INSIGHT

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Informal Guidance Issued to Corporates on Regulatory Matters

Introduction

Indian Securities Market has developed over a period of 75 years with regular amendments and changes in the regulatory mainstream, adaption of new policies to enable India to match up with the world economic reforms, wealth creation for the Indian investors and creating a trustworthy position of India at the global stage to attract investment in the Indian Capital Market. As per the recent Bloomberg report dated May 31, 2023, India secured 5th place in the Global stock market among the top 10 most-valued countries with a valuation of over $3.31 trillion. India experienced an increase of almost $330 billion market cap, with Foreign Investors, investing nearly $6.3 billion in local equities in March and April.

With the changes in Technology and the regular developments in infrastructure, Information Technology, economic policies, and world economic reforms, there has been a constant need to bring out changes in the regulations for ease of the investors in the Capital and Securities Market. Regulations and amendments need interpretations and guidance, sometimes when the intent of the regulation is not clear and corporates seek guidance from the Regulator itself in understanding the applicability of the transaction or whether a particular transaction can be executed.

The Securities and Exchange Board of India has introduced the Informal Guidance Scheme, 2003 wherein the:

▪ Intermediaries registered with the Board under Section 12 of the SEBI Act
▪ Any listed company
▪ Any company which intends to get any of its securities listed and which has either filed a listing application with any stock Exchange or a draft offer document with the board or the Central Listing Authority
▪ Any mutual fund trustee company or asset management company
▪ Any acquirer or prospective acquirer under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation 1997;

Can seek guidance from the Board on the enforcement, applications and interpretation of regulations.

The Informal Guidance can be sought and given in two forms:

i. **No-action letters**: in which a Department of SEBI indicates that the Department would or would not recommend any action under any Act, Rules, Regulations, Guidelines, Circulars or other legal provisions administered by SEBI to the Board if the proposed transaction described in a request made under para 6 is consummated;

ii. **Interpretive letters**: in which a Department of SEBI provides an interpretation of a specific provision of any Act, Rules, Regulations, Guidelines, Circulars or other legal provision being administered by SEBI in the context of a proposed transaction in securities or a specific factual situation;

A request seeking informal Guidance should specify whether it is a request for no action or an interpretative letter accompanied by a fee of Rs. 25,000.

Informal Guidance issued by the Securities and Exchange Board of India

Application by Bank of Baroda seeking guidance under Regulation 17(1C) of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations)

The fact of the Case

Bank of Baroda (**"Applicant Company"**) is a new bank constituted under the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970 (Banking Companies Act) and is not a Company incorporated under the Companies Act, 1956/2013. The Government of India (i.e., the President of India) is identified as a Promoter of the Bank and holds 63.97% of the paid-up share capital of the Bank.

Currently, there are 12 directors on the board of the bank out of which 5 are whole-time directors (including 1 MD & CEO and 4 EDs), 1 is an RBI Nominee director, 1 is a Government of India Nominee Director and 5 are Independent Director (including 3 shareholder's directors). Only shareholder's directors are being elected by the shareholders of the bank and all other categories of directors are being appointed/nominated by the Government of India.

Guidance sought

The Applicant has requested for guidance of the Securities and Exchange Board of India ***with respect to the recent amendment made in the proviso of Regulation 17(1C) of the LODR Regulations, which states that***:

"The listed entity shall ensure that approval of shareholders for appointment or re-appointment of a person on the Board of directors or as a manager is taken at the next general meeting or within a time period of three months from the date of appointment, whichever is earlier."

Provided that a public sector company shall ensure that the approval of the shareholders for appointment or re-appointment of a person on the board of Director or as a Manager is taken at the next general meeting"

▪ The Banking Companies Act, of 1970 provides for the election of up to 3 directors on the board of the Bank by shareholders other than the Central Government. Will the amendment of SEBI LODR Regulations prevail over the Bank's Governing Act?
▪ The terms of appointment/nomination are decided by the Government of India, what would be the status of directors in case the agenda for appointment/re-appointment is disapproved by shareholders?
▪ Can the Government of India vote on said resolution?

Guidance by SEBI

1. The Erstwhile provisions of Regulation 15(2) of the LODR Regulations, provided dispensation to listed entities that were not companies but body corporates or were governed by other statutes. The amendment intended to bring about uniformity in the governance of all listed entities. Further, the overriding effect of the provisions of any enactment arises only when there is inconsistency or repugnant in the said enactment vis-à-vis any other law. If any enactment is silent on a particular subject matter and any other law mandates it, such a requirement would have to be complied with. In the context of this query, the Applicant company has to abide by the provisions of Regulation 17(1C) in the absence of any provisions in the Banking Companies Act, 1970;
2. As per regulation 17(1C) of the LODR Regulations, the approval of shareholders is required for the appointment/re-appointment of a person on the Board of Directors or as manager, hence as per Query 2 of the Applicant Company, if the shareholders do not approve the resolution for appointment, such person would cease to be the director.
3. As per Query 3 of the Applicant Company, since the LODR Regulations place no restriction on voting by a shareholder, hence in the absence of any expressed prohibition under LODR Regulations, the Government of India can vote in favour of such resolution.

