

Western India Regional Council of
The Institute of Chartered Accountants of India

International Taxation Refresher Course
June 26, 2020

Overview of Mergers & Acquisitions - International Tax, Legal and
Commercial Aspects

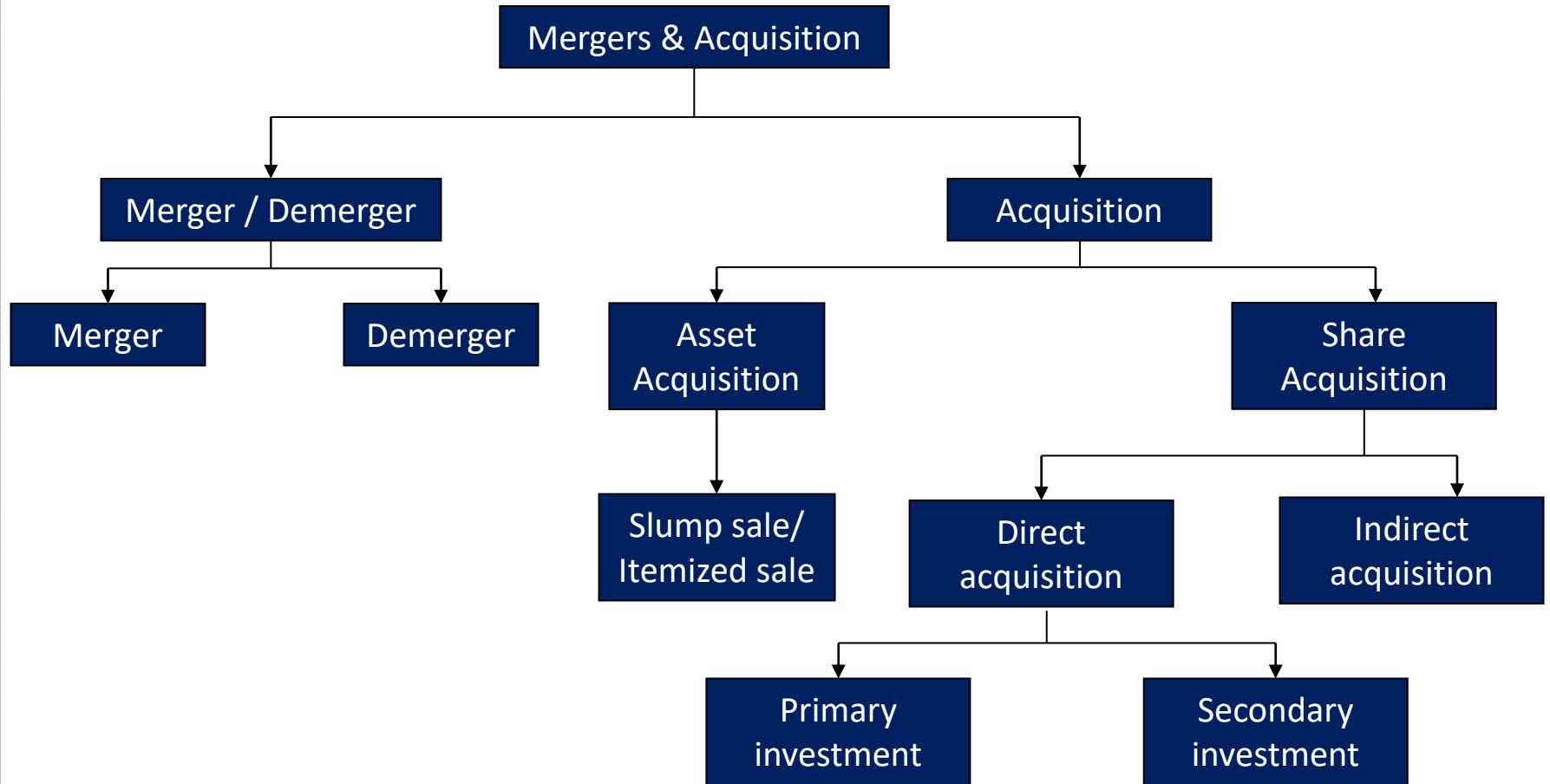
- CA. Uday Ved

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Overview

Modes of Mergers and Acquisitions

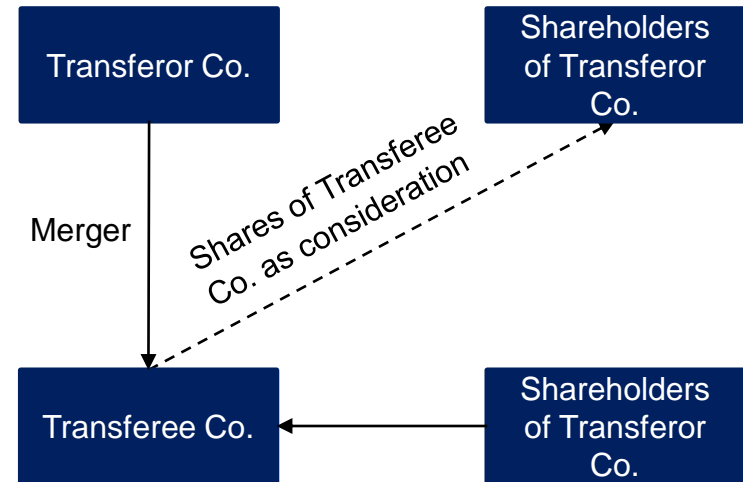


Mergers

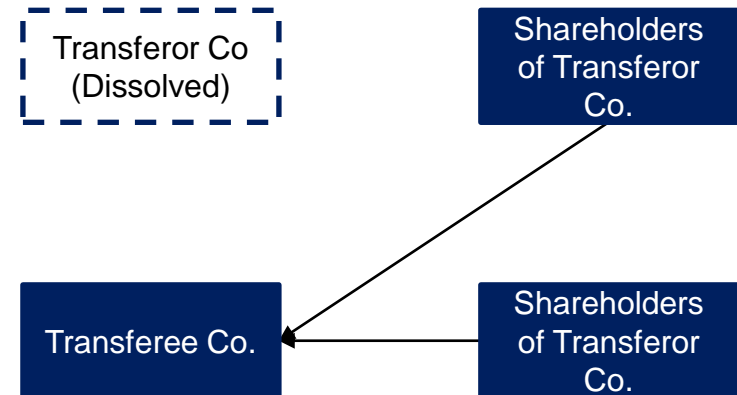
Meaning:

- Consolidation of two or more entities to form an amalgamated company
- NCLT driven process effected through a scheme of arrangement under the Companies Act, 2013 ('the Companies Act')
- Involves transfer of assets and liabilities from one or more transferor companies to a transferee company
- Consideration may be paid by way of the following to the shareholders of the transferor company:
 - Cash;
 - Shares of the transferee company (preferred)
- Merged company:
 - in inbound merger: Indian Co.
 - in outbound merger: Foreign Co.
- Time period of 6-8 months (variable)

Transaction structure:



Post transaction:

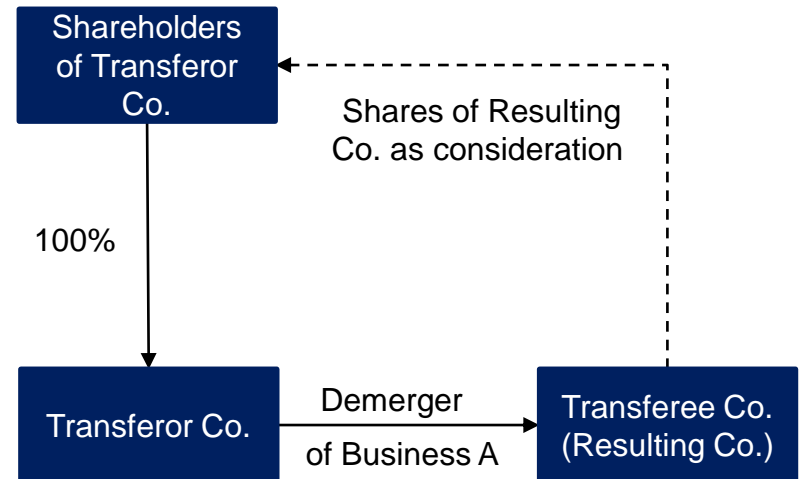


Demergers

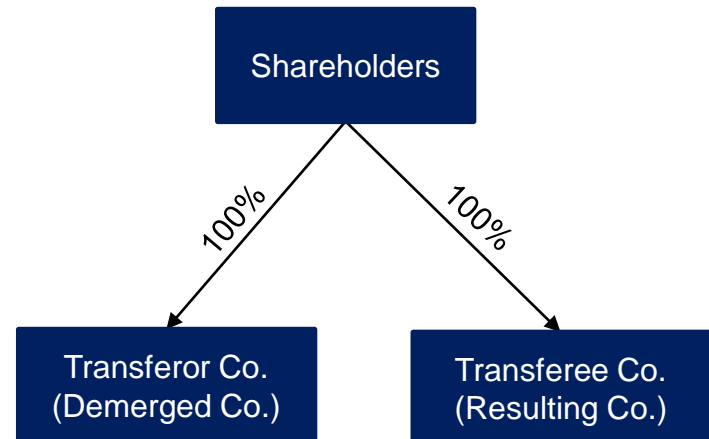
Meaning:

