

Legal Updates

**Transactions in Immovable Property –
Whether covered under section 297?**

-By Nidhi Ladha

Email- nidhiladha@vinodkothari.com

Legal Updates

Sec 297 pertains to cases where there is a presumption of conflict of interest, as it pertains to contracts in which directors are interested. The directors of a company occupy position of trustees and have fiduciary duties towards the company. They must not use the position that they occupy to benefit themselves by contracts with the company. If they enter into any such contract, they must make disclosure thereof. Section 297 covers all the contracts of goods and services in which directors are interested. The question is whether contracts of immovable property can also be treated as contracts under this section as the same cannot be regarded as contracts of goods and services, as per the terms used in the section. The text of the section is mentioned below:

Section 297 says:

“Except with the consent of the Board of Directors of a company, a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the director is a member or director, shall not enter into any contract with the company—

(a) for the sale, purchase or supply of any goods, materials or services; or

(b) after the commencement of this Act, for underwriting the subscription of any shares in, or debentures of, the company:

Provided that in the case of a company having a paid-up share capital of not less than rupees one crore, no such contract shall be entered into except with the previous approval of the Central Government.”

In this section, the terms “goods” and “services” are not defined in the Act. The section was incorporated with a view that the interest of the directors should not be conflicting with that of the interests of the Company; the above words must have a wide interpretation. The meaning of the undefined words used should not be narrowed down, to protect the interest of the shareholders and the company and seen in the broader light.

Meaning of “goods”

In the absence of any definition of “goods” in the Act, reference may be made to the definition given under the Sale of Goods Act, 1930, according to which “goods” means every kind of movable property only. Thus, for purposes of this section any contract for sale or purchase of any immovable property will not be covered.

Legal Updates

Meaning of “services”

The word “service” is used to include the contract for supply of services in which the directors are interested. The term “service” is very contentious in nature. The word “services” may either be taken in a very wide sense, such that the two words “goods” and “services” cover the entire spectrum of economic activities. Alternatively, the word “services” might be restricted to mean such services as are commonly “supplied” in trade and merchandise. Since the purpose of the section is to curb profit-making by directors, the phrase “supply of services” should be interpreted in a wider sense.

The meaning of the term “service” may be taken from the Service Tax Rules where the taxable services have been defined adequately. Previously, section 65(105)(zzzz) did not in terms entail that the renting out of immovable property for use in the course or furtherance of business or commerce would by itself constitute a taxable service and be eligible to service tax under the Act. Accordingly, in *Home Solutions Retail India Limited v. UOI*, the Delhi High Court also held that renting of immovable property will not be regarded as service within the meaning of service under service tax rules. In *Madras Hire Purchase Association v. UOI*, the Madras High court also expressed the same view saying “*the renting of immovable property for use in the course or furtherance of business or commerce by itself does not entail any value addition, and, therefore, cannot be regarded as a service.*”

In the Budget 2010 it was proposed to amend the relevant provisions itself to override the decision of the high courts. Accordingly, the definition of “service” as appearing in section 65(105)(zzzz) of Finance Act, 1994 was amended with retrospective effect by the Finance Act, 2010 so as to include the renting of property also within its ambit. Previously, the section covered any services *in relation to* renting of property but after amendment, the renting itself is to be regarded as taxable services and thus, any contract with the directors for renting of property will be covered by the definition of service and will attract provisions section 297.

Further, the term "services" has also been defined in Consumer Protection Act (CPA). The definition provides a list of eleven sectors, service provided to which will come under the purview of the Act. However, the list of these sectors is not an exhaustive one. Service may be of any description and pertain to any sector if it satisfies the following criteria:

1. Service is made available to the potential users, i.e., service not only to the actual users but also to those who are capable of using it.
2. It should not be free of charge, e.g., the medical service rendered free of charge in Government hospital is not a service under the Act;

Legal Updates

3. It should not be under a contract of personal service.

As per the above parameters, and taking a wider meaning of service in CPA, renting of property is covered by the Act.

Department's clarification in the year 1990 - how much relevant today?

The letter issued by the Ministry of Industry, Department of Company Affairs (Company Law Board), *vide No. 9/41/90-CL-X*, dated 27-3-1990 in the case of Sona Steering Systems Ltd on renting of premises by the directors to the company clarified that the proposal of the company, being a transaction in immovable properties, is not covered by the provisions of section 297.

But such clarification does not set the law, (a) since at that time, there was no definition of "service"; and (b) the clarification talks about "transactions in immovable properties" without going into why a renting of immovable property is not a service. Presently, service tax law has elaborate definition of "services" and includes renting activity within its purview. Hence, the clarification of the Department given long time back does not hold good with reference to the present scenario when the definition of service has suitably amended and includes renting of property as service.

As the term "service" as appearing in the section includes renting of immovable property also, any contract for the activity of renting of immovable property will require prior approval of the Board/Central Government as the case may be. Though the sale and purchase of immovable property is not treated as service neither they come within the definition of "goods"; renting of immovable property is an exclusive amendment in the definition of "service" in the service tax rules and hence, are to treated as contracts requiring sanction as per section 297 of the Act.