Court Process and Legal Issues in Compromises, Arrangements & Mergers under the Companies Act, 2013

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Ahmedabad Chapter of WIRC of ICSI

Tushar P. Hemani, Advocate
Preamble:

Under the Companies Act, 2013, Chapter XV deals with Compromises, Arrangements and Amalgamations. In substances, the Scheme remains the same as the substituted 1956 Act, but there are quite a few interesting deviations from the old Act. Since this Chapter is yet not made enforceable, the impact of which would be ascertainable only when the provisions of this Chapter are notified by the Ministry of Corporate Affairs and National Company Law Tribunal starts functioning. Nonetheless, the well settled legal principles more or less, would continue to govern the field even after the new Act is enforced. The idea therefore is to firstly co-relate the old provisions with new ones and then carry out the legal analysis of the new provisions keeping in mind the well settled legal propositions. The paper is therefore, divided into 3 parts:

1. Comparison of Old vs. New Scheme;
2. Legal issues which would continue to govern the field even after new Act is enforced; and
3. Other ancillary issues.
PART I

Basic Understanding

of the Provisions under the

Companies Act, 1956

vis-à-vis

Companies Act, 2013
COMPROMISES, ARRANGEMENTS
AND AMALGAMATIONS

- The provisions relating to amalgamation, mergers, de-mergers, arrangements and compromises are provided under Chapter XV of the Companies Act, 2013.

- The entire chapter comprises of eleven provisions starting from Section 230 and ending at Section 240.

- This Chapter of the 2013 Act is yet to be notified.
### Major Highlights of Section 230 of the Companies Act, 2013:

- Section 230 of the 2013 Act provides for detailed disclosures to be made, one of the disclosures also mandates the applicant to disclose whether the scheme contains a reduction of capital or a corporate debt restructuring.

- The applicant who desires to restructure a corporate debt has to provide a report by auditors on the position of liquidity and also as to whether the corporate debt restructuring is in line with the guidelines provided by the Reserve Bank of India.

- The extensive disclosures are in addition to the disclosures required by s.393 of the 1956 Act. The intent of increased disclosures is to ensure transparency and empower stakeholders by allowing them to take informed decisions.

- Introduction of voting by way of postal ballot (in addition to a court convened meeting), which will ensure larger public participation, the concept of dispensation by providing a threshold for the dispensation of creditors meetings are a welcome measures.

- The 2013 Act also requires that notices be sent to various statutory authorities with regard to a scheme, arrangement or restructuring. This measure may evoke mixed reactions but is aimed to invite the participation of various regulators to assist the Tribunal to take an informed decision.

- The new section also enables the takeover of listed companies through a scheme of compromise or arrangement and places emphasis on the pricing guidelines which the Securities and Exchange Board of India would prescribe ensuring that uniformity in law is maintained.
<table>
<thead>
<tr>
<th>ISSUES</th>
<th>COMPANIES ACT, 1956</th>
<th>COMPANIES ACT, 2013</th>
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<tbody>
<tr>
<td><strong>Sections 391, 393 &amp; 394A vis-à-vis Section 230</strong></td>
<td>Approval by majority in number representing 3/4(^{th}) in value of the creditors or members or class thereof present and voting either in person or by proxy.</td>
<td>Approval by majority in number representing 3/4(^{th}) in value of the creditors or members or class thereof present and voting either in person or by proxy or by postal ballot.</td>
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<tr>
<td><strong>Approval Required</strong></td>
<td>(i) All material facts relating to company, such as latest financial position of the company, the latest auditor’s report on the accounts of the company, the pendency of any investigation proceedings in relation to the company u/s. 235 to 251, and the like.</td>
<td>(i) All material facts relating to company, such as latest financial position of the company, the latest auditor’s report on the accounts of the company, the pendency of any investigation or proceedings against the company;</td>
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<tr>
<td><strong>Disclosures to be made vide an Affidavit at the time of filing an Application before the NCLT</strong></td>
<td>(ii) Reduction of share capital of the company, if any, included in the compromise or arrangement;</td>
<td>(ii) Any scheme of corporate debt</td>
</tr>
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</table>
restructuring consented to by not less than 75% of secured creditors in value, including –

➢ a creditor’s responsibility statement in the prescribed form;

➢ safeguards for the protection of other secured and unsecured creditors;

➢ report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;

➢ where the company proposes to adopt the corporate debt restructuring guidelines specified by
the Reserve Bank of India, a statement to that effect; and

➢ a valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

<table>
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<tr>
<th>Valuation Report</th>
<th>No need to give Valuation Report to the shareholders / creditors along with the notice convening meeting.</th>
<th>Valuation Report to be given to the shareholders / creditors / debenture-holders along with the notice convening meeting.</th>
</tr>
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</table>
| Notice convening meeting | (i) Notice convening meeting to be sent to the shareholders / creditors and shall be given by advertisement.  

(ii) No specific provisions for serving of notice to Income Tax and other regulators. | (i) Notice convening meetings shall be sent to all shareholders / creditors / debenture-holders of the company individually at the address registered with the company.  

(ii) Notice to be served to the Central Govt., Income Tax Authorities, RBI, SEBI, the Registrar, respective |
(iii) The notice and other documents shall also be placed on the website of the company, if any, and in case of listed company, these documents shall be sent to the Securities and Exchange Board and Stock Exchange where the securities of the companies are listed, for placing on their website and shall also be published in the newspapers in such manner as may be prescribed.

| Objection to compromise or arrangement | Objection to scheme of compromise or arrangement can be made by any shareholder and/or creditor, as the | Objection to scheme of compromise or arrangement can be made only by:
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<td>stock exchanges, Official Liquidator, Competition Commission of India, if necessary, and such other sectoral regulators or authorities.</td>
<td>➢ those shareholders who</td>
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**Tushar P. Hemani, Advocate**
| **Order made by the Court / NCLT** | No specific provisions with respect to the order made by the Court / NCLT | An order made by the NCLT shall provide for all or any of the following matters:

a) where the compromise or arrangement provides for conversion of preference shares into equity shares, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable;

b) the protection of any class of creditors;

c) if the compromise or arrangement results in the variation of the |

 holds not less than 10% of the shareholding or

➢ those Creditors who holds not less than 5% of the total outstanding debt as per latest audited financial statement.
shareholders’ rights, it shall be given effect to under the provisions of section 48;

d) if the compromise or arrangement is agreed to by the creditors, any proceedings pending before the Board for Industrial and Financial Reconstruction established under section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985 shall abate;

e) such other matters including exit offer to dissenting shareholders, if any, as are in the opinion of the Tribunal necessary to effectively implement the terms of the compromise or arrangement.

