

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

EXIT ORDER IN RESPECT OF SAURASHTRA KUTCH STOCK EXCHANGE

1. Saurashtra Kutch Stock Exchange Limited (hereinafter referred to as "SKSEL") is a company limited by shares and was recognized as a stock exchange under Section 4 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as "SCRA") for a period of 3 years commencing on July 10, 1989. The said recognition was renewed from time to time under Rule 7 of the Securities Contracts (Regulation) Rules, 1957 (hereinafter referred to as "SCRR") until the recognition granted to SKSEL was withdrawn by an order passed by SEBI under section 5(1) of SCRA dated July 5, 2007 on account of various non-compliances. By this order, SEBI also directed SKSEL to transfer amounts available in its Investor Protection Fund & Investor Services Fund, to SEBI and to set aside sufficient funds for pending arbitration cases, awards, investor claims and other liabilities. SKSEL was further directed to refrain from using the expression 'stock exchange' or any variant in its name or in its subsidiary's name.
2. SKSEL challenged the SEBI order dated July 5, 2007 before the Hon'ble Securities Appellate Tribunal (hereinafter referred to as "SAT"). Hon'ble SAT vide order dated July 13, 2007 upheld the SEBI order and dismissed the appeal. SKSEL challenged the SAT order dated July 13 2007 in a Special Civil Application before the Hon'ble High Court of Gujarat , that was dismissed by Hon'ble High Court vide order dated November 11, 2007. Thereafter, SKSEL filed an appeal under section 22F of SCRA before the Hon'ble Supreme Court against the SAT order dated 13.07.2007. The said appeal was also dismissed by the Hon'ble Supreme Court vide its order dated 14.03.2012.
3. In the meantime, vide Circular No. MRD/DoP/SE/Cir - 36/2008 dated December 29, 2008, SEBI issued Guidelines and laid down the framework for exit by stock exchanges whose recognition is withdrawn and/or renewal of recognition is refused by SEBI and who may want to surrender their recognition. On review of 2008 Guidelines, SEBI issued a new circular for exit of stock exchanges vide Circular No. CIR/MRD/DSA/14/2012 dated May 30, 2012 (hereinafter referred to as '2012 Exit Circular'). This new circular also applies to the *"Stock exchanges that have already been de-recognised"* as on the date of that circular. In terms of

clause 2.4 of 2012 Exit Circular, the derecognized stock exchanges were given two months time to make the application for exit under the 2012 exit circular, failing which such derecognized stock exchanges would be subject to compulsory exit process. I note that SKSEL, a derecognized stock exchange failed to make an application within two months under the 2012 Exit Circular and therefore is subject to compulsory exit process as stipulated under clause 2.4 thereof.

4. Accordingly, in order to complete the exit of SKSEL, SEBI in consultation with SKSEL, appointed H. P. Mehta & Co as valuation agency on November 8, 2012 (hereinafter referred to as "Valuation Agency") , for Verification and Valuation of Assets and Liabilities of SKSEL . The Valuation Agency submitted its report vide letter dated January 10, 2013 (herein after referred as "the valuation report"). The relevant observations in the valuation report are as under:

- (i) The total value of the assets of SKSEL are ₹16,45,63,093.00/- as per the Book Value. The fair value of the same is ₹38,46,65,922.00/-.
- (ii) The total value of liabilities of SKSEL is put as ₹4,54,88,031/- and its contingent liabilities has been stated to be ₹11,78,45,833/-
- (iii) The balance in IPF, ISF and 1% security deposit as on 30.09. 2012 was ₹92,08,491.41/-, ₹87,33,503.00/- and ₹17,13,000/- respectively.
- (iv) No dues were found to be outstanding to SEBI including 10% of the listing fee and the annual regulatory fee.
- (v) The balance of SGF as on 30.09.2012 is ₹40,32,895/- and no initial contribution by members was made towards this fund.
- (vi) The refundable deposits to the trading members of SKSEL amounted to ₹2,05,52,351.00/-

