

**BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA**

**EXIT ORDER IN RESPECT OF:**

**LUDHIANA STOCK EXCHANGE LIMITED.**

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1. Ludhiana Stock Exchange Ltd (hereinafter referred to as "LSE") was incorporated in the year 1981 as a limited company under the Companies Act, 1956. The Central Government had granted recognition to LSE, as a stock exchange under the provisions of section 4 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as the 'SCRA') on April 29, 1983, initially for a period of 5 years, which was subsequently renewed from time to time under rule 7 of the Securities Contracts (Regulation) Rules, 1957 (hereinafter referred to as the 'SCRR').
2. The recognition of LSE was last renewed by Securities and Exchange Board of India (hereinafter referred to as 'SEBI') for a period of one year commencing on the April 28, 2013 and ending on April 27, 2014. The renewal was, however, subject to condition that *the Exchange can commence trading only after complying with all the regulatory requirements imposed by SEBI.*
3. SEBI, vide Circular No. MRD/DoP/SE/Cir - 36/2008 dated December 29, 2008, issued Guidelines and laid down the framework for exit by stock exchanges whose recognition is withdrawn and/or renewal of recognition is refused by SEBI and who may want to surrender their recognition. The said Guidelines were reviewed and modified vide Circular No. CIR/MRD/DSA/14/2012 dated May 30, 2012 (hereinafter referred to as "Exit Circular, 2012"). In terms of clause 2.2 of the Exit Circular, 2012, a stock exchange, where the annual trading turnover on its platform is less than ₹1,000 crore, can apply to SEBI for voluntary surrender of recognition and exit, at any time before the expiry of two years from the date of issuance of the said Circular. In terms of clause 2.3 of the said Circular, if any stock exchange failed to achieve a turnover of ₹1,000 crore, it would be subject to compulsory exit process.
4. The shareholders of LSE in its Extra Ordinary General meeting held on July 15, 2013, passed the resolution to apply to SEBI for exiting as a stock exchange through voluntary surrender of recognition. In this regard, LSE made a request to SEBI for its exit as stock exchange vide letter dated July 17, 2013 thereby informing that the shareholders of LSE at the Extra Ordinary General Meeting held on July 15, 2013, approved the resolution for exit through voluntary surrender of recognition as per the Exit Circular, 2012.
5. Vide letter dated January 25, 2014, LSE also made an application for renewal of recognition of the Stock Exchange under section 3 of the SCRA read with rule 7 of SCRR. In this regard,

vide letter dated February 12, 2014, SEBI informed LSE that its application for renewal of recognition could not be processed as LSE's application for voluntary exit was under process.

6. Accordingly, I proceed to deal with the exit request of LSE in terms of clause 2.2 of the Exit Circular, 2012. I note that as per the Exit Circular, 2012, *inter alia*, the following conditions are required to be complied by the de-recognised/non-operational stock exchanges for seeking exit:
- (a) Permission to distribute its assets would be subject to certain conditions laid down in the Circular as well as other guidelines that may be issued by SEBI, Government or any other statutory body from time to time.
  - (b) For the purpose of valuation of the assets of the stock exchange, a valuation agency appointed by SEBI shall submit its report.
  - (c) The quantum of assets for distribution will be available after payment of the following by the stock exchange:
    - (i) Statutory dues including Income Tax;
    - (ii) Transfer of Investor Protection Fund, Investor Services Fund, 1% security deposit available with the Exchange to SEBI Investor Protection and Education Fund (hereinafter referred to as the "IPEF");
    - (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).
  - (d) Contribution of up to 20% of its assets (after tax) towards IPEF taking into account, *inter alia*, the governance standards of the stock exchange and estimation of future liabilities.
  - (e) The companies exclusively listed on the stock exchange seeking exit shall list their securities on any other recognised stock exchange. If such exclusively listed companies fail to obtain listing on 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.

- (f) The exiting stock exchange 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 investor complaints/grievances lying with it.
  - (g) 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 all relevant documents available on record for the purpose of considering the exit of LSE. 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 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 corporatized 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 LSE was approved by SEBI vide notification F. No. SEBI/MRD/49403/2005 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 LSE.
10. In terms of condition mentioned in para 6(b) above, SEBI in consultation with LSE appointed M/s. Rakshit Khosla & Associates, on August 19, 2013 as the Valuation Agency, for verification and valuation of assets and liabilities of LSE. The Valuation Agency submitted its final report dated March 01, 2014.
11. With respect to the compliance of conditions specified in the Exit Circular, 2012 by LSE and settlement of its liabilities observed by the Valuation Agency, it is important to note the following: -
- (a) In compliance of condition mentioned in para 6(c)(ii) above, as advised by SEBI, LSE has transferred an amount of ₹1,75,51,303/- available in its "Investor Services Fund" vide Demand Draft no. "054783" dated February 22, 2014 and an amount of ₹1,02,77,275/- towards 1% security deposit vide Demand Draft no. "054781" dated February 21, 2014 to the IPEF.
- (b) With regard to Investor Protection Fund (IPF/CPF), LSE had informed that they have received Income Tax Assessment Order with respect to IPF/CPF. Therefore, the entire corpus of Ludhiana Stock Exchange CPF Trust has been transferred to the "Escrow Account" and all the FDRs forming part of CPF Corpus with various scheduled commercial banks has been marked as "lien" in favour of SEBI in terms of "Escrow Agreement" dated November 05, 2014 and the "Escrow Bank" shall hold the money in "Escrow Account" in trust for SEBI till the grant of "NOC" by the Income Tax Department for transfer to SEBI IPEF after finalization and settlement of all the pending assessments/appeals relating tax matters.
- (c) The entire amount of ₹2,57,88,950.15/- is kept in an escrow account under the control of SEBI and the Trustees of CPF of the Exchange, till the settlement of the matter with the Income tax Department, Ludhiana. The escrow account shall be jointly operated as per the terms of the escrow agreement. LSE needs to pursue the matter expeditiously which is pending in the appeal before the Income Tax Appellate Authority.
- (d) In compliance of condition mentioned in para 6(c)(iii) above,

