents

regarding the purchase property is available with the Company. The counterparty entity-Signature Builders Pvt. Ltd. had submitted that the money was transferred for share application money. Further, submitting different documents to BSE and SEBI clearly shows that the reason given by QIL that the amount was utilized for purchasing 2BHK flat was an afterthought. Since the amount was returned back by Signature Builders Pvt. Ltd. without paying any interest, SEBI concluded that the amount paid to Signature Builders Pvt. Ltd. was actually an interest-free loan.

h.. **Rekha Malhotra:** The contention of QIL that ₹ 6,00,000 was paid to Rekha Malhotra for purchase of fabric is not tenable. No valid legal documents regarding the purchase of fabric is available with QIL. Further, submitting different documents to BSE and SEBI clearly shows that the reason given by the Company that the amount was utilized for purchase of fabric was an afterthought. In view of the above, SEBI concluded that the amount paid Rekha Malhotra was actually an interest-free loan.

i. **Chanson Shipping and Packaging Company Private Ltd:** The contention of QIL that ₹ 50,00,000 was paid to Chanson Shipping and Packing Co. Pvt. Ltd. for office cum warehouse is not tenable. No details/documents regarding the purchase property is available with QIL. The reply of counterparty entity is also silent on whether any agreement for office cum warehouse was made. Further, submitting different documents to BSE and SEBI clearly shows that the reason given by QILthat the amount was utilized for taking office cum warehouse was an afterthought. Since the amount was returned back by Chanson Shipping and Packing Co. Pvt. Ltd. without paying any interest, SEBI concluded that the amount paid to Chanson Shipping and Packing Co. Pvt. Ltd. was actually an interest-free loan.

SEBI concluded that QIL has used the funds of preferential allotment to advance loans without interest in most cases and with some interest in few cases. No adverse inference was drawn with respect to utilisation of funds for purchase of fabric as it was main object as per MOA. SEBI further noted that few of the landings have been carried out without any agreements or MoU. With respect to some of the other lendings that were done through MoU/agreements/other documents, it was observed that the said agreements were not executed on stamp paper, not notarized not registered, interest payable not a part of terms in many documents, thus severely hampering the legal validity and scope of enforcing the agreement. SEBI thus summarised that Loans amounting to ₹ 4.67 crores were given from the preferential allotment money. Further, ₹ 1.81 crores were given to different counterparties which were subsequently returned and again utilized. ₹ 0.17 crores were also paid to stock broker for trading in the stock market. As such, Noticee-1 mis-utilized the issue proceeds by not deploying funds for the stated objects of the preferential issue.

Ratification of utilisation of funds done

SEBI stated that ratification was done after six years that too on receipt of notice from BSE. SEBI stated that past fraudulent acts and deeds

of QILcannot be legitimized by subsequent ratification of the same by shareholders of QIL.

Role of directors in the misutilization of preferential issue proceeds

Noticee No.4 was an independent, non-executive director of QIL, he was actively involved in the activities of QIL. Also, Yogesh Bansal and Ankit Agarwal (other directors) were authorized, jointly and severally to sign and file the necessary form and papers with the Registrar of Companies and to take other steps as may be required. Noticee 2 to 4 all attended 19 Board meetings conducted during the investigation period and the only Audit Committee meeting during the year 2013-14 as per annual report. Noticee-4 played a significant role in QIL as he was the chairman of the Audit Committee and Nomination and Remuneration Committee during the period 2013-14. SEBI further stated that Noticee 1 did not utilize the funds as stated in the objects of the issue and utilized the same for making loans and advance and thus there was a variation in the object of utilization of fund, which the Noticee-1 should have disclosed under clause 43 of listing agreement. However, the Noticee-1 failed to do so. Hence, it is established that Noticee-1 failed to utilize the fund as stated in the object and failed to disclose the same under clause 43 of listing agreement and therefore has violated the provisions of clause 43 of the erstwhile Listing Agreement (which is now regulation 32 of the LODR Regulations) read with section 21 of SCRA. **All the above contentions of SEBI were affirmed by Securities Appellate Tribunal ('SAT') in its order dt: February 28, 2023.**

Name of Noticee	*Violation*	*Penal provision*	*Amount*	*SAT*
QIL	Section 12A(a), (b), (c) of SEBI Act read with Regulations 3(a), (b), (c), (d), 4(1), 4(2)(f) and (r) of PFUTP Regulations	Section 15HA of the SEBI Act	500,000	upheld
	Clause 43 of the erstwhile Listing Agreement (which is now regulation 32 of the LODR Regulations) read with section 21 of SCRA.	Section 23A(a) of the SCRA Section 23E of the SCRA	200,000	Upheld
Ankit Agarwal	Section 12A(a), (b), (c) of SEBI Act read with Regulations 3(a), (b), (c), (d), 4(1), 4(2)(f) and (r) of PFUTP Regulations	Section 15HA of the SEBI Act	500,000	Cancelled on technical grounds
Ganesh Prasad Gupta	Section 12A(a), (b), (c) of SEBI Act read with Regulations 3(a), (b), (c), (d), 4(1), 4(2)(f) and (r) of PFUTP Regulations	Section 15HA of the SEBI Act	500,000	Upheld
Yogesh Bansal	Section 12A(a), (b), (c) of SEBI Act read with Regulations 3(a), (b), (c), (d), 4(1), 4(2)(f) and (r) of PFUTP Regulations	Section 15HA of SEBI Act, 1992	200,000	Upheld

IBC

In the matter of *Chandra Prakash Jain IRP (Applicant) For Mayfair Leisures Ltd. vs Director of Enforcement Department of Revenue (Respondent)* at National Company Law Tribunal (NCLT) Ahmedabad dated 6 March 2023.

