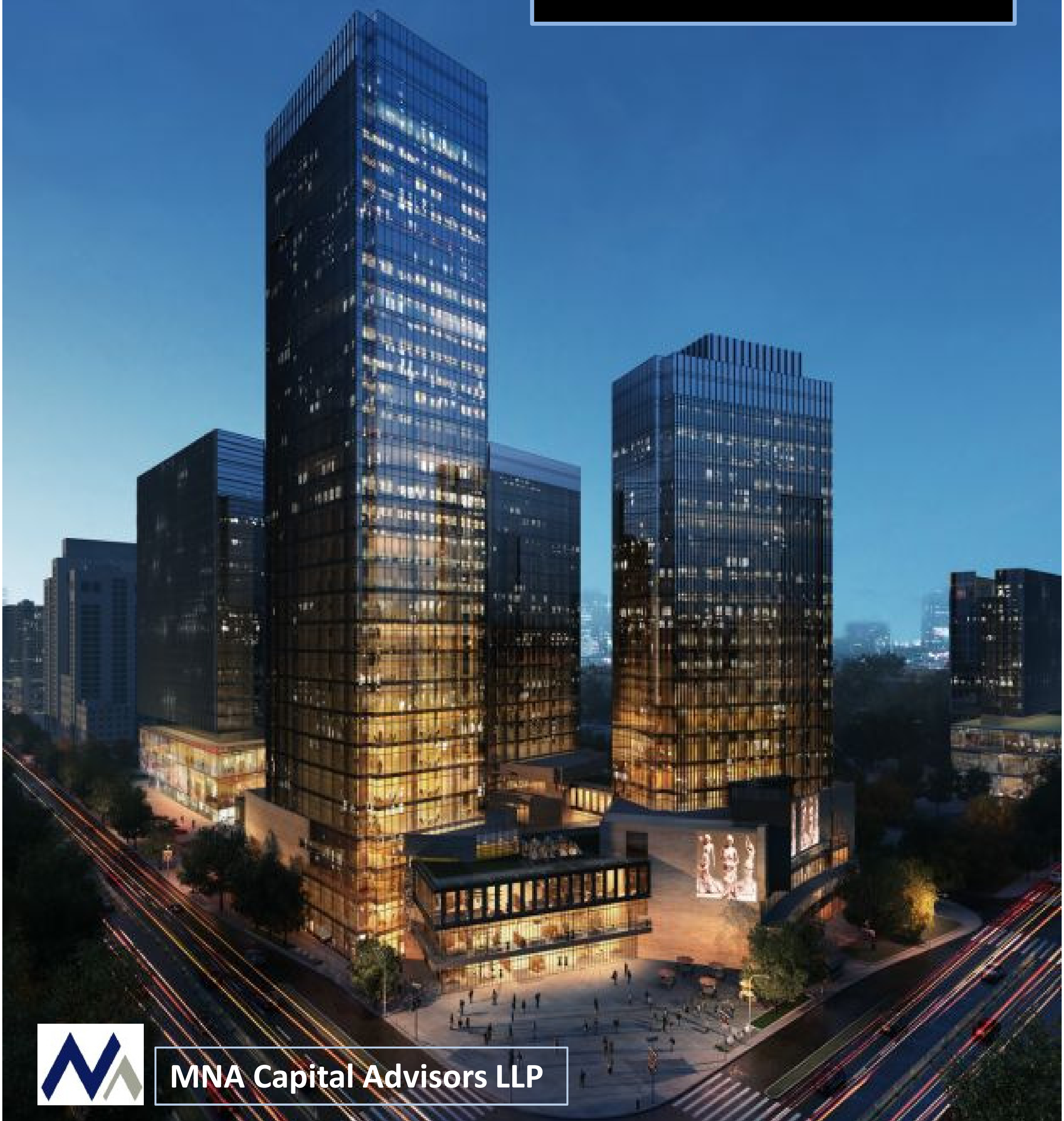
For internal circulation only

MNA TIMES

FEBRUARY 2018



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PREFACE

We are delighted to present our first edition of MNA Times.

M&A (including bankruptcy code) is becoming an important tool for the growth (and quite often, survival) of an organisation. Since our firm is focused on M&A, we have been requested by clients and professional colleagues to share updates in this space – This compilation is an attempt towards this objective. May we highlight here that this internal circulation is primarily a compilation of useful articles and updates and the views and credits to the articles are strictly of the respective authors / firms.

In this maiden issue, we have covered the following:

- **Deals reported in January 2018**–This month has seen limited deals - the merger of IDFC Bank and Capital First stands out. We have provided a list of deals along with certain reported parameters.
- **Budget 2018 and Tax**– We believe that this budget was a political document albeit consolidating the Modi Government's position on sensible reforms and fiscal prudence. What remains to be seen as always is the execution, especially in the volatile markets. Since enough has been written about the budget proposals, we are highlighting only the tax announcements related to M&A.
- **Bankruptcy Code** – We have covered two articles – One, relating to barring defaulting promoters for participating in the process [**#** Essar Steel Case]; and second, relating to "ease of closing business in India" through a liquidation process under the Bankruptcy Code. We are currently engaged on two assignments for MNCs and have found the process relatively smooth.
- **Companies Act –** We have included the summary of the proposed amendments to this Act via the Companies Amendment Bill of 2018. We have also included a notification of September 2017 relating to restriction on number of layers of the subsidiaries. This, we believe, is an important feature of the Companies Act 2013 and corporate houses may require restructuring on this account.
- **FDI Policy** – FDI regime in India has been consistently liberalising. We have included an article on the key changes proposed in the FDI policy 2018, notably highlighting liberalisation of 'single brand retail' and issuance of shares to a non-resident for consideration other than cash.
- **Succession Planning** – SEBI has come out with clear guidelines on how the promoter's ownership in a listed company can be transferred to a family trust without invoking the process of open offer. This is a welcome clarification as the process has taken significant time and caused hardship in the past.

We hope you will enjoy reading this issue. We will be delighted to have your feedback and discuss on any of the topics listed.

- Team MNA

INDEX

- Deals reported in January 2018
- Announcements in Budget 2018 related to M&A
- Liberalization of the FDI Policy
- Key Takeaways from Companies (Amendments) Bill, 2017
- New rules for corporate control limit on layers of subsidiaries
- Voluntary Liquidation made easy under IBC
- Defaulting promoters barred from being resolution applicants
- Deemed dividend is not taxable in the hands of loan recipient concern – Supreme Court Ruling
- SEBI Guidelines on transfer of equity shares to a trust

DEALS REPORTED IN JANUARY 2018

Source : Vccedge

Date	Target	Buyer	Deal Value ($ mn)	Industry	Sector	Deal Features	Percentage Sought (%)	Change in Control	EqV / Book Value	EV / Total Income	EV / EBITDA	EV / Profit After Tax	Sources
1-Jan-18	Prestige Retail Ventures Ltd., Various Malls	Prestige Retail Ventures Ltd.	53.57	Real Estate	Financials	Minority Shareholder Increasing, Domestic		No					BSE (http://www.bseindia.com/xml-data/corpfiling/AttachHis/de12ade7-a0f2-4264-9515-e4973886c206.pdf), Economic Times (https://retail.economictimes.indiatimes.com/news/food-entertainment/entertainment/prestige-to-acquire-capitalands-mall-biz-stake-for-rs-342-cr/62332251)
10-Jan-18	Aerserv LLC	InMobi Technologies Pvt. Ltd.	90	Media & Entertainment	Consumer Discretionary	Outbound	100	Yes					Economic Times (https://economictimes.indiatimes.com/small-biz/startups/newsbuzz/inmobi-acquires-la-based-startup-aerserv-for-90-million/articleshow/62446755.cms)
11-Jan-18	Union Cement Company P.S.C.	Shree Cement Ltd.	283.35	Manufacturing	Materials	Outbound	92.83	Yes					VCCircle (https://www.vccircle.com/shree-cement-to-acquire-majority-stake-in-uaes-union-cement/), BSE (http://www.bseindia.com/xml-data/corpfiling/AttachHis/19e59004-dce9-41f3-b863-3c7f265b4d10.pdf)
11-Jan-18	Vatika Hotels Pvt. Ltd.		47.17	Hotels & Resorts	Consumer Discretionary	Buyback		No					Business Standard (http://www.business-standard.com/article/markets/vatika-hotels-buys-back-shares-from-goldman-for-rs-3-bn-plans-ipo-in-q3-118011100811_1.html)
13-Jan-18	Capital First Ltd.	IDFC Bank Ltd.	1,460.00	BFSI	Financials	Stock Merger, Domestic	100	Yes	4.16	6.93	12.79	87.1	Times Of India (https://timesofindia.indiatimes.com/business/india-business/idfc-bank-agrees-to-acquire-warburg-backed-lender-capital-first/articleshow/62485959.cms)
20-Jan-18	Hindustan Petroleum Corporation Ltd.	Oil and Natural Gas Corporation Ltd.	5,778.41	Oil & Gas	Energy	Domestic	51.11	Yes	3.54	0.47	7.37	14.36	Economic Times (https://energy.economictimes.indiatimes.com/news/oil-and-gas/ongc-completes-rs-36915-crore-hpcl-acquisition-becomes-first-integrated-oil-major/62725587)
22-Jan-18	Sterlite Power Grid Ventures Ltd.	Sterlite Power Transmission Ltd.	158	Energy	Utilities	Majority Shareholder Increasing Shareholding, Domestic	28.4	No					Economic Times (https://economictimes.indiatimes.com/industry/energy/power/sterlite-power-acquires-stanchart-stake-for-rs-1010-crore/articleshow/62695443.cms),
24-Jan-18	MX Player	Times Internet Ltd.	200	Technology	Information Technology	Outbound		Yes					techstory (http://techstory.in/times-internet-mx-player-2018/), Inc42 (https://inc42.com/buzz/times-internet-mx-player-ott/)
29-Jan-18	KPIT Technologies Ltd.	National Engineering Industries Ltd., Birlasoft India Ltd.	107.21	IT/ITES/BPO/KPO	Information Technology	Tender Offer/ Open Offer, Domestic	15.71	No	3.16	3.37	16.17	26.55	BSE (http://www.bseindia.com/xml-data/corpfiling/Attachhis/B20F25B2_A552_4F9B_A7E7_D491A9A28336_081349.pdf) ,

CAPITAL FIRST

Merger synergies vital

India Equity Research | Banking and Financial Services

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Ideas create, values protect

Key takeaways

Merger: (1) Applications have already been made to RBI and approvals are awaited. All subsidiaries like housing finance have been merged into the parent company to avoid any regulatory delays; 2) priority will be to build CASA and grow retail faster than wholesale; 3) looking to expand branches of the merged entity to 400-500 in the next three-five years; 4) post merger, Mr. Vaidyanathan's stake will dip from 4.5% (direct) + 7% (options) to 1.5-1.7% (direct) + 3.6 - 3.7% (options). While Warburg will have to lower its stake from 10.3% to 10.0%, IDFC will have to increase its stake from 37% to 40%; 5) over the next three-five years, the company (merged entity) aims to achieve 15-20% overall growth with retail growing at 25-30%, looking to decrease the book composition from 65:35 corporate to retail to 40:60; 6) merger should typically take six-seven months in best case scenario, while six-nine months in worse case; 7) combined entity will have RoE of 8-9%, then dip following branch expansion and inch up gradually.

