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NCLAT refrains from interfering in NCLAT sanction

National Company Law Appellate Tribunal (NCLAT) rejects revenue's contention that the scheme of arrangement (the Scheme) was to be rejected, as it has been devised to avoid and evade taxes. NCLAT refrained from interfering with the sanction granted by National Company Law Tribunal (NCLT) to the scheme.

NCLAT¹ struck off the allegations made by revenue, that the scheme was being used as a device to avoid and evade taxes. NCLAT relied on the Supreme Court ruling in case of *Department of Income tax Vs. Vodafone Essar Gujarat Ltd.*², and upheld the approval granted by NCLT to the scheme. Further the NCLAT mentioned that Revenue can initiate appropriate proceedings for recovery of any tax, statutorily due from the petitioner companies or any other person liable to pay such tax.

Background:

- Reliance Jio Infocomm Limited (RJIL) – Demerged or Transferor Company (Petitioner Company No.1), Jio Digital Fibre Private Limited (JDFPL) - Resulting Company (Petitioner Company No.2) and Reliance Jio Infratel Private Limited (RJIPL) - Transferee Company (Petitioner Company No. 3) (collectively referred to as 'Petitioner Companies'), moved joint petition under Sections 230-232 of the Companies Act, 2013, seeking approval for the Composite Scheme of Arrangement amongst RJIL and JDFPL and RJIPL and their respective shareholders and creditors.
- Scheme overview:
 - Demerger of the optic fibre undertakings of RJIL to JDFPL at values appearing in the books of RJIL. In consideration for the demerger, equity and/or preference shares of JDFPL would be issued to the shareholders of RJIL on a proportionate basis
 - Transfer of tower infrastructure undertaking to RJIPL as a going concern, i.e., slump sale at book value. In consideration for slump sale, RJIL would receive equity and/or preference shares of RJIPL
 - RJIL issued its preference shares at substantial premium to its holding company, Reliance Industries Limited (RIL), aggregating to INR 65,000 crore. These funds were utilised by RJIL for investment in the optic fibre and tower infrastructure undertakings.
 - Pursuant to the Scheme being effective from 31 March 2019, the preference share capital and corresponding share premium would be cancelled and converted into an equivalent amount of loans from RIL to RJIL (INR 7,822 crore), JDFPL (INR 45,342 crore) and RJIPL (INR 11,836 crore).
- NCLT, Ahmedabad Bench, directed petitioner companies to serve a notice to Regional Director and Income-tax department for their representations, if any, on the scheme.

¹ [2019] 112 taxmann.com 275 (NCL-AT)

² [2015] 16 SCC 629

- Under the aforesaid instructions of NCLT, the Petitioner Companies filed a notice with the jurisdictional income-tax department. Subsequently, Petitioner Companies also filed a notice with the Income-tax department, intimating about the date of final hearing.
- Revenue responded to the said notices stating that it was a “very busy period” for the department and requested for adjourning the final hearing to somewhere in April 2019 (which is beyond the Appointed Date of 31 March 2019).
- Final hearing was conducted on 18 March 2019 and nobody appeared on behalf of Revenue for the final hearing. Final order sanctioning the Scheme was pronounced on 20 March 2019 and the said order captured the submissions made by Revenue and issued necessary directions sought by them.
- Revenue challenged the order of NCLT, suggesting that the matter should have been adjourned. Revenue contended that the NCLT while sanctioning the Scheme, has not adjudicated upon the following objections raised by them –
 - Petitioner companies have sought to convert the redeemable preference shares into loan i.e. conversion of share capital into debt, which is not only contrary to the well-settled principles of company law (Section 55 of Companies Act, 2013), but would also reduce the profitability or the net total income of the Petitioner Companies causing huge loss in revenue to the department.
 - Conversion of share capital into loan will have two-fold consequence. First, shareholders become creditors, who can seek repayment of the loan irrespective of profitability of the Petitioner Companies; and secondly, the Petitioner Companies would be liable to pay interest on loan to its creditors, which otherwise would not have to be paid to shareholders. Payment of interest would reduce the total income of the petitioner companies artificially, which is not permissible in law.
 - Scheme intends to indirectly achieve what it cannot accomplish directly under the law. i.e. it envisages indirect release of assets by RJIL to its shareholders, thereby avoiding dividend distribution tax, which would have been attracted otherwise in light of the provisions of Section 2(22)(a) of the Income-tax Act, 1961.
 - Scheme does not fulfil the requirements of Section 2(19AA) of Income-tax Act, 1961 which defines the term ‘demerger’ and it could only be referred to as purported demerger, which does not fulfil the requirements of law.

