Legal Decisions[1]

LD/62/10
CIT, International Taxation
vs.
Nike Inc.
March 7, 2013 (KAR)
[Assessment Years 1999-2000 to 2006-2007]

Section 9, read with section 5, of the Income-tax Act, 1961 – Income Deemed to accrue or arise in India

Where non-resident established a liaison office in India that undertook the activities in assisting the Indian manufacturer to manufacture the goods according to specification and in seeing that the said goods manufactured has an international market i.e., it could be exported, and further the assessee is earning income outside India under a contract which is entered outside India, no part of assessee's income could be taxed in India either under Section 5 or Section 9

The assessee is a world known name or brand in sports apparels. It has its main office in USA. It has various associated enterprises or subsidiaries in various parts of the world. The assessee from its office in USA arranges for all its subsidiaries all over the world the various brands of sports apparels for sale to the various customers. The arrangement is through procurement by manufacture from the manufacturer, who directly dispatches the apparels to the various subsidiaries spread all over the world. The assessee with a view to spread its wings mainly from the point of view of procurement of various apparels by manufacture with the assistance of various manufacturers from the various parts of the world approached the Reserve Bank of India to allow it to open a liaison office in India.

In the application for permission by the RBI, the assessee had categorically stated that the liaison office will not undertake any activity of trading, commercial or any industrial nature or enter into any business contracts in its own name without the previous approval of the RBI. It was also committed that the assessee will not charge commission or fees or remuneration in regard to any of the services rendered by it in India. The third commitment was that the entire expenditure of liaison office in India will be borne by the assessee from US by sending funds through regular banking channels to India. It was also undertaken that the liaison office in India shall not borrow or lend without the prior approval of RBI. The RBI granted permission to the assessee under Section 29(1)(a) of the Foreign Exchange Regulation Act for opening of a liaison office in India.

In response to a notice under section 148 the assessee filed its nil return of income by contending that in terms of *Explanation* (b) to Section 9(1)(i), no income is deemed to accrue or arise in India to a non-resident from operations that are confined to the purchase of goods in India for the purposes of export. Further, in terms of Central Board of Direct Taxes Circular No. 20 dated 07.07.1964 a non-resident will

[1] *Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.org.*

not be liable to tax in India on any income attributable to operations confined to purchase of goods in India for export, even though the non-resident has an office or an agency in India for the purpose, or the goods are subjected to any manufacturing process before being exported from India.

The revenue however opined that the income of the assessee was chargeable to tax in India which was set aside by the Tribunal on appeal.

The Karnataka High Court held as follows:

On facts the assessee is not carrying any business in India. They have established a liaison office. The object of establishing the said office is to identify the manufacturers, give them the technical know-how and see that they manufacture goods according to their specification which would be sold to their affiliates. The person who purchases the goods pays the money to the manufacturer, in the said income, the assesee has no right.

In fact, the evidence on record shows that Nike, USA bears the entire expenses of the liaison office. The buyer who is a non-resident may in turn pay some consideration to the assessee outside India, the contract between the assessee and the buyer if at all is entered outside India.

Even if any income arises or accrues to the assessee, it is outside India. Therefore, *Explanation* (1) to sub-section (2) of Section 5 expressly states income accruing or arising outside India shall not be deemed to be received in India within the meaning of the Section. However, under Section 9, all income accruing or arising whether directly or indirectly through or from any "business connection" shall be deemed to be accrued or arises in India. Now by *Explanation* (2) "business connection" has been explained which includes any business activities carried out by a person who acting on behalf of the non-resident as a habitual exercise in India; or an authority to conclude Contracts on behalf of non-resident unless his activities are limited to the purchase of the goods or merchandise for the non-resident. If the said definition is read with Clause (b) of *Explanation* 1 to Sub-Section (1) of Section 9 in the case of a non-resident, no income shall be deemed to accrue or arise in India to him whether directly or indirectly through or from any "business connection", which are confined for the purpose of export. In the first place, the assessee is not purchasing any goods. The assessee is enabling the manufacturers to purchase goods of a particular specification which is required by a foreign buyer to whom the manufacturer sells. As the orders are placed by the assessee with the manufacturer and the goods are manufactured according to their specification which is the requirement of the buyer and even if it is held, though the goods are supplied to the buyer, it is deemed to be supplied to the assessee, the whole object of this transaction is to purchase goods for the purpose of export. Once the entire operations are confined to the purchase of goods in India for the purpose of export, the income derived therefrom shall not be deemed to accrue or arise in India and it shall not be deemed to be an income under Section 9. The proviso to clause (b) of *Explanation* 1 to Sub-section (1)(i) of Section 9 was deleted with the object to encourage exports thereby so that the Country can earn foreign exchange. The activities of the assessee in assisting the Indian manufacturer to manufacture the goods according to their specification is to see that the said goods manufactured has an international market, therefore, it could be exported. In the process, the assessee is not earning any income in India. If at all it is earning income outside India under a contract which is entered outside India, no part of their income could be taxed in India either under Section 5 or Section 9.