Other highlights: 1) 45% borrowings are bank borrowings and balance bonds. CP is still an area which is open and could look at those for the short-term CD and 2W loans where spreads are around 17-18%. Also, since the merger is not very far, looking for only 12-24 months of borrowing rather than higher cost three-five years; 2) no plans of capital raising as of now; 3) incremental borrowing will largely be through market borrowing, thus on portfolio basis the mix will shift away from bank borrowing.

Investment conclusion

CAFL's earnings are poised to post ~40% CAGR over FY16-19E riding healthy AUM CAGR, prudent product shift strategy, operating leverage benefits, controlled credit cost and higher cross-sell opportunities. We anticipate optimal product strategy anchored by stringent risk mitigants to fuel smart J-shaped surge in return ratios—RoA/RoE of 1.9%/18-19% by FY19E. Though valuations appear expensive considering historical RoE, given the sustainable growth phase and sharp RoE recovery, we expect it to re-rate further as earnings and visibility improve. We maintain **'BUY/SO'.**

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	**Outperformer**
Risk Rating Relative to Sector	**Medium**
Sector Relative to Market	**Overweight**

MARKET DATA *(R : CAPF.BO, B: CAFL IN)*

CMP	:	INR 677
Target Price	:	INR 1,033
52-week range (INR)	:	902 / 585
Share in issue (mn)	:	98.9
M cap (INR bn/USD mn)	:	67 / 1,044
Avg. Daily Vol. BSE/NSE ('000)	:	866.0

Share Holding Pattern (%)

	Current	Q1FY18	Q4FY17
Promoters *	35.6	36.0	61.1
MF's, FI's & BK's	12.4	10.9	6.2
FII's	24.0	25.7	8.4
Others	28.0	27.4	24.3

** Promoters pledged shares (% of share in issue) : Nil*

PRICE Performance (%)

	Stock	Nifty	EW BFSI Index
1 month	(9.0)	(0.6)	0.9
3 month	(9.9)	0.4	0.7
12 month	(4.3)	19.3	25.0

Financials (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Net revenue	15,989	21,315	26,310	32,141
Net profit	2,169	3,095	4,221	5,390
Diluted EPS (INR)	22.3	31.8	43.3	55.3
Adj book value (INR)	226.4	244.8	279.7	337.0
P/ABV (x)	3.0	2.8	2.4	2.0
RoAE (%)	11.1	13.1	15.8	17.6

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February 7, 2018

ANNOUNCEMENTS IN BUDGET 2018 RELATED TO M&A

Source : BDO India Publication

Corporate Tax

The rates of income-tax for the fiscal year 2018-19 are proposed as under:

Sr. No.	Particulars	Basic Tax Rate		Surcharge		
		Turnover for fiscal year 2016-17 <= INR 2,500 Mn	Turnover for fiscal year 2016-17 > INR 2,500 Mn	Total Income up to INR 10 Mn	Total Income above INR 10 Mn upto INR 100 Mn	Total Income above INR 100 Mn
1.	Domestic Company					
	– Normal Tax Rate	25%	30%	Nil	7%	12%
	– Minimum Alternative Tax	18.5%	18.5%	Nil	7%	12%
2.	Foreign Company					
	– Normal Tax Rate	40%	40%	Nil	2%	5%

The levy of Education cess and Secondary and Higher education cess @ 2% and 1% respectively, is proposed to be discontinued. A new cess by the name of “Health and Education Cess” is proposed to be introduced and levied @ 4%. Such new cess shall be levied on the amount of tax computed inclusive of surcharge (wherever applicable) in all cases.

Marginal relief will continue to be allowed in cases where taxable income is more than INR 10 Mn or INR 100 Mn.

Dividend Distribution Tax

Case	Basic Rate
Deemed Dividend u/s 2(22)(e)	30%
Other Dividends	17.65% (Grossed up)

A surcharge @ 12% shall be levied on the amount of DDT.

The levy of Education cess and Secondary and Higher education cess @ 2% and 1% respectively, is proposed to be discontinued. A new cess by the name of “Health and Education Cess” is proposed to be introduced and levied @ 4%. Such new cess shall be levied on the amount of tax computed inclusive of surcharge.

The above amendments shall take effect from fiscal year 2018-19.

Amendments in Respect to Companies under IBC, 2016

Set off and carry forward of losses

Section 79 of the IT Act provides carry forward and set off of losses in a closely held company shall not be allowed in cases where there is a change in beneficial ownership of the shares carrying not less than 51% of voting power, as compared to the year of such losses.

Restructuring of companies seeking resolution under IBC, 2016, may involve change in beneficial ownership beyond 51%. This would result in lapse of brought forward losses, which in turn could discourage the restructuring.

The Finance Bill proposes to relax the conditions of section 79 of the IT Act, in cases of companies whose resolution plan has been approved by the NCLT under the IBC, 2016, after giving an opportunity of hearing to the jurisdictional Principal Commissioner/ Commissioner.

The amendment is proposed to be effective from fiscal year 2017-18.

} **Relaxation of MAT provisions**

As per the provisions of section 115JB of the IT Act, while computing MAT on companies book profits are to be reduced by lower of brought forward losses or unabsorbed depreciation as per the books of account. In a case where either the brought forward loss or unabsorbed depreciation is nil, no reduction is allowed for the balance brought forward loss or unabsorbed depreciation while computing book profits.

In order to reduce the roadblocks faced by the companies seeking resolution under IBC, 2016, the Finance Bill proposes to allow reduction of the aggregate amount of

unabsorbed depreciation and loss brought forward from the book profits while computing MAT.

The above proposal is in line with the CBDT press release dated January 6, 2018.

The above amendment is proposed to be made effective from fiscal year 2017-18.

} **Return of income can be signed by Insolvency Professional**

With respect to companies whose application for resolution process has been admitted by the NCLT under IBC, 2016, the tax return is required to be signed by the Insolvency Professional appointed by the Adjudicating Authority.

Long Term Capital Gains on Sale of Listed Securities

Currently, section 10(38) of the IT Act provides exemption from long-term capital gains to transaction of sale of equity share in a company or a unit of an equity oriented fund or a unit of a business trust, where STT is paid on such transactions.

Taking into consideration the optimism and attractive returns in financial assets and to balance the flow of investments towards manufacturing sector, the finance minister has proposed to re-introduce long term capital gains tax on listed securities.

Accordingly, a new proviso has been inserted in section 10(38) of the IT Act to limit the exemption to March 31, 2018. Further, in order to bring the new taxation regime in place, section 112A has been introduced to the IT Act.

Section 112A of the IT Act lays down the mechanism for determination of the long-term capital gains tax payable on the sale of an equity share in a company or a unit of an equity oriented fund or a unit of a business trust (i.e. REIT and InvIT).

Accordingly, a taxpayer shall be liable to pay long-term capital gains tax @ 10%, on gains exceeding INR 100,000. Resident individuals and HUFs having income below the basic exemption limits can reduce their tax liability arising under section 112A of IT Act to the tune of balance basic exemption limit available to them.

The provisions of the section 112A shall not apply to the transfer undertaken on a recognised stock exchange located in any IFSC and where the consideration for such transfer is received or receivable in foreign currency.

Capital gain under this section shall be computed without giving effect to indexation and foreign exchange fluctuation.

Where the long term capital asset (listed securities as covered hereinabove) is acquired by the taxpayer before the February 1, 2018, cost of acquisition shall be deemed to be the higher of:

(i) the actual cost of acquisition of such asset; and

(ii) the lower of—

- the fair market value of such asset (which refers to the highest price on stock exchange for quoted shares as on January 31, 2018 and in case of units which are not listed, net asset value as on January 31, 2018); and
- the full value of consideration received or accruing as a result of the transfer of the capital asset

The benefit of deductions under Chapter VI-A and rebate under section 87A of the IT Act, shall not be allowed from such capital gains.

The introduction of long term capital gains tax coupled with the grandfathering provisions which protect the capital gains earned upto January 31, 2018 is a well balanced approach to bring tax on listed securities market without causing an immediate impact on the stock exchange. It is important to note that tax arbitrage remains possible for tax payers who have a substantial amount of gain arising between January 31, 2018 to March 31, 2018.

The amendment is proposed to be effective from fiscal year 2018-19.

Amendments in Relation to Start-Ups

In a further impetus to start-up entities, the Finance bill has proposed to amend the definition of eligible businesses under Section 80-IAC of the IT Act:

- to include calable business model with a high potential of employment generation or wealth creation; and
- Do away with the requirement of start-ups driven by technology or intellectual property.

Further, the following amendments are proposed to be inserted. The same is tabulated below:

Benefit/ Condition	Existing provision	Proposed provision	Remarks
Profit deduction	Available to businesses incorporated till March 31, 2019	Proposed to be extended for businesses incorporated till March 31, 2021	The amendment is favourable
Maintainability of turnover of less than INR 250 Mn	Applicable till fiscal year ended March 31, 2021	Applicable for 7 years from the date of incorporation	The amendment casts onerous condition. Further there is ambiguity on whether the deduction shall be withdrawn even for earlier years, if this condition is breached.