Facts of the case

- M/s. Mayfair Leisure Limited is the Corporate Debtor (CD) and was admitted in Corporate Insolvency Resolution Process (CIRP) vide order dated 2 June 2020 at National Company Law Tribunal (NCLT) filed by the Financial Creditor (FC) i.e., Bank of India under section 7 of the Insolvency and Bankruptcy Code (IBC).
- NCLT appointed Chandra Prakash Jain as the Interim Resolution Professional (IRP) which is applicant in this case.
- It was noted by the applicant that the property was already attached by the Enforcement Directorate vide its provisional attachment order dated 24 April 2018. The said order was confirmed by the Hon'ble PMLA Appellate Tribunal vide its order dated 3 December 2018. The Prevention of Money Laundering Act 2002 (PMLA) Appellate Tribunal vide order dated 12 May 2020 had directed that the status of the property of the CD had to be maintained as it was on 7 April 2018 during investigation of the money laundering under PMLA, which was initiated based on Central Bureau of Investigation (CBI).
- Therefore, the application was filed by IRP u/s 60(5) and 14 of the IBC read with Rule 11 of NCLT Rules seeking release of attachment of property by the Enforcement Directorate, Ahmedabad.

Arguments of the Applicant

- It was argued by the applicant that they were informed by Suspended Management that the property of the CD had been attached by CBI on 5 April 2018 and the same was confirmed by the Hon'ble Gujarat High Court in 2019. It was further informed that the property was also attached by the Enforcement Directorate (ED) vide its provisional attachment order dated 24 April 2018.
- The Hon'ble PMLA Appellate Tribunal vide order dated 12 May 2020 had directed that the status of the property of the CD had to be maintained as it was on 7 April 2018 during investigation of the money laundering under PMLA. It was further stated that pursuant to this order, they were not able to take the possession of the property, nor they were able dispose it off.
- Further, the applicant submitted that vide letter dated 17 June 2020 they had intimated ED about initiation of CIRP of the CD, yet ED had not even filed its claim.
- In response to the letter, ED confirmed vide letter dated 26 June 2020 that the immovable assets of the CD were attached by their office. The applicant in response issued another letter dated 21 July 2020 and requested the ED to release the attached property to take charge of the CD.

Arguments of the Respondent

- It was submitted that the office of the Respondent traced immovable properties valued at ₹ 1122.72 crores and provisionally attached the same vide Provisional Attachment Order. Subsequently, a complaint was made

before the Adjudicating Authority, PMLA, New Delhi for confirmation of the attachment. The Adjudicating Authority, PMLA, New Delhi confirmed the provisional attachment of the properties valued at ₹ 1122.72 crores vide order dated 1 October 2018.

- It was also mentioned that Prosecution Complaint (PC) in the designated Special Court under PMLA has also been filed.
- Further, the money laundering case was recorded by ED on 5 April 2018 and the provisional attachment order of the immovable assets was issued on 24 April 2018, which was prior to the admission of the instant application before NCLT.
- Further, the moratorium vide directions issued by NCLT are in respect of proceedings of civil nature as well as disposal of the properties of the CD, whereas the action taken by the Directorate under PMLA, is a criminal matter as the said properties are derived from criminal activities.
- Moreover, a complaint has already been filed before Hon'ble Special Court and the immovable properties attached by the ED was required to be available before Hon'ble Special Court under PMLA for the purpose of confiscation of the same to the Central Government as well as for imposition of penal action on the company and its directors/ responsible officers under the provisions of PMLA.
- It was also submitted that the objectives of PMLA and IBC are different. The concerns of the applicant regarding availability of the properties were already covered under the provisions of PMLA. Once it is established that the money involved in the case is laundered, the said properties which are provisionally attached will stand confiscated and will be dealt as per section 8(8) of PMLA. The claimants with a legitimate interest in the property would be considered during the proceedings before the Special Court under PMLA.
- Hence, it was argued that the present application was not maintainable.

