

Business Restructuring

Tax & FEMA framework for M&As in India

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By Deepa Dalal



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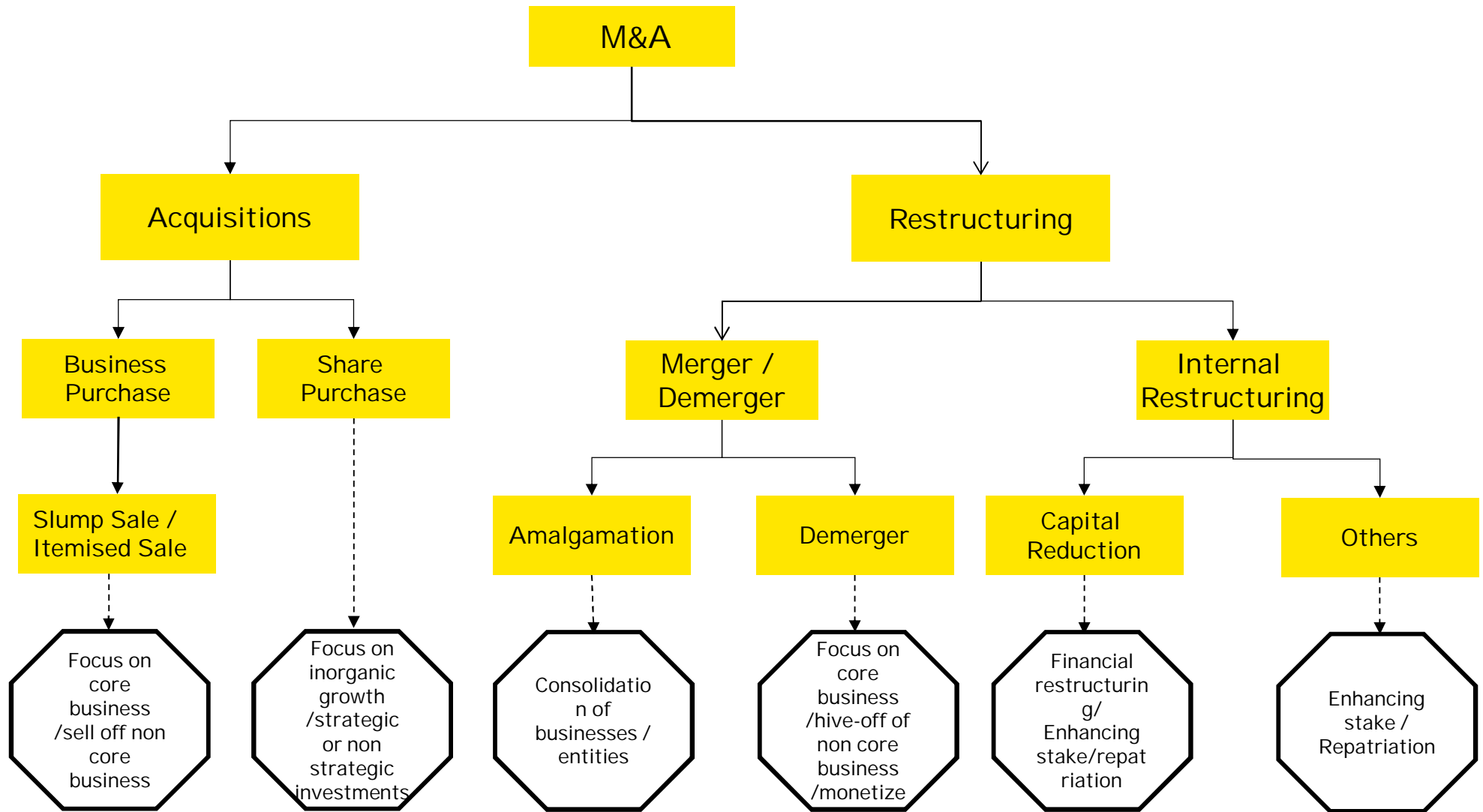
Agenda

- ▶ Modes of M&A in India
- ▶ Legislative framework of M&A
- ▶ Tax & Regulatory aspects of –
 - ▶ Merger
 - ▶ Demerger
 - ▶ Business sale
 - ▶ Share sale
- ▶ Case study