The proposed amendments shall take effect from fiscal year 2017-18.

DDT on Deemed Dividends

Presently, dividend distributed by a domestic company is subject to DDT. However, dividend under section 2(22)(e) of IT Act (commonly referred as 'deemed dividend') is taxed in the hands of the shareholder and thus not subject to DDT. Such dividends trigger a withholding tax obligation for the company.

Considering the complexities involved in tracking the shareholders and collecting taxes, the Finance Bill proposes to extend the DDT regime on deemed dividend as well. Explanation to section 115Q of IT Act has been deleted so as to include deemed dividend within the ambit of 'dividend' for the purposes of computing DDT. Additionally, rate of DDT on such deemed dividends is proposed at 30%. However, unlike DDT on other dividends, the rate of 30% is not subject to grossing up.

As a result of the above amendment, such deemed dividends would now be exempt in the hands of the recipient under section 10(34) of the IT Act.

The above amendment is proposed to be made effective from fiscal year 2018-19.

LIBERALIZATION OF THE FDI POLICY

Source : Khaitan & Co

KHAITAN &CO
Advocates since 1911

NEWSFLASH

ERGO

Analysing developments impacting business

NEW YEAR BEGINS WITH FURTHER LIBERALISATION OF THE FDI POLICY

25 January 2018

Background

The Department of Industrial Policy & Promotion (DIPP), on 23 January 2018, by way of Press Note No. 1 (2018 Series) (PN 1), notified certain amendments to the Consolidated Foreign Direct Investment Policy dated 28 August 2017 (FDI Policy).

These changes have been made with the intention of liberalising and simplifying the FDI Policy to promote ease of doing business in India. This newsflash highlights the major changes introduced in the FDI Policy.

Details of the proposed changes

- Single Brand Retail Trading (SBRT)

  - FDI, in excess of 49% of the paid-up capital of a company engaged in SBRT, required the approval of the DIPP. This has now been done away with and 100% FDI is allowed through the automatic route in the SBRT sector.

    Comment

    The government had been contemplating allowing 100% FDI in the SBRT sector under the automatic route for a while. The proposed amendment comes at a time when companies are actively lobbying for easier regulatory approvals in relation to the SBRT sector, and is in line with the gradual steps being taken by the government to liberalise the sector and cut delays in the flow of such investments.

    This amendment will make it easier for foreign brand owners to incorporate wholly owned subsidiaries in India to undertake SBRT, without tying up with any local Indian partner. This will also enable them to exercise greater control over their business in India.

  - Under the FDI Policy, companies that are engaged in SBRT and have foreign investment in excess of 51% (Majority SBRT Entities) are required to source 30% of the value of goods purchased from India (Local Sourcing Norms).

The Local Sourcing Norms have been tweaked and now, companies engaged in SBRT are permitted to set off their 'incremental sourcing' of goods from India, for global operations during the initial 5 years, beginning 1 April of the year of the opening of first store.

After completion of this 5-year period, the SBRT entity shall be required to meet the 30% sourcing norms directly towards its Indian operations, on an annual basis.

Comment

The Local Sourcing Norms that were applicable to entities undertaking SBRT in India required Majority SBRT Entities to source at least 30% of the value of the purchased goods from India. The Local Sourcing Norms had to be met; initially as an average of 5 years' total value of the goods purchased by the company, beginning 1 April of the year during which the first tranche of FDI was received, and thereafter on an annual basis.

The revised Local Sourcing Norms will permit Majority SBRT Entities to off-set additional global sourcing (above current levels) to satisfy the Local Sourcing Norms.

This is a welcome step, especially for the apparel industry as several brands presently source products from India for their global operations. If such brands increase their sourcing for global operations from India, such increased sourcing can be offset against the requirements of the Local Sourcing Norms. However, this offset is available only for a period of 5 years and Majority SBRT Entities will need to comply with the Local Sourcing Norms for their retail operations in India thereafter.

- The additional conditions prescribed under the FDI Policy, in relation to FDI in SBRT viz. products sold to be of a single brand, products sold to be branded during manufacturing, etc., shall remain.

➢ Civil Aviation

- Under the FDI Policy, foreign investors, including foreign airlines, were allowed to invest, under government approval route, in the capital of Indian companies operating scheduled and non-scheduled air transport services, up to the limit of 49% of their paid-up capital. However, the said condition was not applicable to Air India.

- The government has done away with this restriction, and PN 1 has permitted foreign airlines to invest up to 49%, in Air India under approval route. However, such investment in Air India is subject to two conditions:

  - foreign investments in Air India including that of foreign airlines cannot exceed 49% either directly or indirectly; and

  - substantial ownership and effective control of Air India would continue to be vested in Indian national(s).

Comment

The aforesaid changes have been made to facilitate the disinvestment of the government from Air India.

- Construction Development: Townships, Housing, Built-up Infrastructure and Real Estate Broking Services

  Paragraph 6 of PN 1 clarifies that real-estate broking does not amount to real estate business and is, therefore, eligible for 100% FDI under automatic route.

  Comment

  The FDI Policy currently defines Real estate business as "*dealing in land and immovable property with a view to earning profit there from and does not include development of townships, construction of residential/ commercial premises, roads or bridges, educational institutions, recreational facilities, city and regional level infrastructure, townships. Further, earning of rent/ income on lease of the property, not amounting to transfer, will not amount to real estate business.*"

  Given the broad definition of the real estate business, the aforesaid clarification is indeed a welcome move. Prior to the clarification, it could have been argued that real estate broking falls under the ambit of real estate business, although, in essence, real estate broking does not involve any ownership in real estate.

  Additionally, since real estate broking is under the 100% automatic route and does not fall within any of the sectors under the FDI Policy wherein conditions have been prescribed for receiving foreign investment, Limited Liability Partnerships (LLPs) are also permitted to engage in real estate broking, and receive foreign investment under the automatic route.

- Power Exchanges

  In terms of the FDI Policy, FDI up to 49% was permitted under the automatic route in power exchanges registered under the Central Electricity Regulatory Commission (Power Market) Regulations 2010. However, FII/FPI purchases were specifically restricted to the secondary market.

  PN 1 has now deleted this provision, thereby allowing FIIs/FPIs to invest in power exchanges through the primary market.

- Issue of equity shares against non-cash consideration

  As per the FDI Policy, issue of equity shares against non-cash consideration like pre-incorporation expenses, import of machinery, etc. was permitted under government approval route.

  This position has now been partially liberalised and issue of shares against non-cash consideration like pre-incorporation expenses, import of machinery, etc. shall be permitted under the government route *only* for sectors requiring government approval. Accordingly, issue of shares against non-cash consideration would not require prior government approval for sectors under the automatic route.

  However, even for sectors under automatic route, issue of equity shares against such non-cash consideration is permitted under automatic route subject to compliance with certain conditions including approval of the shareholders by way of a special resolution and customary reporting requirements under the FDI Policy.

- Foreign investment into an Indian company, engaged only in the activity of investing in the capital of other Indian company/ies/ LLP and in the Core Investing Companies (CIC)

Under FDI policy, foreign investment in an Indian company that is engaged only in the activity of investing in the capital of other Indian companies/ LLPs, required prior government approval, regardless of the amount or extent of foreign investment.

PN 1 clarifies that foreign investment in investing companies registered as Non-Banking Financial Companies (NBFC) with the RBI, would be under 100% automatic route.

PN 1 further clarifies that FDI in CICs and other investing companies, engaged in the activity of investing in the capital of other Indian companies/LLPs, is permitted under government approval route. CICs will have to, additionally, follow RBI's regulatory framework for CICs.

Comment

PN 1 clarifies that in instances where a company is a CIC, foreign investments in such CICs would require prior approval of the Department of Economic Affairs.

- Competent Authority for examining FDI proposals from countries of concern

Earlier, FDI from 'countries of concern' (i.e., Pakistan and Bangladesh), were processed by the Ministry of Home Affairs (MHA) even if such investments were made in sectors under the automatic route. FDI from countries of concern in activities under the government approval route sectors/activities requiring security clearance were processed by the respective Administrative Ministries/Departments.

This process has been revised and now, the DIPP (not MHA) would process FDI applications in relation to investments in automatic route sectors which require approval only in case the investment is from a country of concern.

Comment

Generally, the process of obtaining security clearance from the MHA is time consuming, leading to delays, in some cases, of more than 6 months. It appears that the government has taken note of this delay and has tasked the DIPP with the role of reviewing such applications involving investments in automatic route sectors by entities from a country of concern.

- Pharmaceuticals

The definition of 'medical devices' has been amended in the FDI Policy.

- Audit firms

PN 1 imposes certain conditions with respect to auditors that can be appointed by the Indian investee companies receiving foreign investments.

Accordingly, in case a foreign investor wishes to specify a particular auditor/audit firm that has international network to be appointed as an auditor for the Indian investee company, then:

- audit of such investee companies should be carried out as joint audit; and
- one of the auditors should not be part of the same network.

Comment

The rationale for imposition of the abovementioned conditions is not clear. This may also increase the cost of doing business in India if a foreign investor wishes to use its global auditor to audit its Indian subsidiary.

Comment

The changes introduced by the DIPP are certainly a welcome change and in line with the steady stream of reforms being introduced to liberalise the foreign investment regime and attract more foreign investment. However, it must be noted that these reforms shall only come into effect when consequent changes are made to the provisions of the Foreign Exchange Management (Transfer and Issue of Securities to Persons Resident Outside India) Regulations, 2017.

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TAKEAWAYS FROM COMPANIES (AMENDMENT) BILL, 2017

Source : Taxguru.com

Print

25 Key Takeaways from Companies (Amendment) Bill, 2017

taxguru.in/company-law/25-key-takeaways-companies-amendment-bill-2017.html

akashgadiya

The **Companies (Amendment) Bill, 2017** has been passed by both the houses of parliament and is awaiting President's assent. The proposed Amendments are broadly aimed at addressing difficulties faced by stakeholders and facilitating ease of doing business. Here are the 25 key takeaways from the said Bill:

1. Ratification of Auditor [Section 139(1)]: The first proviso to S.139(1) required that the matter relating to appointment of auditor be placed for ratification by the members in each AGM. This requirement has now been omitted.

