IN THE HIGH COURT OF DELHI

COMPANY PETITION NO. 334/2009

Reserved on : 22-09-2010
Date of pronouncement: 29-03-2011

In the matter of
The Companies Act, 1956:

And

Petition under Sections 391 to 394 of the Companies Act, 1956

Scheme of Arrangement between:

M/s. Vodafone Essar Limited
.. Non-petitioner/Transferor Company No. 1

M/s. Vodafone Essar Mobile Services Limited
.. petitioner/Transferor Company No. 2

M/s. Vodafone Essar East Limited
.. Non-petitioner/Transferor Company No. 3

M/s. Vodafone Essar Gujarat Limited
.. Non-petitioner/Transferor Company No. 4

M/s. Vodafone Essar South Limited
.. petitioner/Transferor Company No. 5

M/s. Vodafone Essar Digilink Limited
.. petitioner/Transferor Company No. 6

M/s. Vodafone Essar Cellular Limited
.. Non-petitioner/Transferor Company No. 7

AND

M/s. Vodafone Essar Infrastructure Limited
.. petitioner/Transferee Company

Through Dr. Abhishek Manu Singhvi, Sr. Adv. with Ms. Niti Dixit and Mr. Shankh Sengupta, Advocates for the petitioners
Mr. Parag P. Tripathi, ASG with Mr. Nitin Mehta and Mr. Anuj Bhandari, Advocates for the Income Tax Deptt.
Dy. Registrar of Companies in person

SUDERSHAN KUMAR MISRA, J.

1. Four companies have moved this Court under Sections 391 to 394 of the Companies Act, 1956 seeking sanction of the Scheme of Arrangement between M/s. Vodafone Essar Limited (hereinafter referred to as the transferor company no. 1); M/s. Vodafone Essar Mobile Services Limited (hereinafter referred to as the petitioner/ transferor company no. 2); M/s. Vodafone Essar East Limited (hereinafter referred to as the transferor company no. 3); M/s. Vodafone Essar Gujarat Limited (hereinafter referred to as the transferor company no.4); M/s. Vodafone Essar South Limited (hereinafter referred to as the petitioner/transferor company no. 5); M/s. Vodafone Essar Digilink Limited (hereinafter referred to as the petitioner/transferor company no. 6); M/s. Vodafone Essar Cellular Limited (hereinafter referred to as the transferor company no. 7) and M/s. Vodafone Essar Infrastructure Limited (hereinafter referred to as the transferee company).

2. The registered offices of the petitioner/transferor companies no. 2, 5 & 6 and the transferee company, all of whom have approached this Court, are situated at New Delhi, within the jurisdiction of this court.

3. The registered offices of the transferor company Nos.1, 3, 4 and 7 are situated at Mumbai, Kolkata, Ahmedabad and Coimbatore, respectively.

4. The petitioner/transferor company no. 2 was originally incorporated under the Companies Act, 1956 on 27th March, 1992 with the Registrar of Companies, Tamil Nadu under the name and style of

Sterling Cellular Limited. The company changed its name to Hutchison Essar Telecom Limited after passing the necessary resolution to this effect and obtained the fresh certificate of incorporation on 12th August, 2002. The company again changed its name to Hutchison Essar Mobile Services Limited and obtained the fresh certificate of incorporation on 1st March, 2005. Thereafter, the company shifted its registered office from the State of Tamil Nadu to NCT of Delhi and obtained a certificate in this regard from the Registrar of Companies, NCT of Delhi & Haryana at New Delhi On 20th June, 1997. The company finally changed its name to Vodafone Essar Mobile Services Limited and obtained the fresh certificate of incorporation on 3rd July, 2007.

5. The petitioner/transferor company no. 5 was originally incorporated under the Companies Act, 1956 on 7th December, 1995 with the Registrar of Companies, NCT of Delhi & Haryana at New Delhi under the name and style of Barakhamba Sales & Services Private Limited. The company changed its name to Barakhamba Sales & Services Limited after passing the necessary resolution to this effect and obtained the fresh certificate of incorporation on 22nd June, 2001. The company again changed its name to Hutchison Essar South Limited and obtained the fresh certificate of incorporation on 12th February, 2002. The company finally changed its name to Vodafone Essar South Limited and obtained the fresh certificate of incorporation on 4th July, 2007.

6. The petitioner/transferor company no. 6 was originally incorporated under the Companies Act, 1956 on 21st March, 1995 with the Registrar of Companies, Tamil Nadu under the name and style of

Aircel Digilink India Limited. Thereafter, the company had shifted its registered office from the State of Tamil Nadu to NCT of Delhi and obtained a certificate in this regard from the Registrar of Companies, NCT of Delhi & Haryana at New Delhi On 20th June, 1997. The company changed its name to Vodafone Essar Digilink Limited and obtained the fresh certificate of incorporation on 4th July, 2007.

7. The petitioner/transferee company was originally incorporated under the Companies Act, 1956 on 19th January, 2007 with the Registrar of Companies, Maharashtra, Mumbai under the name and style of Perfect Tribute Impex Private Limited. The company changed its name to Vodafone Essar Infrastructure Private Limited after passing the necessary resolution to this effect and obtained the fresh certificate of incorporation on 18th October, 2007. The company again changed its name to Vodafone Essar Infrastructure Limited and obtained the fresh certificate of incorporation on 17th January, 2008. Thereafter, the company had shifted its registered office from the State of Maharashtra to NCT of Delhi and obtained a certificate in this regard from the Registrar of Companies, NCT of Delhi & Haryana at New Delhi on 28th June, 2008.

8. The authorized share capital of the petitioner/ transferor company no. 2, as on 31st March, 2009, is Rs.2,00,00,00,000/- divided into 20,00,00,000 equity shares of Rs.10/- each. The issued, subscribed and paid up capital of the company is Rs.1,99,71,64,690/- divided into 19,97,16,469 equity shares of Rs.10/- each.

9. The authorized share capital of the petitioner/ transferor company no. 5, as on 31st March, 2009, is Rs.10,42,00,00,000/- divided into 54,00,00,000 equity shares of Rs.10/- each aggregating

Rs.5,40,00,00,000/-; 2,00,000 preference shares of Rs.100/- each aggregating Rs.2,00,00,000/- and 5,000 preference shares of Rs.10,00,000/- each aggregating Rs.5,00,00,00,000/-. The issued, subscribed and paid up capital of the company is Rs.7,01,60,75,000/- divided into 53,96,07,500 equity shares of Rs.10/- each aggregating Rs.5,39,60,75,000/-; 2,00,000 preference shares of Rs.100/- each aggregating Rs.2,00,00,000/- and 1,600 preference shares of Rs.10,00,000/- each aggregating Rs.1,60,00,00,000/-.

10. The authorized share capital of the petitioner/ transferor company no. 6, as on 31st March, 2009, is Rs.1,01,20,00,000/- divided into 10,12,00,000 equity shares of Rs.10/- each. The issued, subscribed and paid up capital of the company is Rs.1,01,10,00,000/- divided into 10,11,00,000 equity shares of Rs.10/- each.

