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Article

Stamp Duty issues in slump sale transactions

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Slump Sale

Slump sale is a commonly used method of business acquisition wherein an undertaking as a *"going concern"* is transferred from one entity to another. The term *'slump sale'* incorporated under the Income Tax Act, 1961[1] ("IT Act") has been defined to constitute the following elements: (a) sale of an undertaking/ business activity[2] taken as a whole– *lock, stock and barrel;* (b) sale shall be for a lump sum consideration; and (c) no separate values shall be assigned to individual assets and liabilities.

However, specific values can be assigned to individual assets or liabilities for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees. This is because the assets constituting the business in a slump sale transaction may include movable property (tangible and intangible, including intellectual property), immovable property (land, buildings, plant & machinery that are permanently fixed or embedded to the earth), unsecured loans, advances/deposits, human resources and contracts, and stamp duty chargeability and registration requirement for each type of asset/liabilities shall vary. In order to give effect to the transaction, the parties typically enter into a Business Transfer Agreement ("BTA" or "Agreement"), which *inter alia* records the following terms and conditions:

(a) The assets of the business undertaking to be transferred to the Purchaser are listed in the schedule to the Agreement;

(b) The lump sum consideration for sale is specified (*sale price is generally based on a business valuation report*);

(c) The BTA shall specify the date ("Closing Date"), prior to which all necessary approvals, permissions, documents to consummate the transaction are obtained;

(d) Typically, the seller shall make requisite representations and warranties with respect to the legal status and financial health of the business undertaking as on the Closing Date;

(e) Upon obtaining all requisite documents and approvals, the transfer of business takes place on the Closing Date.

Stamp Duty chargeable on BTA

Stamp duty is a duty payable upon the execution of certain instruments or documents specified in the Indian Stamp Act, 1899 ("IS

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1 Section 2(42C) of the Income Tax Act, 1961

2 Explanation 1 to Section19AA defines *"undertaking"* to 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.

Act") or the relevant State Stamp Act as the case maybe. In absence of any State stamp legislation, the IS Act applies. The general principle with regard to stamp duty is that duty has to be determined with reference to an instrument, not in reference to a transaction.[3] Therefore, to understand the stamp duty liability for a specific transaction, it is important to understand the instruments involved in the transaction and the subject-matter of the instrument.[4]

It is common practice for a BTA to be structured as an *"agreement to sale"*. In such cases, the Agreement provides a general framework pursuant to which the business undertaking is transferred on the Closing Date. BTA in itself may not contemplate any transfer and can mandate the execution of a deed of *"conveyance"*[5] on or before the Closing Date to effectuate the transfer. However, there are instances where the Agreement contains recitals with respect to the payment of consideration, handing over of the possession of property along with title deeds of such property. In such cases, the BTA assumes the color of a "conveyance" and stamp duty is levied accordingly.

Since the transfer envisaged under the Agreement is the sale of a business undertaking as a whole, it cannot be specifically equated with the sale of movable or immovable property. The IS Act as well as State Stamp Acts do not contain specific provisions levying duty on an agreement relating to the transfer of "business" as such. Therefore, it is imperative that each asset proposed to be transferred to the purchaser *vide* a BTA is individually identified for the purpose of stamp duty as movable or immovable. The levy of stamp duty depends on the State in which the Agreement is executed. For better clarity, let us examine the stamp duty implications on a BTA under Central and certain State legislations.

Positon under the Indian Stamp Act, 1899

On perusal of the definition of "conveyance" under the IS Act, it is understood that no distinction is made between moveable and immovable property.[6] Tangible moveable property can be sold by delivery to the purchaser on receipt of the price without an actual conveyance, but if a conveyance in writing comes into existence, it is chargeable to duty as such. Intangible movable property such as actionable debt or goodwill has to necessarily be transferred under a written instrument and chargeable as conveyance. Whereas land/buildings are immovable property,

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3 *Swadeshi Cotton mills Co,* in Re AIR 1932 All 29.

4 Section 2(14) of the IS Act defines *"Instrument"* to include every document by which any right or liability is, or purports to be, created, transferred, limited, extended, extinguished or recorded.

5 In terms of the IS Act, the term "conveyance" has been defined in an exhaustive manner to include any instrument or conveyance on sale, by virtue of which any property (moveable or immovable) is transferred inter vivos and which is not specifically provided in the schedule to the IS Act.

6 "Immovable property" includes land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth and "movable property" includes any property except immovable property.

machinery installed in a factory premises (fixed to the ground) can be considered as an immovable property, depending on the degree and permanency of the attachment, and the purpose of installing and attaching the machinery. For instance, the sale of a fertilizer plant as part of a slump sale along with land and building, would be considered as immovable property if it was always intended that the plant remains permanently affixed to the land and building being transferred.[7]

Article 5 to the Schedule of the IS Act prescribes the stamp duty chargeable on an *"Agreement or Memorandum of an Agreement"*. Article 5 further sub-classifies several categories on the basis of the subject-matter of an agreement prescribing specific duty applicable to a particular instrument. A residuary provision is provided under Article 5(c) wherein all such agreements not specifically provided for are classified and duty payable is separately prescribed.

If a contract does not intend to operate as an immediate transfer of the sale of property, such instrument is required to be stamped as an agreement rather than a conveyance. An agreement to sell a business undertaking with its assets including goodwill, would not amount to conveyance but would be merely a contract to sell, although the parties intended that when the transaction was completed, it should take effect from the date of the agreement and although in order to effect the contemplated sale, no actual deed of conveyance was prepared subsequently with regard to goodwill and movables (a sale deed being executed only in respect of immovable property).[8]

Therefore, under the IS Act, a BTA not evidencing a transfer of property shall be duly stamped as an agreement under Article 5(c), thereby requiring deed of conveyance to be executed on or before the Closing Date. Whereas the execution of a conveyance deed for the purpose of immovable property is absolutely necessary to establish title and ownership, transfer of ownership of movable property can be made by delivery of such property. In the event the BTA records the transfer of both movable and immovable property without the requirement of executing a conveyance deed, the BTA shall be construed as a conveyance and stamp duty as prescribed under Article 23 would be leviable on the said instrument.