Application by Nectar Lifesciences Limited ("Applicant Company") regarding the applicability of Business Responsibility and Sustainability Reporting (BRSR) as per Regulation 34 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("SEBI LODR Regulation")

The fact of the Case

Applicant Company is listed on the National Stock Exchange Limited ("**NSE**") and BSE Limited ("**BSE**") and was covered in the top 1000 listed entities based on market capitalisation as on March 31, 2021, however, it has fallen below the threshold limit as on March 31, 2022. As per Regulation 34 of the SEBI LODR Regulation, the Applicant Company had filed the Business Responsibility Report for that Financial Year.

Guidance Sought

As per Regulation 34 of the SEBI LODR Regulations, read with SEBI Circular dated May 10, 2021, with effect from F.Y. 2022-23, the requirement of filing Business Responsibility Reporting (BRR) shall be replaced with the filing of Business Responsibility and Sustainability Reporting (BRSR) which describes the initiatives taken by the listed entity from the environment, social and governance perspective.

The applicant Company sought guidance/ clarifications regarding the applicability of BRSR on the Company for the F.Y. 2022-23:

- The Applicant Company is not on the list of top 1000 listed entities based on Market Capitalisation as on March 31, 2022, and also on March 31, 2023
- As per Regulation 3(2) of the SEBI LODR Regulations, the provisions of LODR Regulations on the basis of market capitalisation will continue to be applicable even if the listed entity falls below such thresholds- in respect to this clause, the company was on the list of top 1000 listed entities based on market capitalisation as on March 31, 2021
- Since the Applicant Company was liable to comply with the reporting of BRR, whether the Applicant Company should continue with the reporting of BRR or it has to comply with BRSR as a replacement of BRR as per Regulation 3(2) r/w Regulation 34 of LODR Regulations.

Guidance by SEBI

1. As per Regulation 34 of the LODR regulation read with Para 7 of the BRSR Circular till the F.Y 2021-2022, the top 1000 listed entities on the basis of market capitalisation shall submit BRR in their annual report and thereafter 2022-23, such listed entities shall submit the BRSR report.
2. The Applicant Company was not on the list of 1000 listed entities based on market Capitalisation as on March 31, 2022, and March 31, 2023, and hence the requirement of submitting the BRSR as per Regulation 34(2)(f) does not apply to the Company. Further Regulation 3(2) of SEBI LODR Regulation was inserted w.e.f May 05, 2021, in the context of Regulation 34(2)(f), it shall apply only to the entities that are in the list of top 1000 listed entities computed as on March 31, 2022.

Request for Informal Guidance by ABM International Limited ("Applicant Company") under Regulation 35 (2)(d) under Part A of Chapter VI (Special Provisions for Small Companies) of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021 ("Delisting Regulations")

Facts of the Case

The Applicant Company is a Public Listed Company where the shares of the Company are listed at the National Stock Exchange of India Limited ("NSE") and the equity shares are infrequently traded. The Company has paid up share capital and net worth amounting to Rs. 9,40,80,000/- and Rs. 20,64,02,732/-.
The total number of shares transferred to the Investor Education and Protection Fund Account is comprised of 1,24,384 representing 1.32% of the total number of shares.

Guidance Sought

- Interpretation of Regulation 35(2)(d) under Part A of Chapter VI of the Delisting Regulations
- Whether Shares transferred to the Investor Education and Protection Fund shall be excluded for the purpose of calculation of consent of 90% of total public shareholding in compliance with Regulation 35(2)(d) under Part A of Chapter VI of Delisting Regulations.

Guidance by SEBI

SEBI quoted the definition of Public Shareholding as defined under Rule 2(e) of the Securities Contract Regulation Rules, 1957 (SCRR) which is reproduced as under:
"Public shareholding" means equity shares of the company held by the public including shares underlying the depository receipts if the holder of such depository receipts has the right to issue voting instruction and such depository receipts are listed on the International exchange in accordance with the Depository Receipts Scheme, 2014:
Provided that the equity shares of the Company held by the trust set up implementing employee benefit schemes under the regulations framed by the Securities and Exchange Board of India shall be excluded from Public shareholding."
In context to the above definition, it may be construed that the shares transferred to the Investor Education and Protection Fund's (IEPF) account in terms of Section 124(6) of the Companies Act, 2013 would be included for the purpose of calculation with consent to 90% of the total public shareholding in compliance with Regulation 35(2)(d) under Part A Chapter VI of the Delisting Regulations.

SEBI also gave the reference of Regulation 21 of Chapter III of the Delisting Regulations, which deals with the Voluntary Delisting and the counter offer made through reverse book building under Regulation 22, and expressly excludes the shares transferred to the Investor Education and Protection Fund for the purpose of calculation with consent to 90% of the total public shareholding. Hence the exclusion of certain categories of shareholding from the ambit of "public shareholding" under Regulation 21 cannot be extended to Regulation 35(2)(d) under Part A Chapter VI of the Delisting Regulations.

