Team Code: C-15

BEFORE THE NATIONAL COMPANY LAW TRIBUNAL, BENGALURU BENCH

19th Day of February, 2017

COMPANY APPLICATION (CA) 1 OF 2017

COMPANY APPLICATION (CA) 2 OF 2017

COMPANY APPLICATION (CA) 3 OF 2017

IN

COMPANY PETITION (CP) 10 OF 2017

(WINDING UP PETITION)

IN THE MATTER OF SECTION 280 OF THE COMPANIES ACT, 2013

GLOBAL OFFICE SUPPLIERS PVT. LTD., BENGALURU

SHAREHOLDERS OF STALWART ONLINE STORES PVT. LTD.

ADDITIONAL COMMISSIONER OF INCOME TAX, BENGALURU

DEPUTY COMMISSIONER OF COMMERCIAL TAX, BENGALURU

v.

STALWART ONLINE STORES PVT. LTD., BENGALURU

- Global Office Suppliers Pvt. Ltd (Petitioner No. 1), a company incorporated under Companies Act, 1956 and Stalwart Online Stores Pvt. Ltd. (Respondent Company), a company incorporated under Companies Act, 2013 agreed that Global will sell stationery items directly to Stalwart under the inventory model and directly supply the goods to the customers under the marketplace model. Under the inventory model, payment should be made in 3 working days, failing which, Post Dated Cheques (PDCs)

will be issued and upon their dishonour, 24% interest and penalty would be levied till the dues are settled.

- Stalwart failed to make payments from July, 2015 to July, 2016 and drew 12 PDCs which were dishonoured by Stalwart's bank. Stalwart made intermittent payments of 6 crores in the meanwhile. There were delays in delivery of goods by Global to the customers of Stalwart under the marketplace model. Global served a legal notice on Stalwart and then filed a winding up petition before the NCLT, Bengaluru to wind up Stalwart.
- In the meanwhile, in February, 2016, Stalwart advanced a loan of INR 50 crores to Galileo Investors Pte. Ltd. (hereinafter 'Galileo') out of its sales proceeds by a board resolution in which two Indian promoters, Galileo and Sam voted. This was done without informing the rest of the shareholders. There was no written loan agreement. It appeared to 26% resident shareholders (Petitioner No. 2) as a case of related party transaction (RPT) under the Act. They filed an impleading petition.
- The Income-Tax Department (Petitioner No. 3) noticed that that the loan constituted 'dividend' as per the Income-tax Act, 1961 and thus taxes should have been withheld by Stalwart. Commercial Tax Department, Bengaluru (Petitioner No. 4) felt that Stalwart was indirectly involved in selling goods for a commission. The IT department and the Karnataka Commercial Tax Department issued notices to Stalwart and filed impleading petitions independently in the main winding up petition for their dues to be settled at par with secured creditors.

The issues raised by the parties are:

1. Whether Stalwart should be wound up on the petition filed by Global.

2. Whether Stalwart should be wound up based on the impleadment filed by its shareholders.
3. Whether the impleading petitions filed by the Tax Departments are valid.

- Global invoked Sec. 280 read with Sec. 271(b) of the Act which provides winding up jurisdiction to this Tribunal in cases of inability to pay debts. Stalwart vehemently opposed the maintainability of this petition on the ground of presence of two alternative remedies namely, the arbitration clause and the Summary Suit proceedings before the City Civil Court, Bengaluru. Global contended that the power of ordering winding up being strictly a statutory power, cannot be exercised by an arbitrator, whose source of power emanates from the contractual agreement of the parties. This position has been affirmed in ***Prime Century City Development Pvt. Ltd.* v. *M/S Ansal Builders Ltd.*, (2003) 42 SCL 256 (Del).** Further, it had contended that a mere pendency of a civil suit is not a bar to the admission of winding up petition based on the same debt. [***Madhya Pradesh Iron and Steel Co.* v. *G.B. Springs Pvt. Ltd.*, (2003) 54 CLA (Snr) 9 (Del)**]. It had relied on Sec. 442 of the Companies Act, 1956, which grants power on the Court to stay the proceedings that are pending before any other Court. In the present situation, it is seen that neither the arbitration clause in the agreement nor the civil suit proceedings would act as an effective remedy with respect to the relief sought by Global. Thus, Stalwart's objection to the maintainability is rejected.
- Global had appealed to this Tribunal that as per Sec. 271(2)(a) of the Act, where the debtor had failed to pay the debt amount within three weeks thereafter, such a company is deemed to be unable to pay its debts. Such an act would give rise to a statutory insolvency and is a valid ground for winding up of the company. [***Ofu Lynx Ltd.* v. *Simon Carves India Ltd.*, AIR 1990 Cal 4181**]. Stalwart opposed this contention by arguing that, where there is a *bona fide* claim for non-payment, inability under this