| Certificate of Company’s Auditor | No specific provision with respect to filing of the certificate of the company’s auditor. | No compromise or arrangement shall be sanctioned unless a certificate by the company’s auditor has been filed with |
the NCLT to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133 viz. by the Central Govt. as recommended by the Institute of Chartered Accountants of India constituted u/s. 3 of Chartered Accountants Act, 1949 in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

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<thead>
<tr>
<th>Dispensation of the meeting</th>
<th>No specific provision for dispensation of the meeting.</th>
<th>NCLT may dispense with calling of a meeting of the creditors having at least 90% value agree and confirm by way of affidavit.</th>
</tr>
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<tbody>
<tr>
<td>Buy back of securities by scheme of compromise</td>
<td>A scheme of compromise or arrangement can include any buyback of securities.</td>
<td>A scheme of compromise or arrangement can include any buyback of securities, provided it is in accordance with buy-back provisions as</td>
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_Tushar P. Hemani, Advocate_
A scheme of compromise or arrangement cannot include a “takeover offer”. A scheme of compromise or arrangement may include “takeover offer” in a prescribed manner. In the case of listed companies such takeover offer shall be as per the SEBI regulations.
**SECTION 231:-**

- **Major Highlights of Section 231 of the Companies Act, 2013:**

<p>| ✔ The power of the Tribunal to supervise the implementation and execution of the scheme of compromise or arrangement at the time of making the order or any time thereafter continues. |
| ✔ The power of any person to apply which existed in s. 392 of the 1956 Act is not available under the s. 231 of the 2013 Act. |
| ✔ The <em>suo motu</em> power to Tribunal to order a winding up if the company is unable to pay its debts continues to exist under the new law. |</p>
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<tr>
<td><strong>Section 393 vis-à-vis Section 231</strong></td>
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<tr>
<td>No major amendments have been made in the said Section.</td>
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<tr>
<td><strong>Power of Court / NCLT</strong></td>
<td>i) To supervise the carrying out of the compromise or arrangement with the creditors and shareholders</td>
<td>i) To supervise the implementation of compromise or arrangement with the creditors and shareholders</td>
</tr>
<tr>
<td></td>
<td>ii) Winding up order can be passed either on its own motion or on application of any person interested in the affairs of the company if the company is unable to pay its debts</td>
<td>ii) Winding up order can be passed on its own motion if the company is unable to pay its debts</td>
</tr>
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*Tushar P. Hemani, Advocate*
**SECTION 232:-**

### Major Highlights of Section 232 of the Companies Act, 2013:

- The important *proviso* under s. 394 of the 1956 Act, which required the filing of the report by the Registrar and the Official Liquidator, has not been included in the s. 232 of the 2013 Act. This may mean notice would be issued to the Official Liquidator and the Registrar under s. 230 of the 2013 Act.

- Section 232 of the 2013 Act prohibits the maintenance of the treasury stock.

- The norm and practice of indirectly holding investments through intermediaries like a private trust is now prohibited and cannot be structured by companies.

- Importance on compliance with accounting standards and of providing liquidity to the shareholders is rightly placed.

- Exit options which were structured through selective capital reduction petitions have now found support through the provisions of this section wherein on merger of a listed company with an unlisted company, the exit option to shareholders through a pre-determined formula or valuation can be given.

- Post facto compliance wherein a statement would be required to be filed by the Chartered Accountant or Company Secretary certifying the implementation of the scheme, have also been introduced.

- Section 232 of the 2013 Act has omitted the definitions of “Transferor Company” and “Transferee Company”. New
propositions of amalgamation being “merger by formation of a new company”, “merger by absorption” and scheme involving division of undertaking, property/liability have been introduced by way of explanation.

- The concept of “Appointed Date” has been introduced under this section.

- The clubbing of authorised capital which was normally litigated and objected by the Registrar is now permitted under this section.
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<tr>
<td><strong>Section 394 vis-à-vis Section 232</strong></td>
<td></td>
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</tr>
<tr>
<td>Transfer of Listed Company with an Unlisted Company</td>
<td>No specific provision for compromise / arrangement between a listed transferor company and an unlisted transferee company</td>
<td>In case of compromise / arrangement between a listed transferor company and an unlisted transferee company, Court / NCLT to provide that the transferee company shall remain unlisted company until it becomes listed and exit option to be given to the shareholders of the transferor company wherein the exit price to be not less than the price under any SEBI Regulations.</td>
</tr>
<tr>
<td>Compliance</td>
<td>No specific provision for filing of statement by the company until completion of scheme indicating whether the scheme is being complied as per the orders of the Court / NCLT.</td>
<td>A company shall file a statement in the prescribed form and time every year duly certified by a chartered accountant or a cost accountant or a company secretary indicating whether the scheme is being complied with in accordance with the orders of the Court / NCLT or not.</td>
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*Tushar P. Hemani, Advocate*
**SECTION 233 [Newly Introduced]:**

**Major Highlights of Section 233 of the Companies Act, 2013:**

| ✓ | This section provides for amalgamations between two or more small companies or between a holding company and its wholly owned subsidiaries. |
| ✓ | Small companies which meet the threshold of s. 2(85) of the 2013 Act viz. definition of ‘Small Company’ can avail the merger route under this section. |
| ✓ | This is an attempt to reduce time lines and provide a platform to facilitate amalgamations without approval of the Tribunal. |
| ✓ | Section 233 of the 2013 Act prohibits the maintenance of the Treasury Stock. |
| ✓ | Section 233 of the 2013 Act gives legal sanctity to the concept of Clubbing of Authorised Capital. |
| Section 233 | Fast Track Merger | No specific provisions for expediting merger. | Provisions made to facilitate merger between two or more small companies or between a holding company and its wholly-owned subsidiary company or such other class or classes of companies as may be prescribed without moving the Court / NCLT.