Request for Informal Guidance by Dhanlaxmi Bank Limited in relation to "Minimum Subscription" as mentioned under Regulation 86 of the SEBI (ICDR) Regulations, 2018.

Facts of the Case

Dhanlaxmi Bank Limited is a professionally managed listed Company without any identifiable promoter/promoter group, proposing to raise capital through Rights issue for increasing Tier I Capital and not for financing of Capital Expenditure for a project.

Guidance Sought

Whether any relaxation is available to a professionally managed Listed Company in India without any identifiable promoter/promoter group proposing a rights issue with respect to minimum subscription requirement under Regulation 86 of the SEBI (ICDR) Regulations.

SEBI Guidance

Regulation 86 of the SEBI (ICDR) Regulations is reproduced below:

The minimum subscription to be received in the issue shall be at least ninety per cent of the offer through the offer document. [Provided that minimum subscription criteria shall not be applicable to an issuer if:

(a) the object of the issue involves financing other than financing of capital expenditure for a project; and
(b) the promoters and the promoter group of the issuer undertake to subscribe fully to their portion of rights entitlement and do not renounce their rights except to the extent of renunciation within the promoter group.]

In the context of the above regulation, SEBI reiterated that the exemption from the requirement of the minimum subscription requires the twin conditions of the proviso clause to be met. However, for a professionally managed listed company

without an identifiable promoter/promoter group, compliance with both the proviso clause conditions is not possible, hence in order to get the exemption from the minimum subscription, compliance with the first condition is sufficient.

Request for Informal Guidance by Sky Industries Limited in relation to the applicability of the Corporate Governance provisions of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR Regulations)

Facts of the Case

Sky Industries Limited is a Public Limited Company, whose equity shares are listed on the BSE Limited, having a paid-up share capital of Rs. 6.85 crore and a net worth of Rs. 32.87 crore.

Securities and Exchange Board of India vide Circular No. CIR/CFD/POLICY CELL/7/2014 dated September 15, 2014, amended the erstwhile Clause 49 of the Listing Agreement to add the word "and" instead of "or" with the intention to cover only entities who cross both the thresholds i.e., paid up share capital exceeding Rs. 10 crore and net worth exceeding Rs. 25 crore.

The applicability of Corporate Governance provisions still continues under Regulation 15(2) of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirement) Regulations, 2015.

Guidance Sought

The Company had requested SEBI to provide guidance on the applicability of the provisions of Regulation 17 to 27 and clause (b) to (i) and (t) of the 26(2) and para C, D, and E of Schedule V of SEBI LODR Regulations.

SEBI Guidance

SEBI issued its guidance as under:

1. On and from the date of commencement of SEBI LODR Regulations, all circulars issued by SEBI on the provisions of the Listing Agreement stand rescinded.
2. Compliance with the Corporate Governance provisions becomes applicable when both the condition of Paid up share capital and net worth are met.

Further, if the conditions become applicable to the listed entity at a later date then the same shall be complied within six months from such date.

"Provided further that once the conditions of Corporate Governance become applicable, they shall continue to remain applicable till such time the equity share capital or the net worth reduces and remains below the specified threshold for a period of three consecutive financial years".

Conclusion

SEBI withholds by virtue of Paragraph 10 of the Securities and Exchange Board of India (Informal Guidance) Scheme, 2003 that "SEBI shall not be under any obligation to respond to a request for guidance made under this scheme and shall not be liable to disclose the reasons for declining to answer this request."

Further, the guidance provided by the SEBI does not express a decision of the Board on the guidance sought by the Companies.

Prevention of Money Laundering Act and the Three Practicing Professionals

Introduction

Money laundering is the practice of fraudulently disguising the source of funds earned through unlawful activities such as the sale of illegal drugs, corruption, embezzlement, or gambling by rerouting them through a legitimate source. With different definitions, it is illegal in numerous jurisdictions.

Three steps, termed placement, layering, and integration, can be used to categorise the money laundering process.

In the placement stage of money laundering, the launderer introduces his illicit gains into the financial system by dividing large sums of money into less obvious smaller sums that are then deposited directly into a bank account, or by buying a series of financial instruments that are later gathered and deposited into accounts at another location.

The layering happens when the fund enters the financial system. In order to separate the monies from their source, the launderer converts or moves them repeatedly at this step. The money may be transferred through the buying and selling of financial instruments, or the launderer may simply wire the money through a network of accounts at different banks across the world.

Criminal proceeds are moved to integration by the money launderer once they have successfully processed them through the first two stages of the procedure. The money now returns to the mainstream economy. The money-launderer may decide to invest it in businesses, real estate, or opulent items.

