Merger & Acquisition, Corporate Restructuring- Key Considerations

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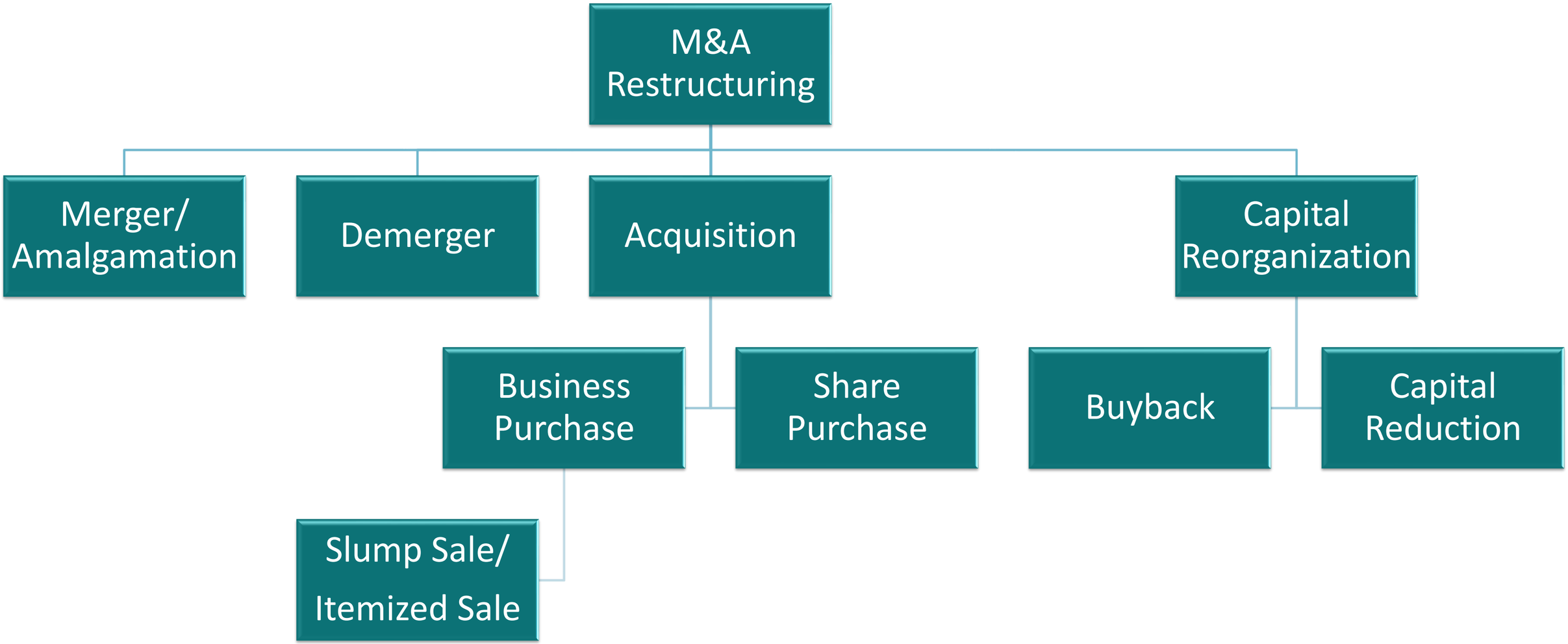
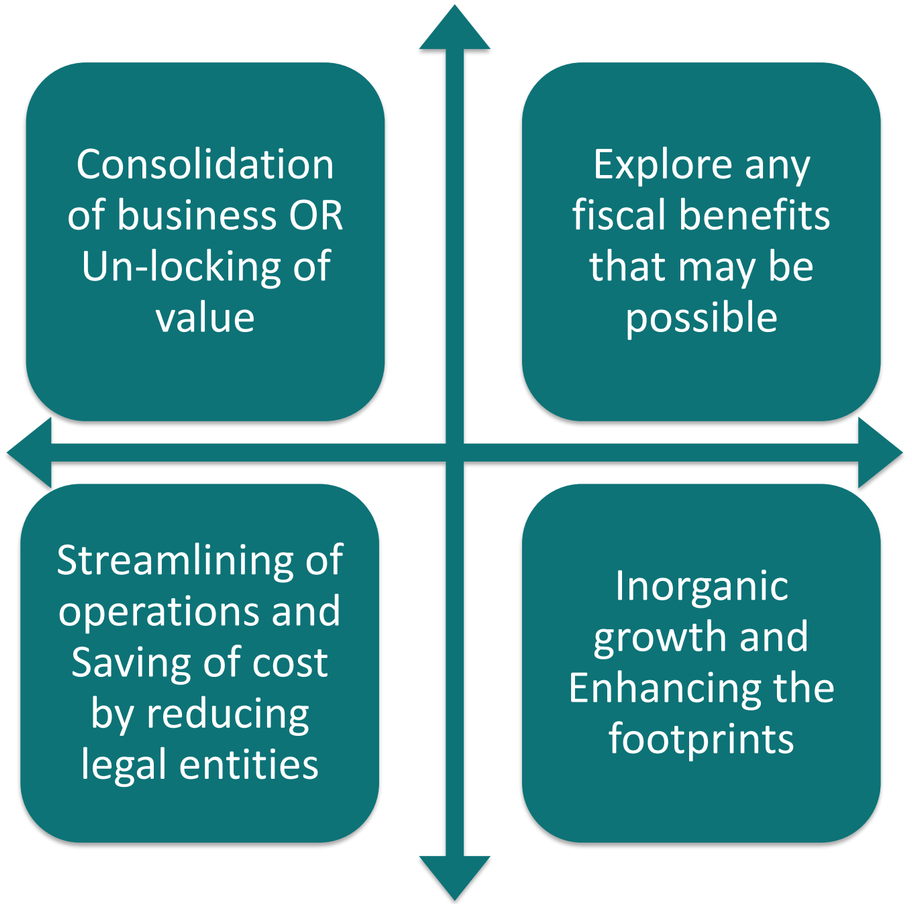
M&A Modes, Drivers, Considerations & Framework