2. Private Placement [Section 42]: The process of private placement of securities has been simplified. It has been provided that private placement offer and application shall not carry any right of renunciation and that money received under the private placement shall not be utilized unless the return of allotment is filed with the ROC. Such return has to be filed within 15 days of allotment as against the 30 days time period provided earlier.

3. Concept of Significant Beneficial Owner Introduced [Section 90]: As per S.90, every individual, who acting alone or together, through one or more persons, holds beneficial interests, of not less than 25%, in shares of a company shall be identified as "significant beneficial owner" (SBO). Such SBO will have to make a declaration about influence and his nature of interest etc. Every company has to maintain register containing prescribed details of SBOs and file periodic returns with the Registrar within such time, in such form and manner as may be prescribed.

4. Penal Provisions Rationalized: The penal provisions for procedural and technical defaults are rationalized and liabilities are reduced. Two new sections with respect to factors for determining the level of punishment and for lesser penalties for one person companies and small companies are also inserted and penal provisions for these companies are reduced

5. Loan to related parties [Section 185]: A completely new S.185 has been proposed which has categorized loans into prohibited, conditional and eligible. Loans to Director of company/ holding company or partner/relative/firm of such director is expressly prohibited. Conditional category includes any other person in whom the Director is interested (other than expressly prohibited) and involves passing of special resolution by the company in its general meeting along with the condition that If the borrower is a Company then loan should be utilized for its principal business activity. There is no change in the eligible category which includes loan to MD/ WTD as a part of service condition or scheme and loans by companies in their ordinary course of business by charging interest as per tenure etc.

Professionals

6. Filing Fees [Section 403]: Additional filing fees of Rs.100 per day may be levied. Different amounts may be specified for different form and different classes of companies. In case of default on two or more occasions in submission of forms, higher fees of not less than Rs.200 per day may be levied.

7. Participation through Video Conferencing [Section 173(2)]: Directors are now allowed to participate on certain items which are restricted at Board meetings through video conferencing or other audio visual means, if there is quorum through physical presence of directors. For instance, if there are 6 directors present in the Bangalore office and 1 Director joins from San Francisco through video conferencing, the Director in San Francisco can now participate in discussion and vote on important matters since there is quorum through physical presence. Earlier, there were restriction imposed vide Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014.

8. Name Approval [Section 4(5)]: The period for reservation of name is substituted from “60 days from date of application” to “20 days from date of approval”. In case of existing company, Registrar may reserve the name for a period of 60 days from the date of approval.

9. Registered Office [Section 12(1) and 12(4)]: Earlier S.12(1) required that a company shall, on and from the fifteenth day of its incorporation, have a Registered Office (RO). This implied that it could not have a RO from the date of incorporation. The Amendment Bill corrects this and provides for a company to have a RO within 30 days of incorporation. Further, even the time period for notifying the Registrar on change of RO through Form INC-22 has been increased from 15 days to 30 days.

10. Minimum Number of Members [New Section 3A]: The new section provides that if at any time the number of members falls below the minimum number prescribed in S.3(1) and the company carries on business for more than 6 months, every person who is a member at that time shall be severally liable for payment of the whole debts of the company contracted during that time, and may be severally sued.

11. Consolidated Financial Statements [Section 129(3)]: While preparing the consolidated financial statements, the main concern was whether to include associate companies or not. After the amendment the concern gets addressed as the term “associate companies” is inserted in addition to the subsidiaries.

12. Signing of Financial Statement [Section 134(1)]: Earlier the CEO was required to sign the financial statements only if he was a Director of the company. Post amendment, irrespective of the fact that the CEO is appointed as the Director or not, he shall sign the financial statements.

13. Extract of Annual Return (Form MGT-9) [Section 134(3)(a)]: Form MGT-9 formed a part of the Board’s report. This form now does not have to be accompanied with the Board’s report and instead a link to the annual return hosted on the website shall be provided in the Board’s report.

14. Performance Evaluation of Directors [Section 134(3)(p), 178(2) and Schedule IV]: Various provisions pertaining to performance evaluation of directors have been aligned. Amendment in S.178(2) provides that the Nomination & Remuneration Committee (NRC) shall specify the manner for effective evaluation of performance of Board, its committees and individual directors to be carried out either by the Board, by the NRC or by an independent external agency and review its implementation and compliance.

15. Abridged Board Report for One Person Company (OPC) and Small Company [New Section 134(3A)]: The Central Government is empowered to prescribe an abridged Board's Report for One Person Company and Small Company.

16. Corporate Social Responsibility [Section 135]: CSR provisions were applicable to companies that satisfied certain conditions related to net worth, turnover and net profit "in any financial year". The words "any financial year" have now been replaced by the words "immediately preceding financial year".

17. Circulation of Annual Accounts to Members [Section 136(1)]: Amendment to sub-section (1) of section 136 to provide that copies of audited financial statements and other documents may be sent at shorter notice if 95% of members entitled to vote at the meeting agree for the same. MCA has clarified this through a circular dated July 21, 2015. This is now provided in the Act itself.

18. 'Self-declaration' to replace 'Affidavit' [Section 7]: Section 7 required an **affidavit** from each of the subscribers to the memorandum and from persons named as the first directors in the articles that they are not convicted of any offence etc. The word affidavit has now been replaced with **declaration**, thereby making the process of incorporating a company easier.

19. General Meetings [Section 100(1)]: The wholly owned subsidiary of a company incorporated outside India is now allowed to hold its extra ordinary general meeting (EGM) outside India.

20. Deposit of 1 Lakh omitted [Section 160]:160 required any person other than retiring director who is nominated as director shall keep a deposit of Rs.1 Lakh with the company which shall be refunded if the person proposed gets elected as a director or gets more than 25% of total valid votes cast. This requirement shall now not be applicable in case of appointment of independent directors or directors nominated by nomination and remuneration committee.

21. Reporting of Change in Shareholding by Listed Company [Section 93]:93 required all listed companies to file a return with the Registrar with respect to change in the number of shares held by promoters and top ten shareholders of such company, within fifteen days of such change. This information is also required by SEBI/Stock Exchanges and hence this section has been omitted to avoid duplicity of reporting and reduce the compliance burden on companies.

22. Disclosure in Prospectus [Section 26]:26 laid out a list of information to be included in the prospectus issued by public companies. This list has now been pruned to state that such information required by SEBI in consultation with the Central Government shall be specified.

23. Managerial Remuneration [Section 197]: The requirement of approval of the Central Government (CG) for Managerial Remuneration above the prescribed limits are replaced by approval through special resolution by shareholders in general meeting. Therefore, no CG approval is now required for public companies for payment of remuneration to MD even exceeding 11% of net profits. Approval of the CG would be needed only for variance to the conditions specified in part I of Schedule V for the appointment of MD/ WTD. For payment of remuneration exceeding limits or for waiver of recovery of excess remuneration, prior approval of banks, financial institutions, non-convertible debenture holders or secured creditors is proposed. Director should repay the excess remuneration, if any, to the Company within a maximum period to 2 years. Further, reporting duty is casted on auditors to report payment of remuneration in conformity with the provisions of the Act and disclose any excess remuneration.

24. Definitions [Section 2]: Definition of Net worth has been amended to include debit or credit balance of profit and loss account in the calculation of net worth, thereby plugging an anomaly. Further, definitions of Associate company, Cost accountant, Debenture, Financial year, Holding company, Key Managerial Personnel, Small Company and Turnover have also been amended.

25. Deposits [Section 73]: Maintenance of Deposit Repayment Reserve for Public Deposits is proposed to be changed to 20% of the amounts maturing during the next year in place of 15%. The condition of deposit insurance for public deposits is removed permanently. In case of defaulting company, permanent ban from raising deposits to be reduced to a period of 5 years from the date of making default good.

DISCLAIMER: The information given in this document has been made on the basis of the provisions stated in the Companies (Amendment) Bill, 2017 and **Companies Act, 2013**. It is based on the analysis of the facts and our understanding and interpretation of applicable laws as on date. We expressly disclaim any financial or other responsibility arising due to any action taken by any person on the basis of this document.

(The author of this post is a practicing Chartered Accountant. For any suggestions or comments you can write to caakashgadiya@gmail.com or contact +91 99454 45180.)

NEW RULES OF CORPORATE CONTROL : LIMIT ON LAYERS OF SUBSIDIARIES

Source : KPMG

MCA notifies provisions relating to restriction on layers of subsidiaries under the Companies Act, 2013

3 October 2017

First Notes on

Financial reporting

Corporate law updates

Regulatory and other information

Disclosures

Sector

All

Banking and insurance

Information, communication, entertainment

Consumer and industrial markets

Infrastructure and government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

Within the next 3 months

Post 3 months but within 6 months

Post 6 months

Forthcoming requirement

Background

Subsidiary – *current requirements of the Companies Act, 2013*

Section 2(87) of the Companies Act, 2013 (2013 Act) defines the terms 'subsidiary' or a 'subsidiary company' in relation to any other company (i.e. the holding company). It also contains a proviso which provides that specified class or classes of holding companies should not have more than a prescribed number of layers[1] of subsidiaries. This proviso was not made effective till now.

Investment company – *current requirements of the 2013 Act*

Section 186(1) of the 2013 Act provides that a company is not allowed to make investment through more than two layers of investment companies. However, the restriction of two layers of investment companies is not applicable in the following cases:

a) A company acquires any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country

b) A subsidiary company having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

As per the explanation to Section 186(1), an investment company means a company whose principal business is the acquisition of shares, debentures or other securities.

These provisions (proviso to Section 2(87) and Section 186(1)) are aimed at monitoring the misuse of multiple layers of subsidiaries for diversion of funds/siphoning off funds and to ensure minority investor protection.

Recommendations of the Companies Law Committee and the Companies (Amendment) Bill, 2016

The Companies Law Committee (CLC) in its report issued in February 2016 proposed to remove the restriction on layers of subsidiaries on the ground that notification of these provisions would have a substantial bearing on the functioning, structuring and the ability of companies to raise funds. Also according to the CLC, sufficient safeguards have been built into the oversight mechanism of the Securities and Exchange Board of India (SEBI) and the stock exchanges with respect to investment companies. In line with the recommendations made by the CLC, the Companies (Amendment) Bill, 2016 also proposed to omit such restrictions.