Money Launderers and Their Hunt to Launder Money

Money launderers are constantly searching for innovative ways to launder their money. As established financial centre countries create thorough anti-money laundering laws, economies with developing or rising financial centres but insufficient controls are particularly vulnerable. Money launderers will take advantage of variations in national anti-money laundering systems since they frequently relocate their networks to nations and financial systems with inadequate or inefficient responses.

Money laundering could have major social and political repercussions if it is not stopped or handled in an inadequate manner. Organised crime can take over financial

institutions, invest its way into the management of significant economic sectors, or corrupt public servants and even entire governments.

Therefore, transnational cooperation is crucial in the battle against this threat because money laundering is a worldwide occurrence. Numerous actions have been taken to address the issue on a global scale.

Recent Initiative by the Indian Finance Ministry

Presently, a major initiative has been taken by the Indian Finance Ministry through the Gazette ***notification no. S.O. 2036(E) dated 3rd May 2023*** to bring professionals like practising Chartered Accountants, Company Secretaries and Cost Accountants under the purview of the Prevention of Money Laundering Act 2002 while they undertake the financial transactions on behalf of their clients. However, the revised definition of entities covered by the PMLA appears to have excluded lawyers and other legal experts. The notification covers a) buying and selling immovable property; b) managing client money, securities, and other assets; c) managing bank, savings and securities accounts; d) organising contributions for creating, operating, and managing companies, and creating and managing limited-liability partnerships or trusts; and e) buying or selling business entities.

For these transactions, CAs, CSes, and CWAs have been designated as reporting entities. So, the question arise *'Who are reporting entities?'* and *"How do these professionals come under its purview after the notification?'*

As per section 2(1)(wa) of the Act, **"reporting entity"** means a banking company, financial institution, intermediary or a person carrying on a designated business or profession.

As per section 2(1)(sa)(vi) of the Act, **"a person carrying on a designated business or profession"** means a person carrying out such other activities as the Central Government may, by notification, so designate, from time to time.

In the exercise of the power conferred by the above section, the Central Government notifies that the financial transaction carried on by a relevant person on behalf of his clients, in the course of his or her profession, in relation to the following activities:

(i) Buying and selling of any immovable property;
(ii) Managing of client money, securities and other assets;
(iii) Management of bank, savings and securities accounts;
(iv) Organisation of contributions for the creation, operation and management of companies.
(v) creation, operation and management of companies, limited liability partnerships or trusts, and buying and selling of business entities,

shall be an activity for the purpose of said sub-section.

As explained by the notification that for its purpose, **'relevant person'** includes –

(i) an individual who has obtained a certificate of practice under section 6 of the Chartered Accountants Act, 1949 (38 of 1949) and practicing individually or through a firm, in whatever manner it has been constituted;
(ii) an individual who has obtained a certificate of practice under section 6 of the Company Secretaries Act 1980 (56 of 1980) and practicing individually or through a firm, in whatever manner it has been constituted;
(iii) an individual who has obtained a certificate of practice under section 6 of the Cost and Works Accountants Act, 1959 (23 of 1959) and practicing individually or through a firm, in whatever manner it has been constituted;

Further, the announcement makes it clear that routine services like account certification or fee-based financial advising will not be covered by the Act. The amendments are anticipated to support investigative authorities in their investigation into questionable transactions involving shell companies and money laundering, according to experts.

The Impact on the Three Practicing Professionals

The three practicing professionals are now included in the definition of **"Reporting Entity"** since the Central Government has the authority to notify them via section 2(1)(sa)(vi) of the Act.

The practice of chartered accountants, company secretaries, and cost accountants—who are reporting entities—are significantly impacted by the notification in terms of their roles and obligations. The following details these duties:

1. According to section 11A of the Act, every reporting entity *shall verify the identity of its client* and the beneficial owner by Aadhar authentication or offline verification of Aadhar or use of passports or any other officially valid document or modes of identification.
   The notified professionals are required by this section to do KYC for their customers and confirm their legal identity before engaging in any required financial transactions on their behalf.
2. As per section 12 of the Act, every reporting entity shall
   (1) (a) *maintain a record* of all transactions, including information relating to transactions covered under clause (b), in such a manner as to enable it to reconstruct individual transactions;

(b) furnish to the Director within such time as may be prescribed, information relating to such transactions, whether attempted or executed, the nature and value of which may be prescribed;

(e) maintain a record of documents evidencing the identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.

(2) Every information maintained, furnished or verified, save as otherwise provided under any law for the time being in force, shall be kept confidential.

(3) The records referred to in clause (a) of sub-section (1) shall be maintained for a period of five years from the date of the transaction between a client and the reporting entity.

(4) The records referred to in clause (e) of sub-section (1) shall be maintained for a period of five years after the business relationship between a client and the reporting entity has ended or the account has been closed, whichever is later.

