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Regulatory Alert
Tracking change

Consideration need not be paid by transferee company in every case of demerger

Issue no: RA/18/2015

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Synopsis

- Provisions of section 394 of Companies Act, 1956 are merely enabling provisions. These enabling provisions cannot be construed as compulsory in any sense.
- The consideration for transfer of an undertaking as part of a scheme of arrangement need not always be in the form of an allotment of shares of a transferee company.
- The consideration for such transfer can be any legitimate consideration, which includes allotment of shares of a holding company of the transferee company.

Background

- The transferor company viz. Sterling Holding Resorts (India) Limited (SHRIL), was a listed public company engaged in the business of vacation ownership and leisure hospitality.
- The two transferee or resulting companies viz. Thomas Cook Insurance Services (India) Limited (TCISIL) and Thomas Cook (India) Limited (TCIL), were engaged in the business of corporate agency for travel insurance, and integrated travel and travel related services respectively.
- The composite scheme of arrangement and amalgamation entered into by the above mentioned companies consisted of two parts:
  - Demerger of an undertaking of SHRIL pertaining to the time share and resort business on a going concern basis from SHRIL (and its transfer and vesting in TCISIL); and
  - Amalgamation of the residual undertaking of SHRIL (i.e. exclusive of the demerged undertaking) with TCIL on a going concern basis.
- After demerger and amalgamation as aforesaid, the scheme envisaged dissolution of SHRIL.
- The consideration of the demerger and amalgamation was discharged in the form of allotment of specific number of equity shares of TCIL to equity shareholders of SHRIL (in the identified ratio).The scheme provided for separate share exchange / share entitlement ratio for amalgamation and demerger.

Issue

The Regional Director opposed the scheme before the Honorable High Court of Bombay on the following grounds:

- The scheme was against the provisions of Income-tax Act, 1961 having regard to the definitions of 'demerger' and 'resulting company' contained in sections 2(19AA) and 2(41A) read with section 2(19AAA) of the Income-tax Act, 1961
- Section 394 of the Companies Act, 1956, requires that only a transferee company can allot shares towards consideration of transfer, and not any other person. In the present case, for demerger and transfer of the undertaking of the time share and resort business of SHRIL, the equity shares were allotted by TCIL, the parent company of the transferee company and not the transferee company itself viz. TCISIL.

Decision

On compliance with the provisions of the Income-tax Act, 1961

- There is no prohibition contained in the Income-tax Act to a scheme such as the one proposed here
- If a scheme of arrangement does not amount to 'demerger' within the meaning of the Income-tax Act, 1961 it may have certain tax implications for the companies in question.
- Framing of a scheme and the corresponding sanction by the Court do not in any way prejudice the application of section 2(19AA) of the Income-tax Act, 1961.
- By sanctioning the present scheme, the Court is not in any way accepting the company's case that the scheme, as framed, complies with the provisions of 'demerger' within the meaning of section 2(19AA). In fact, the Court is inclined to clarify that the sanction of the scheme, as proposed by the Court, does not in any way bind the Income-tax Department to take any particular view of the scheme of arrangement sanctioned by this Court insofar as the tax implications of the transaction are concerned.

- Based on the above, the Regional Director and Income-tax department raised no further objections to the scheme on the ground of non-compliance with the provisions of the Income-tax Act, 1961.