Recently, the Ministry of Corporate Affairs (MCA) pointed out that it has been receiving

[1] *Layer* in relation to a holding company means its subsidiary or subsidiaries.

reports that certain companies may create shell companies for diversion of funds or money laundering. Therefore, MCA decided to operationalise the provisions relating to the restriction on number of layers for holding companies (Section 2(87)) and retain the requirements of Section 186(1) regarding the number of layers of investment companies. Accordingly, MCA issued draft rules for public comments through a notice (no.3/3/2017-CL-I) dated 28 June 2017.

New development

On 20 September 2017, MCA issued notifications with regard to the following:

- Application date of proviso to Section 2(87) of the 2013 Act with effect from 20 September 2017
- Issue of Companies (Restriction on number of layers) Rules, 2017 (Restriction on layers Rules).

Overview of the notified provisions

- **Restriction on layers of subsidiaries by holding companies (proviso to Section 2(87)):** A holding company can create up to two layers of subsidiaries only. However, one layer which consists of one or more wholly-owned subsidiary or subsidiaries would not be taken into account for computing the number of layers.

  The restriction regarding layers of the companies would not affect a holding company from acquiring a subsidiary incorporated in a country outside India, if such subsidiary has subsidiaries as per the laws of such country.

  The proviso to Section 2(87) is applicable from 20 September 2017.

- **Restriction on layers of investment companies (Section 186(1)):** The requirement for making an investment through not more than two layers of investment companies would continue to apply. The Section currently allows a holding company to acquire a subsidiary incorporated in a country outside India, if such subsidiary has subsidiaries as per the laws of such country. However, an investment company being a subsidiary of a holding company (covered under the proviso to Section 2(87)), would also be counted for the purpose of layer requirements.

- **Exemption from restrictions:** The above mentioned restrictions under both 'proviso to Section 2(87) and Section 186(1)' would not be applicable to the following class of companies:

  a) A banking company
  b) A systemically important Non-Banking Financial Company (NBFC) registered with the Reserve Bank of India (RBI)
  c) An insurance company
  d) A government company.

- **Actions required by the holding companies:** All holding companies, other than exempted companies, that have layers of subsidiaries in excess of two on or before the commencement of the Restriction on layers Rules (i.e. on or before 20 September 2017) would be required to comply with the following requirements:

  a) *Filing of return with the ROC:* A return in Form CRL-1 (format specified in the annexure to the Restriction on layers Rules) comprising details of the layers of subsidiaries is required to be filed with the Registrar of Companies (ROC) within a period of 150 days from the date of publication of these rules in the official gazette (i.e. 17 February 2018).

  b) *No subsequent addition to the layer:* A holding company with layers of subsidiaries in excess of two should not add any additional layer of subsidiary subsequent to the date of commencement of Restriction on layers Rules (i.e. 20 September 2017).

  c) *Reduction in the number of layers:* The Restriction on layers Rules do not require holding companies to reduce the number of layers if in excess of two.

  However, in case a holding company reduces one or more layers after the commencement of the Restriction on layers Rules (i.e. after 20 September 2017), then the number of layers should not be more than the number of layers it has post such reduction or two layers, whichever is more.

  For instance, a holding company with four layers of subsidiaries and it proposes to reduce one layer post commencement of the Restriction on layers Rules (i.e. after 20 September 2017), then such a company should have maximum three layers of subsidiaries (i.e. higher of three layers post reduction or two layers).

- **Penal provisions:** On contravention of any of the above mentioned provisions, every officer of the company who is in default would be punishable with a fine up to INR10,000 which could be extended to INR1,000 for every day after the first during which such contravention continues.

Our comments

The notification of two layers of subsidiaries is likely to help MCA keep a vigil over the number of layers of subsidiaries of the parent entities. However, these requirements would be challenging for companies that plan to grow both organically and inorganically through multiple layers of companies. Further, these requirements are likely to cause inflexibility while companies organise their management structures. We hope that the government would put in place other measures to curb diversion of funds activities and the requirements limiting the number of layers of subsidiaries would be waived off in future.

As mentioned above, the Restriction on layers Rules is applicable prospectively from 20 September 2017 and does not require companies with more than two layers of subsidiaries to reduce the number of layers provided they file a return comprising details of their subsidiaries to the ROC. The companies are not allowed to make any addition to its existing layers if in excess of two. Additionally, the number of layers post reduction, if any, should not be more than the number of layers it has after such reduction or two, whichever is more.

There are certain areas which require additional consideration. These are as follows:

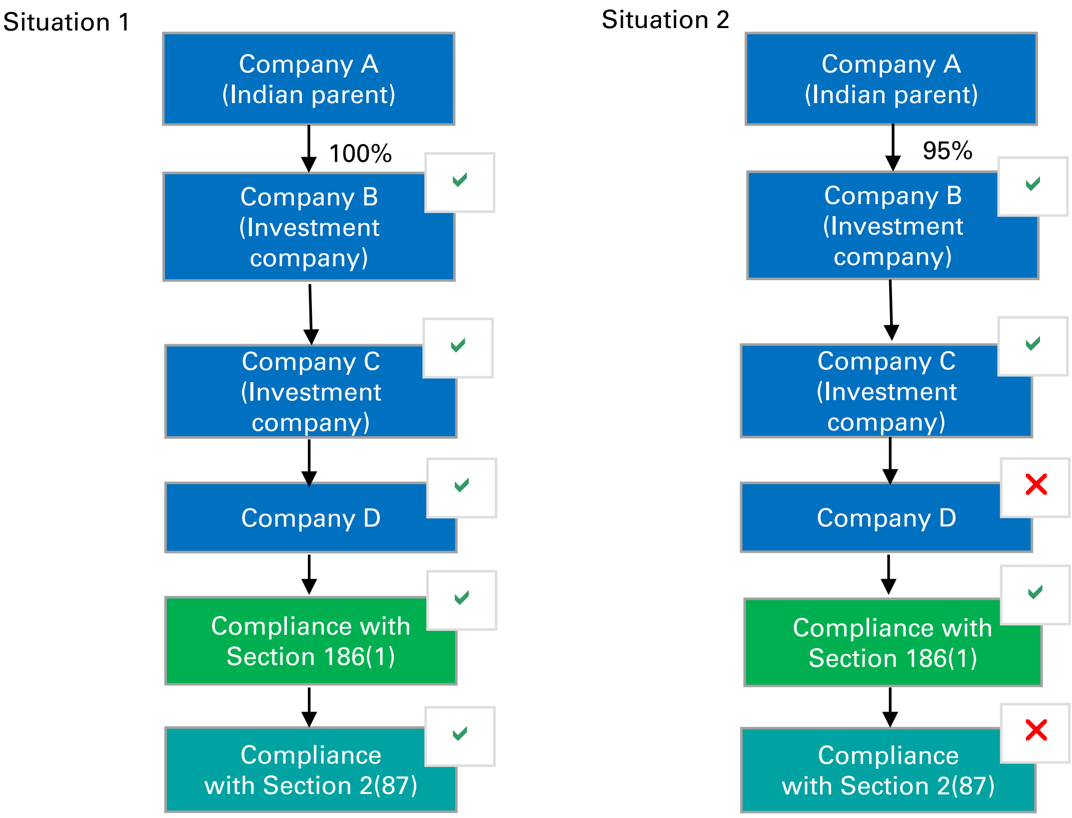
- **Section 2(87) restriction vs 186(1) restriction:** Proviso to Section 2(87) of the 2013 Act allows specified class of companies to have up to two layers of subsidiaries (excluding one or more wholly-owned subsidiary or subsidiaries) whereas, Section 186(1) provides that the company is not allowed to make investment through more than two layers of investment companies. Section 2(87) is a pervasive section and would apply to all classes of companies including investment companies (covered in Section 186(1)).

  Currently, Section 186(1) allows a parent company to form two layers of investment companies while there was no restriction on the number of operating companies. However, with the application of proviso to Section 2(87), a company cannot form more than three layers (assuming one layer is a wholly-owned subsidiary) of companies for both operating and investment companies. If, however, first subsidiary is not a wholly-owned subsidiary then the parent company cannot have more than two layers of investment and operating companies. Therefore, proviso to Section 2(87) is likely to be more restrictive in nature. This can be illustrated with the help of following examples.

  Examples:

  An investment company A proposes to form subsidiaries B, C and D where company B would be a wholly-owned subsidiary of A. B would be an investment company situated in Mauritius and C would be another investment company situated in Cypress while D would be an operating company in the United Kingdom. Now as per the notified provisions, company A could continue with all of them as its subsidiaries (as B is a wholly-owned subsidiary which is not to be counted for computation of two layers).

  However, if company A proposes to own 95 per cent stake in company B, then in such a case, company A would not be able to create one operating company D as it can only create two layers of companies as per proviso to Section 2(87).



(Source: KPMG in India's analysis, 2017)

Our comments (cont.)

- **Implication on Merger and Acquisition (M&A) transactions in India:** The Restriction on layers Rules specifically exempts a holding company from acquiring a subsidiary incorporated in a country outside India, if such subsidiary has subsidiaries as per the laws of such country. However, it does not contain any exemption for number of layers of subsidiaries for M&A transactions between Indian companies. There could be various situations that a group could be organised in various layers of subsidiaries and if it considers to acquire another group (with various layers of subsidiaries) then:

  a) The purchaser would not be able to add a new subsidiary, it would be required to purchase through existing set of companies

  b) The selling company would have to create a flatter structure in order to facilitate the acquisition.

  This could pose significant challenge to M&A activity within the Indian companies including taxes and stamp duties on such transactions.

- **Regulatory requirement to form subsidiaries or special purpose entities or businesses formed as a conglomerate:** The provisions could also pose challenges to companies that are required to form various layers of subsidiaries or special purpose entities by certain regulations like infrastructure companies or real estate companies to claim certain concessions from the government. Additionally, large conglomerate business houses that operate through different verticals with step-up holding and step-down subsidiary companies would also need to consider the implications of the notified provisions.