Approval required of:

- Registrar of Companies;
- Official Liquidator;
- Members or class of members holding at least 90% of total no. of shares;
- Majority of creditors or class of creditors representing 9/10\(^{th}\) in value;
- Each of the companies involved in the merger shall file a declaration of solvency with the ROC. |
**SECTION 234 [Newly Introduced]:-**

**Major Highlights of Section 234 of the Companies Act, 2013:**

| ✔️ | This section enables, facilitates and provides legal sanctity to structure cross-border amalgamations between Indian Companies and Foreign Companies. |
| ✔️ | Prior to the introduction of this section, only mergers of Foreign Company being the Transferor Company and the Indian Company being the Transferee Company were permitted. |
| ✔️ | This new section also facilitates the merger of an Indian Transferor Company with a Foreign Transferee Company. |
| ✔️ | All the Mergers under this section would require prior approval of the Reserve Bank of India. |
| **Section 234** |
|------------------|------------------|------------------|
| Merger of Indian Company with Foreign Company | Indian Company cannot be merged with Foreign Company | Foreign Company, may with prior approval of Reserve Bank of India, merge into Indian Company or vice versa. The consideration for merger can be in the form of Cash and / or Depository Receipts or partly in Cash and partly in Depository Receipts. This would apply to Foreign Companies in jurisdictions as notified by the Central Government. |
SECTION 235:-

Major Highlights of Section 235 of the Companies Act, 2013:

| ✔️  | This section provides the mechanism under which the Transferee Company under a scheme or contract can acquire shares of the dissenting shareholders. |
| ✔️  | The power to acquire shares of the dissenting shareholders would be available to the Transferee Company only if such scheme or contract is approved by holders of not less than 9/10th of the value of the shares whose transfer is involved. |
| ✔️  | This dissenting shareholders under this section have a right to make an application to the Tribunal and if the Tribunal does not make an order to the contrary, the Transferee Company can send the notice along with the instrument of transfer which shall be executed by any person appointed by the Transferor Company and thus register the Transferee Company as the holder of the shares. |
| ✔️  | Upon registration of the instrument, the dissenting shareholders would be informed and the sum received as consideration from the Transferor Company shall be deposited in a separate bank account and held in trust by the Transferor Company. |

Section 395 vis-à-vis Section 235

No major amendments have been made in the said Section.
**SECTION 236:-**

Major Highlights of Section 236 of the Companies Act, 2013:

<p>| ☑️ | This section facilitates and provides an exit mechanism for minority shareholders at a fair price and helps the promoter/promoter group achieve the objective of having a 100% promoter held entity. |
| ☑️ | This section provides that in event of any acquirer or persons acting in concert with the acquirer reached 90% of the equity share capital of a company on account of either an amalgamation, share exchange or conversion of securities or for any other reasons, such acquirer or person shall notify the company their intention to buy the remaining equity shares held by the minority shareholders. |
| ☑️ | This section seeks to create a balance between the interests of the promoters and minority shareholders. |
| ☑️ | This section can be invoked by the acquirer/persons acting in concert whose equity share holding increases to 90% not only on account of an amalgamation, but also when there is a share exchange i.e. purchase of equity shares by way of a share purchase agreement or conversion of securities i.e. in event of the security held by the preference shareholder or debenture holder being converted into equity share capital or for any other reasons. |</p>
<table>
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<tr>
<th><strong>Section 395 vis-à-vis Section 236</strong></th>
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<tbody>
<tr>
<td><strong>Offer to sell by Minority shareholders to Majority shareholders</strong></td>
<td>No specific provision for offer to sell by the minority shareholder to the majority shareholders.</td>
</tr>
<tr>
<td><strong>The minority shareholders of the company may also offer to sell their shares to the majority shareholders at a price determined in accordance with the rules as may be prescribed.</strong></td>
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<tr>
<td><strong>Purchase of Minority shareholding by Majority shareholder/s</strong></td>
<td>No specific provisions for acquisition of minority shareholders by majority shareholders.</td>
</tr>
<tr>
<td><strong>Acquirer and / or Person acting in concert with such acquirer or person / group of persons holding 90% or more of the issued equity share capital of the company by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, can purchase the remaining equity shares of the company from the minority shareholders at a price determined by registered valuer.</strong></td>
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</tr>
<tr>
<td><strong>Minority shareholders may also offer to the majority shareholders to purchase their equity shareholding in the company at a price determined by the registered valuer.</strong></td>
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**SECTION 237:-**

**Major Highlights of Section 237 of the Companies Act, 2013:**

- This section provides for the process of amalgamating companies in public interest.

- This section provides that every member or creditor or a debenture holder of the Transferee Companies shall have the same right and interest in the Transferee Company.

- In the event of the rights and interest of the member, creditor, debenture holder being lesser in the Transferee Company if compared with the rights and interest which existed in the Transferor Company, then such member, creditor or debenture holder shall be entitled for compensation as fixed by such authority as prescribed.

- Any grievance of the shareholder, creditor or debenture holder against the assessment of compensation can be appealable within 30 days from the date of publication of such assessment in the official gazette.

**Section 396 vis-à-vis Section 237**

No major amendments have been made in the said Section.
**SECTION 238:-**

**Major Highlights of Section 238 of the Companies Act, 2013:**

| ✔️  | This section provides when an offer has been made pursuant to a scheme or contract under s. 235 of the 2013 Act, every circular containing such offer shall contain such information as may be prescribed along with a statement by or on behalf of the Transferee Company, disclosing the steps it has taken to ensure that necessary cash will be available. |
| ✔️  | The circular for the offer under s. 235 of the 2013 Act would have to be presented with the Registrar and can be issued only after its registration. |
| ✔️  | The Registrar may refuse to register the circular for reasons to be recorded in writing. |
| ✔️  | The section also provides for not only a remedy of Appeal against refusal of registration but also contains penal provisions of fine. |
| ✔️  | The above amendment is brought into force in order to provide for a stringent mechanism with respect to issuing of the scheme or offer to the transferor company and its shareholders. |
### Section 395(4A) vis-à-vis Section 238

| Registration of offer of scheme involving transfer of shares | No specific provisions for registering the offer of scheme which involves transfer of shares or any class of shares in the transferor company to the transferee company. | The transferor and transferee company both have to register the circular which involves an offer of scheme with respect to transfer of shares or any class of shares with the registrar for registration before issuing the same. |