Position under the Bombay Stamp Act, 1957 ("BS Act")

The BS Act follows a scheme similar to the IS Act, wherein Article 5 of its Schedule prescribes stamp duty to be levied on an instrument which is an *"Agreement or its records or Memorandum an Agreement"*. It is to be noted that Article 5(h)(A)(iv) specifically identifies an agreement that: (a) creates any obligation, right or interest; (b) has monetary

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7 *Duncans Industries Ltd v. State of UP,* AIR 2000 SC 355.

8 *In Re, Swadeshi Cotton Mills Co 1932, ALJ 394:* AIR 1932 ALL 291 (SB) and others.

value; and (c) is not covered under any other provision of the BS Act.

The stamp duty chargeable may extend up to two rupees for every thousand rupees of the monetary value stated in the Agreement. An agreement in the nature of a BTA squarely falls under Article 5(h)(A) of the BS Act. Despite the generic nature of the description in Article 5(h)(A), the BS Act has retained a residuary provision under Article 5(h)(B) which prescribes stamp duty of only INR Hundred (100) with respect to agreements not otherwise provided for. Given that Article 5(h)(A) describes the instrument more specifically, a BTA executed in the State of Maharashtra should be duly stamped under Article 5(h)(A) rather than Article 5(h)(B).

Article 25 of the BS Act prescribes the stamp duty payable on an instrument of conveyance with respect to movable and/or immovable property, as the case may be. However, the BS Act specifically states that if an agreement to sell an immovable property effectuates the transfer of possession of such property before or after execution, the same shall be deemed to be a conveyance and stamp duty shall be levied accordingly. The BS Act also provides an exemption in case the *'agreement to sale'* is deemed as a conveyance. That is, in case the BTA itself effectuates the transfer of movable and immovable property constituting the business, resulting in such instrument being duly stamped as conveyance under Article 25 of the BS Act, the stamp duty paid on such agreement shall be adjusted towards the total stamp duty leviable on the conveyance deed.

Position under the Karnataka Stamp Act, 1957 ("KS Act")

The KS Act deviates from the BS Act as well as the IS Act, in light of specific provisions dealing with the transfer of movable and immovable property under Article 5 of KS Act. Article 5(e) of the KS Act prescribes the stamp duty chargeable on an agreement relating to sale of immovable property with part-performance of the contract being made. In the event possession of the property is delivered or agreed to be delivered prior to execution of conveyance, the stamp duty prescribed is the same as the duty prescribed with respect to a conveyance deed as specified in Article 20. Similar to the BS Act, the KS Act also provides for set-off of the stamp duty against the duty paid on the conveyance deed. In the event possession of the property is not delivered, the stamp duty liability on such agreements shall be restricted to INR twenty thousand.

Similarly, Article 5(g) of the KS Act prescribes the stamp duty payable with respect to an agreement relating to the sale of movable property. In the event possession of movable property is delivered or agreed to be delivered without executing a conveyance deed, the stamp duty prescribed on such agreement is three percent (3%) of the consideration or the market value of the property, whichever is higher. In the event the possession of the property is not delivered, the stamp duty liability is restricted to INR twenty thousand.

Apart from these provisions, a residuary clause under Article 5(j) of the KS Act provides that any agreement not specifically provided for in Article 5 shall be duly stamped for INR two hundred. Therefore, the stamp duty payable on a BTA executed in the State of Karnataka shall depend upon the structure of the BTA, whether conveyance deed is proposed to be executed by the parties with respect to the movable properties forming part of the business undertaking and whether a business undertaking purported to be transferred under a BTA can be equated to a movable property or an immovable property.

Word of caution

BTA typically comprises of numerous items of transfer, which may include all kinds of tangible, intangible, contracts, movable property and immovable property. While a slump sale transaction is the preferred mode of business acquisition from an income-tax perspective, given the complexities involved in the determination of stamp duty on the instrument of transfer, it is recommended that the parties should approach the relevant stamp authority for adjudication of stamp duty[9] and seek the opinion of the District Officer with respect to the determination of the duty chargeable on the instrument, if there is any ambiguity in the concerned Stamp Act. It is always necessary and beneficial for the parties to treat stamp duty aspects very carefully to avoid any penalties, which can be as high as ten times the actual stamp duty payable.

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Notifications & Circulars

SEBI issues Guidance note on Board evaluation: The process of Board evaluation of a company forms a crucial aspect of corporate governance. India's regulatory framework governing Board evaluation by listed entities, though nascent, has progressed from starting as a voluntary exercise under SEBI's Listing Agreement and the Corporate Governance Voluntary Guidelines, Ministry of Corporate Affairs, Government of India (2009) to being mandatory under the Companies Act, 2013 and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('LODR'). Now, based on an analysis of Board evaluation practices currently prevalent in India and global best practices in various jurisdictions, the Securities and Exchange Board of India ('SEBI') has released a Guidance Note[10] for listed entities to provide more clarity on the Board evaluation process and covers key issues at the pre-evaluation, evaluation and post-evaluation stages.

Though recommendatory in nature, the Guidance Note aims to encourage listed entities to undertake Board evaluation as an exercise that goes beyond minimum

[9] Section 31 of the IS Act, BS Act and the KS Act.

[10] SEBI/HO/CFD/CMD/CIR/P/2017/004 dated January 05, 2017, issued by SEBI

mandatory legal compliances – that Board evaluation should be more than a 'box-ticking exercise' for a listed entity was reiterated by the International Advisory Board (IAB) of SEBI in its 7th Meeting subsequently held[11]. Certain recommendations that shall enhance transparency in the Board evaluation process are as follows:

External Evaluation: In addition to self-evaluation being done internally by a company, SEBI recommends involving independent external experts (not being a related party or having conflict of interest) as part of the Board evaluation process.