- Involves transfer of undertaking from one company to another (demerged company to resulting company)
- NCLT driven process effected through a scheme of arrangement under the Companies Act
- For consideration, resulting company issues it's own shares to shareholders of demerged company
- Time period of 6-8 months (variable)

Transaction structure:



Post transaction:



Asset acquisition

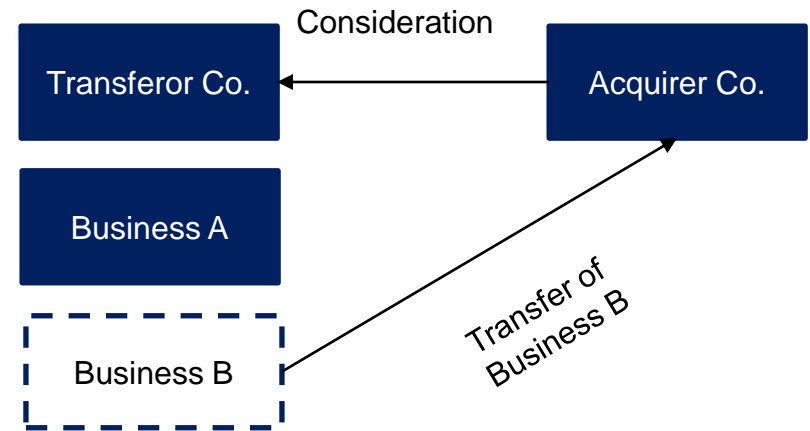
Acquisition of business on a going concern basis:

- Recognised as 'slump sale' under tax laws;
- Transfer of business undertaking on a going concern basis for lump sum consideration;
- Consideration in form of cash, shares or other instruments of the acquirer;
- Values not to be assigned to individual assets / liabilities – no 'cherry picking', business to be transferred lock stock barrel;
- Effected through business transfer agreement ('BTA').

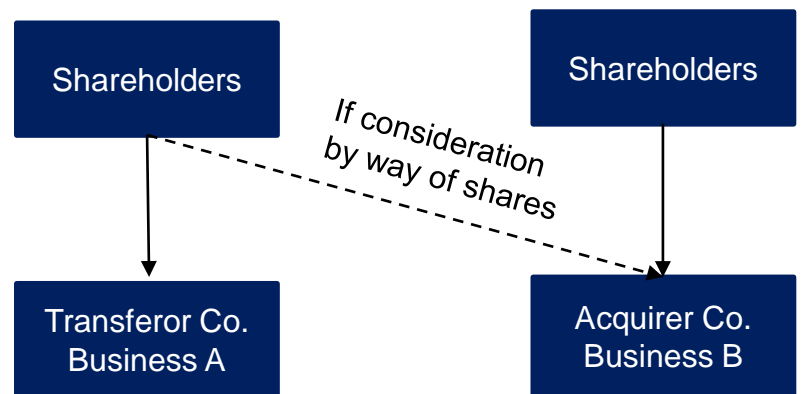
Acquisition of individual assets:

- Assets acquired individually; assets could be cherry picked;
- Individual values for each asset assigned.

Transaction structure:



Post transaction:



Share acquisition

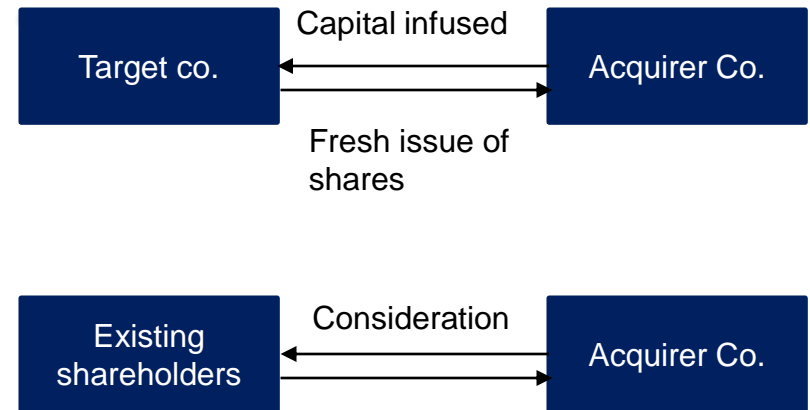
Direct acquisition:

- Acquisition by way of:
 - Primary investment;
 - Secondary investment;
- Primary investment – fresh issue of shares by target co.;
- Secondary investment – transfer of shares by existing shareholders for cash / shares of acquirer co. or other instruments;
- Secondary investment effected by way of share purchase agreement ('SPA').

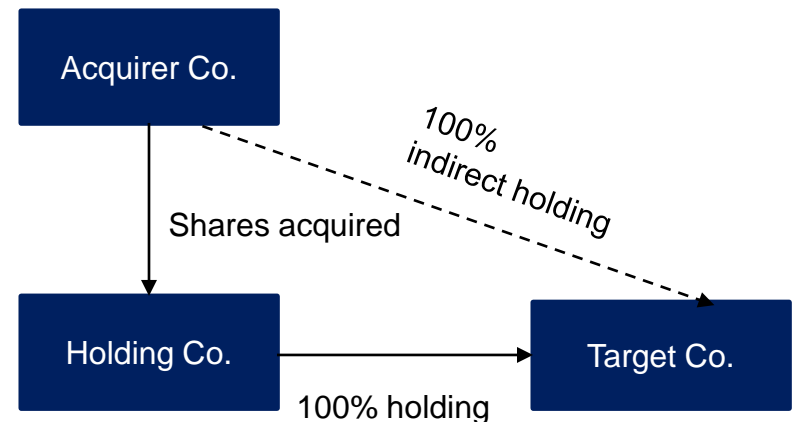
Indirect acquisition:

- Acquisition of shares of company holding shares of target co.

Direct acquisition:



Indirect acquisition:



Key relevant provisions

Income tax

Key relevant provisions under the Income Tax Act, 1961 ('the IT Act'):

- **Tax neutral merger – conditions as prescribed under section 2(1B) of the IT Act**
 - All the property and liabilities of the transferor co. become that of transferee company by virtue of merger;
 - Shareholders holding not less than 3/4th in value of shares become shareholders of the amalgamated co.;
 - Amalgamated company is an Indian company [section 47(vi)].
- **Tax neutral demerger – conditions as prescribed under section 2(19AA) of the IT Act**
 - All the property and liabilities related to the undertaking become that of resulting company by virtue of demerger;
 - All the property and liabilities are transferred at book value immediately before the demerger;
 - Resulting co. issues shares to the shareholders of the demerged co. as consideration;
 - Shareholding holding not less than 3/4th in value of shares become shareholders of resulting company ;
 - Transfer of undertaking on going concern basis;
 - Demerger is in accordance with conditions notified if any, under section 72A(5);
 - Resulting Company is an Indian Company [Section 47(vib)].
- **Slump sale – conditions as prescribed under section 2(42C) of the IT Act**
 - Transfer of an undertaking on going concern basis;
 - Transfer for a lump sum consideration;
 - No values to be assigned to individual assets and liabilities.

Income tax

- **Undertaking – Explanation 1 to section 2(19AA) of the IT Act**
 - Shall include any part of an undertaking, or a unit or division of an undertaking or entire business activity but does not include individual assets or liabilities or combination thereof.
- **Transactions not regarded as transfers – section 47 of the IT Act**

Clause	Transaction
(iv)	Transfer from parent company to its WOS, provided that the WOS is an Indian company
(v)	Transfer from WOS to its parent company, provided the parent company is an Indian company
(vi)	Transfer of capital asset by amalgamating co. to the amalgamated co. if the amalgamated co. is an Indian company
(via)	Transfer of capital asset being shares held in Indian co. by amalgamating foreign co. to the amalgamated foreign co., if – <ul style="list-style-type: none"> • At least 25% of the shareholders of the amalgamating foreign co. continue to remain shareholders of the amalgamated foreign co.; • Transfer does not attract capital gains tax in the country in which the amalgamating co. is incorporated.
(viab)	Transfer of capital asset being shares of foreign co. referred to in Explanation 5 to Section 9(1)(i) of the IT Act (indirect transfer provisions) to the amalgamated foreign co. if conditions as mentioned above are fulfilled.