Issues for consideration:

Whether the Scheme is devised to avoid and evade taxes and accordingly should have not been sanctioned by NCLT?

Ruling of National Company Law Appellate Tribunal:

- Representations made by the Revenue demonstrate that liberty was sought to allow the Revenue to examine the aspect of any tax implication as a result of the scheme. In case it is found that the Scheme ultimately results in tax avoidance, or is not in accordance with the provisions of Income-tax Act, 1961, then Revenue will be at liberty to initiate the appropriate course of action, as per law.
- In addition to such liberty, revenue observes that petitioner companies are giving undue favour to their shareholders, and overall the Scheme results into tax avoidance.

- On one hand, revenue is seeking authority to examine the aspect of any tax implication arising as a result of the scheme and on the other hand, revenue has concluded that the Scheme is giving undue favour to the shareholders of the company and also the overall scheme results into tax avoidance.
- NCLAT held that without placing any evidence on record or substantiating the allegation by appearing before the NCLT, it was not open to Revenue to hold that the Scheme results into tax avoidance.
- NCLAT further held that, NCLT while sanctioning the scheme has allowed the revenue to enquire on whether any part of the Scheme amounts to tax avoidance or not, and whether any part of the scheme is against the provisions of the Income-tax Act, 1961. Further, the NCLT order ensures that revenue is free to take appropriate actions during the course of the assessment, in accordance with the requirements of Income-tax Act, 1961. Also, petitioner companies have accepted to abide by the principles of law and assist the Revenue at the time of assessment, which is sufficient enough and does not warrant the scheme to be rejected.
- Mere fact that a Scheme may result in reduction of tax liability, does not furnish a basis for challenging the validity of the same. NCLAT referred to the ruling of *Hon'ble Gujarat High Court in case of Vodafone Essar Gujarat Limited Vs. Department of Income Tax*³ wherein following was held –
 - Sanction to the Scheme is granted while protecting the right of the Revenue to recover the dues in accordance with law, irrespective of the sanction of the Scheme. Sanctioning the scheme shall not defeat the right of the Revenue to take appropriate recourse, for recovering the existing or previous liability of any of the companies participating in the scheme.
 - Companies are further directed not to raise any issue regarding maintainability of any proceedings in respect of assets sought to be transferred under the proposed scheme and the same shall bind to all the companies.
 - The pending proceedings against the transferor company shall not be affected in view of the sanction given to the scheme, by this court.
 - In short, the right of the revenue is kept intact to undertake appropriate proceedings regarding recovery of any tax from the transferor or transferee company, as the case may be, and pending cases before the Tribunal shall not be affected in view of the sanction of the scheme.
- NCLAT observed that aforesaid ruling of Gujarat High Court was affirmed by the Hon'ble Supreme Court⁴, whereby the Supreme Court declined to entertain the special leave petitions. The Supreme Court further stated that Revenue is entitled to undertake appropriate proceedings for recovery of any tax, statutorily due from transferor or Transferee Company or any other company liable for payment of such tax due.
- NCLAT held that the present case in question is fully covered by the decision of Hon'ble Supreme Court and in view of the liberty granted to revenue, NCLAT refused to overrule the decision of NCLT.

³ [2013] 176 Com Cas 7

⁴ [2015] 16 SCC 629

Comments:

NCLAT's ruling will definitely provide relief to companies carrying out corporate restructuring, considering their commercial objectives in mind. This ruling will act as a precedent that revenue will have to substantiate with proper evidence on record and convince NCLT to object to any scheme and request for its rejection on the ground that Scheme is devised only for evading taxes. It is important to note that while sanctioning any scheme, NCLT generally, grants liberty to revenue for examining the matter in detail and take appropriate actions in accordance with law at the time of assessment.

However, there have been instances in the past where few benches of NCLT have rejected the scheme taking in consideration similar objections raised by the revenue. It would be interesting to observe the future approach of both, Revenue as well as various benches of NCLT, post this ruling.



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