

Key Provisions of Merger, Demerger & Restructuring



9th February 2019

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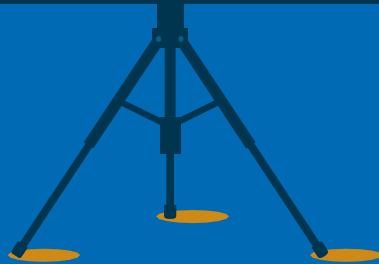
Presentation Contents

1 Background

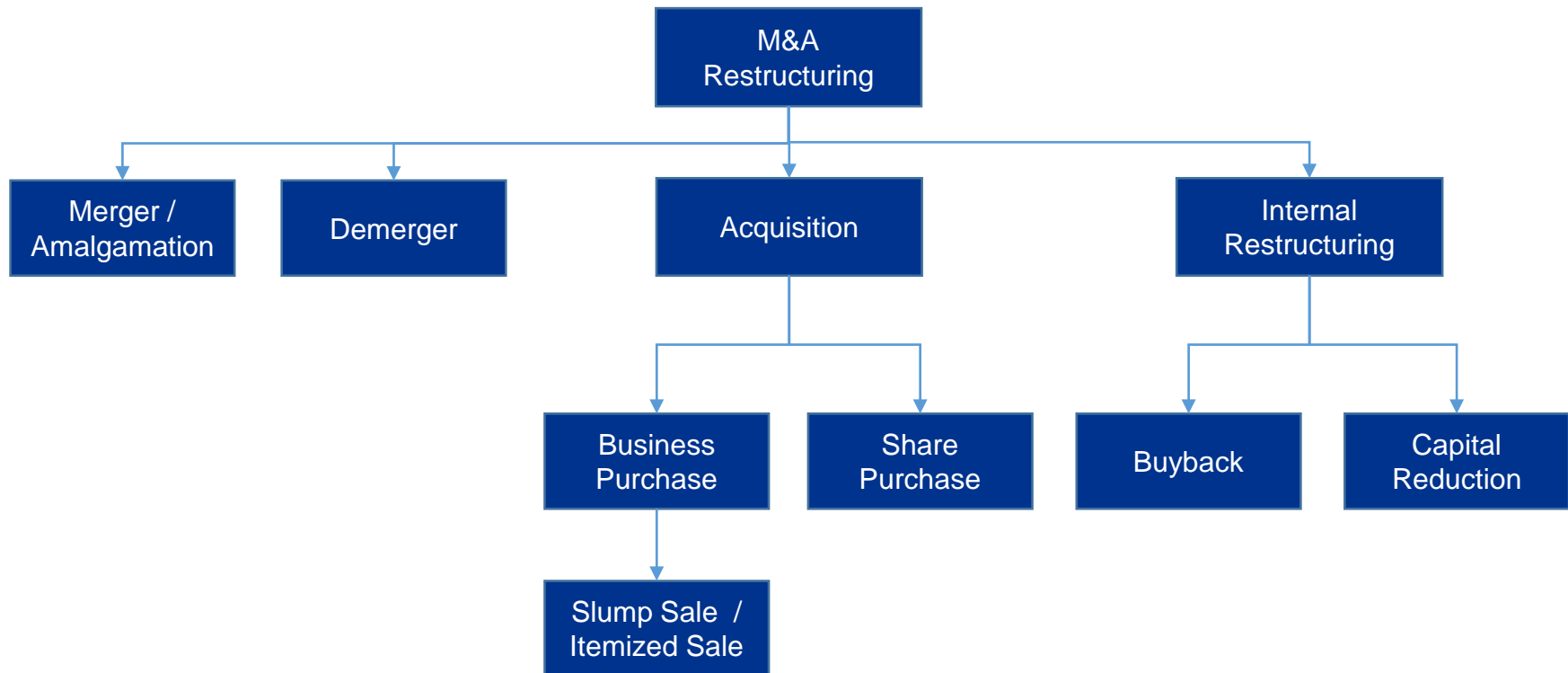
2 Merger

3 Demerger

4 Restructuring



Modes of M&A Restructuring



M&A - Key Drivers



Consolidation of businesses OR Un-locking of value



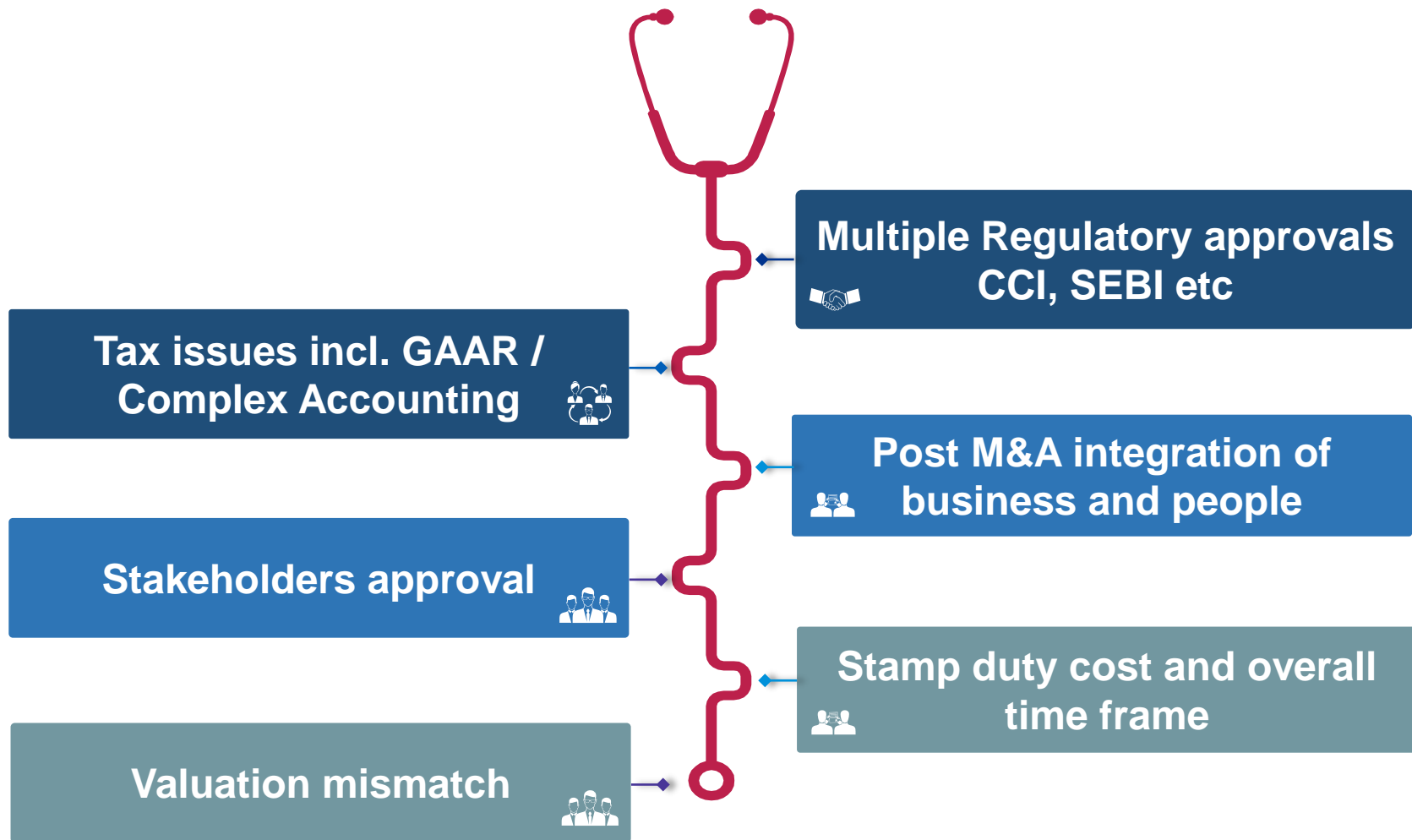
Explore any fiscal benefits that may be possible

Streamlining of operations and Saving of admin costs by reducing legal entities

Inorganic growth and Enhancing the footprints

While the above drivers are illustrative, corporate houses undertake M&A / Structuring for various reasons