3. Section 12A puts an obligation on the reporting entity *to furnish information to the Director* whenever called for.
4. According to section 12AA of the Act, every reporting entity shall, prior to the commencement of each specified transaction, *verify the identity of the clients undertaking such specified transaction*, take additional steps to examine the ownership and financial position, including sources of funds of the client, and record the purpose behind conducting the specified transaction and the intended nature of the relationship between the transaction parties.
5. A punishment may be imposed on practising Chartered Accountants, Company Secretaries, and Cost Accountants in accordance with section 13 of the Prevention of Money Laundering Act 2002 in the event that they fail to carry out their obligations under the Act. The Director is the reporting authority in such cases.

Conclusion

The government's recent moves suggest that it is stepping up its efforts to crack down on money laundering and the creation of shell corporations, trusts, firms, and LLPs, among other money-laundering-related activities. The professionals should now be extremely cautious when dealing with customers, keeping meticulous records of the transactions carried out on their behalf, enabling their own office address to be used for the registration of client companies, acting as a nominee shareholder on behalf of others, etc. In addition to processing transactions and maintaining records, the job of professionals has expanded to include in-depth analysis of all relevant factors before processing transactions.

Demystifying Share Valuation Methods Under the Income Tax Act, 1961: A Comprehensive Guide

Any transactions involving the issuance of unquoted shares or transfers/receipt of unquoted shares must be processed in accordance with the relevant sections of the Income-Tax Act, 1961 (Act) and Income-Tax Rules, 1962. For these types of transactions, the Fair Market Value (FMV) of unquoted shares is used as a basis for determining the tax liabilities of the parties involved. The relevant rules under the Income-Tax Rules, 1962 provide comprehensive guidelines for determining the Fair Market Value of such shares. An attempt has been made in this article to provide guidelines on valuation, pursuant to sections 56(2)(viib), 50CA, and 56(2)(x) of the Act, that deal with the issuance, transfer or receipt of unquoted shares.

Section 56(2)(viib) – Issuance of Unquoted Share and Securities

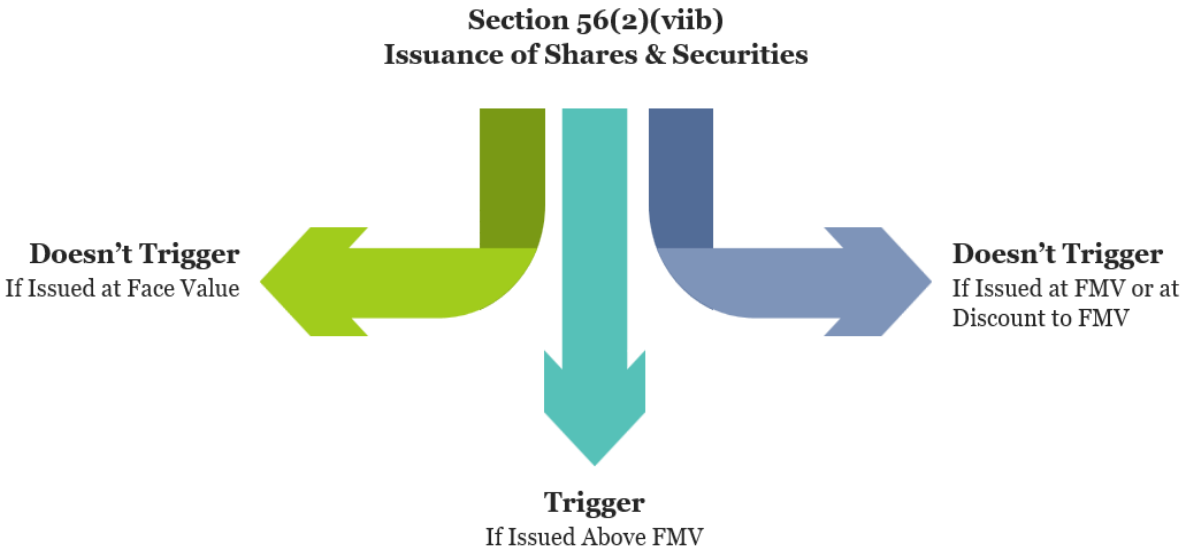
The Background

The Finance Minister in its 2012 Budget speech explained the intention of Section 56(2)(viib) of the Income-Tax Act, 1961 as follows:
"..to deter the generation and use of black money I propose to..increase the onus of proof of closely held companies for funds received from shareholders as well as taxing share premium in excess of fair market value"
Therefore from the budget speech, it is clear that Section 56(2)(viib) is an anti-abuse provision with the objective to arrest the circulation of unaccounted money by appropriate taxing.

The Concept

Section 56(2)(viib) deals with taxation related to the issuance of Shares and securities of unlisted Companies.
'The Section of the Income-Tax Act, 1961, inter alia, provides that where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person ***being a resident****, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares, the aggregate consideration received for such shares as exceeds the fair market value of shares shall be chargeable to income-tax under the head 'income from other sources'.*

However, in the Finance Bill 2023, the said regulation has been amended by the Government and a draft valuation methodology U/S 11UA of the Income-Tax Rules, 1962 has been recommended. Under the amendment, contributions received from ***non-residents*** shall also be included along with contributions received from resident Indians for the purpose of issuance of shares.