Held

- The NCLT observed that in the case of High Court of Madras in the matter of Deputy Director, office of the Joint Directorate of Enforcement vs. Asset Reconstruction Company of India Ltd. and others it was stated that NCLT has no jurisdiction to go into the matters governed under the PMLA and, therefore, section 14 of IBC having consequent upon an order passed by NCLT declaring moratorium, would not apply to the PMLA which is a distinct and special statute having its own objective and as such section 14 of IBC would not bar a proceeding under the PMLA.
- Accordingly, it was held that a proper recourse to be resorted by the CD to approach the 'Competent Forum' under the PMLA to its logical end or any other 'Jurisdictional Forum' (other than the purview of IBC) in the manner known to law and in accordance with Law. In view thereof, the application was rejected.

CA Hardik Mehta CA Tanvi Vora

OTHER LAWS

FEMA – Update and Analysis

In this article, we have discussed rules and regulations under FEMA for those affecting Emigrating and Immigrating Indians.

A. Understanding Residential Status under FEMA applicable to Individuals

Person Resident in India ('PRII') means a person residing in India for more than 182 days during the course of the preceding financial year but does not include :-

A. a person who has gone out of India or who stays outside India, in either case –

   a. for or on taking up employment outside India, or

   b. for carrying on outside India a business or vocation outside India, or

   c. for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;

B. a person who has come to or stays in India, in either case, otherwise than –

   a. for or on taking up employment in India, or

   b. for carrying on in India a business or vocation in India, or

   c. for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;

Person Resident outside India ('PROI') means a Person who in not resident in India.

Understanding the definition:

a. It is an intention based definition viz. different in comparison to residential status under Income Tax Act wherein it is more factual depending on the number of days stay.

b. The status is evaluated on the particular day of transaction. In contrast under Income Tax it is for a period i.e. financial year.

c. Documentary evidence such as visas and other travel and employment records are important to prove intention.

B. Emigrating Indians

Emigrating Indian is a person who leaves India for various reasons such as employment, business, relocation etc but does not include someone who goes out of India on visits.

As explained above in the definition of residential status, based on the intention of the emigrating Indian, he would be considered a PROI immediately upon his departure from India. As such, Foreign Exchange Management Act, 1999 applies to the whole of India and therefore, not applicable to a PROI. However, in case of emigrating Indians, FEM Act, 1999 and its rules and regulations will be applicable to i) transactions affecting his or her assets or liabilities in India; ii) his or her future transactions with PRIs.

We have listed and analyzed below the impact on transactions done at the time when such emigrating person was Resident in India and the status of assets held in India before emigrating:

a. Bank Accounts

- Existing resident account should be re-designated to NRO account if person leaves India for uncertain period (for employment or business or vocation outside India)
- Balances in EEFC and RFC(D) can be credited to NRE/FCNR(B) accounts
- PROI can remit up to USD 1 million out of sale proceeds/balances in their account maintained with AD Banks in India

b. Demat Accounts

- Sec 6(5) permits PROI to continue to own securities which were acquired while person was resident of India (Section 6(5) explained below)
- Securities in Demat account can be continued to be held by PROI
- PROI needs to Intimate Depository about change in his residential status
- Schedule 3 and 4 of Non Debt Instrument Rules permits Non-resident Indian ('NRI')/Overseas Citizen of India ('OCI') to make portfolio investments on repatriation and non- repatriation basis
- The investment in securities (Demat Account) existing on date of becoming NRI/OCI will be characterized as non-repatriable investment
- For making fresh investment on repatriation basis, new Demat account needs to be opened

c. Insurance Policies

- Life/General Insurance Policy taken in India can be continued.
- No permission required for payment of premium

d. PPF Account

- As per F. No. 01/10/2016-NS dated 23rd February, 2018 an NRI can continue to operate PPF account and continue to invest further till the time it matures (after 15/5 years)
- After maturity, PPF account cannot be renewed

e. Foreign Currency Investment made outside India under LRS and ODI

- All foreign currency investments made under LRS can be continued
- In case of ODI transactions, upon turning PROI, investments will no longer be considered ODI. Intimation to RBI is required to be given and Form FC Part G will be required to be filed for cancellation of UIN.

f. Immovable Property and Agricultural Land

- The NRI cannot invest in agricultural land and plantations

- They may continue to own existing Agricultural land acquired before attaining NRI status
- The PROI cannot continue to be a partner in a partnership firm which is involved in agricultural/plantation activity or real estate business, i.e. dealing in land and immovable property

g. *Loan*

- NRI cannot receive loan in INR from non-relative in India
- Existing loans under erstwhile regulation can be continued as permitted up to due date of repayment

h. *Interest in LLP*

- PROI can continue as partner of Indian LLP even after becoming PROI
- Fresh investment in LLP towards capital may be made through NRO to make it distinctively clear that fresh investment is also on non-repatriation basis
- Fresh investment in form of loan cannot be made in LLP
- Existing Loan to LLP may be continued. However, repayment of loan by LLP or firm shall be made to NRO account

i. *Interest in Indian Partnership Firm*

- PROI can even continue to be as partner of Indian Partnership Firm even after becoming PROI
- Fresh investment as capital in firm to be made compulsorily through NRO.
- Fresh Loan cannot be given.
- Indian Partnership Act permits firm having all NRIs/OCIs partners. No need of having resident partner.

j. *Status of Assets held in India before emigrating – Section 6(5) of FEMA*

A PROI may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India

- Assets (Share/Securities, Immovable Property and Indian Currency) which were acquired at time when a person was resident in India can be continued to be held even after he turns out non – resident.
- The same can even be transferred or invested.
- Further, NR can inherit the same from a resident u/s 6(5) of FEMA.