Key challenges in M&A / Restructuring



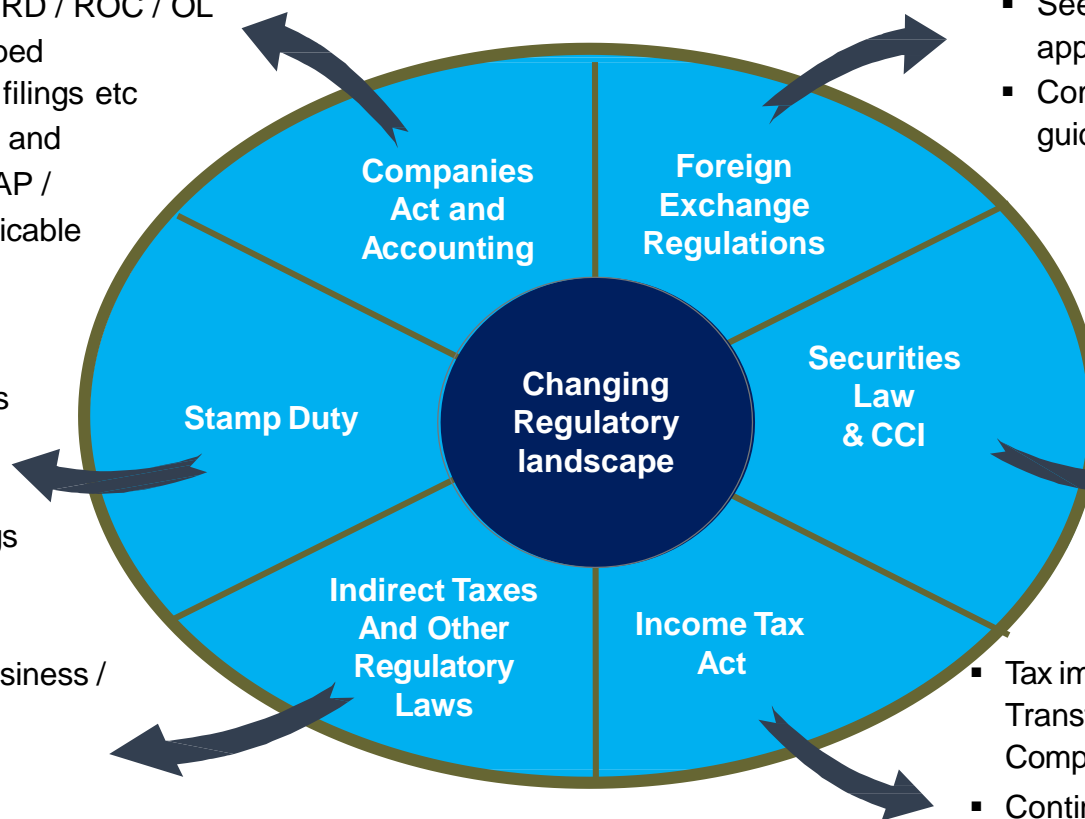
M&A Framework



- Scheme of arrangements u/s 230 – 234 of the Companies Act, 2013
- Approvals from NCLT / RD / ROC / OL
- Complying with prescribed procedures, resolution, filings etc
- Accounting implications and disclosures under I-GAAP / Ind-AS, as may be applicable

- Understanding state specific stamp duty laws
- Planning levies/ registration charges
- Adjudication proceedings etc.

- GST applicability on business / asset transfer
- Regulatory approvals, if applicable



- FDI/ ODI implications, Cross Border Merger implications etc.
- Seeking necessary RBI approvals
- Complying with prescribed guidelines

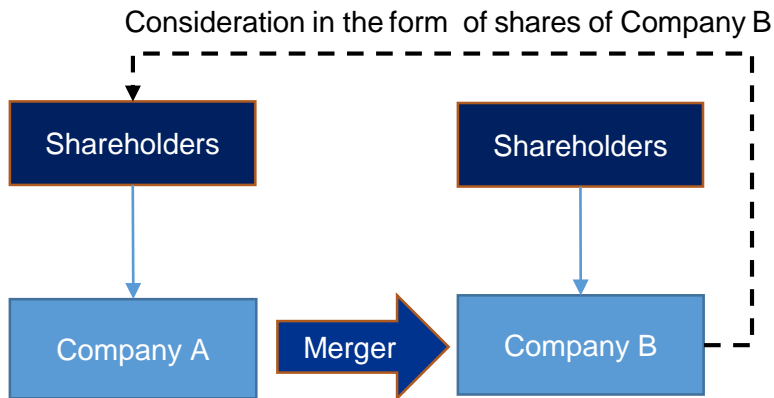
- Compliance with SEBI Regulations/approvals
- Stock exchange approvals/compliances
- Compliances for listing of shares
- Takeover code implications
- Approval of CCI for Combinations

- Tax implications in the hands of the Transferor Company, Transferee Company and Shareholders
- Continuity of carry forward of losses
- Tax neutrality of restructuring and continuity of fiscal benefits

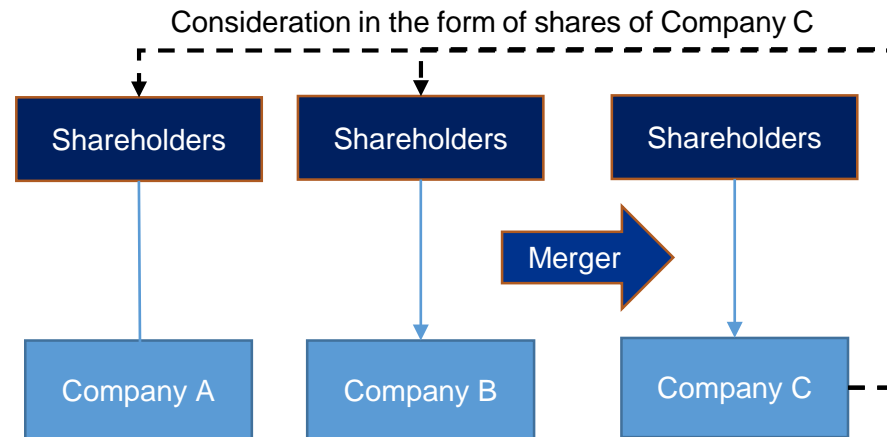
In the recent times, most of the above have undergone a change resulting into increased time frame for understanding and decision making

Merger

Merger - Typical Ways

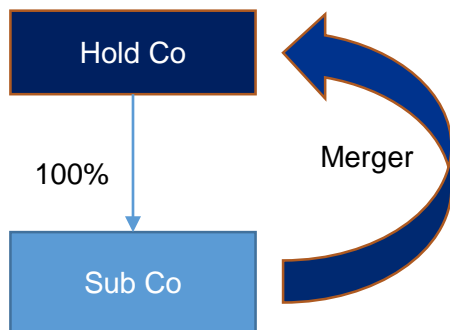


Merger of Company A with Company B



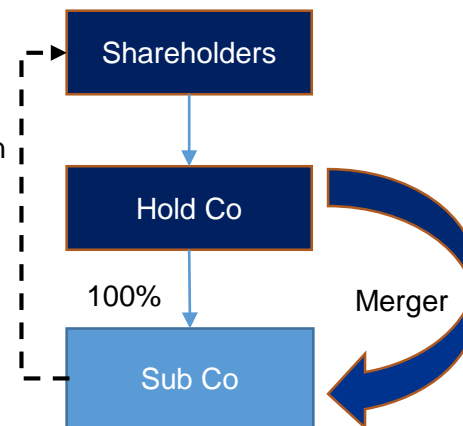
Merger of Companies A & B with Company C

No shares to be issued by Hold Co



Merger of Sub Co with Hold Co

Consideration in the form of shares of Sub Co



Merger of Hold Co with Sub Co

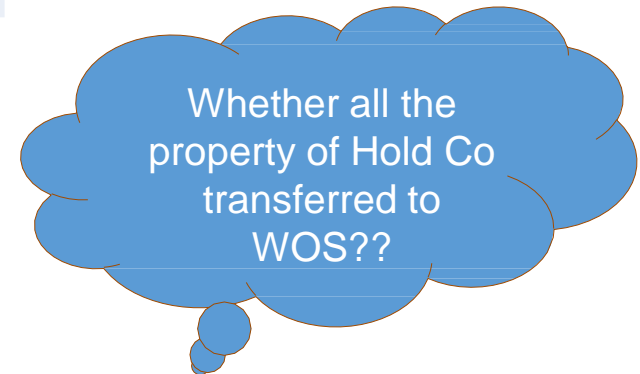
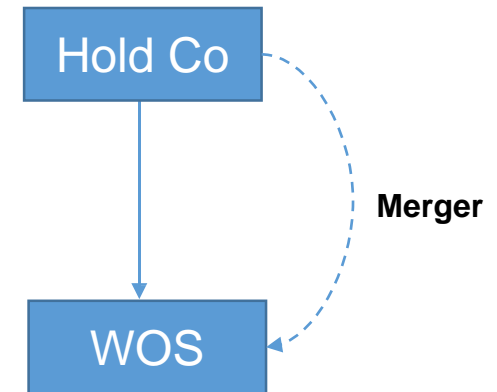
Amalgamation - Definition [section 2(1B)]



All the property and liabilities of the amalgamating company to be transferred to the Amalgamated Company

Balance Sheet of Hold Co

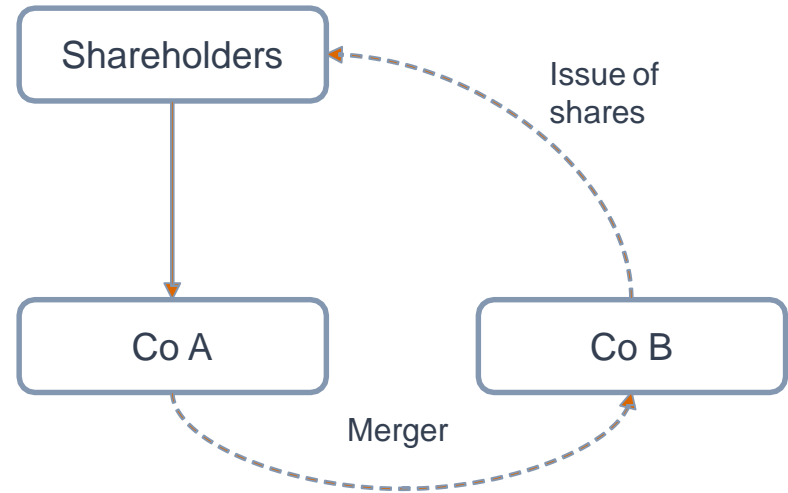
Liabilities		Assets	
Share Capital	100	Investment in WOS	100
Other Liabilities	50	Other Assets	50



Amalgamation - Definition [section 2(1B)]



- Shareholders holding **not less than 3/4th in value of the shares in the amalgamating company or companies** (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company



Merger of WOS into Holding Company.. Whether Tax Neutral?

If 9 out of 10 shareholders don't become shareholders of amalgamated company??