Modes of M&A in India



Reorganization Tools : Snapshot



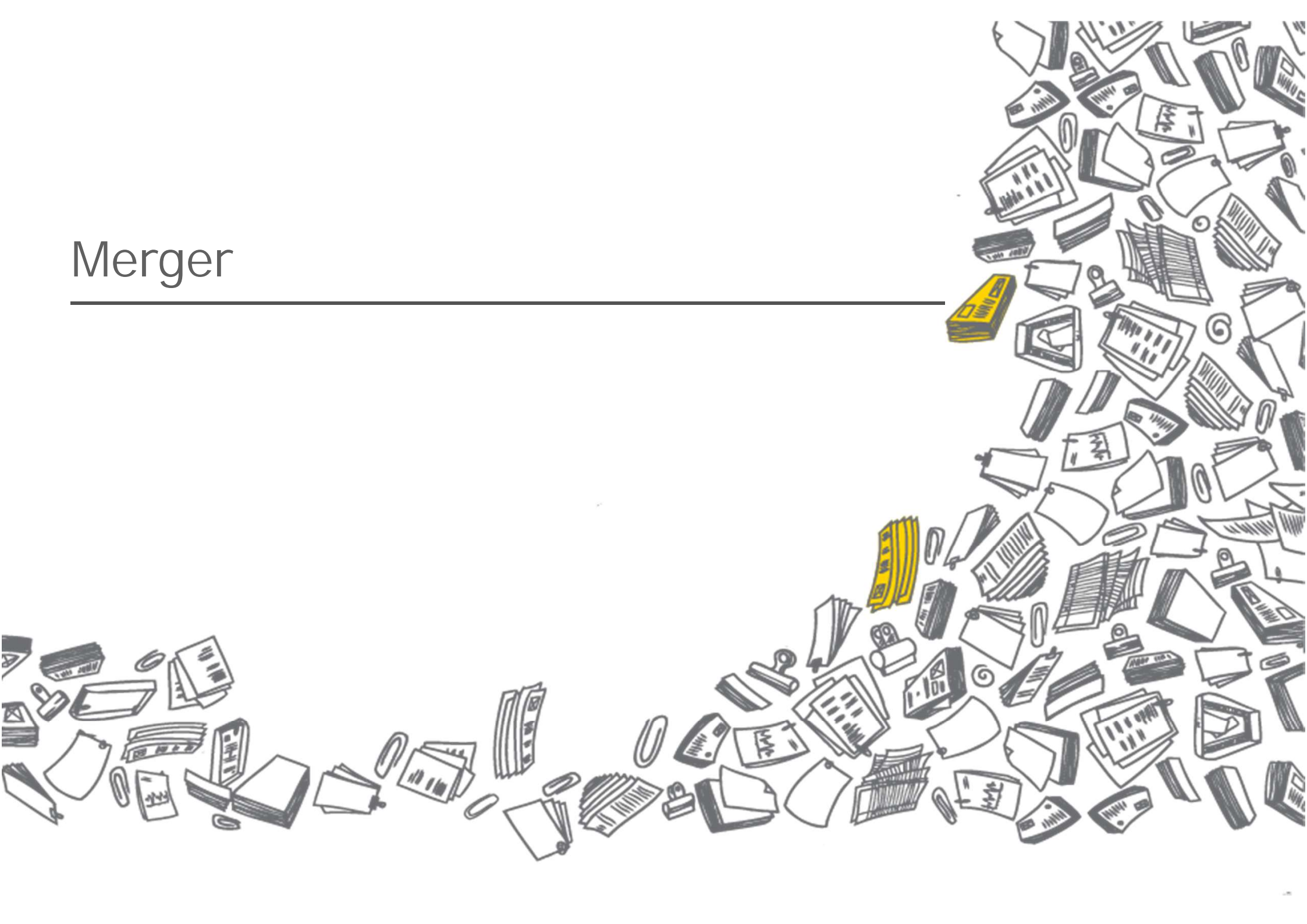
Legislative Framework of M&A in India



Snapshot of Indian laws impacting M&A



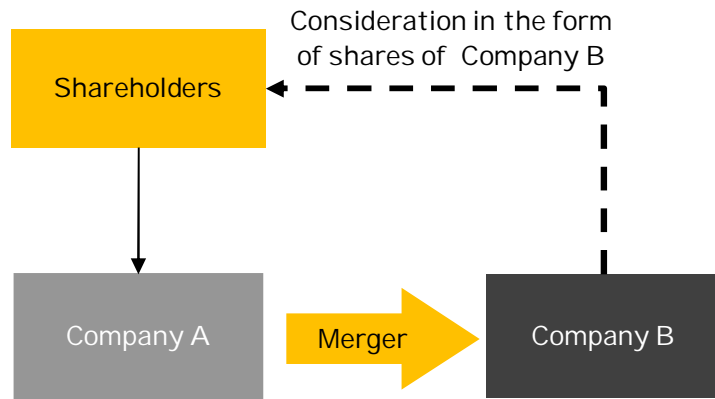
Merger



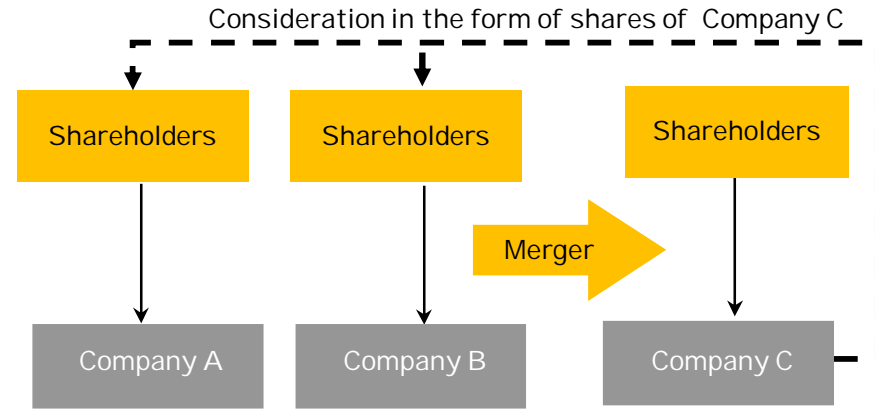
Merger

- ▶ Merger refers to consolidation of two or more entities
- ▶ Involves transfer of assets and liabilities from one or more transferor companies to a transferee company
- ▶ In consideration, typically the transferee company issues shares to the shareholders of transferor company

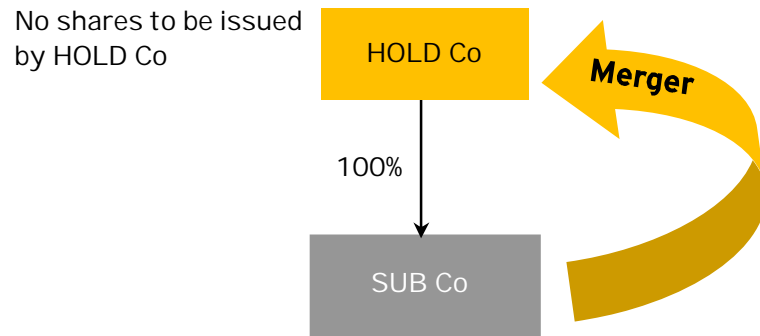
Domestic Merger Situations



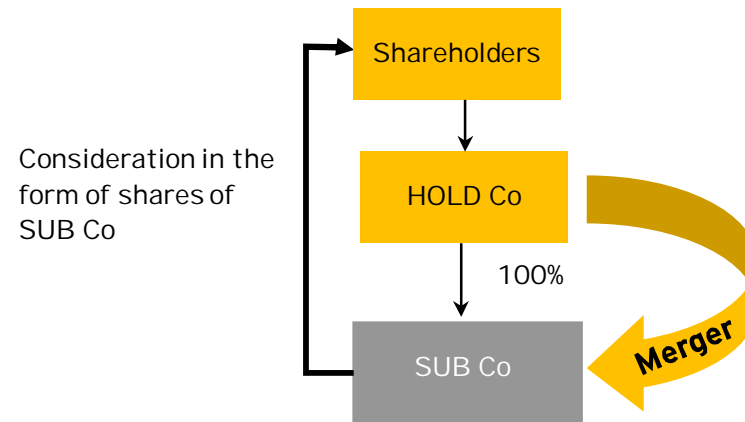
Merger of Company A with Company B



Merger of Companies A & B with Company C



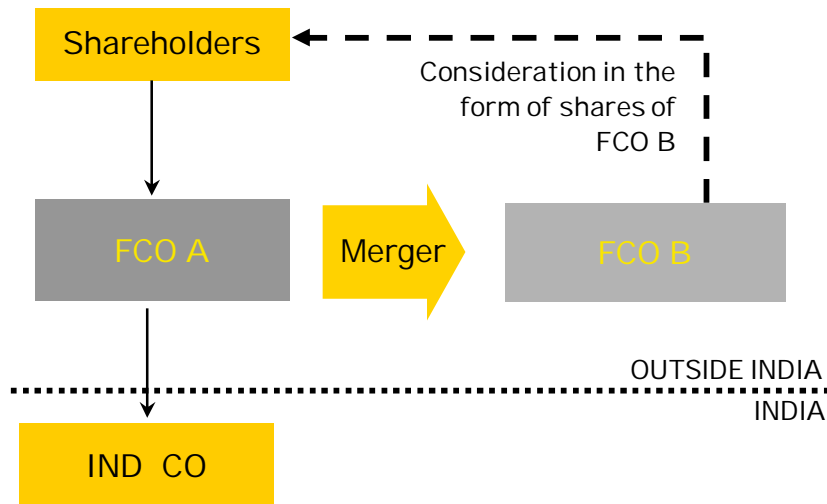
Merger of SUB Co with HOLD Co



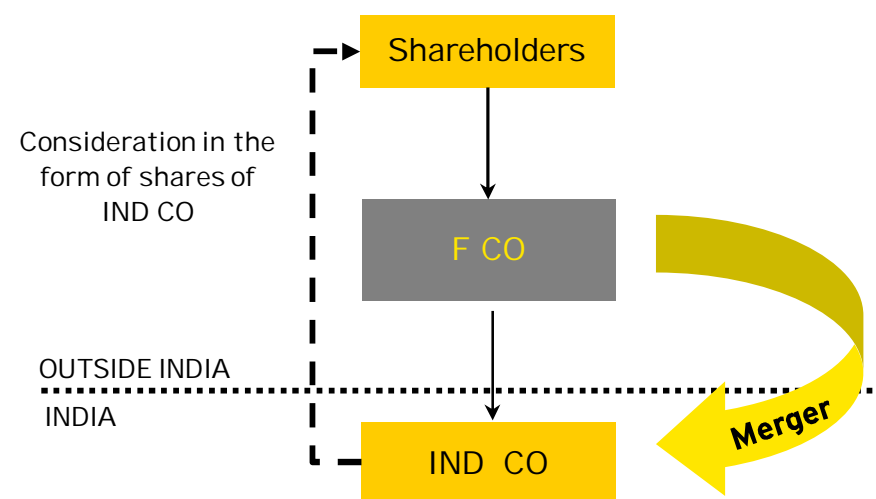
Merger of HOLD Co with SUB Co

Cross Border Merger Situations

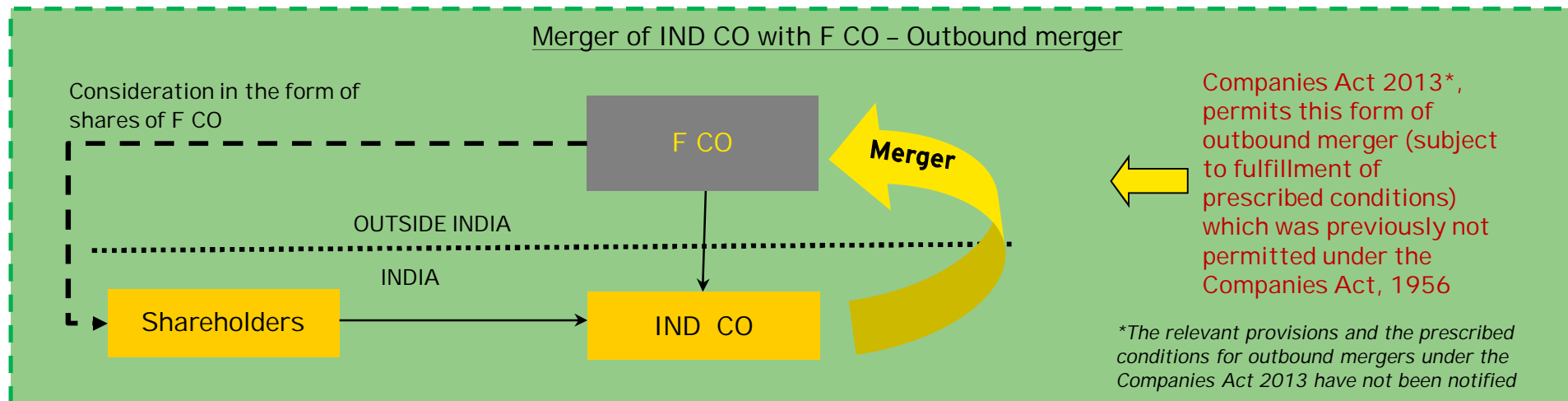
Merger of FCO A (holding IND CO) shares with FCO B