C. Returning Indians

Returning Indian (a.k.a. Immigrating Indian) for the purpose of this article is a person who comes back to India after being a PROI. It also covers NRIs who chose to move to India for various reasons such as employment, business, relocation etc but does not include someone who comes to India on visits.

Based on the above definition of residential status, based on the intention of the immigrating Indian, he would be considered a PRII immediately upon his arrival to India. Foreign Exchange Management Act, 1999 and its rules and regulations would apply in its totality to a PRII. It is therefore important to understand what impact such move would have on transactions done at the time when such person was resident outside India and the status of assets outside held before returning to India which we have listed and analyzed below:

a. Bank Accounts

- Foreign Bank Accounts can be continued to be held u/s 6(4)
- NRE accounts should be re-designated to resident accounts immediately upon return to India (for employment or business or vocation outside India)
- Funds in NRE accounts can even be transferred to RFC at option of the account holder
- NRO accounts to be re-designated to resident rupee accounts
- FCNR deposits can be continued till maturity. On maturity the same shall be converted to rupee deposit accounts or RFC account

b. Insurance Policies

- Life/General Insurance Policy taken outside in India can be continued
- No permission required for payment of premium
- Maturity proceeds or amount of any claim due shall be repatriated to India within 7 days of receipt

c. Investment made outside India

- Can be continued to be held u/s 6(4)

d. Income earned through employment or business or vocation outside India

- Permitted to receive income earned through employment or business or vocation outside India taken up or commenced while such person was resident outside India as per A.P. (DIR Series) Circular No. 90 dated 09/01/2014.

e. Other Assets

- PRI may freely utilize all their eligible assets abroad as well as income on such assets or sale proceeds thereof received after their return to India for making any payments or to make any fresh investments abroad without RBI approval
- Provided the cost of such investments and/or any subsequent payments received therefore are met exclusively out of funds forming part of eligible assets held by them and the transaction is not in contravention to extant FEMA provisions.

f. Status of Assets Outside India held before returning - Section 6(4) of FEMA

A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India

- Assets (Share/Securities, Immovable Property and Foreign Currency) which were acquired at time when a person was resident outside India can be continued to be held even after he turns resident
- The same can even be transferred or invested
- Further, Resident can inherit the same from a non resident u/s 6(4) of FEMA.

Rahul Hakani
Advocate

Niyati Mankad
Advocate

Best of The Rest

SHIVASHANKARA AND ORS. V/S HP VEDAVYASA CHAR – ORDER DT. 29/03/2023 PASSED IN CIVIL APPEAL NO.10215 OF 2011 [SUPREME COURT]

***Order VI Rule 17 of CPC** - in dealing with prayers for amendment of the pleadings the Courts should avoid hyper technical approach. But at the same time, Court should keep reminded of the position that the same cannot be granted on the mere request through an application for amendment of the written statement, especially at the appellate stage ---*

***Order XLI Rule 23 of CPC** – it is settled position that the Court to which the case is remanded has to comply with the order of remand and acting contrary to the order of remand is contrary to law*

***Order XXII Rule 2 of CPC** - Suit won't Abate for not impleading all LRs of deceased defendant if estate was substantially represented by other defendants*

***Transfer of Property Act, 1882; Section 52 - Lis Pendens** - It is a well settled position that wherever TP Act is not applicable, such principle in the said provision of the said Act, which is based on justice, equity and good conscience is applicable in a given similar circumstance, like Court sale etc. - Transfer of possession pendente lite will also be transfer of property within the meaning of Section 52 and, therefore, the import of Section 52 of the TP Act is that if there is any transfer of right in immovable property during the pendency of a suit such transfer will be non est in the eye of law if it will adversely affect the interest of the other party to the suit in the property concerned. We may hasten to add that the effect of Section 52 is that the right of the successful party in the litigation in regard to that property would not be affected by the alienation, but it does not mean that as against the transferor the transaction is invalid.*

***In Suit for Possession** - Prior Possession becomes relevant when both parties fail to establish title*

***Possessory Title** - Principle of "jus tertii"- 'right of a third party - no defendant in an action of trespass can plead the 'jus tertii' that the right of possession outstanding in some third person.*

***Possessory Title** - when the facts disclose no title in either party, at the relevant time, prior possession alone decides the right to possession of land in the assumed character of owner against all the world except against the rightful owner - 'Possessio contra omnes valet praeter eur cui ius sit possessionis' (he that hath*

possession hath right against all but him that hath the very right)"

Facts

1. The Respondent herein i.e. the Orig. Plaintiff filed a Suit in the Trial Court in Bangalore ("TC") seeking decree inter alia for recovery of possession and prohibitory and mandatory injunctions with respect to certain properties. The Plaintiff submitted all the oral and documentary evidence of his claim. The Appellants herein i.e. the Defendants did not lead any evidence. After considering the evidences, the Trial Court partly decreed that the Plaintiff would be entitled to recover possession of Suit Property from the Defendants by due process of law in case of failure on the part of the Defendants to vacate and deliver the Suit Property within the period stipulated.

