

## **Section 391 To 394 – Business Tool for Restructuring**

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What we learn as a student in respect of provisions of Section 391 to section 394 in the Companies Act, 1956, is in reality some thing different while implementing. The provisions of these sections have wide applicability in restructuring the business. Though the words merger, de-merger or amalgamation are not used in these sections, through the interpretation of various terms like – arrangement, compromise and reconstruction, the same meaning has been derived.

Presently High Courts are empowered to give orders under these sections. After going through the schemes put before and approved by these High Courts, the wide scope of applicability of these sections gets unfurled before us.

Here are some real life cases, which may interest you, which has been dealt under section 391 of the companies act, 1956 by the author.

### **Case I**

#### **De-merger – Hiving Off**

A Private Limited having three manufacturing units situated at different locations in MIDC area in Pune. The manufacturing facilities at each plant were independent to each other. In one of the manufacturing facilities only machining activity was being carried out. Promoters of this company were of the opinion that to exploit the business potential of these activities, those need to be separately handled. Various options like selling the undertaking to new entity, forming a subsidiary and spinning off the activity of machining to this entity, de-merger were thought of. In the mean while it came to the notice that one of the plot can not be transferred – where machining activity was being carried out – for minimum five years. Considering pros and cons of various alternatives, it was decided to de-merge or hive off the unit engaged in machining activity.

It was business reorganization. The benefits under the said hiving off were -

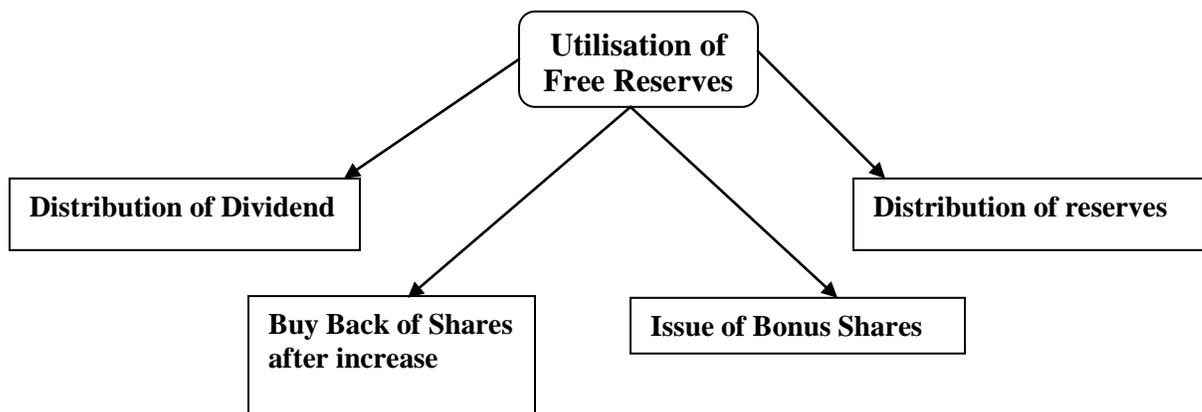
- No capital gains on the assets transferred in to the de-merged company. All assets and liabilities were transferred at the book value to the resulting company.
- Transfer of plot is possible without attracting transfer premium but only minimum transfer fees. Stamp duty applicable on transfer is according to entry no. 25da in schedule I of the Bombay Stamp Act where there was reduction on outflow.
- No generation of money for purchase of plot.
- MIDC approval was easy to get as there was High Court order.
- Even the promoters separated from each other in the most friendly manner.
- Cash outflow from the entities involved was least minimum.

## Case II

### Distribution of Reserves

In case of one of the STPI registered unit (private limited company) as per the audited balance sheet of the company more than Rs. 10 Crores were standing at the credit of General Reserves. Paid up capital of the company was paltry Rs. 1 Lac only. NRIs were holding 90% of the shares in the paid up capital. The board of the company wanted to distribute maximum amount out of its general reserves to its shareholders in one go. There was liquid cash, in the form of deposits, available with the company.