LD/62/11

CIT

vs.

Mentor Graphics (Noida) Pvt.Ltd.

April 4, 2013 (DEL)

[Assessment Year 2002-2003]

Section 92C of the Income-tax Act, 1961 – Transfer Pricing – Computation of

Merely because one profit level indicator of a comparable, out of a set of comparables, is lower than the profit level indicator of the taxpayer, it cannot be held that the transaction reported by the taxpayer is at an arm's length price

The most appropriate method, as accepted both by the respondent/assessee and by the revenue, was the transactional net margin method. The Transfer Pricing Officer has generally rejected the comparables submitted by the respondent/assessee in his transfer pricing report and has rejected the suggested arm's length price based on a profit level indicator of 6.99% as determined by the respondent/assessee and, in place thereof, the Transfer Pricing Officer adopted a profit level indicator of 24.53% and determined the arm's length price of the international transactions at ₹10,34,40,177 as against ₹8,88,66,320 returned

by the respondent/assessee. This resulted in an adjustment of ₹1,45,73,857 in the income of the assessee being the difference between the arm's length price and the price charged by the assessee from its associated enterprise (IKOS System Inc.) for rendering services to them. Thereafter, the assessing officer passed the assessment order after making the aforesaid addition which was deleted by the Tribunal.

The dispute that has arisen in the present case is with regard to the observation of the Tribunal to the effect that where one of the prices determined by the most appropriate method is less than the price as indicated by the respondent/assessee, that may be selected and there would be no need to adopt the process of taking the arithmetical mean of all the prices arrived at through the employment of the most appropriate method.

The Delhi High Court held as follows:

The observation of the Tribunal is incorrect. When more prices than one are thrown up by the most appropriate method, the statute requires that the arm's length price shall be taken to be the arithmetical mean of such prices. This is the plain and simple meaning of the *proviso* to section 92C(2).

A reading of sub-section (3) of section 92C makes it clear that if the assessing officer in the course of any proceeding of assessment, on the basis of material or information or documents in his possession, is of the opinion that any of the 4 conditions (a) to (d) stipulated in sub-section (3) are satisfied then, the assessing officer may proceed to determine the arm's length price in relation to the international transaction in accordance with the provisions of sub-section (1) and sub-section (2) of section 92C on the basis of such material or information or documents available with him. Provided, of course, that an opportunity is given by the assessing officer to the assessee to show cause as to why the arm's length price should not be so determined on the basis of material or information or document in the possession of the assessing officer. In other words, in the aforesaid circumstances the assessing officer may himself embark upon the determination of the arm's length price. However, where the assessing officer considers it necessary to do so, he may with the previous approval of the commissioner, refer the computation of the arm's length price to the Transfer Pricing Officer.

The Transfer Pricing Officer had rejected the comparables submitted by the respondent/assessee. However, that rejection was of all comparables, generally. None of the 16 comparables submitted by the respondent/assessee were specifically rejected. The Transfer Pricing Officer had not indicated as to how each of the comparables suggested by the respondent/assessee did not fulfil the criteria which was adopted by him.

The Tribunal set out the respondent/assessee's comparables after applying all of the Transfer Pricing Officer rejection criteria and came to the conclusion that seven companies fulfilled the criteria of being comparables.

The arithmetic mean of the profit level indicator (Operating Profit/Total Cost) came to 3.61% as against 6.99% of the respondent/assessee. The Tribunal also noted that the Transfer Pricing Officer had not made any adverse comment against eight companies which had been suggested as comparables by the respondent/assessee.