Assessment and Feedback: SEBI recommends assigning different weights to different criteria of evaluation, depending on the concerned organisation's requirements, circumstances, outcome of previous assessments, stage of Board's maturity, etc. Along with conducting evaluation through questionnaires and interviews, SEBI recommends use of evaluation software as well as providing feedback to individual directors, the Committees as well as the Board as a whole – orally and/or in writing with provisions for confidentiality where possible. This is significant in the context of objectivity in re-appointment and/or removal of directors.

Frequency of Evaluation: Listed entities are encouraged to conduct board evaluation at regular intervals and as a continuous process, rather than as only an annual exercise.

Additional Disclosures: Currently, LODR and Companies Act, 2013, requires disclosure of certain aspects of the Board evaluation process to be made to the shareholders on an annual basis. Section 134(3) of the Companies Act, 2013, read with Rule 8(4) of the Companies (Accounts) Rules, 2014, mandates a listed company and every public company having paid-up share capital of INR 25 crore or more calculated at the end of the preceding financial year (barring a Government Company in case its directors are evaluated by the Central or State Government, as the case may be, as per its own evaluation methodology), to include a statement indicating the manner in which the formal annual evaluation has been made by the Board (of its own performance as well as of performance of its committees and individual directors), in the report prepared by its Board of Directors. SEBI recommends that listed entities should voluntarily provide additional disclosures such as results of the Board evaluation, actions taken following such Board evaluation, etc. The IAB in their 7th Meeting reiterated that it would be a good practice for the results of the Board evaluation process as a whole to be disclosed to shareholders.

Action Plan: Based on suggestions/responses gathered from various stakeholders in the Board evaluation process (Chairperson, independent directors, external assessors, etc.), SEBI recommends that a comprehensive action plan be prepared, addressing areas of improvement

[11] PR No. 4/2017 dated January 14, 2017 on 'Seventh Meeting of the International Advisory Board of SEBI' issued by SEBI

required for Board members, timelines and persons responsible for implementation, and provision of timely review of such action plan.

SEBI bans secret profit sharing agreements: The Securities and Exchange Board of India (SEBI), by its Notification dated January 4, 2017, has effected amendments to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR) to regulate side agreements between investors and employees of listed entities. In October 2016, SEBI had released a consultative paper to regulate the practice of side agreements that certain private equity (PE) firms enter into with top personnel and key managerial personnel of listed investee companies. These arrangements allowed PE firms to share a certain portion of their gains (made over and above certain pre-determined threshold at the time of their exit from their investments) with key managerial personnel of the concerned investee company. This issue was brought under the scanner on exit of certain investors from a listed entity whose Managing Director (MD) and Chief Executive Officer (CEO) had entered into "Incentive Fee Side Agreements", which were neither disclosed to the shareholders nor to the stock exchange. The defence taken by the MD and the CEO was that such payments were to be received by them and were not part of the company's books of accounts.

SEBI considered the ramifications of such arrangements on public shareholders who were not being consulted prior to such agreements becoming effective. In wake of this and to regulate such practices, SEBI released a proposal in October 2016 inviting public comments. [For a detailed analysis of SEBI's consultative paper, please refer to the November, 2016 issue of our Corporate Amicus].

The earlier proposal had sought to amend SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 by introducing a new sub-regulation to Regulation 26, which pertains to obligations with respect to directors and senior management. As per the proposed amendment, all employees, including the directors / promoters of listed companies would be restricted from entering into any agreement with respect to compensation or profit sharing without first obtaining the approval from the Board as well as the shareholders (through an ordinary resolution). Further, all existing agreements would continue only upon disclosure to the stock exchanges and approval from the shareholders through an ordinary resolution in the forthcoming general meeting. Pending such approval or in the event of the shareholders not approving any such an arrangement around incentive sharing, any agreement would be liable to be terminated. Now, in furtherance to this discussion paper, SEBI vide its Notification has brought into effect the corresponding amendments to the LODR.

Importantly, the Notification has distinguished between three categories of agreements for compensation/reward or profit sharing in connection with dealings in securities of a listed entity – agreements which have expired, agreements subsisting as on the date of the Notification, and agreements executed henceforth. SEBI's earlier consultation paper had missed taking expired compensation agreements into account.

With effect from Jan 04, 2017:-

(i) Agreements that have expired but were entered into during the last three years, are required to be disclosed to stock exchanges for public disclosure;

(ii) Subsisting agreements, in addition to requiring mandatory disclosure to stock exchanges, are required to be placed before the Board of Directors for approval. In the event the Board of Directors accord their approval, such subsisting agreement is required to subsequently be placed before the shareholders in the forthcoming general meeting for their approval (by way of an ordinary resolution); and

(iii) Proposed agreements shall mandatorily require prior approval of both the Board of Directors and shareholders (by way of an ordinary resolution), in addition to mandatory disclosure to stock exchanges.

SEBI eases norms for angel investors: SEBI, by its Notification dated January 4, 2017 has brought about amendments to Regulations 19E and 19F of the SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations). With the aim to encourage alternative modes of investment in India, SEBI has increased the upper limit of number of angel investors permitted to invest in an angel fund scheme from 49 (forty nine) to 200 (two hundred).

Prior to the Notification, Regulation 19F permitted angel funds to invest in venture capital undertakings that, *inter-alia,* had been incorporated during the preceding three years from the date of such investment. Now, by permitting angel funds to invest in venture capital undertakings that have been incorporated during the preceding five years from the date of such investment, the amendment further seeks to harmonize Regulation 19F with the definition of 'start-up' given by Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, vide its Notification G.S.R.180(E) dated February 17, 2016. To increase investor participation, the lock-in period for angel investors has been reduced from 3 (three) years to 1 (one) year and the minimum investment requirement has been reduced from 50,00,000 (fifty lakhs) to 25,00,000 (twenty-five lakhs).