It was possible to utilize these reserves in the following ways:



Buy back was not possible unless there is increase in capital. If company does bonus issue and then bought back the share, outflow on account of ROC fees, locking reserves into capital and following the buy back of share rules was essential. Still the amount which can be distributed was restrictive. There are also rules regarding declaration of dividend out of general reserves. Those are also restrictive in nature and hence not of use in current case.

Hence to distribute maximum amount to shareholders, it was suggested to implement a scheme under section 391 of the Companies Act, 1956, for financial restructuring, through confirmation of High Court. Scheme was drafted. The desired amount to be distributed and which not of the use of the company, out of the general reserves, was petitioned to be distributed to the shareholders without attracting the provisions of Section 205 of the Companies Act, 1956. Within three months High Court approved the scheme. Reserves were distributed. Reserve Bank of India's permission was also obtained for remittance of reserves to NRI shareholders.

The company was required to pay the dividend distribution tax on the amounts so distributed as the distribution of reserves amounts as deemed dividend.

### **Case III**

#### **Reverse Merger**

R Private Limited ( R ) was looking for suitable premises of its own. R was a profit making company. P Private Limited ( P ) was to dispose off the plot of land and also the business, which was in co-operative Industrial Area. P was carrying certain losses in its Balance Sheet. After considering various options, amalgamation of R into P was suggested as the best alternative. Revaluation assets and liabilities of P was carried out before the appointed date. Because of revaluation, net worth of P became positive. There was no taxability for P due to revaluation. In the scheme itself, it was provided that the name of the company to be changed from P Private Limited to R Private Limited.

What R achieved through this merger –

- There were no society transfer charges for transfer of plot standing in the name of P, as R was merged into P. Name change procedure only followed.
- No stamp duty under conveyance as there was no transfer. Name change procedure only followed.
- Losses of P were carried forward and taken benefit of in amalgamated entity. Provisions of section 72A in IT act were are not applicable as amalgamating company, R, was not carrying any losses.
- Name of P was changed to R with minimum of procedure as scheme itself was containing the name change clause and High Court has approved it.

### **Case IV**

#### **Restructuring – different case**

M Industries Limited (M) is a closely held public limited company. M is having two manufacturing divisions situated at different places and manufacturing different products say X and Y. M is entering into a foreign collaboration related to the products X being manufactured in one of its divisions. This division is situated on MIDC plot. Collaborator wants majority stock in this division. It is also proposed that M would get shares in the collaborating foreign company against disinvestment of majority holding in the said division (SWAP transaction). The division manufacturing product Y is situated on free hold plot. M wants to merge this division in its another group company N Ltd.

One of the big amount assets was impaired in the present balance sheet of M. There were bad debts and slow moving items in the stock. The management of M was also thinking of cleaning the Balance Sheet.

The Management of M wanted all the above proposals need to be taken care of at one go. There should be minimum cash outflow and minimum government permissions involved.

To achieve all this in one go, it was proposed to restructure the business by -

- hiving off its division, manufacturing product Y, in resultant company N which is already in existence.
- also include in the scheme the financial restructuring under section 391. It would include reduction of capital / security premium reserves / reserves not represented by assets (impaired assets, bad debts and slow moving items in the stock).
- Activity of manufacturing product X would continue in M, where collaboration can be sought. Transfer of shares to foreign collaborator and acquiring shares in foreign collaborator company, being cash less transaction, would involve FIPB approval.

## **Case V**

### **Creation of subsidiaries and selling shares in them to collaborators**

In one of the proposals it was suggested that the assets and liabilities of P Division and of C Division (both these divisions belong to E Limited ) would be transferred to the two different resultants companies namely P Limited and C Limited respectively. This could be achieved through slump sale or through de-merger. E Limited would be allotted equity shares in these de-merged companies representing excess of assets over liabilities. Thus E Limited would hold entire share capital of these hived off subsidiaries. In future E Limited would sell part of its holding in P and C to the collaborator/s.

### **Conclusion**

From above cases one can conclude that the applicability of section 391 to 394 is wide enough to achieve many things under the term restructuring. It is a different code itself which presently High Court can write.