Income tax

- **Transactions not regarded as transfers – section 47 of the IT Act (Cont...)**

Clause	Transaction
(vib)	Transfer of capital asset of demerged co. to the resulting co., if the resulting co. is an Indian co.
(vic)	Transfer of capital asset being shares held in Indian co. by demerged foreign co. to the resulting foreign co., if – <ul style="list-style-type: none"> • Shareholders holding not less than 3/4th in value of shares of the demerged foreign co. continue to remain shareholders of the resulting foreign co.; • Transfer does not attract capital gains tax in the country in which the demerged co. is incorporated.
(vid)	Transfer or issue of shares by resulting co. to the shareholders of the demerged co., if the transfer or issue is in lieu of consideration for demerger
(vii)	Transfer by a shareholder of capital asset being shares of amalgamating co. if – <ul style="list-style-type: none"> • Transfer is made in consideration of the allotment to him the shares of amalgamating co. (except where amalgamated co. is itself a shareholder); • Amalgamated co. is an Indian company.

*Transfer between WOS and parent company shall be tax neutral subject to holding-subsidary relationship exists for 8 years [section 47A of the IT Act]

Income tax

- **Tax computation under slump sale – section 50B of the IT Act**
 - Cost of acquisition to be equivalent to net worth of the undertaking i.e. aggregate of total value of the assets reduced the by the liabilities appearing the books;
 - The aggregate value of assets shall be as under –
 - For depreciable assets, WDV of the assets computed in accordance with section 43(6);
 - For capital assets in respect of which whole of expenditure allowed / allowable under section 35D, 'Nil';
 - For other assets, value as appearing in the books.
- **Section 50C and 50CA of the IT Act**
 - If land or unquoted shares transferred at less than stamp duty value ('SDV') / fair market value ('FMV'), SDV or FMV to be regarded as cost of acquisition.
- **Section 56(2)(viib) of the IT Act**
 - Issue price higher than the FMV, difference to be taxable in the hands of the company issuing shares;
 - Applicable to companies in which public not substantially interested;
 - Applicable if shares issued to resident.
- **Section 56(2)(x) of the IT Act**
 - Receipt of 'property' for consideration less than FMV, difference taxable in hands of the recipient;
 - Exemption provided to merger / demerger covered under section 47;
 - Exemption provided to various other transactions covered under section 47.

Income tax

- **Section 72A of the IT Act**
 - Carry forward and set-off accumulated losses and unabsorbed depreciation in case of qualifying merger / demerger permitted.
- **Section 79 of the IT Act**
 - Carry forward and set-off losses shall not be allowed in case of change in more than 49% shareholding;
 - Applicable to companies in which public are not substantially interested;
 - Not applicable to unabsorbed depreciation.
- Buy-back of shares by domestic Indian company from shareholders – company to pay additional tax of 20% (plus surcharge and cess as applicable) [section 115QA of the IT Act]. Buy-back income exempt in the hands of shareholders [section 10(34A) of the IT Act].
- Capital reduction – income distributed on account of capital reduction to the extent of accumulated profits deemed as dividend under section 2(22)(d) of the IT Act. Reduction of capital could be subject to tax in hands of shareholders as capital gains.

- **Foreign direct investments in India**
 - Governed by Foreign Exchange Management (Non-Debt Instrument) Rules, 2019 ('NDI rules');
 - NDI rules were introduced in year 2019 and replaced the following regulations:
 - Foreign Exchange Management (Transfer of Issue of Security by a Person Resident outside India) Regulations, 2017; and
 - Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018;
 - Permits investments in prescribed non-debt instruments of an Indian company / LLP subject to entry routes, pricing guidelines, sectoral caps and other conditions mentioned therein;
 - NDI rules continue to provide relaxation to NRI / OCI to invest on non-repatriable basis i.e. entry routes, sectoral cap, pricing guidelines, etc. shall not apply.
- **Overseas direct investments**
 - Governed by Foreign Exchange Management (Transfer or Issue of any foreign security) Regulations, 2004 ('ODI regulations');
 - Permits resident individuals and Indian party (company, partnership firm, LLP or any other body incorporated under the Act of Parliament) subject to specified thresholds;
 - Divestment in overseas investments with or without write-off permitted subject to conditions specified therein.

FEMA

Foreign Exchange Management (Cross Border) Regulations, 2018

Inbound Merger

Particulars	Key aspects
FDI	<ul style="list-style-type: none">• NDI rules viz. pricing guidelines, entry routes, sectoral caps, etc. to apply
ODI	<ul style="list-style-type: none">• In case foreign subsidiary is getting merged into Indian parent Co., Indian Co. to comply with ODI disinvestment provisions
Representative branch outside India	<ul style="list-style-type: none">• Premises of Foreign Transferor Co deemed to be a branch office of Indian Transferee Co and guidelines prescribed under FEMA 10 (R) will apply
Liabilities and borrowings	<ul style="list-style-type: none">• ECB guidelines to be evaluated before such acquisition• Foreign loan / guarantees acquired pursuant to merger to comply with ECB and guarantees regulations• End use condition shall not apply• No remittance from India for repayment permitted within 2 years
Assets held outside India	<ul style="list-style-type: none">• Immovable property held outside India of Foreign Transferor Co can be held by Indian Transferee Co if permissible under FEMA• If Indian Transferee Co. not permitted to hold any liability / borrowing / asset outside India, the same may be extinguished / sold within 2 years
Foreign currency bank account	<ul style="list-style-type: none">• Indian Transferee Co. permitted to open/ maintain FCY bank A/c outside India for putting through transactions incidental to the cross border merger for a maximum period of 2 years.

FEMA

Foreign Exchange Management (Cross Border) Regulations, 2018

Outbound Merger

Particulars	Key aspects
ODI	<ul style="list-style-type: none">Foreign Transferee Co, may issue securities to shareholders of Indian Transferor Co. in compliance with ODI regulations;For individual shareholders: FMV of such securities to be within LRS.
Place of business in India	<ul style="list-style-type: none">Premises of Indian Transferor Co deemed to be a branch office of Foreign Transferee Co.;FEMA regulations concerning LO / BO / PO to apply;Restriction on manufacturing business by Branch Office.
Liabilities and borrowings	<ul style="list-style-type: none">Premises of Foreign Transferor Co deemed to be a branch office of Indian Transferee Co and guidelines prescribed under FEMA 10 (R) will apply
Assets held in India	<ul style="list-style-type: none">Loan / guarantees transferred to Foreign Transferee Co to be repaid as per scheme approved by NCLT;NOC to be obtained from lender;Foreign Transferee Co not permitted to acquire any liability towards a lender in India in INR that is not permitted under FEMA;
Special non-resident rupee ('SNRR') account	<ul style="list-style-type: none">Foreign Transferor Co. permitted to open / maintain SNRR bank A/c in India Foreign Exchange Management (Deposit) Regulations, 2016 for putting through transactions incidental to the cross-border merger for a maximum period of 2 years

Foreign Exchange Management (Cross Border Merger) Regulations, 2018:

Miscellaneous points for Inbound and Outbound Mergers

Valuation

- To be valued as per Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 ('the Companies (CAA) Rules')

Compensation

- Payment of compensation to shareholder of the Indian Co. / Foreign Co. to be in accordance with the Scheme sanctioned by the NCLT

Regularization of non-compliances:

- Companies to ensure completion of required regulatory actions with respect to non-compliance, contravention and violation of FEMA provisions prior to merger

Deemed approval

- Transaction undertaken in accordance with these Regulations to be deemed to have prior approval by RBI (as required under provisions of Companies Act)
- Certificate from MD / Whole Time Director and CS, ensuring compliance with these Regulations to be furnished along with the application made to NCLT

Companies Act

Cross Border Mergers under the Companies Act:

- MCA notified **Section 234** of the Companies Act on April 13, 2017
- Section 234 of the Companies Act permits cross border mergers or amalgamations of an Indian company with a foreign company (incorporated in countries as notified by the Central Government) and vice-versa.
- MCA also amended the – **insertion of a new Rule 25A**
- Rule 25A of Companies (CAA) Rules *inter alia*, provides that cross border mergers and amalgamations would be permitted on fulfilment of following conditions:
 - On obtaining prior approval* of the Reserve Bank of India ('RBI');
 - After complying with the provisions of section 230 - 232 of the Companies Act.
- All other rules laid down in Companies (CAA) Rules have to be followed *mutatis mutandis* for cross border mergers and amalgamations

*Deemed approval under FEMA regulations

SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011

- SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 ('the Takeover Regulations') incorporated to regulate hostile takeovers and protection of minority interest – last amended in September 2018;
- The Takeover Regulations address critical issues:
 - open offer triggering event;
 - offer size;
 - indirect acquisitions;
 - exemptions from open offer obligations;
 - offer price calculations, etc.;
- **Applicability:**
 - Direct and indirect acquisition of shares or voting rights / control over a target company that is listed on a recognized stock exchange;
 - Direct acquisition – Directly acquiring shares / voting rights / control over the target company;
 - Indirect acquisition – Indirect acquisition is one that would enable any person to exercise or direct the exercise of voting rights / control over the target company.

if along with his shareholding in Person Acting in Concert ('PAC')) exceeds 25% or acquisition of more than 5% if the acquirer holds 25% or more in the target company but less than the maximum permissible non-public shareholding;
- The Takeover Regulations provide exemption from open offer obligation in specific cases.