With coming into effect of the newly inserted Regulation 19F(6), angel funds have now been allowed to also invest in securities of companies incorporated outside India, subject to the guidelines issued by the Reserve Bank of India and SEBI from time to time.

Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, amended:

Issuance of convertible notes to person resident outside India investing in start-ups: The Reserve Bank of India, through its Notification dated January 10, 2017, has notified Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Fifteenth Amendment) Regulations, 2017. By way of this amendment, a new Regulation 6D to Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 has been added, pursuant to which a private company which is recognized as a 'start-up' (under the criteria specified in the Notification G.S.R.180(E) dated February 17, 2016 issued by Department of Industrial Policy and Promotion, Ministry of Commerce and Industry) has now been allowed to issue a new instrument named 'convertible notes' to a person resident outside India (other than an individual who is a citizen of Pakistan or Bangladesh or an entity which is registered / incorporated in Pakistan or Bangladesh).

Henceforth, foreign investors may purchase convertible notes, under automatic route or under government approval route (as the case may be), for an amount of INR 25,00,000 (Indian Rupees Twenty Five Lakhs) or more in a single tranche, subject to certain conditions. The consideration may be received by inward remittances through banking channels or by debit to the NRE / FCNR (B) / Escrow account maintained by the non-resident concerned, in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016. Further, a person resident outside India may acquire or transfer such convertible notes from or to a person resident in India or outside India, provided that the transaction takes place in accordance with the pricing guidelines as prescribed by the Reserve Bank of India.

Amendment to Schedule 1 (Foreign Direct Investment Scheme): The Reserve Bank of India, vide a Notification dated January 10, 2017, has amended Annex B to Schedule 1 of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000. The amendment seeks to combine the separate provisions governing "foreign investment in commodity exchanges" and "foreign investment in infrastructure company in the securities market", under erstwhile paragraphs F.4 and F.6 of Schedule 1, respectively.

Earlier, the investments caps and entry route for foreign investment in a commodity exchange and an infrastructure company in securities market was upto 49% under automatic route. Further, foreign institutional investors/foreign portfolio investors were allowed to invest in these sectors, only through purchases in the secondary market.

By way of this amendment, this restriction has now been deleted and going forward, any foreign investment including investment by foreign portfolio investors in infrastructure companies in the securities market (i.e. in stock exchanges, commodity derivate exchanges, depositories and clearing corporations), will be subject to regulations issued by Central Government, Securities Exchange and Board of India and Reserve Bank of India, from time to time . The cap and entry route for investment has been retained as it was earlier.

Allotment of shares to the ESOP Trust - SEBI issues informal guidance: According to Regulations 3 and 4 of the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 (*"Takeover Code"*), an acquirer is mandatorily required to make an open offer to acquire the shares of the public shareholders upon the substantial acquisition of shares or voting right or control of a target company.[12] The Takeover Code provides for open offer triggers based on thresholds of the shares or voting rights acquired. An interesting question came up before the Securities and Exchange Board of India regarding ascertainment of an open offer trigger by a promoter due to issuance of shares issued to an employee stock option trust by way of an informal guidance under the SEBI (Informal Guidance) Scheme, 2003.

Capital Trust Limited ("Target Company") sought an informal guidance from SEBI on mandatory requirement of an open offer upon allotment of shares in lieu of warrants to the promoter and simultaneous issuance of shares to the ESOP Trust. The individual promoter in this case held 43.26% shares in the Target Company and certain unconverted warrants. While the promoter desired to convert the pending warrants, the Target Company simultaneously wanted to issue shares to the ESOP Trust (set up for the benefit of the employees as per the SEBI (Share Based Employee Benefits) Regulations, 2014 ("SBEB Regulations"). Consequently, upon issuance of shares to the ESOP Trust, the promoter shareholding would increase by only 4.99%, i.e. within the 5% creeping acquisition limit that would not otherwise trigger an open offer.

The questions posed before SEBI were whether the allotment of shares to the ESOP Trust would be considered as increase in the number of shares for calculation of the conversion of warrants into equity shares and whether the calculation with respect to the number of shares is correct consequent to the conversion of the warrants by the promoter being below/within the creeping acquisition limits as prescribed in the Takeover Code, thus not requiring the promoter to make an open offer.

As per Regulation 3 of the SBEB Regulations, a company may implement an ESOP scheme either directly or through an irrevocable trust. However the SBEB Regulations prescribe certain embargos in respect of powers to be

[12] Mandatory Open Offer Triggers as per the Takeover Code are as follows:

(i) Initial Threshold: Acquisition resulting in entitlement of 25% or more of voting rights;

(ii) Creeping Acquisition: After the Initial Threshold, acquisition of voting rights exceeding 5% in any financial year;

(iii) Control: Regardless of the shareholding, acquisition of control.

exercised by trustees of such ESOP Trusts. SEBI responded that as per Regulation 3(5) of the SBEB Regulations, the trustees of an ESOP trust are prohibited from voting on shares held by such Trust and such shares will therefore, not be taken into account for calculating percentage of voting rights under Takeover Code.[13]

Consequently, in respect of the shareholding level of the promoter post conversion of the warrants and issuance of the shares to the ESOP Trust, SEBI considered it to be beyond the creeping acquisition limit. SEBI's response implies that the issue of shares to the promoter would exceed 5% of the voting rights in the Target Company, and hence the promoter would be required to make a public announcement of an open offer to the other shareholders by virtue of creeping acquisition, since in computing the open offer triggers, only the shares with voting rights are considered. This would clearly result in an increase in voting rights of the promoter beyond the creeping acquisition limit of 5% as shares issued to ESOP Trust which do not carry any voting rights would not be considered in calculating the total voting rights available to shareholders.