Merger of FCO with IND CO



Merger of IND CO with F CO – Outbound merger



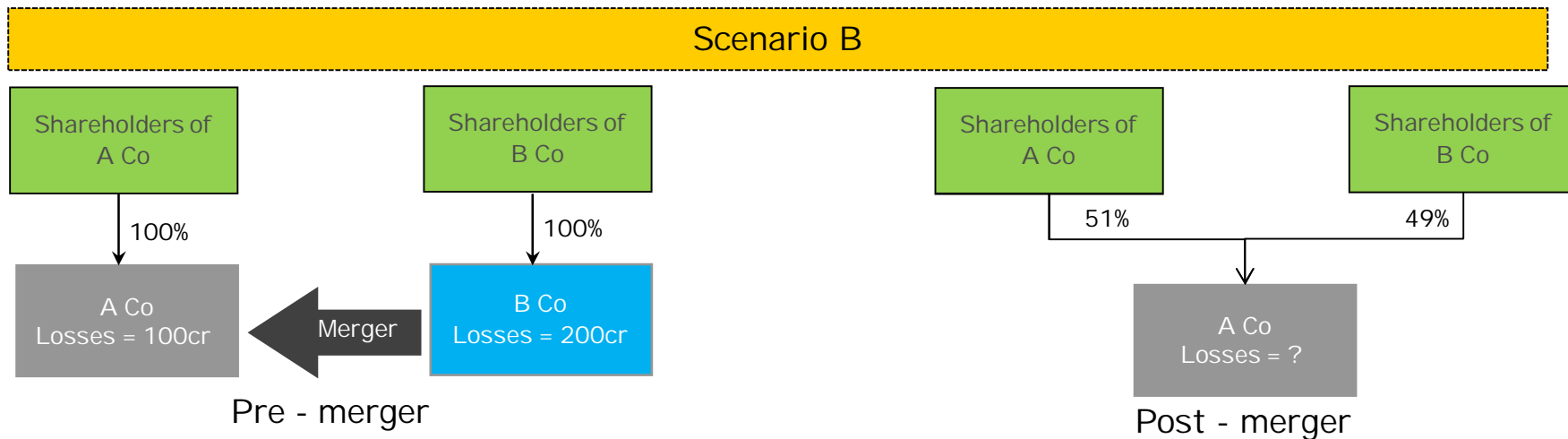
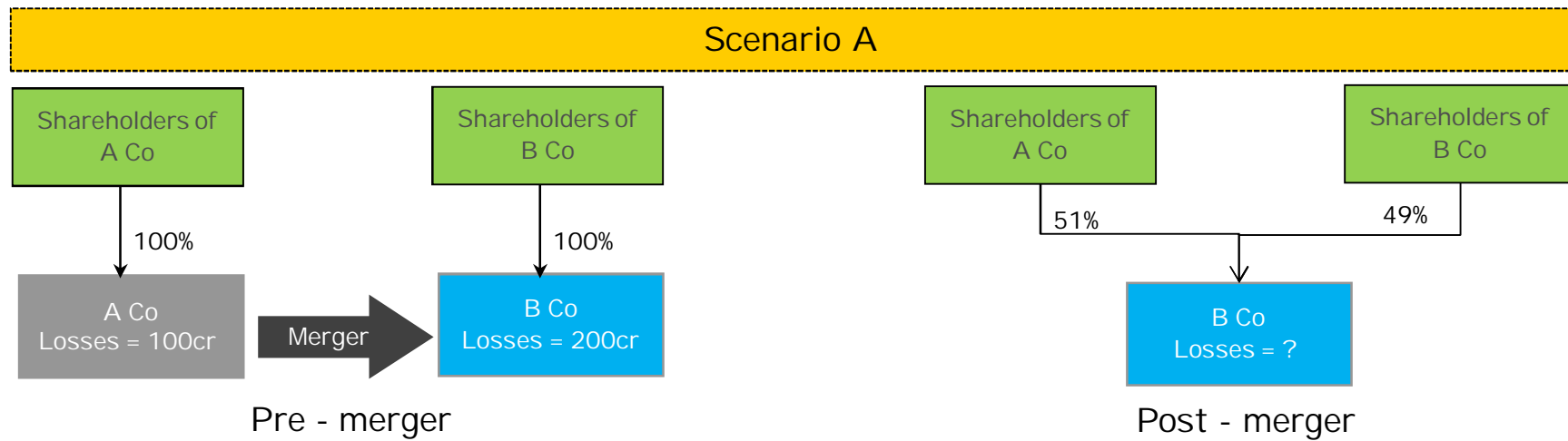
Key tax implications

- ▶ Tax neutral subject to fulfilment of certain conditions
- ▶ Carry forward & set off of losses / unabsorbed depreciation
- ▶ Depreciation allowable on proportionate basis
- ▶ Merger expenses amortisable
- ▶ Cost of acquisition (COA)
- ▶ Period of holding
- ▶ COA of capital assets transferred to Transferee Co = Cost incurred by Transferor Co for acquiring such assets

Key tax considerations

- ▶ Appointed date v. Effective Date
- ▶ Whether equity and preference shareholders should be issued equity and preference shares respectively on amalgamation?
- ▶ Tax holiday benefits
- ▶ MAT credit
- ▶ Change in shareholding – lapse of losses (Case Study in ensuing slide)
- ▶ Goodwill on merger
- ▶ Applicability of transfer pricing provisions