Inbound merger

Inbound merger

Income tax:

- Conditions of 'amalgamation' to be met [defined in section 2(1B) of the IT Act]
- Tax neutral transfers:
 - Transferor company's perspective: Transfer of capital assets from foreign transferor company to an Indian transferee company exempt [section 47(vi) of the IT Act];
 - Shareholders perspective: Transfer of shares of the transferee company in exchange for shares of the transferor company exempt [section 47(vii) of the IT Act];
- Carry forward of losses in case of qualifying merger permissible [Section 72A of the IT Act];
- If not a qualified merger, capital gain tax, 50C, 50CA and 56(2)(x) of the IT Act implications to be evaluated;
- Legal process of merger involves NCLT route which involves obtaining a NOC from the Income tax authorities; Strong business rationale for merger to be adequately documented;
- Misc. considerations: Expenditure incurred in connection with amalgamation [35DD of the IT Act], written down value and depreciation on assets taken over;

FEMA:

- Governed by Foreign Exchange Management (Cross Border Merger) Regulations, 2018:
 - Pricing guidelines, entry routes, sectoral caps, attendant conditions, prohibited sectors, governed by NDI rules;
 - If an inbound merger results into holding of a subsidiary / branch office / liaison office / project office outside India, respective FEMA regulations to be complied with;

Inbound merger

FEMA (Cont.):

- If foreign Transferor co. has existing borrowings / loans / guarantees outside India – Indian transferor company to comply with External Commercial Borrowing ('ECB') guidelines:
 - No remittance from India within 2 years;
 - End use condition not to apply;
- Immovable properties of foreign Transferor Co. located outside India can be continued to be held by Indian Transferee Co. if permitted under respective FEMA regulations [Notification No. FEMA 7(R)/2015-RB dated January 21, 2016];
 - When asset / security outside India not permitted to be held, asset / security to be sold within 2 years from the date of sanction of the Scheme by NCLT & sale proceeds to be repatriated immediately;
 - Where liability outside India not permitted to be held, it may be extinguished from the sale proceeds of such overseas assets within 2 years.
- Transferor Co permitted to open/ maintain FCY bank a/c outside India for putting through transactions incidental to the cross border merger for a maximum period of 2 years;
- Requisite FEMA filings to be complied with:
 - Form FCGPR to be submitted within 30 days of issue of shares;
 - In case foreign subsidiary is getting merged into the Indian parent company – reporting of disinvestment required in Form ODI;
 - Other FEMA filings as a result of resultant structure (overseas JV / WOS / Branch office / Liaison office / Project office coming into existence).

Inbound merger

Companies Act:

- Regulated section 230 to section 232 and section 234 of the Companies Act and the Companies (CAA) Rules;
- Merger or amalgamation with foreign company permitted by and in accordance with section 234 of the Companies Act ;
- Rule 25A of the Companies (CAA) Rules permits an inbound merger after obtaining prior approval of the RBI¹ and after complying with provisions of section 230 to section 232 of the Companies Act;
- Process to be followed as per section 230 – section 232 of the Companies Act and Companies (CAA) Rules – NCLT approved process, involves meeting of shareholders and creditors, conducting valuation of companies, obtaining NOC from ROC, Regional Director and various statutory authorities like income tax authorities, SEBI etc.;
- Appointed date of amalgamation is the date mentioned in the Scheme with effect from which the amalgamation takes place;
- Forms as provided in the Companies (CAA) Rules to be carefully drafted and submitted within prescribed timelines;
- Merger to be effected through an order of the NCLT;
- Effective date is the date on which the Court order sanctioning the Scheme is filed with the ROC concerned.

1. Deemed approval under FEMA

Outbound merger

Outbound merger

Income tax:

- No tax exemptions under section 47 of the IT Act;
- Indian transferor co.'s perspective: Capital gains tax implications in the hands of the transferor co.;
- Shareholders of Indian transferor co.'s perspective: Capital gains tax implications (in respect of exchange for shares of the Foreign transferor Co.) in the hands of the shareholders of transferor Co.;
- Foreign transferee co. required to obtain PAN, TAN and undertake other relevant statutory and regulatory compliances in India;

FEMA:

- Governed by Foreign Exchange Management (Cross Border Merger) Regulations, 2018;
 - **ODI:** Indian Transferor Co. merging into Foreign Transferee Co., may issue securities to shareholders of Indian Transferor Co. in compliance with ODI regulations. If shareholders are individuals, then fair market value of such securities should be within limits provided by LRS
 - **Place of business in India:** Premises of Indian Transferor Co deemed to be a branch office of Foreign Transferee Co and FEMA LO/BO/PO guidelines will apply – Restriction on manufacturing business by branch

Outbound merger

FEMA (Cont.):

➤ Liabilities & borrowings:

- Outstanding Loan / guarantees transferred to Foreign Transferee Co to be repaid as per scheme approved by NCLT;
- NOC to be obtained from lender.
- Foreign Transferee Co. not permitted to acquire any liability towards a lender in India in INR that is not permitted under FEMA

➤ Assets held in India:

- Immovable property of Indian Transferor Co can be held by Foreign Transferee Co if permissible under FEMA
- Assets permitted to be transferred in any manner for undertaking a transaction permissible under FEMA
- Where assets not permissible to be held, Foreign Transferor Co. to sell such assets / securities within 2 years from date of sanction given by NCLT
- Sale proceeds to be repatriated immediately through banking channels
- Repayment of Indian liabilities from sale proceeds within 2 years permitted

➤ SNRR account:

- Resulting Co. permitted to open/ maintain SNRR Bank A/c in India Foreign Exchange Management (Deposit) Regulations, 2016 for putting through transactions incidental to the cross border merger for maximum period of 2 years from date of sanction given by NCLT

Outbound merger

Companies Act:

- Regulated by section 234, and section 230 to section 232 of Companies Act and the Companies (CAA) Rules;
- Rule 25A of the Companies (CAA) Rules:
 - Permits an outbound merger after obtaining of prior approval of the RBI¹, and after complying with provisions of section 230 to section 232 of the Companies Act;
 - Permissible jurisdiction as specified in Annexure B of Companies (CAA) Rules must be ensured
 - Foreign transferee company to ensure valuation is conducted in accordance with internationally accepted principles by members of a recognised professional body in the jurisdiction of the transferee company;
- Process to be followed as per section 230 – section 232 and Companies (CAA) Rules:
 - NCLT approved process
 - Conducting valuation of companies
 - Involves meeting of shareholders and creditors
 - obtaining NOC from ROC, Regional Director and various statutory authorities like income tax authorities, SEBI
- All other conditions as applicable to a merger as per provisions of the Company laws to apply *mutatis mutandis* to outbound merger – merger is effective in line with order passed by NCLT
- Transferee company to be dissolved on submission of NCLT order and requisite ancillary documents to the ROC.

1. Deemed approval under FEMA

Miscellaneous points – FEMA

Foreign Exchange Management (Cross Border Merger) Regulations, 2018:

Miscellaneous points for Inbound and Outbound Mergers

Valuation

- To be valued as per Rule 25A of the Companies (CAA) Rules (*previously covered*)

Compensation

- Payment of compensation to shareholder of the Indian Co. / Foreign Co. to be in accordance with the Scheme sanctioned by the NCLT

Regularization of non-compliances:

- Companies to ensure completion of required regulatory actions with respect to non-compliance, contravention and violation of FEMA provisions prior to merger

Deemed approval

- Transaction undertaken in accordance with these Regulations to be deemed to have prior approval by RBI (as required under provisions of the Companies Act)
- Certificate from MD / Whole Time Director and CS, ensuring compliance with these Regulations to be furnished along with the application made to NCLT

Demerger

Demerger

Income tax:

- Conditions of 'demerger' to be met [defined in section 2(19AA) of the IT Act];
- Tax neutral transfers:
 - Transferor company's perspective: Transfer of capital assets from demerged company to the resulting Indian Co. exempt [Section 47(vib) of the IT Act];
 - Shareholders perspective: Transfer / issue of shares by the Indian resulting Co. to the shareholders of the Foreign demerged Co. exempt [section 47(vii) of the IT Act];
- If not a qualified 'demerger', capital gain tax 50C, 50CA, and 56(2)(x) of the IT Act implications to be evaluated;
- No tax exemptions for outbound demergers - capital gain tax payable in line with provisions of the Act.