Although there were nine companies listed, only eight were relevant inasmuch as there was no data for Top Media Entertainment. The arithmetical mean of the PLI in the cases of these eight companies also comes to 4.47% which was again lower than the PLI of the respondent/assessee which was 6.99% for the relevant year.

The sum and substance of the Tribunal's order is that the criteria adopted by the Transfer Pricing Officer for searching comparables was not correct. Secondly, the Transfer Pricing Officer had not specifically rejected any of the comparables of the respondent/assessee. The Tribunal was of the view that the comparables of the respondent/assessee ought to have been accepted and, had that been the case, there would have been no need for the Transfer Pricing Officer to search for comparables. Of course, in passing the order, the Tribunal made certain general observations that unless and until the comparables drawn by the tax payer were rejected, a fresh search by the Transfer Pricing Officer could not be conducted. However, this has to be tempered with the relevant statutory provisions which are clearly set out in sub-section (3) of section 92C of the said Act which stipulates four situations whereunder the assessing officer/ Transfer Pricing Officer may proceed to determine the arm's length price in relation to an international transaction. If any one of those four conditions are satisfied, it would be open to the assessing officer/Transfer Pricing Officer to proceed to determine the arm's length price. This clarification of the observation of the Tribunal was necessary. The Tribunal had gone further and reduced the

list of comparables to merely four. It was the right approach to be adopted by the Tribunal. The Tribunal should have stopped at the point where it decided on facts that the comparables given by the respondent/ assessee were to be accepted and those searched by the Transfer Pricing Officer were to be rejected. The only option then left to the Tribunal was to derive the arithmetical mean of the profit level indicators of the comparables which were accepted by it. In this case such comparables happen to be those of the respondent/assessee. The Tribunal, in selecting only one profit level indicator out of a set of profit level indicators had clearly erred in law. However, in the facts of the present case that would not make any difference to the respondent/assessee's case inasmuch as even if the arithmetical mean of the comparables as accepted by the Tribunal are taken into account, the profit level indicator would, whether the seven companies are taken into consideration or all eight companies are taken into consideration, be less than 6.99% which is the profit level indicator of the respondent/assessee for the relevant year, that is, financial year ending 31.03.2002. The reference to the OECD guidelines by the Tribunal in the impugned order are in the context of the reliance placed by the Transfer Pricing Officer on the very same guidelines, in particular, to paragraph 3.27 thereof. In the present case, there are specific provisions of sub-rules (2) and (3) of Rule 10B of the said Rules as also of the first proviso to section 92C(2) of the said Act which apply. Therefore, the question of applying OECD guidelines does not arise at all.

The Tribunal was wrong in holding that if one profit level indicator of a comparable, out of a set of comparables, is lower than the profit level indicator of the taxpayer, then the transaction reported by the taxpayer is at an arm's length price. The proviso to section 92C(2) is explicit that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices.

LD/62/12

CIT-XVII, Delhi

vs.

Silver Oak Laboratories P. Ltd.

June 13, 2013 (SC)

Section 194C of the Income-tax Act, 1961 – Deduction of Tax at Source – Payments to Contractors/Sub-Contractors

The term "work" will not include manufacturing or

supplying a product according to the requirement or specification of a customer

The amendment in Section 194C of the Act vide Finance (No.2) Act, 2009, with effect from 1st October, 2009, defines "work" to include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. In fact, it is clarified that the definition of the word "work" will not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person other than such customer.

Note: Judgment and order dated 11/11/2008 in ITA No.1259/2007 of The High Court of Delhi, upheld.

LD/62/13
CIT-IV, Kolkata
vs.
Madan Theatres Ltd.
May 14, 2013 (CAL)

Section 271(1)(c) read with Section 50C of the Income-tax Act, 1961 – Penalty – For Concealment of Income

Where assessee in its return disclosed actual sale consideration received towards sale of a property but Assessing Officer invoking provisions of section 5C(1) took deemed sale consideration of Stamp Valuation Authorities, which was higher than actual sale consideration and made addition to income of assessee, on basis of such deemed consideration penalty under section 271 (1) (c) could not be imposed on assessee.