2. The Defendants filed First Appeal ("RFA") being RFA No.1966 of 2007 in the High Court of Karnataka at Bengaluru ("HC"). In the said RFA, they filed an Application under Order XLI Rule 27 of the Code of Civil Procedure, 1908 ("CPC") seeking permission to produce additional evidence. The HC allowed the said Appeal by Order dated 29/10/2007 by directing the TC to dispose of the Suit after taking evidence.

3. Thereafter, on 27/11/2007 the Plaintiffs filed Special Leave to Appeal (i.e. Civil Appeal No.5201 of 2009) in the Supreme Court challenging the said Order 29/10/2007 whereas the TC took up the matter and posted it for Defendants' evidence. The Defendant Nos. 1 and 2 filed an application for amendment of the written statement before the Trial Court. Besides the same, three more applications were filed before the TC viz., (1) seeking permission to file additional written statement; (2) seeking permission to produce 8 documents; and (3) to recall PW-1. The TC allowed only the applications for permission to produce documents and to recall PW-1, by order dated 13.11.2007. This TC's Order was stayed by Order dated 13/11/2007 passed by HC in WP No. 18328 of 2007.

4. Thereafter, the said Order dated 29/10/2007 of the HC was modified by the Apex Court in Civil Appeal No.5201 of 2009 whereby the TC was directed to record the evidence as directed by the HC and to submit a report thereon to the HC to enable it to dispose of the appeal within the time stipulated.

5. Thereafter, the TC took up the matter and posted it for the evidence of the Defendants. They filed I.A. No. 8 of 2009 seeking permission to amend the written statement ("WS") which came to be dismissed by the TC.

6. Later, TC transmitted the recorded evidence to the High Court along with its report. In HC, the Defendants filed three Misc. Application ("MA") in HC (i) under Order 41 Rule 2 r.w. Sec 151 of the CPC to raise additional grounds 16A and l6B in the Appeal, (ii) under Order 41 Rule 2 r.w. Sec 151 CPC to raise additional grounds 16C and 16D in the Appeal and (3) under Order 6 Rule 17 r.w. Sec 151 of the CPC for amendment of WS.

7. It is pertinent to note that in the present case, the plaintiff was claiming merely recovery of possession (on basis of

prior possession) and not ownership of the Suit Property (which was part of a larger property owned by third parties/ persons, as alleged by the Defendants). In the WS as well, the Defendants did not state and submit that they had a better title than that of the Plaintiff. It was their case that third person had better right, title and interest in the Suit Property. It was only at Appellate Stage that the Defendants by way of MAs by seeking amendment tried to contend that: -

(i) the said third parties had filed a petition for evicting the Plaintiff as HRC No. 10020 of 1991

(ii) The Defendants had pleaded that the ownership of the suit property was with the said third parties and did not claim possession specifically and it is thereafter that they sought to bring in a plea that pursuant to an agreement for sale entered into between those parties viz., the 1st defendant viz., Exhibit D-1 dated 01.03.1993 possession of the suit schedule property was delivered to the 1st Appellant herein. However, the 2nd Defendant during his chief examination itself admitted that the Plaintiff was then in possession of the suit schedule and also in his Affidavit and that he also admitted during his chief examination that as on the date of Exhibit D-1, possession of the property was not taken as the said third parties had assured to secure possession and hand it over to the 1st Defendant.

(iii) Further, attempt was made to bring in new plea by amending the WS that the 2nd Defendant (the deceased 2nd Appellant) had purchased the suit property as per sale deed dated 05.10.2000 i.e. purchased during the pendency of the Suit filed by the Plaintiff.

8. The HC answered the points formulated against the Defendants and in favour of the Plaintiff. The said Misc. Application seeking amendment of the written statement and permission to raise additional grounds viz., ground No.16 (c) and 16(d), were dismissed. In regard to the maintainability of the suit raised by the Defendants, same was rejected and Suit was held as maintainable. On the question whether the Suit is bad for non-joinder of necessary parties (raised by the Defendants) it was held in the negative.

9. Based on conclusions and findings, the HC by judgment and decree dated 09/09/2010 held that the Plaintiff was entitled to the Judgment and Decree as decreed by the TC and consequently, the RFA No.1966 of 2007 was dismissed with cost. Against this Order, the Defendants filed Appeal u/s 136 of the Constitution of India before the Supreme Court

Issues

Whether the impugned judgment is inflicted with perversity or any patent illegality warranting interference in invocation of the power under Article 136 of the Constitution of India?