11. The authorized share capital of the petitioner/ transferee company, as on 31st March, 2009, is Rs.5,00,000/- divided into 50,000 equity shares of Rs.10/- each. The issued, subscribed and paid up capital of the company is Rs.5,00,000/- divided into 50,000 equity shares of Rs.10/- each

12. Copies of Memorandum and Articles of Association of the petitioner/transferor companies no. 2, 5 & 6 and the transferee company have been filed on record. The audited balance sheets as on 31st March, 2008 of the petitioner/ transferor companies no. 2, 5 & 6 and the transferee company along with the report of the auditors have also been placed on record.

13. A copy of the Scheme of Arrangement has been filed on record and the salient features of the Scheme have been incorporated

and detailed in the petition and the accompanying affidavits. Under that scheme, it is proposed to demerge the passive infrastructure assets of eight transferor companies and transfer them to the transferee company. The transferor companies No. 2 to 7, and the transferee company are the wholly owned subsidiaries of transferor company No.1, i.e. Vodafone Essar Mobile Services Ltd. Out of these, three transferor companies, being Nos. 2, 5 and 6, and the transferee company, lie within the jurisdiction of this Court. The four remaining transferor companies, being Nos. 1, 3, 4 and 7, are within the jurisdiction of the High Courts of Bombay, Calcutta, Gujarat and Madras, respectively, as mentioned above. The Scheme has already been sanctioned by the High Courts of Bombay, Calcutta and Madras, and is pending before the High Court of Gujarat and this Court. It is further submitted that the Scheme envisages that on the appointed date, inter alia, the Passive Infrastructure Assets of all the transferor companies shall stand transferred to and vested in the transferee company. It is claimed that the segregation of the Passive Infrastructure Assets business and the telecommunications services business is to enable further growth and maximise value in each of the businesses. It is also claimed that it will improve the quality of services to customers by establishing a high service standard and delivering services in an environment friendly manner and will also increase the speed of roll-out and efficiency through the sharing of infrastructure. This initiative of the petitioners is stated to be in line with global trends, as well as the policy of the Government of India, as reflected in the Report of the Working Group on the Telecom Sector for the Eleventh Five Year Plan (2007-2012) issued by the Department of

Telecommunications, Ministry of Communications and Information Technology, Government of India, wherein it is recommended, inter alia, in Chapter 5.5. thereof, that the parties concerned;

> "Promote sharing of infrastructure so that costs can be kept down – this is essential for rural penetration. Incentivize such sharing."

14. So far as the share exchange ratio is concerned, the Scheme provides that the Scheme is intended to restructure, within the VEL Group, the holding of the assets constituting the Passive Infrastructure Assets in a more efficient manner consistent with the diverse needs of business, and does not involve any movement of assets or liabilities to any company outside the VEL Group. Since the transfer of the Passive Infrastructure Assets is within the VEL Group, such transfer shall be without any consideration. Accordingly, the transferee company shall not be required to issue any shares or pay any consideration to any of the transferor companies or their shareholders for acquiring the Passive Infrastructure Assets.

15. It is claimed by the petitioners that no proceedings under Sections 235 to 250A of the Companies Act, 1956 are pending against the petitioner/transferor companies no. 2, 5 & 6 and the transferee company

16. The Board of Directors of the petitioner/transferor companies no. 2, 5 & 6 and the transferee company in their separate meetings held on 21st September, 2007 & 30th April, 2008 have unanimously approved the proposed Scheme of Arrangement. Copies of the Resolutions passed at the meetings of the Board of Directors of

the petitioner/transferor companies no. 2, 5 & 6 and the transferee company have been placed on record.

17. The petitioner companies had earlier filed CA (M) No. 113/2010 seeking directions of this court to dispense with the requirement of convening the meetings of their shareholders, secured and unsecured creditors, which are statutorily required for sanction of the Scheme of Arrangement. By order dated 29th May, 2010, this court allowed the application and dispensed with the requirement of convening and holding the meetings of the shareholders and creditors of the petitioner companies to consider and, if thought fit, approve, with or without modification, the proposed Scheme of Arrangement.

18. The petitioner companies have thereafter filed the present petition seeking sanction of the Scheme of Arrangement. On 31st July, 2009, notice in the petition was issued to the Regional Director, Northern Region. Citations were also directed to be published in the Delhi, Mumbai, Kolkata, Chennai and Ahmedabad editions of 'Times of India' (English), and 'Nav Bharat Times' (Hindi); 'Ananda Bazar Patrika' (Bengali); 'Dina Malar' (Tamil) and 'Sandesh' (Gujarati) respectively, in terms of the Companies (Court) Rules, 1959. Affidavit of service has been filed by the petitioners showing compliance regarding service on the Regional Director, Northern Region and also regarding publication of citations in the aforesaid newspapers on 24th to 27th August, 2009 respectively. Copies of the newspaper clippings containing the publications have been filed along with the affidavit of service.

19. In response to the notices issued in the petition, Dr. Navrang Saini, Regional Director, Northern Region, Ministry of

Corporate Affairs has filed his report dated 16th September, 2009. Relying on Clause 4.4.1 of Part-III of the Scheme, he has stated that, upon sanction of the Scheme of Arrangement, all the employees of the transferor companies engaged in or in relation to the Passive Infrastructure Assets of the Transferor companies who are in such employment as on the appointed date shall continue to remain employees of the respective transferor companies, without any break or interruption in their services.

20. The Regional Director has further submitted that the details of individual assets and liabilities and values thereof pertaining to, "Passive Infrastructure Assets", of all the transferor companies proposed to be transferred to the transferee company are not mentioned in the Scheme, and that such details of individual assets and liabilities thereof should have been part of the Scheme so that the same are known to the shareholders and creditors of all the companies.

21. In response to the above objection, the petitioner companies in their rejoinder stated that assets have been defined in the Scheme of Arrangement and that, as such, the assets being transferred are identifiable and a list of assets of each of the petitioner companies is not required to be a part of the Scheme. The petitioner companies have also placed on record a provisional list of assets to be transferred by each of the petitioner companies, as at 31st March, 2009. The petitioner companies further undertake to file a final list of assets for the transferor companies Nos. 2, 5 and 6 after receiving the approval of this Court, to form a part of the sanctioned Scheme. The

undertaking is accepted, and in view of the same, this objection does not survive.

22. The Regional Director, while referring to Para 3.1.1 of Part-III of the Scheme regarding accounting treatment in the books of the transferee company, has further submitted that the transferor companies Nos. 2, 5 and 6 have failed to submit a valuation report and that all the transferor and transferee companies may be directed to obtain a valuation report from a recognized firm of Chartered Accountants.

23. In response to the above objection, the petitioner companies in their rejoinder have submitted that the petitioner companies, including the transferee company, are 100% subsidiaries of transferor company no. 1 and that since the restructuring involves movement of assets within the Vodafone Essar Limited group of companies, such transfer of assets shall be without consideration, and therefore, no shares are required to be issued by the transferee company to any of the petitioner companies or to any of their shareholders, and accordingly, no valuation report is required to be prepared with respect to the Scheme. In support of the above submission, the petitioner companies relied on the judgment of this court in **Re: Bharti Airtel Limited** [CP No. 233/2007, decided on 26th November, 2007] wherein a similar Scheme of Arrangement involving demerger of Passive Infrastructure Assets into a group company, where no consideration was to be paid nor were any shares to be issued by the transferee company to the transferor company, was sanctioned. In view of the above, the objection raised by the Regional Director does not survive.