Merger - Tax consideration



In the hands of	Taxability / Treatment	Section	Conditions
Amalgamating company	No capital gains tax on transfer of assets	47(vi)	Amalgamated company should be an Indian company
Shareholders of Amalgamating Company	No capital gains tax on transfer of shares	47(vii)	<ol style="list-style-type: none"> 1. Consideration to be <i>in form of shares in amalgamated company</i> (except where the amalgamated company itself is a shareholder) 2. Amalgamated company should be an Indian company
Cost of acquisition of shares received on amalgamation by the shareholders	= Cost of acquisition of shares held by the shareholders in the amalgamating company	49(2)	Transfer as referred u/s. 47(vii)
Period of holding of shares received on amalgamation by the shareholders	Includes period of holding of shares held by the shareholders in the amalgamating company	Expln. (i)(c) to 2(42A)	Transfer as referred u/s. 47(vii)

Discharge of consideration by way of mix of equity and debenture or cash

Merger - Tax consideration



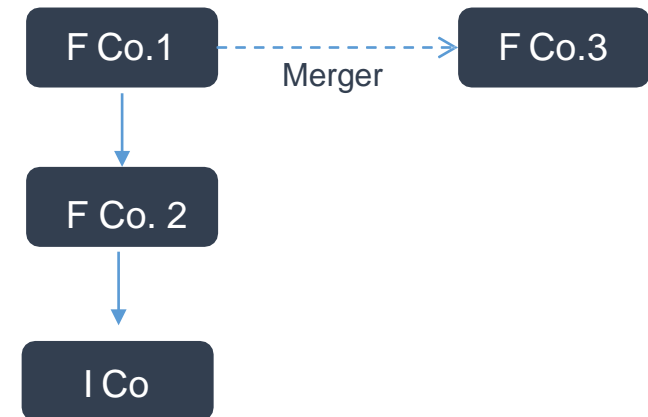
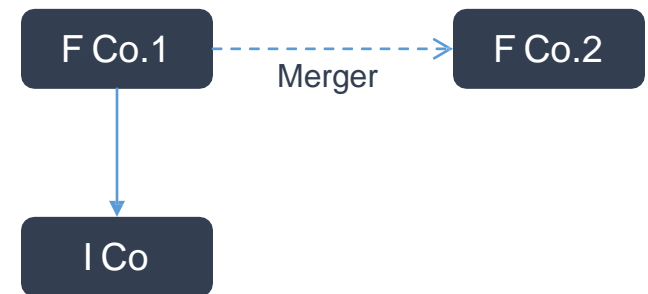
In the hands of	Taxability / Treatment	Section	Conditions
Cost of Assets for Amalgamated Company: - Stock - Capital Assets - Depreciable Assets	= Cost of acquisition of the stock / capital assets to the amalgamating company = WDV of depreciable assets held by amalgamating company	- 43C - Expln. 7 to 43(1) - 49(1) - Expl. 2 to 43(6)(c)	Amalgamated company should be an Indian company
Period of holding of capital assets received by Amalgamated company pursuant to amalgamation	Includes period for which capital assets were held by the amalgamating company	Expln. (i)(b) to 2(42A) r.w.s. 49(1) and 47(vi)	

Impact of Merger on carry forward of business losses and unabsorbed losses –Section 72A

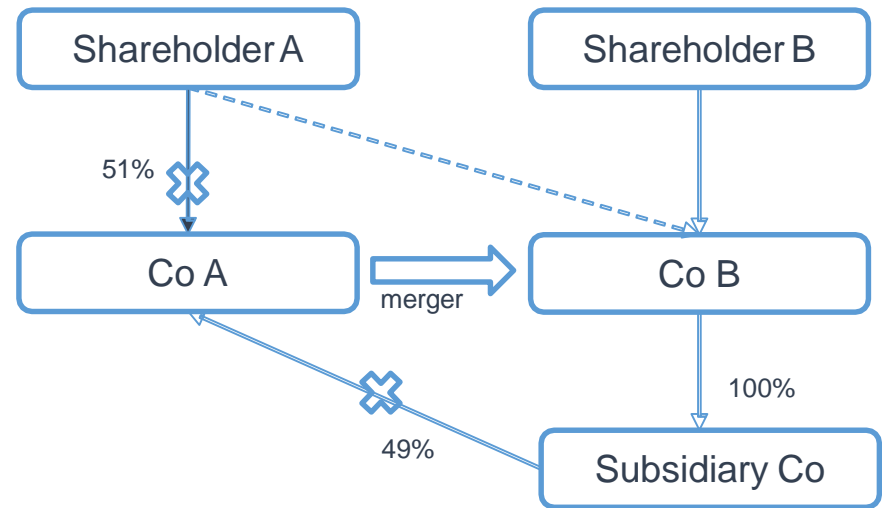
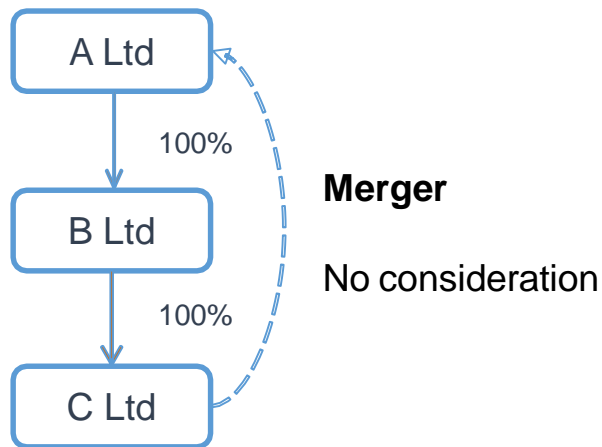
Amalgamation of Foreign Companies



- Shares in I Co transferred from F Co.1 to F Co.2 pursuant to merger of F Co.1 with F Co.2
- Transfer exempt u/s 47(via) if following conditions are satisfied:
 - 25% shareholders of Transferor company continue as shareholders of Transferee company
 - Such transfer does not attract tax in the F Co.1 country
- No implication under Sec. 56(2)(x) to F Co 2 since transfer exempt under 47(via) and 47(viab)
- ICo entitled to carry forward and set off earlier years tax losses against the current year income since
 - the change in shareholding is on account of merger of two foreign companies; and
 - 51% of shareholders of amalgamating co. becomes shareholder of amalgamated Co. [Proviso 2 to section 79]

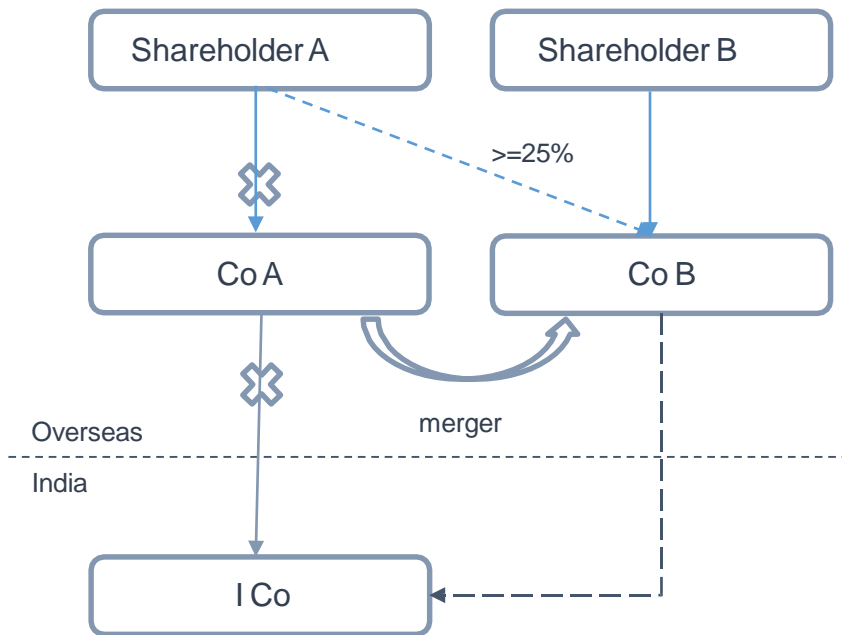


Case Study 1 - Whether 2(1B) compliant?



- Condition of at least 75% shareholder becoming shareholder in Co B is not fulfilled
- Is merger compliant of Section 2(1B)?

Case Study 2 - Overseas Merger



Tax implications in India on transfer of shares of I Co to Co B?

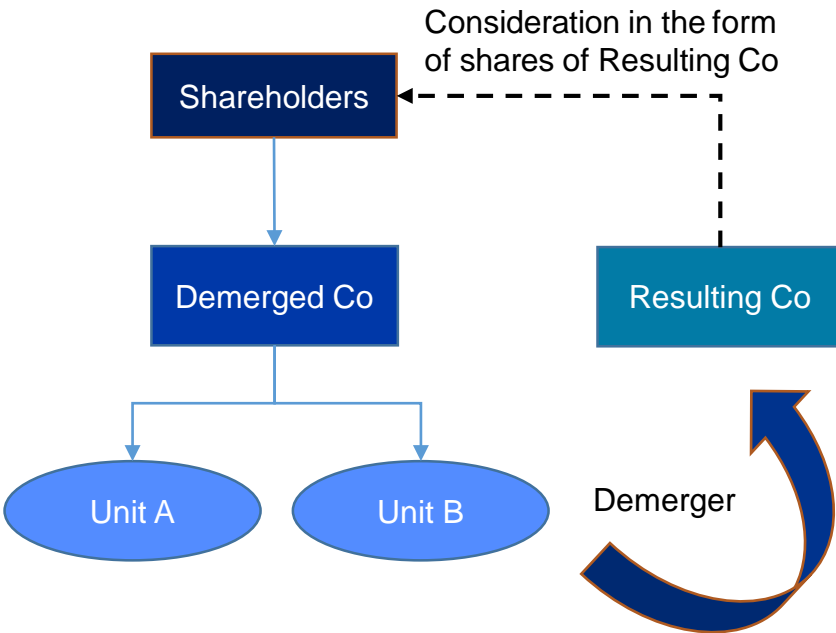
Conditions u/s 47(via):