Overview of corporate and regulatory law on cross border demergers

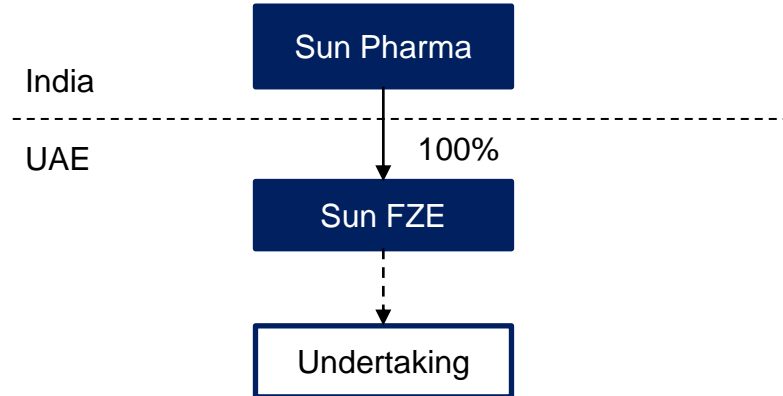
- Cross border *demergers* are not explicitly mentioned in section 234 of the Companies Act, and the FEMA provisions
- **Companies Act:** However, Section 232 (in accordance with which cross border mergers and amalgamations are to be effected) specifies that a 'scheme' includes a scheme of demerger
- **FEMA:** Draft Foreign Exchange Management (Cross Border Merger) Regulations covered 'demerger' but the same was removed from the final regulations

Inbound demerger | Recent update

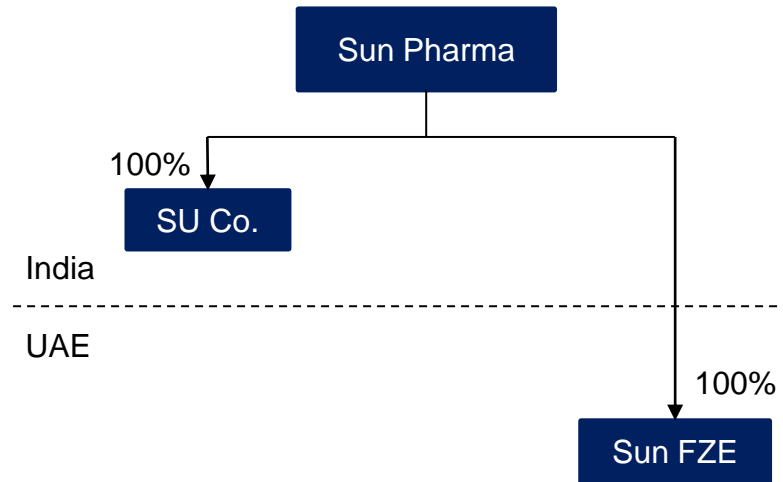
Facts:

- Sun Pharma Global FZE ('Sun Pharma Global'), a UAE entity sort to demerge and transfer specific undertaking ('SU Co.') to Sun Pharma;
- Sun Pharma Global was an indirect WOS of Sun Pharma;
- The arrangement was approved by the shareholders, creditors and also approval from other regulatory authorities such as SEBI, ROC, income tax authorities etc.;
- Initially prior approval from RBI was sought;
- However, later the RBI announced Foreign Exchange Management (Cross Border Arrangement) Regulations, 2018. Requisite compliances were fulfilled by Sun Pharma;
- Aforesaid compliances amounted to deemed approval of RBI. In this regard, waiver from obtaining prior approval was sought;
- Additional notice was sent to RBI regarding the final stand taken – no specific objections raised by RBI.

Transaction structure:



Post transaction:



Inbound demerger | Recent update

Key observations:

- All the section 230-232 of the Companies Act have same nomenclature as mergers and amalgamation;
- Section 234 of the Companies Act refers only to cross border mergers & amalgamations and not demergers. In this regard, Sun Pharma submitted as under:
 - Section 234 of the Companies Act shall apply mutatis mutandis to schemes of mergers and amalgamation;
 - The above view in line with Regulation 9 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 which provides as under:

“ Merger or demerger or amalgamation of Indian companies

*(1) Where a scheme of merger or amalgamation of two or more Indian companies or reconstruction **by way of demerger or otherwise of an Indian company has been approved by NLCT / competent authority of transferee company ... ”***

Decision of the NCLT:

- Based on facts and circumstances of the case, NCLT allowed the proposed scheme of arrangement (inbound demerger)

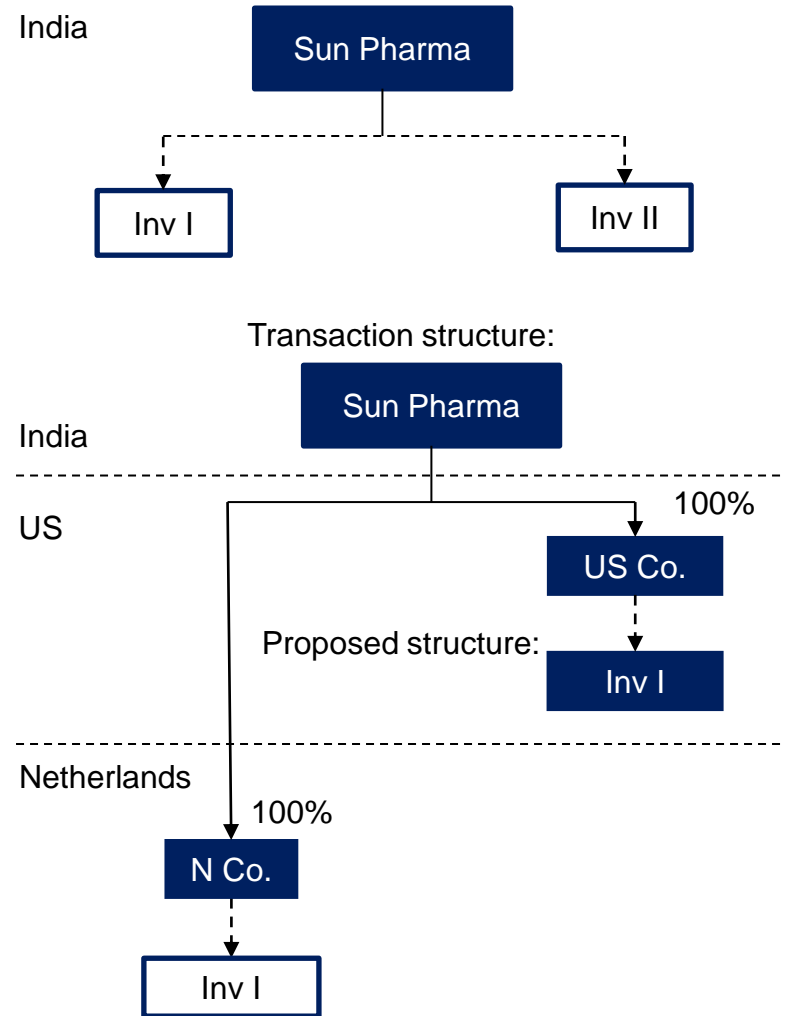
Source

<https://nclt.gov.in/sites/default/files/Jan-final-orders-pdf/FINAL%20Sun%20Pharmaceutical%20Industries%20Ltd%20Vs%20--.pdf>

Outbound demerger | Recent update

Facts:

- Sun Pharma sort to demerge two of its investment undertakings (i.e., Inv I & Inv II) in India into two overseas entities (Netherlands and US entities);
- Both the resulting companies are directly or indirectly wholly owned subsidiaries of Sun Pharma;
- The arrangement was approved by the shareholders, creditors and also approval from other regulatory authorities such as SEBI, ROC, income tax authorities etc.;
- Further, RBI also did not raise any specific objections to the Scheme.



Outbound demerger | Recent update

Decision of the NCLT:

NCLT did not approve the outbound demerger arrangement citing the following reasons: -

- Section 234 of the Companies Act refers only to cross border mergers & amalgamations and not demergers – therefore, Section 234 restricts demerger of Indian company with foreign company;
- Rule 25A of Companies (CAA) Rules is silent on ‘demergers’;
- With respect to Foreign Exchange Management (Cross Border Merger) Regulations, 2018 –
 - Draft regulations included ‘demerger’ in the definition of ‘cross border merger’
 - However, notified final regulations intentionally deleted / excluded the word ‘demerger’

Relevant statues should be harmonized to permit inbound as well as outbound demergers.