Held

The court refused to grant interference in the impugned judgment under Article 136 and dismissed the Appeal due to the following reasons: -

1. The court held that the high court was right in refusing to allow the two MAs as in the case on hand, prayer to amend the plaint was allowed by the TC as per order dated 01.09.1995. Accordingly, the amendment was carried out by the plaintiff. Indisputably, thereafter, during the span of one year or thereabouts more than 8 opportunities were given to the Defendants therein to file additional WS, if any. Indubitably, the materials on record reveal that the opportunities were not availed and no additional WS was filed the Defendants. The only reason submitted by Defendants for filing these applications at the appellate stage was mistake and oversight.

2. While dealing with prayers for amendment of the pleadings, the Court reiterated that the Courts should avoid hyper technical approach. But at the same time, courts should keep reminded of the position that the same cannot be granted on the mere request through an application for amendment of the WS, especially at the appellate stage.

3. Moreover, if these applications were allowed, it would amount to revival of the Suit which would have been contrary to the said order dt. 29/10/2007 passed by Supreme Court in Civil Appeal No. 5201 of 2009

4. In regards to Order XLI Rule 23 (i.e. remand of case by Appellate Court), the Supreme Court once again reiterated that there can be no doubt with respect to the settled position that the Court to which the case is remanded has to comply with the order of remand and acting contrary to the order of remand is contrary to law. In other words, an order of remand has to be followed in its true spirit.

5. The Court further observed that it is a well-nigh settled position that wherever Transfer of Property Act is not applicable, the principle in contained the provision of Section 52 thereof, which is based on justice, equity and good conscience is applicable in a given similar circumstance, like Court sale etc. Further, transfer of possession pendente lite will also be transfer of property within the meaning of Section 52 and, therefore, the import of Section 52 of the TP Act is that if there is any transfer of right in immovable property during the pendency of a suit such transfer will be non est in the eye of law if it will adversely affect the interest of the other party to the suit in the property concerned. The Court held that the effect of Section 52 is that the right of the successful party in the litigation in regard to that property would not be affected by the alienation, but it does not mean that as against the transferor the transaction is invalid. The said provision of Section 52 did not indeed annul the conveyance or the transfer otherwise, but renders it subservient to the rights of the parties to a litigation of India. Accordingly, the transfer of property vide sale deed dated 05.10.2000 shall not affect the rights of the Plaintiff.

6. The Court further held that the Suit cannot be held to be abated in the event of death of one of the defendants (i.e. Original 3rd Defendant who was father of the Defendant No. 1 and 2), when the estate/interest was being fully and substantially represented in the suit jointly by the other defendants (i.e. his sons) along with deceased defendant and when they are also his legal representatives. The Court further held that in such cases, by reason of non- impleadment of all other legal heirs consequential to the death of the said defendant, the defendants could not be heard to contend that the suit should stand abated on account of non- substitution of all the other legal representatives of the deceased defendant.

7. The court further held that the principle of "jus tertii"- 'right of a third party' is not applicable in the facts of the present case. The court held that no defendant in an action of trespass can plead the 'jus tertii' that the right of possession outstanding in some third person.

8. The court further held that when the facts disclose no title in either party, at the relevant time, prior possession alone decides the right to possession of land in the assumed character of owner against all the world except against the rightful owner- 'Possessio contra omnes valet praeter eur cui ius sit possessionis' (he that hath possession hath right against all but him that hath the very right)". Thus, the court held that as far the right of the Plaintiff qua the Defendants are concerned, the Plaintiff right to possession of suit property is established on account of his prior possession.

9. Further, the Defendants never contended that they were ever in possession of the Suit Property. According to High Court, in such circumstances, when the facts disclose no title in either party, at the relevant time, prior possession alone decides the right to possession of land in the assumed character of owner against all the world except against the rightful owner.

IN THE GOODS OF: BUDDHADEV BOSE (DEC.) - ORDER DT 28.03.2023 PASSED IN PLA NO. 426 OF 2019 [CALCUTTA HIGH COURT]

Section 63 of the Indian Succession Act - Grant of Probate of the Will – Attesting Witness should speak not only about testator's signature or affixing his mark to the Will but also each of the witnesses had signed the Will in presence of the testator – To be an attesting witness, it is essential that the witness should have put his signature for the purpose of attesting that he has seen the executant sign or has received from a personal knowledge of his signature.

Facts

Brief facts of the case are as under: -

1.	24/10/2013	The Testator executed his Last Will and Testament on 24/10/2013 by appointing the Petitioner as Executrix of his last Will. The Will is a registered Will and the date of registration is also 24/10/2013. As per the Will, the Testator had executed the Will on 24/10/2013 but one of the two attesting witnesses; namely Dr. Shiladitya Nandi put the date in the said Will as 22/10/2013 (i.e. the date of signature of the witness in the will is different from the date of execution of the Will by the testator and also date of registration.)
2.	30/07/2019	The Testator of the Will, Mr. Buddhadev Bose died on 30/07/2019 leaving behind his wife, Manjusri Bose, Son, Debjyoti Basu and a daughter i.e. the Petitioner herein.
3.	19/12/2019	The Petitioner filed the present Application for grant of probate of the said Last Will and Testament dated 24/10/2013. The Testator's wife and son submitted their affidavits confirming the same and have no objection with grant of probate.
4.	15/02/2023	In the Will, there are two attesting witnesses but the Petitioner examined only one witness. The Petitioner examined the attesting witness on commission on 15/02/2023 and during his examination also the witness stated that he signed the Will on 22/10/2013 and believes the date to be true. The other attesting witness

Issues

Whether there could be a grant of probate of the Will and Testament even when the attesting witness had signed the will on a date different than the date of the execution of the Will?