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_Tushar P. Hemani, Advocate_
**SECTION 239:-**

**Major Highlights of Section 239 of the Companies Act, 2013:**

| ✓ | This section provides that books and papers of the amalgamating company or the company in which shares have been acquired by another company under this Chapter shall be required to maintain the same and cannot be disposed off without the prior permission of the Central Government. |
| ✓ | This section has been inserted to ensure that the past records of the companies are maintained which can be utilized in the future for any process of investigation which may be initiated by any Central or State regulatory authority. |

**Section 396A vis-à-vis Section 239**

No amendment has been made in the said Section.
**SECTION 240 [Newly Introduced]:-**

**Major Highlights of Section 240 of the Companies Act, 2013:**

| ✓ | This section states that any offences committed under this Act by the officers of the Transferor Company prior to any merger, amalgamation or acquisition shall continue to exist even after such merger, amalgamation or acquisition. |
| ✓ | This section has been inserted to ensure that the officers of the Transferor Company do not escape any liability which might have arisen on account of violation under the Act. |

<table>
<thead>
<tr>
<th><strong>Section 240</strong></th>
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<tbody>
<tr>
<td>Liability of officers of the Transferor Company</td>
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</table>
ISSUES AND IMPACT ANALYSIS VIS-À-VIS COMPROMISES, MERGERS, AMALGAMATION & DE-MERGERS UNDER COMPANIES ACT, 2013

ISSUES –

→ Due to involvement of so many authorities / agencies the speed of Compromises, Mergers and Amalgamation may get affected.

→ No specific provision for dispensation of the meetings of the members or class of members unlike that of creditors hence, giving an impression that a compulsory meeting of shareholders would have to be convened.

→ The reading of sub-section 5 of s. 230 of the 2013 Act gives an impression that the notices are to be sent “if necessary”. Thus, there may be a possibility that the notices to the statutory authorities may be dispensed with on a case to case basis. (“if necessary” may be going with CCI alone).

→ Scope and grounds of intervention of the regulatory authorities is vague and unclear – If the views are not expressed within the period of 30 days then the section states that it will be assumed that they have no representation to make on the proposals. It is unclear, if this would mean that it is understood that they have granted consent of the scheme of compromise or arrangement.

Tushar P. Hemani, Advocate
As per s. 230(11) of the 2013 Act in case of listed companies the
takeover offers shall be in accordance with the SEBI guidelines.
However, under s. 230(12) of the 2013 Act, the Tribunal restricts its
jurisdiction to entertain grievances with respect to takeover offers
only to unlisted entities. If this sub-section is interpreted in the
present form, it would mean that shareholder grievances involving
scheme containing takeover offers in listed companies cannot be
entertained by the Tribunal leaving the aggrieved shareholder
remediless.

In case of fast track merger approval required from Members
holding 90% Shares and Creditors holding 90% in value, may be
difficult.

Other statutory regulations require alignment:-

- Income Tax
- RBI
- SEBI
- FEMA
- Accounting Standards
- Delisting Regulations
IMPACT –

→ Internal Restructuring will increase due to separate provision for Small Companies (Only Private Companies) and Holding and Wholly Owned Subsidiary Company under Fast Track Merger

→ Only relevant issue on Compromise, Arrangement, Mergers and Amalgamation will be raised due to prescribed limit for objecting the scheme

→ Dissenting Shareholder will easily exit the Compromise, Arrangement, Merger and Amalgamation

→ There will be more Cross- Border transactions in form of Mergers and Amalgamation

→ Role of other authority like Income Tax, Reserve Bank of India, etc. becomes important.
PART II

Legal Issues

Meetings:

- Section 391(1) of the Companies Act prescribes that the Court may, on the application of the company or any creditor or any member of the company or in the case of a company which is being wound up, of the Liquidator, order meeting of the creditors or members for the purpose of ascertaining wishes of the creditors and members of the proposed Scheme of Amalgamation. The first question that arises for our consideration is as to whether holding of a meeting is a must. This issue is not free from doubt. According to the judgments of Delhi High Court and Andhra Pradesh High Court, recently followed by Gujarat High Court, a scheme of amalgamation is an arrangement between the two companies and their respective shareholders only and accordingly the meetings of the creditors of the transferor company are not required. I have my own reservation to this proposition, inasmuch as so far as the creditors of the transferor company are concerned, they are being called upon to recover their debts from the transferee company as against the transferor company. The scheme of amalgamation may certainly, in a given case, affect them prejudicially. It is, therefore, advisable to call the meetings of the creditors of the transferor company. There can be no controversy, however, as regards
a need to call the meetings of the shareholders of both the companies. In case of a large or medium size company the shareholders and the creditors might be substantial in number and might be spread over at quite far away places. But take a case of a small company, say, a private company of which shares are held within the family and looking at the size of the business it does not have a large number of creditors. If the company is in a position to obtain letters of consents from the shareholders and the creditors agreeing to the proposed Scheme of Amalgamation, is it possible for the company to request the Court to dispense with holding of such meetings would be an empty formality and would result into unnecessary waste of time and energy? Though there is no specific provision in the Companies Act authorising the Court to dispense with holding of such meetings, as the powers under Section 391(1) of the Companies Act are discretionary, if the facts justify, in my opinion, it is open to the Court to dispense with holding of such meetings.

- Now under the new Act, creditors meetings can be given a go for both the transferor and transferee companies. However, consent affidavit of creditors or class of creditors having at least 90% of the value must agree and confirm.