The bottom line

Companies should take appropriate actions and file Form CRL-1 (details of the layers of subsidiaries) by 17 February 2018.

VOLUNTARY LIQUIDATION MADE EASY UNDER IBC

Source : Chartered Secretary Journal, September 2017

Voluntary Liquidation made easy under IBC

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BACKGROUND

Closing the loop on corporate liquidation, the Central Government has, on 30 March 2017, notified, inter alia, Section 59 of the Insolvency and Bankruptcy Code, 2016 (Code) which deals with voluntary liquidation of corporate entities with effect from 1 April 2017. On the following day, the Insolvency and Bankruptcy Board of India (Board) has also, *vide* its notification dated 31 March 2017, notified the Insolvency and Bankruptcy

Voluntary liquidation was governed by the provisions of the Companies Act, 1956 (1956 Act) as neither the relevant sections of the Companies Act, 2013 (2013 Act) nor the Code were in force. This article explains Section 59 of the Insolvency and Bankruptcy Code, 2016 (Code) which deals with voluntary liquidation of corporate entities with effect from 1 April 2017.

Board of India (Voluntary Liquidation Process) Regulations, 2017 (Regulations) with effect from 1 April 2017. This has set the ball rolling for the voluntary liquidation of a corporate person under the Code, which includes companies, limited liability partnerships and any other persons incorporated with limited liability.

To put things into perspective, prior to the aforesaid notifications, voluntary liquidation was governed by the provisions of the Companies Act, 1956 (1956 Act) as neither the relevant sections of the Companies Act, 2013 (2013 Act) nor the Code were in force. Further, by virtue of the notification of the Eleventh Schedule of the Code (notified with effect from 15 November 2016), various winding up provisions of the 2013 Act had been amended and voluntary winding up sections under the 2013 Act were omitted. Accordingly, under the previous voluntary liquidation regime, the provisions of the 1956 Act continued to apply in relation to voluntary winding up proceedings before the High Courts.

To analyse the effect of the notification of the relevant provisions of the Code as well as the Regulations on voluntary liquidation proceedings, we have segregated our analysis for the proceedings already pending and those which will be initiated on and from 1 April 2017.

PENDING VOLUNTARY WINDING UP PROCEEDINGS

Rule 4 of the Companies (Transfer of Pending Proceedings) Rules, 2016 (Transfer Rules), which has been notified on 7 December 2016 and brought into force from 1 April 2017, prescribes that all applications and petitions relating to voluntary winding up of companies pending before a High Court prior to 1 April 2017, shall continue to be dealt with by the High Court in accordance with the provisions of the 1956 Act.

It has further been amended and clarified as under:

Pending proceeding relating to voluntary winding up All proceedings relating to voluntary winding up of a company where notice of the resolution by advertisement has been given under sub-section (1) of section 485 of the Act but the company has not been dissolved before the 1st day of April, 2017 shall continue to be dealt with in accordance with provisions of the Act."

FRESH VOLUNTARY WINDING UP PROCEEDINGS TO BE INSTITUTED UNDER THE CODE

On a conjoint reading of Section 59 of the Code, Sections 434 (1) (c) and 465 of the 2013 Act and Rule 4 of the Transfer Rules, all fresh proceedings for voluntary winding up on and from 1 April 2017 shall be instituted before the NCLT and shall be governed as per the provisions of the Code and the Regulations.

Some of the important aspects of the voluntary liquidation process under the Code and the Regulations have been set out below:

INITIATION OF THE PROCESS

As per Section 59 of the Code read with the Regulations, any corporate person (excluding any financial service provider) may initiate a voluntary liquidation proceeding if it satisfies the following conditions:

- it has not committed any default;
- if majority of the directors or designated partners of the corporate person make a declaration verified by an affidavit to the effect that (i) the corporate person has no debt or it will be able to pay its debts in full out of the sale proceeds of its assets under the proposed liquidation; and (ii) liquidation is not initiated to defraud any person;
- such declaration is accompanied by the audited financial statements and valuation report of the corporate person;
- within 4 (four) weeks of such declaration, a special resolution (an ordinary resolution would suffice in cases of voluntary liquidation by reason of expiry of its duration or occurrence of any dissolution event) is passed by the contributories* requiring the corporate person to be liquidated and appointing an insolvency professional as a liquidator(Contributories' Resolution); and
- creditor(s) representing two-thirds in value of the total debt owed by the corporate person, approve the Contributories' Resolution within 7 (seven) days of its passage (Creditors' Approval).

***** As per the Regulations, a 'contributory' means a member of a company, partner of a limited liability partnership, and any other person liable to contribute towards the assets of the corporate person in the event of its liquidation.

LIQUIDATION COMMENCEMENT DATE

Subject to the Creditors' Approval (if required), the voluntary liquidation proceedings in respect of a corporate person shall be deemed to have commenced from the date of passing of the Contributories' Resolution (Liquidation Commencement Date). On and from the Liquidation Commencement Date, the corporate person shall cease to carry on its business except as far as required for the beneficial winding up of its business.

PUBLIC ANNOUNCEMENT AND COLLATION OF CLAIMS

The Regulations prescribe that immediately (and not later than 5 (five) days) upon his appointment, the liquidator shall make a public announcement for calling upon operational creditors, financial creditors, workmen, employees and any other stakeholders of the corporate person to submit their claims as on the Liquidation Commencement Date within 30 (thirty) days of the Liquidation Commencement Date. The liquidator is required to verify the claims within 30 (thirty) days of the last date of receipt of the claims. The liquidator may either admit or reject a claim, in whole or in part, and prepare a list of stakeholders, on the basis of proof of the claims accepted.

PRIMARY FUNCTIONS OF THE LIQUIDATOR

- To value, sell, recover and realize all assets of and monies due to such corporate person in a time-bound manner;
- Opening a bank account for the purpose of receiving all moneys due to the corporate person;
- Distribution of proceeds to the stakeholders within a period of 6 (six) months of receipt of the proceeds; and
- To preserve a physical or an electronic copy of the reports, registers and books of account for at least 8 (eight) years after the dissolution of the corporate person, either with himself or with an information utility.

Earlier, starting a business in India was easier, but their closure was a cumbersome and time-consuming process. The issue of voluntary winding up regulations is a step forward for easy closure of solvent businesses in India. The regulation aims at speedy winding up and protecting/balancing the interest of all the stakeholders of the company. Voluntary liquidation can also happen if a vital member of the organization leaves the company and the shareholders decide not to continue operations.

COMPLETION OF LIQUIDATION

Once the affairs of the corporate person have been completely wound up and its assets fully liquidated, an application shall be made by the liquidator to the NCLT for its dissolution along with a final report (*inter alia* consisting of audited liquidation accounts, statement(s) demonstrating details of the disposed assets and their manner of sale, and statement(s) that all debt has been discharged and sufficient provision has been made in case of any adverse outcome of a pending litigation). Pursuant to this application by the liquidator, the NCLT shall pass an order for dissolution and the entity shall stand dissolved from the date of NCLT's order.

With the above notification, winding up the proceedings of solvent companies are omitted from the Companies Act, 2013 and are now governed by the Code. The forum to deal with the process will be the respective NCLT Benches from now on instead of the High Court. Winding up of insolvent companies is already being governed by the provisions of the Code. The IP who acts as the liquidator for the process of voluntary winding up assumes a key role in the process since the Code has given the authority to the liquidator for completely driving the process of winding up. Hence, the efficiency of the winding up process would be largely dependent upon the person who is appointed as the liquidator of the company.

Earlier, starting a business in India was easier, but their closure was a cumbersome and time-consuming process. The issue of voluntary winding up regulations is a step forward for easy closure of solvent businesses in India. The regulation aims at speedy winding up and protecting/balancing the interest of all the stakeholders of the company.

Voluntary liquidation can also happen if a vital member of the organization leaves the company and the shareholders decide not to continue operations.

The Insolvency and Bankruptcy Board of India has notified the Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017 ("**New Regulations**") on March 31, 2017. The New Regulations provides the process for

initiating voluntary liquidation by a corporate person i.e. companies, limited liability partnerships and any other persons incorporated with limited liability.

Before introduction of New Regulations, voluntary liquidation of the companies was governed by the Companies Act, 1956 ("**CA 1956**") since the provisions as mentioned in the Companies Act, 2013 ("**CA 2013**") had never been notified. Now, the Government has repealed / omitted the provisions of voluntary liquidation as mentioned in CA 1956 as well as CA 2013 vide notification dated March 31, 2017 and May 28, 2016, respectively.

The erstwhile CA 1956 and CA 2013 had 38 and 20 sections dealing with voluntary liquidation, respectively. Chapter V of Part II of the IBC consist of only one section, i.e. Section 59, which deals with voluntary liquidation.

Another key point to be noted that, voluntary winding up under the CA 1956 had been segregated into two types, i.e. members' voluntary winding up and creditors' voluntary winding up. This distinction has now been eliminated under the IBC.

In terms of Section 59 of the IBC, only a corporate person is allowed to initiate voluntary liquidation process, which has not committed any default. It is imperative to understand, whether the word 'default' includes past default or existing default of a corporate person? While analysing the definition of a default which is defined under the IBC to mean – "*non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not repaid by the debtor or the corporate debtor, as the case may be*", we observed that it contains those debts which have become due and payable and are not repaid. It seems that default, which occurred in past and had been cured, is not intended to be covered hereunder. Hence, the word 'default' will include the existing debts of a corporate person. The aforesaid condition did not exist in CA 1956.