24. The Regional Director, while referring to Para 2.4 of Part-II of the Scheme, has further submitted that the transferee company may be directed to obtain the necessary approvals from the Department of Telecommunications for transfer of licenses after sanction of the Scheme by this court, pursuant to the Department of Telecommunications' letter No. 820-I/2003-LR dated 9th June, 2003, in which the Department of Telecommunications has clarified that the licensee may transfer the licenses with prior written approval of the licensor even in cases of amalgamation under Sections 391/394 of the Companies Act, 1956.

25. In response to the above objection, the petitioner companies have submitted that none of the transferor companies are transferring any telecommunication licenses issued by the Department of Telecommunications to the transferee company pursuant to this Scheme and that the aforesaid letter issued by the Department of Telecommunications has no application to this Scheme. Consequently, the transferor companies before this court will continue to operate as telecommunication service providers even after the demerger is effected. It is further submitted that the transferee company has been registered as an Infrastructure Provider Category- I by the Department of Telecommunications, which permits the transferee company to establish and maintain Passive Infrastructure Assets to lease, rent or sell such assets to licensees of the telecom services under Section 4 of the Indian Telegraph Act, 1885. A true copy of this registration certificate dated 17th June, 2008 has also been placed on record by the petitioners. In view thereof, this objection raised by the Regional Director does not survive.

26. After the citations were published in the newspapers on 27th August, 2009, counsel for the Income Tax Department appeared on 18th September, 2009 and stated at the bar that certain queries had been raised by the income tax authorities in respect of the Scheme. The Income Tax Department's formal objections to the Scheme were filed in this Court on 10th November, 2009.

27. The rationale behind the objections of the income tax authorities is that since the transferor companies propose to transfer only the assets of the transferor companies to the transferee company, without transferring the liabilities in respect thereof as well, including any contingent liabilities, the liabilities would remain with the transferor companies after the demerger. Consequently, a continuous charge of interest and other liabilities would remain in the hands of the transferor companies in respect of the transferred assets, thus reducing the taxable profits in their hands, which would in turn lower the tax burden on the transferors, thereby adversely affecting the revenue's interest. It was further pointed out that the proposed Scheme contemplated transfers for 'nil' consideration. It was also claimed that if the proposed Scheme was sanctioned by this Court, the accounts of the transferee company would reflect an exorbitant and inflated income, but as the transferee company was an infrastructure company, being an Infrastructure Provider Category I, it could claim deductions under the various provisions of Chapter VI-A of the Income Tax Act, 1961 on its profits, thereby also leading to a loss of revenue for the income tax authorities. The Income Tax Department also apprehended that once the assets were transferred, and their value consequently removed from the account books of the transferor

companies, the net worth of some of the transferor companies might be rendered negative, and that, therefore, there was a real likelihood that those companies would be unable to pay their existing and contingent tax liabilities, since there was allegedly insufficient material to demonstrate that those companies would be able to generate enough income to meet the same. It was further claimed that the Scheme, as it stood, was against public interest for these reasons. These are, broadly, the issues raised by the Income Tax Department, which are, in my view, to be considered keeping the tax authorities' interest in mind, i.e. that nothing in the Scheme should come in the way of applicability of the relevant taxing statutes to the transactions flowing therefrom. Although it is disputed by the petitioners, the Income Tax Department has claimed an outstanding tax liability of approximately Rs. 19 crore against the petitioners before this Court, from assessment year 1999-2000 onwards.

28. In this context, two broad submissions were made by the Income tax Department. The first was that the expression 'arrangement with members' used in S. 391, did not contemplate a gift from one party to the Scheme to the other party for the reason that the aforesaid expression contemplated an arrangement in the nature of a contract with a consideration involved, which is missing in this case. The second submission was that the Scheme is against public interest.

29. At the outset, it is necessary to record that Dr. Singhvi, counsel for the petitioners, submitted, on instructions, that notwithstanding any sanction or approval that may be granted by this Court to the proposed Scheme, his clients would be bound by all

obligations that may be imposed on them under the applicable provisions of the Income Tax Act, 1961. By stating this, the petitioners clearly outlined their stand at the beginning of these proceedings, to the effect that the sanctioning of the Scheme would not ipso facto grant any immunity to the petitioners qua any liability that may be imposed on them under the relevant provisions of the Income Tax Act, in accordance with law.

30. The first issue to be decided is whether an arrangement, as understood in S.391, does not contemplate a transfer by way of gift from one party to the Scheme to another. Undisputably, a company may transfer property to another company. [See, **Hindustan Lever v State of Maharashtra,** (2004) 9 SCC 438]. Under the Gift Tax Act, 1958, any person may make a gift, and 'person' is defined in S.2(xviii) thereof to include, inter alia, a company, whether incorporated or not. A Division Bench of the Karnataka High Court in **Sanjiv V. Kudva v Commissioner of Income Tax, Karnataka**, (1981) 127 ITR 354 (Kar) has held that the meaning of 'gift' in the Income Tax Act, 1961 must be given the same meaning as that in S.2(xii) of Gift Tax Act, 1958, i.e. a gift is the transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration. Therefore, it seems that there is no legal impediment to a company transferring property by gift.

31. Admittedly, in the Scheme, certain assets are to be transferred without consideration, and without transfer of liabilities in respect thereof. According to the petitioners, these are, "transfers by way of gift", and the relevant clauses in the Memorandum of Association of the petitioner companies give them the power to do so.

The petitioners also referred to S.5 of the Transfer of Property Act, 1882, read with S.122 thereof, to contend that a transfer between companies would constitute a gift, provided it was of existing property, transferred voluntarily, made without consideration, and was accepted by or on behalf of the donee. Further, according to the petitioners, the logical consequence of such a transfer by way of gift, is that such a transfer is exempt from the payment of capital gains tax under S.47(iii) read with S.45 of the Income Tax Act, 1961.

32. However, according to the Tax Department, the transfer of assets by way of 'gift' is impermissible, because a scheme of arrangement under S.391-394, does not and cannot include a gift, as understood in law, and that the, "arrangement", contemplated by Section 391 can only be a transaction in the nature of a contractual arrangement for consideration. In respect of the effect of this transaction on the non-leviability of capital gains tax, the income tax authorities submitted that this rendered the Scheme contrary to public interest, which issue will be taken up subsequently. But first, the issue whether a transfer by gift is within the scope of a Scheme of arrangement, shall be dealt with.

33. S.391 contemplates a scheme which is a compromise or arrangement with a company and its creditors or any class of them, or between a company and its members or any class of them. According to counsel for the Income Tax Department, the present Scheme falls into neither of the above categories, and therefore, cannot be sanctioned by this Court in exercise of its jurisdiction under S.391 because it contemplates neither a compromise nor an arrangement. According to counsel, the scope of the expression, "arrangement",

contemplated under S.391, is limited only to a contract which involves the transfer of consideration from each party to the other, and therefore cannot include a "gift". He relied mainly on **In re: NFU Development Trust Ltd.,** (1972) 1 WLR 1548, and **State of Punjab & Ors. v Ganpat Rai**, (2006) 8 SCC 364 in support of this proposition.

