# DUTY PLANNING AND LEGAL ISSUES IN REAL ESTATE PLANNING

The transfer of property is governed by Transfer of Property Act. Section 5 of the said Act define transfer of property i.e. an act by which a living person conveys properties in present or in future to one or more other living persons. The term 'living person' includes a company or association or body of individuals whether incorporated or not. The word 'convey' appearing in the forgoing provision means to make over or transfer. A property movable or immovable can be transferred in several ways such as by sale, mortgage, lease, gift, trust etc. So far as an immovable property is concerned, every such transaction barring few cases, is required by law to be in writing. The exceptions are transfer of immovable properties worth less then Rs.100/-, transfer by way of lease of tenancy where the period of lease or tenancy is less then 12 months, mortgaged by way of deposit of title deeds, partition of Hindu Joint Property, dedication of property for charitable or religious endowment, a gift or wakf by a Muslim etc.

While entering into and carrying out any transaction relating to transfer of an immovable property, the consideration of the effect of such transaction under the Income Tax Act or the effect of the provisions of the Act on such transaction assumed great importance. Similarly, payment of stamp duty under the Stamp Act is another aspect with which a conveyancer is most directly and practically concerned. Practically every deed relating to an immovable property is required to be stamped with the prescribed stamp duty. Stamp duty is payable upon every instrument which is chargeable before or at the time of execution or immediately thereafter. Another Act which is connected with conveyancing is Indian Registration Act, 1908. This Act makes certain documents compulsorily registerable and other optional. Practically all documents relating to an immovable property of the value of Rs.100/- and more and in which any element of transfer is involved requires registration. The consequence of non registration are given in section 49 by virtue of which the document which require registration but not registered shall not affect any immovable property comprise therein, confer any power to adopt or be received as evidence of any transaction affecting such property or conferring such power in the absence of registration.

**THE COMPANIES ACT, 1956 :** A company registered under this Act is a body corporate and is capable of purchasing or acquiring any immovable property and disposing of the same like any individual subject to restriction if any contained in the memorandum and articles of associations. A company on its incorporation becomes a juristic person distinct from the share holders. While transferring or taking on transfer any immovable property to or for a limited company it is necessary to examine the Memorandum and Articles of Association of the company. The memorandum of the company contains the object and the power of the company. The

Articles of the Association of the company contains rules and regulations governing the internal management of the company alongwith powers duties and liabilities of its share holder and directors of the company under section 46 of the Act a company can enter into a contract through a person acting under its authority. Under section 48 a company may execute a power of attorney empowering any person to execute deeds on its behalf. The most important provision is section 293 under which the board of Directors can not without the consent of the company in its general meeting sell, lease or otherwise dispose off the whole or substantial undertaking of the company or borrows money if the total borrowed money/loan would exceed the aggregate of the paid up capital of the company and its free reserves. These are restrictions on the Board of Directors but if the company in its general meeting by simple majority approve the transaction it would be binding on the company. A bonafide purchaser or lessee or lender is protected against the above said restrictions and the restrictions against selling or leasing the property do not apply while the company is doing business of selling or leasing its property.

As the conveyance of immovable property involves a sizable payment of duties under the stamp act and also subject to taxation under the Income Tax Act, tax planning governing every conveyance assume importance.

Another method adopted by the companies to save payment of duties is to adopt amalgamation or merger. Merger is the fusion of two or more existing companies or absorption of one company into another. All assets liabilities and stocks of one company stand transfer to transferee company in consideration of payment in the form of equity shares of transferee company or debentures or cash or a mix of two or three modes. In the case of merger one company survives and the other lose its corporate existence. The survivor acquire the assets and liability of the merged company.

Amalgamation contemplate a state under which two companies are so joint as to form a third entity, or one company is absorbed into and blended with another company. Amalgamation does not involve formation of a new company to carry on the business of the old company.

**LEGAL ASPECT OF MERGER :** Section 394 of the Companies Act explain the scope, conditions and procedure of merger/Amalgamation. The merger/takeover of the corporate enterprises is further subject to Industries (Development and Regulation) Act, 1951, Monopolies and Restrictive Trade Practices Act, Competition Act, 2002, Foreign Exchange Management Act, 1999, Sick Industrial Companies (Special Provisions) Act, 1985, Income Tax Act, 1961, Securities Contract (Regulation) Act, 1956, Securities and Exchange Board of India, Act, 1992, SEBI (substantial acquisition of share and takeovers) regulation 1997, Stamp Act etc.