The assessee sold a property at a sum of ₹2,51,50,000. For the purpose of stamp duty, however, the value was estimated at a sum of ₹5,19,77,000 and on that basis the stamp duty was realised. During the assessment, the assessee had disclosed the sale price at a sum of ₹2,51,50,000. The Assessing Officer invoking provisions of section 50C(1) fixed the sale price at a sum of ₹5,19,77,000 and imposed penalty under Section 271(1)(c) on the assessee. Both the Commissioner (Appeals) and Tribunal deleted the Penalty.

On appeal by the Department, the Calcutta High Court held that in the instant case, as far as the amount of consideration of sale for the purpose of computation of capital gain under section 48 is concerned, even if the valuation of property as per the stamp valuation authority is more than the actual sale consideration, the provisions of section 50C(2) allow the assessee to choose the actual sale consideration if the assessee is convinced about the fair market value of such property being the same as consideration actually received by the assessee. Assessing Officer invoked the provisions of section 50C(1) and deemed the sale consideration at ₹5,19,77,000 as per the valuation of stamp valuation authorities and assessee chose not to contest the same under section 50C(2) as it would not have made any difference in the tax liability of the assessee because the capital gain still remained a loss. However, the belief of assessee at the time of filing of return of income that the valuation of property by stamp valuation authorities could not be the fair market value of the property was a bona fide belief though not pursued further in view of the provisions of section 50C(2).

Further, the revenue had also not shown as to how the assessee could be held to have actually received this amount which was in excess of the amount of ₹2,51,50,000. It had also not been shown as to whether any corresponding addition had been made in the hands of the buyer.

The fact remained that the actual amount received was offered for taxation. It was only on the basis of the deemed consideration that the proceedings under Section 271(1)(c) started. The revenue had failed to produce any *iota* of evidence that the assessee actually received one paisa more than the amount shown to have been received by him.

Thus the appeal of the revenue dismissed.

Arbitration Act

LD/62/14
Antrix Corp. Ltd.
Vs.
Devas Multimedia P. Ltd.
May 10, 2013 (SC)

Section 11 read with Sections 13 and 34 of the Arbitration and Conciliation Act, 1996 – Appointment of Arbitrator

Where the parties had agreed that the procedure for the arbitration would be governed by the ICC Rules, the same would necessarily include the appointment of an Arbitral Tribunal in terms of the Arbitration Agreement and the ICC Rules and if it is so done, Arbitration Petition for the appointment of an Arbitrator under Section 11(6) must fail

The agreement entered into between the Petitioner-Antrix and the Respondent-Devas provided that the rights and responsibilities of the parties under

the Agreement would be subject to and construed in accordance with the laws in India, which, in effect, means the Arbitration and Conciliation Act, 1996. Article 20 of the Agreement would specifically deal with arbitration and provides that disputes between the parties regarding the provisions of the Agreement or the interpretation thereof, would be referred to the Senior Management of both the parties for resolution within three weeks, failing which the dispute would be referred to an Arbitral Tribunal comprising of three Arbitrators. It was also provided that the seat of arbitration would be New Delhi in India and the arbitration would be conducted in accordance with the rules and procedures of the International Chamber of Commerce (ICC) or UNCITRAL.

The Respondent invoked the provisions of Article 20 of the Agreement and approached the ICC for the appointment of an Arbitral Tribunal in accordance with the rules of arbitration and, pursuant thereto, the Respondent appointed its nominee Arbitrator. In fact, after the Respondent had invoked the arbitration clause, the Petitioner came to know of the same from the Respondent's request for arbitration which was forwarded by the ICC to the Petitioner on 5th July, 2011. By the said letter, the Petitioner was also invited by the ICC to nominate its nominee Arbitrator, but instead of nominating its Arbitrator, the Petitioner once again requested Devas to convene the Senior Management Meet on 27th July, 2011, in terms of the Agreement. Simultaneously, the Petitioner appointed a former Judge of the Supreme Court, Mrs. Sujata V. Manohar, as its Arbitrator and informed the ICC Court accordingly. However, disputes were also raised by the Petitioner with the ICC that since the Agreement clearly intended that the arbitration proceedings would be governed by the Indian law, which was based on the UNCITRAL model, it was not available to the Respondent to unilaterally decide which of the rules were to be followed. It was only thereafter that the Petitioner took recourse to the provisions of Section 11(4).

The Supreme Court held as follows:

Section 11 is very clear as to the circumstances in which parties to a dispute, and governed by an Arbitration Agreement, may apply for the appointment of an Arbitrator by the Chief Justice of the High Court or the Supreme Court.