**Scope and extent of Explanatory Statement:**

- Once the Court orders holding of the meeting, it would be necessary for the Company to dispatch to the shareholders and the creditors notices calling the meeting together with a copy of the Scheme of

_Tushar P. Hemani, Advocate_
Amalgamation, the proxy form as also an explanatory statement under Section 393(1)(a) of the Companies Act. Compliance with this Section is mandatory and before a Scheme of Compromise of Arrangement is taken up for hearing, the Court must be satisfied that such a statement was annexed to the notice convening the meeting (Re: Siddhpur Mills Ltd. (1972) 42 Company Cases 265). It may be noted that it is necessary that such a statement should not only state the terms of the Scheme of Amalgamation, but also explain the effect of the Scheme. That apart, the interests which the Directors, etc. may have in the proposed Scheme of Amalgamation are also required to be mentioned insofar as the Scheme is likely to result into and have effect upon them different from material interests which any other persons interested in the Scheme may have. Would it be necessary in such an explanatory statement to give the detailed reasoning about the commercial decisions? Say, is it necessary to give the detailed justification of how share exchange ratio is worked out? Answer appears to be in the negative. Disclosure of the exchange ratio of shares is a sufficient compliance under the Scheme and the procedure by which it was worked out need not be disclosed in such a statement (Re: Jitendra vs. Alembics Co. Ltd. – 64 Company Cases 206). This judgment has been approved by the Supreme Court of India in the case of Hindustan Lever Employees Union vs. Hindustan Lever Ltd. (AIR 1995 SC 470).
**Power of Court to sanction Scheme even if not approved by the majority:**

- At the meetings so called, the Scheme of Amalgamation will have to be discussed. Thereupon it will be put to vote which has to be, under the Rules, by ballot only. The law requires that such a Scheme of Amalgamation to be binding on all the shareholders/creditors must be approved by majority in number 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 where proxies are allowed by proxy. It is the duty of the Court to examine, when ultimately the petition is presented before it for confirmation of the Scheme of Amalgamation, that the meeting was duly convened and conducted and that the Scheme was accepted by a competent majority and the majority was acting in good faith and for common advantages of the whole class and that what they did was reasonable, prudent and proper. It may be noted that in a decision in the case of S. M. Holding Finance Pvt. Ltd. vs. Mysore Machinery Mfrs. Ltd. (In liqn.), the Karnataka High Court (78 Comp. Case 432) has taken a view that the provision of Sec.392 (now S. 231) is not mandatory and the Court may sanction a scheme even if statutory majority did not approve the same at the meeting provided there was substantive compliance of law.
Role and Power of the Court:

- After these formalities are completed successfully the petitions will have to be filed in the Court seeking for sanction of the Scheme of Amalgamation. It is well settled that while sanctioning the scheme of Amalgamation the Court does not act as a mere rubber stamp. The Court does not merely see that requirements of law have been complied with nor would it simply endorse the resolution passed by the shareholders or creditors merely because it happens to be by a prescribed majority or even unanimously. The Court is bound to consider the terms of the Scheme of Amalgamation so as to decide whether it is fair and reasonable taking into consideration the various relevant aspects.

At the same time though the power of the Court is very wide, there are certain limitations on them. Firstly, though the Scheme may be open to criticism the Court will not interfere unless it is affirmatively shown to be unfair (Re: M.G. Investment and Industrial Co. Ltd. vs. New Schorrock Spg. and Mfg. Co. Ltd. – 42 Company Cases 145 Bombay). In other words, the Court does not sit in judgment over the commercial wisdom of the body of the shareholders and/or creditors and unless they are not given appropriate information as required under the law or unless the minority is coerced into agreeing to something by the majority, the Court would not disregard the wishes of the majority. Similarly, the Scheme of Amalgamation should not be examined in the way harping critic, hair-splitting expert, meticulous
accountant or a fastidious counsel would do it. It must be tested from the point of view of an ordinary reasonable shareholder acting in a businesslike manner and bearing in mind all the circumstances, prevailing at the time when the meeting is called upon to consider the Scheme of Amalgamation in question [Navajivan Mills Ltd. (supra)].

The question of the jurisdiction of the Court in the matter of sanction of scheme of amalgamation has come up for consideration before the Supreme Court in the case of Miheer H. Mafatlal vs. Mafatlal Industries Ltd. (AIR 1997 SC 506) and the Court held as under:

“It is the commercial wisdom of the parties to the scheme who have taken an informed decision about the usefulness and propriety of the scheme by supporting it by the requisite majority vote that has to be kept in view by the Court. The Court certainly would not act as a Court of appeal and sit in judgment over the informed view of the concerned parties to the compromise as the same would be in the realm of corporate and commercial wisdom of the concerned parties. The Court has neither the expertise nor the jurisdiction to delve deep into the commercial wisdom exercised by the creditors and members of the company who have ratified the Scheme by the requisite majority. Consequently the Company Court's jurisdiction to that extent is peripheral and supervisory and not appellate. The Court acts like an umpire in a game of cricket who has to see that both the teams play their game according to the rules and do not overstep the limits. But subject to that how best the game is to be played is left to the players and not to the umpire.”

“Consequently the propriety and the merits of the compromise or arrangement have to be judged by the parties who as sui juris with their open eyes and fully informed about the pros and cons of the Scheme arrive at their own reasoned judgment and

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agree to be bound by such compromise or arrangement. The Court cannot, therefore undertake the exercise of scrutinising the scheme placed for its sanction with a view to finding out whether a better scheme could have been adopted by the parties. This exercise remains only for the parties and is in the realm of commercial democracy permeating the activities of the concerned creditors and members of the company who in their best commercial and economic interest by majority agree to give green signal to such a compromise or arrangement.”

We may also useful refer to the observations found in the oft-quoted passage in Bucklay on the Companies Act, 14th Edition. They are as under:

“In Exercising its power of sanction the Court will see, first that the provisions of the statute have been complied with, secondly, that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interest adverse to those of the class whom they purport to represent and thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of this interest, might reasonably approve.

