

Katalyst Kaleidoscope

October 2017: Tax and Regulatory Highlights

A. Income-tax Highlights

1. **Company cannot be a part of 'family arrangement':** The Bombay HC, in the case of B.M. Mohata Textiles, has held that a company, being a separate legal entity, cannot be a part of family arrangement and any transfer of shares by a company pursuant to a 'family arrangement' would be subject to capital gains tax. Ordinarily, any transfer of property by an individual to another individual (both forming a part of the same family, larger or otherwise) would not be subject to capital gains tax, if such property is transferred pursuant to a bona fide 'family arrangement' since such transaction would not be considered as 'transfer'.
2. **No deemed dividend implications on the loan recipient, if such recipient is not a 'registered shareholder':** The Supreme Court, in the case of Madhur Housing and Development Co, deciding upon a batch of 135 appeals, has held that there would not be any deemed dividend implications in the hands of a concern, being a recipient of a loan ("Borrower"), from another concern ("Lender"), where the shareholder holds more than 10% beneficial stake in the Lender and more than 20% beneficial interest in the Borrower. Dividend u/s 2(22)(e) of the Income-tax Act, 1961 can only be deemed in the hands of a 'registered shareholder' and the legal fiction does not broaden the concept of a 'registered shareholder'. Therefore, there could not be any implications in the hands of a mere recipient of loan who is not a registered shareholder of the Lender on the presumption that the loans or advances would ultimately be made available to the shareholders of the company giving the loan or advance.
3. **Clarification on PoEM Guidelines for regional headquarters:** CBDT has recently clarified¹ that in case of regional headquarters ("RHQs") of multinational companies providing services to its subsidiaries within the general and objectives principles of global policy laid down by the parent entity and not being specific to a particular entity, it would not be a basis to re-domicile the residence of such subsidiaries in India by virtue of applicability of Place of Effective Management provisions; however, CBDT has also clarified that such an arrangement would nonetheless be subject to General Anti-Avoidance Regulations.

B. Corporate Law Highlights

1. **MCA notifies² restrictions on layers of subsidiaries:** No company would be now permitted to have more than 2 layers of subsidiaries (except banking companies, NBFCs, insurance companies and government companies). While computing "layers" of subsidiaries, wholly owned subsidiaries are to be excluded. The MCA has provided for grandfathering of existing subsidiaries with a restriction on creating any additional layer of subsidiaries.
2. **No stamp duty on NCLT-sanctioned share capital reduction:** NCLT (Mumbai Bench) sanctioned reduction of share capital u/s 66 of Companies Act, 2013 by Thomson Reuters International Services Pvt. Ltd., without any consequential stamp duty implications, since the Maharashtra Stamp Act, 1958 did not attract levy of stamp duty in absence of specific levy on the same.

¹ CBDT Circular 25 of 2017 dated 23rd October 2017

² Companies (Restriction on number of layers) Rules, 2017 notified on 20th September 2017

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3. **NCLT dispenses meetings of shareholders & creditors meetings of companies involved in a Scheme of Arrangement³:** The NCLT (Principal Bench, Delhi) noted that the Board of Directors have unanimously granted their approval and none of the companies are undergoing investigation proceedings under Companies Act/ any other law. NCLT (Mumbai Bench), however, is averse to dispensing the meeting of equity shareholders.

C. Securities' Law Highlights

1. **Supreme Court denies continuity of "disclosed promoter" status under the Takeover Code pursuant to a demerger:** The SC, in the case of Laurel Energetics Pvt. Ltd., has observed that to avail exemption from open offer obligations in case of inter-se transfer of shares of a listed company under the Takeover Code, the concerned promoters have to be disclosed as such for a period of 3 years; therefore, in case of a demerger into a new resulting company, even though the promoters were disclosed as such in the demerged company, such previous disclosure period would not be considered for the purposes of computing 3 years in the new resulting company.
2. **Open offer triggered pursuant to indirect merger of foreign holding company, if not approved by any Court/ Regulatory Body:** SEBI, in the case of Xchanging Technology Services Private Limited, has issued an Interpretative Letter observing that in case of merger of foreign indirect holding company ("FCo1") of an Indian listed company with another foreign holding company ("FCo2") resulting in change of ownership/ control of FCo1 would trigger open offer obligation under the Takeover Code (which ordinarily is not required if the merger is pursuant to a Scheme) even if due process for merger has been followed as per the foreign laws which, unlike Indian law, do not mandate a Court/ regulatory body approval.