34. **NFU Development Trust Ltd.'s** case (supra) dealt with a Scheme of arrangement that had been propounded which would have had the effect of forfeiting the rights of some of its members. At the meeting, although some members opposed the Scheme, it was, however, approved by a three-quarter majority vote. Later, when the petition for sanction of the Scheme was presented to the Court, it was opposed by some directors and members of the company. An objection was raised to the effect that the terms of the proposed Scheme did not qualify as an 'arrangement' under the English statute, i.e. the Companies Act, 1948, for the reason that the members were being stripped of all their rights and were receiving no compensating benefit of any description in lieu thereof, except for the extinction of their nominal contingent liability to contribute in the event of winding up. Counsel for the Income Tax Department relied on the following portion of that judgment;

> *"Mr. Rice's second submission was that the terms of the scheme were such that it did not qualify as an arrangement within the meaning of Section 206 of the Act. The effect of the scheme would be that all the members of the company except the NFU Development Co. and such of the so-called new members as were not already members of the*

company, would be stripped of all their rights and receive in exchange no compensating benefit of any description, except the theoretical extinction of their contingent liability to contribute five new pence in case of a winding up; theoretical, because it is de minimis and has no significance in the context of a non-trading company with assets of £3,000,000 and liabilities which do not exceed £25,000. A member loses his right to attend the annual general meetings and other meetings of the company; his right to make his voice heard at meetings; his right to receive the board's annual report and the company's accounts; his right to question the use which the board makes or omits to make of the company's considerable financial resources; the right to vote on the remuneration of directors; the right to put himself forward for appointment to an area electoral college and thus acquire a say in the election of a director. Admittedly the rights of a member are very limited, and so it may be said that a member does not lose much under the scheme because he has not much to lose. Nor did he pay much for his membership rights in the first place - merely an entrance fee of five shillings. Be that as it may, the company has become prosperous, no doubt as a result of the support which members gave to the company's marketing undertaking during the period that it traded, and the profit thereby made by the company. However little a member originally paid for his membership, and however small his effective stake in the company and his opportunity to control its operations, nevertheless he has rights and under the scheme he loses all."

He also relied on the following;

> *"Then comes the more serious point, whether this is a compromise or arrangement which is within either the words of the section or within the true spirit of the legislation; that is to say, whether the court has either jurisdiction to sanction it, or ought to sanction it. I do not think myself that the point of jurisdiction is worth discussing at much length, because everybody will agree that a compromise or agreement which has to be sanctioned by the court must be reasonable, and that no arrangement or compromise can be said to be reasonable in which you can get nothing and give up everything. A reasonable compromise must be a compromise which can, by reasonable people conversant with the subject, be regarded as beneficial to those on both sides who are making it. Now I have no doubt at all that it would be improper for the court to allow an arrangement to be forced on any class of creditors, if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such, otherwise the sanction of the court would be a sanction to what would be a scheme of confiscation. The object of this section is not confiscation."*

35. Relying on these observations, counsel contended that even if all members and shareholders of a company had given their consent to a Scheme, which would have the effect of forfeiting their rights in the company, this Court must still refuse to sanction this Scheme. In effect, his submission is that whilst it is always open to any member of a company, either of the majority or of the minority, to agree to any Scheme which would not give him any compensating benefit, and while such an act would be valid in law, the Company

Court cannot sanction a Scheme of such a nature. He submitted that this would be the outcome even if all members, without exception, voted in favour of the scheme proposed, and no member raised any objection before the Court. According to him, the Scheme proposed in the present case is confiscatory.

36. To my mind, such a proposition cannot be countenanced. The expression 'arrangement' has not been defined in the Companies Act, 1956. The ordinary meaning of the word is as follows;

> ""**arrangement *n.* –** 1. The act or process of arranging or being arranged, 2. The condition of being arranged; the manner in which a thing is arranged. 3. Something arranged. 4. Plans, measures (make your own arrangements) 5. A composition arranged for performance by different instruments or voices. 6. Settlement of a dispute etc.
>
> See, Concise Oxford English Dictionary, 10th Edition.

37. In **NFU Development Trust Ltd.'s** case (supra), the Court was satisfied on facts that the Scheme, which had been passed by the majority, intended to confiscate the rights of the objecting minority shareholders. It was of the view that confiscation of the rights of an objecting minority member by virtue of a majority-approved Scheme, cannot amount to either a 'compromise' or an 'arrangement' by that company with its members and therefore any sanction granted to such a Scheme would amount to sanctioning a scheme of confiscation. It also took the view that it would be improper for the Court to allow such an arrangement to be forced on any class of members, since it could not reasonably be supposed by any sensible commercial standard to be for the benefit of that class.

The relevant distinguishing factor was that, in that case, the objectors were the members who were subject to the proposed confiscation. However, in the present case, as also clarified by Dr. Singhvi at the Bar, in view of the nature of the shareholding between the transferors and transferee company, there is clearly no question of any confiscation of the rights of any party to the Scheme. Furthermore, all the concerned shareholders have given their consent and there is no objecting shareholder.

38. Mr. Mehta, who addressed the Court for the Income Tax Department on this aspect, further sought to interpret the meaning of the words, "compromise or arrangement", as used in **NFU Development Trust Ltd.'s** case (supra), to necessarily include some element of, 'give and take'. He submitted that if the petitioners had been able to demonstrate that there was an element of give and take in the proposed Scheme under the consideration of this Court, i.e. that the members or shareholders of the transferor companies received anything after the demerger, only then would it amount to an arrangement. According to him, giving the assets without receiving anything in return from the transferee, in effect, automatically amounts to a confiscation of the aforesaid assets by the transferee company. Mr. Mehta was invited to place any authority before this Court in support of this proposition, to which he responded that he had not come across any judgment on this point.

39. To my mind, the expression, 'give and take' used in **NFU Development Trust Ltd.'s** case (supra) must be read in the context of the finding that the arrangement proposed therein was found to be confiscatory in nature. Furthermore, there is a significant difference

between an arrangement which is confiscatory in nature and an arrangement which contemplates a gift. In the case of a gift, the donor may have no expectation of a return, but this does not mean that the subject matter of the gift has been confiscated from the donor by the donee. Expressions such as, "confiscation" and "forfeiture" normally contemplate the taking and seizing of property, or the deprivation thereof, as a penalty. It can be said that these expressions have, within them, elements of involuntariness with regard to the persons who suffer confiscation or forfeiture, and, in that sense, since the very foundation of a gift is voluntariness, they are the very antithesis of a gift. It follows, therefore, that it would be absurd to suggest that a gift has either resulted in, or is a consequence of, any confiscation or forfeiture. Furthermore, the expressions used in Section 391 is, "arrangement"; but nothing prevented the Legislature, in its wisdom, from specifically mentioning the requirement of a, "contract for consideration", also in that Section. Although **NFU Development Trust Ltd.'s** case (supra) interpreted the expression "arrangement" to mean an implied give and take, the Court did not specify that "give and take" was to mean reciprocal promises by way of consideration. To my mind, the expression "give and take" used in that judgment implies a degree of voluntariness in the transactions contemplated by the Scheme between all parties thereto, and no more. Even the offer of a gift by the donee and its required acceptance by the done, are sufficient to satisfy this test. In that case (supra), the Court did not venture further since that decision was rendered in the light of a scheme passed by the majority which operated to confiscate the rights of the objecting minority. The scheme was held to be a confiscatory transaction because there was no element of voluntary, 'give and take', in the sense explained above, since it could not be said that what was given, was given willingly, or that it was taken with the consent of the giver. In the light of the foregoing, it becomes clear that in a confiscatory Scheme, since there is no element of voluntariness, there can be no give and take, as understood above. To put it differently in that case (supra), there was no 'giving' by the members whose rights were being forfeited, rather, there was only a 'taking' sanctioned by the majority of the members as per the Scheme, which made the Scheme confiscatory qua the objecting minority. Therefore, the Court refused to sanction such a Scheme. It is in that sense that the Court in **<u>NFU Development Trust Ltd.'s</u>** case (supra) used the expression 'give and take'. To my mind, the present factual matrix is different from that of the abovementioned case, as is the nature of the Scheme propounded.