As will be evident from section 11, when any of the parties to an Arbitration Agreement fails to act in terms thereof, on the application of the other party, the Chief Justice of the High Courts and the Supreme Court, in different situations, may appoint an Arbitrator.

In the instant case, the respondent Devas, without responding to the Petitioner's letter written in terms of Article 20 of the Arbitration Agreement, unilaterally addressed a Request for Arbitration to the ICC International Court of Arbitration for resolution of the disputes arising under the Agreement and also appointed its nominee Arbitrator. On the other hand, the Petitioner

appointed its nominee Arbitrator with the caveat that the arbitration would be governed by the Act and called upon Devas to appoint its nominee Arbitrator under the said provisions. As Devas did not respond to the Petitioner's letter, the Petitioner filed the application under Section 11(6).

Once the Arbitration Agreement had been invoked by Devas and a nominee Arbitrator had also been appointed by it, the Arbitration Agreement could not have been invoked for a second time by the Petitioner, which was fully aware of the appointment made by the Respondent. It would lead to an anomalous state of affairs if the appointment of an Arbitrator once made, could be questioned in a subsequent proceeding initiated by the other party also for the appointment of an Arbitrator. While the Petitioner was certainly entitled to challenge the appointment of the Arbitrator at the instance of Devas, it could not do so by way of an independent proceeding under Section 11(6) of the 1996 Act. While power has been vested in the Chief Justice to appoint an Arbitrator under Section 11(6), such appointment can be questioned under Section 13 thereof. In a proceeding under Section 11, the Chief Justice cannot replace one Arbitrator already appointed in exercise of the Arbitration Agreement.

When there was a deviation from the methodology for appointment of an Arbitrator, it was incumbent on the part of the Chief Justice to assign reasons for such departure.

Sub-Section (6) of Section 11, quite categorically provides that where the parties fail to act in terms of a procedure agreed upon by them, the provisions of Sub-Section (6) may be invoked by any of the parties. Where in terms of the Agreement, the arbitration clause has already been invoked by one of the parties thereto under the I.C.C. Rules, the provisions of Sub-section (6) cannot be invoked again, and, in case the other party is dissatisfied or aggrieved by the appointment of an Arbitrator in terms of the Agreement, his/its remedy would be by way of a petition under Section 13, and, thereafter, under Section 34.

The law is well settled that where an Arbitrator had already been appointed and intimation there of had been conveyed to the other party, a separate application for appointment of an Arbitrator is not maintainable. Once the power has been exercised under the Arbitration Agreement, there is no power left to, once again, refer the same disputes to arbitration under Section 11, unless the order closing the proceedings is subsequently set aside.

When the Arbitral Tribunal is already seized of the disputes between the parties to the Arbitration Agreement, constitution of another Arbitral Tribunal in respect of those same issues which are already pending before the Arbitral Tribunal for adjudication, would be without jurisdiction.

Article 20 of the Arbitration Agreement in question provided that the arbitration proceedings would be held in accordance with the rules and procedures of the International Chamber of Commerce or UNCITRAL, Devas was entitled to invoke the Rules of Arbitration of the ICC for the conduct of the arbitration proceedings. Article 19 of the Agreement provided that the rights and responsibilities of the parties thereunder would be subject to and construed in accordance with the laws of India. There is, therefore, a clear distinction between the law which was to operate as the governing law of the Agreement and the law which was to govern the arbitration proceedings. Once the provisions of the ICC Rules of Arbitration had been invoked by Devas, the proceedings initiated thereunder could not be interfered with in a proceeding under Section 11. The invocation of the ICC Rules would, of course, be subject to challenge in appropriate proceedings but not by way of an application under Section 11(6). Where the parties had agreed that the procedure for the arbitration would be governed by the ICC Rules, the same would necessarily include the appointment of an Arbitral Tribunal in terms of the Arbitration Agreement and the said Rules. Arbitration Petition under Section 11(6) for the appointment of an Arbitrator must, therefore, fail and is rejected, but this will not prevent the Petitioner from taking recourse to other provisions of the aforesaid Act for appropriate relief.

SEBI

LD/62/15

Nirma Industries Ltd.

vs.

