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STAMP DUTY ON SECURITY DOCUMENTS IN FAVOUR OF SECURITY TRUSTEE A PANDORA'S BOX



The recent judgement of the Supreme Court on stamp duty on security documents executed in favour of the Security Trustee may have a more far-reaching impact on lending than one would expect

A division bench of the Supreme Court has recently, in its decision in *Chief Controlling Revenue Authority vs. Coastal Gujarat Power Ltd. & others* held that a mortgage deed executed between borrower and a security trustee, who acts for the benefit of the lending banks in a consortium lending, would not be treated as a single document but as a document encompassing 'distinct matters' or 'distinct transactions' and would be liable for stamp duty as if distinct mortgages were recorded in favour of each lending bank.

For all practical purposes, it is yet to be seen as to whether the courts will interpret this judgement to make it applicable in cases other than consortium lending, like debenture issuances, where security documents are generally executed in favour of a debenture trustee; however there is an imminent possibility that it might have wider and far-reaching stamp duty implications in multiple lending transactions.

Background Of The Case

The borrower, Coastal Gujarat Power Limited, had availed loans from thirteen lenders by entering into separate loan agreements. These lenders subsequently formed a consortium as a trust and appointed State Bank of India, as the Security Trustee.

The borrower thereafter executed an Indenture of Mortgage ('Mortgage Deed') with the said Security Trustee, mortgaging its assets as mentioned therein. The question arose, for the purpose of stamp duty, as to whether the Mortgage Deed will have to be treated as a single document or combination of thirteen mortgages dealing with the borrower and lenders under Section 5 of the Gujarat Stamp Act, 1958 (Act).

The Chief Controlling Revenue Authority decided against the borrower and held it as a combination of thirteen mortgages, which decision was subsequently upheld by the Deputy Collector. The revision application filed by the borrower was also thereafter dismissed, giving rise to reference proceedings before the Gujarat High Court.

Judgement Of The Gujarat High Court

By judgement and order dated December 3, 2012, the full bench of Gujarat High Court answered the reference in favour of the borrower and against the revenue authority, holding that the borrower was not required to pay the deficit stamp duty on the Mortgage Deed. The High Court noted that stamp duty is payable on instruments and not on transactions.

The High Court further opined that merely because the intended effect is achieved by executing one single document as against different sets of documents, it would not entitle the revenue authority to justify its conclusion that the result achieved by executing one single document comes within the purview of Section 5 of the Act. The High Court also noted that the Security



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Trustee was the only mortgagee under the Mortgage Deed and no rights had been created in favour of the secured parties or any other persons. Similarly, the Security Trustee alone was empowered to enforce the mortgage against the borrower under the Mortgage Deed upon occurrence of an event of default.

The High Court accordingly held that Section 5 of the Act applies in a situation where several 'distinct matters' or 'distinct transactions' are clubbed in one single instrument. That levy of stamp duty is on an instrument and not on the object behind the instrument; therefore, the provision contained in Section 5 of the Act cannot be construed in a way as to empower the revenue authority to levy duty on a transaction outside the instrument.

Supreme Court Judgement

The Supreme Court, however, overruled the judgement of the Gujarat High Court and answered the reference in favour of the revenue authority holding that the Mortgage Deed will have to be treated as a combination of thirteen mortgages dealing with the borrower and lenders under Section 5 of the Act.

The Supreme Court, while noting that the borrower entered into separate loan agreements with those thirteen financial institutions, observed that had the borrower entered into separate instruments of mortgage with each of the lenders for securing the loan, there would have been a separate document for distinct transactions. Further, the court held that, on a proper construction of the Mortgage Deed, it could be safely regarded as thirteen distinct transactions which would fall under Section 5 of the Act.

After considering the provisions of the Stamp Act and also in light of the ratio decided by the Constitution Bench of the Supreme Court in *The Member, Board of Revenue Vs. Arthur Paul Benthall* (Benthall case), the Supreme Court concluded that the High Court had committed serious error of law in interpreting the provisions of Section 5 and 6 of the Act, and consequently, the answer given by High Court on the reference cannot be sustained in law.

Analysis

(a) Overlooking the long-standing practice and nature of security trustee

The main contention of the revenue authority in this case was that the lending banks had formed the consortium and had executed the Mortgage Deed instead of several distinct instruments of mortgage with the sole purpose of evading stamp duty.

