

Tax planning, structuring and case studies

Refresher Course on Due Diligence, Investment
Banking, M&A Advisory for SMP, WIRC, ICAI



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11 September 2020

Presentation Outline



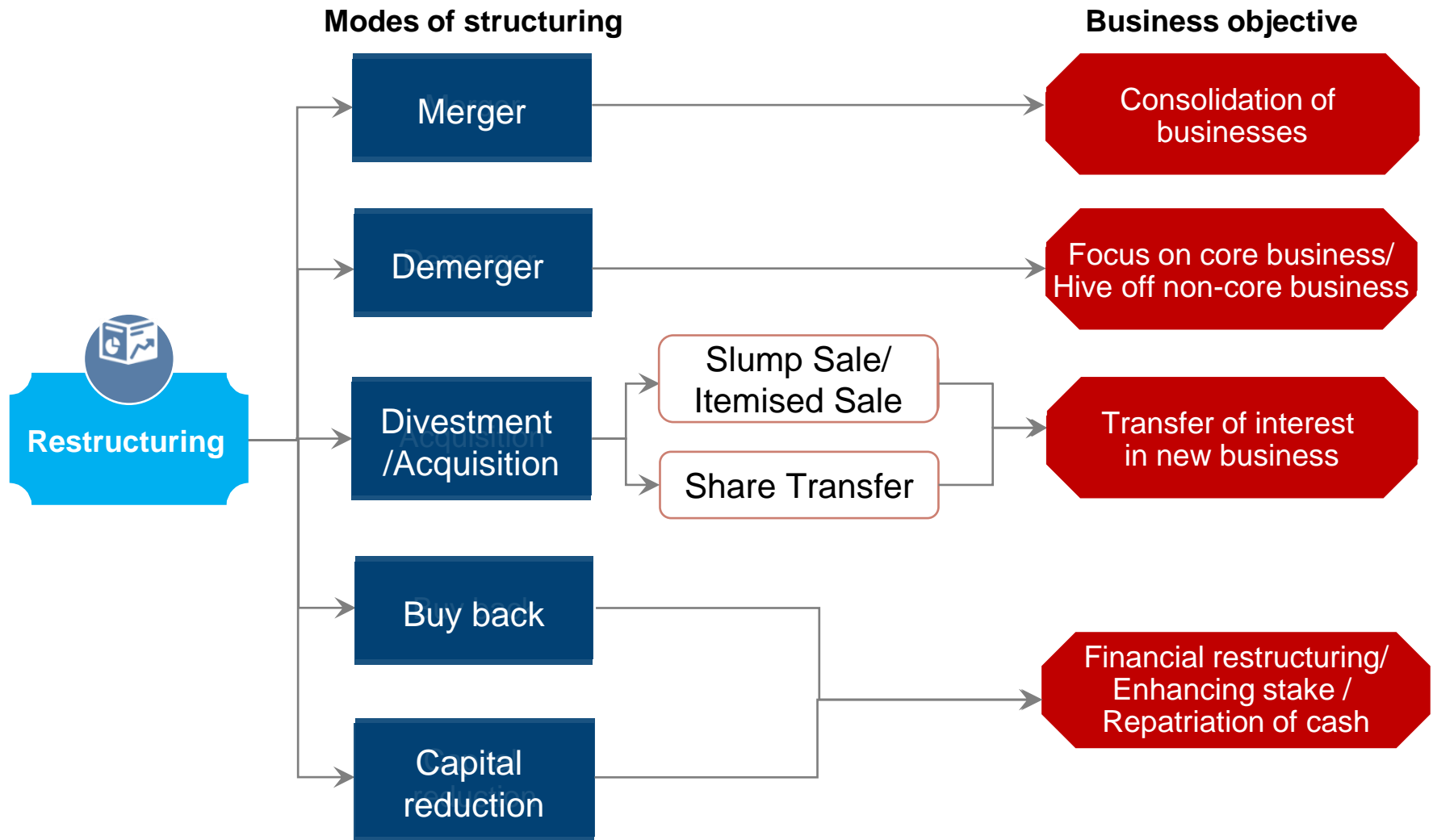
Rationale for business structuring

Rationale for business structuring

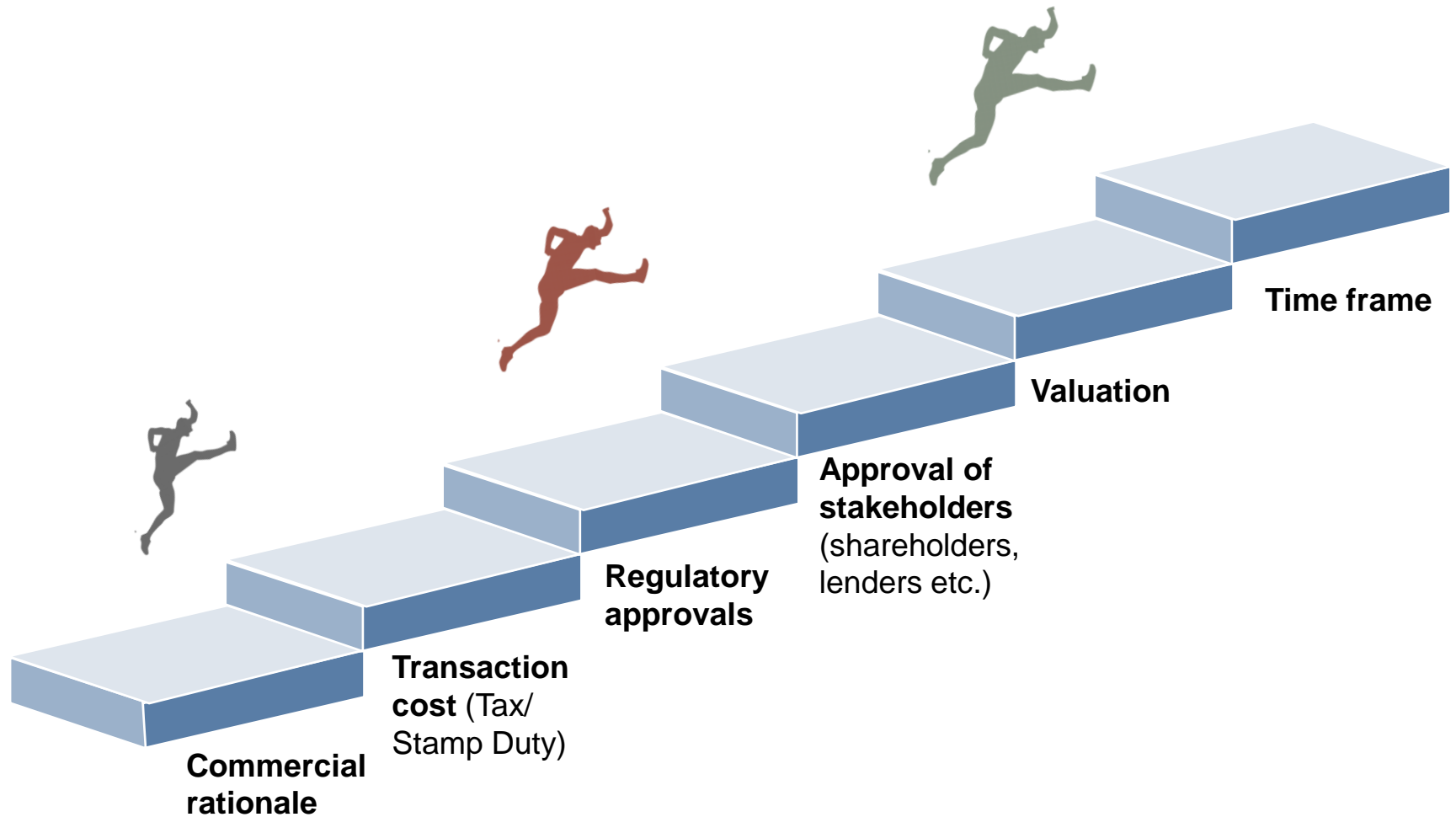


- ✓ Consolidation/separation of businesses
- ✓ Investor entry
- ✓ Simplification of legal structure
- ✓ Mitigate inadvertent regulatory non-compliance
- ✓ Unlocking of value
- ✓ Inorganic growth
- ✓ Separation / family arrangement
- ✓ Listing of shares
- ✓ Fiscal benefits
- ✓ Debt servicing