1. At-least 25% shareholders of Co A
· continue to be shareholders of Co B
2. Exempt in foreign country

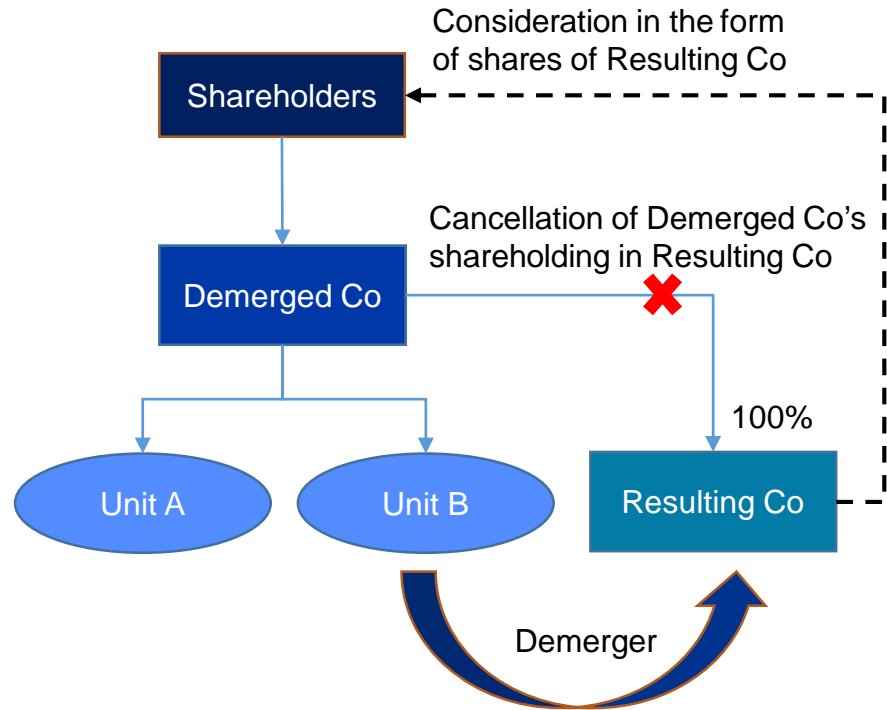
Whether the merger would be tax neutral if Co A holds Debenture, Bonds (i.e. other than shares) or immovable / movable properties ??

Demerger

Demerger - Modus operandi

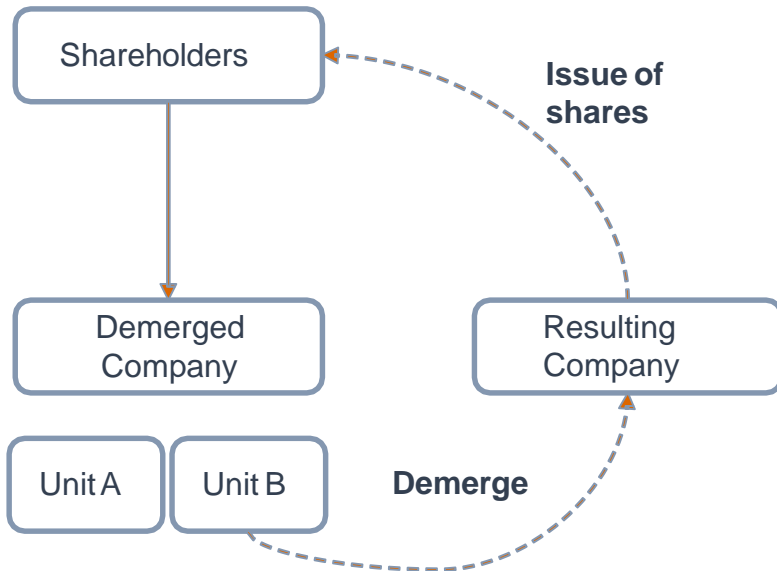


Non-Mirror shareholding Demerger



Mirror shareholding demerger – this is typically carried out by the listed company and pursuant to demerger the resulting company will also get listed

Demerger - Meaning



Meaning [Section 2(19AA)]

- Transfer of one or more undertakings from the Demerged company to the Resulting company

Conditions

- Transfer of all properties and liabilities at **book values**
- Discharge of consideration by issue of shares on proportionate basis (except where Resulting company is the Hold Co)
- Allotment of shares to shareholders holding not less than $3/4^{\text{th}}$ in value of the shares in the Demerged company
- Transfer to be on a going concern basis

Demerger - Consideration



Section 2(19AA) - Demerger

.....

.....

.....

(iv) the resulting company issues its shares to the shareholders of the demerged company on a **proportionate basis**;

(v) the shareholders holding **not less than three-fourths in value of the shares** in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger,

Whether shares to be issued on a proportionate basis [clause (iv)] to each class and kind of shares?

Whether condition prescribed in clause (v) is to be fulfilled for each class and kind or on an overall basis?

Undertaking - Meaning



“**Undertaking**” shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof **not constituting a business activity**

What is an Undertaking?

An undertaking refers to a business activity engaged with a view to earn profits

In General parlance:

- Undertaking refers to a division or a part of a business enterprise carrying on operations independently
- Means an “enterprise”, “venture” or engagement”

Whether investment undertaking can be demerged?

Demerged Co has only 1 undertaking – can that be demerged?

Liabilities relating to the undertaking:



Liabilities include –

- a. the liabilities which arise out of the activities or operations of the undertaking;
- b. the specific loans or borrowings (including debentures) raised, incurred and utilized solely for the activities or operations of the undertaking; and
- c. so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger

Common borrowings –
whether proportion of
aggregate liabilities to be
considered for transfer or
individually?

Demerger - Tax Consideration



Demerged Company

“Demerged company” means the company whose undertaking is transferred to a resulting company pursuant to demerger [section 2(19AA)]

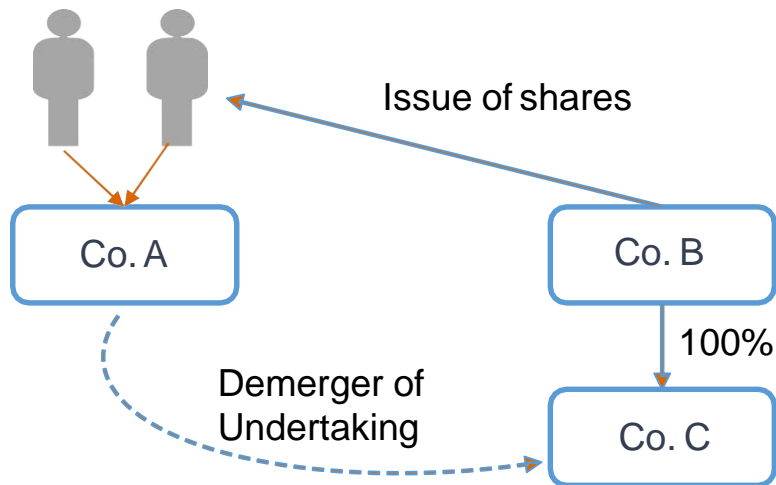
Resulting Company

[Section 2(41A)]

- **“Resulting company”** means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger [section 2(41A)]

Whether wholly owned subsidiary includes step down wholly owned subsidiary also?

Case Study 3 – Resulting Company



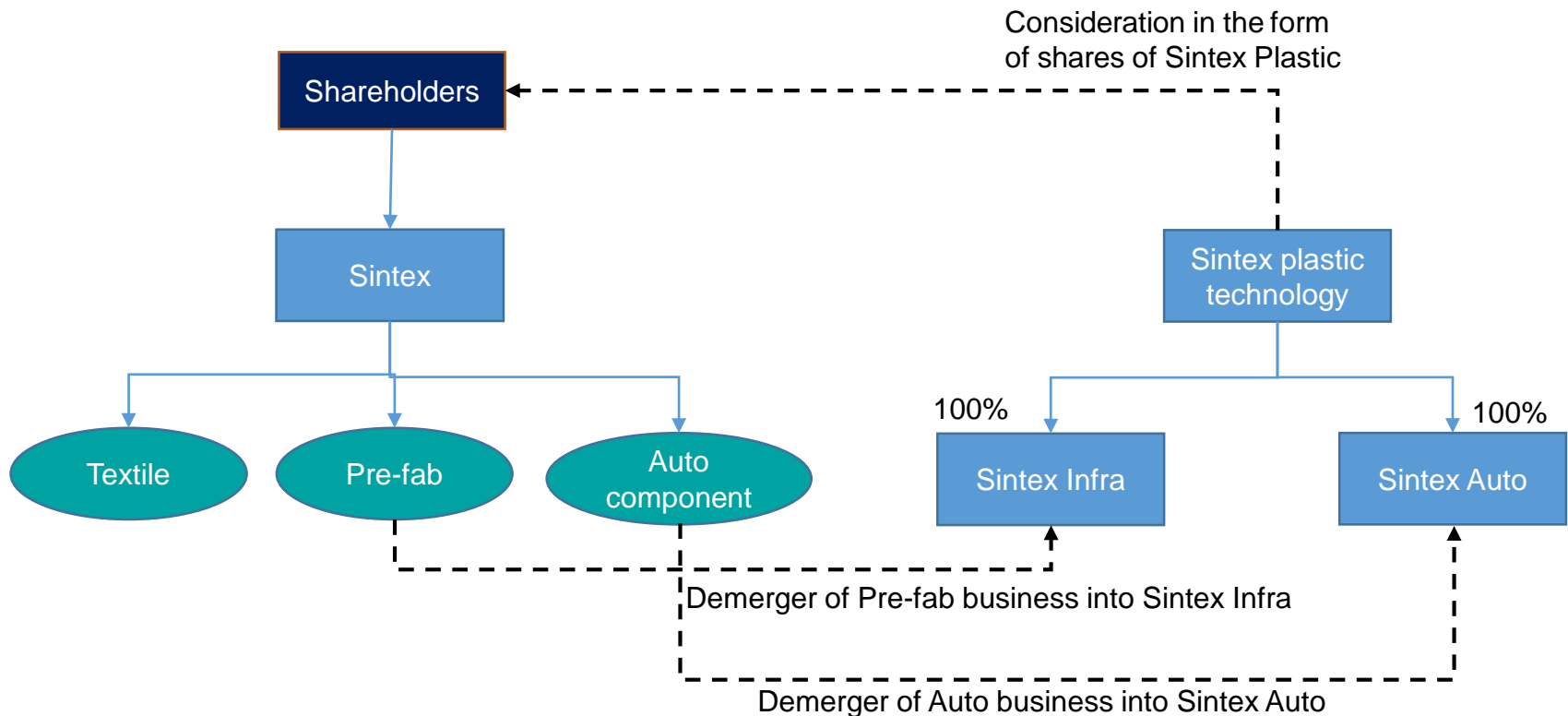
Question:

Whether demerger as per section 2(19AA)?