Section cannot be inferred. It further argued that, where the goods supplied were of sub-standard quality, it was held to be a *bona fide* claim. [***Surat Goods Transport Service* v. *Golkonda Engineering Enterprises Ltd.*, (2012) 169 Com Cases 24** and ***U.V. Shenoy* v. *Karnataka Engineering Products Co. P. Ltd.*, (1981) Com Cases 116 (Kar)**]. In the present case, Global supplied poor quality goods to Stalwart's customers under the marketplace model business, which adversely affected its sales and could not sustain the rise in competition and Foreign Direct Investment (FDI) issues in the market.

- It is the contention of Global that the cheques issued by Stalwart, each amounting to INR 1 crore were dishonoured by Stalwart's bank due to insufficiency of funds. In such cases, it has to pay a penalty of Rs. 20,00,000 per month and 24% simple interest p.a. Global had invoked Section 60 of the Indian Contract Act, 1872 which lays down the appropriation of the intermittent payments of INR 6 crores towards interest and penalty and therefore, the remaining amount due to it is 13.92 crores. The learned Senior Advocate on behalf of the respondent has vociferously argued that the payments had to be appropriated towards principal as Global had voluntarily supplied the goods and there was neither any demand to pay the interest and penalty nor any other legal recourse to signify such demand. The learned Senior Advocate had placed reliance on ***Bhagwandas Metals Ltd.* v. *Raghavendra Agencies and Ors.*, C.S. No. 392 of 1998 (Mad.)** and ***C.V. George & Co.* v. *Marshall Sons Ltd.*, AIR 1979 Pat. 124**, wherein it was stated that,

> *"when invoices are raised for principal amount without any specific demand for interest and penalty, then such payments had to be appropriated towards the principal."*

- The learned Senior Advocate of the respondent had contended that Global cannot demand payment of interest and penalty based on the common law doctrines, *Juri Ex Injuria Non Oritur,* which excludes any person from claiming a right arising out of his own wrong doing. Stalwart had further argued that, its winding up is opposed to public interest which includes the interest of thousands of employees, shareholders etc.
- We find force in the arguments put forward by the Respondent Company. Global had breached the contract by not performing its contractual obligations as per the agreed terms and cannot be allowed to take an advantage of his own fault (*Nullus Commodun Capare Potest De Injuria Sua Propria*) by winding up Stalwart. Thus, the petition for winding up on the ground of inability to pay debts is dismissed as there is a *bona fide* dispute with regard to the amount due as held in ***Ashok Aggarwal* v. *Amitex Polymers Pvt. Ltd.*, (2014) 49 Taxmann.com 127 (Del)** and also because this jurisdiction cannot be utilized merely as a means to realise the existing debts as held in ***Asim Pharmachem Industries* v. *Nilsin Ultrachem Ltd.*, (2013) 176 Com Cases 460.**
- In furtherance with the second issue, the maintainability of the petition has been invoked under Sec. 280 read with Sec. 271 (g) to wind up Stalwart under just and equitable grounds. Stalwart vociferously objected the petition on the ground of *forum non conveniens* as the first remedy available to the oppressed minority is to move to the Tribunal under Sec. 241, for which the remedy is not winding up. However, this objection made by the respondent has been rejected as the shareholders are not merely contending oppression but winding up on just and equitable grounds.
- The learned Senior Advocate on behalf of the shareholders had argued that loan advancement of INR 50 crores to Galileo is an illegal transaction because there is no record of this loan advancement which is mandated by the Act under Sec. 186(9) and Sec. 189(1) if it is a related party transaction. Further, the Senior Advocate had argued

that this loan advancement is prohibited by the Act under Sec. 185(1) as Galileo and Sam are directors by virtue of their vote in the board resolution. Further, even if any loans are to be given then such loan advancement has to be done, then the same can be given by the approval of the shareholders by way of a special resolution at a shareholder meeting as per the proviso of Sec. 185(1). Stalwart had strenuously objected these contentions of the shareholders by arguing that Sec. 185 is subject to Sec. 186 of the Act, which prescribes that a loan which does not exceed 60% of the paid-up share capital, it would be sufficient if a resolution sanctioning it is passed at a board meeting with the consent of the directors present at the meeting. Hence, there is no requirement of conducting a shareholders' meeting and seeking their approval for such transactions.