Case Study – Carry forward and set off losses upon merger

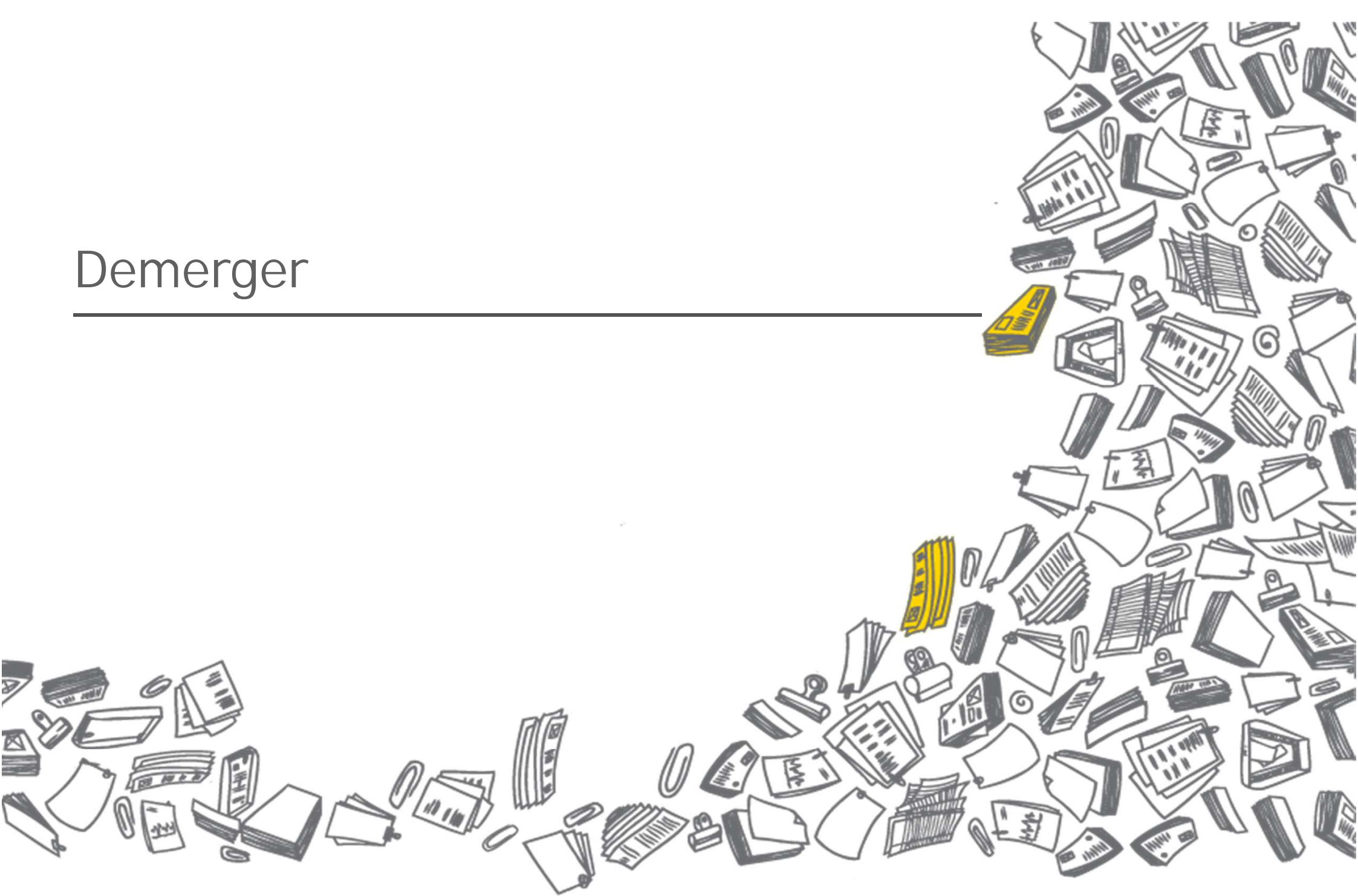


*Assumed conditions specified u/s 72A satisfied

Key FEMA implications

- ▶ No FIPB approval required for shares issued pursuant to merger
 - ▶ Prescribed conditions to be fulfilled
 - ▶ Foreign shareholding does not exceed the specified limits under FDI
 - ▶ Not engaged in activities which are prohibited under the FDI policy

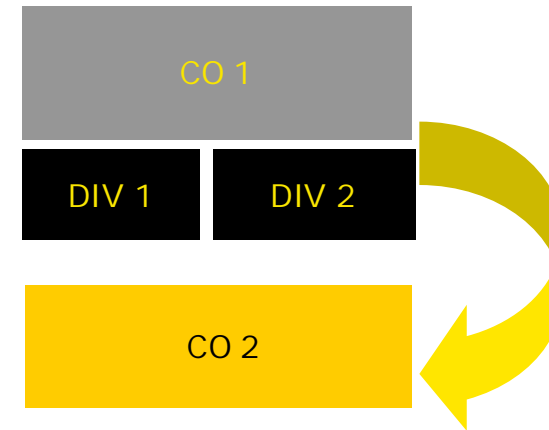
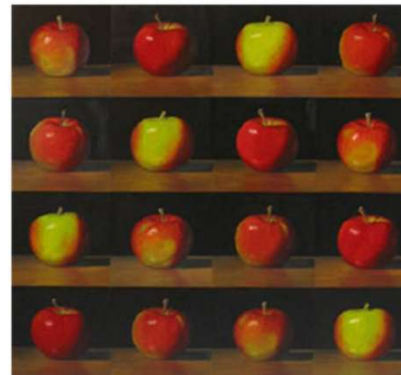
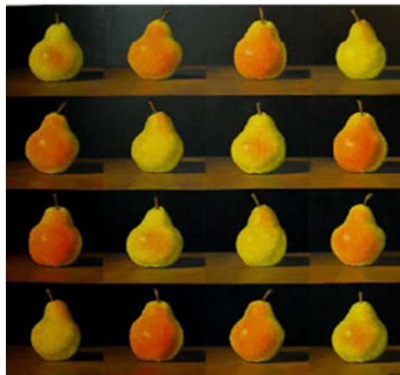
Demerger



What is demerger?

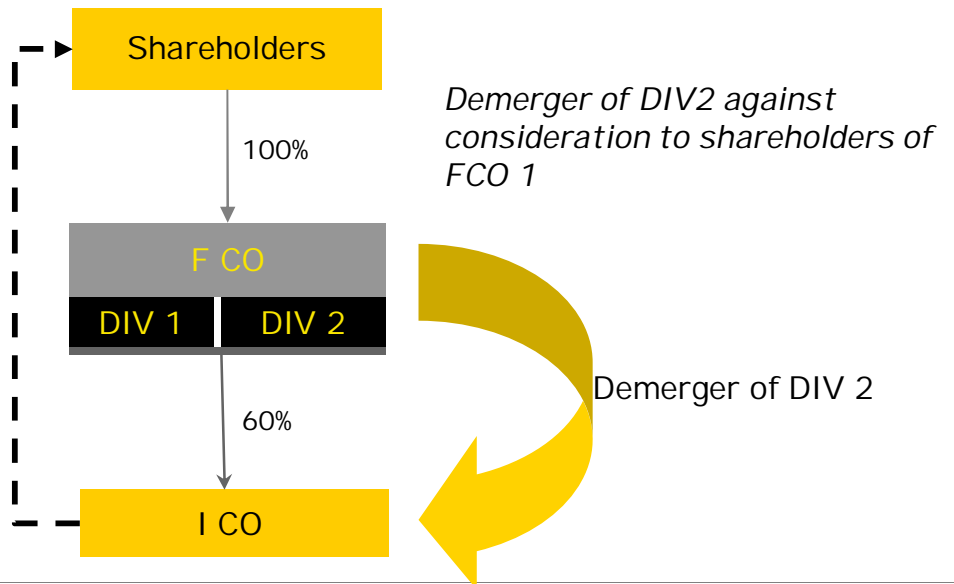
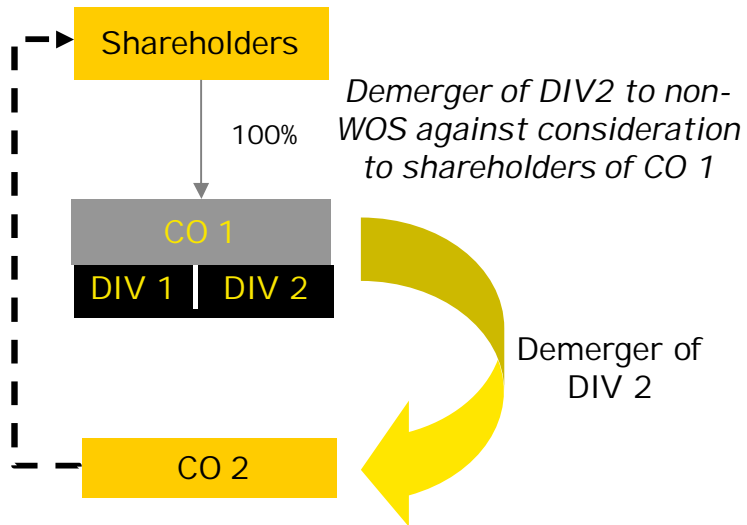
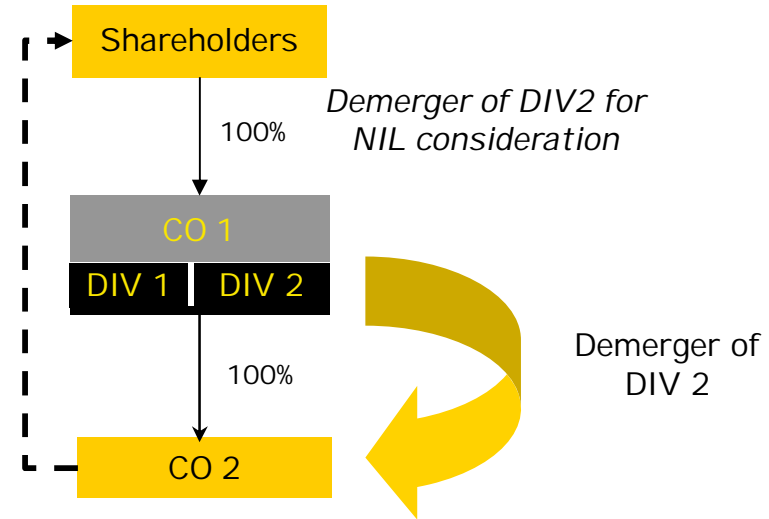
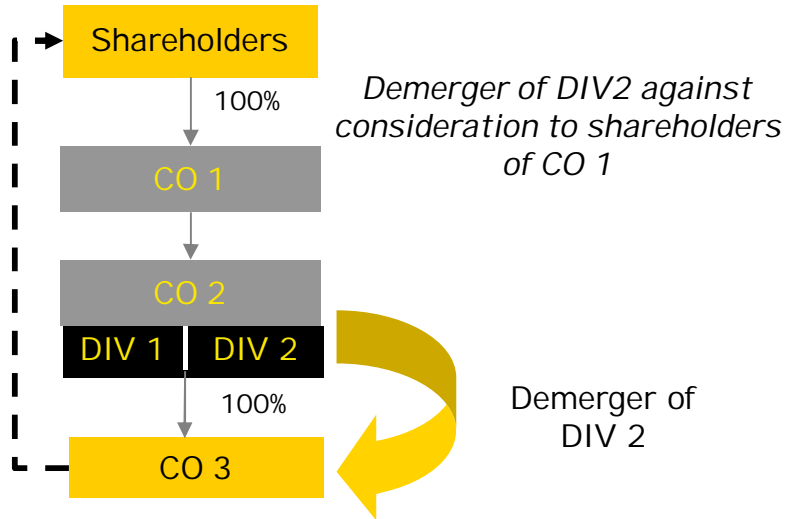


v/s



- ▶ Demerger involves transfer of identified business from one company to another
- ▶ In consideration, the company which acquires the business, issues shares to shareholders of the selling company
- ▶ Demerger is a Court approved process similar to merger