“Resulting company” means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and

the resulting company in consideration of such transfer of undertaking, issue shares to the shareholders of the demerged company

Demerger - A Case Study



The undertakings were transferred to Sintex Infra and Sintex Auto but shares were issued by the holding company i.e. Sintex plastic technology under section 2(41A) of the IT Act

Demerger - Tax Consideration



In the hands of	Taxability / Treatment	Section	Conditions / Remarks
Demerged Company	No capital gains tax on transfer of assets	47(vib)	Resulting company should be an Indian company
Shareholders of Demerged Company	No capital gains tax on receipt of shares from the resulting company	47(vid)	
Cost of Assets for Resulting Company: - Depreciable Assets - Capital Asset	= WDV of depreciable asset to be the same as WDV in the hands of the Demerged Company = No specific provision for cost of Capital Asset acquired	- Expln 7A to 43(1) - Expln 2B to 43(6)(c) - 49(1)	Resulting company should be an Indian company
Cost of acquisition of shares received on demerger by the shareholders	= Cost of acquisition of shares in demerged company be split on the basis of net book value of the assets transferred bearing to the Net worth of the Demerged Company immediately before such demerger	49(2C)	

Demerger - Tax Consideration



In the hands of	Taxability / Treatment	Section	Conditions / Remarks
Period of holding of shares received on demerger by the shareholders	Includes period of holding of shares held in the demerged company	Explanation 1(i)(g) to Section 2(42A)	
Period of holding of capital assets	Includes period of holding of capital assets held in the demerged company	Expln 1(i)(b) to 2(42A) r.w.s. 49(1) and 47(vib)	

Demerger - Tax Consideration



Cost split up in the hands of shareholders

- **“Cost of acquisition of shares of resulting company”** [Section 49(2C)]

$$\begin{aligned} &= \text{Cost of acquisition of shares} && \text{Net book Value of the assets} \\ &\text{in demerged Company} && \text{transferred in the demerger} \\ & && \hline & && \text{Net worth of the demerged} \\ & && \text{company before the demerger} \end{aligned}$$

- **“Cost of acquisition of the original shares held by the shareholders in the demerged company”** [Section 49(2D)]

= Cost of acquisition of shares in demerged company – cost of acquisition of shares of resulting company arrived at under section 49(2C)

- **“Net worth”** is defined as the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger

Whether the definition of Net worth is to be interpreted strictly to include only ‘General Reserve’?

How does the above formula work in case where a negative net-worth undertaking is transferred?

MAT Credit, Goodwill and Section 56 - Merger/Demerger



MAT Credit

- MAT payable on book profits in the absence of Nil / lower tax profits
- Credit for MAT allowable to the assessee company who has paid such taxes
- Amalgamating company ceases to exist after amalgamation
- No specific provision in the IT Act for carry forward of MAT credit in case of amalgamation or demerger. However, Mumbai ITAT* and Ahmedabad ITAT** have endorsed a favorable view in case of amalgamation and demerger (proportionate basis) respectively

Goodwill

- Excess consideration paid over the value of the net assets taken over from the Transferor Company may be considered as Goodwill arising on amalgamation
- Further, goodwill is an intangible asset u/s 32(1)(b) of the Act and depreciation on goodwill should be allowable under this section - *CIT vs Smifs Securities Limited [TS-639-SC-2012]*

Section 56

- No implications on receipt of properties in the hands of the Transferee Company/Resulting Company pursuant to amalgamation or demerger - Clause (IX) to the proviso of Section 56(2)(x)

* SKOL Breweries Ltd vs ACIT [2008] 28 ITATINDIA 998 (Mum)

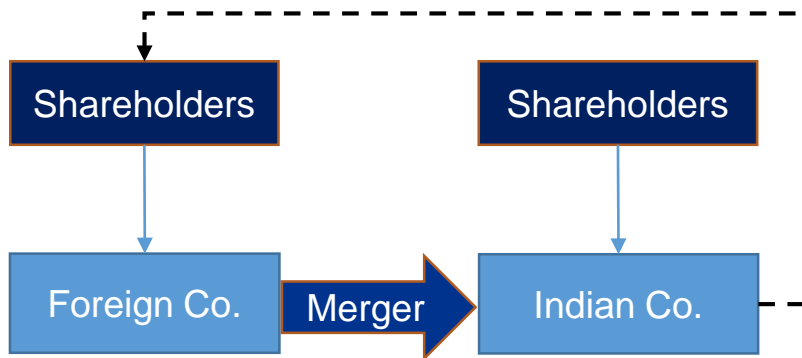
** Adani Gas Ltd. v. ACIT (ITA Nos. 2241 & 2516/Ahd/2011)

Cross Border Merger

Cross Border Merger

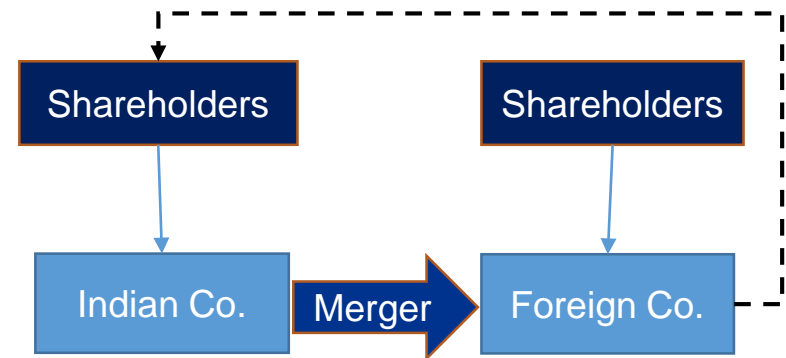


Consideration in the form of shares of Indian Co.



Inbound Mergers are mergers wherein a foreign company merges with an Indian company

Consideration in the form of shares of Foreign Co.



Outbound Mergers are mergers wherein an Indian company merges with a foreign company