Modes of M&A and Restructuring



M&A- Key Drivers



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

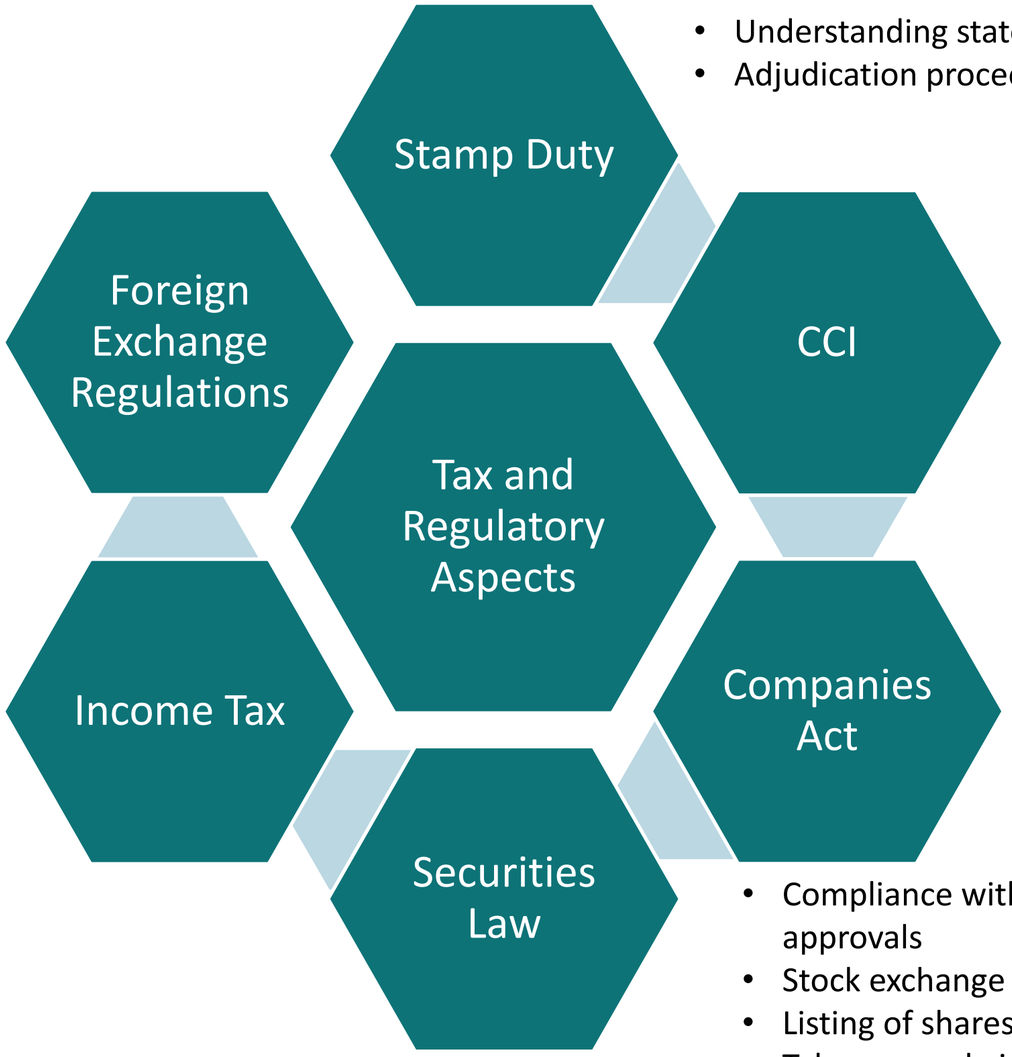
M&A - Key Considerations

- Commercial – Synergy, expansion, divestment, desired shareholding structure, etc.
- Companies Act, 2013
- SEBI Regulations
- FEMA Regulations
- Tax Considerations
- Stamp Duty
- Other Stakeholders approval/ comfort
- Entry and Exit strategies

M&A Framework- Tax and Regulatory Aspect

- Understanding state specific stamp duty laws
- Adjudication proceeding etc.