Section 394 of Companies Act cast an obligation on the court to be satisfied that the scheme of Amalgamation or merger is not contrary to public interest. In Amalgamation of companies, the courts have evolved the principal of ‘Prudent Business Management Test’ or that the scheme should not be a device to evade law. When the court is concerned with the scheme of merger with a subsidiary of a foreign company then the test is not only whether the scheme shall result in maximizing the profit of the share holder or whether the interest of employees was protected but it has to ensure that the merger shall not result in impending promotion of industry or obstruct the growth of national economy. When the merger is with a subsidiary of a foreign company then economic interest of the country may have to be given precedence. In Amalgamation atleast one company losses its corporate entity and amounts to winding up. When the court, sanctioning scheme of Amalgamation, orders dissolution of the transferor company without going through the process of winding up, such order becomes effectives for tax purposes also. Sub-section 2 of section 394 provides that where an order provide for the transfer of any property or liabilities then by virtue of the order, that property shall be transferred to and vest in, and those liabilities shall be transferred to and become the liabilities of the transferee company. The effective date of Amalgamation for this purpose will be the date so specified in the order.

**EFFECT OF AMALGAMATION ON TENANCY RIGHTS :** where by virtue of merger of two companies all property rights including tenancy rights in a property are transferred to the transferee company by virtue of sanctioning of the scheme duly approved by the court, it gives a statutory force to the scheme and the arrangement no more remained a mere private agreement between the two or more parties. The company which emerges from the Amalgamation becomes entitled to the tenancy rights of the earlier company. However, its has to comply with the requirement of the State Rent Act so as to complete the formalities of the transfer of the tenancy right. If it is not done, the transfer of tenancy rights became ineffective (1986) 60 Com. Cases 1013 (SC).

**AMALGAMATION AND INCOME TAX ACT :** In order to get the recognition of an Amalgamation under the Income Tax Act, 1961, the scheme of Amalgamation has to satisfy the test laid down in section 2(1B) of the Income Tax Act. One of the conditions is that share holders holding not less then nine-tenths in value of the shares in the Amalgamating company become share holders of the Amalgamated company by virtue of the Amalgamation. The above said ratio of share does not include the shares already held immediately before the Amalgamation by the Amalgamated company, its nominee or subsidiary.

**AMALGAMATION AND TAX PLANNING :** The jurisdiction of the court while sanctioning any scheme of Amalgamation is comprehensive in as much as it is the duty of court to be satisfied that the scheme is not contrary to public interest. Any thing which is detrimental to public or against any statue, rule, regulation and scheme of the constitution of the country is termed as against public interest or against public policy. The court should be satisfied with all aspects of the schemes including even a suspected evasion of tax. A scheme can not be considered fraudulent or illegal merely because it is arranged in such a way to avoid capital gain or any other tax liability as a person is entitled lawfully to do anything or conduct his affairs in such manner as to avoid and reduce tax liabilities so far as the means are lawful. In case of Mc-Dowell & Company Limited Vs. CTO, (1985) 154 ITR 148, the Supreme Court held that tax planning may be legitimate provided it is within the frame work of the law. Colourable devices can not be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by dubious methods. It is obligation of every citizen to pay the taxes honestly without resorting to subterfuges.

The court will not however, refuse to sanction a scheme of Amalgamation merely because capital gains tax is thereby going to be avoided when the purpose of the scheme is not avoiding taxes. However, if the court finds that the Amalgamation scheme has been made solely to facilitate the transfer of a building to the transferee company of a transferor company without attracting the liability to pay capital gain tax the court can refuse sanction of the scheme. If the court arrives at a conclusion that the purpose of Amalgamation is defeating tax by creating a paper company and transferring an asset to such company which can without consequence be Amalgamation with another company to whom the capital assets was to be transferred so that on Amalgamation it may pass on to the Amalgamating company then the scheme is to avoid payment of tax. The machinery of judicial process can not be pressed into service for defeating the public interest.

Section 47 of the Income Tax Act provide exemption from applicability of section 45 regarding taxation of capital gain on transfer of assets in the case of Amalgamation vide clauses (vi), (via), (viaa), (vib), (vic), (vid) and (vii).

Even where all necessary formalities in regard to Amalgamation with a view to secure exemption as provided under the law including those discussed above are complied but it was found that the transaction/scheme was a subterfuge, a device for the avoidance of tax liabilities, the court could refuse the grant of sanction to the scheme of Amalgamation.

**AMALGAMATION AND STAMP DUTY :** Amalgamation involves change of ownership. The change of ownership of assets attract stamp duty at the rates differently fixed in different states, the same being state subject. Stamp duty is payable on shares, debentures, fresh issues as well as on transfer of property. Any instrument which is specified in Schedule-I of the stamp act of the state whenever executed attract payment of stamp duty at the rate mentioned in the Stamp Act. Some of the instruments which would be executed in some types of Amalgamation subject to payment of stamp duty are, scheme of Amalgamation, transfer deed in respect of the properties of the undertaking etc.