The Court does not sit merely to see that the majority are acting bona fide and thereupon to register the decision of the meeting, but at the same time, the Court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considering the matter with a view to the interest of the class which it is empowered to bind, or some blot is found in the Scheme.”
Valuation of Shares and Exchange Ratio:

- Under Section 394A of the Companies Act, 1956, the Court has to give notice of every application made to it under Section 391 or 394 to the Central Government and shall take into consideration the report, if any, made to it by the Central Government before passing any order under these Sections. Quite often the Central Government through the Regional Director raises objections as regards the fixation of exchange-ratio of shares. When the said share exchange ratio is approved unanimously or by substantial majority in the meeting of the shareholders, is it, open to the Central Government to raise such an objection? As to what should be the ratio in which the shares of the transferor company should be exchanged for the shares of the transferee company is a matter affecting only the shareholders of the company. In that view of the matter if the shareholders of the companies do not object, the Regional Director has no right to raise such an objection so long as the Scheme of Amalgamation is not otherwise detrimental to public interest (Re: Hindustan Instruments Ltd. – 64 Company Cases 116 Punjab & Haryana; Kandla Sugar Mills Ltd. – 55 Company Cases 305; Mahavir Weaves Pvt. Ltd. – 83 Company Cases 180 (Guj.). In the case of Miheer H. Mafatlal (supra), the Supreme Court also considered the question of the fixation of share exchange ratio and held as under:

“*It must at once be stated that valuation of shares is a technical and complex problem which can be appropriately left to the consideration of experts in the field*

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of accountancy. Pennington in his Principles of Company Law mentions four factors which had to be kept in mind in the valuation of shares:

(1) Capital Cover;
(2) Yield;
(3) Earning Capacity; and
(4) Marketability

For arriving at the fair value of share, three well known methods are applied:

(1) The manageable profit basis method (the Earning Per Share Method);
(2) The net worth method or the break value method, and
(3) The market value method."

So many imponderables enter the exercise of valuation of shares."
whether to approve the Scheme of Amalgamation or not. The exchange ratio was only one of the items. They thought it fit in their commercial wisdom to accept the Scheme as a whole along with the exchange ratio presumably in expectation of better profits in years to come when the amalgamated companies would operate and when there would be, according to the shareholders better prospects of earning greater dividends. They willingly agreed to give in exchange two shares of transeree company for five shares of transferor company and made them available to the shareholders of transferor company.

In this connection we may also refer to a decision of Maugham J., in Re Hoare & Co. (No.2) case (1933) AIER 105 wherein it was laid down that where statutory majority had accepted the offer the onus must rest on the applicants to satisfy the Court that the price offered is unfair. In this connection following pertinent observations were made by the learned Judge:

"The other conclusion I draw is this - the Court ought to regard the scheme as a fair one inasmuch as it seems me impossible to suppose that the Court, in the absence of any strong grounds, is to be entitled to set up its own view of fairness of the scheme in opposition to so very large a majority of shareholders who are concerned. Accordingly, without expressing a final opinion on the matter because there may be special circumstances in special cases. I am unable to see that I have any right to order otherwise in such a case as I have before me, unless it is affirmatively established that notwithstanding the views of a very large majority of shareholders, the scheme is unfair."

We may also refer to a decision of the Gujarat High Court (or Madras High Court ?) in Kamala Sugar Mills Limited (1984) 55 Company cases p.308 dealing with an identical objection about the exchange ratio adopted in the Scheme of Compromise and Arrangement. The Court observed as under:

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“Once the exchange ratio of the shares of the transferee company to be allotted to the shareholders of the transferor company has been worked out by a recognised firm of chartered accountants who are experts in the field of valuation and if no mistake can be pointed out in the said valuation it is not for the Court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the shareholders of the two companies or to say that the shareholders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest.”

These observations in our view represent the correct legal position on this aspect.”

Role of the Official Liquidator:

- Similarly, under the second proviso to sub-section (1) of Section 394 of the Companies Act, it is provided that no order of dissolution of the transferor company shall be made by the Court unless the Official Liquidator has on the scrutiny of the books and papers of the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest. Here again quite often it is found that the Official Liquidator exceeds his brief. His only duty is to look into the past conduct of the company so as to find out as to whether it has acted in a manner prejudicial to the interests of the members or to public interest. It is not open to the Official Liquidator to opine on the merits or demerits of the Scheme of Amalgamation much less opine about the future. The rationale behind this provision

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is that as the amalgamating company is dissolved without winding up unless such a scrutiny takes place the past misdeeds of the company may never be brought to the notice of the Court which would mean that amalgamation would be an escape route for unscrupulous elements so that their misdeeds would never be found. With only that end in view the scrutiny of the books of account must be undertaken and there need not be a roving inquiry into each and every transactions much less about the wisdom of the terms and conditions of the Scheme of Amalgamation.

**Accounting Aspects of Merger / Amalgamation :**

- The Institute of Chartered Accountants of India (‘ICAI’) has issued an “Accounting Standard” (‘AS’) being AS 14 under the head ‘Accounting for Amalgamation’. This AS has come into effect in respect of the accounting period commencing on or after 1-4-95 and is mandatory in nature.

- The first question that would arise on amalgamation is accounting treatment of reserves. According to AS the nature of accounting treatment of reserves in amalgamations will depend upon the nature of amalgamation. There are two categories of amalgamations – one in the nature of merger and another in the nature of purchase.

  (i) An amalgamation is regarded as in the nature of merger if there is a genuine pulling of not only the assets and liabilities of both the companies, but also of shareholders’ interest and of the

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business of the companies. In such a situation the identity of the reserves of the transferor company would be preserved and they would appear in the books of the transferee company in the identical form in which they appeared in the books of the transferor company. Accordingly, the free reserves of the transferor company would continue to be regarded as a free reserve in the identity of the reserves being preserved, the aggregate of the consideration and the reserves would be deducted from the book value of the net assets of the transferor company. If the result of the computation is positive, the same will be credited to capital reserve. However, if it is negative the same will be debited to goodwill.

(ii) The amalgamation is in the nature of purchase if in effect it is made by which, one company acquires another company and as a consequence the shareholders of the transferor company normally do not continue to have proportionate share in the equity of the transferee company or the business of the transferor company is not carried on in its pre-amalgamation form. In this situation all the reserves will not be transferred in the books of the transferee company. The reserves which were created by the transferor company pursuant to the requirements of and for availing of the benefits under the Income-tax Act, for example, investment allowance reserve of development rebate reserve, etc. and where the Income-tax Act requires that identity of the reserves should be preserved for a specified period or
other reserves are created in terms of requirement of some other statute and their identity is required to be maintained under the provisions of law; such reserves will not be carried over in the books of the transferee company. Rest of the reserves will not be carried over. Therefore, aggregate of the consideration and the amount of only such carried forward reserves would be deducted from the book value of the net assets of the transferor company (or in the case of revaluation), the revalued amount. If the result of the computation is positive it will be capital reserve; if it is negative it will be goodwill.