Held

As per the provisions of Section 63 of the Succession Act, 1925, to be valid a Will should be attested by two or more witnesses and propounder should examine one attesting witness to prove the Will. Moreover, attesting witness should speak not only about testator's signature or affixing his mark to the Will but also each of the witnesses had signed the Will in presence of the testator. To be an attesting witness, it is essential that the witness should have put his signature for the purpose of attesting that he has seen the executant sign or has received from a personal knowledge of his signature. If, a person put his signature on the document for some other purpose, he is not an attesting witness.

As in the present case, as per the Will and the evidence of one of the attesting witness he had signed the Will on 22/10/2013 (i.e. prior to the date of execution of the Will by the Testator), the Petitioner failed to prove the Will. Therefore, the Court refused to grant probate of such Will.

ML-413

HANUMAN MOTORS PVT. LTD. & ANR VS. M/S. TATA MOTORS FINANCE LTD ORDER DT 01/03/2023 PASSED IN ARBITRATION PETITION NO. 241 OF 2022 [BOMBAY HIGH COURT]

Section 12(5) of the Arbitration & Conciliation Act, 1996 – Unilateral Appointment of Arbitrator in Loan Agreement – Not in accordance with law – Award set aside.

Facts

In the present case, the Court was concerned with an Arbitration Petition filed under Section 34 of the Arbitration and Conciliation Act, 1996 challenging an Award dated 8/11/2021 passed by a Sole Arbitrator inter alia and particularly on the ground that the Arbitrator was unilaterally appointed by the Respondent which was contrary to Section 12(5) of the Act r.w. Seventh Schedule, Item I thereof. The Arbitration Agreement was contained in a clause of the Loan Agreement which the Petitioner claimed was forged and fabricated. On 3/4/2021, the Ld. Arbitrator accepted his nomination and fixed the schedule for the arbitral proceedings. On 9/4/2021, the Advocate representing the Petitioner sent a letter, requesting for a copy of the agreement and called upon the Respondent not to proceed further as the Ld. Arbitrator was appointed without the consent of the Petitioner. Later, the Petitioner also sent a letter dated 6/9/2021 to the learned arbitrator, challenging the execution of the said Agreement and further took a stand that they had not consented to the arbitration proceedings. On 21/10/2021, the petitioners sent a letter to the respondent reiterating their stand. On 8/11/2021, the Ld. Arbitrator passed the impugned award, allowing the claim of the respondent, thereby directing the petitioners to pay a sum of ₹ 5,78,437.83, to the respondent with interest @ 18% per annum.

Issues

Whether the unilateral appointment of sole arbitrator completely vitiates the arbitral impugned arbitral award rendering it vulnerable for interference in Section 34 of the Act?

Held

The Hon'ble Bombay High Court observed that the Amendment of The Arbitration & Conciliation Act in 2015 brought about significant changes, including in Section 12 sub-section (5) thereof which opens with a non-obstante clause. The unilateral appointment of the sole arbitrator in the present case completely vitiated the impugned award, rendering it vulnerable to interference on this ground alone. The unilateral appointment of arbitrator by the respondent vitiated the entire proceedings from the very beginning and this aspect goes to the very root of the matter. The real crux of the matter is that when one of the parties to the dispute has an overwhelming and unilateral power to appoint a sole arbitrator, the same completely vitiates such an appointment as being hit by Section 12(5) read with the Seventh Schedule of the said Act. The Court went further to hold that mere participation in the arbitral proceedings also cannot disentitle the petitioners from raising the said issue in the present petition filed before this Court. Hence, the Petitioners were entitled to raise the said issue while challenging the impugned award under Section 34 of the said Act. Thus, the Court allowed the petition and quashed the impugned award.