- LSE has paid the necessary dues outstanding to SEBI including 10% of the listing fee vide NEFT dated January 09, 2014 amounting to ₹29,700/-, vide NEFT dated April 09, 2014 amounting to ₹1,28,884/-, vide NEFT dated November 20, 2014 amounting to ₹97,137/-, and the annual regulatory fee vide Demand Draft no."054780" dated February 21, 2014 amounting to ₹1,00,000/-.
  - LSE has paid the outstanding registration fees vide Demand Draft no. "596466" dated November 14, 2014 amounting to ₹26,88,098/-, vide Cheque no. "653978" dated November 17, 2014 amounting to ₹11,80,012/- and interest on outstanding registration fees vide Demand Draft no. "596465" dated November 14, 2014 amounting to ₹7,041/- of brokers dues as specified in the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 till the date of such de-recognition.
- (e) In compliance of condition mentioned in para 6(c)(iv) above, LSE has given an undertaking dated November 17, 2014 (hereinafter referred to as the "Undertaking") to clear all the liabilities and/or retain the assets/amount more than that for clearance of the final liabilities arising due to contingent liabilities mentioned in the Undertaking, before distribution of assets of LSE.
- (f) In compliance of condition mentioned in para 6(d) above, LSE has contributed an amount of ₹20,00,000/- vide Cheque no. "653977" dated November 17, 2014 towards IPEF.
- (g) In compliance of condition mentioned in para 6(e) above, LSE in its Undertaking has stated that it has taken necessary steps in terms of SEBI Circular dated May 30, 2012 and May 22, 2014 and other Circular/directions issued by SEBI from time to time. It has further undertaken to extend all the co-operation to SEBI and other authorities with regards to any matters/issues that may arise subsequently.
- (h) In compliance of condition mentioned in para 6(f) above, LSE in its Undertaking has stated that there are no arbitration disputes/investor complaints pending against it.
- (i) With regard to other liabilities and contingent liabilities as pointed out by the Valuation Agency, LSE in its Undertaking has stated that it undertake to clear any additional amount that may become liable to be paid on account of any of the stated liabilities in the Undertaking.
- (j) In compliance of the condition mentioned in para 6(g) above, vide its Undertaking, LSE has declared that LSE Securities Limited, its functional subsidiary, is a Corporate member of National Stock Exchange of India Limited and BSE Ltd. and is providing

trading facilities to all LSE Members registered with SEBI as its sub-brokers on NSE and/or BSE.

(k) LSE in its Undertaking has stated that the cases lodged against it, details whereof have been submitted to SEBI, are the only cases pending before various legal fora.

12. From the valuation report and Undertaking of LSE, it is observed that all the known liabilities have been brought out and there is no other future liability that is known as on date. I note that LSE has substantially complied with the conditions contained in the Exit Circular, 2012 subject to its Undertakings. I, therefore, am of the view that it is a fit case to allow exit to LSE in terms of clause 8 of the Exit Circular, 2012.

13. I, therefore, in exercise of the powers conferred upon me by virtue of section 19 read with section 11(1), section 11(2)(j) of the Securities and Exchange Board of India Act, 1992 and sections 4, 5 and 12A of the SCRA, allow the exit of Ludhiana Stock Exchange Limited as a stock exchange and hereby direct it to:-

- (a) comply with its tax obligations under the Income Tax Act, 1961;
- (b) comply with the Undertakings given by it to SEBI;
- (c) comply with other consequential conditions of the Exit Circular, 2012;
- (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;
- (e) provide required information to the Ministry of Corporate Affairs on identifying vanishing companies which were listed on Ludhiana Stock Exchange Limited for inclusion in the list of vanishing companies maintained by the Ministry of Corporate Affairs;
- (f) expeditiously pursue the matter related to CPF pending in appeal before the Income Tax Appellate Authority.

14. This order shall come into force with immediate effect. A copy of this order shall be forwarded to the Income Tax Authorities and the State Government of Punjab and the Ministry of Corporate Affairs intimating the exit of Ludhiana Stock Exchange Limited and for appropriate action at their end as per applicable laws.

Sd/-

**DATE: DECEMBER 30<sup>th</sup>, 2014**

**PLACE: MUMBAI**

**RAJEEV KUMAR AGARWAL**

**WHOLE TIME MEMBER**

**SECURITIES AND EXCHANGE BOARD OF INDIA**