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Recent Decision on Stamp Duty on Debt Assignment

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Introduction

Assignment of debt is one of the most common forms of transactions in financial markets. It essentially entails transfer of a debt from a creditor (assignor) to a third-party (assignee).

One of the biggest challenges faced in debt assignment transactions in India is the significant stamp duty implication on the deed of assignment. Considering the volume of assignment transactions undertaken generally by banks and financial institutions or by asset reconstruction companies (“**ARCs**”), the stamp duty levied becomes a significant cost in such transactions.

The Constitution of India (“**Constitution**”) confers upon the Parliament and each State Legislature the power to levy taxes and other duties. The subjects on which the Parliament or a State Legislature or both can legislate are specified in the Seventh Schedule of the Constitution. The Seventh Schedule is divided into 3 (three) lists:

1. Union List;
2. State List; and
3. Concurrent List.

The Parliament has the exclusive power to legislate on the subjects enumerated in the Union List. The State List enumerates the subjects on which each State Legislature can legislate and such laws operate within the territory of each State. The Parliament, as well as the State Legislatures, have the power to legislate over the subjects listed in the Concurrent List.

The entry pertaining to levy of stamp duty in the Union List is as follows: -

“91. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.”

The entry pertaining to levy of stamp duty in the State List is as follows: -

“63. Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.”

The entry pertaining to levy of stamp duty in the Concurrent List is as follows: -

“44. Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty.” [emphasis supplied]

From the aforementioned entries, it is clear that the power to legislate on the rate of stamp duty chargeable on instruments of debt assignment (since it is not covered under Entry 91 of the Union List) is with the State Legislature. However, the power to determine whether stamp duty can be charged or not on a specific instrument is in the Concurrent List.

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In this regard, it may be noted that pursuant to the Enforcement of Security Interest and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Act, 2016 ("**Amendment Act**"), the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI**") and the Indian Stamp Act were amended to provide for an exemption from stamp duty on a deed of assignment in favour of an ARC.

As mentioned above, the power to legislate on whether stamp duty is payable or not on an instrument is in the Concurrent List. Therefore, the Parliament has the power to legislate on the aforesaid subject.

Pursuant to the Amendment Act, section 5(1A) was inserted in SARFAESI which provides that any agreement or document for transfer or assignment of rights or interest in financial assets under section 5(1) of SARFAESI in favour of an ARC is not liable to payment of stamp duty.

In several States, notifications have been issued for remission and/ or reduction of stamp duties on debt assignment transactions. For instance, in Rajasthan, the stamp duty chargeable on any agreement or other document executed for transfer or assignment of rights or interests in financial assets of banks or financial institutions under section 5 of SARFAESI in favour of ARCs¹ has been remitted. Further, in Maharashtra, the stamp duty on instrument of securitization of loans or assignment of debt with underlying security has been reduced to 0.1% (zero

point one percent) of the loan securitized or the debt assigned subject to a maximum of Rs. 1,00,000 (Rupees one lac)².

Certain State Governments, such as those of Rajasthan and Tamil Nadu have reduced the stamp duty based on the nature of the financial asset being assigned. In Rajasthan, the stamp duty has been reduced for assignment of standard assets whilst in Tamil Nadu, the stamp duty has been reduced for assignment of non-performing assets and assignment in favour of ARCs.

This paper discusses a recent decision by the Allahabad High Court in the case of *Kotak Mahindra Bank Limited v. State of UP & Ors.*³ ("**Kotak case**"), where it was held that an instrument of assignment is chargeable with stamp duty under Article 62(c) (Transfer) of Schedule 1B of the Indian Stamp Act, as applicable in Uttar Pradesh ("**UP Stamp Act**"), as opposed to Article 23 (Conveyance) of Schedule 1B of the UP Stamp Act.

The stamp duty payable in various States under Article 23 or the relevant provision for conveyance is on an ad valorem basis whereas the stamp payable under Article 62(c) or relevant provision for transfer of interest secured, *inter alia*, by bond or mortgage deed, is a nominal amount. For instance, in Uttar Pradesh, the stamp duty payable under Article 62(c) is Rs. 100 (Rupees one hundred).

¹ Notification No. F4(3)FD/Tax/2017-110 dated March 8, 2017 issued by Finance Department (Tax Division) Government Of Rajasthan.

² Notification No.Mudrank-2002/875/C.R.173-M-1 dated May 6, 2002 issued by Revenue & Forests Department, Government of Maharashtra.

³ Reference Against MISC. Acts. No. 1 of 2016, order dated February 9, 2018.

Decision in the Kotak case

In the Kotak case, Kotak Mahindra Bank Limited (“**Kotak**”) had purchased and acquired certain loans from State Bank of India (“**Assignor**”) along with the underlying securities.

The question for consideration before the full bench of the Allahabad High Court was whether the deed executed by the applicant with the underlying securities would be chargeable with duty under Article 62(c) or Article 23 of Schedule 1B of the UP Stamp Act.

The court observed that in order to determine whether an instrument is sufficiently stamped, one must look at the instrument in its entirety to find out the true character and the dominant purpose of the instrument. In this case it was observed that the dominant purpose of the deed of assignment entered into between Kotak and the Assignor (“**Instrument**”), was to transfer/assign the debts along with the underlying securities, thereby, entitling Kotak to demand, receive and recover the debts in its own name and right.

Article 11 of Schedule 1B of the UP Stamp Act provides that an instrument of assignment can be charged to stamp duty either as a conveyance, a transfer or a transfer of lease. The court observed that since the Instrument was not a transfer of lease, it would either be a conveyance or a transfer.

The court referred to the definition of conveyance in the UP Stamp Act, which reads as follows:

*“**Conveyance**”. — “Conveyance” includes a conveyance on sale and every instrument by which property, whether movable or immovable, is transferred inter vivos and which is not otherwise specifically provided for [by Schedule I, Schedule IA or Schedule IB] [as the case may be];” [emphasis supplied]*

The court held that the term conveyance denotes an instrument in writing by which some title or interest is transferred from one person to other and that the use of the words “on sale” and “is transferred” denote that the document itself should create or vest a complete title in the subject matter of the transfer, in the vendee. In this case since under the Instrument, the rights of the Assignor to recover the debts secured by the underlying securities had been transferred to Kotak, it was held that the requirement of conveyance or sale cannot be said to be satisfied.

The court further observed that debt is purely an intangible property which has to be claimed or enforced by action and not by taking physical possession thereof, in contrast to immovable and movable property. Where a transaction does not affect the transfer of any immovable or movable property, Article 23 of Schedule 1B cannot have any applicability.

The court's view was that since debt along with underlying securities is an interest secured by bonds and/ or mortgages, transfer of such debt would be chargeable under Article 62(c).

The court further clarified that under the Instrument, merely the right under the contract to recover the debts had been

transferred. Since the borrower(s) had never transferred the title in the immovable property given in security to the Assignor, the Assignor could merely transfer its rights i.e. mortgagee's rights in the property to recover the debts. It was further observed that the Assignor never had any title to the underlying securities and that it merely had the right to enforce the security interest upon default of the borrower(s) in repayment. The right transferred to Kotak was primarily the right to recover the debts, in accordance with law, by proceeding against the underlying security furnished by the bonds/ mortgage deed(s).

Therefore, the court held that the Instrument was chargeable with stamp duty under Article 62(c) of Schedule 1B of the UP Stamp Act.

Whilst coming to the conclusion that assignment of debt would not constitute a conveyance, the court referred to the definition of conveyance to state that debt is an intangible property which has to be claimed or enforced by action and not by taking physical possession thereof, in contrast to immovable and movable property.

In this regard, it may be noted that there are various judicial precedents⁴, where it has been held that an interest (including mortgage interest) in immovable property is itself immovable property.

However, even assuming assignment of debt with underlying securities over immovable property amounts to a conveyance, it

⁴ *Bank of Upper India Ltd. (in liquidation) v. Fanny Skinner and Ors.*, AIR 1929 All 161. See also *Prahlad Dalsukhrai and Ors. v. Maganlal Muljibhai Tewar*, AIR 1952 Bom 454 and *Harihar Pandey v. Vindhayachal Rai and Ors.*, AIR 1949 Pat 170.

may be pertinent to refer to the definition of conveyance in the UP Stamp Act which specifically excludes a conveyance which is otherwise provided for by the Schedule to the UP Stamp Act.

Article 62(c) of the UP Stamp Act reads as follows:

"62. Transfer (whether with or without consideration) –

...

(c) of any interest secured by a bond, mortgage-deed or policy of insurance--"

In view of the above, transfer of any interest secured by a mortgage deed, which is covered under Article 62(c), would be excluded from the meaning of conveyance and would be chargeable to stamp duty under Article 62.

In this regard it may be pertinent to refer to the definitions of 'bond' and 'mortgage deed' under the UP Stamp Act, which is as follows:

"Bond" includes-

(a) any instrument whereby a person obliges himself to pay money to another, on condition that the obligation shall be void if a specified act is performed, or is not performed, as the case may be;

(b) any instrument attested by a witness and not payable to order or bearer, whereby a person obliges himself to pay money to another; and

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(c) any instrument so attested, whereby a person obliges himself to deliver grain or other agricultural produce to another"

*""**Mortgage-deed**". — "mortgage-deed" includes every instrument whereby, for the purpose of securing money advanced, or to be advanced, by way of loan, or an existing or future debt, or the performance of an engagement, one person transfers, or creates, to, or in favour of another, a right over or in respect of specified property;"*

In view of the above, where a debt secured by a bond or a mortgage deed is assigned under a deed of assignment, the stamp duty payable on such deed of assignment will be under Article 62(c) of the UP Stamp Act or corresponding provisions of the Stamp Act of other States.

However, in cases of unsecured loans or loans secured by an equitable mortgage (where there is no mortgage deed), the deed of assignment would attract *ad valorem* stamp duty chargeable on conveyance, since the same will not get covered under Article 62(c) or similar provisions in other states.

The market practice until now has been to stamp the deed of assignment of debt under the relevant article for Conveyance in the applicable Stamp Act. In fact, in States such as Maharashtra, the State Government has issued notifications for reduction of stamp duty on a deed of assignment under the article for Conveyance.

The judgment passed by the Allahabad High Court in the Kotak case may prove to be a welcome step in reducing the incidence of stamp duty on debt assignment transactions. However, it would need to be seen whether in other States a similar view is taken by stamp duty authorities.

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