CA Vijay Bhatt
Hon. Jt. Secretary

CA Mehul Sheth
Hon. Jt. Secretary

THE CHAMBER NEWS

Important events and happenings that took place online/ physical between **1st March, 2023 to 31st March, 2023** are being reported as under:

I. PAST PROGRAMMES

Sr. No.	*Date*	*Topic*	*Speaker*
ACCOUNTING & AUDITING			
1.	28.03.2023	Lecture on Changing audit landscape - learnings from regulatory reviews of NFRA, QRB - Introduction, key changes in last 10 years, expectations of regulatory agencies	CA Nilesh Vikamsey
DIRECT TAXES			
1.	27.03.2023	Lecture Meeting on Intricacies surrounding new Reassessment Provision	Dharan Gandhi, Advocate
HYDERABAD STUDY GROUP			
1.	18.03.2023	Recent Issues under GST	CA Satish Saraf
INDIRECT TAXES			
1.	23.03.2023	Issues under GST for Services provided by Government	Group Leader: CA Payal Shah Chairman: CA A. R. Krishnan
INTERNATIONAL TAXATION			
1.	01.03.2023	Overview of UK Taxation	Mr. Sarin Shringi
2.	06.03.2023	Acquisition and Transfer of Immovable Property under FEMA	Ms. Pooja Desai
3.	21.03.2023	Recent Judicial Decisions	Fenil Bhatt, Advocate

Sr. No.	*Date*	*Topic*	*Speaker*
IT CONNECT			
1.	29.03.2023	Sharing experiences of Using ChatGPT and other AI by Professionals	Audio event on Linkedin.com
PUNE STUDY GROUP			
1.	25.03.2023	Equity as Compensation- All About ESOP & Sweat Equity	Vivek Sadhale, *Advocate* CA Parag Kulkarni CA Ameya Kunte *Moderator*: CA Shreedhar Pathak
RESIDENTIAL REFRESHER COURSE			
1.	The Residential Refresher Course Committee had planned “46th Residential Refresher Course on Direct Taxes” at The Sheraton Grand Palace, Indore from 2nd to 5th March, 2023. The session-wise detail of the RRC is as under:		
	Papers for Discussion:		
a.	Recent Developments in Taxation of Charitable Trusts – A paradigm shift (Changes in last 3 years)		CA Rajesh Kadakia
b.	Case Studies in Direct Taxation		CA Anish Thacker CA Abhitan Mehta
c.	Legality & Consequences of Cash Transactions (Disallowance u/s 40A(3) r.w.r 6DD), Penal consequences (269T, 269SS, 269ST, etc.), Cash found during Survey, Cash deposit in Bank Account, Reporting by FI, etc.)		CA Ketan Vajani *Chairman*: Hiro Rai, Advocate
d.	Paper for Presentation: NRI Taxation including Implications of Overseas Assets		CA Manoj Shah
e.	Brains’ Trust		Saurabh Soparkar, *Senior Advocate* CA Pinakin Desai
STUDENT			
1.	The Student Committee had planned a webinar series on “CA Student Orientation Course”. The session-wise detail of the program is as under:		
a.	13.03.2023	Basics of GST and Annual Return	CA Sumit Jhunjhunwala
b.	14.03.2023	Company Law	CA Priya Vora
c.	15.03.2023	Basics of Income tax and Return filing and Basics of TDS/TCS & advance Tax	CA Kalpesh Katira
d.	16.03.2023	Office Ettiques and Soft Skills	CA Srinivas Vakati
e.	17.03.2023	Introduction to Audit, Auditing Standards and its practical aspects	CA Mehul Sheth

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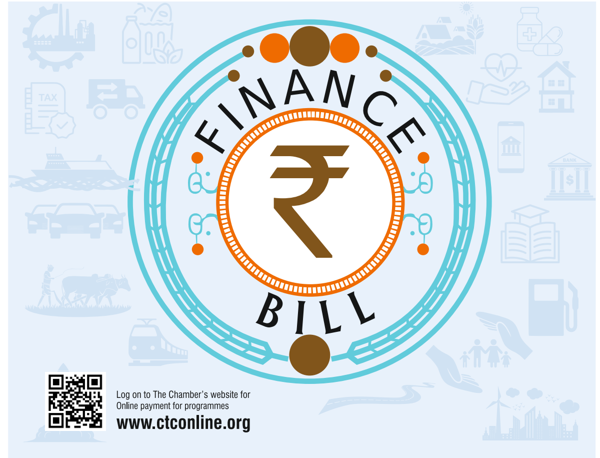

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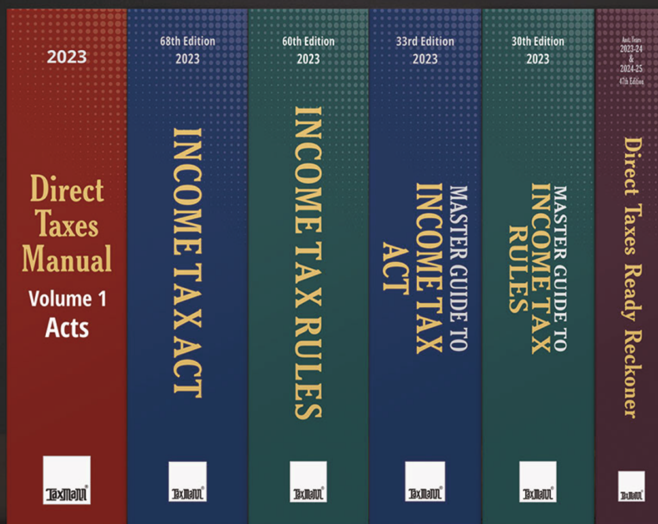

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