In effect, this contention entirely overlooks the long standing practice and very nature and purpose of a security trustee in multiple lending transactions. In the financial world, consortium financing and syndicated loan finance are common means of lending whereby several lenders agree to group together for jointly financing and supervising a single borrower. For administrative

and practical convenience, the group of lenders usually enters into an inter se agreement, appointing one entity amongst them, as a security trustee, for holding the common pool of securities on behalf and for the benefit of all the group members. In all such circumstances, more often than not, a single security document is executed only between the borrower and the security trustee, whereby the secured asset is mortgaged/ hypothecated/ pledged in favour of the security trustee, for the benefit of all the lenders.

This has been a long-standing practice, especially in cases where the risks involved are too large or when the project for which the debt is sought to be raised is too big or simply when the loan amount is too high. Further, execution of security documents only in favour of the security trustee, at the most, can be termed as avoiding stamp duty by adopting a particular structure, which is legal, but not evasion of stamp duty.

(b) One transaction and many beneficiaries: not many transactions

A security document executed in favour of the security trustee generally creates security in favour of only the security trustee, who acts for the benefit of the other lenders. Therefore, it is a single transaction with more than one beneficiary, but not distinct transactions with all the beneficiaries.

The interpretation of the *Benthall* case by the Supreme Court to the present case also appears to be misplaced. In the *Benthall* case, the full bench of the Supreme Court had held that delegation of power by a person in his personal capacity as well as a representative capacity is exactly the same as if different persons join in to execute a power in respect of matters which are unrelated. The Supreme Court accordingly proceeded to hold in that case that since there being no community of interest between personal estate belonging to the executant and trust estate vested with him, they must be held to be distinct matters. In other words, the *Benthall* case deals with a situation where a single person representing in two different capacities for two different matters under an instrument. In the *Benthall* case, clearly there are two different transactions or matters; however, it cannot be said in the same way for an instrument under which a security is created in favour of a security trustee alone.

Section 5 of the Act cannot be applied in a situation where the security is created in favour of only a security trustee since it can be made applicable only when the instrument comprises more than one transaction. The object of Section 5 of the Indian Stamp Act, 1899 (which is similar to Section 5 of the Act) is explained in the *Benthall* case as under:

"Section 4 deals with a single transaction completed in several instruments, and Section 6 with a single transaction which might be viewed as falling under more than one category, whereas Section 5 applies only when the instrument comprises more than one transaction, and it is

immaterial for this purpose whether those transactions are of the same category or of different categories.”

[Emphasis supplied]

(c) Looking beyond the document

The Supreme Court, for arriving at a finding on stamp duty to be charged on the Mortgage Deed, looked into the Security Trustee Agreement entered into between the thirteen lenders and the Security Trustee. This may embolden revenue authorities to look beyond the form of the document by getting into the object of executing the instrument.

Possible Impacts In Lending Business

(a) Applicability across the country

Though the judgement rendered by the Supreme Court, strictly speaking, is in relation to the Act applicable in Gujarat, the reliance placed by the Supreme Court on the *Benthall* Case, which deals with similar provisions of the Indian Stamp Act, 1899, for interpreting Section 5 and 6 of the Act has given an indication that the interpretation made by the Supreme Court could be applicable for the entire country.

(b) Applicability in other security trustee/debenture trustee matters

Though the judgement rendered by the Supreme Court is in relation to the consortium lending by banks where there are

separate loan agreements executed by each lending bank and a single security document executed in favour of the security trustee, a question remains as to what happens in cases other than consortium lending, where a security is created in favour of a trustee who acts on behalf of multiple beneficiaries.

For example, financing by way of issuance of convertible or non-convertible debentures has become a popular method over the past few years and in such issuances, a debenture trustee is almost always appointed to act on behalf of the debenture holders. If the principle laid down by the Supreme Court is to be followed and a security created in favour of such debenture trustee will have to be treated as security created in favour of each debenture holder for the purpose of stamp duty, it could cause greater confusion particularly since there could be hundreds of debenture holders in a situation.

Take Away

While the applicability of the Supreme Court’s decision across the country as well as in cases other than consortium lending is unclear at this stage, one can only hope that the courts clarify the proposition laid down by the Supreme Court in its subsequent cases or that a positive legislative change is made in order to ensure that there is no wider and far-reaching impact in the lending business.



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