New regulations require the compliance of the following additional requirements, which were not mentioned earlier in CA 1956:

1. Additional declaration by the directors that company is not wound up to defraud any person;
2. Only insolvency professional can, who meets the eligibility criteria as specified under New Regulations, be appointed as liquidator;
3. Maintenance and preservation of various registers in the prescribed manner;
4. Preparation of various reports by the liquidator as to be submitted to a corporate person, Registrar of Companies ("**ROC**"); and the Insolvency and Bankruptcy Board of India ("**Board**");
5. Receipt of stakeholders claims by liquidator only in specified forms;
6. The liquidator shall endeavour to wind up the affairs of the corporate person within 12 (twelve) months from the voluntary liquidation commencement date;

Under New Regulations, the Government has also reduced the time period of various compliances. Below is the brief procedure of voluntary liquidation of a corporate person under IBC:

Step I: Submission of declaration(s) to ROC, stating that the company will be able to pay its dues and is not being liquidated to defraud any person;

Step II: Passing of special resolution for approving the proposal of voluntary liquidation and appointment of liquidator ("**Approval**"), within 4 (four) weeks of the aforesaid declaration(s). If a corporate person owes debts, approval of two-third majority creditors would also be required;

Step III: Public announcement inviting claims of all stakeholders, within 5 (five) days of such Approval, in newspaper as well as on website of the corporate person;

Step IV: Intimation to the ROC and the Board about the Approval, within 7 (seven) days of such Approval;

Step V: Preparation of preliminary report about the capital structure, estimates of assets and liabilities, proposed plan of action etc., and submission of the same to a corporate person within 45 (forty-five) days of such Approval;

Step VI: Verification of claims, within 30 (thirty) days form the last date for receipt of claims and preparation of list of stakeholders, within 45 (forty-five) days from the last date for receipt of claims;

Step VII: Opening of a bank account in the name of the corporate person followed by the words 'in voluntary liquidation', in a scheduled bank, for the receipt of all moneys due to the corporate person;

Step VIII: Sale of assets, recovery of monies due to corporate person, realization of uncalled capital or unpaid capital contribution;

Step IX: Distribution of the proceeds from realization within 6 (six) months from the receipt of the amount to the stakeholders;

Step X: Submission of final report by the liquidator to the corporate person, ROC and the Board and application to the National Company Law Tribunal ("**NCLT**") for the dissolution;

Step XI: Submission of NCLT order regarding the dissolution, to the concerned ROC within 14 (fourteen) days of the receipt of order.

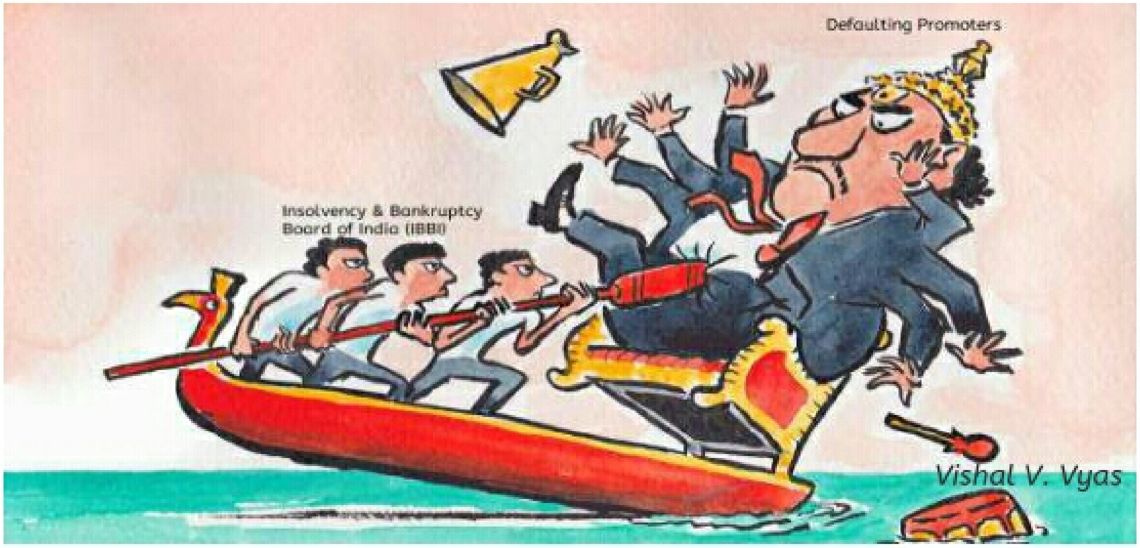
In view of the above, it is evident that the Government intends to expedite the process of voluntary winding up in a time bound manner by introducing the New Regulations. Such move of the Government is welcome by the corporates as well as professionals, since, the voluntary winding up under CA 1956 was a time-consuming process and there was no qualification for appointment of the liquidator. Now, only the insolvency professionals, who are experts on the subject, are allowed to be appointed as liquidators which will expedite the completion of voluntary winding up including resolution of all issues in a time bound manner. CS

DEFAULTING PROMOTERS BARRED FROM BEING RESOLUTION APPLICANTS

Source : MNA Critique Magazine, December 2017

LEGAL

Defaulting Promoters barred from being Resolution Applicants



The long time discussed subject of credibility of the resolution process under the Insolvency and Bankruptcy Code,2016, which is dependent on the sustainability of the Resolution Plan and credibility of the Resolution Applicant, is now settled by the Insolvency and Bankruptcy Board of India(IBBI) by introducing amendment regulations to the Corporate Insolvency Resolution process on 7 November 2017 and subsequent Ordinance passed by the Central Government on 23 November 2017 on the subject.

A key objective of the Insolvency and Bankruptcy Code, 2016 is insolvency resolution of corporate persons in a time bound manner for maximization of value of their assets. This objective would be achieved only if a resolution process ends up with a credible resolution plan that maximizes the value of assets of the corporate debtor, that is, the plan has been drawn unrealistically and would be implemented successfully. Though there is no restriction on as to who can submit a resolution plan, it should come from any person, who can really rescue the insolvent business and the Committee of Creditors is expected to approve the best of them.

However, it was observed that the persons who themselves were responsible for the current debt owed situation of a corporate leading to insolvency proceedings, were submitting their resolution plans to the Insolvency Professional which if approved, may lead to shift the control of the Company again in the hands of those people who dragged the Company in such a situation.

Here from, the question raised about the credit worthiness of the promoters/persons who are submitting the resolution plan to the Insolvency Professional and credibility of their resolution plan.

According to the amendments, especially newly inserted Sec. 29A in the Code vide Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, a person (including promoter) cannot submit Resolution Plan if such person or any other person acting jointly with such person is:

a. Adjudged Insolvent

b. Willful Defaulter as per RBI Guidelines

c. Having NPA Account with one year or more

d. Convicted for offence with imprisonment for 2 years or more

e. Disqualified to act as Director pursuant to the Companies Act, 2013

f. Prohibited by SEBI from trading /accessing Securities Market

g. Indulged in a Preferential /Extortionate Credit / Undervalued/ Fraudulent Transaction in respect of which Adjudicating Authority has made an Order under the Code

h. Executed enforceable guarantee in favour of a creditor of the Company.

i. Subject to any disability corresponding to above clauses (a) to (h), under any foreign law.

To effectuate the spirit of Sec. 29A, it has now been mandated for a person submitting the Resolution Plan to include all the above details /declarations in the resolution plan itself along with his identity so that the Committee of Creditors can carry out due diligence of every resolution plan to satisfy itself that (a) the plan is viable, and (b) the persons who have submitted the plan and who would implement the plan are credible, to avoid the plans which may lead to liquidation, post resolution, and to select the most suitable plan under the circumstances.

In view of substituted subsection 4 of Section 30 of the Codeby virtue of the amendment Ordinance, duty has been cast on the Committee of Creditors to ascertain feasibility and viability of the Resolution Plan before approving the same. Further, in the context of this subsection, the Ordinance applies with retrospective effect which means, all the pending cases of disqualified persons where their resolution plan/s have been filed but not approved by the Committee of Creditors would be subject to rejection if not fitted within the abovementioned specified criteria enlisted for the resolution applicant and the contents of the Resolution Plan. Accordingly, in all the pending cases, the resolution professional shall have to call for newresolution plans if there are no other eligible plans.

Accordingly, Committee of Creditors will have to look at how realistically the plan has been drawn up, is it actually grounded, does it actually take into account aspects like market situation, technological situation as well as the capability of the promoters who is the resolution applicant. Creditors should take in to consideration that the promoters who have to implement these, if are not credible, then how can they entrust the company to the promoters. If the company has to continue to exist, it must be in the hands of desirable persons.

Since Committee of Creditors has to ascertain the credibility of the Resolution Plan and credit worthiness of the resolution applicants, it is surely going to be a subjective test for them to accept a resolution plan where they have to consider the various aspects like credit rating of the Applicant and not to accept a resolution plan simply because the applicant is offering lowest haircut.

Accordingly, Resolution Professional has also been obligated to submit before the Committee of Creditors all the eligible Resolution Plans only, after scrutinizing them within the bracket of requirements under the aforementioned amended regulations and the Ordinance.

IBBI has tightened conditions by introduction the said Section 29A and also putting additional responsibilities on Committee of Creditors and Resolution professional before going ahead with the resolution process. In fact, it should have been there from the day one, hence as a result, these changes are now applicable to all the pending cases as well. This is based on the present trend of promoters' bidding to take back the insolvent companies, allaying fears oflenders that such entities might go back to the very people who wereresponsible for the current mess, at lower prices.

There may be possibility of the disqualified directors becoming employee of the Company and submitting resolution plan under the identity of 'employee', which is not yet directly prohibited. Hence, it is the need of the hour to curb such kind of practices adopted by the disqualified directors/promoters.

As insolvency cases keep mounting in the NCLT, the IBBI is keen to ensure that resolutionprofessionals facilitate a proper shift in ownership in the caseof acquisition of an insolvent company by another entity. Henceforth, if a promoter has to put forth his resolution plan, it is incumbent upon him to put forward a vastly superior plan to stack up with other applicants.As per the language of the new Section 29A, the defaulting promoters cannot put forth their resolution plan even indirectly through any other connected persons like their associate or subsidiary company or any relatives.

However, nobody should consider these initiatives as disadvantageous to the promoters as these amendments are not against promoters, this is for everyone whosoever is putting forth his resolution plan, as the objective of the Code is insolvency resolution in a time bound manner for maximization of value of the assets of the Corporates.

