Shephali

IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

COMPANY SCHEME PETITION NO. 406 OF 2015

IN

COMPANY SUMMONS FOR DIRECTION NO. 262 OF 2015

Sadavani Investments and Trading Company Private Limited …Petitioners

WITH

COMPANY SCHEME PETITION NO. 407 OF 2015

IN

COMPANY SUMMONS FOR DIRECTION NO. 263 OF 2015

COMPANY SCHEME PETITION NO. 408 OF 2015

IN

COMPANY SUMMONS FOR DIRECTION NO. 264 OF 2015

Mr. Hemant Sethi, *for the Petitioners.*
Mr. Parag Vyas, *with Ms. Purnima Awasthi, for the Regional Director.*
Mr. Vinod Sharma, Official Liquidator, *present.*
Ms. Yogini Chauhan, Deputy Official Liquidator, *present.*

CORAM: G.S. PATEL, J
DATED: 18th March 2016

PC:-

1. Heard.

2. This is a Scheme of Amalgamation between two wholly owned subsidiaries and their parent holding company. The surviving objection from the Regional Director is set out in paragraph 6 at pages 90 and 91 of the further Affidavit dated 29th October 2015. This paragraph reads:

> "That the Deponent further submits that,
>
> a) Clause 11(i) and 11 (ii) of the Scheme states that the Transferee Company shall follow the "purchase method" of account of amalgamation and all assets and liabilities of the Transfer Companies shall be recorded in books of account of the Transferee Company at their fair values. In this regard, it is submitted that both the Transferor Companies are 100% subsidiary of the Transferee Company. Except an investment held in another listed Company, both the Transferor companies are not having any other assets. Copies of relevant extracts from the Balance Sheet of the Transferor Companies for the year ending 31/03/2015 are annexed hereto and marked as ***Exhibit 'E1' & 'E2'.*** As both the Transferor Companies are 100% subsidiary of Transferee Company, the Accounting Standard prescribed in As-14, viz., 'Amalgamation in the nature of merger' following pooling interest method shall be applied and accordingly the assets and liabilities of the Transferor Companies have to be transferred on book value basis only.

Without prejudice to the above submission, the Deponent further submits that the Transferee Company is attempting to achieve some undue benefit which they cannot achieve legally otherwise. If the Transferee Company itself directly holds the entire investment (held by both Transferor companies) in another public Company then also Transferee Company would have recorded in its balance sheet the actual investment cost only and not the fair market value which is prevailing in the market. There is no provision for directly reflecting the fair market value of investment as against its actual investment cost. By way of this Amalgamation, the Transferee Company is attempting to show the fair market value of Investment of Rs.4,73,42,880/- as on 31.03.2014 instead of showing the actual value of investment of Rs.11,56,904/-. If the said Clause 11(i) and 11(ii) of the Scheme are allowed then the financial statement of the Transferee Company may not reflect the true and fair view of the financial position of the Company may post amalgamation and as such the Deponent respectfully submits that there is no justification for transferring the assets and liabilities of Transferor Companies to Transferee Company on fair value basis and hence the same may be transferred on book value basis only.

b)Clause 11(vi) of the Scheme provides for adjustment for differences in Accounting

Policies between Transferor Companies and Transferee Company. In this regard, it is submitted that in addition to compliance of Accounting Standard-14, the Transferee Company shall pass such accounting entries which are necessary in connection with the Scheme to Company with other applicable Accounting Standard such as AS-5, etc.

c) It is respectfully submitted that the tax implication, if any, arising out of the Scheme by this Hon'ble Court may not deter the Income Tax Authority to scrutinize the tax returns filed by the Transferee Company after giving effect to the Scheme. The decision of the Income Tax Authority is binding on the Petitioner Companies."

3. I have heard Mr. Sethi for the Petitioners, Mr. Ardeshir who appears as *Amicus* and Mr. Vyas for the Regional Director.

4. What the Affidavit, irrespective of what the actual submission before me on behalf of the Regional Director is, amounts to is that the relevant accounting method to be followed in this matter must be the "pooling of interest method" and it cannot be the "purchase method".