SEBI

May 9, 2013 (SC)

Regulation 27 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 – Withdrawal of Offer

Where appellants with a clear idea regarding financial conditions and future prospects of

target company, acquired huge number of shares of target company and hence, had to make public offer under Takeover Regulation, later on appellants could not be permitted to wriggle out of the obligation of public offer on the ground that this would likely to cause loses to it

The Promoters of listed company SRMTL borrowed ₹48.94 crore from the appellants and pledged equity shares of SRMTL as security. Having acquired the shares of the target company (SMRTL) to the extent which triggered the Regulation 10 of the Takeover Code, the appellants published in the newspaper the proposed open offer to acquire upto 20% of the shares of the existing shareholders. The price offered in the Public Announcement was arrived at as per Regulation 20(4) of the Takeover code, which is applicable to frequently traded shares.

Later on, the appellants requested SEBI that pursuant to the fraud perpetrated by the Promoter Directors of SRMTL and fraudulent embezzlement of funds in SRMTL in excess of ₹350 crore being unearthed, SEBI should either exempt them from making the open offer or to permit them to withdraw the open offer under Regulation 27 of the Takeover Code or to re-fix the price of the Open Offer. The request of the appellants for withdrawal of has been rejected.

The appellants claimed that the respondent did not appreciate that the fraudulent transactions, systematic embezzlement and siphoning of funds was unearthed by special investigative audit and could not have been found by an outside third party like appellants before invoking the pledge.

The Supreme Court held as follows:

There is no reason to read into Regulation 27-the provision that the party seeking to withdraw from the public offer is required to be given an oral hearing before an order is passed on the request for withdrawal. No oral hearing was particularly necessary in the light of the fraud, which has been perpetrated by the promoters of the target company on the innocent shareholders, which will also include the appellants.

The appellants had made and informed business decision which unfortunately for them, instead of generating profits was likely to cause loses. In such circumstances, they wanted to pull out and throw the burden on to the other shareholders. Therefore, no prejudice has been caused to the appellants by the order passed by the SEBI rejecting the request of the appellants.

SAT has correctly concluded that: "Having acquired the shares of the target company which breached the threshold limit prescribed by the takeover code, the appellants were required to make a public officer to acquire further shares of that company for which a public announcement was made. The normal rule being that the public offer once made could not be withdrawn, it was only in the exceptional circumstances that such an offer could be withdrawn.

Provisions of Regulations 27(1) (b) (c) and (d)

The SEBI has been entrusted with the fundamental duties of ensuring orderly development of the securities market as a whole and to protect the integrity of the securities market.

A conspectus of the Regulations would show that the scheme of the Takeover Code is – (a) to ensure that the target company is aware of the substantial acquisition; (b) to ensure that in the process of the substantial acquisition or takeover, the security market is not distorted or manipulated and (c) to ensure that the small investors are given an option to exit, that is, they are offered a choice to either offload their shares at a price as determined in accordance with the takeover code or to continue as shareholders under the new dispensation. In other words, the takeover code is meant to ensure fair and equal treatment of all shareholders in relation to substantial acquisition of shares and takeovers and that the process does not take place in a clandestine manner without protecting the interest of the shareholders.

It cannot be grounds to contend that unless the appellants are allowed to walk away from the public offer they would have to bear losses which would otherwise have been shared by the erstwhile shareholders of the target company. Accepting such a proposition would be contrary to the aims and objectives of the Takeover Code which is to ensure transparency in acquisition of a large percentage of shares in the target company. It would also encourage undesirable and speculative practices in the stock market. Therefore, it cannot be said that Regulation 27(1) (d) would empower SEBI to permit withdrawal of an offer merely because it has become uneconomical to perform the public offer.

The Takeover Regulations, which is a special law to regulate "substantial acquisition of shares and takeovers" in a target company lays down a self contained code for open offer; and also that interest of investors required that they should be given an exit route when the appellants have acquired.

The orderly development of the securities market as a whole requires that public offers once made ought not to be allowed to be withdrawn on the ground of fall in share price of the target company, which is essentially a business misfortune or a financial decision of the acquirer having gone wrong. SEBI as well as SAT have correctly concluded that withdrawal of the open offer in the given set of circumstances is neither in the interest of investors nor development of the securities market. If on ground of fall in prices, public offer is allowed to be withdrawn, it could lead to frivolous offers, being made and withdrawn. This would adversely affect the interests of the shareholders of the target company and the integrity of the securities market, which is wholly contrary to the intent and purpose of the takeover regulations.