DEEMED DIVIDEND IS NOT TAXABLE IN THE HANDS OF A LOAN RECIPIENT CONCERN – SUPREME COURT RULING

Source : KPMG Tax Flash News

KPMG

TAX FLASH NEWS

18 October 2017

Deemed dividend is not taxable in the hands of a loan recipient concern if such concern is not a shareholder of the lender company – Supreme Court

Background

Recently, the Supreme Court in the case of Madhur Housing and Development Company[1] upheld the decision of the Delhi High Court in the case of Ankitech Private Limited[2]. The Delhi High Court had held that deemed dividend would not be taxable in the hands of loan recipient concern if such concern is not shareholder of the lender company. It is taxable in the hands of common shareholders having substantial interest in both the entities.

Delhi High Court decision in the case of Ankitech Private Limited

Facts of the case

- The taxpayer, a private limited company, filed the return declaring income of INR1.45 crore under Section 115JB of the Income-tax Act, 1961 (the Act).
- During the assessment proceedings, the Assessing Officer (AO) noticed that the taxpayer had received advances of INR6.32 crore by way of book entry from Jackson Generators Private Limited (JGPL) and the shareholders having substantial interest in the taxpayer were also having 10 per cent of the voting power in JGPL.
- The AO observed that the two shareholders were holding substantial interests in JGPL which had provided loans and advances to the taxpayer and these shareholders had substantial interest even in the taxpayer. Therefore, under Section 2(22)(e) of the Act the amount received by the taxpayer from JGPL which constituted advances and loans' would be treated as deemed dividend within the meaning of Section 2(22)(e) of the Act and added the aforesaid amount to the income of the taxpayer.
- The Commissioner of Income-tax (Appeal) [CIT(A)] affirmed the order of the AO.
- The Tribunal deleted the addition made by the AO on account of deemed dividend under Section 2(22)(e) of the Act. The Tribunal held that though the amount received by the taxpayer by way of book entry is a deemed dividend within the meaning of Section 2(22)(e) of the Act, the same cannot be assessed in the hands of taxpayer, as it was not the shareholder in the company JGPL. A dividend cannot be paid to a non-shareholder. It would have to be taxed, if at all, in the hands of the shareholders who have a substantial interest in the taxpayer and also holding not less than 10 per cent of the voting power in JGPL.
- The Tribunal relied on the decision of the Special Bench of the Mumbai Tribunal in the case of Bhaumik Colour (P) Ltd.[3]. The decision of the Special Bench has been affirmed by the Bombay High Court in the case of Universal Medicare (P) Ltd.[4].

[1] CIT v. Madhur Housing and Development Company (Civil Appeal No. 3961 of 2013) – Taxsutra.com
[2] CIT v. Ankitech Private Limited [ITA No. 462 of 2009] (Del)
[3] ACIT v. Bhaumik Colour (P) Ltd. [2009] 118 ITD 1 (Mum) (SB)
[4] CIT v. Universal Medicare (P) Ltd. [2010] 190 Taxman 144 (Bom)

Delhi High Court decision

- The Delhi High Court held that the intention behind the provisions of Section 2(22)(e) of the Act is to tax dividend in the hands of shareholders. The deeming provisions as it applies to the case of loans or advances by a company to a concern in which its shareholder has substantial interest, is based on the presumption that the loans or advances would ultimately be made available to the shareholders of the company giving the loan or advance.

- Further, it is an admitted case that under normal circumstances, such a loan or advance given to the shareholders or to a concern, would not qualify as dividend. It has been made so by legal fiction created under Section 2(22)(e) of the Act. It is to be keep in mind that this legal provision relates to dividend. Thus, by a deeming provision, it is the definition of dividend which is enlarged.

- Legal fiction does not extend to shareholder. Loan or advance given under the conditions specified under Section 2(22)(e) of the Act would also be treated as dividend. The fiction has to stop here and is not to be extended further for broadening the concept of shareholders by way of legal fiction.

- The second category specified under Section 2(22)(e) of the Act, i.e., a concern (like the taxpayer herein), which is given the loan or advance is admittedly not a shareholder/member of the payer company. Therefore, under no circumstance, it could be treated as shareholder/member receiving dividend.

- If the intention of the Legislature was to tax such loan or advance as deemed dividend at the hands of deeming shareholder, then the Legislature would have inserted deeming provision in respect of shareholder as well, that has not happened.

- It would always be open to the tax department to take corrective measure by treating this dividend income at the hands of the shareholders and tax them accordingly. As otherwise, it would amount to escapement of income at the hands of those shareholders.

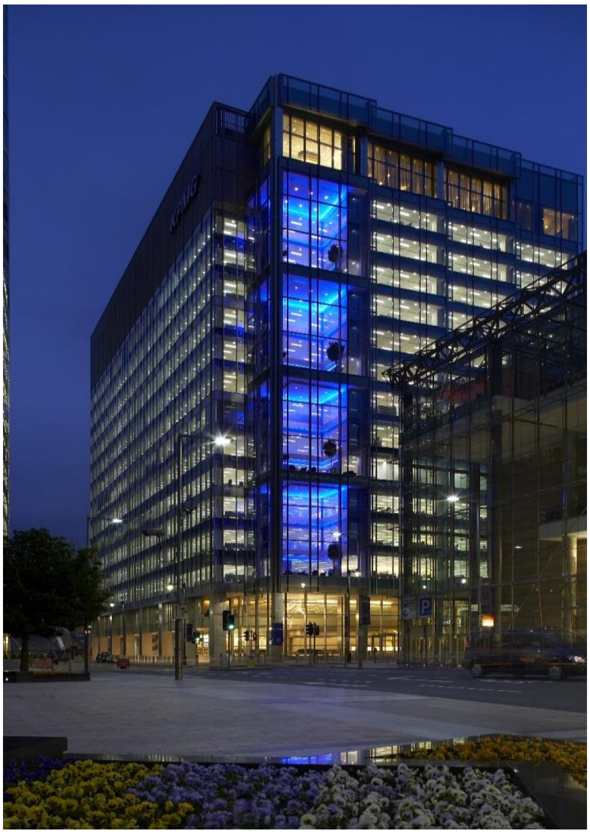
Supreme Court decision

- The Delhi High Court decision in the case of Ankitech Private Limited is a detailed judgment going into Section 2(22)(e) of the Act which arises at the correct construction of the said Section. The Supreme Court does not wish to add anything to the judgment except to say that it is agree therewith.

Our comments

The issue whether deemed dividend is taxable in the hands of the concern in which the shareholders of the lender company has substantial interest or in the hands of such common shareholder has been a matter of debate before the courts. The Special Bench of the Mumbai Tribunal in the case of Bhaumik Colour (P) Ltd. held that in the absence of indication in Section 2(22)(e) of the Act to extend the legal fiction to a case of loan or advance to a non-shareholder, loan or advance cannot be taxed as deemed dividend in the hands of such non-shareholder. The decision of the Special Bench has been affirmed by the Bombay High Court in the case of Universal Medicare (P) Ltd. and the Delhi High Court in the case of Ankitech Private Limited.

The Supreme Court put at rest this controversy and held that deemed dividend is not taxable in the hands of a loan recipient concern if such concern is not a shareholder of the lender company. It is taxable in the hands of common shareholders having substantial interest in both the entities. The Supreme Court decision has provided clarity on the issue and it may help the taxpayers who are facing same issue under Section 2(22)(e) of the Act.



SEBI GUIDELINES ON TRANSFER OF EQUITY SHARES TO A TRUST

Source : Notification SEBI/HO/CFD/DCR1/CIR/P/2017/131 , December 2017

Schedule

Cases involving Trust as acquirer

SEBI in the recent past has received a number of applications pertaining to transfer of shares from promoters to Trusts which were referred to the panel of experts (Takeover Panel) as per Regulation 11 (5) of SAST Regulations. Based on the recommendations of the Takeover Panel, SEBI had passed orders granting / not granting exemption to the applicants. In the recent past, grant of exemption were considered if the following conditions were met by the applicants, expressly in trust deed:

i. The Trust is in substance, only a mirror image of the promoters' holdings and consequently, there is no change of ownership or control of the shares or voting rights in the target company.
ii. Only individual promoters or their immediate relatives or lineal descendants are Trustees and beneficiaries;
iii. The beneficial interest of the beneficiaries of the trust has not been and will not in the future, be transferred, assigned or encumbered in any manner including by way of pledge/mortgage;
iv. In case of dissolution of the Trust, the assets will be distributed only to the beneficiaries of the trust or to their legal heirs;
v. The Trustees will not be entitled to transfer or delegate any of their powers to any person other than one or more of themselves.

In addition, the following undertakings were part of the trust deed:

vi. Any change in the trustees / beneficiaries and any change in ownership or control of shares or voting rights held by Trust shall be disclosed within 2 days to the concerned stock exchanges with a copy endorsed to SEBI for its record;
vii. As far as the provisions of the SEBI Act and the regulations framed thereunder are concerned the ownership or control of shares or voting rights will be treated as vesting not only with the Trustees but also indirectly with the beneficiaries ;
viii. The liabilities and obligations of individual transferors under the SEBI Act and the regulations framed thereunder will not change or get diluted due to transfers to the Trust ;
ix. The Trust shall confirm, on an annual basis, that it is in compliance with the exemption order passed by SEBI. The said confirmation shall be furnished to the company which it shall disclose prominently as a note to the shareholding pattern filed for the quarter ending March 31 each year, under regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015;

x. The Trust shall get its compliance status certified from an independent auditor annually and furnish the certificate to the Stock Exchanges for public disclosure with a copy endorsed to SEBI for its records.

Further, exemptions were granted when the following conditions were complied:

xi. The proposed acquisition is in accordance with the provisions of the Companies Act, 2013 and other applicable laws;
xii. The transferors are disclosed as promoters in the shareholding pattern filed with the Stock Exchanges for a period of at least 3 years prior to transfer (except for holding on account of inheritance);
xiii. There is no layering in terms of trustees / beneficiaries in case of Trusts;
xiv. The Trust deed agreement does not contain any limitation of liability of the trustees / beneficiaries in relation to the provisions of the SEBI Act and all regulations framed thereunder.

The Takeover Panel and SEBI will continue to scrutinise exemption application based on the above conditions. It is further clarified that while the above conditions / undertaking are broad and general in nature, compliance with the above conditions does not guarantee automatic exemption from open offer and all applications will be considered by the Takeover Panel and SEBI on a case to case basis. However, the processing time of applications where the above conditions are complied could be significantly faster.

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