Demerger situations



Key tax implications

- ▶ Tax neutral subject to fulfilment of conditions as per the Income Tax Act
- ▶ Carry forward & set off of losses/ unabsorbed depreciation relatable to demerged undertaking / division
- ▶ Depreciation allowable on proportionate basis
- ▶ Demerger expenses amortisable
- ▶ Cost of acquisition
- ▶ Period of holding

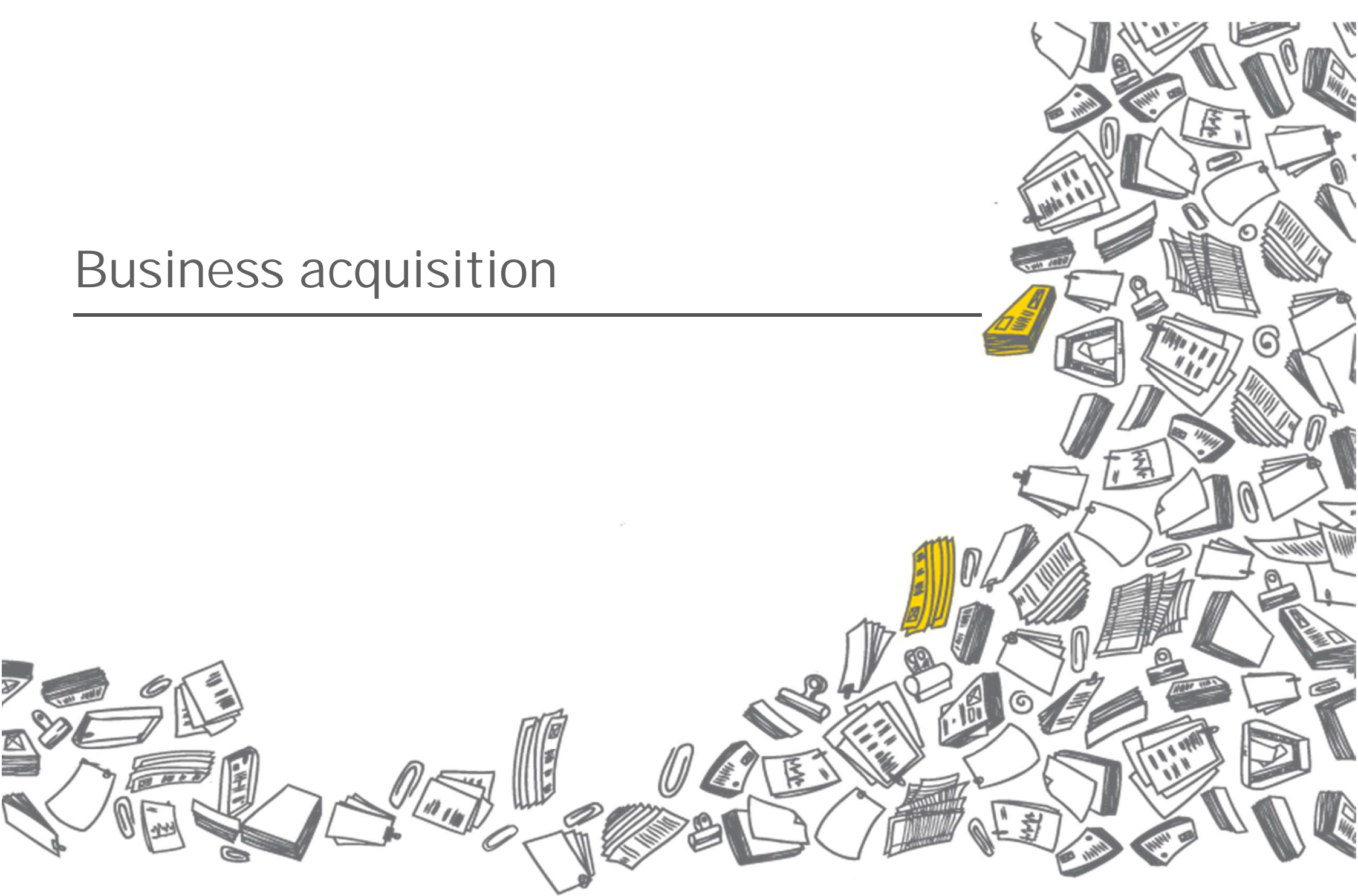
Key tax considerations

- ▶ What constitutes an 'undertaking'?
- ▶ Continuity of tax holiday benefits of the Demerged Co?
- ▶ Whether MAT credit allowed to transferred to the Resulting Co?
- ▶ Issue of cash on demerger?
- ▶ Applicability of transfer pricing provisions?

Key FEMA implications

- ▶ No FIPB approval required for shares issued pursuant to demerger
 - ▶ Prescribed conditions to be fulfilled
 - ▶ Foreign shareholding does not exceed the specified limits under FDI
 - ▶ Not engaged in activities which are prohibited under the FDI policy

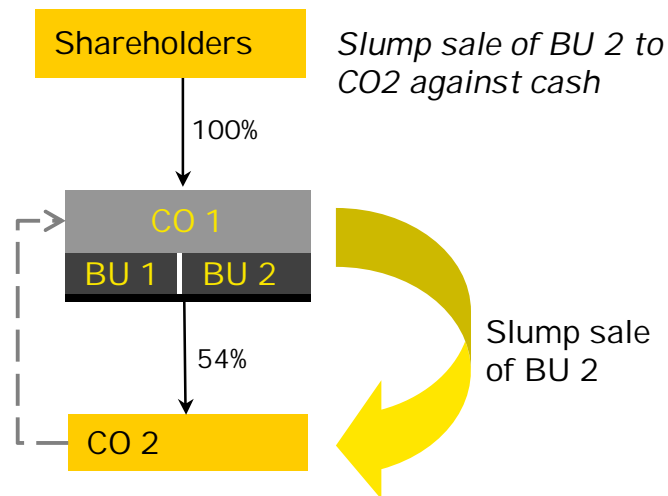
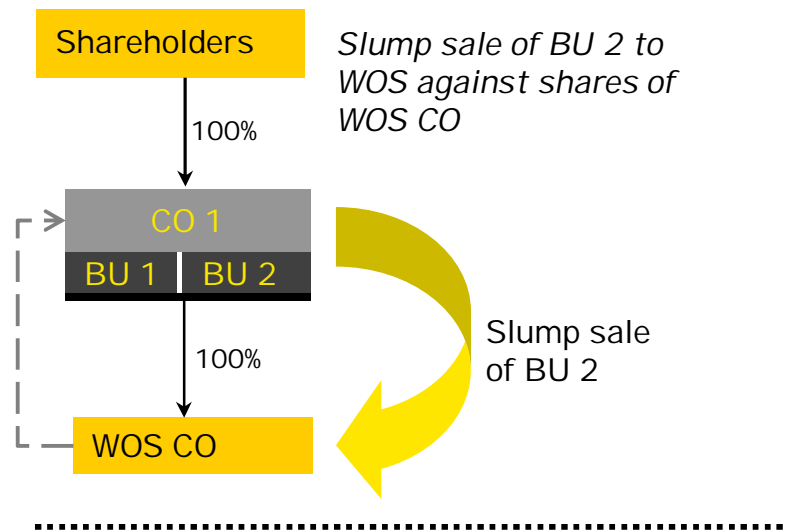
Business acquisition