On compliance with section 394 of Companies Act, 1956

- Provisions of section 394 of the Companies Act, 1956 are merely enabling provisions. The Company Court, while sanctioning the scheme, may or may not make any of the provisions contained in Clauses (i) to (vi) thereof. These enabling provisions cannot be construed as compulsory in any sense.
- Clause (ii) of section 394 provides that if and to the extent the compromise or arrangement provides for allotment or appropriation by the transferee company of any shares, debentures, policies or other like interests in that company as part of the consideration of the scheme, then the Company Court while sanctioning the scheme may make appropriate provision in respect of such allotment or appropriation.
- It is not that in every case the consideration for transfer of an undertaking as part of a scheme of arrangement must come in the form of an allotment of shares of a transferee company or for that matter allotment of any shares.
- The consideration for such transfer can be any legitimate consideration, which the transferor is entitled to accept for contract of transfer. The scheme may, thus, not provide for any allotment of shares at all or provide any other appropriate consideration including allotment of shares of a holding company of the transferee company.
- Acceptance of any particular consideration is part of the commercial wisdom to be exercised by the shareholders of the transferor company. As long as such consideration is not against public interest or in any other manner illegal or inappropriate, it is not for the Company Court to accept or reject such consideration.
- In the past, High Courts have accepted several schemes where consideration for transfer of an undertaking is issued in the form of shares of a company other than the transferee company.
- Based on the above, the Bombay High Court found no merit in the objection raised by the Regional Director.

Source: Bombay High Court in Thomas Cook Insurance Services (India) Ltd. [60 taxmann.com 253]

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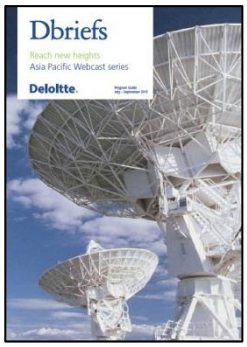
Transfer Pricing Developments in India: Range, Multiple Year Data, Advance Pricing Agreements, and Audits

On 10 September 2015 from 11:30 AM to 12:30 PM IST



Recent transfer pricing developments in India include proposals from the Government to reduce the extent of audits and litigation. The range and multiple year data concept will soon be incorporated into law. Furthermore, some high profile judgments are ensuring that the path to transfer pricing certainty slowly becomes clear in India. What does this mean for your Indian operations? Find out how companies impacted by Indian transfer pricing can navigate the regime with these updates. For more information, visit the **Dbriefs** page.

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Contacts

Ahmedabad
Heritage, 3rd Floor,
Near Gujarat Vidyapith,
Off Ashram Road,
Ahmedabad – 380 014.
Tel: + 91 (079) 2758 2542
Fax: + 91 (079) 2758 2551

Bangalore
Deloitte Centre, Anchorage II,
100/2, Richmond Road,
Bangalore 560 025.
Tel: +91 (080) 6627 6000
Fax: +91 (080) 6627 6010

Chennai
No.52, Venkatanarayana Road,
7th Floor, ASV N Ramana Tower,
T-Nagar,
Chennai 600 017.
Tel: +91 (044) 6688 5000
Fax: +91 (044) 6688 5050

Coimbatore
Shanmugha Manram
41, Race Course,
Coimbatore
Tamil Nadu - 641018
Tel: + 91 (0422) 439 2801
Fax: +91 (0422) 222 3615

Delhi/Gurgaon
Building 10,
Tower B, 7th Floor,
DLF Cyber City,
Gurgaon 122 002
Tel : +91 (0124) 679 2000
Fax : + 91 (0124) 679 2012

Hyderabad
1-8-384 and 385, 3rd Floor,
Gowra Grand S.P.Road,
Begumpet,
Secunderabad – 500 003.
Tel: +91 (040) 6603 2600
Fax:+91 (040) 6603 2714

Kolkata
Bengal Intelligent Park Building Alpha,
1st floor, Block EP and GP Sector V,
Salt Lake Electronics Complex,
Kolkata - 700 091.
Tel : + 91 (033) 6612 1000
Fax : + 91 (033) 6612 1001

Mumbai
Indiabulls Finance Centre,
Tower 3, 28th Floor,
Elphinstone Mill Compound,
Senapati Bapat Marg, Elphinstone (W),
Mumbai – 400013
Tel: + 91 (022) 6185 4000
Fax: + 91 (022) 6185 4101

Pune
106, B-Wing, 7th Floor,
ICC Trade Tower,
Senapati Bapat Road,
Pune – 411 016.
Tel: + 91 (020) 6624 4600
Fax: +91 (020) 6624 4605

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