

When the Family Settles but Corporates Unsettle

*Structuring Corporates
under a Family Arrangement*

The Mohota Wall | Corporate Veil | Four Pathways

The Problem

Company Cannot
Claim Kale Immunity

Four Pathways

Scheme, Inter Se,
CapRed, Rights Issue/ Buyback

No Safe Harbour

New Act
Did Not Fix

Swipe →



01



THE DOCTRINE AND THE WALL

Family Settles. Company Cannot. Mohota Intervenes.

The Kale Doctrine

A family arrangement is not a transfer under S. 2(47). It is a reorganisation of pre-existing rights basis “antecedent title”. No capital gains. No deemed gift. Mutual settlement of competing claims is the consideration.

The Mohota Wall

A company has a separate legal identity. The moment a holding company is the vehicle that effectuates the settlement, the Kale doctrine ceases to protect the transaction.

Double Taxation Risk

Holding company taxed on deemed capital gain under S. 45. Recipient taxed on deemed gift under S. 56(2)(x). Both from the same transaction, both at odds with the substance.

New Act, 2025

Effective 1 April 2026. Architecture carried forward. No safe harbour for family arrangements through corporate vehicles. Mohota remains undisturbed.

The Architectural Problem

*The doctrine was built for families holding property in their own names.
The corporate veil now stands between the family and its ability to reorganise.*



02



PATHWAY 1: SCHEME

Company Demerges. Proportionate but Nominal Shares Issued. NCLT-Sanction Required.

Composite Scheme u/S. 230-232

THE MECHANISM

The company demerges business to respective “Branch Cos”. Branches receive shares in undertaking, not assets. Mohota does not apply – Tax neutrality provisions for demerger apply

'Undertaking' Requirement

CONSTRAINT I

Assets must constitute an undertaking under Explanation 1 to S. 2(19AA) capable of independent operation. Portfolios of shares in subsidiaries: contested territory.

Mirror-Image Proportionality

CONSTRAINT II

Shares of the resulting company must be issued proportionately. But the law mandates proportion, not value. A nominal 1:100 swap ratio satisfies the statute. The inter se cleanup completes the separation.

SEBI Takeover: Reg 10(1)(d)(iii)

CONSTRAINT III

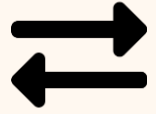
If a listed entity is involved, acquisitions pursuant to NCLT-sanctioned schemes exempt from open offer where 33% continuity of voting rights is maintained. Proportionate demerger satisfies by design.

Strongest Insulation

Tax neutrality under S. 2(19AA) for demerged company, resulting company, and the shareholders. Cost base allocated by book value ratio. Holding period tacks. The cleanest corporate route.



03



PATHWAY 2 : INTERSE TRANSFER

Swap at Shareholder Level.

Company Untouched.

Kale Protects.

Shareholder-Level Exchange

MECHANISM

Branches swap their shareholding i.e., Branch A transfers shares in Co Y to Branch B and Branch B transfers shares in Co in X to Branch A. No corporate asset moves. Transfers are between individual family members pursuant to a bona fide family arrangement.

Not a Transfer Under S. 2(47)

TAX POSITION

No capital gains under S. 45. Deeming Fictions providing for floor valuation do not trigger because the 'transfer' predicate is negated. S. 56(2)(x): mutual relinquishment of claims is adequate consideration.

Takeover Code: Reg 10(1)(a)(ii)

SEBI

If listed entities involved, inter se transfers between promoters disclosed for 3+ years are exempt from open offer. Disclosures apply.

Substratum Must Be Airtight

KEY RISK

Tax authorities may challenge bona fides of the arrangement. Antecedent title, recitals, and the consideration narrative in the deed are the single most important element of defensibility.

Simplistic Route (when available)

*Requires wealth spread across multiple entities. Company is not involved.
Kale doctrine operates directly. No corporate machinery, no NCLT approval.*



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PATHWAY 3: CAPITAL REDUCTION

Cancel the Shares. Settle Through NCLT. Two Forms.

FORM 1: WITHOUT CONSIDERATION

Reciprocal cancellation across two companies. Company A cancels Branch B's shares; Company B cancels Branch A's shares. Neither receives consideration.

Cross-cancellation results in a clean segregation

S. 50CA does not trigger: it requires 'consideration received or accruing' to operate. Zero consideration, zero deeming.

S. 2(22)(d) does not apply: no distribution of assets.

Precondition: wealth held across at least two entities.

FORM 2: WITH CONSIDERATION

Single holding company cancels departing branch's shares. Consideration discharged in cash, instruments, or in-specie distribution.

Bifurcation: accumulated profits portion is deemed dividend under S. 2(22)(d). Residual is capital gains.

S. 50CA applies: FMV as deemed consideration where asset value distributed is lower.

No 25% cap: S. 66 is a distinct mechanism from buyback, with greater flexibility of quantum.

NCLT-Sanctioned Separation

Statutory mechanism displaces Mohota. NCLT's equitable jurisdiction constrains the quantum. The route of choice when wealth is concentrated in a single vehicle.



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PATHWAY 4 : SELECTIVE DILUTION

Rights Issue. Buyback. No Inter-se Transfer. Complex in Execution.

Disproportionate Subscription

RIGHTS ISSUE

Branch A subscribes fully. Branch B abstains. Percentage shifts without any transfer of shares. But Sudhir Menon HUF (Mumbai ITAT) held that S. 56(2)(x) may apply to the excess allotment over the proportionate entitlement – to be tread carefully

Selective Exit for Departing Branch

BUYBACK

S. 68 buyback. Finance Act 2026 restored capital gains treatment, but S. 50CA floor valuation now applies on the computation. For promoters: effective 30% rate (12.5% LTCG + additional tax). Expensive.

Rights + Buyback in Sequence

COMBINED

Rights issue dilutes Branch B. Buyback extinguishes the residual stake. 25% cap per year means phased execution. Corporate Laws (Amendment) Bill 2026 proposes two buybacks per year for debt-free companies.

Commercially Intuitive, Technically Exposed

No NCLT approval needed. But the tax architecture (S. 56(2)(x) on rights, 30% effective rate on buyback, and floor valuation) makes this an expensive route for a family arrangement.



The Takeaway

The doctrine was built for a world where families held property in their own names. The corporate veil now stands in the way of the family's ability to reorganise.

Scheme (S. 230-232)

Strongest insulation. Company demerger involved; nominal shares issued – “Undertaking” Risk continues

Inter Se Transfer

Simplistic route. Shareholder-level swap. Kale protects directly. Requires multi-entity wealth distribution.

Capital Reduction

Two forms. Without consideration: tax-efficient. With consideration: bifurcation and S. 50CA apply. Requires equally valued entities to effectuate this.

Rights + Buyback

No NCLT. But S. 56(2)(x) on rights issue and 30% promoter rate on buyback. Most expensive pathway.

Until the legislature provides a defined framework for family arrangement that acknowledges the reality that in India the family and its corporate structure are a single integrated system, these four pathways will continue to act as bridges.