40. Further, as already pointed out, the decision in the **<u>NFU Development Trust Ltd's</u>** case (supra) was rendered in the context of the fact that the objections of the minority shareholders were overruled by the majority at the AGM, who then approached the court with their objections, contending that the scheme passed by the majority extinguished all their rights without any compensation. It was in that context that the court held that for the arrangement or compromise to be considered reasonable, it must be of a sort considered as such by reasonable persons conversant with the subject. Also, whether the arrangement in that matter was reasonable or not was examined from the standpoint of the objecting shareholders who, it was held, are losing everything and getting nothing. It was in these

circumstances that the Scheme propounded was held to be confiscatory, and not that every transfer without consideration or recompense passing to the transferor as, for example, in a gift, must automatically be declared confiscatory, and therefore unacceptable under Section 391 of the Act. Here, the context is quite different. Not a single shareholder has objected. The Income Tax Department cannot conceivably have the same interest in the company proposing the scheme as the shareholders of that company. And, to my mind, the Income Tax Department is also not in any sort of loco parentis to the shareholders of the transferor companies who have unanimously agreed to transfer their assts without recompense, nor are they the guardians of their interests, and therefore, the Income Tax Department cannot be heard to plead that the scheme must be thrown out because, in its opinion, the Scheme operates as a confiscation of the transferor shareholder's rights. The essence of the idea of confiscation is the taking away or abstraction of something from someone without his consent. Once there is consent, there can be no confiscation.

41. I might add that, on a question being put to counsel for the Income Tax Department as to whether a nominal consideration of Re.1/- would be considered sufficient consideration, he admitted that it would be sufficient and that, in that case, all objections to the issue of transfer by way of a gift would no longer stand and the Scheme would be squarely covered under S.391 of the Companies Act, 1956.

42. Counsel for the Income Tax Department then tried to rely on **<u>State of Punjab & Ors. v Ganpat Rai</u>**, (2006) 8 SCC 364, wherein the expression "compromise" in S.20(3) and (5) of the Legal

Services Authorities Act, 1987, was examined by the Supreme Court to mean that a compromise is always bilateral and implies mutual adjustment, that some element of accommodation on each side is implied in the word itself, and that "it is not apt to describe total surrender". Relying on this judgment, counsel submits that the act by which a donor gifts any property to a donee would be an act of surrender and therefore cannot be construed as an arrangement of the type contemplated under Section 391 of the Companies Act. That decision does not hold that, a "gift" amounts to, "total surrender"; nor does the dictionary meaning of the word, "gift" and "surrender" lead us to any such conclusion. The question whether a "gift" also amounts to a, "total surrender", was not before the Supreme Court in that case. There, the Court was concerned with the issue whether the necessary requirements enabling the Lok Adalat to dispose off the matter were satisfied in that case since, admittedly, there was no settlement or compromise between the parties after reference by the Punjab & Haryana High Court. For this, the Supreme Court examined Section 20 of the Legal Services Authorities Act, 1987 to hold that if no settlement or compromise is arrived at, the Lok Adalat has no power to dispose off the matter. Consequently, the order of the Lok Adalat allowing the writ petition was held to be bad. For counsel to take this to mean that since in lay terms, a gift could also be said to amount to a "total surrender" of the donee's rights, and because a 'total surrender' has been held as not amounting to a settlement or compromise of the type contemplated by the Legal Service Authority Act, therefore, even a gift contemplated under a scheme under Section 391 of the Companies Act has to be construed as something that cannot be countenanced as a part of a permissible 'arrangement or compromise' envisaged therein, amounts to a comparison that is too farfetched. To my mind, relinquishment of a right by a donor, by way of a gift or otherwise, does not amount to a "total surrender" of what is being gifted. The words "surrender" and "gift" are not synonymous, and cannot be used interchangeably. The concise Oxford Dictionary (6th Edition) defines the word, "gift", to mean, "a thing given willingly to someone without payment; a present"; whilst the word, "surrender" is a verb, defined by that Dictionary to mean, "(i) cease resistance to an opponent and submit to their authority, (ii) give up (a person, right, or possession) on compulsion or demand." Although the Supreme Court referred to **NFU Development Trust Ltd.'s** case (supra) while making the aforesaid observation to the effect that a compromise does not mean total surrender, for the reasons I have set out, it has no application in this case. I, therefore, do not agree with the proposition enunciated by the counsel for the Income Tax Department in this behalf and, in my view, this judgment relied on by the objector does not advance his case.

43. At this juncture, the petitioners' response to this issue may also be noted, which was, that the shareholders of the transferor companies and the transferee company have given their unanimous consent to the Scheme for transfer of the passive infrastructure assets for nil consideration, and that there was no dissent expressed by any one of them, nor is there any element of expropriation or surrender in the proposed Scheme. It was also averred by the petitioners that there is indeed a 'compensating advantage' conferred on the transferor companies, i.e. that after the demerger, an asset which previously did

not generate any revenue will become a revenue generating asset, and that the enormous maintenance and installation expenditure required to keep such an asset in working condition will be reduced for the transferor companies. Furthermore, this arrangement is in line with the policy of the Government of India.

44. The petitioners relied on **In re: Larson and Toubro Ltd.**, (2004) 121 Comp Cas 523 (Bom), paragraph 58 thereof, to show that although the expression 'arrangement' has not been defined in the Companies Act, 1956, yet it has been held to be of wide scope, including the reorganization of shares and share capital of a company, among other things. Further reliance was placed by the petitioners on **Guardian Assurance Co, Re**, (1917) 1 Ch. 431, at page 441 thereof, to support the argument that an arrangement extends to and includes, "every transaction between a company and its members which directly affected their proprietary rights in their shares". To meet the objector's contention that S.391 does not contemplate a Scheme of arrangement whereby transfer of assets is made without consideration, the petitioner's counsel has also referred to **In re: Highway Cycle Industries and Sunbeam Auto Ltd**, (1999) 97 Comp Cas 846 (P&H), where no cash consideration was given for transfer of a business undertaking. There it was held as follows;

> *"6. …The proposed scheme need not satisfy the basic ingredients of a contract..."*

This decision was also followed in **In re: SREI Infrastructure Finance Ltd.** (2008) 4 Company Law Journal 196 (Cal), which dealt, inter alia, with the objection by the Central Government that the

Scheme propounded may assist the parties in avoiding payment of capital gains and further that rights, privileges and benefits accruing to the transferee company have not been spelt out under the Scheme and, therefore, it is unfair to the shareholders and ought not to be sanctioned. The Court while noting that "….no shareholder has come forward to challenge the Scheme of Arrangement or to raise any objection in respect thereof", held that "….avoidance of capital gains can be no reason for not sanctioning the Scheme of Arrangement as avoidance of capital gains is a matter of revenue and will attract the provisions of the Income Tax Act" and that, "….the companies cannot escape from their respective liabilities." It was further held that, "it must not be forgotten that a Scheme of Arrangement is between shareholders and the transferor and transferee companies. The Scheme of Arrangement is an arrangement to conduct the business of a company by its shareholders. The shareholders having agreed to conduct the management and the affairs of the company in a particular way must be honoured."