**Treatment of P & L Account Balance:**

- The next question would be as regards balance of profit and loss account. On the same logic as is applicable in the case of reserves, in case of amalgamation, in the nature of merger the transferee company will take over the balance of profit and loss – whether positive or negative. However, in case of amalgamation in the nature of purchase the said balance will not be carried forward and will lose its identity.

**Capitalisation of Revaluation Reserve:**

- Can there be a Scheme of Amalgamation which would result into capitalisation of revaluation reserve? If a company has started business a few years back, on account of inflation, market value of the assets could be quite high as compared to the book value. If the assets are
revalued in the books of accounts same would give rise to the revaluation reserve. Such reserve, under the guidelines issued by the Securities and Exchange Board of India (SEBI) (wherever applicable) cannot be utilized for the purpose of issuance of bonus shares. Therefore, such a revaluation reserve cannot increase the capital base of the company. If such a company which has high intrinsic worth of its share gets amalgamated with another company which has much lower intrinsic worth of the share – its intrinsic worth is equivalent to the face value – and in the process so fixes the exchange ratio of the shares so as to give larger number of shares to the shareholders of the transferor company as compared to their original holding in the said company. In effect the transferee company’s capital would be substantially increased. In reality, one has capitalized the revaluation reserve not on its own but through the medium of a Scheme of Amalgamation.

**Locus Standi of Employees of Transferor Company**

- Do the employees of a transferor company who are likely to be affected on account of the amalgamation have any *locus standi* to challenge the Scheme of Amalgamation. On a scheme of amalgamation being sanctioned the transferor company is dissolved without winding up. Under the circumstances unless the scheme of amalgamation provides otherwise, all the employees of the transferor company will be discharged. As a matter of practice schemes of amalgamation provide that all the employees of the transferor company shall be taken

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over by the transferee company on such terms and conditions of employment. However, it may so happen that the financial position of the transferee company may be so bad so as to jeopardize the chances of the employment of the transferor company. One would have ordinarily felt that in such a situation such employees have a right to challenge the amalgamation. However, in the case of Alembic Chemicals Co. Ltd. (supra) the Gujarat High Court has taken a view that the employees of the transferor company have no *locus standi*.

**Vesting of Tenancy Rights**

- On amalgamation the assets of the transferor company statutorily vest in the transferee company. Though vesting takes place under statutory provisions it is still regarded as transfer. Under the circumstances where the transferor company is a tenant, amalgamation would result into transfer of the tenancy rights as held by the Supreme Court in the case of General Light Appliances Co. Ltd. vs. M.A. Kadar – 60 CC 1013, exposing the amalgamated company to the litigation for vacating the said premises if the landlord does not agree to the said transfer.

**Appointed Date vs. Effective Date**

- A typical scheme of amalgamation provides for two dates, viz., ‘Appointed Date’ and the ‘Effective Date’. The Effective Date would be the date on which the scheme is sanctioned by the High Court and all legal formalities are completed. However, ordinarily, scheme comes

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into effect from a retrospective date which is ‘Appointed Date’. In view of this, many a times questions arise as to how one should recognise the transactions that have been taken place between these two dates. In the case of Marshall and Sons Company (India) Ltd. vs. ITO (88 Company Cases 528) the Supreme Court has clarified that once the scheme is sanctioned by the Court it comes into effect retrospectively from the Appointed Date. In view of this, interesting questions under the Income-tax Act, the Sales-tax Act, Excise Duty laws etc. are likely to arise.

**Colourable Device**

- A Scheme of Amalgamation framed solely with an object of buying over an asset so as to defeat the provisions of the tax laws would not be sanctioned. “The amalgamation of companies must fulfill some need, some purpose, some object and that must have some relation to public interest. If only purpose discernible behind amalgamation is to defeat certain taxes and if for that purpose assistance is sought for from the Court, the Court would be the last instrument to grant such assistance by way of a judicial process to defeat the tax liability or even to avoid the tax liability.” These were the observations of the Gujarat High Court in the case of Wood Polymers Limited – 47 Company cases 597 where a scheme moved for transferring only a specified asset of a company so as to avoid payment of stamp duty was not sanctioned by the High Court. It may be noted that the said judgment has since been approved by the Supreme Court in its celebrated judgment in the case of McDowell and Co. Ltd. (154 ITR 148). It may,
however, be noted that now the order passed by the High Court sanctioning a scheme of amalgamation is also to be treated as an ‘Instrument’ under the Bombay Stamp Act and, therefore, stamp duty at appropriate rate is required to be paid. In view of this, the law laid down by this judgment may not have any application.

**Legal Issues under the Direct Tax**

- **Amalgamation can have tax implications in the hands of the:**

  A. Transferor Company
  
  B. Transferee Company
  
  C. Shareholders of the Transferor Company
  
  D. Shareholders of the Transferee Company

A. **Transferor Company**

- On amalgamation, the transferor company shall be dissolved without winding up.

- Treatment of the following claims of the transferor company:
  
  - Carried forward unabsorbed losses
  
  - Carried forward unabsorbed depreciation

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– Investment allowances including carried forward unabsorbed investment allowance.

• Unabsorbed Depreciation and Carried forward losses - S. 72A r.w. Rule 9C of the IT Rules.
  – Fresh lease of life for Losses
  – Reverse Merger – Bihari Mills Ltd. (56 Company Cases 6)
  – Effect of S.79 of the IT Act.

• Investment Allowance – Section 32A(6) of the Act.

B. Transferee Company

• Actual cost of the Assets of Transferor Company – Explanation (7) to sub-section (1) of Section 43 of the Act.

• Fourth proviso to Section 32(i) of the Act – Proportionate depreciation in the year of Amalgamation.

• Under the provisions of S. 79 for the purpose of carrying forward and setting off unabsorbed business losses it is necessary that not less than 51% of the shareholders holding share on the last day of the previous year in which losses were incurred continue to hold not less than 51% of the shares on the last day of the year in which loss in sought to be set off.