This informal guidance has provided a view to SEBI's position on similar structures involving ESOP Trusts and issuance of shares to acquirers that could be in potential breach of law if mandatory requirements under the Takeover Code are not complied with.

Master Circular on issuance of Prepaid Instruments amended: Earlier, as per the Master Circular on Issuance and Operations of Prepaid Payment Instruments dated July 01, 2016, banks were permitted to issue prepaid instruments only to listed corporate entities for onward issuance to their employees. With effect from December 27, 2016, to promote digital payments, banks have been given permission to issue prepaid instruments to other entities such as unlisted corporates, partnership firms, sole proprietorships, public organizations like municipal corporations, urban local bodies, etc. for onward issuance to their staff, employees, contract workers, etc. However, this permission is granted subject to compliance of, *inter alia,* conditions mentioned herein below:

(i) Banks shall extend this facility only to those entities that have a bank account with them and after obtaining an undertaking that they are not availing of this facility from any other bank.

(ii) Verification of the identity of the staff / employees / contract workers, etc. shall be the responsibility of the concerned entity.

(iii) The bank should put in place proper systems to capture and maintain details of the employees to whom the cards are issued by the concerned entity. Such entity is also required to make available details of bank accounts (if any) of its employees to the bank.

[13] Regulation 3(5) of the SBEB Regulations: *"..The trustees of a trust, which is governed under these regulations,* ***shall not vote in respect of the shares*** *held by such trust, so as to avoid any misuse arising out of exercising such voting rights."*

SEBI revises mergers and acquisitions guidelines for unlisted companies with listed companies: SEBI, at its Board meeting held on January 14, 2017, has decided to ease the regulatory framework for schemes of arrangements and approved the proposals to revise and streamline the framework for mergers and demergers. It has been decided that in case of a merger of an unlisted company with a listed company, the unlisted company shall adhere to disclosure requirements as specified in the format for abridged prospectus. Further, the shareholding of pre-scheme shareholders of the listed entity and Qualified Institutional Buyers of the unlisted company, in the post-scheme shareholding pattern of the merged company, shall not be less than 25% (twenty five per cent). With a view to avoid a scenario of issue of shares to a particular group of shareholders instead of all public shareholders, it has been clarified that the pricing formula under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, shall apply to such mergers.

Further, the merger of a wholly owned subsidiary with its holding company is not required to be filed with SEBI but with the relevant stock exchange for disclosure purposes. Companies would be required to submit a compliance report confirming adherence to the circular and accounting standards duly certified by company secretary, chief finance officer and managing director of the company.

SEBI has also decided to extend the requirement of shareholder approval through e-voting, to schemes involving (a) the merger of an unlisted company resulting in the reduction of voting share percentage of the pre-scheme public shareholders by more than 5% of total capital of merged entity; (b) transfer of whole or substantially the whole undertaking of a listed company where the consideration is not in the form of listed equity; and (c) mergers of an unlisted subsidiary with a listed holding company where the shares of the unlisted subsidiary have been acquired directly or indirectly from promoters or promoter's group.

Ratio Decidendi

Bequest under Indian Succession Act supersedes nomination made under provisions of Companies Act and bye-laws under Depositories Act

Key points:

- The rights of nominee arising by virtue of the nomination made under the provisions of Companies Act, 1956 and bye-laws under the Depositories Act, 1996, do not restrict legal heirs from claiming their rights over the property of the deceased.
- The status of the nominee, post the death of the shareholder or deposit holder is merely that of a trustee holding the financial instruments in a beneficiary capacity for the legal heirs.
- Bequest under Indian Succession Act,

1925, supersedes nomination made as per the provisions of Companies Act, 1956 and bye-laws under the Depositories Act, 1996.

The confusion caused by the 2010 judgment of the Bombay High Court in *Harsha Nitin Kokate* v. *Saraswat Co-Op. Bank Limited* - 2010 (3) Mh.L.J 780 (Kokate Case), has finally been put to rest by its Division Bench. The judgement of the Single bench furthered in the Kokate Case had held that the laws of inheritance would be subservient to the nominations made under Section 109A and B of the Companies Act, 1956 (Companies Act) and Section 9.11 of the bye-laws under the Depositories Act, 1996 (Bye-Laws).

In the extant case, the legal heirs and the nominees of Late Mr. Jayant Shivram Salgaonkar had filed two appeals against the order and judgement passed by a single bench of the Bombay HC on March 31, 2015 (Single Bench Order). The heirs were seeking a grant of probate on the basis of the last will of the deceased, whereas the nominees wanted to exercise ownership rights in the instruments of the deceased, to the exclusion of the heirs on the basis of nomination made in their favour, under Section 45-ZA of the Banking Regulation Act, 1949. The Division Bench of the Bombay HC, after considering a series of judgements of the Supreme Court and after making a detailed analysis of provisions relating to nomination under various statutes, such as the Companies Act, Bye-Laws, Co-operative Societies Act, 1983, Government Saving Certificates Act, 1959, Life Insurance Act, 1938 and Banking Regulation Act, 1949 made three important observations as stated above.

The Division Bench of Bombay HC, therefore, upheld the Single Bench Order and confined the scope of nomination and the rights that are attached to it. [*Shakti Yezdani* v. *Jayanand Jayant Salagaonkar*, - Appeal No. 313 of 2015 and Appeal No. 311 of 2015, decided on 1-12-2016, Bombay High Court]

Claims of secured creditors hold precedence over the claims of unsecured creditors

Key points:

- The claims of secured creditors hold precedence over the claims of unsecured creditors, so long as any balance that is due to the secured creditors stays outstanding and payable to them, even if such claims are not admitted with the liquidator during the winding up proceedings of a company and such secured creditors stand outside the purview of the winding up proceedings.
- Only a limited impediment has been introduced by the Companies Act, 1956 as far as the rights of the secured creditors who stay outside the winding up proceedings are concerned, since Section 529(1) of the Companies Act contemplates for a secured creditor to stand outside the winding up proceeding and still realize his security. This is essentially to protect the rights of the

workmen who are supposed to receive their wages on a *pari passu* basis with the secured creditors.