45. For all of the above reasons, and since the objector has not been able to place any direct authority, precedent or Rule before this Court to support his contention, and in view of the authorities relied on by the petitioners, counsel for the Income Tax Department has failed to persuade this Court that a transfer by way of gift was not permissible under Section 391 of the Companies Act, 1956, or that the Scheme in question was confiscatory, this objection does not survive.

46. The second objection raised by the Income Tax Department was regarding the accounting treatment prescribed in the Scheme. Admittedly, the accounting treatment of the transactions in

relation to the demerger is vital for determining the tax treatment of the same. According to the Income Tax Department, by proposing to transfer assets at book value, the petitioners were trying to evade payment of capital gains tax, which would otherwise have been payable if the assets were to be transferred at market value. Further, according to the Department, it was for this reason that the petitioners had not provided any valuation in respect of the passive infrastructure assets that are proposed to be demerged in terms of the Scheme. Admittedly the transfer of assets by the transferor companies to the transferee company for no apparent or real consideration is in the nature of a gift. The permissibility of such a transfer has been established in the discussion above. However, counsel for the objectors submitted that in view of the faulty accounting treatment prescribed in the Scheme, the petitioners would succeed in evading payment of tax liabilities if this Court were to sanction this Scheme and the accounting treatment proposed therein.

47. Mr. Tripathi, Learned Additional Solicitor General, further contended that any consent that may have been obtained from shareholders of the transferor companies, in respect of a Scheme proposing to transfer valuable assets of those companies to another company, without disclosing the value of those assets to the shareholders, would be a nullity in law, as the substance of the transaction would not be known to the shareholders. According to him, the book value methodology was only available to the petitioners so long as the assets remained with the respective transferor companies, but when a transfer is intended, a 'true and fair' value of the assets is to be disclosed before the assets are actually transferred, in terms of

Accounting Standards 9, 10 and 11, which were prescribed with a view to ensuring transparent transactions. However, Mr. Tripathi conceded that the 'true and fair' value may be higher, equal to, or lower than the book value. Therefore, to my mind, the only pertinent question here is whether there is any onus or obligation on the petitioners to furnish or disclose any such value to its shareholders or to this Court.

48. According to Dr. Singhvi, Senior Counsel for the petitioners, there is no such obligation cast on the petitioners, and no requirement that the value or details of assets in a Scheme have to be listed by the parties to the Scheme. Further, according to him, the circumstances of this particular case show that in any case, the disclosure of the value of the assets proposed to be transferred was immaterial, since the transferor companies largely have only one majority shareholder, which is the transferor company No. 1 itself, who is also part of the Scheme. With regard to the petitioners before this Court, i.e. transferor companies No. 2, 5 and 6 and transferee company; transferor company Nos.2, 6 and the transferee company, are wholly owned by transferor company No.1, while transferor company No.1 has a 49% shareholding in transferor company No.5. According to Dr. Singhvi, the description of the assets given in the Scheme is sufficient and is all that is required. He further urged that there was no requirement in the statute that a transfer of any asset needed to be carried out at 'fair value', and that parties could agree on what constituted a fair price among themselves. However, notwithstanding that there was no requirement in law to provide a valuation of assets proposed to be transferred pursuant to sanction of a Scheme by a Company Court, with a view to establishing the

petitioners' bona fide, the net book value of the passive infrastructure assets proposed to be transferred, as on 31st March, 2009, have been disclosed to this Court by the petitioners and placed on record vide written submissions which were handed over in Court in response to the objections of the Income Tax Department.

49. Counsel for the petitioners also categorically stated that if the Income Tax Department had any objection with regard to the accounting methodology, it would remain open to the tax authorities to proceed against the transferor companies and/or the transferee company after the demerger is effected. It was also stated on behalf of the petitioners that before the tax authorities, they would not take the stand that the issue of taxability cannot be gone into by reason of the order sanctioning the Scheme. The Bombay High Court in **re: Reliance Communications Infrastructure Ltd**, (2009) 151 Comp Cas 538, sanctioned a proposed Scheme with similar directions. The Income Tax Department will consequently be free to examine all aspects of the demerger being effected from the taxation point of view.

50. In this context, the petitioners also relied on **In re: Ajmera Realty and Infra India Ltd**, (2009) 151 Comp Cas 442 (Bom), wherein the Bombay High Court dismissed the Regional Director's objection that neither the petition nor the Scheme provided details of the assets and liabilities proposed to be transferred by way of the demerger, by holding that there was no provision in law which required the balance sheet and profit and loss account or the scheme proposed to enumerate and set out each and every asset which is the subject matter of the scheme. Further, while the Court did not

expressly hold that there was a bar on any creditor, shareholder or any other concerned party in filing an application for those details in the Company Court, any such application would have to be decided by the Court on the facts of a particular case. I am in agreement with this view. The petitioners' response is based on the essential difference between a company, which is a legal entity, and its constituent shareholders. For certain acts, the company is obliged to find support from its constituents, and for that purpose, it is required to disclose all the relevant details to those constituents to enable them to arrive at a decision. However, in case the constituent shareholder happens to be a company whose shares are held by the propounder itself, then, to enable an informed decision to be taken, it is not necessary for the propounder to disclose the relevant details to such a constituent shareholder because it would amount to disclosing something to itself.

51. Further reliance was placed by the petitioners on **In re: Hindalco Industries Ltd.,** (2009) 151 Comp Cas 446 (Bom), in support of their proposition that a dispute regarding accounting standards is not sufficient ground to refuse grant of sanction to a Scheme, is well-founded, although that case dealt with the restructuring of a company and not a demerger. In that case, an objection that sanction of the Scheme would result in violation of Accounting Standards by the petitioner company in the course of effecting the proposed restructuring, which would also result in an inaccurate representation of the petitioner company's financial position, was rejected. It was held by the Court that deviation from

accounting standards, per se, cannot be a ground for rejection of the Scheme.

52. Moreover, since the question of tax treatment of the transactions arising out of the Scheme, which are obviously based on the financial statements and accounts of the petitioners, is being left open, I see no reason why sanction to the Scheme should be withheld only on this ground.

53. Another ancillary issue raised with respect to the issue of the accounting treatment was that the petitioners would then have the benefit of 'double depreciation', to which the petitioners' response was that the Scheme envisages depreciation being claimed by the transferor companies only on the assets that remain with them after the demerger takes effect, while the transferee company shall claim depreciation on the assets it receives after the demerger, and therefore, by this method, there was no question of the petitioners' claiming double depreciation. However, since the objection regarding valuation of those assets, which is necessary to determine the depreciation claimed, has already been discussed above and since it has been made clear that the income tax authorities will have full freedom to question the accounting treatment and the resulting tax liabilities found payable by the petitioners, this ancillary issue is also being left open for determination by the appropriate authority.