**WHETHER AMALGAMATION IS CONVEYANCE AND SUBJECT TO PAYMENT OF STAMP DUTY :** As discussed in the forgoing paragraph, the word convey means transfer and every transfer of immovable property attract stamp duty if it is conveyance. When Amalgamation took place the properties of transferor company goes to transferee company by virtue of sanctioning of the scheme by the court. No separate and formal transfer/sale deed of property/properties are executed. The payment of stamp duty leviable on the conveyance/sale deed thus is avoided/saved. However, some states amended Stamp Duty Act and brought the transfer of properties through Amalgamation within the purview of ‘conveyance’ and subject to payment of stamp duty. Prominently such states are Maharashtra, Karnataka and Gujrat which levy stamp duty on conveyance of movable and immovable properties of transferor company to transferee company as a result of merger and Amalgamation as envisaged under section 394 of the Companies Act. State government of Maharashtra amended the Bombay Stamp Act, 1958 in the year 1993 by bringing merger and Amalgamation within the definition of conveyance leviable to stamp duty, which was followed by state of Gujrat and Karnataka thereafter.

**STAMP DUTY IN MAHARASHTRA :** By virtue of section 2(g) of Bombay Stamp Act, the order of the court ordering the vesting of transfer of assets and liabilities of the transferor company to the transferee company is deemed to be a conveyance and hence stamp duty is attracted. There is a landmark judgment also of the Bombay High Court having serious implication for merger covered not only by Bombay Stamp Act but also Acts of other states. The following are the conclusion drawn by the court :-

1) An Amalgamation under an order of court under section 394 of the Companies Act, 1956 is an instrument under the Bombay Stamp Act.

2) States are well within their jurisdiction when they levy stamp duty on instrument of Amalgamation.

3) Stamp duty would be levied not on the gross value of assets transferred but on the “undertaking”, when the transfer is on a going concern basis i.e. on the assets less liabilities. The value for this purpose would be the value of assets less liabilities. In other words, the value for this purpose would be the value of shares allotted.

This decision was accepted in the Bombay Stamp Act and now stamp duty is liable on the value of share allotted plus other consideration paid. The stamp duty payable in Maharashtra is 10% of the aggregate of the market value of the shares issued or allotted in exchange or otherwise and the amount of consideration paid for such Amalgamation. Provided that (i) the amount of duty shall not exceed an amount equal to 5% of the true market value of the immovable property located within the state of Maharashtra of the transferor company or (ii) an amount equal to 0.7% of the aggregate of the market value of the shares issued or allotted in exchange or otherwise and the amount of consideration paid for such Amalgamation which ever is higher. In case of reconstruction or de-merger the duty shall not exceed an amount equal to 5% of the true market value of the immovable property located within the state of Maharashtra transferred by the de-merging company to the resulting company or an amount equal to 0.7% of the aggregate value of the market value of the shares issued or allotted to the resulting company and the amount of consideration paid for such Amalgamation which ever is higher.

**STAMP DUTY IN KARNATAKA :** Karnataka amended the Karnataka Stamp Act in 1999 bringing Amalgamation of companies within the definition of conveyance and imposing stamp duty on the same. The rate of stamp duty in Karnataka relating to an order made by the High Court under section 394 of the Companies Act in respect of Amalgamation of company is 10%

of the aggregate of market value of shares issued or allotted in exchange or otherwise and the amount of consideration paid for such Amalgamation. Provided that the amount of duty chargeable shall not exceed (i) an amount equal 7% of the market value of the immovable property located within the state of Karnataka of the transferor company or (ii) an amount equal to 0.7% of the aggregate of the market value of the shares issued or allotted in exchange or otherwise and the amount of consideration paid for such Amalgamation which ever is higher. In case of reconstruction or de-merger the duty chargeable shall not exceed (i) an amount equal to 7% of the market value of the immovable property located within the state of Karnataka transferred by the de-merging company to the resulting company or (ii) an amount equal to 0.7% of the aggregate of the market value of the shares issued or allotted to the resulting company and amount of consideration paid for such de-merger which ever is higher.

**STAMP DUTY IN GUJRAT :** Gujrat modified the definition of conveyance in Article 20 of the Bombay Stamp Act, (Gujrat Amendment) applicable to state of Gujrat, in 2000, bringing Amalgamation under section 394 of the Companies Act within the definition of conveyance. The clause was further substituted in 2002. Rate of stamp duty was further amended in 2006. At present the stamp duty leviable in Gujrat state relating to reconstruction or Amalgamation is (i) an amount equal to 0.75% of the aggregate amount comprising of the market value of share issued or allotted in exchange of or otherwise, or the face value of such shares which ever is higher and the amount of consideration if any paid for such Amalgamation or (ii) an amount equal to 0.75% of the true market value of the immovable property situated in the state of Gujrat of the transferor company, which ever is higher, subject to maximum upper limit of 10 crores Rupees in all above contingencies.

The other states however are yet to formulate policy on this aspect.

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