D. Recent Schemes of Arrangement

1. **Listing of business division through demerger:** Recently, various listed companies have entered in Schemes of Arrangement u/s 230-232 of the Companies Act, 2013 to spin-off one of their businesses into a new company by way of tax-neutral demerger by virtue of which the new company would automatically be listed on the bourses. This route is adopted by listed companies which seek value unlocking of a particular business for their shareholders without having to tread the laborious route of a traditional IPO. Few recent examples of demerger of business division from listed company into a new company followed by listing of the new company include:
 - a. Demerger manufacturing business of Tube Investments
 - b. Demerger of power generation and distribution, retail, and other businesses of CESC
 - c. Demerger of renewable energy business of Adani Enterprises
 - d. Demerger of API manufacturing businesses of Strides Shasun and Sequent Laboratories
 - e. Demerger of cotton textile business of DCM

³ Scheme of Arrangement between Mohair Investment and Trading Company Pvt. Ltd. Pier114 Imports Pvt. Ltd., Liquid Investments and Trading Company Pvt. Ltd. and Max Venture Investment Holding Pvt. Ltd.

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2. **Folding up of holding companies:** Recently, various listed companies have entered in Schemes of Arrangement u/s 230-232 of the Companies Act, 2013 to merge their holding companies into the listed companies itself which would result in the individual promoters (being the shareholders of the holding company) directly holding shares of the listing company in a tax-neutral manner. The key tax advantages include mitigation of: i) additional charge of dividend distribution tax or buy-back tax distribution of surplus profits from the holding company to its shareholders in the form of dividend or buy-back of shares; and ii) minimum alternate tax on long-term capital gains tax on sale of shares of listed companies on the floor of the stock exchange which is otherwise exempt from tax. From a regulatory angle, key advantages include: i) mitigation of possible exposure to NBFC/ CIC regulations; ii) mitigation of various onerous compliances/ restrictions (such as inter-corporate investments, related party transactions, etc.) under Companies Act, 2013; and iii) flexibility in inter-se family transfer of shares of listed company. Few listed companies which have folded their holding companies into itself are DCM, Apcotex, Ajanta Pharma, Igarashi Motors India and Kirloskar Pneumatic Company.

E. Other Highlights

1. **Rollout of the Consolidated Foreign Direct Investment Policy, 2017⁴:** The consolidated FDI policy, 2017 has been rolled out with a plethora of welcome changes. Key changes are highlighted as under:
 - a. Conversion of FDI-funded LLPs into companies and vice-versa permitted;
 - b. Liberalisation in key sectors such as pharmaceuticals, single-brand retailing, e-commerce, defence, etc.
 - c. General permission for FDI in entities engaged in any regulated financial services sector;
 - d. Issuance of convertible notes to foreign investors by startups permitted;
 - e. Permission to defer purchase consideration (upto 25% and for a period of 18 months) involving share transfers.
2. **Carrying amounts recorded in the consolidated books to continue post-merger of a subsidiary with its holding company:** IndAS Transition Facilitation Group, in Clarification Bulletin 9, has clarified that upon merger of a subsidiary with its holding company, the amounts of assets/ liabilities adopted in the consolidated books of the holding company should continue post-merger of a subsidiary with the holding company itself, being a common control business combination, as opposed to the carrying amounts appearing in the standalone books of the subsidiary.

Do feel free to reach out to us for a detailed discussion on ketan.dalal@katalystadvisors.in

⁴ Consolidated FDI Policy Circular of 2017 dated 28th August 2017