Source

<https://nclt.gov.in/sites/default/files/final-orders-pdf/Final%20Sun%20Pharmaceutical%20Industries%20Ltd%20Vs%20--.pdf>

Asset acquisition

Asset acquisition

A. Business acquisition

Income tax:

- Transfer of a business undertaking – transferor co.'s perspective:
 - Qualify as slump sale defined under the income tax laws [section 2(42C) of the IT Act];
 - Capital gains tax implications [section 50B of the IT Act] ;
 - In case of transfer of immovable property or shares, applicability of provisions of section 50C and 50CA of the IT Act to be evaluated;
 - Chartered Accountant's report in Form 3CEA to be filed along with return of income;
- Acquisition of business undertaking – acquirer's perspective:
 - Applicability of section 56(2)(x) of the IT Act in case of receipt of 'property' to be evaluated.

Companies Act:

- Special resolution required where undertaking constitutes more than 20% of the net worth of the Transferor co.

Business / Undertaking can be spun off to a wholly owned subsidiary in which an external party can take a stake if required. This can be effected without NCLT route.

Asset acquisition

B. Individual asset acquisition (itemized sale):

Income tax:

- Transfer of assets – transferor co.'s perspective:
 - Transfer of stock-in trade subject to tax under PGBP [section 28 of the IT Act];
 - Transfer of assets (tangible and intangible) subject to capital gains tax [section 45 of the IT Act];
 - Transfer of shares / immovable property for less than the SDV / FMV; SDV / FMV to be regarded as the cost of acquisition [section 50C and 50CA of the IT Act];
- Acquisition of assets – acquirer's perspective:
 - Received 'property' at price less than the FMV; difference taxable in the hands of the acquirer [section 56(2)(x) of the IT Act].

Inbound acquisition

Inbound acquisition – Direct route

A. Primary investment

Income tax:

- Issue of shares – target co.'s perspective:
 - Issue price higher than FMV; difference taxable in the hands of target co. [section 56(2)(viib) of the IT Act] – relevant if shares issued to residents;
 - Nature and source of the income received to be adequately documented [section 68 of the IT Act] – relevant for both residents and non-residents;
- Change in shareholding exceeds 49%; carry forward and set-off of past year losses not allowed [section 79 of the IT Act] – applicable only in case of companies in which public not substantially interested;
- Receipt of shares – acquirer's perspective:
 - At price less than the FMV; difference could be taxable in the hands of acquirer [section 56(2)(x) of the IT Act];

FEMA:

- Governed by NDI rules;
- Non-debt instruments – equity shares, CCPS, CCDs, share warrants, capital participation in LLP;
- Entry routes, pricing guidelines and sectoral caps applicable if investment on repatriable basis;
- NDI rules continue to provide relaxation to NRI / OCI to invest on non-repatriable basis i.e. entry routes, sectoral cap, pricing guidelines, etc. shall not apply.
- Prior approval from Govt. required where the sector falls under approval route;

Inbound acquisition – Direct route

- Intimation to RBI within 30 days (file Form FC-GPR) and issue of shares within 60 days from recipient of investments;
- Form FLA to be filed by July 15, every year.
- Price of shares to be issued shall not be less than:
 - Listed shares: computed in accordance with the SEBI guidelines;
 - Unlisted shares: valuation as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant / Merchant Banker / Cost Accountant.

Recent key update: FDI in India by entities resident of countries sharing land borders with India shall fall under the government approval route [Press note no. 3, dated April 17, 2020]

Companies Act:

Issue of shares to non-existing shareholders:

- Issue of shares through private placement and issue of application and offer letter;
- Conducting meeting of members and passing of special resolution;
- Filing of necessary applications / documents with the MCA – MGT-14, PAS-3, PAS-4, etc.

Issue of shares to existing shareholders:

- Issue of shares through right issue;
- Conducting board meeting and passing of board resolution;
- Filing return of allotment with MCA (PAS-3).

Inbound acquisition – Direct route

B. Secondary investment

Income tax:

- Transfer of shares – existing shareholder’s perspective:
 - Capital gains tax implications [section 45 of the IT Act];
 - Share transfer at less than FMV; FMV to be regarded as the cost of acquisition [section 50CA of the IT Act];
- Change in shareholding exceeds 49%; carry forward and set-off of past year losses not allowed [section 79 of the IT Act] – applicable only in case of private limited companies;
- Receipt of shares – acquirer’s perspective:
 - At price less than the FMV; difference taxable in the hands of acquirer [section 56(2)(x) of the IT Act].

Consideration in form of shares and / or any other capital instruments:

- Valuation of capital instruments (shares, share warrants, options, etc.) received to be documented;
- 50CA and 56(2)(X) of the IT Act implications to be evaluated;
- Substance in the transaction and underlying non-tax rationale to be adequately documented.

Inbound acquisition – Direct route

Milestone / earning based consideration:

- Consideration for shares deferred and payable on milestone basis – capital gains may apply on contingent consideration at the time of transfer itself;
- Issue of share warrants / options exercisable on achieving pre-agreed milestones – 56(2)(x) implications to be evaluated.

FEMA:

- Governed by NDI rules;
- General permission to investment by way of acquiring existing shares;
- Transfer from non-resident to another non-resident (sale / gift):
 - Prior Govt. approval required if company engaged in sector falling under Govt. route;
 - Transfer of shares if transferee intends to hold on repatriable basis – subject to adherence to entry routes, pricing guidelines, sectoral caps, etc.;
 - Filing of Form FC-TRS within 60 days
- Transfer from a resident to non-resident (sale) – subject to adherence to entry routes, pricing guidelines, sectoral caps, etc.;
- Gifting of shares by resident to non-resident falls under Govt. approval route; gifting permissible only if donor and donee are relatives (capped at 5% of the paid-up capital and value at USD 50,000);
- Deferment of consideration permissible up to 25%; to be paid within 18 months;
- Form FC-TRS to be filed within 60 days by resident transferor / transferee.

Inbound acquisition – Indirect route

Income tax:

- Transfer of shares of a foreign co. – transferor's perspective:
 - Capital gains arising on transfer of shares / interest in a company / entity deriving its value substantially from assets located in India, subject to tax in India [section 9(1) of the IT Act];
 - Indirect transfer provisions applicable if:
 - FMV of Indian asset exceeds INR 10 crores; and
 - Represent 50% of the total assets of the foreign company / entity;
 - Valuation of the shares of the Indian Co. and assets of the foreign co. to be documented;
 - Taxability under the treaty to be evaluated;
 - Substance in the transaction / arrangement should be adequately documented;
- Acquisition of indirect control in Indian co. – acquirer's perspective:
 - Withholding tax obligations may arise;
 - Declaration from the transferor in respect of transaction not resulting into indirect transfer may be obtained;
- Indian co. required to file Form 49D within 90 days from the end of financial year.

Recent key update: AAR in case of Tiger Global International II Holdings [2020] 116 taxmann.com 878 (AAR) rejected the application on grounds that the arrangement was for tax avoidance and denied the beneficial capital gains tax provisions under the India-Mauritius treaty in respect of capital gains arising under the indirect transfer provisions.

Outbound acquisition

Outbound acquisition

Income tax:

- Receipt of shares – acquirer’s perspective:
 - At price less than FMV; difference taxable in the hands of acquirer [section 56(2)(x)];
 - Disclosure in Schedule FA of the income tax return.

FEMA:

- Governed by ODI Regulations;

Overseas direct investment by Indian Party:

- Indian party may invest overseas without any prior approval subject to the following:
 - Financial commitment capped at 400% of the net worth as per the last audited balance sheet;
 - Overseas JV or WOS should be engaged in bonafide business except real estate / banking / financial services;
 - Indian party should not be on the Reserve Bank’s Exporter’s caution list / defaulter’s list;
 - All transactions related to JV / WOS to be routed through one branch of designated AD bank;
 - Files Form ODI – Part I duly supported with requisite documents within 30 days of investment;
- Investment by way of swap of shares valuation to be obtained from a Category I Merchant Banker.