As per the provisions of Section 56(2)(viib), any excess consideration above FMV from the issuance of shares and securities will be deemed to be the income of the Issuer Company from other sources and is taxable accordingly.

Determination of Fair Market Value - 11UA(2)

Rule 11UA(2) of the Income-tax Rules 1962 is used to determine the Fair Market Value of unquoted equity shares. Accordingly, the FMV of unquoted equity shares is

Method a	***Method b***	***Method c - Draft 11UA(2)***
$\frac{A-L}{(PE)} \times (PV)$	*The fair market value of the unquoted equity shares is determined by a* ***Merchant Banker*** *as per the Discounted Free Cash Flow (DCF) method.*	***Valuations exclusively by Merchant Banker***[1] a. *Comparable Company Multiple Method* b. *Probability Weighted Expected Return Method* c. *Option Pricing Method* d. *Milestone Analysis Method* e. *Replacement Cost Methods*

[1] *Under Draft Rule 11UA(2), five other valuation methods are provided for non-residents, where Merchant Bankers are to conduct valuations.*

Method a:

Where –
A = *Book value of the assets in the Balance sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;*
L= book value of liabilities shown in the balance sheet, but not including the following amounts, namely -

i. *the paid-up capital in respect of equity shares;*
ii. *the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;*
iii. *reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;*
iv. *any amount representing provision for taxation, other than the amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;*
v. *any amount representing provisions made for meeting liabilities, other than ascertained liabilities;*
vi. *any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;*

PE = total amount of paid-up equity share capital as shown in the balance sheet;
PV= the paid-up value of such equity shares;

A Merchant Banker's report issued not more than 90 days prior to the proposed issue of shares may be adopted as deemed FMV under subrule 2 of rule 11UA. The new amendment has also proposed to provide a safe harbour of a 10% variation in value on account of forex fluctuation, bidding process and variation in other economic indicators, which may affect the valuation of unquoted equity shares. This safe harbour concept applies to both resident and non-resident investors.

To simplify

Scenario	*Face Value*	*Fair Marke Value*	*Issue Price*	*Applicability*
A	*10*	*100*	*100*	*Doesn't Trigger 56(2)(viib)*
B	*10*	*100*	*125*	*Trigger 56(2)(viib) as shares are issued at higher than FMV*
C	*10*	*100*	*75*	*Doesn't Trigger 56(2)(viib)*
D	*10*	*100*	*5*	*No, but as per Section 53 of the Companies Act, shares can't be issued at a discount to face value.*

Exclusions

The provisions of section 56(2)(viib) will not apply to the following categories of persons (including those mentioned in the proposed change as notified by CBDT)

- Any amount received from a venture capital company or a venture capital fund.
- The amount received from Government and Government related investors like the Central Bank, Sovereign Wealth Fund, international or Multilateral organisations; or agencies including entities controlled by the Government or where direct or indirect ownership of the Government is 75% or more.
- Banks or Entities involved in Insurance Business where such entity is subject to applicable regulations in the country where it is established or incorporated or is a resident.
- Any of the following entities, which is a resident of certain countries or specified territories (Specified Nations) having robust regulatory framework:-
  - Entities registered with the Securities and Exchange Board of India as Category-I Foreign Portfolio Investors.
  - Endowment Funds associated with a university, hospitals or charities,
  - Pension Funds created or established under the law of the foreign country or specified territory,
  - Broad-Based Pooled Investment Vehicle or Fund where the number of investors in such vehicle or fund is more than 50 and such fund is not a hedge fund or a fund which employs diverse or complex trading strategies.

Specified Nations

Australia	France	New Zealand
Austria	Germany	Norway
Belgium	Iceland	Russia
Canada	Israel	Spain
Czech Republic	Italy	Sweden
Denmark	Japan	United Kingdom
Finland	South Korea	United States

Section 50 CA & Section 56(2)(x) – Sale/Transfer of Unquoted Equity Shares

In case, an owner transfers shares of unlisted companies to another person, the owner is liable to pay Capital Gain tax. The capital gain tax is levied on the difference between the sale consideration and the cost of acquiring such shares. However, the sale consideration has to be equal to or higher than the fair market value (FMV) of such shares. If the sale consideration is lower than the FMV of such shares then the following Sections of the Act shall be triggered:

Seller/Buyer	Section	Description
Seller	Section 50CA	If the Fair Market Value (FMV) is higher than Sale Consideration, then, the FMV of such shares shall be deemed to be the Sale Consideration. In such cases, FMV will replace the actual Sale Consideration.
Buyer	Section 56(2)(x)	If the buyer acquires shares at a price which is lower than FMV, then the buyer has to pay the tax on the difference between FMV and the actual price paid under the head 'Income from Other Source'.