• Exception to Section 79 of the Act:
• Company in which public are substantially interested.

• Do not apply to carried forward unabsorbed depreciation which would be available even if there is a complete change in the shareholding pattern – CIT v. Kalpaka Enterprise Pvt. Ltd. 157 ITR 658 (Ker), CIT v. Subhalaxmi Mills Ltd. 148 ITR 863 (Guj), CIT v. Concord Industries 119 ITR 458 (Mad).

• Treatment of expenditure / losses, bad debts etc. of the transferor company – CIT vs. Veer Bhadrarao Koteswararao and Company (158 ITR 152)

• Effect of S. 43C (cost of acquisition in the hands of the amalgamating company)

• Tax / TDS compliances during intervening period.

• Credit for advance-tax paid by the transferor company.

• Filing of Appeal by the amalgamating company.

• Impact on reassessment.

C. Shareholders of the transferor company

• On amalgamation, shareholders of the transferor company would receive, against their investment in the shares of the transferor company, shares and/or debentures and/or cash from the transferee company.

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• Section 47(vii) r.w.s. Section 49(2) r.w.s. Explanation (i)(c) of Section 2(42A) of the Act clarify that amalgamation is a tax neutral event.

• Some issues:
  
    • Whether amalgamation is at all a transfer so as to render a shareholder of the transferor company liable to pay capital gains tax on the transaction? – CIT vs. Rasiklal Maneklal (177 ITR 198)(SC), Vania Silk Mills Pvt. Ltd. vs. CIT (191 ITR 647)(SC), CIT vs. R. M. Amin (106 ITR 368)(SC), CIT vs. Master Raghuvir Trust (151 ITR 368)(Karnataka).

    • If shareholders of the transferor company get debenture and/or cash of the transferee company, exemption under Section 47(vii) of the Act would be available to the assessee? – CIT vs. Gautam Sarabhai (173 ITR 216) (Guj.)

    • What would be the position if the shares are held by the shareholders of the transferor company not as a capital asset or investment, but as a stock in trade? (91 ITR 8 (SC))

D. Shareholders of the transferee company

• No Impact
• **Taxability in the hands of Shareholders in case of De-merger or halving off a division from an existing company:**

  – The transfer of shares by the shareholders of the transferor company in lieu of shares of the transferee company on demerger is not regarded as transfer and hence gains arising from the same are not chargeable to tax in the hands of the shareholders of the transferee company. [Section 47(vid)]

  – Distribution of shares of the transferee company to the shareholders of the transferor company on de-merger will not be treated as deemed dividend [Clause (v) of section 2(22)].

  – In case of de-merger, cost of acquisition of shares of the transferee/resulting company will be the amount which bears to the cost of acquisition of shares of the transferor/de-merged company, the same proportion as the net book value of assets transferred bears to the net worth of the de-merged company immediately before de-merger [Section 49(2C)]:

    – Wherein Net worth is equal to Paid-up Share Capital + General Reserve as per books of the de-merged company immediately before de-merger.

    – The cost of acquisition of shares of the de-merged company will be the original cost of shares of de-merged company after reducing the cost of shares of the resulting company as computed above. [Section 49(2D)].

*Tushar P. Hemani, Advocate*
PART III

Other Ancillary Issues

Stamp Duty

- **Overview:** Whether it would be necessary to pay any stamp duty if the transfer has taken place under the Scheme of Amalgamation would depend upon the provisions of the Stamp Act. As the law on stamp duty is different in each State it will be difficult to answer the question which would hold good in that situation. Suffice it to say, in Gujarat and in Maharashtra on account of legislative amendment stamp duty is payable on the value of the assets transferred under the Scheme of Amalgamation. However, this rate is far lower than the normal rate of stamp duty payable on conveyance of fixed assets. Under the circumstances, even after payment of such stamp duty, in a given case, amalgamation may be advisable. That apart, stamp duty is required to be paid on the value of share issued by the transeree company to the shareholders of the transferor company. Therefore, if before the scheme is sanctioned, all the shares of the transferor company are taken over by the transeree company so as to make it a wholly owned subsidiary of the latter, no shares may have to be issued on the scheme being sanctioned. Thereupon, the stamp duty may not have to be paid at all.

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• Levy on “execution of an instrument” and not the transaction; the instrument must be specified in the Schedule to Stamp Act. High Court order effecting merger treated as conveyance liable to stamp duty depending upon the following factors:

  • State in which order effecting merger is passed

  • Location of immovable property of the Transferor Co.

  • It is to be levied in the state in which the property is situated or in which the instrument is executed or taken for some reasons

• Levy could be different for each of the modes of transaction

  • Amalgamation / slump sale / itemized sale

• Rate of Stamp duty in Gujarat

  • Article 20(d) of the Gujarat Stamp Act, 1958 levies duty on High Court order;

    ▶ 1% of the market value or face value whichever is higher, of shares issued and consideration paid not exceeding; OR

    ▶ 1% of the value of immovable property located in Gujarat;

    whichever is higher (subject to maximum Rs.25.00 Crs.)
• **Issues under Other Indirect Taxes**

- Registration – Import Export Code (IEC Code) / Registration Cum Membership Certificate (RCMC)
- Endorsement of new units acquired
- Export obligation of Transferor Company to be fulfilled by Transferee Company
- Import License are to be endorsed in the name of Transferee Company
- Liability of successor: No explicit provision under the Customs Act, 1962 and Central Excise Act, 1944.
- Registration / De-registration – Rule 9 of Central Excise Rules, 2002 (Fresh registration for Transferee Company + Surrender of registration of Transferor Company)
- PLA Balance – Transferor Company to get refund
- Cenvat credit balance – Ref. to Rule 10 of the CENVAT Credit Rules, 2004 (“Credit Rules”)
- Transaction between the two Companies during interim period
- VAT / Sales tax not payable – Appointed Date relevant for tax purposes – [Marshall Sons & Co (India) Limited vs. Income tax Officer (223 ITR 809 – SC) & Castrol India Limited vs. State of Tamil Nadu (114 STC 468 – Chennai)]
- VAT / Sales tax paid on purchases – ITC Set-off available if goods held in stock transferred.

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Tushar P. Hemani, Advocate