5. The valuation Report has brought out other liabilities as per the books of SKSEL and its contingent liabilities as follows:

- a) Non-Current Liabilities including Long Term Liabilities & Other Deposits as on 30.09.2012 is ₹2,94,42,352/
- b) Deferred tax liability as on 30.09.2012 is ₹60,000/-
- c) Current Liabilities as on 30.09.2012 is ₹13,03,131/-
- d) Provision for income tax on current year's estimated Income up to September 2012 is ₹750,000/- which is not provided in the books of accounts

- e) Contingent liability of ₹10,52,73,604/- arising on account of the Special Leave Petitions filed by the Department of Income Tax before the Hon'ble Supreme Court of India pertaining to exemption claimed by SKSEL u/s. 11 of the Income Tax Act, 1961 for the Assessment Years 1994-95, 1995-96, 1996-97, 1997-98, 2000-01 & 2001-02.
- f) Contingent liability of ₹53,36,527/- arising on account of Show Cause Notice issued by Department of Service Tax raising demand for the period March 2006-March 2012, which is pending for adjudication before the Joint Commissioner of Service Tax :
- g) Contingent liability of ₹3,72,638/- arising on account of demands raised by the Employees' State Insurance) Department for the period 01.01.1993 - 31.03.2003. SKSEL has obtained stay against demand from the Hon'ble ESI Industrial Tribunal, Rajkot and in accordance with the directions in the order, the Exchange has provided bank guarantee to the extent of ₹1,75,000/-. Further proceedings are pending in the matter.
- h) Contingent liability of ₹69,63,064/- arising on account of Employee Termination liabilities towards Gratuity, Retrenchment Compensation & Notice Pay payable, assuming the Retrenchment Date of 31st December, as per the Certificate from Labour Law Consultant.
- i) Summary of the liabilities as per the books of SKSEL and the contingent liabilities of SKSEL is given below:

Sr. No.	Particulars as on 30.09.2012	Amount ₹
1	Non-Current Liabilities including Long Term Liabilities & Other Deposits	2,94,42,352
2	Deferred Tax Liability	60,09,045
3	Current Liabilities	13,03,131
4	Investor Services Fund	87,33,503
5	Statutory dues-Provision for Income Tax	7,50,000
6	Contingent liability for Income Tax	10,52,73,604
7	Contingent liability for Service Tax	53,36,527
8	Contingent liability for Employee State Insurance	3,72,638

9	Contingent liability for employee termination	69,63,064
	TOTAL ₹.	16,34,33,864

6. I note that by 2012 Exit Circular , *inter alia* , following conditions are to be satisfied with by the de-recognised/non-operational stock exchanges for the purpose of their exit:

- a) Permission to distribute its assets would be subject to certain conditions as laid down in the circular as well as the other guidelines that may be issued by SEBI, Government or any other statutory body from time to time.
- b) The quantum of assets for distribution will be available after payment of the following :
 - i. Statutory dues including Income Tax ;
 - ii. Transfer of Investor Protection Fund(IPF) , Investor Services Fund, 1% security deposit available with the Exchange to SEBI Investor Protection and Education Fund ;
 - iii. The exiting exchange shall pay the following dues to SEBI;
 - Dues outstanding to SEBI including 10% of the listing fee and the annual regulatory fee;
 - The outstanding registration fees of brokers/trading members of such de-recognised stock exchanges as specified in the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 till the date of such de-recognition;
 - In case of any shortfall in collection of dues of the brokers to SEBI, the exiting Stock Exchange will make good the shortfall;
 - iv. Refund of deposit (refundable) to the stock brokers including their initial contribution/ deposit to Settlement Guarantee Fund / Trade Guarantee Fund (SGF/ TGF).
- c) Contribution of up to 20% of its assets (after tax) towards SEBI Investor Protection and Education Fund (IPEF) taking into account, inter alia, the governance standards of the stock exchange and estimation of future liabilities.
- d) The companies exclusively listed on the exiting stock exchange shall list their securities on any other recognised stock exchange. If such exclusively listed companies fail to obtain listing of any other recognised stock exchange, they will cease to be listed companies and will be moved to the dissemination board by the exiting stock exchange. Such dissemination board would be provided by a Stock

Exchange with nationwide trading terminals. The exiting stock exchange as well as exchange providing dissemination board will give wide publicity about the dissemination board in one leading national daily and one local daily.