In the instant case, the High Court of Bombay has furthered the point that the claims of secured creditors hold precedence over the claims of unsecured creditors even when such claims are not admitted with the liquidator and such secured creditors stand outside the purview of the winding up proceedings.

Put differently, it was held by the Bombay HC that after the all the payments have been made by the court receiver/official liquidator under Section 529A of the Companies Act, 1956 during the liquidation process, the surplus amount left with the court receiver will have to be used to pay the secured creditors (and no other class of creditors) so long as any balance that is due stays outstanding and payable to such secured creditors.

In the instant case, ICICI Bank Limited and Metropolitan Infrahousing Limited were the debenture-holders of M/s Pal Peugeot Ltd. (PPL), the company in liquidation (Company). When the Company was ordered to be wound-up, the secured creditor, ICICI, chose to stay out of the winding up proceedings. ICICI and Metropolitan submitted that the surplus amount lying with the court receiver, after the sale of the secured properties of the Company, must be directed to be paid to them in proportion to their holdings or to the debenture trustee (ICICI Bank) and further prayed that no part of this amount should be paid to the unsecured creditors, so long as there is an unpaid balance amount due to them under the decree of the Court. Additionally, ICICI and Metro claimed that the interest accrued thereon, after the date of the winding up order should also be paid to them.

The dispute that arose for the Bombay HC's decision was whether the secured creditors can be paid the interest due to them after the date of the winding up order from the surplus amount lying with the court receiver, *before* all other claims including that of the unsecured creditors have been satisfied.

In this regard, the Bombay HC observed that Rules 154 and 179 of the Companies (Court) Rules, 1959 which provide for the manner of distribution of proceeds of sale of assets during liquidation of a company apply only to creditors who choose to remain within the winding up proceedings and specifically exclude the secured creditors who choose to remain outside the winding up proceedings.

The Bombay HC further opined that the rights of the secured creditors who choose to stay out of the winding up proceedings are governed by Section 529A of the Companies Act and that the proviso to Section 529(1) of the Companies Act expressly contemplates for a secured creditor to stand outside of the winding up proceeding and still realize his security. As per this provision, the debt due to every secured creditor is subject to a *pari passu* charge in favour of workmen. Therefore, only a limited impediment has been introduced by the Companies Act as far as the rights of the secured creditors who stay outside the winding up proceedings are concerned. This is essentially to protect the rights of the workmen to receive their wages on a *pari passu* basis with the secured creditors in terms of Section 529A of the Companies Act. Accordingly, the Bombay HC ordered that the entire balance surplus amount lying with the court receiver/ official liquidator, along with the interest accrued, thereon must be directed to ICICI and Metro. [*ICICI Bank Ltd.* v. *Official Liquidator*, Suit No. 3636/1999, decided on 23-11-2016, High Court of Bombay]

No winding-up due to non-payment of professional fee which was disputed on ground of incomplete services

Key points:

- Action for winding up of a company cannot be exercised against a solvent company, if the liability of the company is disputed *bona fide* by it.
- Winding-up petition cannot partake the character of a money recovery suit, unless liability is clearly admitted by the company and not paid off
- Despite serving of statutory notice, jurisdiction of winding up of a company is not available to be exercised for exerting any kind of pressure on the company
- While the court ordered for dismissal of the winding up petition based on the abovementioned points, remedy was available to the aggrieved for recovery of the amount of claim in the form of a civil suit.

The present case before the Karnataka High Court arose out of a winding up petition filed against the respondent company by the petitioner. The contention was in relation to alleged non-payment of professional fees by the respondent Company to the petitioner. Petitioner had entered into an agreement to provide architectural design services to the Respondent Company for constructing a residential building in two phases (*Phases I and II*) in Bangalore.

Subsequent to providing services and not receiving the due consideration for the same, the Petitioner had served the Respondent Company with statutory notice under section 434 of the Companies Act, 1956 claiming a sum of Rs. 99,08,025/- (*Rupees Ninety-Nine Lakhs Eight Thousand and Twenty-Five Only*) with interest at the rate of 18 (*Eighteen*) percent per annum. Despite sending several reminders and a notice to the Respondent Company asking for payment of the claimed amount, when the same was not received by the Petitioner, the Petitioner decided to move forth and take action against the Respondent Company by filing a winding up petition.

The Respondent Company submitted its statement of objections as a rebuttal to Petitioner's alleged claim, wherein it stated (i) that complete services for Phase II were not provided by the Petitioner and therefore payment was not made; however payment with respect to Phase I was made; (iii) there was no admission of liability on its part as it is a 'going concern' and pays taxes regularly, hence it is not commercially insolvent or unable to pay its debts.

The Court was satisfied that (i) while the professional fees for Phase I was paid, the same for Phase II was disputed as the Petitioner's services were not continuously engaged by the Respondent Company and (ii) there was no final admitted liability created in favour of Petitioner by the Respondent Company towards payment of professional fees of the alleged amount.

The Hon'ble Court dismissed the winding up petition as the same was not maintainable and stated that jurisdiction of winding up of a company cannot be exercised merely to create pressure on the Respondent Company, if the liability of such Respondent Company has been genuinely disputed by it. However, the Petitioner can approach other forums where it can exercise statutory alternative remedies for redressal of its grievances, in accordance with law.