Slump sale v. Itemised sale



Slump Sale

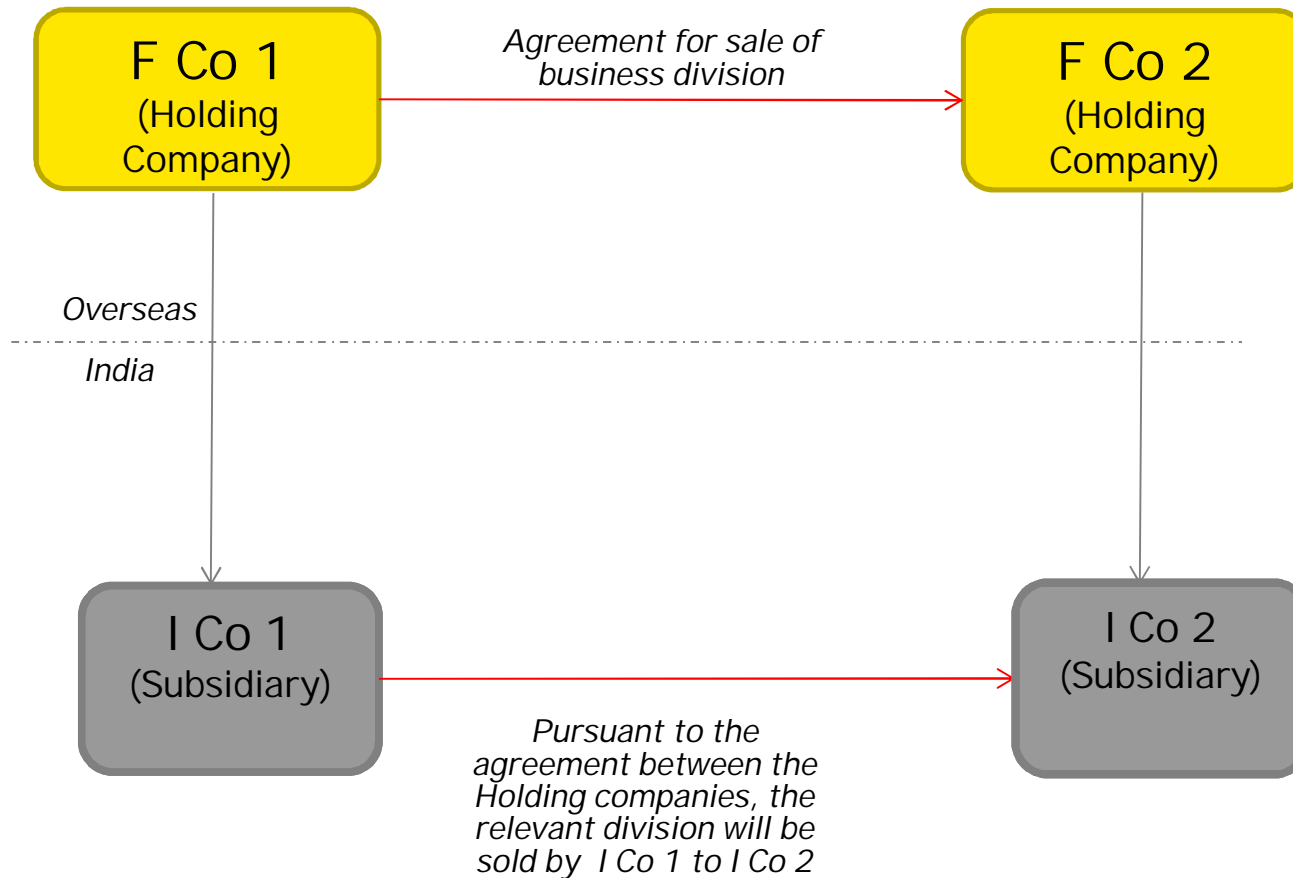


- ▶ Transfer of identified business from one company to another for a lump sum consideration
- ▶ In consideration, the buyer company to pay cash to the seller company
- ▶ Values not to be assigned to individual assets / liabilities during sale
- ▶ No Court approval required
- ▶ Undertaking defined to include –
 - ▶ A part of an undertaking
 - ▶ Unit or division of an undertaking
 - ▶ Business activity taken as a whole

Key tax considerations

- ▶ Special provision to compute capital gains on slump sale
- ▶ Tax net worth certificate
- ▶ Will the transaction be regarded as a slump sale if certain assets or liabilities are not taken over by the purchaser?
- ▶ Can depreciation be claimed on the amount paid over and above the value of business which is termed as 'Goodwill'?
- ▶ Tax deductions/exemptions (section 80-IA,80-IB,10AA) in the case of slump sale, whether will be transferred to the new company?
- ▶ Whether TP provisions would apply to a slump sale transaction?

Case study

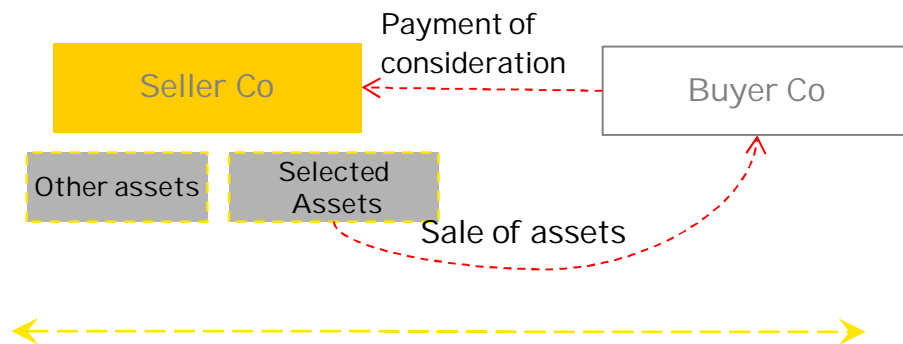


Question: Will the transaction of sale of business by I Co 1 to I Co 2 be considered as a 'Deemed International Transaction' u/s 92B(2)?

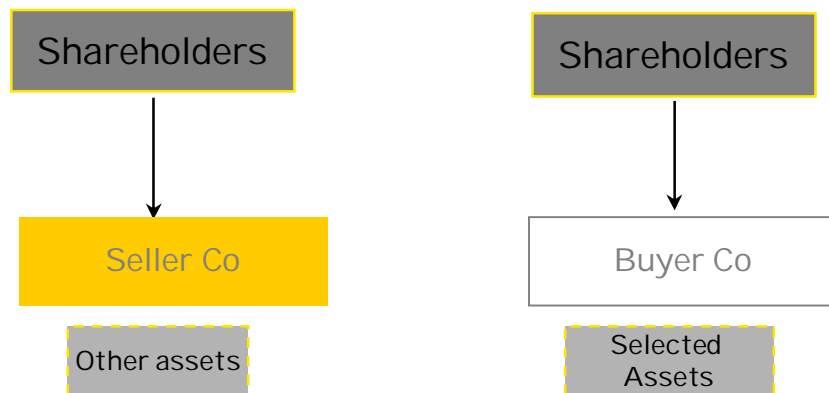
Key FEMA considerations

- ▶ Transfer of ECB as a part of undertaking – RBI approval required?
- ▶ Issue of shares against slump sale of business by a foreign owned company – resulting in downstream investment
- ▶ If business is not under automatic route – whether approvals required for transfer of business