5. It is an accepted position that Accounting Standard 14 ("**AS-14**") is to be applied. Under this Accounting Standard, in matters of amalgamation and the treatment of the resultant goodwill and services, a company has the choice, subject to certain conditions, of one of two accounting methods. One option is the "pooling of interests" method and the second is the "purchase method". Section 3 of AS-14 contains certain definitions. Paragraph 7 sets out broadly the two main methods of accounting. Paragraphs 7 to 13 are material:

> "7. There are two main methods of accounting for amalgamations:
>
> (a) the pooling of interests method; and
>
> (b) the purchase method.
>
> 8. The use of the pooling of interests method is confined to circumstances which meet the criteria referred to in paragraph 3(e) for an amalgamation in the nature of merger.
>
> 9. The object of the purchase method is to account for the amalgamation by applying the same principles as are applied in the normal purchase of assets. This method is used in account for amalgamations in the nature of purchase.
>
> *The Pooling of Interests Method*
>
> 10. Under the pooling of interests method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts (after making the adjustments required in paragraph 11).
>
> 11. If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting

policies, a uniform set of accounting policies is adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

The Purchase Method

12. Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation. The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

13. Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company. For example, the transferee company may have a specialised use for an asset, which is not available to other potential buyers. The transferee company may intend to effect changes in the activities of the transferor company which necessitate the creation of specific provisions for the expected costs, e.g.

planned employee termination and plant relocation costs."

6. On a plain reading of Sections 7 and 8, the pooling of interest method is limited to those situations that meet the criteria specified in Paragraph 3(e). Now Paragraph 3(e), part of the definitions paragraph, reads:

> "**3(e)Amalgamation in the nature of merger** is an amalgamation which satisfies all the following conditions.
>
> (i) All the assets and liabilities of the Transferor Company become, after amalgamation, the assets ad liabilities of the Transferee Company.
>
> (ii) Shareholders holding not less than 90% of the face value of the equity shares of the Transferor Company (other than the equity shares already held therein, immediately before amalgamation, by the Transferee Company or its subsidiaries or their nominees) become equity shareholders of the Transferee Company by virtue of the amalgamation.
>
> (iii)The consideration for the amalgamation receivable by those equity shareholders of the Transferor Company who agree to become equity shareholders of the Transferee Company is discharged by the

> Transferee Company wholly by the issue of equity shares in the Transferee Company, except that cash may be paid in respect of any fractional shares.
>
> (iv) The business of the Transferor Company is intended to be carried on, after the amalgamation, by the Transferee Company.
>
> (v) No adjustment is intended to be made to the book values of the assets and liabilities of the Transferor Company when they are incorporated in the financial statements of the Transferee Company except to ensure uniformity of accounting policies."

7. From this, it is clear that if any one of the sub-paragraphs (i) to (v) of paragraph 3(e) are *not* satisfied, then the pooling of interest method cannot be invoked. Even Mr. Vyas for the Regional Director states, and I imagine there is no real dispute about this, that the provisions of 3(e)(v) have not in fact been met, as there are clearly adjustments intended to be made to the book value of assets and liabilities of the Transferor Company when incorporated in the financial statements of the Transferee Company.

8. To my mind, this eliminates all possibility of the Transferee Company ever legitimately using the pooling of interests method. In fact, in the Scheme had the Transferee Company proposed to use the pooling of interest method, that would have been completely incorrect and contrary to AS-14. An objection to that would have had to be upheld.

9. I should imagine that this in itself is sufficient to meet the objection as stated on Affidavit by the Regional Director for the pooling of method's conditions are clearly not met. But across the Bar, Mr. Vyas now suggests that what the Company should use as an accounting method is some sort of modified or hybrid version of the purchase method. He relies on paragraph 36 of the AS-14 in this regard. Paragraph 36 reads:

> "36. In preparing the Transferee Company's financial statements, the assets and liabilities of the Transferor Company should be incorporated at their existing carrying amounts or, alternatively, the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation. The reserves (whether capital or revenue or arising on revaluation) of the Transferor Company, other than the statutory reserves, should not be included in the financial statements of the ..."

10. It is now Mr. Vyas's case that the Transferee Company should show the actual investment value rather than the fair market value of the investment. Nothing in paragraph 36 suggests this. The basis of Mr. Vyas's objection seems to be that there is no "consideration" since two wholly owned subsidiaries are being amalgamated and merged with their parent. This is, in my view, not relevant to the question of choice of accounting method. If the framers of AS-14 intended to draw a distinction or make an exception for cases where wholly owned subsidiaries are merged with their parents, they would undoubtedly have said so. Nothing is shown to me to demonstrate that there exists any such exception or distinction.

11. I am also unable to understand the purpose of this objection. It seems to suggest that if at some unknown point in future in some circumstances equally unknown the Transferee Company disposes of some or all of its assets at an as yet unknown price, there may perhaps be some unknown issue of Capital Gains Tax. It is not on this kind of idle speculation that the Regional Director can take such objections.

12. In any case, this is not the objection taken in the Affidavit at all. It is only advanced across the Bar. The only objection on Affidavit is that the purchase method could not have been used at all and only the pooling of interests method was legitimately possible. As I have noted, the pooling of interests method is eliminated by definition and cannot possibly be used in this situation.

13. There is no substance to this objection. All the remaining objections have been dealt with. The Petition is made absolute in these terms.

(G. S. PATEL, J.)