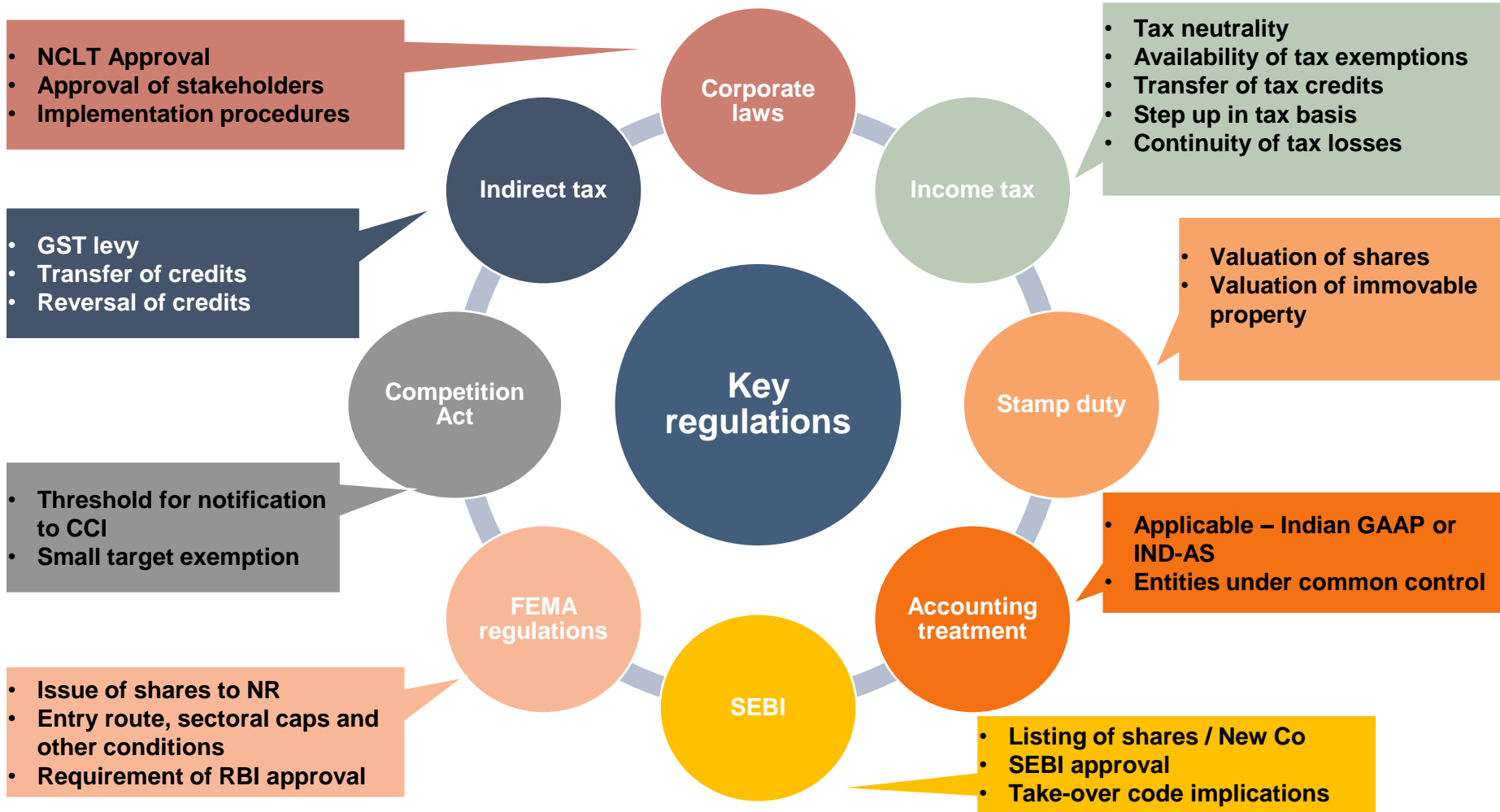
Modes of structuring - snapshot



Key challenges



Laws and key considerations impacting structuring



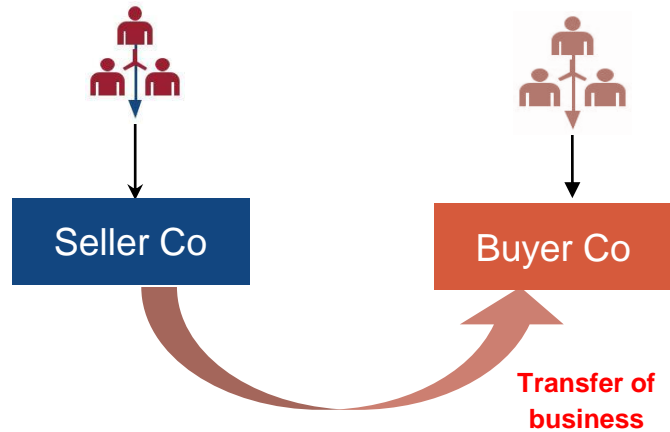
Industry specific laws like Insurance, Banking, Telecom, etc. should also be considered

Key modes of Structuring

Business vs Share Transfer

Business Transfer v. Share Transfer

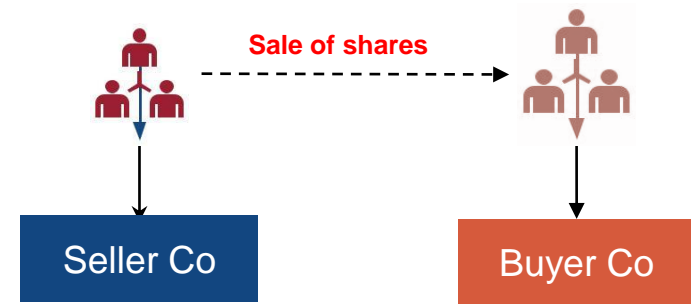
Business Transfer



Considerations

- Transfer of business to Buyer Co
- Entity remains with the seller with or without other business

Share Transfer



Considerations

- When company owns only desired business for buyer
- Otherwise, pre-acquisition restructuring required

Key considerations - Business Transfer vs Share Transfer

Parameters	Perspective	Business Deal	Share Deal
Historical risks	Buyer	●	●
Acquisition Funding – Interest Deductibility	Buyer	●	●
Cherry picking of assets and liabilities	Buyer	●	●
Carry forward of losses	Buyer	●	●
Step-up in costs – tax depreciation	Buyer	●	●
Stamp duty, GST, etc.	Transaction	●	●
Seller's overall tax costs	Seller	●	●
Goodwill/ PPA	Buyer	●	●
Disruption to business	Buyer	●	●

Slump Sale

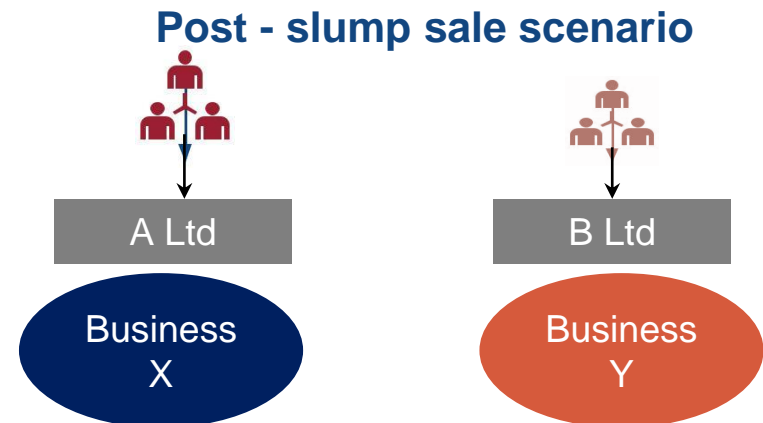
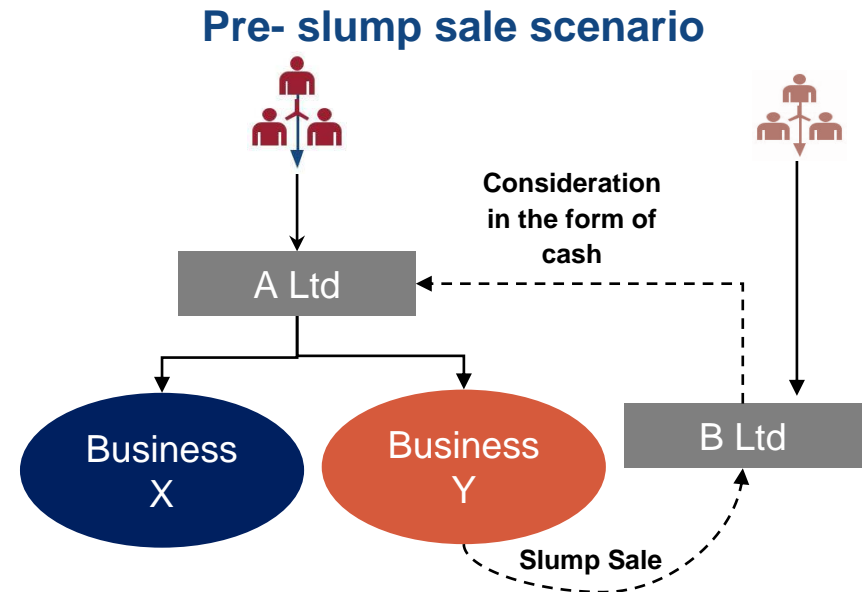
Slump Sale

Concept:

- Transfer of identified business undertaking / division through
 - **Business Transfer Agreement / NCLT approved Scheme**
 - Transfer for lump sum consideration without values being assigned to individual asset and liabilities
- Buyer to discharge consideration in the form of **cash**

Key Drivers:

- **Segregation** of core and non-core business
- Monetization and **value unlocking**



Slump Sale

- Slump sale defined under section 2(42C) of the Income-tax Act, 1961 ('ITA')
*"slump sale" means the transfer of one or more **undertakings** as a result of the **sale for a lump sum consideration** without values being assigned to the individual assets and liabilities in such sale*
- Computation of capital gains as per section 50B – **Net-worth** of the undertaking (to be computed in prescribed manner) deemed to be the **cost of acquisition**
- **Proportionate depreciation** – Applicability of sixth proviso to section 32(1) in case of slump sale treating it as **succession**?
- Accumulated **losses** and unabsorbed depreciation **not eligible** for carry forward under slump sale
- **Tax holiday** u/s 80-IA, 80-IB, etc. **should not get jeopardized** pursuant to slump sale
- Arguably, **no GST** should be attracted since entire business is transferred on a going-concern basis

Merger / Amalgamation

Merger / Amalgamation

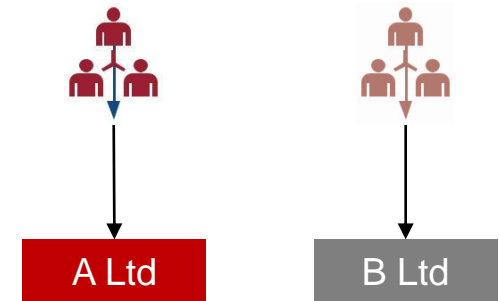
Concept:

- Union of two or more companies into one company
- All assets, liabilities, contracts and employees of the transferor company are transferred to the transferee company
- Transferee company **issues shares** to the shareholders of transferor company as consideration
- Transferor company would cease to exist post-merger

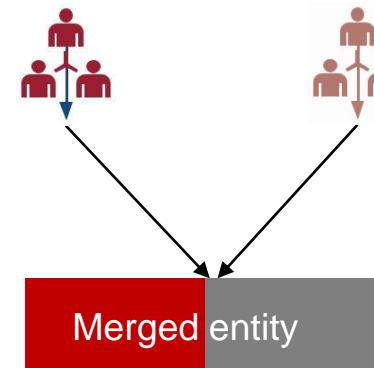
Key Drivers:

- **Operational synergies** (pooling of resources, economies of scale, etc.)
- Develop **focused brand image/ stronger market standing** through a single flagship company
- **Rationalizing operating/administrative costs** by reducing the number of companies
- Exploring **fiscal benefits** that may be possible on consolidation
- **Overcoming competitive pressure**

Pre-merger scenario



Post-merger scenario



Merger – Important aspects

- Merger to satisfy conditions of section 2(1B)
 - All the assets and liabilities of amalgamating company to be transferred
 - Shareholders holding **at least 3/4th in value** of shares in the amalgamating company (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary to become shareholders of amalgamated company)
- Carry forward of business loss and unabsorbed depreciation of amalgamating company permissible subject to satisfaction of conditions prescribed under section 72A
 - **Fresh lease** of life to **business losses / unabsorbed depreciation**
- Where conditions of section 72A are not satisfied, in certain judicial precedents*, it has been held that unabsorbed depreciation to be added to block of assets transferred to amalgamated company
- Depreciation available to amalgamated company on WDV of block of assets of amalgamating company
- **Tax holiday** under certain provisions (section 80-IA, section 80-IB etc.) **not available** to amalgamated company
- Arguably, **no GST** should be attracted since entire business is transferred on a going-concern basis

* *CIT vs Hindustan Petroleum Corpn Ltd [1990] 52 Taxman 512; CIT vs Silical Metallurgic Ltd [2010] 324 ITR 29 (Madras HC); EID Parry (India) Ltd vs DCIT [2012] 23 taxmann.com 348 (Madras HC); ACIT vs JSW Steel Ltd (ITA No.156/Bang/2011)*

Merger – Fast Track Route

- Provisions for fast track merger under section 233 of the Companies Act, 2013
- Section 233 provides for a **scheme of merger or amalgamation** =
 - between 2 or more **small companies***
 - between **holding company and its WOS**
- Scheme to be **sanctioned by RD** – NCLT approval not required
- Scheme to be **approved by** –
 - **Shareholders** holding at least **90%** of total number of shares
 - **Majority of creditors** representing **9/10th** in value
- Whether **demerger** under fast track route permissible?
 - Sub-section (1) refers to merger or amalgamation
 - Sub-section (12) provides that section 233 shall **mutatis mutandis** apply to scheme of compromise or **arrangement as per section 230 and section 232**

**Small company means a company, other than a public company, whose paid-up share capital does not exceed 50 lacs and turnover does not exceed 2 crores. This definition does not apply to holding and subsidiary company.*

Demerger

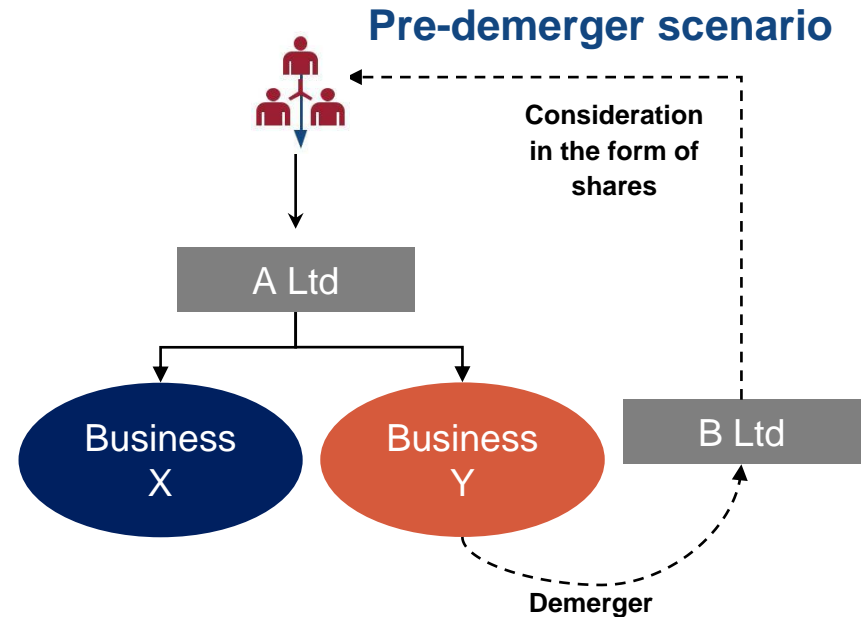
Demerger

Concept:

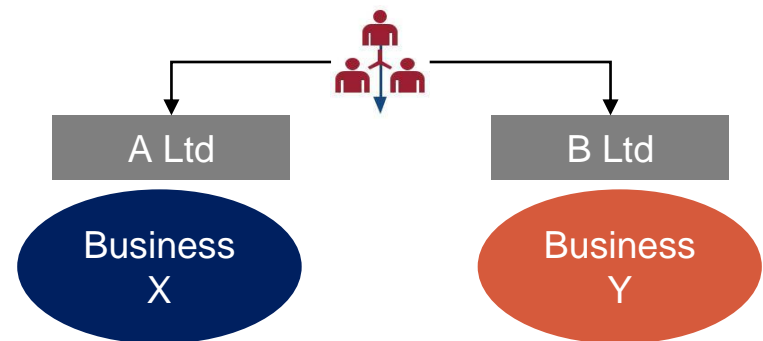
- Transfer of identified business undertaking from one company (i.e. demerged company) to another company (i.e. resulting company)
- In consideration, the resulting company **issues shares** to shareholders of the demerged company

Key Drivers:

- **Segregation** of core and non-core business
- Monetization and **value unlocking**
- Dedicated **management focus** on each business segment
- Attracting **investors / funding**



Post-demerger scenario



Demerger – Key aspects

- Demerger defined under section 2(19AA) of the Income-tax Act
- Transfer of business under demerger should constitute an **eligible 'undertaking'** – on a **going concern** basis
- Shareholders holding not less than 3/4th in value of the shares in demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) to become shareholders of the resulting company
- Resulting company to issue its **shares as consideration** to the shareholders of demerged company on a proportionate basis (except where resulting company is shareholder of demerged company)
- All the properties and liabilities of the demerged undertaking to be transferred at **values appearing in its books** of account immediately before the demerger
 - **Not applicable** where the resulting company records the value of properties and liabilities of undertaking at a value different from the value appearing in the books of account of the demerged company, immediately before the demerger, **in compliance with Ind AS**
- Depreciation available to resulting company on WDV of block of assets of demerged company
- Tax holiday under certain provisions (section 80-IA, section 80-IB etc.) **not available** to resulting company
- Arguably, **no GST** should be attracted since entire business is transferred on a going-concern basis

Demerger – Key issues

Accumulated business losses and unabsorbed depreciation (Section 72A)

**Directly
relatable to the
demerged
undertaking**

To be carried forward and set off in the hands of the resulting company

**Amount not
directly
relatable to the
demerged
undertaking**

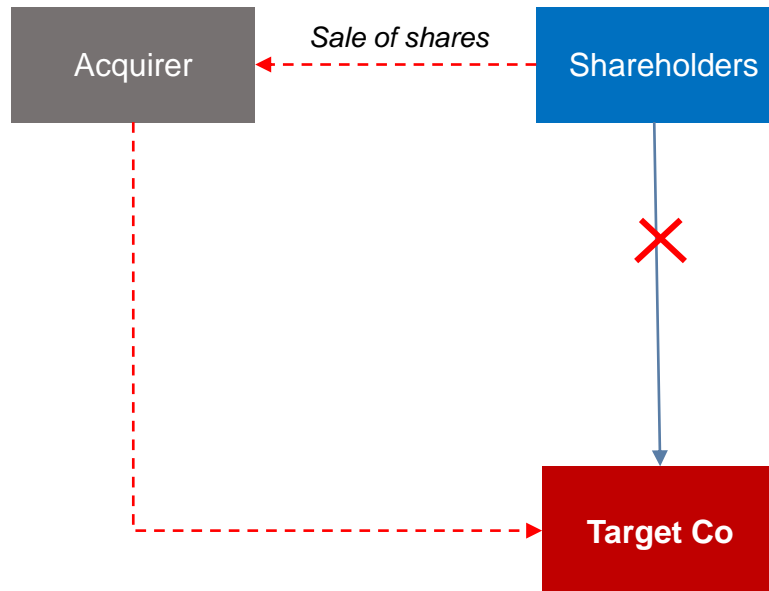
To be apportioned between the resulting company and the demerged company in the ratio of the assets transferred to resulting company and assets retained by the demerged company

No fresh lease of life for carry forward of business losses

Unlike merger no conditions need to be fulfilled to carry forward and set off tax losses

Acquisition Structuring

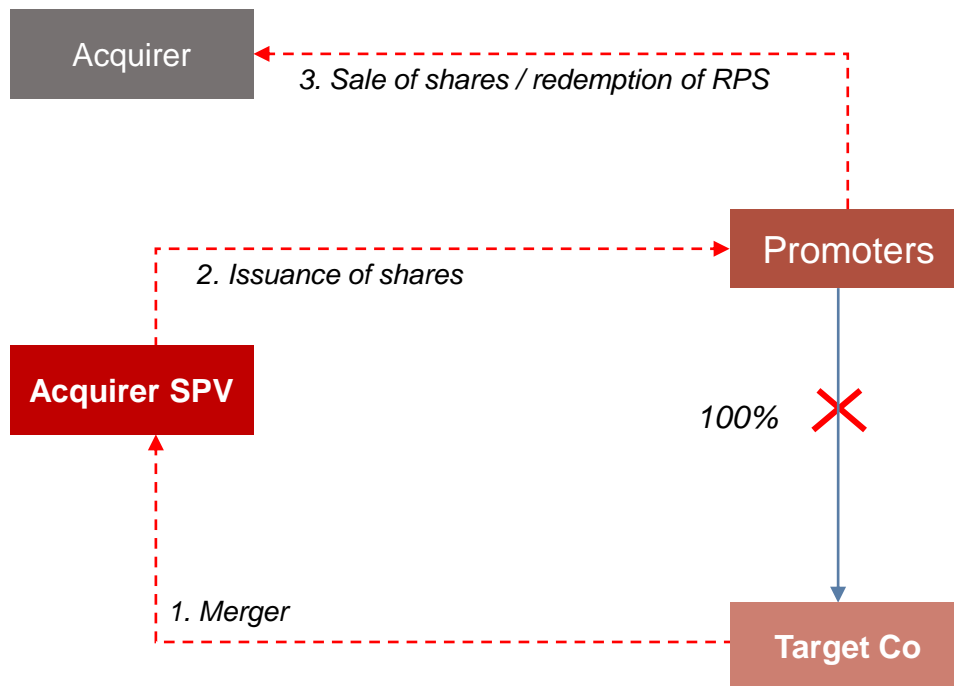
Acquisition of Shares



Transaction structure

- Direct acquisition of shares of Target Co by Acquirer
- Not time consuming – can be implemented in short span of time
- Deduction / amortization of cost of acquisition of shares not available to the Acquirer against its taxable income

Merger of Target with Acquirer/Acquirer SPV



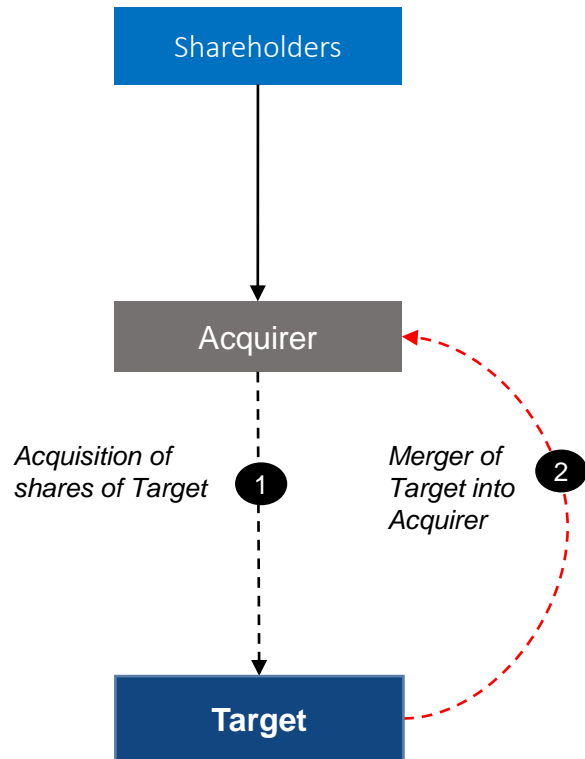
Transaction structure

1. Target to be merged into Acquirer SPV under a scheme of arrangement to be approved by NCLT
2. Pursuant to merger, Acquirer SPV to issue Equity shares / Redeemable Preference Shares (RPS) to shareholders of the Target
3. Acquirer to purchase equity shares / Acquirer SPV to redeem RPS issued to shareholders of the Target pursuant to merger

Claim of depreciation on goodwill recorded on merger can be explored while computing taxable income of Acquirer / Acquirer SPV [Ref: SC decision in case of Smifs Securities]

Merger of Target post acquisition

Proposed Transaction



Issue

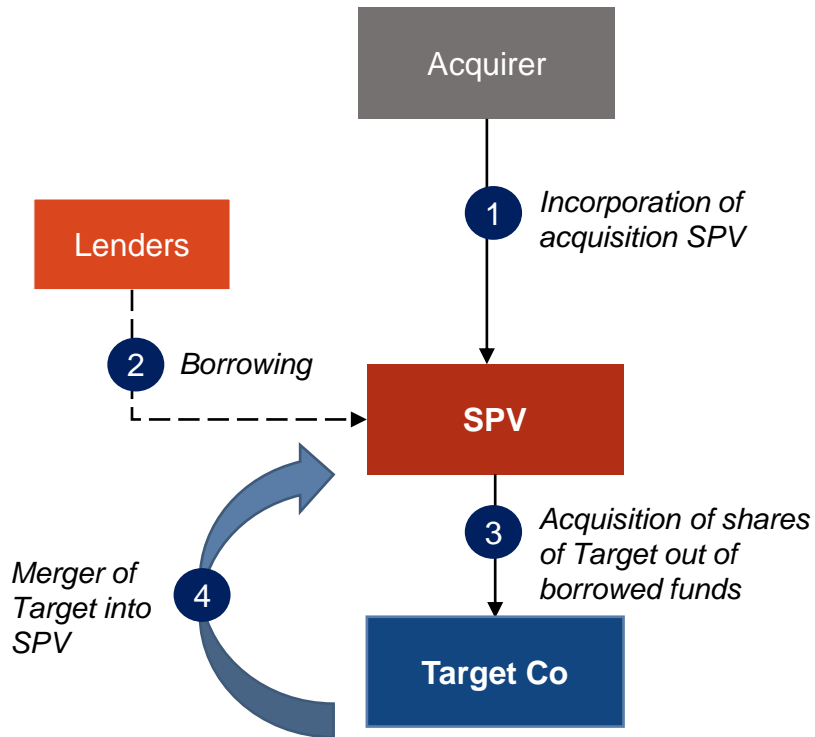
- In case of acquisition of target business through acquisition of shares, cost of investment not available for amortization
- Further, due to applicability of Ind AS, subsequent merger could be treated as common control business combination – Accordingly, no recognition of goodwill possible

Thoughts

- In order to record goodwill/ intangibles, merger of Acquirer with Target Company may be considered immediately post acquisition with an **appointed date as the acquisition date**
- Recording of goodwill / intangibles in books of Acquirer upon merger considering concept of **transitory control** under Ind AS 103
- Strong **commercial rationale** for acquisition of shares followed by merger pertinent
- **Precedent – Mylan Laboratories***

Leveraged Buy-Out

Proposed structure



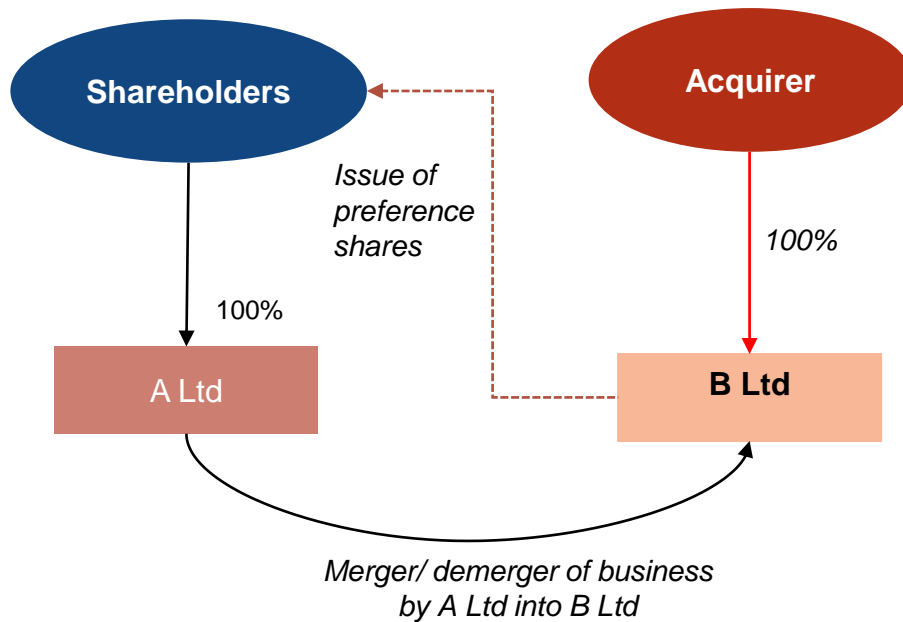
Transaction structure

1. Incorporation of SPV by Acquirer
2. Loan availed by SPV for acquisition of shares of Target Co
3. SPV to acquire shares of Target Co out of borrowed funds
4. Merger of Target Co into SPV

Deductibility of interest on borrowed funds to Target Co u/s 36(1)(iii) post merger?

Continuity of tax losses

Objective: Acquisition of A Ltd by B Ltd by ensuring continuity of tax losses of A Ltd



- Substantial accumulated tax losses in A Ltd
- Direct acquisition of shares of A Ltd by Acquirer to trigger provisions of section 79
 - Tax losses in A Ltd to lapse on change in majority shareholding
- Merger / demerger of A Ltd into B Co (owned by Acquirer) can be explored
- B Co to issue RPS as consideration to shareholders of A Ltd upon merger / demerger
- Tax losses of A Ltd to get transferred to B Ltd upon merger / demerger subject to compliance with section 72A

Divestment Structuring

Divestment Structuring (1/2)

Thoughts

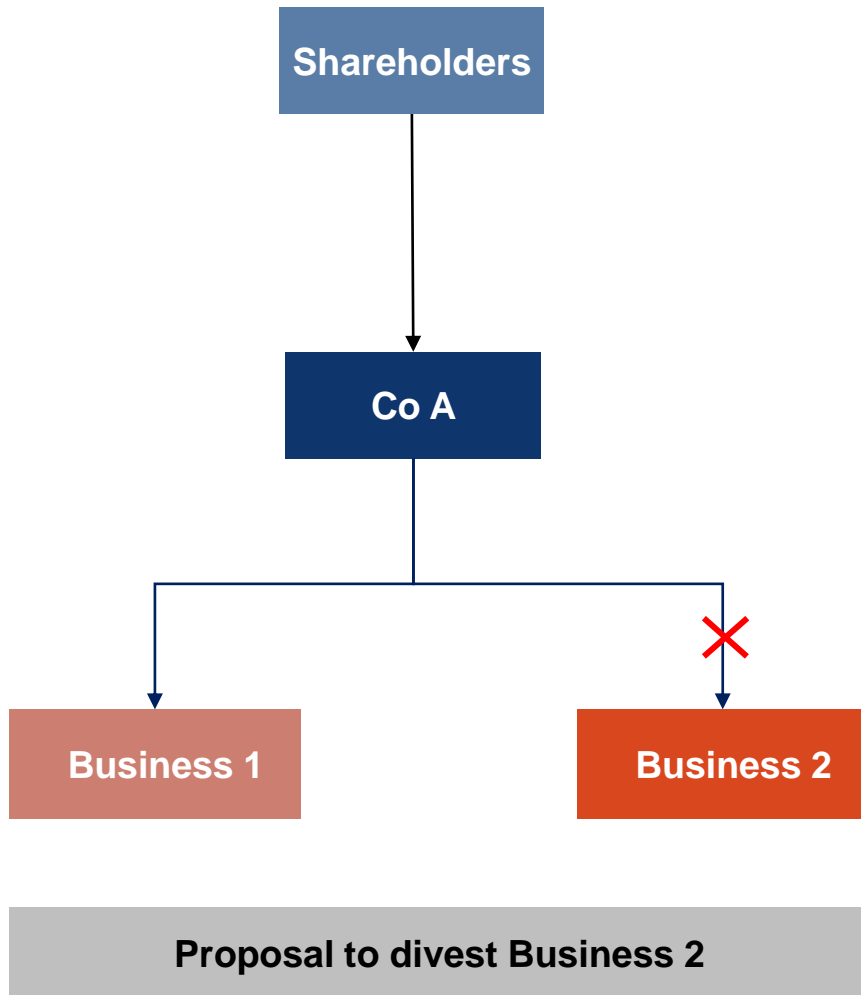
Combination of alternatives could be explored:

- **Outright sale** of shares by promoters
- **Carving out / sale** of the business undertaking from the company **followed by buy-back / dividend distribution**
- **Demerger** of the business undertaking from the company followed by sale of shares

Considerations

- Implications under **section 56** of the Income-tax Act, 1961
- Tax Costs – **Grandfathering benefits** in case of shares of Listed Co.
- FEMA considerations – **non-resident shareholders**
- Trigger of **open offer** under SEBI Takeover Code
- SEBI implications – **future delisting** of shares
- **Minority shareholding squeeze** out by the buyer
- **Optimisation of tax** in the hands of promoters (purchase of residential property etc.)

Divestment Structuring (2/2)



- Depending upon tax and commercial considerations, following options may be explored –
 - Slump sale of Business 2 to Buyer
 - Slump sale of Business 2 to WOS of Co A followed by sale of shares of WOS to Buyer
 - Demerger of Business 2 into Buyer Co and issue of RPS by Buyer Co to shareholders of Co A followed by purchase / redemption of RPS
 - Demerger of Business 1 into another company held by existing shareholders and subsequent acquisition of shares of Co A (housing Business 2) by Buyer

Pre-IPO Structuring

Pre IPO structuring

Multiple layers



- **Typical structures involve multi-tier holdings**
 - Impacts **value maximization** and other inefficiencies in compliances, funds flows etc.
 - Need to review such structures and **remove additional layers** by way of merger

Value optimization

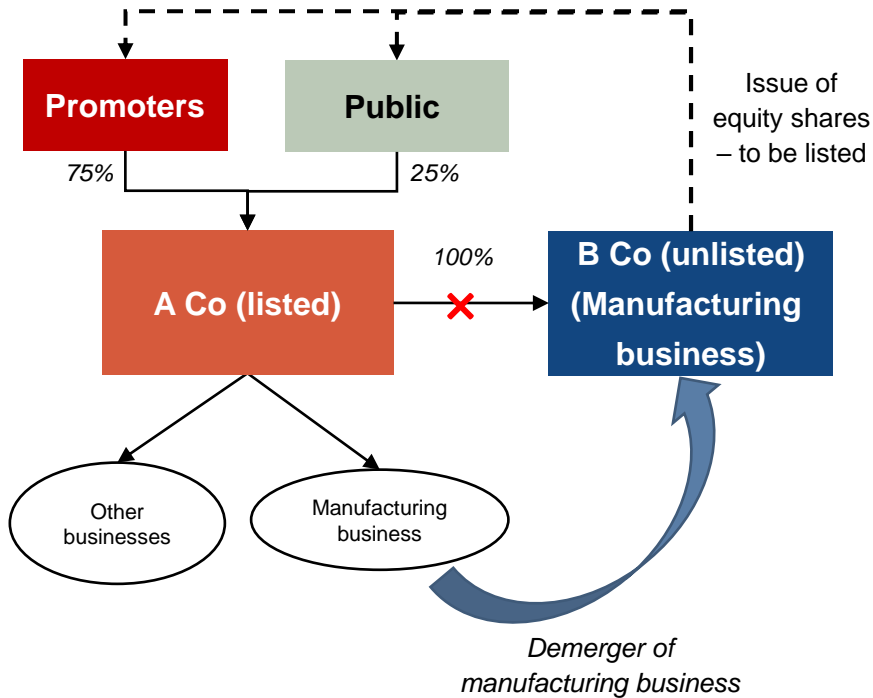


- **Overall structure and business review to identify potential value dilution drivers**
 - Loss making business may need to be **segregated** prior to IPO filings
 - Carve out **non-core activity** prior to IPO, for instance, real estate
 - Tax positions to be looked at to **optimise tax pay-outs** and build more cash value (mergers of any loss making group companies/ subsidiaries, tax optimisation at business level etc.)
 - Strategy and **structure for IPRs** relating to business to be reviewed and firmed up

Case Studies

Case Study 1 – Listing without IPO

Case Study 1 – Listing without IPO (1/5)



Objective

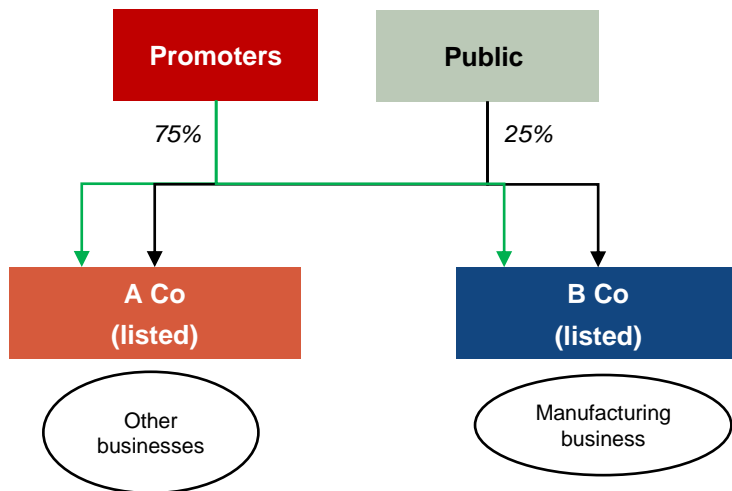
- Consolidation of manufacturing business of the Group in Co B
- Listing of manufacturing business of the Group

Transaction

- Demerger of manufacturing business from A Co (listed) into B Co (unlisted)
- Issue of equity shares by B Co to shareholders of A Co – to be listed pursuant to demerger
- Mirror shareholding in resulting company

Case Study 1 – Listing without IPO (2/5)

Resultant structure



Key takeaways

- Enables **listing** of business without IPO process
- Hiving-off of an identified business undertaking in a separate entity in a **tax neutral** manner
 - Assets and liabilities being transferred should meet the test of ‘undertaking’ to ensure section 2(19AA) compliant demerger
- **Value unlocking** of hived off business
- **No valuation** required when directly / indirectly **mirror holding**

Grandfathering benefit for capital gains on sale of shares of B Co

- Suppose shares of A Co are listed on BSE and NSE as on 31 January 2018
- Demerger from A Co into B Co is undertaken in FY 2018-19
- Shares of B Co become listed on BSE and NSE in April 2020
- Whether benefit of proportionate market price of shares of A Co (grandfathered cost) as provided u/s 55(2)(ac) would be available in respect of shares of B Co?
- Relevant provisions of the Income-tax Act discussed in next slide

Case Study 1 – Listing without IPO (4/5)

Section 49(2C)

(2C) The **cost of acquisition** of the shares in the **resulting company** shall be the amount which bears to the **cost of acquisition** of shares held by the assessee in the **demerged company** the **same proportion** as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

Section 49(2D)

(2D) The **cost of acquisition** of the **original shares** held by the shareholder in the demerged company shall be deemed to have been **reduced** by the amount as so arrived at under sub-section (2C).

Section 55(2)(ac)

(ac) subject to the provisions of sub-clauses (i) and (ii) of clause (b), in relation to a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust referred to in section 112A, **acquired before the 1st day of February, 2018**, shall be higher of—

- (i) the **cost of acquisition** of such asset; and
 - (ii) lower of—
 - (A) the **fair market value** of such asset; and
 - (B) the **full value of consideration** received or accruing as a result of the transfer of the capital asset
- (a) "**fair market value**" means,—
- (i) in a case where the capital asset is listed on any recognised stock exchange as on the **31st day of January, 2018**, the highest price of the capital asset quoted on such exchange on the said date:

Case Study 1 – Listing without IPO (5/5)

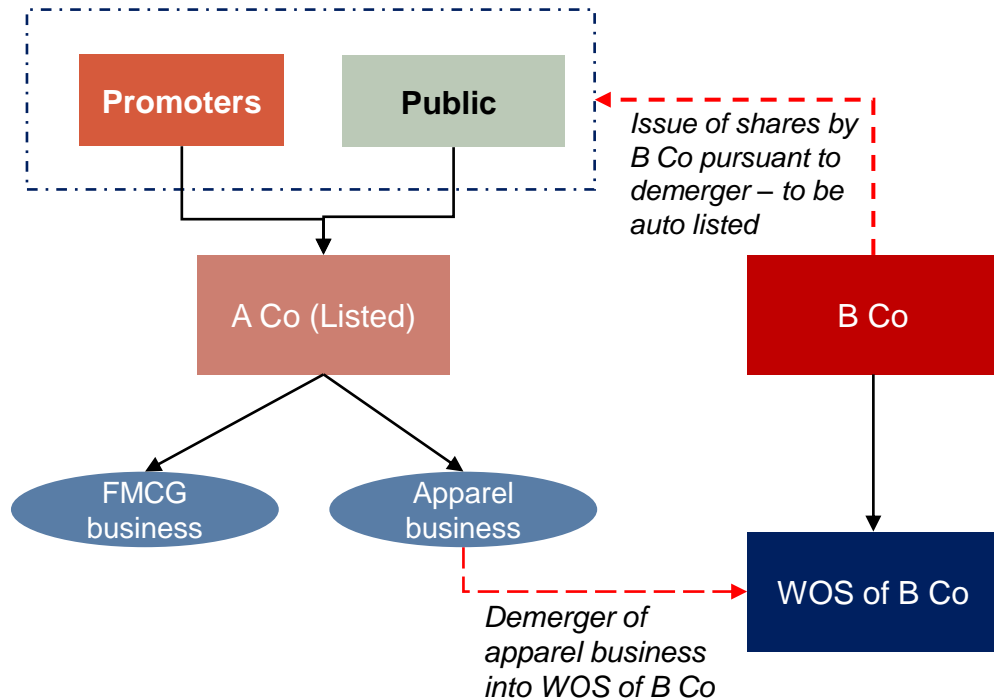
Section 112A

(1) Notwithstanding anything contained in section 112, the tax payable by an assessee on his total income shall be determined in accordance with the provisions of sub-section (2), if—

- (i) the total income includes any income chargeable under the head "Capital gains";*
- (ii) the **capital gains arise from the transfer of a long-term capital asset being an equity share in a company** or a unit of an equity oriented fund or a unit of a business trust;*
- (iii) securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004 (23 of 2004) has,—*
 - (a) in a case where the long-term capital asset is in the nature of an equity share in a company, been paid on acquisition and transfer of such capital asset; or*
 - (b) in a case where the long-term capital asset is in the nature of a unit of an equity oriented fund or a unit of a business trust, been paid on transfer of such capital asset.*

Case study 2 – Demerger and issue of shares by holding company of resulting company

Case study 2 – Demerger and issue of shares by holding company of resulting company (1/2)



Objective

- To carve out apparel business from A Co and house it under B Co vertical
- Apparel business entity to be unlisted

Transaction

- Co A to demerge its apparel business into WOS of B Co
- B Co to issue equity shares to shareholders of A Co – shares to be listed
- Demerger should be regarded to be in accordance with section 2(19AA) and hence tax neutral

Definition of Resulting Company under section 2(41A) of the Income-tax Act, 1961

“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

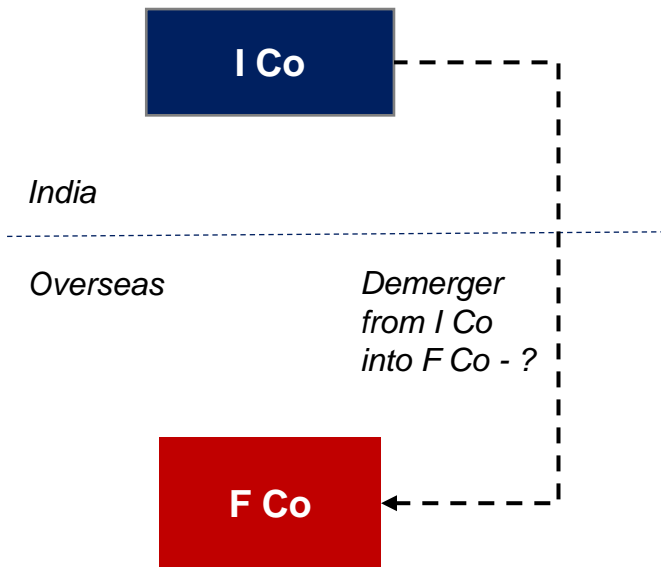
Case study 2 – Demerger and issue of shares by holding company of resulting company (2/2)

Key takeaways

- This structure can be explored in following cases:
 - Demerger of a business from listed company **without listing the business** directly
 - **Funding / investment** for demerged business
 - Regulated business – **demerge regulated business** into SPV and issue of shares by parent company
 - Retain control over the business – **control over business through parent** where promoter holding in a listed parent is not enough to provide control
 - Without listing of business, provides **liquidity to seller** in the form of listed shares

Case study 3 – Cross Border Demerger

Case Study 3 – Cross Border Demerger (1/2)



- Section 234 of the Companies Act, 2013 and Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 use the expression '**merger and amalgamation**'
- Foreign Exchange Management (Cross Border Merger) Regulations, 2018 define cross border merger as under:
*...means any **merger, amalgamation or arrangement** between an Indian company and foreign company...*
- Whether cross border **demerger** permissible?
- Contrary views taken by Ahmedabad bench of NCLT in two cases –
 - **Permitted** in case of scheme between Sun Pharma Global FZE and Sun Pharmaceuticals Industries Limited involving **inbound demerger**
 - **Not permitted** in case of scheme between Sun Pharmaceutical Industries Limited, Sun Pharma (Netherlands) B.V. and Sun Pharmaceuticals Holdings USA Inc. involving **outbound demerger**

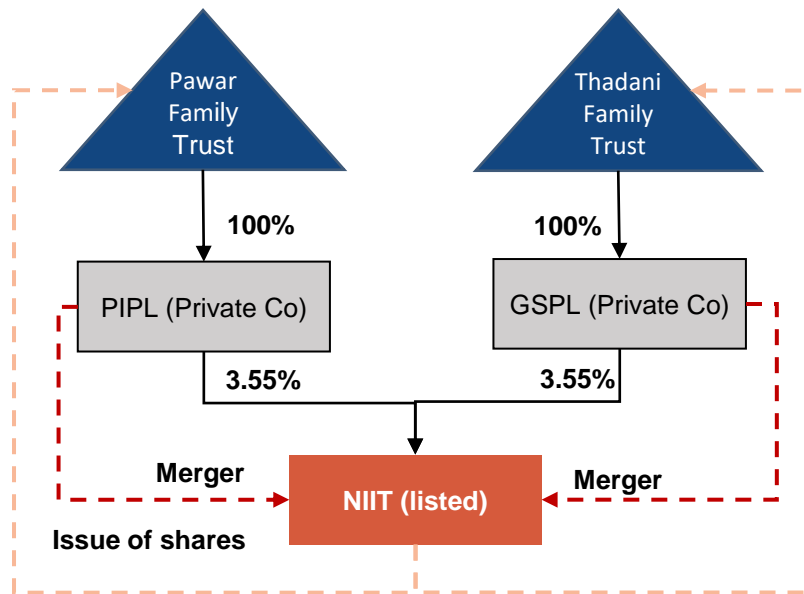
Case Study 3 – Cross Border Demerger (2/2)

- **No specific condition** u/s **2(19AA)** requiring **resulting company** to be an **Indian company**
- Following not regarded as transfer for the purpose of section 45 –
 - **Section 47(vib): any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company**
 - **Section 47(vid): any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking**
- Section 47(vib) (exemption for demerged company) requires resulting company to be Indian company
 - **No such requirement** under **section 47(vid)** (exemption for shareholders of demerged company)
- In case of **outbound demerger** –
 - **Exemption should be available to shareholders of demerged company** in respect of shares received pursuant to demerger u/s 47(vid)
 - **Exemption not available to demerged company** under the Income-tax Act
- Can it be argued that in **absence of consideration** received by demerged company, **capital gains tax liability** should not arise?
 - In *ITO v. M/s. Datex Ohmeda (India) Pvt Ltd**, Tribunal deleted the addition on account of capital gains in the hands of demerged company even though the transaction was not demerger as per section 2(19AA)

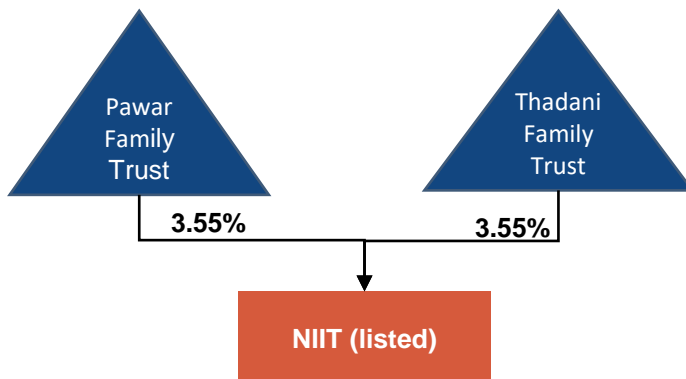
* ITA No. 2038/Kol./2014

Case study 4 – Merger of Investment Co with Listed Co

Case study 4 – Merger of Investment Co with Listed Co (1/2)



Resultant structure



Transaction

- Merger of PIPL and GSPL with NIIT
- Investment of PIPL and GSPL in NIIT will get cancelled pursuant to merger
- NIIT will issue equivalent shares to shareholders of PIPL and GSPL

Rationale for merger

- Reduction of **shareholding tiers**
- Bringing shares directly under trusts for **succession planning**
- No change in **promoter shareholding** of NIIT

Case study 4 – Merger of Investment Co with Listed Co (2/2)

Objections by Income-tax department

- Provisions of section 47 of the Income-tax Act misused and evasion of tax liabilities – in effect merger results in transfer of listed company shares from PIPL and GSPL to the trusts
- Appointed Date for scheme as March 31, 2017 is intended to avoid tax liability which may arise under Section 56(2)(x) introduced in Finance Act, 2017

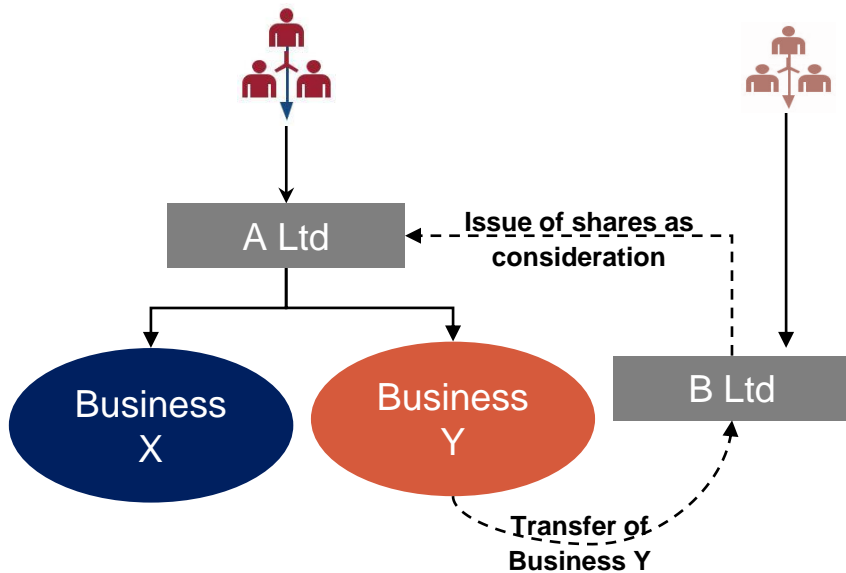
Ruling of Delhi Bench of NCLT

- Court/ Tribunal cannot sit over the views of shareholders / board, unless their views against framework of law and public policy
- Onus on Income-tax authorities to establish scheme is vehicle to evade tax ONLY - authorities failed to demonstrate the same. Tax efficient and beneficial way of structuring a transaction possible and not tax evasion.

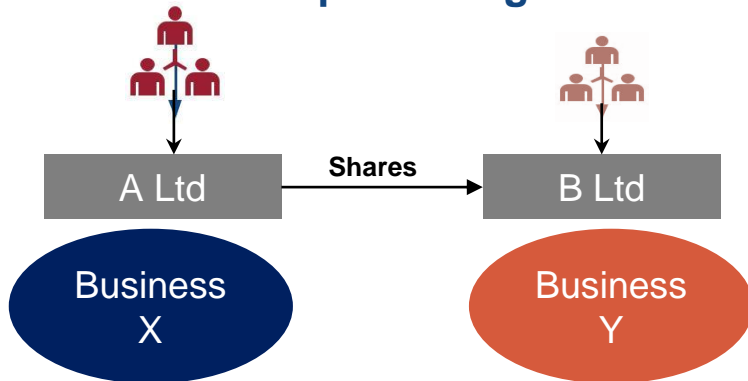
Similar scheme rejected by Mumbai bench of NCLT in case of Ajanta Pharma owing to adverse observations raised by Income-tax authorities

Case study 5 – Slump Exchange

Case study 5 - Slump Exchange



Post - slump exchange scenario



- Issue of shares by B Ltd as consideration for acquisition of Business Y instead of cash consideration
- Bombay HC in case ***Bharat Bijlee Ltd¹*** – transaction in nature of ‘exchange’ does not fall within the scope of ‘slump sale’
 - Not liable for capital gains tax in ***absence of computation mechanism for cost*** of acquisition of undertaking
- Delhi HC in case of ***SREI Infrastructure²*** took a ***contrary position*** holding that slump exchange transactions are taxable
- Appeal is ***pending before SC*** in both the cases
- Slump sale definition in Section 2(42C) – two important tests to be met
 - (1) ***“Transfer”***, by way of; (2) ***“sale”*** for a lump sum consideration
 - Definition of transfer u/s 2(47) includes exchange, hence ***exchange is transfer***
 - ‘Sale’ is ***not defined*** in the Act

1. 45 taxmann.com 104
2. [2012] 251 CTR 129 (Delhi)

Case study 6 – Merger of LLP into Company

Case Study 6 – Merger of LLP into Company (1/2)

- **Companies Act 1956** defines 'transferor company' to **include any body corporate**
- Section 230-232 of the **Companies Act, 2013** uses the term company and **not 'body corporate'**; Section 234 defines foreign company means any company and body corporate outside India
- **LLP Act, 2008** – Provides for amalgamation of LLP into LLP; however, **no specific provision** for amalgamation of LLP into Company
- **Divergent rulings of NCLT**
 - **Permitted** – NCLT, Chennai bench in case of Real Image LLP and Qube Cinema Technologies Pvt Ltd
 - **Intention** of Parliament **to permit merger** of a foreign LLP with an Indian Company under section 234 of the Companies Act, 2013
 - It would be wrong to presume that Act prohibits merger of Indian LLP with Indian Company
 - Case of **omission of language** in the statute – **casus omissus**, i.e. a case which was omitted to be included but which would otherwise have been included given the same was covered in the erstwhile Act
 - **No express legal bar** to allow merger of Indian LLP with Indian Co.
 - **Permitted** – NCLT Mumbai in case of Vertis Micro Systems LLP & Foreahead Solutions Pvt
 - **No discussion** on the issue of merger of LLP into Company
 - **Not permitted** - NCLT Ahmedabad in Kediya Ceramics (partnership firm)
 - Legislature in its wisdom thought it fit to make available the provisions of amalgamation only to companies and not body corporates

Case Study 6 – Merger of LLP into Company (2/2)

- **No specific provision** under the Income-tax Act **for tax neutrality** in case of merger of LLP into company
 - Tax implications for partners, LLP and Company need consideration
- **Alternative modes** for achieving the desired objective of consolidation of LLP and company –
 - **Slump sale** of business from LLP into Company
 - **Conversion** of LLP into Company followed by demerger



Concluding Remarks

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- ✓ Structuring to be backed by commercial purpose and substance
- ✓ Adopting a holistic approach – evaluation of tax, regulatory and accounting implications
- ✓ Tax – an important factor for consideration in deal structuring. Focus on tax optimization while structuring a transaction imperative
- ✓ Overlap between tax planning and tax avoidance
- ✓ Enforcement of GAAR by tax authorities - Robust documentation to demonstrate bona fides of the transaction imperative in GAAR era
- ✓ Timelines for implementation – obtaining approvals from regulatory authorities, shareholders and creditors
- ✓ Review of transaction costs – stamp duty, litigation cost, etc.



Q&A



Thank You