Itemised - sale of Business



Post itemized sale scenario



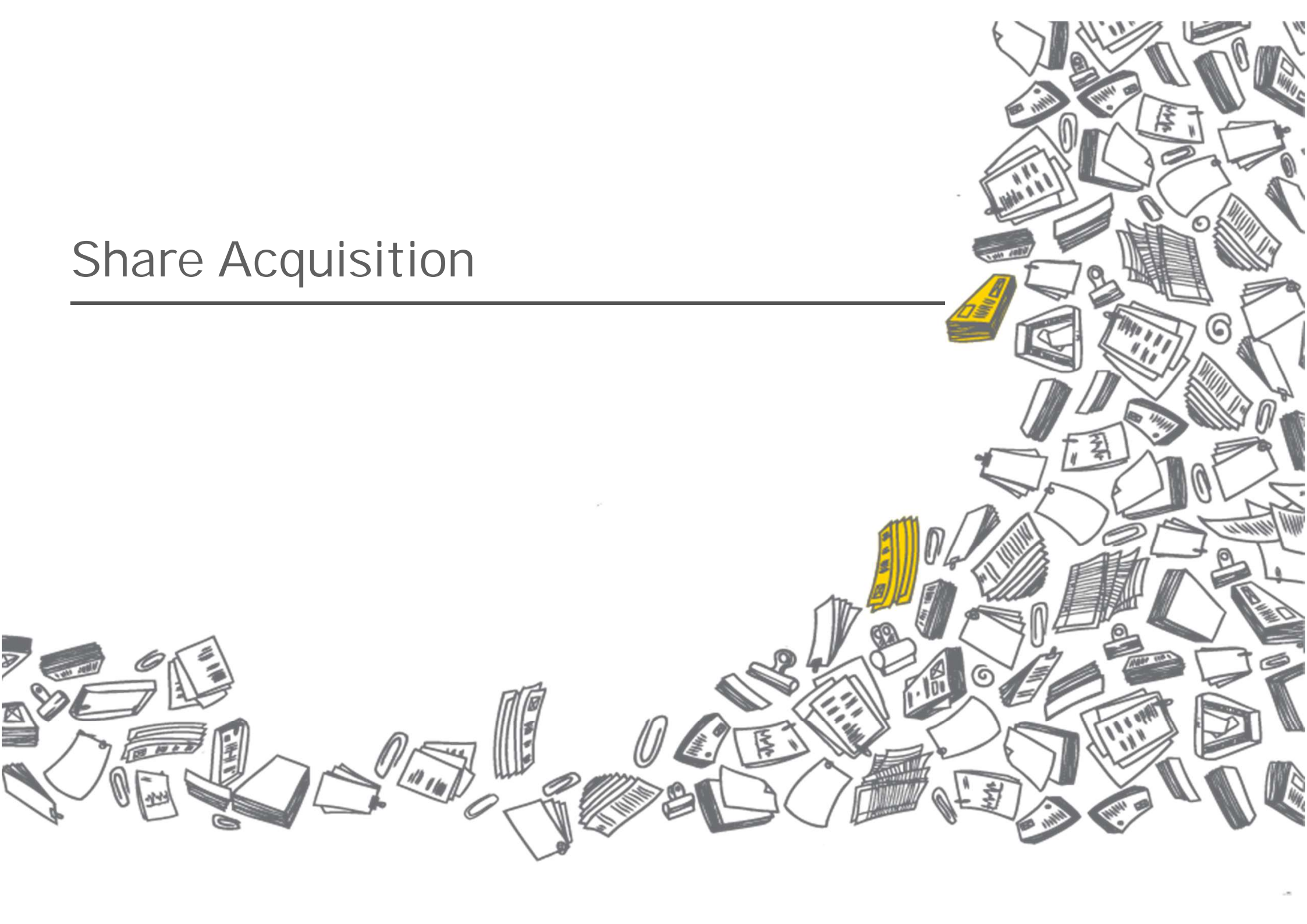
- ▶ Involves transfer of business wherein consideration is identified against each asset
- ▶ Not necessary what is transferred constitutes a business undertaking
- ▶ In consideration, the Buyer Co pays cash to the Seller Co
- ▶ No requirement for the Buyer Co to continue to undertake the business
- ▶ No Court approval required

Cherry Picking of assets and allocation of value to individual assets based on their inherent commercial advantage

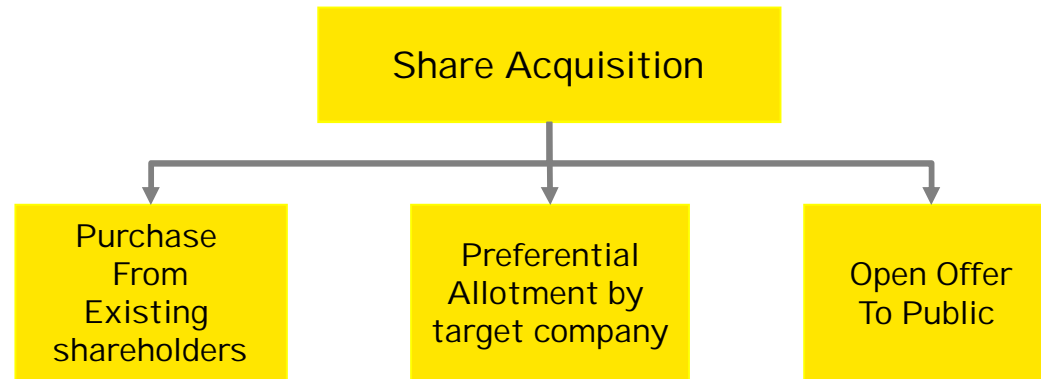
Key tax considerations

- ▶ Transaction non-tax neutral
 - ▶ Gains arising on sale of capital assets taxed as Long/ short term capital gains depending on period of holding
- ▶ Provisions of Section 50 shall apply in the case of sale of depreciable assets that form a part of a block of assets
- ▶ Provisions of Section 50C apply in case of sale of capital asset being land / building
 - ▶ Stamp duty value to be considered as full value of consideration for computation of capital gains
- ▶ Applicability of domestic transfer pricing provisions

Share Acquisition



Share sale



Key Aspects

a. Purchase of shares from existing shareholders

- ▶ Existing shareholders would transfer shares of the target company to the acquirer
- ▶ Payment of purchase consideration by acquirer company to the shareholders
- ▶ Could also be done by share swap

b. Preferential allotment by target company

- ▶ Allotment of fresh shares by the target company
- ▶ Payment of purchase consideration by acquirer company to the target company

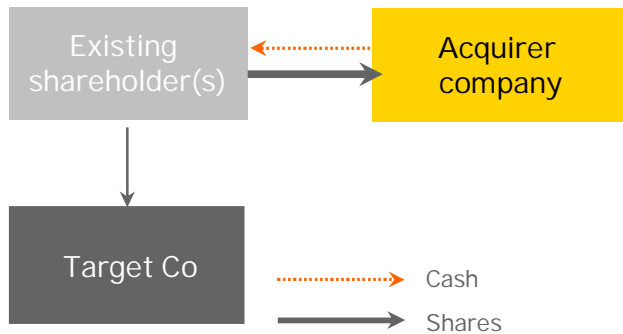
c. Open offer to Public

- ▶ Open offer to Public by acquirer / promoters (in case of listed company)