Where the appellants wanting to withdraw the public offer merely wishes to cut its losses at the expense of the innocent shareholders, who are entitled under the Regulations to the exit option, the appellants would have to buy the shares at the quoted prices, placing a financial burden on the appellants. The aim of the appellants was merely to avoid such an added burden.

Fraud

In the present case, no fraud has been played on the appellants as such. The shares were acquired by the appellants on the basis of an informed business decision. The appellants cannot be permitted to take advantage of their own laxity to justify seeking withdrawal of the public offer.

The appellants were aware of the litigation against SRMTL and its Directors. The litigation commenced in the year 2003 i.e. before the public announcement made by the appellants. In fact, the letter of offer itself refers to the pending litigation by and against the target company and its directors.

The appellants cannot be permitted to wriggle out of the obligation of a public offer under the Takeover Regulations. Permitting them to do so would deprive the ordinary shareholders of their valuable right to have an exit option under the aforesaid regulations.

SCRA

LD/62/16

Bhagwati Developers (P.) Ltd.
vs.
Peerless General Finance & Investment Co. Ltd.
July 15, 2013 (SC)

Section 2(h)(i) of the Securities Contracts (Regulation) Act, 1956 – Securities – Definition of

Securities Contract (Regulation) Act applies even to public limited company though not listed in stock exchange

For shares of a public limited company to come within the definition of securities they have to satisfy that they are marketable. As is evident from the dictionary meaning, the expression "marketable" has been equated with the word saleable.

What is required is free transferability. Subject to certain limited statutory restrictions, the shareholders possess the right to transfer their shares, when and to whom they desire.

Therefore, shares of public limited company though not listed in the stock exchange come within the definition of securities and hence, the provisions of Regulation Act apply.

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Section 13 read with Section 2(i) and Section 16 of the Securities Contracts (Regulation) Act, 1956 – Contracts and Options in Securities - Contracts in Notified areas illegal in certain Circumstances

Substantial part of consideration for transfer of shares, passed years after transfer of shares - Contract for share transfer could not be said to be a spot delivery contract - Such transfer would be null and void

The Regulation Act was enacted to prevent "undesirable transaction in securities by regulating business of dealing therein" and from that one cannot infer that it was to apply only to the transfer of shares on the stock exchange.

In the case of *Naresh K. Aggarwala & Co. v. Canbank Financial Services Ltd. (2010) 10 SCC 178*, it was held that the definition [of securities under section 2(h)(i)] does not make any distinction between listed securities and unlisted securities.

The provisions of the Regulation Act would cover unlisted Securities of Public Limited Company. In other words, shares of a Public Limited Company not listed in the stock-exchange are covered within the ambit of Regulation Act.

Section 16(1) of the Act confers power on the Central government to prohibit contracts in certain cases.

In order to prevent undesirable stipulation in specified securities in any State or area the Central Government by notification is competent to declare that no person in any State or area specified in the notification shall, save with the permission of the Central Government, enter into any contract for the sale or purchase of any security specified in the notification. The Central Government in exercise of the aforesaid power issued notification dated 27th of June, 1969 and declared that in the whole of India "no person" shall "save with the permission of the Central Government enter into any contract for the sale or purchase of securities other than such spot delivery contract" as is permissible under the Act, the Rules, bye-laws and the Regulations of a recognised stock exchange. The appellant, therefore, can come out of the rigours of Section 16 of the Act only when it satisfies that the transaction comes within the definition of "spot delivery contract".

A contract providing for actual delivery of securities and the payment of price thereof either on the same day as the date of contract or on the next day means a spot delivery contract.

One T took loan from company B. The formal agreement had been claimed to be executed on 10-11-1986 transferring the entire 3530 shares of Peerless purchased from the loan amount and the transfer was in its repayment. However, the agreement dated 21-11-1994 in respect of compromise decree provided that the sale of shares took place on 30-10-1987 and in consideration thereof Bhagwati paid a sum of ₹10 lakhs on 21-11-1994 and further the dividend on the entire shares up to the accounting year 1989-90 amounting to ₹8,64,850 to be retained by T. The plea of the appellant that it is a spot delivery contract was fit to be rejected. ■