Determination of Fair Market Value - 11UA(1)(c)(b)

The fair market value of unquoted equity shares shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner, namely:—

The fair market value of unquoted equity shares =

$$(A + B + C + D - L) \times \frac{PV}{PE}$$

A= book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance sheet as reduced by,—

i. any amount of income tax paid, if any, less the amount of income-tax refund claimed, if any; and

ii. any amount shown as an asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

B = the price that the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;

C = fair market value of shares and securities as determined in the manner provided in this rule;

D = the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property;

L= book value of liabilities shown in the balance sheet, but not including the following amounts, namely:—

i. the paid-up capital in respect of equity shares;

ii. the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;

iii. reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;

iv. any amount representing provision for taxation, other than the amount of income tax paid, if any, less the amount of income tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;

v. any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

vi. any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PV= the paid-up value of such equity shares;

PE = total amount of paid-up equity share capital as shown in the balance sheet;

To simplify

Scenario	*Face Value*	*Fair Market Value*	*Issue Price*	*Applicability*
A	*10*	*100*	*100*	*Doesn't Trigger 56(2)(x)*
B	*10*	*100*	*125*	*Doesn't Trigger 56(2)(x)*
C	*10*	*100*	*75*	*Triggers both 50 CA for the Seller and 56(2)x) for the Buyer.*

Exclusions

Applicability of 56(2)(x) is exempted when unquoted shares received –

- From relatives
- On the occasion of the marriage of an individual;
- Under a will or by way of inheritance;
- Transactions not regarded as transfers different subsections of section 47;
- From or by any trust or institution registered under section 12A or section 12AA;
- From any local authority as defined in the explanation to clause (20) of section 10
- From an individual by a trust created solely for the benefit of the relative of the individual.

Interplay of Section 50CA and 56(2)(x)

Where property is transferred for less than fair value, an interplay of sections 50CA and 56(2)(x) can result in a double whammy. To avoid double taxation, the cost of acquisition on subsequent sales will be determined according to Section 56(2)(x)-Section 49(4).

X - Buyer		Y - Seller	
Buy Price/Share	100	Sell Price/Share	100
FMV	120	FMV	120
		Actual Cost of Acquisition	70
Income from Other Sources U/S 56(2)(x)	**20**	**Capital Gain U/S 50 CA**	**50**
Impact Under Section 49(4)			
When X Sells			
Sell Price/Share (FMV at the Time of Selling)			150
Cost of Acquisition (FMV at the Time of Acquisition)			120
Capital Gains			30

When X sells the shares, he will be able to claim INR 120 as the cost of acquisition, even though the actual purchase price of the shares was only INR 100.

[The article is to be continued in the next issue]

Important IBC Judgments

1. A judicial interpretation of Section 29A(h) of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as "the Code").

Section 29A(h) is stated hereinbelow:
"A person shall not be eligible to submit a resolution plan if such person or any other person acting jointly or in concert with such person has executed a guarantee in favour of a creditor in respect of a corporate debtor against which an application for insolvency resolution made by such creditor has been admitted under this Code and such guarantee has been invoked by the creditor and remains unpaid in full or part."

The Hon'ble Supreme Court in the matter of Bank of Baroda & Anr. V/S. MBL Infrastructures Limited & Ors. , held that - *The word "such creditor" in Section 29A(h) has to be interpreted to mean similarly placed creditors after the application for insolvency application is admitted by the adjudicating authority. As a result, what is required to earn a disqualification under the said provision is a mere existence of a personal guarantee that stands invoked by a single creditor, notwithstanding the application being filed by any other creditor seeking initiation of the insolvency resolution process.*

Reference: Judgment of the Hon'ble Supreme Court dated 18.01.2022 in Civil Appeal No. 8411 of 2019 – In the matter of Bank of Baroda & Anr. V/s. MBL Infrastructures Limited & Ors.

2. Whether the Appellant(s)/ Applicant is entitled to be given a copy of the Resolution Plan or any part of the Resolution Plan in the Appeal. The question which has arisen in the present proceeding is as to whether the Resolution Plan after it being approved by the Adjudicating Authority, still continues to be a confidential document, so as to deny access to any of the claimants.

The Hon'ble NCLAT, New Delhi in the matter of Association of aggrieved Workmen of Jet Airways (India) Limited V/s. Jet Airways (India) Ltd. & Ors. stated that - Resolution Plan after its approval by the Adjudicating Authority is no more a confidential document, so as to deny access to even a claimant. It is true that the Resolution Plan even though it is not a confidential document after its approval, cannot be made available to each and to anyone who has no genuine claim or interest in the process. On various grounds access to Resolution Plan even if it is not a confidential document after approval can be denied in proper and appropriate cases. However, the Hon'ble Court in this matter directed that part of the Resolution Plan which deals with the claim of workmen and employees should be provided to the Appellant by the Successful Resolution Applicant.

Reference: Judgment of Hon'ble NCLAT, New Delhi dated 20.01.2022 in Company Appeal (AT) (Insolvency) No. 643 of 2021 & I.A. No.1700 of 2021 – In the matter of Association of aggrieved Workmen of Jet Airways (India) Limited V/s. Jet Airways (India) Ltd. & Ors.