- The shareholders appealed before this Tribunal that this transaction also amounts to a related party transaction as Galileo and Sam are directors and are related parties as per Sec. 2(76)(i) of the Act and thereby, amounts to siphoning of funds which makes them fear for future transactions. Stalwart opposed this contention by stating that they are exempted from being recognized as a related party as per the notification released by the Ministry of Corporate Affairs on June 5, 2015. Further, Stalwart had contended that this is not a related party transaction under Sec. 188 of the Act as the list is exhaustive in nature. Further, it has contended that in the event of this list being inclusive, where there is a consent of the board to enter into a contract or arrangement with a related party, such transactions to that extent remain valid.
- We strongly agree to the fact that approval from the shareholders should have been taken before entering into this transaction. However, there is no need for a special resolution being passed for related party transactions as the same has been relaxed by the Companies (Amendment) Act, 2015. An ordinary resolution would have been

passed as the members of the Board hold 74% of the voting stocks in the company. The question of non-voting by the interested parties in such resolution does not arise as Second proviso to Sec. 188(1) of the Act has been relaxed by the exemption notification. Therefore, an ordinary resolution would have been passed without any hesitation. We opine that ordering winding up of Stalwart, does not in any way protect the interests of the shareholders. Instead, we order Stalwart to enter into a written loan agreement with Galileo and record this transaction in the register as mandated by this Act. Therefore, winding up petition is dismissed without any costs.

- In regard to the third issue, it is vehemently argued by the learned Senior Advocate appearing on behalf of the Stalwart that the petitions filed by the Tax Departments are not maintainable as they are premature. The reason cited is that the claims have not yet been ascertained and an assessment order has not yet been passed under Sec. 143(3) of the IT Act. Moreover, it is contended that the question of priorities under Sec. 280(e) can be decided by the Tribunal only when winding up order is passed.
- However, the learned Additional Advocate General of Karnataka has contended that under Sec. 38(1) of KVAT Act, every dealer shall be deemed to have been assessed to tax based on the return filed by him. The IT Department and Commercial Tax Department have also brought the court's attention to the wide interpretation given to Sec. 280 of the Companies Act, 2013 (which is *para materia* to Sec. 446 of the 1956 Act) and have relied on various judgments including ***Karnataka Light Metal Industries P. Ltd. v. Provisional Liquidator Karnataka Steel & Wire Products Ltd.*** **(1985) 57 Comp Cases 668 (Kar.)**, in which the Hon'ble High Court of Karnataka observed,

> *"A reading of this section as a whole reveals that the legislature intended to authorize the court to give directions about any claim made by or against the company even before the court orders winding up."*

- This position has been affirmed by the Hon'ble Supreme Court in umpteen judgments including ***Sudarshan Chits v. O. Sukumaran Pillai*** **AIR (1984) SC 1579**.

- We therefore agree that the impleading petitions by the tax departments are maintainable and not premature as the Tribunal has the jurisdiction to decide any claims against the company before the winding up order is passed. For reaching this conclusion, cognizance is also taken of cases dealing with workman dues wherein it is the responsibility of the Tribunal to decide such matters expeditiously even before the winding up order is passed to prevent multiplicity of suits.

- The learned Additional Advocate General of Karnataka has argued that the loan of INR 50 crores advanced by Stalwart to Galileo is deemed dividend as Firstly, 'Dividend', as defined in Art. 10 of the India-Singapore Tax Treaty includes 'deemed dividend' and Secondly, as per the IT Act, amount advanced fulfils all conditions of deemed dividend as given in Sec. 2(22)(e) of the IT Act, 1961. It is further argued that Stalwart has failed to deduct tax at source under Sec. 195, he is an assessee in default as per Sec. 201.

- On the other hand, Stalwart has relied on Sec. 90 of the IT Act and ferociously argued that reliance must exclusively be placed on the India-Singapore Tax Treaty as it is more beneficial to the Assessee. The contention is that 'debt claims' in the Treaty have been used synonymously with 'loans' as suggested by a reading of Art. 11(4) of the Treaty. Since the definition of 'Dividend' under Art. 10 of the Treaty excludes debt claims, loans are excluded from the purview of dividend. We appreciate the contention however, the charging provision in the present case is the IT Act and not the Treaty.