- e) The exiting entity shall set aside sufficient funds in order to provide for settlement of any claims, pertaining to pending arbitration cases, arbitration awards, not implemented, if any, liabilities/claims of contingent nature, if any, and unresolved investors complaints/grievances lying with it.
 - f) The exiting exchange may provide trading opportunity to their trading members to trade on stock exchanges having nationwide terminals through their subsidiary company, which will function as a normal broking entity.
7. I have considered the valuation report, the information, undertakings and the relevant documents available on record for the purpose of considering the case of compulsory exit of SKSEL. With regard to the income tax obligation in respect of transfer of capital assets of a stock exchange, I note that section 47(xiii) of the Income Tax Act, 1961 provides as under:-

Section 47 (xiii):

Nothing in Section 45 applies to any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company:

Provided that –

(e) the demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation which is approved by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);]”

8. In respect of the tax treatment to a stock exchange post its corporatisation and demutualization, the following recommendation of the Justice Kania Committee which was the basis for the amendment in section 47(xiii) of the Income Tax Act, 1961 to provide tax benefit to the corporatised and demutualised stock exchanges is worth mentioning:

“as corporatisation and demutualisation of a stock exchange is essentially a conversion from a not-for profit entity to a for-profit company, and would result in a distribution of assets, the Income Tax

Act should be amended if necessary, so that the past profits of an stock exchange which were not taxed when it had the character of a not for profit entity should not be taxed when its character changes. In other words, the accumulated reserves of the stock exchange as on the day of corporatisation should not be taxed. However, there would be no objection to taxation of these reserves, in the hands of the shareholders when these are distributed to shareholders as dividend at the net applicable tax rate; equally all future profits of the stock exchange after it becomes a for profit company may be taxed”.

9. The corporatisation and demutualisation scheme of SKSEL was approved by SEBI vide notification dated September 15, 2005 (hereinafter referred as "the scheme"). The scheme, *inter alia*, provided for the segregation of ownership and management from the trading rights of the members, restriction on voting rights of shareholders who are also trading members, composition of the Governing Board etc. in accordance with the provisions of Section 4B(6) of the SCRA, utilization of assets and reserves and other matters required for the purpose of and in connection with the corporatisation and demutualisation of SKSEL. In terms of the scheme, SKSEL was required to complete its demutualisation within the 'appointed date' notified by SEBI. I note that SKSEL did not demutualise itself as required under section 4A and 4B of the SCRA and its scheme as approved by SEBI and thus, did not comply with condition stipulated in proviso to section 47(xiii) of the Income Tax Act, 1961. Thus, the tax benefit provided in section 47(xiii) of the Income Tax Act, 1961 is not available to SKSEL accordingly it shall distribute its assets in accordance with the provisions of its articles/ rules and the applicable laws including the Income Tax Act, 1961. I note that SKSEL vide its letter dated March 26, 2013 has undertaken and confirmed that it shall settle all its statutory dues.
10. I note that SKSEL in order to satisfy compliance of various conditions of 2012 Exit Circular, SKSEL has made following payments to SEBI-
 - (a) Vide Cheques nos. 015723 and 015722 dated March 28, 2013 SKSEL has transferred 1% Security deposit and ISF to SEBI Investor Protection and Education Fund (IPEF) amounting to ₹17,13,000/-, and ₹87,33,503.00/- respectively.
 - (b) Vide Demand draft no. 29501 dated 28.12.2012 SKSEL has paid the necessary dues outstanding to SEBI including 10% listing fee contribution to SEBI and the annual regulatory fee for an amount of ₹3,42,500.00.
 - (c) Vide Cheque no. 015726 dated March 28, 2013 SKSEL has paid the outstanding registration fees of its brokers to SEBI amounting to ₹84,20,194 as specified in the

SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 till the date of its de-recognition on July 05, 2007.