Recent key update: An Indian party is not permitted to acquire a JV or WOS that already has direct / indirect investment in India under the automatic route. The Indian party will have to approach the Reserve Bank of India (‘RBI’) for prior approval through its AD bank. [FAQs on ODI – Q. 64]

Outbound acquisition

Overseas direct investment by resident individuals:

- Investments in JV or WOS capped up to USD 2,50,000 per person per financial year under the liberalized remittance scheme ('LRS');
- JV or WOS to be engaged in bonafide business except real estate / banking / financial services;
- JV or WOS to be an operating entity – no step-down subsidiary to be set-up or acquired;
- General permission granted to acquire foreign securities as:
 - Gift from any person resident outside India;
 - Under Cashless ESOP Scheme – without any remittance outside India;
 - Under ESOPs – if he is an employee / director of an Indian branch, office or Indian subsidiary of foreign co.;
 - Right shares (if initial acquisition was in line with the FEMA laws);
 - Qualifying shares for becoming a director;
 - Part / full consideration in lieu of professional services / director's remuneration;
- Form ODI – Part I to be filed within 30 days of investment;
- Valuation report in respect of shares acquired to be obtained – applicable in all the cases.

Post investment obligations:

- Receipt of share certificate / other related documents within 6 months;
- Dues receivable to be repatriated within 60 days from due date;
- Submit Annual Performance Report ('APR') by December 31st of every year;
- Filing of Form FLA by July 15 of every year.

Outbound acquisition

Divestment:

- Divestment may be by way of transfer / sale, liquidation or merger / amalgamation;
- Divestment could be with or without write-off of investments (subject to specific conditions); in case conditions are not met, prior approval may be required;
- Filing of Form ODI – Part III within 30 days of divestment;
- Sale proceeds to be repatriated within 90 days from the date of sale / transfer.

Companies Act:

- Restriction on investment through more than 2 layers of companies not applicable if investment made in foreign company [section 186(1) of the Companies Act];
- Investment in securities cannot exceed:
 - 60% of the paid-up share capital; or
 - 100% of the free reserves and securities premium account [section 186(2) of the Companies Act];
- In case investments exceed the limits mentioned above – prior approval of members by passing special resolution;
- Section 186(1) and (2) of the Companies Act not applicable in case of a PLC.

Cross border M&A – Other issues

General Anti Avoidance Rule ('GAAR')

- GAAR is triggered when taxpayer enters into 'impermissible avoidance arrangement' ('IAA');
- IAA – if the main purpose of the arrangement is to obtain tax benefit along with one of the tainted tests:
 - Not at arm's length
 - Lacks commercial substance
 - Results in abuse of the Act
 - Not for a bonafide purpose
- Threshold for invoking GAAR – aggregate of tax benefit of INR 3 crores;
- Central Board of Direct Taxes ('CBDT') has issued Circular No. 7/2017 dated January 27, 2017 and has, inter alia, clarified the following:
 - GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction;
 - Where the Court / NCLT has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.

Points for consideration:

- It is the taxpayer's prerogative to choose the method for executing a transaction. However, the Company should take due care while choosing the alternative for the proposed transfer so as to not invoke the provisions of GAAR. The focus of GAAR is commercial substance over form;
- It would be imperative for the taxpayer to adequately document and demonstrate the underlying non-tax rationale of the proposed transaction / arrangement;
- The NCLT rejected the scheme of merger in Ajanta Pharma's case on the grounds that scheme was designed to avoid taxes.

Principal Purpose Test ('PPT')

- MLI has entered into effect in India on April 1, 2020;
- Going forward, the covered tax agreements ('CTA') to be read along with MLI;
- Part III of the MLI deals with treaty abuse – includes minimum standards (Article 6 & 7);
- Article 7 provides that treaty benefit shall not be available if one of the main purposes of the arrangement / transaction was to obtain treaty benefit;
- India may include simplified limitation of benefit provisions in the CTAs based on bilateral negotiations.

Points for consideration:

- It will be critical for the taxpayers to ensure that they fulfill the PPT;
- Indian businesses required to withhold taxes as a result of the cross border M&A could obtain following declarations / representations as a measure of safeguard:
- The non-resident entity adequately fulfills the PPT and is eligible to obtain treaty benefits;
- In case PPT is triggered and the non-resident entity is not eligible to claim treaty benefits, it shall make good all the losses (including interest and penalty) if any that may arise on lower withholding of taxes.

Case Studies

Case study 1 | Business acquisition

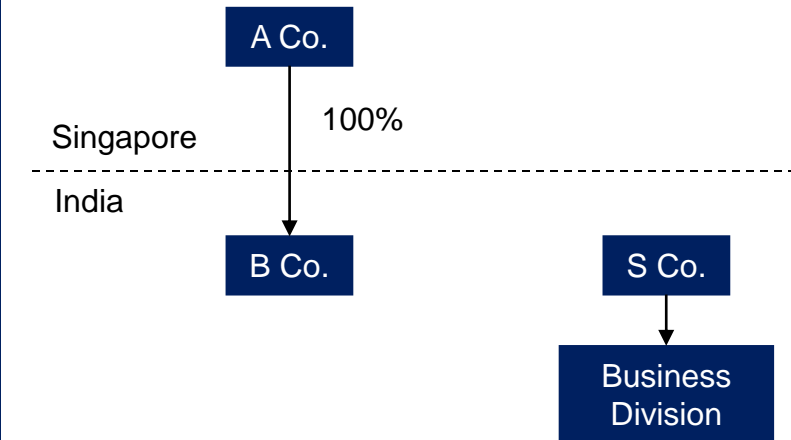
Facts:

- B Co. is owned and controlled by A Co.;
- B Co. to acquire one of S Co.'s business division;
- The parties have agreed to execute the transaction as under –
 - New Co. to be set-up;
 - Transfer of business division to New Co. through slump sale;
 - Shares of New Co. to be issued to B Co. in lieu of consideration equivalent to 40% of the New Co.;
 - Balance 60% to be held by S Co.

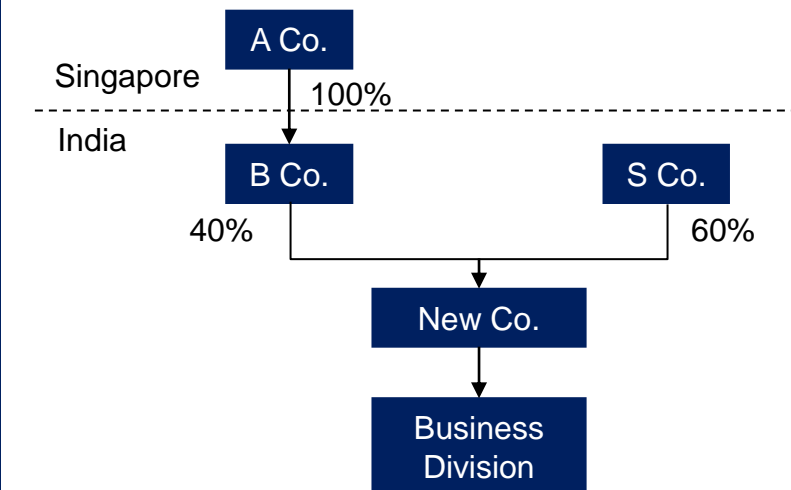
Points for consideration:

- Capital gains tax;
- Stamp duty;
- Downstream investment;
- Applicability of pricing guidelines, sectoral caps under FEMA;
- Section 56(2)(x) implications.

Transaction structure:



Post transaction:



Case study 2 | Indirect acquisition

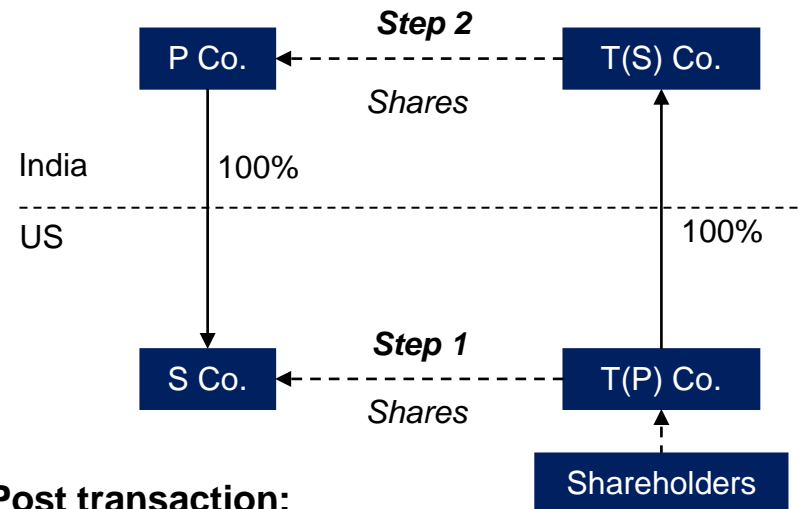
Facts:

- P Co., an Indian company has WOS in US, S Co. which desires to acquire shares of T(P) Co. in US;
- The shareholders of T(P) Co. are non-residents from India tax perspective;
- T(P) Co. has a wholly owned subsidiary in India;
- Shares of T(P) Co. substantially derives its value from asset located in India i.e., T(S) Co.;
- For the proposed acquisition, the following steps are to be undertaken –
 - Step 1: Shares of T(P) Co. (incl. shares of T(S) Co.) acquired by S Co. from the existing non-resident shareholders;
 - Step 2: Shares of T(S) Co. transferred from T(P) Co. to P Co for no consideration.