- Reliance is placed by the Petitioner on the OECD Commentary which states,

"Where dividends are actually distributed by the base company, the provisions of a bilateral convention regarding dividends have to be applied in the normal way because

there is dividend income within the meaning of the convention.. The general principle set out above would suggest that the credit should be granted, though the details may depend on the technicalities of the relevant legislation."

Thus, Sec. 2(22)(e) of the IT Act is significant in deciding the present matter.

- It is also Stalwart's contention that since the amount will be returned at a later point of time, it is only a loan and not dividend. However, it is an established principle that fact of repayment of loan is immaterial and Sec. 2(22)(e) will squarely apply [***Tarulata Shyam v. CIT*, [1977] 108 ITR 345 (SC)**].
- The point for consideration now is if the amount advanced is deemed dividend under the IT Act. Since all other conditions under Sec. 2(22)(e) of IT Act are undoubtedly satisfied, the point of contention in the present case is if the present loan advancement, out of sales proceeds, was out of accumulated profits of the company. The Additional Advocate General of Karnataka has relied on the Hon'ble Supreme Court's judgment in ***First Income Tax Officer v. Short Brothers (P) Ltd.* 1960 60 ITR 83** that says,

"accumulated profits include all profits of the company up to the date of payment including current profits of the year".

- Therefore, all profits of the company till the time of loan advancement will be categorized as commercial profits, which are included under accumulated profits. However, this argument is entirely fallacious as 'sales proceeds' cannot be equated to 'profits' in the first place. It is very logical that sales proceeds can be present even if the company is in losses. Moreover, deduction of expenses must be made from sales proceeds to arrive at profits.

- In view of the same, the we hold that the claims of the IT Department are not valid as the amount advanced does not fulfill the criteria of deemed dividend as laid down in the IT Act.
- The Commercial Tax Department's contention is that Stalwart is liable to be register itself as a dealer and discharge its VAT and CST liabilities under the marketplace model. The Additional Advocate General of Karnataka has vehemently argued that commission agents are included in the definition of dealer under both the KVAT and CST Acts and since Stalwart is acting as commission agent by deducting commission for indirectly effecting sale, it is liable to be registered as a dealer. However, the learned Senior Advocate appearing on behalf of the Stalwart is of the view that Stalwart is not an agent of the seller because Firstly, as per Sec. 182 of the Indian Contract Act, 1872, an agent is a person employed to do an act for another or represent another in dealings with third persons and Secondly, the essence of agency to sell is the delivery of goods to a person who is to sell them [***State of Madras v. Gannon Dunkerley& Co.*, 1958 AIR 560**].
- As regards the first contention, since Stalwart uses its own website to facilitate sale, neither does it do an act on behalf of seller nor does it represent the seller in dealings with third persons. As far as the second contention is concerned, the physical possession of the goods remains with the supplier and they are never delivered to Stalwart, making it incapable of being a commission agent. Since mere collection of commission is not sufficient to prove agency [***Bhopal Sugar Industries Ltd. v. STO* [1977] 40 STC 42 (SC)**], we are of the view that Stalwart is not acting as a commission agent of the seller.
- Reliance is also placed on the decision in the case of ***M/s. Amazon Seller Services Pvt. Ltd. v. CCE* (AAR/ CE/04/2012)** in which it was exclusively held,

"E-commerce companies provide services on principal to principal basis."

- The learned Senior Counsel has also argued that the principle of Noscitur a Sociis, which means that the meaning of a word is to be judged by the company it keeps, must be applied in the present case. We agree with this contention. Applying this legitimate rule of construction to construe words found in an Act, it is seen that 'selling' must be interpreted in the light of 'buying', 'distributing' and 'supplying'. Since Stalwart is in no way involved in the distribution, buying or supplying of goods, it cannot be said to be selling the goods, directly or indirectly.
- In view of the above, we hold that Stalwart does not qualify as a dealer under the marketplace model under both KVAT and CST Acts as it is only a service provider and wrongfully imposing VAT and CST on it, when it is already discharging service tax liabilities would lead to an undue gain to the revenue departments and violation of the principle of Revenue Neutrality. We are therefore unable to agree with the revenue departments. Since the claims of the tax departments are fallacious, the question of being treated at par with secured creditors does not arise.
- Case dismissed. No order as to costs.
- Accordingly, we pronounce this ruling on this, 19th day of February, 2017.