Challenges in Cross Border Merger *(still some path to cross...)*



Inbound Merger

Outbound Merger

Treatment of accumulated losses of foreign company

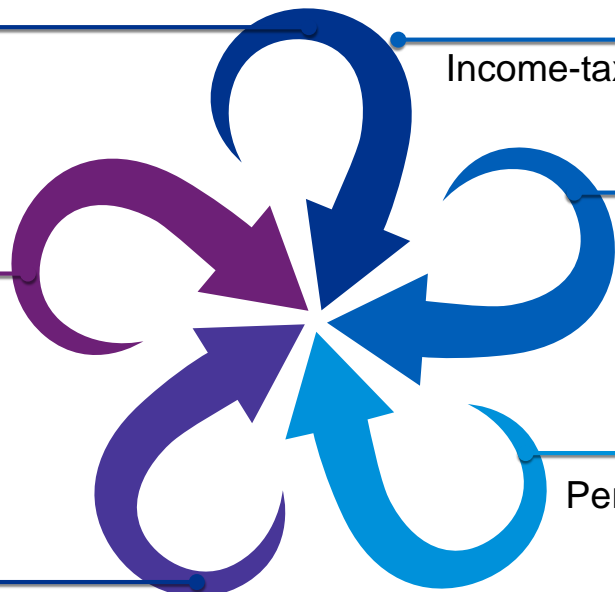
Income-tax exemption not available

Indian amalgamated co to comply with FEMA Cross border merger regulations

Issue of shares to resident only up to LRS

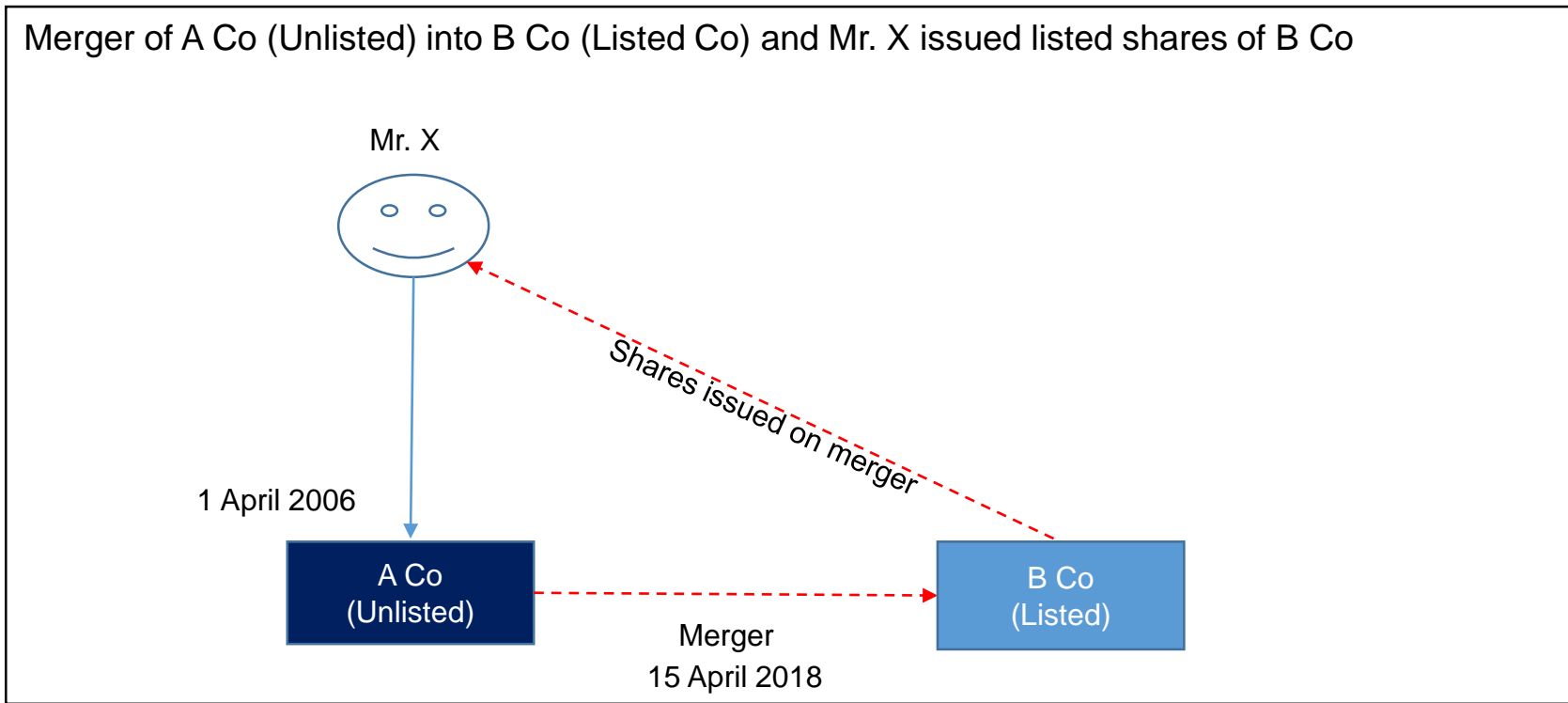
Permanent Establishment risk

Round tripping issue



Case Studies on Merger and Demerger

Case study 4

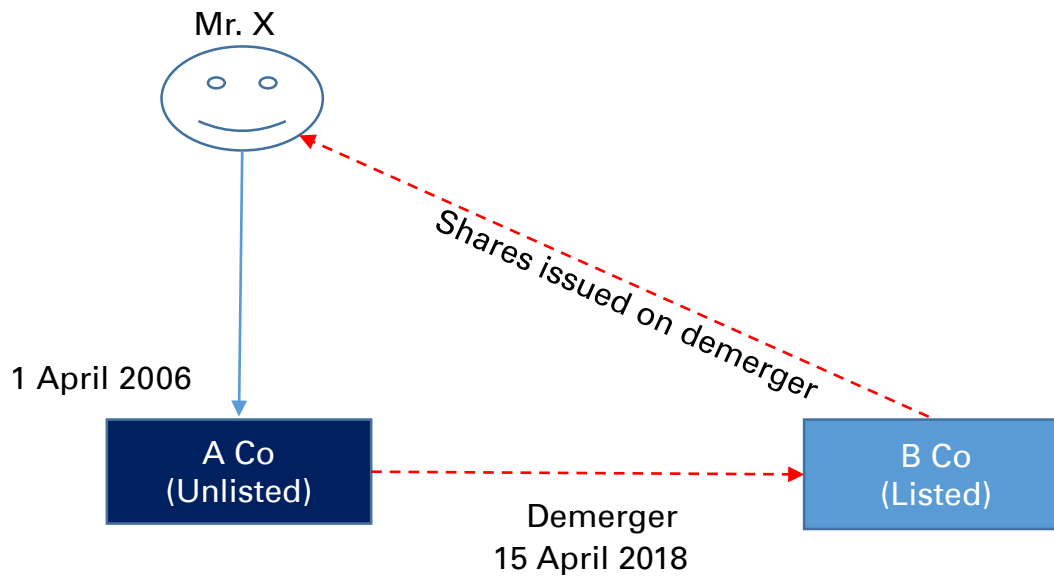


What will be the cost of acquisition of B Co.'s shares in the hands of Mr. X ?

Case study 5



Demerger of A Co (Unlisted) into B Co (Listed Co)

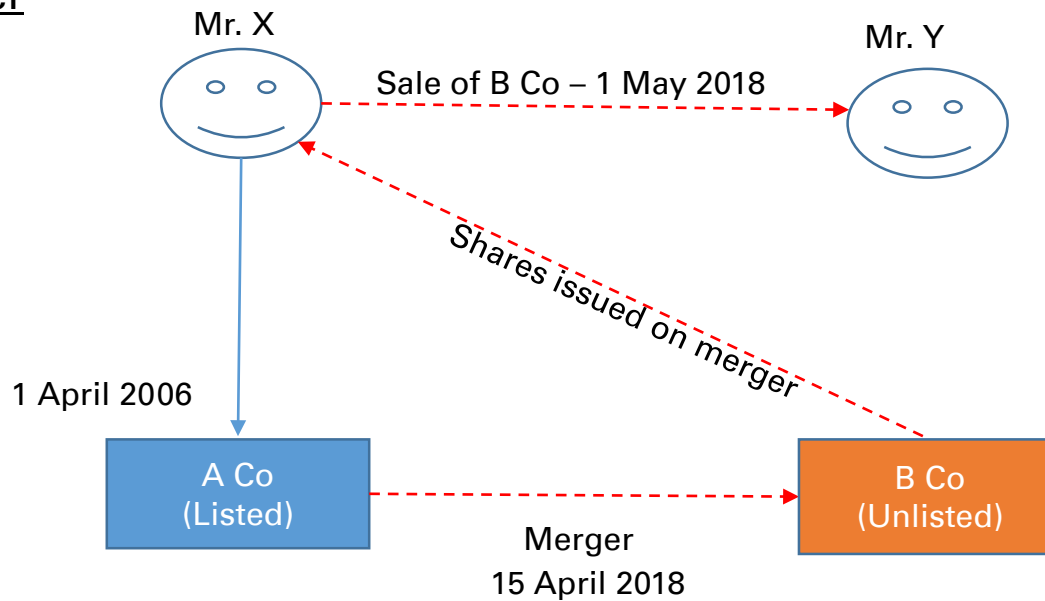


How the cost of acquisition of shares of B Co. in the hands of Mr. X would be computed?

Case study 6



Merger of A Co (Listed) into B Co (Unlisted) and B Co getting listed pursuant to merger

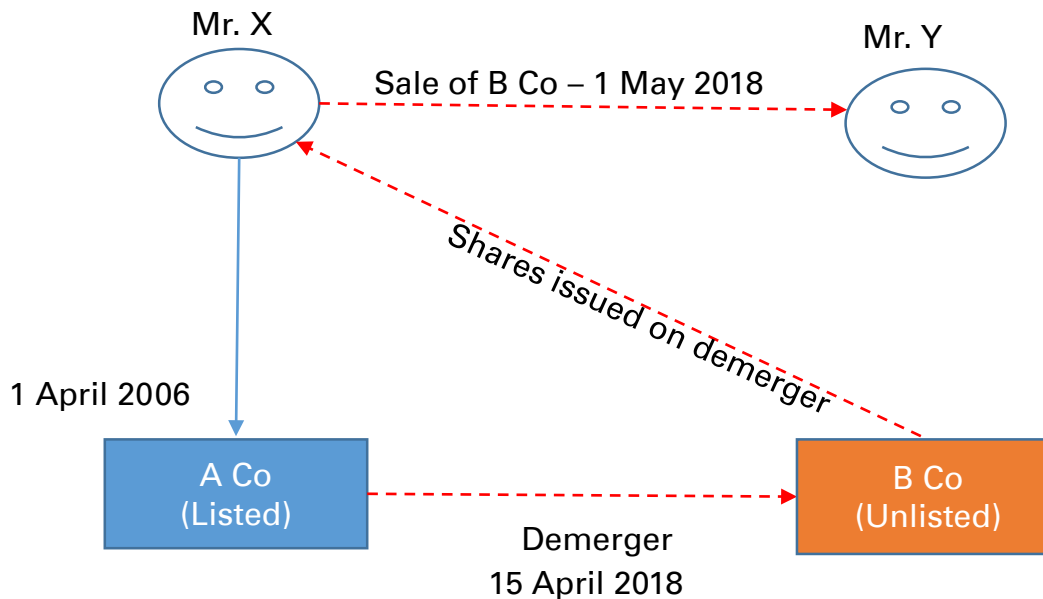


What will be the cost of acquisition of A Co.'s shares in the hands of Mr. X ?