3. Section 60(2) of the Code requires that for an insolvency Resolution Process to be initiated against the guarantor there must be CIRP or Liquidation Process pending against the principal borrower/ Corporate Debtor–Is this correctly interpreted?

The Hon'ble NCLAT, New Delhi in the matter of State Bank of India V/s. Mahendra Kumar Jajodia observed that - The purpose and object of the sub-section 2 of Section 60 of the Code is that when proceedings are pending in **'a'** National Company Law Tribunal, any proceeding against Corporate Guarantor should also be filed before **'such'** National Company Law Tribunal. The idea is that both proceedings be entertained by one and the same NCLT. **The sub-section 2 of Section 60 does not in any way prohibit the filing of proceedings under Section 95 of the Code even if no proceedings are**

pending before NCLT. It further observed that **Section 60(2) is applicable only when CIRP or Liquidation Proceeding of a Corporate Debtor is pending, when CIRP or Liquidation Proceeding is not pending with regard to the Corporate Debtor there is no applicability of Section 60(2).**

Reference: Order of Hon'ble NCLAT, New Delhi dated 27.01.2022 in Company Appeal (AT) Insolvency No. 60 of 2022 and Company Appeal (AT) Insolvency No. 61 of 2022 – In the matter of State Bank of India V/s. Mahendra Kumar Jajodia and in the matter of State Bank of India V/s. Bhanwar Lal Jajodia

4. Is there a difference between the 'supersession of Directors' under the RBI Act and the 'suspension of Directors' under the Code? Whether a 'Superseded director', who had vacated office on supersession of Board under RBI Act, is entitled to the notice of CoC meeting and has the right to participate in the meeting of the CoC?

The Hon'ble NCLAT, New Delhi in the matter of Dheeraj Wadhawan V/s. The Administrator, Dewan Housing Finance Corporation Limited & Ors. held that - Superseded Directors are those Directors who have been removed or deemed to have demitted office and who were not holding the position of Director on the CIRP commencement date, cannot be considered a Director Simpliciter to benefit from participating in the meeting of CoC. Section 45-IE (4)(a) of the RBI Act provides that upon making an order of supersession of the Board of Directors of a non-banking financial company, Director shall from the supersession of the Board of Directors vacate their offices. After vacation or removal from the office of the Director, the said person cannot claim their entitlement to participate in the CoC of the Corporate Debtor. A removed Director from the Board of Directors cannot interfere in the Company's affairs per contra a suspended Director always remains on the erstwhile Board of the Company and assist the IRP/RP as per requirement.

Reference: Order of Hon'ble NCLAT, New Delhi dated 27.01.2022 in Company Appeal (AT) (Insolvency) No. 785 of 2020 and Company Appeal (AT) (Insolvency) No. 647 of 2021 – In the matter of Dheeraj Wadhawan V/s. The Administrator, Dewan Housing Finance Corporation Limited and in the matter of Dheeraj Wadhawan V/s. The Administrator, Dewan Housing Finance Corporation Limited & Ors.

5. Entitlement of wages/salaries of the workmen/ employees during the CIRP period and the amount due and payable to the respective workmen/employees towards the Pension Fund, Gratuity Fund and Provident Fund.

The Hon'ble Supreme Court in the matter of Sunil Kumar Jain and others V/s. Sundaresh Bhatt and others held that if during the CIRP the corporate debtor was a going concern, the wages/salaries of such workmen/employees who worked shall be included in the CIRP costs and in case of liquidation of the corporate debtor, dues towards the wages and salaries of such workmen/employees who worked when the corporate debtor was a going concern during the CIRP, being a part of the CIRP costs are entitled to have the first priority and they have to be paid in full first as per Section 53(1)(a) of the IB Code. The wages and salaries of all other workmen/employees of the Corporate Debtor during the CIRP who have not worked and/or performed their duties when the Corporate Debtor was a going concern, shall not be included automatically in the CIRP costs. Only with respect to those workmen/employees who worked during CIRP when the Corporate Debtor was a going concern, their wages/salaries to be included in the CIRP costs and they shall have the first priority over all other dues as per Section 53(1)(a) of the IB Code.

However, the wages and salaries of the workmen/employees of the pre-CIRP period will have to be governed as per the priorities mentioned in Section 53(1) of the IB Code.

Further, Section 36(4)(iii) of the IB Code specifically excludes "all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund", from the ambit of "liquidation estate assets". Considering Section 36(4) of the IB code and when the provident fund, gratuity fund and pension fund are kept out of the liquidation estate assets, the share of the workmen's dues shall be kept outside the liquidation process and the concerned workmen/employees shall have to be paid the same out of such provident fund, gratuity fund and pension fund if any, available and the Liquidator shall not have any claim over such funds.

Reference: Judgment of Hon'ble Supreme Court dated 19.04.2022 in CIVIL APPEAL NO. 5910 OF 2019– In the matter of Sunil Kumar Jain and others V/s. Sundaresh Bhatt and others.

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