54. The third objection put forth by the objector was that, since it was for nil consideration, the proposed demerger might result in the net worth of some transferor companies decreasing significantly, almost to the extent of being rendered negative, which would affect their solvency and, consequently, any outstanding tax liabilities that

may be payable by them. Admittedly, the petitioner companies propose to transfer valuable assets which have a potential to generate income, and as per the Scheme, will receive no consideration for the transfer. The net worth of a company is relevant for assessing its solvency. The Department contended that the petitioners had been unable to demonstrate that, after the proposed demerger, the transferor companies and transferee company would have sufficient assets to meet any tax liability that may arise, meaning thereby that the transferors would be rendered insolvent after the demerger, and therefore, for this Court to sanction a Scheme that may result in the coming into existence of a palpably insolvent company would be against public interest. It was also contended that, in addition, since the Scheme contemplated a change in the ownership of the passive infrastructure assets with their transfer to the transferee company, the transferor companies may well be obliged thereafter to pay the transferee company for the use of those assets. If that were to happen, naturally, there would be an increase in the revenue of the transferee company, since the charges paid by the transferor companies would be income in the hands of the transferee company, on which it would be liable to pay tax. Yet, at the same time, the amount paid to the transferee company by the transferor companies would be a sort of revenue expenditure, thereby distorting the tax liability of the transferor companies. However, if the passive infrastructure assets were to remain in the hands of the transferor companies themselves, liability to pay tax would be only on the incomes generated for the transferor companies by the use of those assets and nothing further.

55. In response, the petitioners disputed that there was any outstanding tax liability payable by the companies at present, and that if any tax liabilities were found payable after the demerger, the transferor companies and the transferee company would continue to generate revenue from their operations and meet the same. Admittedly, the ability of the petitioners to meet tax demands can only be assessed by the revenue stream that they are able to generate. Counsel for the petitioners argued that, even if it were assumed for the sake of argument that the post-demerger net worth of the transferor companies would become negative, even in that situation, each transferor company would be generating sufficient revenue from its telecom operations to meet its tax demands. According to the petitioners, the transferor companies will be more than able to meet all alleged tax claims that were mentioned in the objections filed by the Income tax Department, if found ultimately payable by the petitioners. According to the petitioners themselves, the estimated net worth of the transferor companies, as at 31st March, 2009, was Rs.14,058 crores, and after demerger, the net worth of all the transferor companies, would be approximately Rs.10,078 crores. Details of incomes from operations, mobile telecommunications services and license fees, which show that the transferor companies before this Court are generating more than enough revenue to meet any tax liability, were placed on record by the petitioners in the petition as well as in the written response to the objections. They are as follows:

a) Transferor company No. 2 - Rs. 2038.73 crores, as at 31st March, 2009

b) Transferor company No. 5 - Rs. 6963 crores, as at 31st March, 2009

c) Transferor company No. 6 - Rs 3130.15 crores, as at 31st March, 2009.

56. The Income Tax Department's fourth objection was that the proposed Scheme was contrary to law and should be dismissed irrespective of the legality of the transaction from the income tax point of view, in the public interest. Counsel for the petitioner raised the question of how the Income Tax Department, being a department of the Central Government, was objecting to the Scheme, when the Central Government, vide the Regional Director's report, had not objected to the same on this ground.

57. Mr. Tripathi relied on **In re: Wood Polymer**, (1977) 109 ITR 177 (Guj), to contend that restrictions that may apply to the exercise of the Income Tax Department's jurisdiction over a return that is being assessed by it confining its jurisdiction to the question of revenue alone, need not automatically apply to this Court in its exercise of company jurisdiction under S.391 to 394 which enable this Court to examine whether the Scheme was in public interest or not. In **In re: Wood Polymer** (supra), while the Central Government had not objected to the Scheme, the Official Liquidator himself raised an objection to the Scheme, to the effect that the transferee company was being created purely to facilitate the evasion of capital gains tax, whereas the Central Government had not objected to the Scheme. Reliance was placed on the following observations made therein, at page 624 thereof;

> *"…If the party seeks assistance of the court only to reduce tax liability, the court should be the last instrument to grant such assistance or judicial*

> *process to defeat such a tax liability, or even to avoid tax liability…"*

58. In the aforesaid judgment, at page 623 thereof, the Court has also made certain observations about the scope of the term 'public interest' used in S.394, which are reproduced as follows;

> *"The expression "public interest" must take its colour and content from the context in which it is used. The context in which the expression "public interest" is used should permit the court to find out why the transferor-company came into existence, for what purpose it was set up, who were its promoters, who were controlling it, what object was sought to be achieved through creation of the transferor-company and why it is now being dissolved by merging it with another company. All these aspects will have to be examined in the context of the satisfaction of the court whether its affairs have not been carried on in a manner prejudicial to public interest. That is the colour and content of the expression "public interest" as used in section 394(1), second proviso, and the facts of this case will have to be examined keeping in view the colour and content of the expression "public interest"."*

59. In reply, the petitioner's counsel referred to **Union of India & Ors. v Ambalal Sarabhai Enterprises Ltd.**, (1983) 55 Comp Cas 623 (Guj), where Wood Polymers case (supra) was also considered by a Division Bench of the Gujarat High Court which distinguished it on facts and further explained it as follows;

> *"In the case of Wood Polymer [1977] 47 Comp Cas 597 (Guj), the only purpose discernible behind the amalgamation was to defeat capital gains tax and prior to the amalgamation, a situation was brought about by creating a paper company and transferring an asset to such company which can, without further consequence, be amalgamated with another company to whom the capital asset was to be transferred so that, on amalgamation, it could pass on to the amalgamated company, it would distinctly appear that the provision for such a scheme of amalgamation was utilised for the avowed object of defeating tax. Such is not the situation here. The*

purpose for which amalgamation is proposed, is not to defeat tax."

60. Therefore, it was the petitioners' submission that, in the present case, the present Scheme, being an internal arrangement between companies who have commonality of ownership, is consistent with the policy of the Government of India, and will also allow the transferor companies to operate independently, therefore, it cannot be said that the avowed object of the Scheme is merely to defeat tax. Moreover, reliance was placed on **In re: SREI Infrastructure Finance Ltd.,** (2008) 4 Com LJ 196 (Cal) and **In re: Tata Tea Ltd.**, (2008) 144 Comp Cas 236 (Cal), which followed the former, and held that;

> "*With regard to the first objection it has been submitted that avoidance of capital gains can be no reason for not sanctioning a scheme which is otherwise lawful or valid as held in A.W. Figgis & Co. (P.) Ltd. In re (supra) and the unreported decision in C.P. No. 288 of 2007 - since reported as SREI Infrastructure Finance Ltd."*

61. **SREI Infrastructure**'s case (supra) pertains to a scheme of arrangement under Sections 391 to 394 of the Companies Act, 1956, wherein transfer of the benefits of the license held by the transferor company to the transferee company, was objected to on the ground that the transferor company was, in fact, effecting the outright sale of the license to the transferee company, and since no time limit was fixed for payment of the consideration for the sale by the transferee company to the transferor company, therefore, by this arrangement, the transferor company was avoiding the burden of capital gains tax. It was further contended that the benefits of the license, to be transferred by the transferor company to the transferee

company, were not specified, and therefore, the shareholders of both the companies were not in a position to make an informed decision with regard to the fairness and adequacy of the consideration which was to ultimately pass from the transferee company to the transferor company. It was in these circumstances that the Calcutta High Court held that so long as there is no allegation of violation of any provisions of the Companies Act, 1956, and so long as there was compliance with Sections 391, 392 and 394 of that Act, the objection raised by the Central Government regarding avoidance of capital gains was not material and that these were commercial matters best left to shareholders, and that this objection could not per se invalidate the scheme for the alleged reason of avoidance of tax liability since it would, in any case, attract the provisions of the Income Tax Act, as a company cannot escape from its tax liabilities. [See also, **Jindal Iron and Steel Co. Ltd. v Assistant Commissioner of Income Tax 5(2)**, 2003 (154) ELT 380 (Bom)]

62. Simply because the tax payable under the business structure adopted by the assessee, which he is otherwise entitled to adopt in law, is reduced, does not, in my view, ipso facto, make such adoption illegal or impermissible on the ground that it is opposed to the public interest.