Case study 7



Demerger of A Co (Listed) into B Co (Unlisted) and subsequent listing of B Co

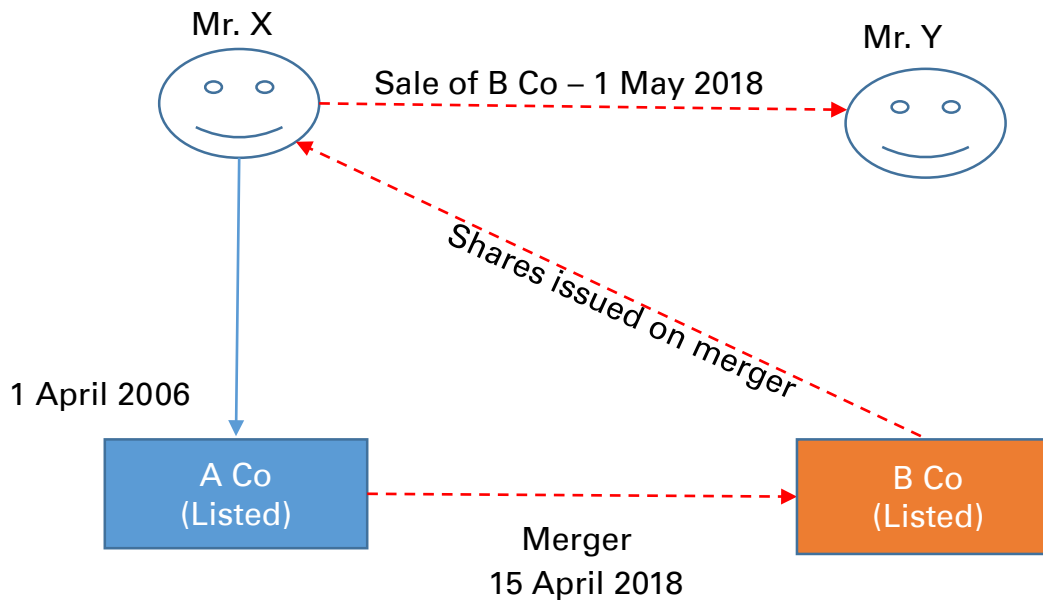


How the cost of acquisition of shares of A Co. in the hands of Mr. X would be computed?

Case study 8

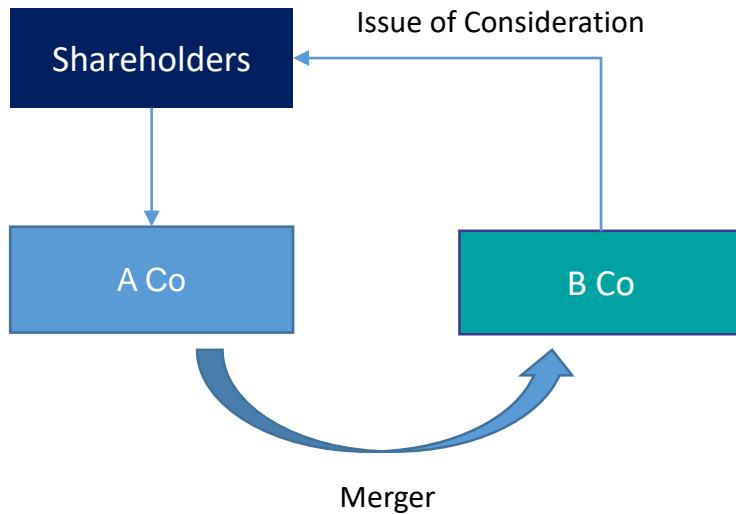


Merger of A Co (Listed) into B Co (Listed)



What will be the cost of acquisition of A Co.'s shares in the hands of Mr. X ?

Case study 9



- A Co. and B Co are related parties;
- The consideration paid by the B Co. is more than the fair value of net assets of A co.
- B Co. recorded the difference between the consideration and the fair value of net assets of A co. as “Goodwill”

Whether B co. can claim tax depreciation on the Goodwill arising pursuant to merger ?

Buy-back of Shares

Buy-back of Shares



Taxability provisions

[Section 115QA]

- From 1 June 2013, Buyback tax provisions were introduced on unlisted companies and exemption was provided to its shareholders, as buy-back tax was to be paid by the company
- Currently, buy-back of shares is taxable @ 23.296% (incl. of Surcharge & Cess) on the difference between buy-back consideration and amount which was received by the company for issue of such shares
- Buy-back provisions are not applicable to listed companies so gains on buy-back, if any, are taxable in hands of shareholder of the listed company

Other provisions

- In case of corporate shareholders, MAT may be applicable
- No deemed dividend implications on buyback [*Clause (iv) to section 2(22)*]
- Following issues are still unresolved:
 - No provisions of allowability of any expenses incurred during the buy back of shares by the Company have been introduced.
 - Benefit on account of indexation which the shareholders can opt for in case of normal scenario of sale of shares instead of buy-back.

Buy-back of Shares



Taxability in the hands of	Listed Shares				Unlisted Shares	
	Buyback through Stock Exchange Mechanism (subject to STT)		Buyback directly from Shareholders (Not subject to STT)			
	Equity Shares	Preference Shares	Equity Shares	Preference Shares	Equity Shares	Preference Shares
Company						
Liability of Buyback Tax	No	No	No	No	Yes	Yes
Shareholders						
Held more than 12 months (listed shares) / 24 months (unlisted shares) *	10% (gains exceeding INR 1 lakh)	20% (with indexation) 10% (without indexation)		Exempt u/s 10(34A)		
Held upto 12 months (listed shares) / 24 months (unlisted shares) *	15%	As per slab rates				

* Plus applicable surcharge and cess

Capital Reduction

Capital Reduction of Shares



Tax implications in the hands of the company

- Distribution to shareholders by a Company on the reduction of its capital is deemed as dividend to the extent to which the Company possesses accumulated profits, whether capitalized or not
- Deemed dividend u/s 2(22)(d) is subject to Dividend Distribution Tax u/s 115-O of the IT Act

Tax implications in the hands of the shareholders

- Reduction of share capital by a company and pro-rata distribution of cash / assets to the shareholders amount to transfer and therefore, taxable as capital gains
- For determining the amount liable to capital gain tax, full value of consideration is reduced by the amount, which has been reckoned as dividend

Other provisions

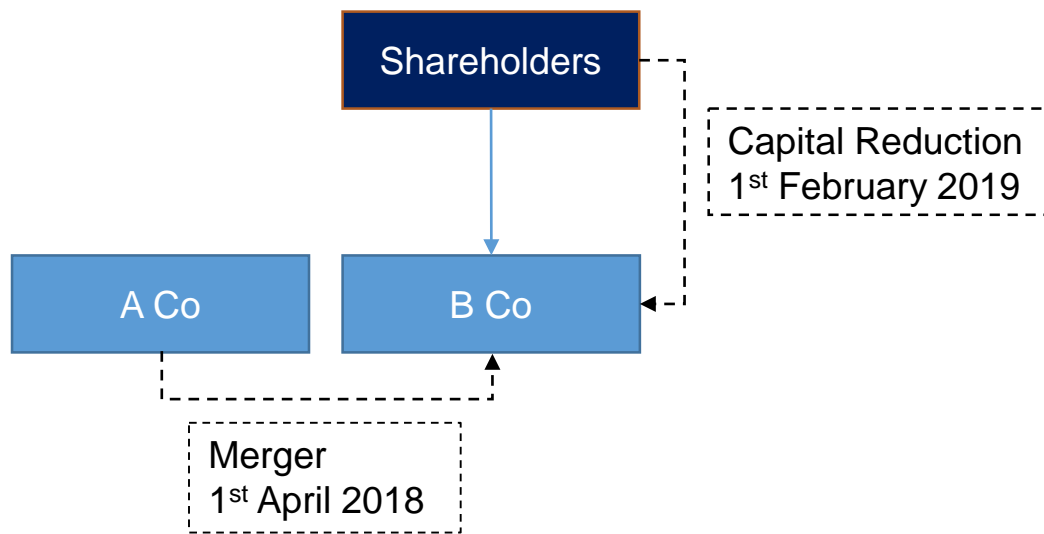
- Capital loss on account of capital reduction in the hands of the shareholders not involving payment of any consideration cannot be allowed under the provisions of IT Act. [*Bennett Coleman & Co. Ltd. v. The Addl. CIT (ITA No 3013/MUM/2007)*]
- As there is no receipt of shares by the company, Section 56(2)(x) – Not Applicable

Impact of Explanation 2A of section 2(22)



Explanation 2A of section 2(22)

In case of an amalgamated company, the accumulated profits, whether capitalized or not, or loss, as the case may be, shall be increased by the accumulated profits, whether capitalized or not, of the amalgamating company on **the date of amalgamation**

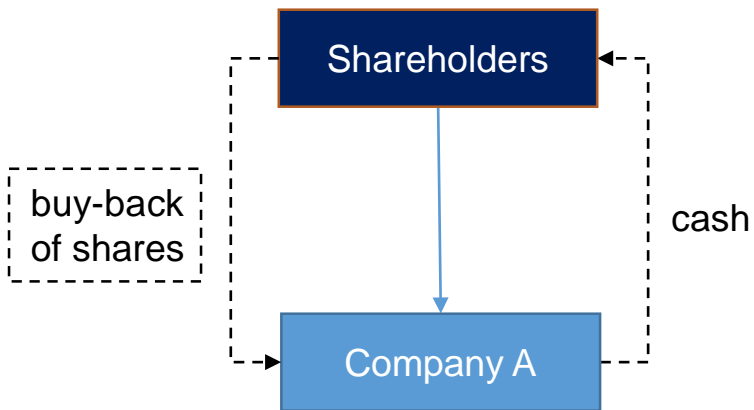


Particulars	INR
Accumulated Profit of A Co	420
Accumulated Profit of B Co	80
Total	500

Accumulated profit
for capital reduction

What if the merger had happened in 2017? Can accumulated profits of A Co. be considered at the time of capital reduction?

Case Study 10

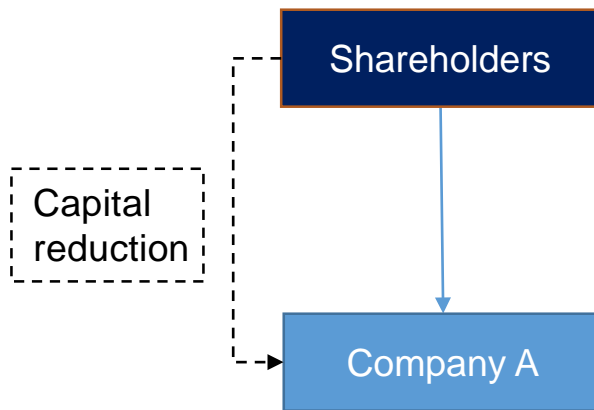


Facts of the case:

- Company A, an Indian unlisted company, undertakes buy back of its own shares
- Company A to buy back 20 lakh shares at Rs. 100/share. Fair market value of the same is Rs. 120/share
- Company A to pay cash as a consideration to the shareholders whose shares are being bought back

Will there be any tax implication u/s. 56(2)(x) of the IT Act in the hands of Company A?