This ruling has been supported in the cases of *IBA Health (I) Pvt. Ltd. v. Info-Drive Systems Sdn. Bhd.*[14] and *Amalgamated Commercial Traders (P) Ltd. v. A.C.K. Krishnaswami and Anr.*[15] Such strategies adopted to pressurize a company to make payment by filing a winding-up petition would be non-maintainable and vexatious in effect. However, the aggrieved party may take recourse under other appropriate fora for redressal of its grievances. For instance, a civil suit for recovery of the amount claimed from the Company may be filed in accordance with provisions of Civil Procedure Code, 1908. [*Praxis Inc.* v. *Nandhini Hotels Pvt. Ltd* - Order dated November 5, 2016 under Company Petition No. 157/2015, Karnataka High Court]

Prospective or Retrospective applicability of Arbitration Amendment Act, 2015

Key points:

(1) A challenge to the enforcement of an arbitral award where arbitration proceeding commenced prior to October 23, 2015 would be governed by the un-amended Arbitration Act.

(2) The right to have an arbitral award enforced is an accrued right and the amended provisions of Arbitration Act will not affect such accrued right(s).

(3) The issue in this judgment has been considered by various High Courts[16] (at various stages) in relation to arbitrations commenced before October 23, 2015 that were required to be adjudicated by Courts. High Courts in India have taken different views.

Background:

The Arbitration Amendment Act was enacted on October 23, 2015 to cure difficulties in the

14 *Civil Appeal No. 8230 of 2010 (Arising out of SLP (C) No. 886 of 2010*

15 *(1965) 35 CC 456 (SC)*

16 Madras HC in the matter of *New Tirupur Area Development Corporation Ltd.* vs. *M/s. Hindustan Construction Co. Ltd*; Bombay High Court in the matter of *Rendezvous Sports World* vs. *the Board of Control for Cricket in India* 2016 SCC Online Bom 255; Calcutta High Court in the matter of *Tufan Chatterjee* v. *Rangan Dhar* AIR 2016 Cal 213 & Electrosteel Castings Limited vs. Reacon Engineers (India) Private Limited (2016)2CALLT277(HC); Delhi HC in the matter of *Madhava Hytech-Rani (JV)* vs. *Ircon International Limited* MANU/DE/3371/2016 & ICI-*SOMA JV* vs. *Simplex Infrastructures Ltd* MANU/DE/2773/2016.

applicability of Arbitration and Conciliation Act, 1996 (*"Arbitration Act"*). Although, Arbitration Amendment Act is a welcome move, it has ambiguities with respect to retrospective or prospective applicability of the same.

Legal Analysis of relevant provisions of Arbitration Amendment Act & Arbitration Act

I. Section 26

Section 26 of the Arbitration Amendment Act on which the controversy mainly hinges states that:

Nothing contained in the Arbitration Amendment Act shall apply to the arbitration proceedings commenced in accordance with the provisions of Section 21 of the un-amended Arbitration Act unless otherwise agreed by the parties (*"First Part"*). Further, the section states that Arbitration Amendment Act shall apply in relation to arbitration proceedings commenced on or after the date of commencement of Arbitration Amendment Act (*"Second Part"*).

Although, Section 26 of the Arbitration Act is clear regarding applicability of provisions of Arbitration Amendment Act to arbitration proceedings, it is not very vocal on the applicability of the same to incidental court proceedings.

II. Section 34 & 36

Under the Arbitration Act, the filing and pendency of a challenge to an arbitral award operated as an automatic stay on enforcement of the arbitral award.

However, *per* the new Arbitration Amendment Act an application to set aside the arbitral award under section 34 will not by itself render that award unenforceable, unless the Court grants an order of stay of the operation of the said arbitral award in accordance with the amended provisions of Section 36 (3) on a separate application made for that purpose

The Amended Act further specifies that while considering grant of stay in case of an arbitral award for payment of money, courts shall have due regard to the provisions of the Code of Civil Procedure, 1908 relating to grant of stay of a money decree.

Facts of the present case:

The timeline of events in the case at hand is as follows:

July 10, 2014: Arbitral Tribunal pronounced the interim award.

Oct 13, 2015: Arbitral Tribunal pronounced the final award.

Oct 23, 2015: Arbitration Amendment Act came into effect.

Jan 4, 2016: Petition challenging the arbitral award was filed before the single judge bench of Delhi HC.

May 31, 2016: Single judge bench of Delhi HC directed the appellants to deposit a sum of INR 2,70,00,000 (Indian Rupees Two Crore Seventy Lakh). It further rules that only on making of such a deposit, notice was to be issued to the Respondents, otherwise the petition would have stood dismissed.

Thereafter, an appeal has been filed before the

Division Bench of Delhi HC challenging the order of the Single judge bench.

Issues involved:

The primary issue involved herein is the applicability of Arbitration Amendment Act to the court proceedings initiated after the commencement of Arbitration Amendment Act, challenging the enforcement of an arbitral award passed in an arbitration proceeding which is initiated before October 23, 2015.

Arguments Advanced:

The Appellant contended that the change in law with regard to the enforcement of an award under Section 36 of the Arbitration Amendment Act tends to take away vested right of an automatic stay on the filing of the petitions under Section 34 of the un-mended Arbitration Act. These amendments would operate only prospectively, that is, to arbitral proceedings commenced after 23.10.2015 and not to arbitrations commenced prior to 23.10. 2015. To support its argument, the appellant has put reliance on:

(i) Section 6 of the General Clauses Act, 1897 which deals with effect of repeal. It explicitly states that a repeal of an enactment would not affect any right acquired or accrued under the repealed enactment, unless a different intention appears in the repealing act.

(ii) Decision of Supreme Court in the matter of Hitendra Vishnu Thakur v. State of Maharshtra[17] and others which states that a statute which affects substantive rights is presumed to be prospective in operation, unless made retrospective, either expressly or by necessary intendment.