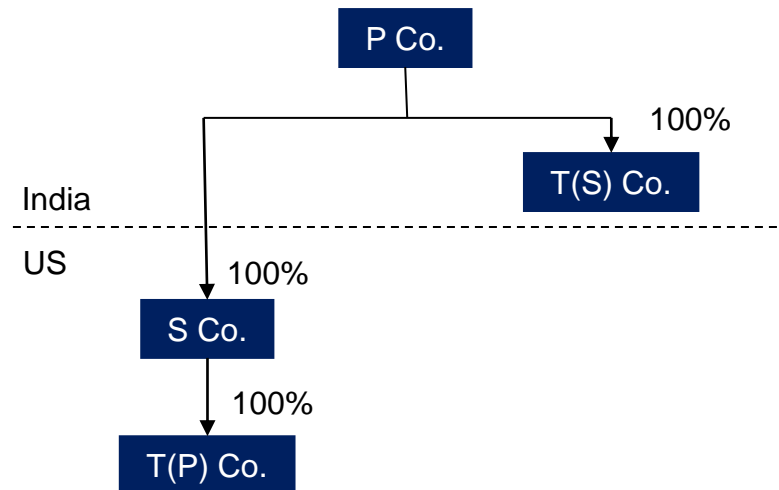
Points for consideration:

- Round tripping;
- Capital gains tax;
- Indirect share transfer provisions;
- Valuation aspects under FEMA.

Transaction structure:



Post transaction:



Case study 3 | Merger of foreign entities

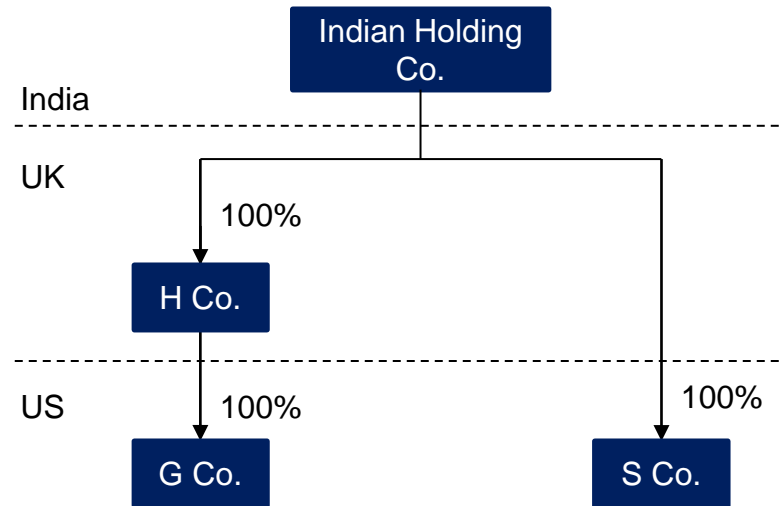
Facts:

- S Co. is wholly owned subsidiary of Indian listed company ('Indian holding co.');
- S Co. to merge into G Co. - for which the following steps are undertaken –
 - S Co. to transfer all its assets and liabilities to G Co. (i.e., acquisition through asset purchase) for no consideration;
 - Valuation of S Co. is negative – as per Rule 11UA as well as DCF method;
 - S Co. to liquidate; no distribution to Indian holding co. at the time of liquidation.

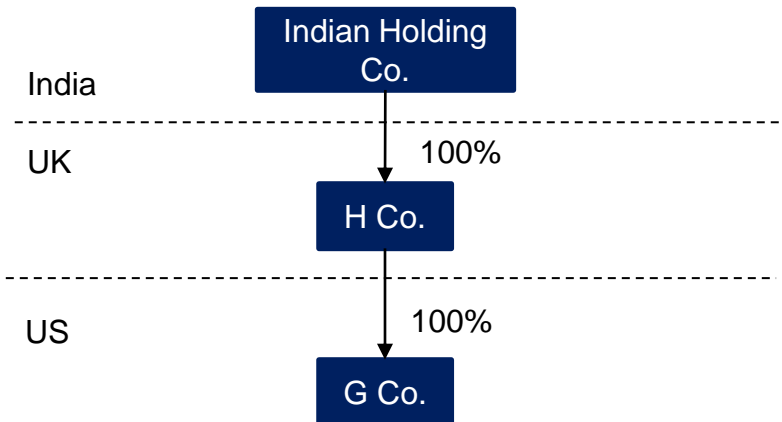
Points for consideration:

- Valuation aspects under FEMA;
- Write off investments;
- Capital gains / loss in India and US;
- GAAR implications.

Transaction structure:

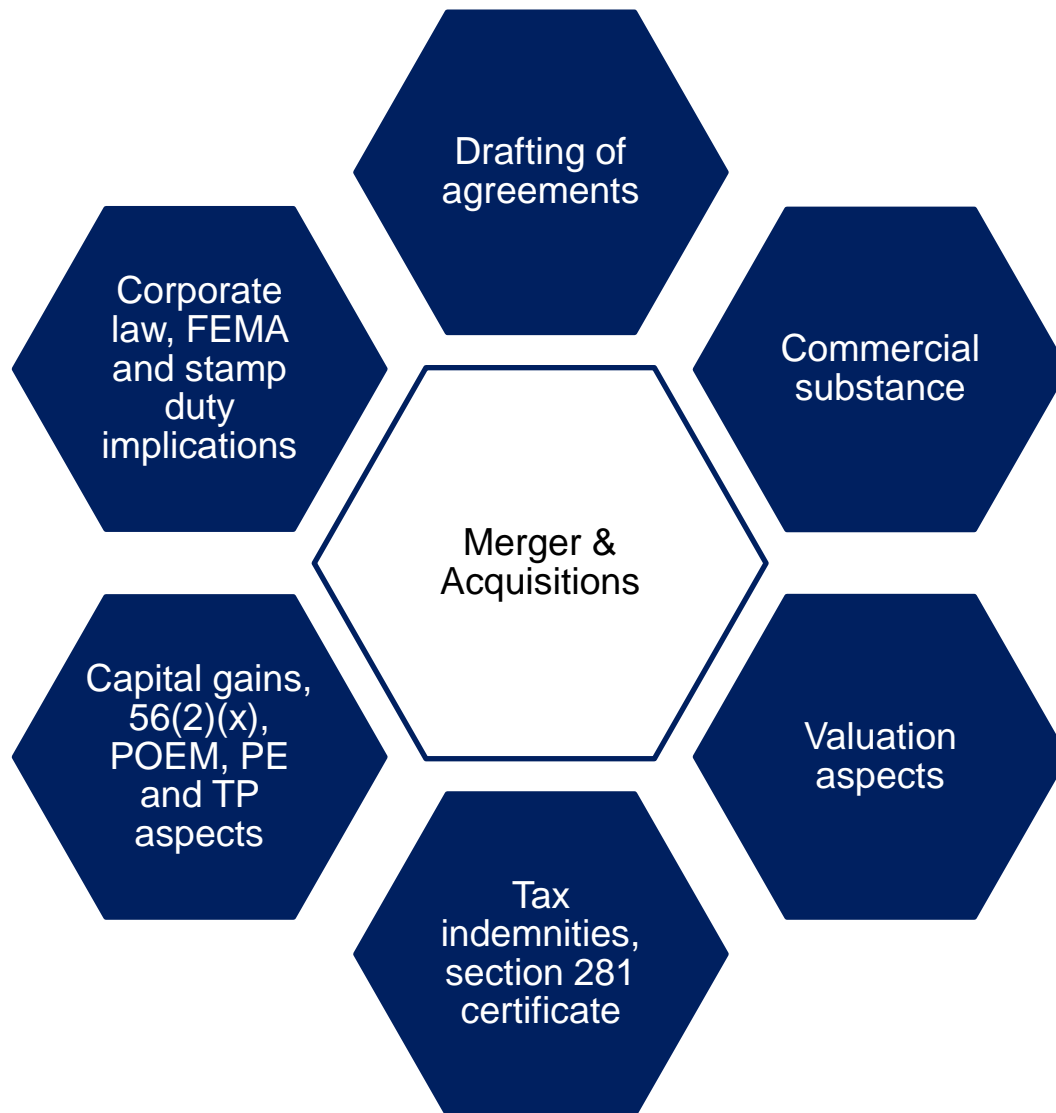


Post transaction:



To sum up...

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Thank you

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