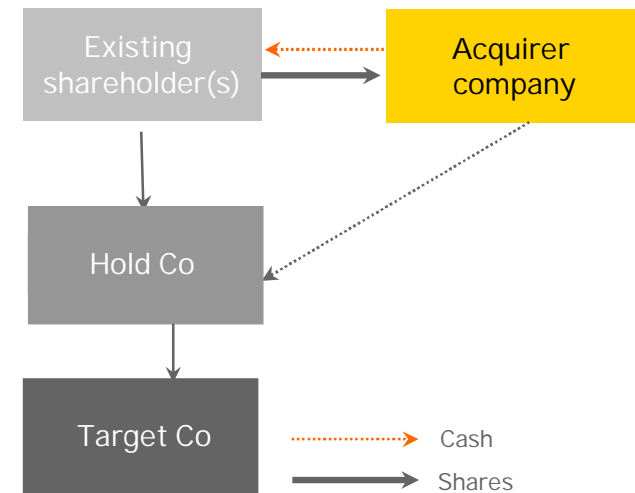
Domestic share acquisitions

Buy out of equity stake from existing shareholders

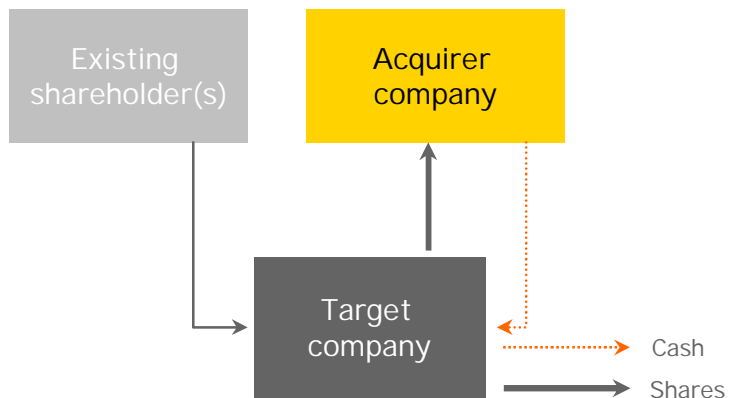
Scenario 1



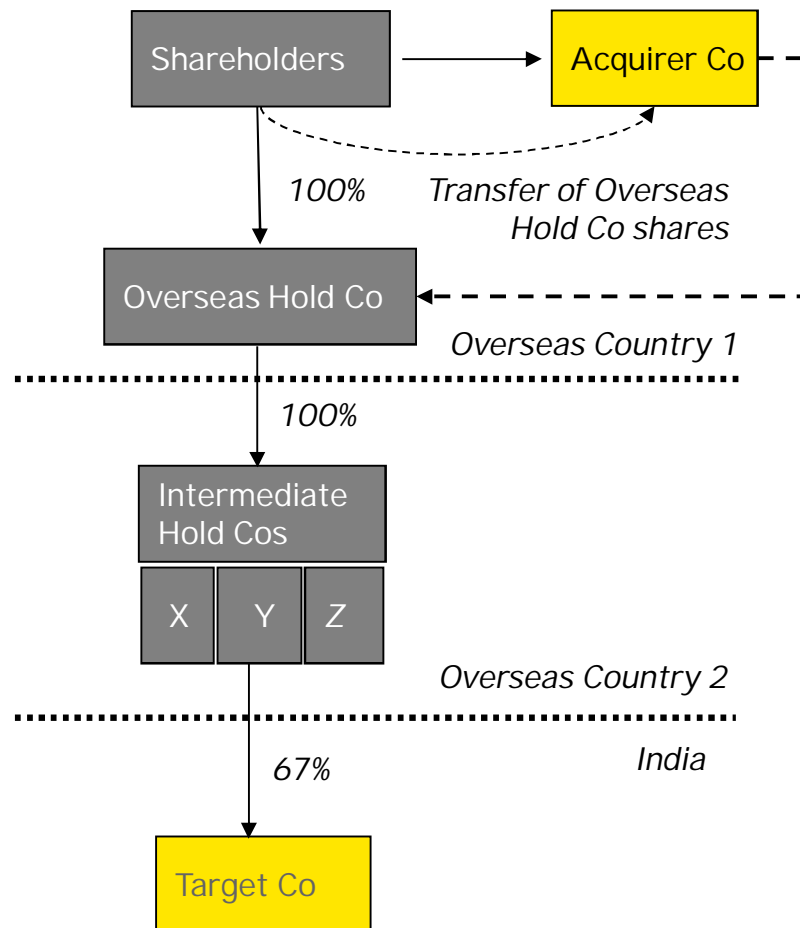
Scenario 2



Preferential issue by target company



Global share acquisitions



Key tax considerations

- ▶ Transfer of shares taxable as capital gains
- ▶ Indirect transfer taxable in India if it derives substantial value from Indian assets
 - ▶ Treaty benefit available
- ▶ Applicability of transfer pricing on transfer / issue of shares between associated enterprises
- ▶ Lapse of business losses if shareholding changes by more than 51%

Key FEMA considerations

- ▶ RBI / FEMA approval required – if business of the company is not under automatic route
- ▶ Pricing guidelines to be complied with

Acquisition through	Listed shares	Unlisted shares
Infusion - Preferential allotment	Not less than average of weekly high & low of closing prices during 6 month or 2 week, whichever is higher	Price not less than value determined as per DCF method
Transfer of shares by Resident to Non-resident*	Not less than average of weekly high & low of closing prices during 6 month or 2 week, whichever is higher	Price not less than value determined as per DCF method
Transfer of shares by Non-resident to Resident*	Not more than average of weekly high & low of closing prices during 6 month or 2 week, whichever is higher	Price not more than value determined as per DCF method

- ▶ Sectorial caps to be complied with
- ▶ Reporting requirements – filing of Form FC-GPR / FC-TRS

* Exception for transaction which are compliant with the specific/explicit, extant and relevant SEBI regulations / guidelines (such as IPO, Book building, block deals, delisting, exit, open offer/ substantial acquisition / SEBI SAST)

Questions?





Thank you

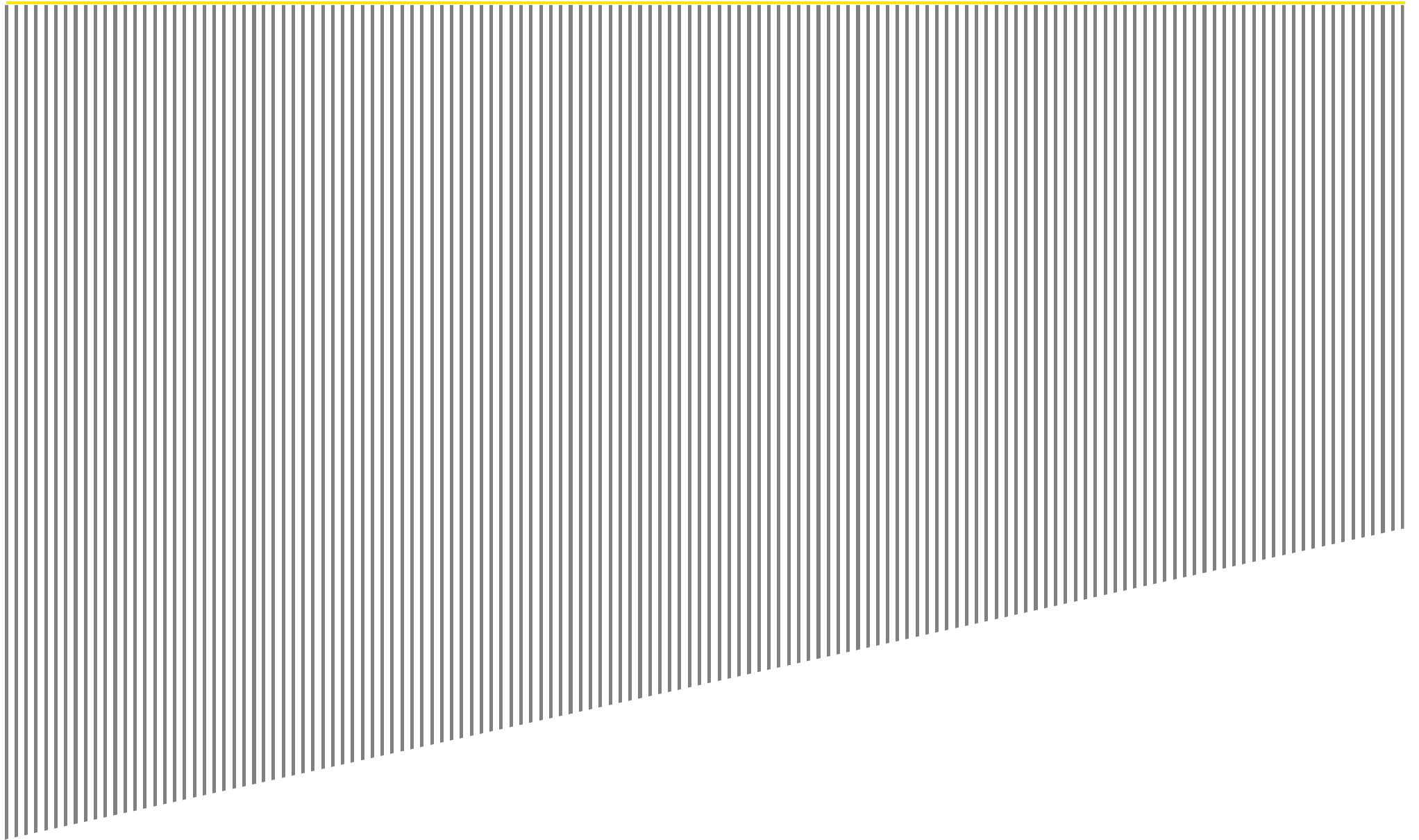


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Annexures



Sec 92B(2) : Deemed International Transaction

Prior to Finance (No 2) Act, 2014,

- ▶ Section 92B(2) of the Income Tax Act, 1961 defined 'Deemed International Transaction' as-
A transaction entered into by an enterprise with a person other than an associated enterprise shall be deemed to be an international transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.
- ▶ Accordingly a transaction between an enterprise with an unrelated person was deemed to be an international transaction, if:
 - ▶ there exists a prior agreement between such other person and AE of the enterprise; or
 - ▶ where terms of relevant transaction are determined in substance between such other person and AE
- ▶ However, since section 92B(2) fiction applied for section 92B(1), it created an ambiguity- whether 'deemed international transactions' would cover a case where both the contracting entities are Indian residents.

Deemed International Transaction- Meaning

Post Finance (No 2) Act, 2014,

- ▶ In order to provide clarification, Section 92B(2) which defined 'Deemed International Transaction' was amended to include the words-

"where the enterprise or the associated enterprise or both of them are non-residents irrespective of whether such other person is a non-resident or not."

- ▶ Thus the amendment extended the applicability of the deeming fiction to transactions between two resident unrelated enterprises could be subject to TP if there exists a prior agreement or understanding (in substance) with a NR AE of either of the enterprise.