Case Study 11

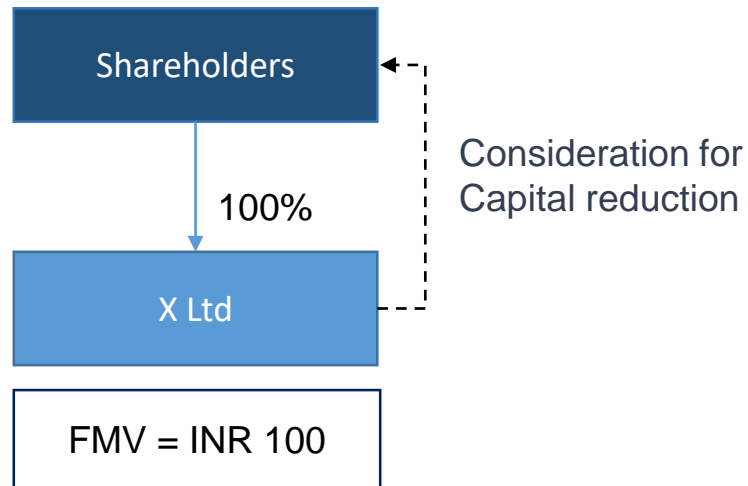


Facts of the case:

Company A, an Indian company, undertakes capital reduction against accumulated losses of the company and no cash is paid on capital reduction to the shareholders

What will be the taxability of loss on capital reduction in the hands of the shareholders?

Case Study 12



Whether Section 50CA applies in any of the below scenarios?

- Consideration paid on capital reduction is INR 150
- Consideration paid on capital reduction is INR 40
- Capital reduction is done at par value
- Capital reduction is done at NIL value

Key regulatory provisions governing mergers and demergers

SEBI / Stock Exchanges (only if listed company is involved)



- Listed Entities to comply with **Regulation 11, 37 and 94** of LODR for every Scheme of Arrangement proposed u/s 230 to 234 and Section 66 of CA 2013
- SEBI Circular dated March 10, 2017 (*as amended*) provides conditions and compliances by Listed Entities while undertaking Scheme of Arrangement
- WOS Merger/Demerger from WOS to parent – No SEBI/SE approval – Only intimation to SE
- Filing of Scheme of Arrangement by Listed Entities with NCLT only post receipt of observation letter or No objection letter (“Letter”) from SEs
 - Such Letter to be placed before Tribunal
 - Validity of Letter is 6 months from date of its issue
 - Submission of prescribed documents with SEs post sanction of Scheme



- Amalgamation / Demerger is regulated under section 230 to 234 of the Companies Act, 2013
- Approval of NCLT, MCA, RD, OL and other applicable authorities will be required
- One of the most important documents in the process is the Scheme of Amalgamation / Arrangement
- Apart from others, following clauses in the scheme requires specific attention :
 - Vesting of Assets and Liabilities
 - Consideration
 - Appointed date and Effective date
 - Accounting treatment
 - Conditionality



Finalizing the scheme of amalgamation / arrangement and other relevant documents



Board meetings & Audit committee meetings (as applicable) of all the companies



Filing of the scheme with the Stock Exchanges (in case of listed companies) and other regulators (as may be applicable)



Obtaining No-Objection Certificate from the Stock Exchanges and approvals from other regulators (as may be applicable)



Filing applications with NCLT



Hearing of the applications by the NCLT and NCLT shall give directions to convene the meeting of shareholders and creditors and to issue notices to regulatory authorities



Shareholders and creditors meeting and issuing notices to regulatory authorities



Filing petition



Admission of petition



Obtaining regulatory approval like RD, RoC, OL, etc. (as may be applicable)



Final hearing at NCLT



Filing Order with ROC



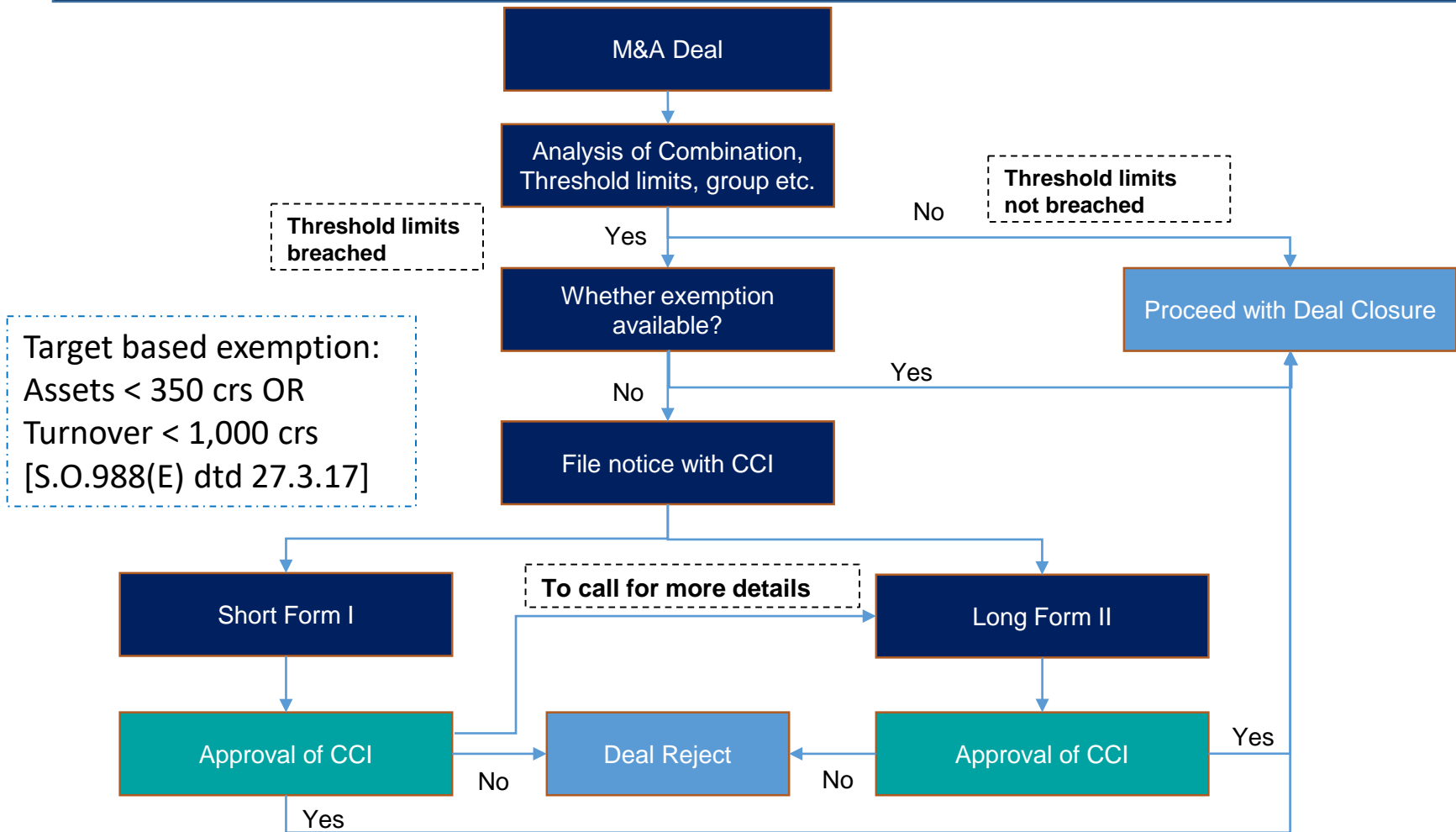
Stamp Duty implications on Merger / Amalgamation and Demerger

- Duty is payable in the States—
 - where order approving the scheme is passed; and
 - where the properties of transferor company are located
- Specific entry in the Schedule levying duty on NCLT order sanctioning amalgamation - *Maharashtra, Gujarat, Rajasthan, Haryana Karnataka, Andhra Pradesh*
- Article 25 (da) of Schedule 1 to Maharashtra Stamp Act, 1958 as below:
 - 10% of the market value of shares issued or consideration paid. However, the duty shall not exceed higher of:
 - 5% of the Market value of the property located within the state of Maharashtra or
 - 0.7% of the Market value of the shares issued
 - However, there is an overall cap of Rs. 25 crores in Maharashtra
- No specific entry in case of states other than the above
 - Depending on the state, possibility of mitigation of stamp duty could be explored through appropriate transfer mechanism

Competition Laws



Process Chart





Abbreviation	Expansion
CA 2013	Companies Act, 2013
CCI	Competition Commission of India
DDT	Dividend Distribution Tax
FDI	Foreign Direct Investments
GST	Goods & Service Tax
Hold Co	Holding Company
I-GAAP	Indian General Accepted Accounting Principles
Ind AS	Indian Accounting Standards
IT Act	Income-Tax Act, 1961
ITAT	Income Tax Appellate Tribunal
INR	Indian Rupees
LRS	Liberalized Remittance Scheme



Abbreviation	Expansion
LODR	SEBI(Listing Obligation and Disclosure Requirements) Regulations
M&A	Mergers & Acquisitions
NCLT	National Company Law Tribunal
OL	Official Liquidator
RD	Regional Directors
ROC	Registrar of Companies
RBI	Reserve Bank of India
Sub Co	Subsidiary Company
SE	Stock Exchange

Thank You