(iii) Further, Section 26 of the Arbitration Amendment Act does not express any intention of retrospective application prior to October 23, 2015 and therefore, it would operate prospectively and not to arbitrations commenced prior to October 23, 2015.

The Respondents, on the other hand, argued that the amended provisions would apply to court proceedings and, therefore, automatic stay could not be granted after the enactment of Arbitration Amendment Act. The Respondents raised the following arguments:

(i) They emphasized on the difference between the phrases "to the arbitral proceedings" and "in relation to arbitral proceedings". *Relying on Thyssen Stahlunion Gmbh* v. *Steel Authority of India Limited*[18], Respondents contended that the phrase in relation to arbitral proceedings cannot be given a narrow meaning to mean only pendency of the Arbitration proceedings before the Arbitrator. It would cover not only proceedings pending before the Arbitrator but would also cover the proceedings before the Court and any proceedings which are required to be taken under old Act (Arbitration Act, 1940).

[17] (1994) 4 SCC 602

[18] (1999) 9 SCC 334

(ii) The use of expression "to arbitral proceedings" instead of "in relation to arbitral proceedings", explains that the legislative intent was to limit its scope and, therefore, the said section 26 could not be extended to include post-arbitral proceedings.

(iii) Aid to Section 6 of the General Clauses Act ought not to be resorted because of use of the restrictive phrase in Section 26 of the Amending Act.

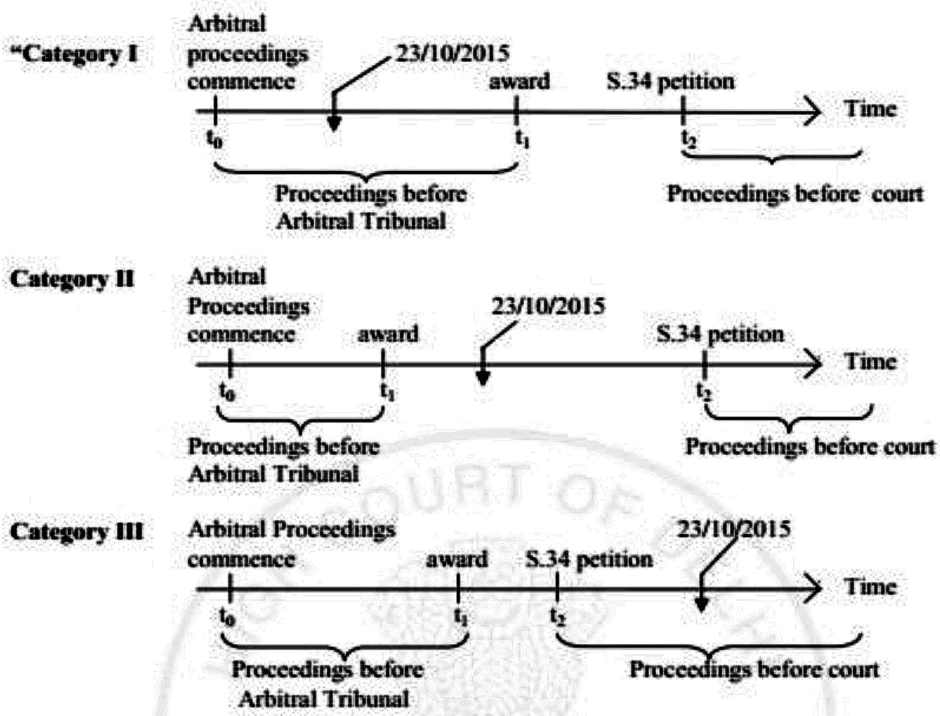
Judgment:

After taking all arguments and contentions into consideration, Delhi HC held that:

The challenge to the arbitral award in the present case would be governed by the un-amended Arbitration Act. Delhi HC further recorded that the right to an automatic stay upon filing of a challenge was an accrued/ vested right of the parties, and as such cannot be taken away retrospectively unless a different intention to that effect appears in the amending law.

Delhi HC on interpretation of Section 26

Delhi HC stated that Section 26 of the Arbitration Amendment Act, if interpreted in the manner suggested by the respondents will not exhaust all category of cases contemplated by the Delhi HC (mentioned herein-below):



t_0 = date on which arbitral proceedings commence

t_1 = date of award

t_2 = date of filing of petition under Section 34 of the said Act

23.10.2015 = date on which amending act commenced."

According to the Delhi HC, situations contemplated under Category II and Category III will not be covered under First Part of Section 26, if a narrow interpretation is given to the term "to arbitration proceeding" used therein. Further, the High Court stated that according different interpretation to the terms "to arbitral proceedings" & "in relation to arbitral proceedings" would lead to serious anomalies. These anomalies arise in context of amendments to both Section 9 and Section 17 of Arbitration Act. Therefore, if both the phrases are provided different meanings, the amended provisions would apply to proceedings under Section 9 of the Act, but not to proceedings under Section 17 in respect of arbitral proceedings commenced prior to October 23, 2015.

Thus, according to Delhi HC the term "to arbitral proceeding" should be given the same expansive meaning as "in relation to arbitration proceedings" to avoid any anomaly with respect to applicability of Section 26 of the Arbitration Amendment Act.

Conclusion:

The Arbitration Amendment Act introduced amendments to Section 36 of the Arbitration Act to prevent misuse of then existing provisions on automatic stay of proceedings on challenge of arbitral awards. The amendments tried to create a balance between the rights of award-holder & award-debtor. However, Section 26, in its present form coupled with unequal judicial opinion has faded the impact aimed by Arbitration Amendment Act. The much awaited Supreme Court ruling in the matter of Rendezvous Sports World vs. the Board of Control for Cricket in India will hopefully put this controversy to rest and provide much needed clarity on the applicability of Arbitration Amendment Act. [*Ardee Infrastructure Private Limited* v. *Anuradha Bhatia* - Judgment dated January 6, 2017, Delhi High Court].

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