63. Not only does the policy of the government, which is, in a sense, the custodian of the public interest, contemplate the sort of structure proposed, it actively seeks to promote it by suggesting that incentives should be given for its adoption. The policy specifically states that by this method, "costs can be kept down.." and that, "this is essential for rural penetration". Such an approach is also stated to

be in line with global trends. I fail to see how then, a scheme aimed at achieving just that must be held to be opposed to the public interest merely because, by its adoption, revenue payable by the transferor company might decrease with no corresponding increase in the revenue payable by the transferee company since the latter would be entitled to exemption under an incentive scheme of the government. It is strange that while on the one hand the government in its wisdom seeks to promote the sharing of infrastructure by the setting up of infrastructure companies and also decides to give such companies the incentive of tax exemption, the income tax department wants that in this case, no such thing should be permitted by the court because its overall revenue collection will go down.

64. Finally, the petitioners contended that similar schemes of arrangement for the demerger of passive infrastructure into a subsidiary for 'nil' consideration, pertaining to the petitioners' competitors, namely, Reliance, Bharti, Airtel and Idea, have been duly sanctioned without any objection to the same from the Income Tax Department. These are **In re: Reliance Telecom Infrastructure Ltd.**, CP Nos. 68, 69 and 70 of 2007, Bombay High Court, decided on 16th March 2007; **In re: Bharti Airtel Ltd.**, CP No.233 of 2007, Delhi High Court, decided on 26th November, 2007; and **In re: Idea Cellular Ltd**., CP No. 167 of 2009, Gujarat High Court, decided on 31st August, 2009. However, counsel for the Income Tax Department claimed that the Schemes sanctioned in the abovementioned matters were, in fact, not identical to the one under consideration in the present petition and, therefore, this justified the differential treatment being accorded to the petitioners herein. Be that as it may, the fact

remains that the Scheme under consideration, when placed before the High Courts of Madras, Karnataka and Bombay for their approval, was not objected to by the income tax authorities. It is an admitted position that the objections have only been raised by the Income Tax Department to the Schemes filed in this Court and in the Gujarat High Court.

65. Certain additional submissions were also made on behalf of the tax authorities. The first was that the Income Tax Department must be permitted to retain its recourse for recovery in respect of any existing or future tax liabilities of the transferor companies or the transferee company, in respect of the assets sought to be transferred under the proposed Scheme, and that this protection must be made explicit by this Court in its final order and has to bind all the parties to the Scheme, particularly the transferor and transferee companies. I am in agreement with this. As already noted in the preceding paragraphs, there can be no limitation on the powers of the Income Tax Department for recovery, including imposition of penalties etc.

66. The second submission was as regards the tax treatment accorded to the various transactions referred to in the Scheme. The Department's stand was that the approval of the Scheme should in no manner affect the tax treatments of the transactions under the Income Tax Act, 1961 or any other applicable taxing statute, nor would sanction of the Scheme or the effect thereof serve as a defence for the companies concerned against tax treatment under the aforementioned statutes.

67. The Court has a discretion in the matter of granting sanction, and the scope of its inquiry is not limited by any rigid

principles, except insofar that, in addition to examining the statutory compliances, it must be seen whether the proposed Scheme is reasonable, and can be viewed as beneficial to those likely to be affected by it. The burden to prove this lies on the petitioner. Arrangements similar to those proposed by the scheme are being followed not only by the petitioner's competitors in India, it also conforms to the global standards being adopted by various companies overseas. It bears repetition that in addition, the policy of the Government of India has also recommended that sharing of infrastructure be promoted and that incentives be given for this. The scheme also has this object in view. All this goes to show that the object of the Scheme is not merely aimed at avoidance of tax. The high earnings of the transferee company's assets would naturally be subjected to tax in the hands of the transferee company, and the liabilities that remain behind with the transferor companies would not be available to the transferee company for adjustment against profit before tax. However, if the transferee company is further entitled to other benefits or deductions notified by the Government in its wisdom, the Income Tax authorities cannot complain.

68. As regards the accounting principles used and the validity of their adoption by the petitioners, the question is left open to the Income Tax Department to inquire into the correctness or otherwise of the same, independently of the sanction of the Scheme.

69. Further, the petitioners have fairly admitted that any question of tax liability is within the purview of the Income Tax Department and that it is free to pursue either the transferor companies or of the transferee company, as it may be advised,

notwithstanding the sanction of the Scheme by this Court. Neither counsel seeks a finding by this Court with regard to the tax implications of the proposed Scheme. It is agreed that the Scheme may be sanctioned whilst relegating the parties to the appropriate fora to determine the tax liability, if any, that may arise. No action which may be violative of a statute is being legitimized by approval of the Scheme, and the income tax authorities are free to move against any of the parties concerned, in case they are of the belief that there has been any impermissible evasion of payment of tax by the petitioners.

70. In my view, if the Court is indeed to sanction the Scheme, the powers of the Income Tax Department must remain intact. The authorities relied on by the petitioners also support this proposition, with the only exception being a situation where the Scheme itself has only one purpose, which is to create a vehicle to evade the payment of tax, rather than mere avoidance of tax. It is also true that the scope of objection that may be raised by the Central Government and the Regional Director is larger, and that of the tax authorities is confined to the question of revenue. It is not open to this Court, in the exercise of company jurisdiction, to sit over the views of the shareholders and Board of Directors of the petitioner companies, unless their views were against the framework of law and public policy, which, as discussed above, is not the conclusion reached here. It is purely a business decision based on commercial considerations.

71. No objection has been received to the Scheme of Arrangement from any other party.

72. In view of the approval accorded by the equity shareholders, secured and unsecured creditors of the petitioner

companies, and the Regional Director, Northern Region, to the proposed Scheme of Arrangement, as well as the submissions of the Income Tax Department, there appear to be no further impediments to the grant of sanction to the Scheme of Arrangement. Consequently, sanction is hereby granted to the Scheme of Arrangement under Sections 391 and 394 of the Companies Act, 1956 on the aforesaid terms while reserving the right of the Income Tax Authorities to the extent stated above. The petitioner companies will comply with the statutory requirements in accordance with law. Certified copy of this order be filed with the Registrar of Companies within five weeks. It is also clarified that this order will not be construed as an order granting exemption from payment of stamp duty as payable in accordance with law. Upon the sanction becoming effective from the appointed date of Arrangement, that is Ist April, 2009, the passive infrastructure assets of the transferor companies No. 2, 5 and 6 shall stand merged in the transferee company.

73. The petition is allowed in the above terms.

74. Dasti.

SUDERSHAN KUMAR MISRA, J.

March 29, 2011.