- (d) Vide Cheque no. 015725 dated March 28, 2013 SKSEL has contributed an amount of ₹ 15,00,000/out of its assets (after tax) to SEBI IPEF for resolving investor complaints, if any, pertaining to SKSEL arising in future.
- (e) Vide Cheque no. 015724 dated March 28, 2013 and Demand Draft no. 030336 dated April 2, 2013, SKSEL has transferred an amount of ₹69,08,125.41/

11. With regard to the balance of ₹92,08,491.41 in its IPF brought out in the valuation report, SKSEL vide its letter dated March 20, 2013 has stated the balance in IPF is ₹ 69,08,125.41 since it had paid ₹27,05,366/ as salary, for the period 01.03.2007 to 30.09.2012, to 2 employees of its IPF Trust , who were involved in the work of spreading awareness about the new IPOs, Capital Market, Currency Derivatives Market, and for printing of market related brochures and distribution of the same amongst the Brokers/Investors etc, and DOs or DONTs awareness for the Investors. SKSEL has submitted that the Valuation Agency has considered only ₹4,05,000/ towards salary of those two employees for the period 01.03.2007 to 30.09.2012 and has requested to consider ₹27,05,366/ paid towards salary to the said two employees during 01.03.2007 to 30.09.2012.
12. SKSEL has sought to justify its request based on a letter from M/s Kotak Mandavia & Co., its Chartered Accountant, stating that if the previous years' expenditure is written back, it may create tax liability. They have further argued that the statutory audit over the years has recognized the defrayment of salary of the employees and that the employees were discharging their duties towards investor services. This request has been found acceptable given that the work has been carried out in the interest of Investor Protection Fund Trust.
13. As regards condition mentioned in paras-6(b)(iv) , 6(d), 6(e) and 6(f) above, SKSEL vide its duly executed undertaking dated March 26, 2013 has undertaken and declared -
 - (a) That it shall pay all the refundable deposits to its members.
 - (b) That there are no exclusively listed companies at SKSEL.
 - (c) That there are no arbitration matters or investor claims pending as on date.
 - (d) That M/s SKSE Securities Ltd, a functional subsidiary is a Corporate member of National Stock Exchange Ltd & BSE Ltd and is providing trading facilities to all SKSEL Members.

- (e) That it shall settle all the above mentioned liabilities and contingent liabilities before distribution of assets to its shareholders.

14. From the valuation report and undertaking dated March 26 , 2013 of SKSEL, it is observed that all the known liabilities have been brought out and that there is no future liability that is not known as on date. I note that SKSEL has substantially complied with the conditions contained in 2012 Exit Circular subject to its undertakings. I, therefore, am of the view that it is a fit case for compulsory exit of SKSEL in terms of clause 2.4 of 2012 Exit Circular.
15. I, therefore, in exercise of the powers conferred upon me by virtue of section 19 read with sections 11(1) and 11(2) (j) of the Securities and Exchange Board of India Act, 1992 and sections 4, 5 and 12A of the SCRA, order the compulsory exit of Saurashtra Kutch Stock Exchange Limited as a Stock Exchange and hereby direct SKSEL to :
- a) Comply with its tax obligations under Income Tax Act, 1961;
 - b) Comply with the undertakings given by it to SEBI;
 - c) Comply with other consequential conditions of 2012 Exit Circular; and
 - d) Change its name and not to use the expression “Stock Exchange” or any variant of this expression in its name and to avoid any representation of present or past affiliation with the stock exchange, in all media.
16. A copy of this order shall also be forwarded to the Income Tax Authorities and the State Government of Gujarat intimating the exit of SKSEL and for appropriate action at their end as per applicable laws.

DATE: April 5th , 2013

PLACE: MUMBAI

RAJEEV KUMAR AGARWAL

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA