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When the Family Settles but Corporates Unsettle: Structuring Corporates under A Family Arrangement

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I. The Doctrine and Its Limits

The family arrangement is not a creature of statute. It has no dedicated legislative definition, no prescribed form, and no mandatory registration requirement that applies uniformly across its uses. In its substantive character, the family arrangement remains primarily a creature of equity and of judicial policy: a category recognised by Indian courts over more than a century of succession litigation as deserving special treatment on the ground that the law should support the private resolution of family disputes rather than incentivise their continuation through courts.

The context in which family arrangements arise is structurally predictable. Most Indian business houses have been seeded by a family, with the baton of management and control passing across generations. Often, several unrelated businesses are housed in a single vehicle, typically a common holding company, but are distinctively managed and controlled by different members of the family. Over time, two conditions emerge that make a family arrangement either necessary or prudent; firstly, the mismatch between ownership and operational involvement i.e. certain family members are active participants in the daily operations of the business while others, holding shares through inheritance or earlier allocation, are passive beneficiaries enjoying economic benefits while contributing nothing to the enterprise, secondly, the entanglement of family sensitivities, inter-generational differences in ideology, management style, and lifestyle expectations, with the commercial fabric of the enterprise. A family arrangement addresses both conditions simultaneously: ownership is aligned with the family members who manage and control the respective businesses, and the passive members' connection with the holding vehicle is broken through a cash settlement or an allocation of specific assets.

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The leading authority remains the Supreme Court's decision in *Kale v. Deputy Director of Consolidation (1976)*, which identified the essential conditions: a bona fide settlement of existing or possible disputes, voluntariness, some antecedent title, claim, or interest in the property being settled, even if the claim is not legally perfect; a purpose of preserving peace or avoiding litigation; and some quid pro quo, each party giving up something and receiving something, even if the exchange is not commercially equivalent. What the Court identified, and what subsequent authority has consistently elaborated, is that the legal title that each party receives pursuant to a genuine family arrangement is not new title acquired through a conveyance. It is pre-existing title clarified and confirmed. The arrangement is a reorganisation of rights that were always there but that the ambiguity of joint ownership, coparcenary character, or competing claims had left unresolved.

This theory has profound practical consequences. It is the source of the "not a transfer" treatment under Section 2(47)[1] of the Income-tax Act, 1961 ("*Act*"): an inter se transfer of property between individual family members pursuant to a bona fide family arrangement is not a "transfer" and therefore, not exigible ineligible to capital gains tax under Section 45[2]. As a corollary, the deeming implications under Sections 50C[3] and 50CA[4] (imputing fair market value as deemed consideration) should not trigger, and the receipt of property pursuant to a family arrangement should not attract Section 56(2)(x)[5] (deemed gift), since the non-monetary consideration, being the settlement of competing claims and the preservation of family peace, constitutes adequate consideration within the meaning of that provision. Multiple judicial precedents in the context of the erstwhile Gift Tax Act, 1958 have upheld this position.

The doctrine, however, has a structural boundary that the Bombay High Court crystallised in *B.A. Mohota Textiles Traders (P.) Ltd. v. CIT***[6]**: a company has a separate legal identity, and a transfer by a company cannot claim the family arrangement immunity that its members enjoy. A company cannot have a "family" and an "antecedent title" to its own assets. Where the holding company is caused to effectuate the settlement The moment a holding company is the vehicle that effectuates the settlement, the *Kale* doctrine ceases to protect the transaction and the company is exposed to capital gains under Section 452 on the difference between the consideration (which in a family settlement is often nominal or nil) and the cost of acquisition. Simultaneously, the recipient faces exposure under Section 56(2)(x)5 on the receipt of property for inadequate consideration, unless the recipient qualifies as a "relative" within the statutory definition, a definition that is internally inconsistent and produces different outcomes for the same relationship depending on the provision invoked. The result is potential double taxation i.e. the holding company taxed on a deemed capital gain, and the recipient taxed on a deemed gift, both arising from the same transfer, both at odds with the substance of the transaction.

The Income-tax Act, 2025, effective 1 April 2026, carries forward this architecture without a safe harbour for family arrangements effected through corporate vehicles. The *Mohota* principle remains undisturbed. The question, therefore, is not whether the law provides a safe harbour (it does not), but how the structuring practitioner navigates the corporate veil to achieve the commercial objectives of the family arrangement without creating a tax event that destroys value in the process. This article examines four structuring pathways.

II. Pathway 1: Through a Scheme of Arrangement

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The most structurally robust pathway is to embed the family arrangement within a composite scheme of arrangement under Sections 230 to 232 of the Companies Act, 2013. Instead of the holding company "transferring" assets to family members directly (which triggers *Mohota*), the holding company itself demerges an identified "undertaking", with each branch receiving a resulting company containing the businesses or investments attributable to that branch. The family members are not parties to a transfer; they are shareholders of a company that has been reorganised pursuant to a NCLT-sanctioned scheme. This is the strongest insulation against the *Mohota* principle, because the scheme does not involve the company "transferring" anything to anyone; it involves the company splitting itself into two or more successor entities, with each shareholder receiving shares in the resulting company in proportion to their existing holding.

If the demerger satisfies the conditions of Section 2(19AA)[7] of the Act, tax neutrality follows at all three levels: demerged company, resulting company, and shareholders. The cost base is allocated between the demerged and resulting companies in proportion to the book values of the assets retained and transferred, and the shareholders' holding period tacks. The critical structuring constraints are threefold.

i. "Undertaking" constraint

First, the assets being transferred must constitute an "undertaking" as defined under explanation 1 to Section 2(19AA) of the Act, capable of being carried on independently by the resulting company; where the holding company's assets are financial investments (shares in operating subsidiaries) rather than operating businesses, the question of whether a portfolio of shares constitutes an "undertaking" becomes contested.

ii. Mirror-image shareholding constraint

Second, the mirror-image constraint on share issuance requires that shares in the resulting company be issued to all shareholders of the demerged company in proportion to their existing holdings. At first glance, this appears to frustrate the commercial objective of a family arrangement, which is to give different assets to different branches. However, the proportionality requirement is a requirement of proportion, not of value. The law mandates that shares be issued to all shareholders proportionately; it does not prescribe a floor value or a minimum swap ratio at which those shares must be issued. The resulting company can therefore issue shares at a nominal swap ratio, for instance one share of the resulting company for every hundred shares held in the demerged company. Both branches receive shares in the resulting company in proportion to their existing holdings, satisfying the statutory condition, but the aggregate issuance is nominal. The inter se transfer that follows, Branch B transferring its nominal resulting company shares to Branch A, and Branch A transferring its demerged company shares to Branch B, then completes the separation. Because these are transfers between individual family members pursuant to a bona fide family arrangement, they benefit from the "not a transfer" immunity under Section 2(47) and because the swap ratio was designed to keep the resulting company issuance nominal, the value being moved at the inter se stage on the resulting company side is nominal. The economic substance of the separation would be achieved through the demerger itself; the inter se transfer is the cleanup step that aligns 100% ownership with the intended branch.

iii. Value differential constraint

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Third, any cash equalisation payment to address residual value differentials could be settled at the family level under the “family arrangement” umbrella.

On the regulatory side, where the undertaking being demerged includes a stake of more than 25% in a downstream listed entity, the question arises whether the demerger triggers an open offer obligation under the SEBI Takeover Code, since the shareholders of the resulting company would be acquiring, indirectly, a controlling stake in the downstream listed company. Regulation 10(1)(d)(iii) provides an exemption for acquisitions pursuant to a scheme of arrangement or reconstruction, including a demerger, sanctioned by the NCLT, provided that the shareholders holding at least 33% of the voting rights in the transferor entity (i.e., the demerged company) continue to remain shareholders in the resulting company. In a proportionate demerger where all shareholders of the demerged company receive shares in the resulting company in proportion to their existing holdings, this condition is satisfied by design: the entire shareholder base of the demerged company continues as shareholders of the resulting company, and the 33% threshold is met with a substantial margin, even where the resulting company issues nominal shares since the cumulative base continues to remain. The open offer obligation under the Takeover Code should therefore not be triggered, even where the undertaking being transferred includes a controlling stake in a downstream listed entity, so long as the scheme is NCLT-sanctioned and the continuity of voting rights condition is met.

III. Pathway 2: Inter Se Transfer at Shareholder Level

The second pathway operates at the shareholder level rather than the corporate level, and is available where the family's wealth is distributed across multiple entities rather than concentrated in a single holding company. Where Branch A controls Company X and Branch B controls Company Y, but each branch also holds a minority or equal stake in the other's company (a common outcome of historical joint ownership), the family arrangement can be effectuated through an inter se exchange of shareholdings: Branch A transfers its shares in Company Y to Branch B, and Branch B transfers its shares in Company X to Branch A, with or without a cash settlement to address any residual value differential. The company as a vehicle is not involved in the transfer at all. No corporate asset moves. The transfers are between individual family members, and each transfer is pursuant to a bona fide family arrangement that reorganises pre-existing antecedent rights.

The defensibility of this pathway on the income-tax side is strong, provided the foundational conditions of the *Kale* doctrine are satisfied. The inter se transfer is not a "transfer" within the meaning of Section 2(47), because it is a reorganisation of pre-existing rights, not an alienation. Capital gains under Section 45 do not arise. The deeming fictions under Sections 50C and 50CA, which impute fair market value as deemed consideration, should not trigger, because the predicate for their application is the existence of a "transfer," and the family arrangement immunity negates that predicate. On the Section 56(2)(x) side, the position requires a two-layered analysis. First, the "relative" definition under Section 56(2)(x) is narrow, and if the transferor and transferee fall within the statutory definition of "relative," the provision is not attracted at all, since transfers between relatives are excluded from deemed gift scope. Second, even where the parties do not satisfy the "relative" definition (which is a real risk given the internal inconsistency of the definition across provisions of the Act), the family arrangement itself supplies the consideration: the mutual relinquishment of competing claims, the quid pro quo of each branch receiving what it needs in exchange for giving up what the other branch needs, and

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the preservation of family peace, constitute adequate consideration within the meaning of the provision. This is the argument that has been upheld in the Gift Tax Act context across multiple judicial precedents, and while it has not been tested under Section 56(2)(x) in its current form, its doctrinal foundation is the same. Where a cash settlement accompanies the share exchange to address a value differential, the cash settlement is itself part of the consideration for the arrangement and should be assessed within the same framework of adequacy, not as an isolated payment for which no return consideration exists.

On the regulatory side, if one or more of the companies involved is listed, the inter se transfer between family branches triggers Regulation 10 of the SEBI Takeover Code. However, the position here is more favourable than is commonly assumed; regulation 10(1)(a)(ii) provides a specific exemption for inter se transfers amongst qualifying persons, which includes transfers between promoters who have been disclosed as part of the promoter group in the shareholding pattern filed with the stock exchange for a period of not less than three years prior to the proposed transfer. Where both branches of the family have been disclosed as promoters for the requisite three-year period, and the family arrangement involves a transfer of shares between them, the exemption under Regulation 10(1)(a)(ii) is available, and no open offer obligation is triggered. The transfer must be reported to the stock exchange and the acquirer must make the requisite disclosures, but the substantive regulatory burden of an open offer does not apply. The exemption falls away in two situations; first, where the transferee branch has not been disclosed as a promoter for the requisite three-year period; and second where the transfer results in a reclassification of the promoter group that SEBI regards as a change of control rather than a reorganisation within the existing promoter group. Both scenarios are edge case in the typical family separation context and unlikely to arise where the respective branches already exercise control over the respective listed entities.

As compared to Pathway 1, the family arrangement operates at the shareholder level; the downstream restructuring operates at the corporate level. The residual risk is that the tax authorities may challenge the bona fides of the family arrangement itself, particularly if the antecedent title is not clearly established or if the arrangement appears to be a colourable device for tax avoidance rather than a genuine settlement of competing claims, in which case the entire edifice of tax neutrality collapses. The construction of the substratum, documented through the recitals and the consideration narrative in the family arrangement deed, is therefore the single most important element of this pathway's defensibility.

IV. Pathway 3: Capital Reduction Under Section 66 of the Companies Act, 2013

The third pathway deploys the capital reduction mechanism under Section 66 of the Companies Act, 2013 as a separation tool. Capital reduction in the family arrangement context operates in two structurally distinct forms, each with materially different tax consequences.

i. Shares cancellation without consideration

The first form is the shares cancellation without consideration (monetary or *in specie* distribution of properties), which is available where the family's wealth is held across two or

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more companies in which both branches hold shares. In this structure, Company A (which Branch A will retain) reduces its share capital by cancelling the shares held by Branch B without consideration, and simultaneously Company B (which Branch B will retain) reduces its share capital by cancelling the shares held by Branch A without consideration. Each branch surrenders its shareholding in the company it does not wish to control, and receives nothing in return from that company. The commercial consideration for each cancellation is the reciprocal cancellation in the other company: Branch A gives up Company B in exchange for Branch B giving up Company A. The tax position of shares cancellation without consideration is relatively straightforward; Section 50CA of the Act deems fair market value as consideration where the actual consideration for transfer of unquoted shares is less than their FMV; however, Section 50CA is triggered only where there is a "consideration received or accruing as a result of the transfer." Where the shares cancellation is without consideration, there is no consideration on which the deeming implications can operate, and therefore, there should be no capital gains tax implications. The question of deemed dividend under Section 2(22)(d)[8] of the Act does not apply since there is no distribution of assets. Shares cancellation without consideration, executed reciprocally across two companies as part of a single-family arrangement, is therefore a tax-efficient form of capital reduction in the family context, though it requires the structural precondition of the family's wealth being held across at least two entities.

ii. Share cancellation with consideration

The second form is the asset-distribution cancellation, which applies where a single holding company must be divided between two branches and there is no second entity to facilitate a reciprocal without consideration structure. Here, the holding company reduces its share capital by cancelling the shares held by the departing branch and discharging the consideration through cash, financial instruments, or in-specie distribution of specific assets (such as shares in an operating subsidiary). This avoids the *Mohota* characterisation because the capital reduction is NCLT-sanctioned under Section 66 of the Companies Act, 2013 and operates as a statutory mechanism rather than a voluntary transfer. The departing branch receives its settlement not as a transfer of property from the company, but as consideration for the cancellation of its shares. The remaining branch retains 100% of the holding company and its underlying assets.

The tax treatment of this form of capital reduction is materially more complex. The consideration received by the departing shareholder is bifurcated: to the extent the distribution is attributable to the company’s accumulated profits, it is deemed dividend under Section 2(22)(d) of the Act and taxable as income from other sources at the applicable slab rate; the residual consideration, representing a return of capital, is treated as capital gains and taxed on the difference between the consideration received and the cost of acquisition of the cancelled shares. Section 50CA4 applies in this form, because there is a consideration received (the assets distributed), and where the fair market value of the shares being cancelled exceeds the value of the assets distributed, the deemed consideration provisions can impute a higher value.

The two other aspects worth noting are; firstly, the NCLT's equitable jurisdiction operates as a de facto constraint on the quantum and terms of the reduction, since the jurisdictional NCLT must be satisfied that the reduction is not prejudicial to the interests of creditors and is fair and equitable to all classes of shareholders. Secondly, the cap of 25% of the aggregate of paid-up share capital and free reserves of the company under Section 68(2)(c) does not apply to a capital reduction under Section 66 of the Companies Act, 2013, which is a separate mechanism entirely, giving this pathway greater flexibility in quantum than the

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buyback route.

V. Pathway 4: Selective Dilution Through Rights Issue or Buyback

The fourth pathway is perhaps the most commercially intuitive but also the most technically exposed. Instead of transferring any asset or cancelling any share through a NCLT-approved process, the holding company changes its shareholding pattern, effected through a disproportionate rights issue, or through a selective buyback or a combination of both, achieving the same separation of economic interests without any "transfer" in the conventional sense.

i. The Rights Issue Route

The holding company issues shares on a rights basis to all shareholders at a uniform price, set at face value or at a price significantly below the fair market value of the underlying assets, which is permissible for a private company (not subject to SEBI pricing norms). Branch A subscribes fully to its entitlement whereas Branch B deliberately does not subscribe, allowing its shareholding to dilute. The effect is that Branch A's percentage holding increases while Branch B's declines, achieving a shift in economic ownership without any transfer of shares or assets.

The income-tax treatment of such a disproportionate rights issue was examined by the Mumbai Tribunal in *Sudhir Menon HUF v. ACIT*[9] and subsequently in *ACIT v. Subodh Menon*[10], wherein the Tribunal held that Section 56(2)(vii)(c) of the Act does not apply so long as the allotment is proportionate to the existing shareholding, because there is no "property received" by any shareholder when the allotment merely apportions the value of the existing holding over a larger number of shares;, however, the Tribunal distinguished between a proportionate allotment and a disproportionate one: where a shareholder's percentage holding *increases* as a result of the allotment (because another shareholder has abstained from subscribing), it held that Section 56(2)(vii)(c) would apply to the extent of the disproportionate allotment.

This creates a structuring constraint but not an insurmountable one. The tax exposure under Section 56(2)(x) of the Act (the current provision, corresponding to the erstwhile Section 56(2)(vii)(c)) arises only to the extent of the disproportionate allotment and must be factored in by suitably determining the allotment ratios and pricing. Where the rights issue price is at face value and the fair market value is substantially higher, the disproportionate allotment exposes the subscribing branch to tax on the difference between FMV and subscription price multiplied by the excess shares over the proportionate entitlement. The non-subscribing branch, on the other hand, suffers an economic dilution (its percentage holding declines and the value of its existing shares decreases).

ii. The Buyback Route

The buyback route presents itself either as an alternative to the rights issue or as a complementary mechanism deployed in sequence with it. Under Section 68 of the Companies Act, 2013, the holding company can undertake a buyback of the exiting branch's shareholding directly. In a combined structure, the rights issue first reduces Branch B's holding, and the buyback then extinguishes its residual stake – together

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achieving a clean separation; where no rights issue has been undertaken, the buyback operates as a standalone exit mechanism, with Branch B tendering its shares and receiving cash while Branch A remains as the continuing shareholder.

The corporate law imposes three principal constraints: first, the aggregate buyback in any financial year is capped at 25% of the company's aggregate paid-up equity capital and free reserves (Section 68(2)(c)); second, the company's post-buyback debt-equity ratio should not exceed 2:1; and third, a cooling-off period of one year must elapse between the closure of one buyback offer and the commencement of the next. Collectively, these constraints mean that where the departing branch's shareholding is substantial, the buyback may need to be spread across multiple financial years, each capped at 25%, which extends the separation timeline. The Corporate Laws (Amendment) Bill, 2026 proposes a partial relaxation of these constraint: if enacted, prescribed classes of debt-free companies would be permitted to conduct two buyback offers within a single financial year, with a minimum inter-offer gap of six months, which could compress the timeline for completing a phased buyback driven separation.

The Finance Act, 2026 has restored capital gains treatment for buyback proceeds, replacing the short-lived "deemed dividend" characterisation under Section 2(22)(f)[11] of the Act as introduced by the Finance (No. 2) Act, 2024. Buyback proceeds are now again taxed under the head "Capital Gains" with the cost of acquisition deducted in a single integrated computation, and tax is payable only on the actual gain and more importantly, the floor valuation principles under section 50CA to determine deemed consideration would also come into play, resulting in a higher capital gains, ultimately higher capital gains tax. For promoters, the amendment introduces an additional tax in addition to the long-term capital gains tax of 12.5%, which effectively restores the tax rate to 30% for non-corporate promoters and 22% for corporate promoters (excluding surcharge and cess). In the family arrangement context, the exiting branch member is invariably a promoter (holding well in excess of 10% in a family holding company), and will therefore bear the 30% effective rate on the buyback gain, making buyback an expensive route for a family arrangement.

VI. The Big Picture

The family arrangement doctrine was built for a world in which families held property in their own names. The Supreme Court's recognition in *Kale* that a reorganisation of pre-existing rights is not a transfer at all, was forged in that context. What has changed in the five decades since is not the doctrine but the architecture through which Indian families hold their wealth. The business that the patriarch started is no longer in their name; it sits inside a company, often inside several companies, layered through decades of incremental structuring decisions taken for reasons of regulatory compliance, tax efficiency, or commercial convenience, none of which had anything to do with succession planning. The corporate veil that was erected to serve the enterprise now stands between the family and its ability to reorganise itself.

This is not merely a tax problem, though the tax consequences are where the pain is felt most acutely. It is an architectural problem. A family that has built its wealth through corporate structures must, when the time comes to separate, restructure through those same corporate structures, and each restructuring step carries its own corporate law

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requirements, regulatory approvals, and tax consequences, none of which are displaced by the fact that the underlying transaction is, in substance, a settlement of competing family claims.

The four pathways examined in this article are the structuring response to that architectural reality. Each convert what is, in substance, a family partition into what is, in form, a corporate transaction that the statute recognises. Until the legislature provides for a defined framework for family arrangement i.e., a safe harbour that acknowledges the reality that in India the family and its corporate structure are not separate domains but a single integrated system, the structures will continue to act as bridges to achieve a family arrangement that the law ought to have provided.

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[1] Section 2(109) of the Income-tax Act, 2025 (“New Act”)

[2] Section 67 of New Act

[3] Section 78 of New Act

[4] Section 79 of New Act

[5] Section 92(2)(m) of New Act

[6] IT Appeal No. 73 of 2002 order dated 12th June 2017

[7] Section 2(35) of New Act

[8] Section 2(40)(d) of New Act

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[9] ITA No 4887/Mum/2012 order dated 12th March 2014

[10] ITA No 2776/Mum/2015 order dated 7th December 2018

[11] Section 2(40)(f) of New Act

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