- FDI/ ODI implications, Cross Border Merger implications etc
- Seeking necessary RBI approvals
- Pricing Guidelines



- Approval of CCI for Combinations

- Tax implications in the hands of the Transferor Company, Transferee Company and Shareholders
- Tax neutrality of restructuring
- Withholding taxes
- No Objection Certificate
- Indemnities and Warranties

- Scheme of arrangement u/s 230-234 of the Companies Act, 2013
- Approvals from NCLT/ RD/ ROC/ OL
- Accounting implications and disclosures under I-GAAP / Ind-AS, as may be applicable

- Compliance with SEBI Regulations/ approvals
- Stock exchange approvals
- Listing of shares
- Takeover code implications

Concept of Merger Vs Demerger Vs Slump sale

Merger- Definition and Conditions

" Amalgamation" under normal parlance means:-

- Merger of one or more companies with another company; or
- Merger of two or more companies to form one company

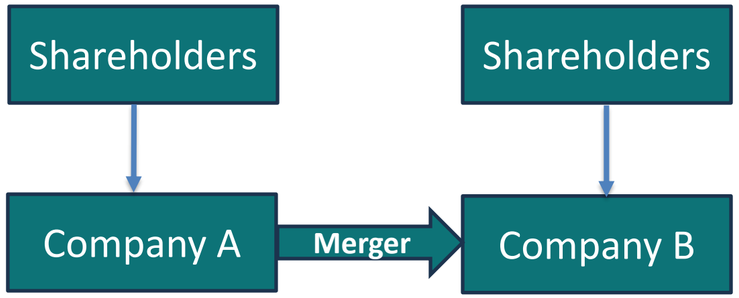
Conditions to be satisfied for tax neutral amalgamation **[Section 2(1B)]**

- Transfer of ***all properties*** & liabilities by the amalgamating company to the amalgamated company;
- Issue of shares to the shareholders holding not less than ***3/4th shares (in value)*** in the amalgamating company ***(other than the shares already held by the amalgamated company or its nominees or its subsidiary)***

Mergers of WOS into Holding Company Tax neutral merger even though shares are not issued to the shareholders of amalgamating Company

Merger- Illustrations

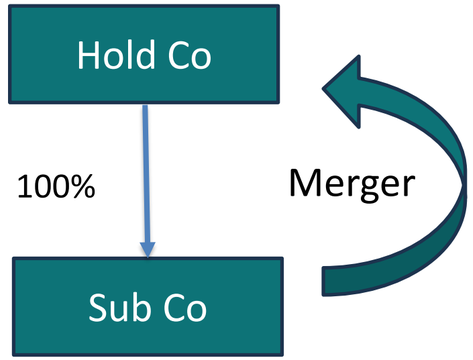
Consideration in the form of Company B



Merger of Company A with Company B.

E.g. Vodafone Idea merger

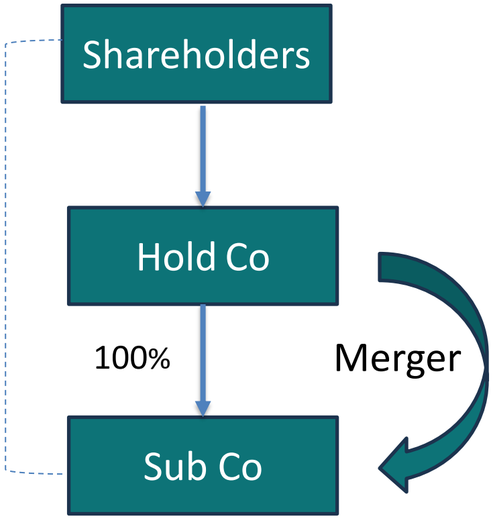
No shares to be issued by Hold Co



Merger of Sub Co with Hold Co.

E.g. Bill Forge Private Limited (WOS) merged with Mahindra CIE Automotive Limited

Consideration in the form of shares of Sub Co



Merger of Hold Co with Sub Co.

E.g. Saurashtra Cement Limited

Merger- Tax Implications

Particulars	Taxability / Treatment
In the hands of Amalgamating Company	No capital gains tax on transfer of capital assets provided ➢ Amalgamated company should be an Indian company [Section 47(vi)]
In the hands of Shareholders of Amalgamating Company	No capital gains tax on transfer of shares provided ➢ Consideration to be in form of shares in amalgamated company(except where the amalgamated company itself is a shareholder) ➢ Amalgamated company should be an Indian company [Section 47(vii)]
Cost of acquisition of shares received on amalgamation by the shareholders	It shall be cost of acquisition of shares held by the shareholders in the amalgamating company provided ➢ 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 provided ➢ Transfer as referred u/s. 47(vii)

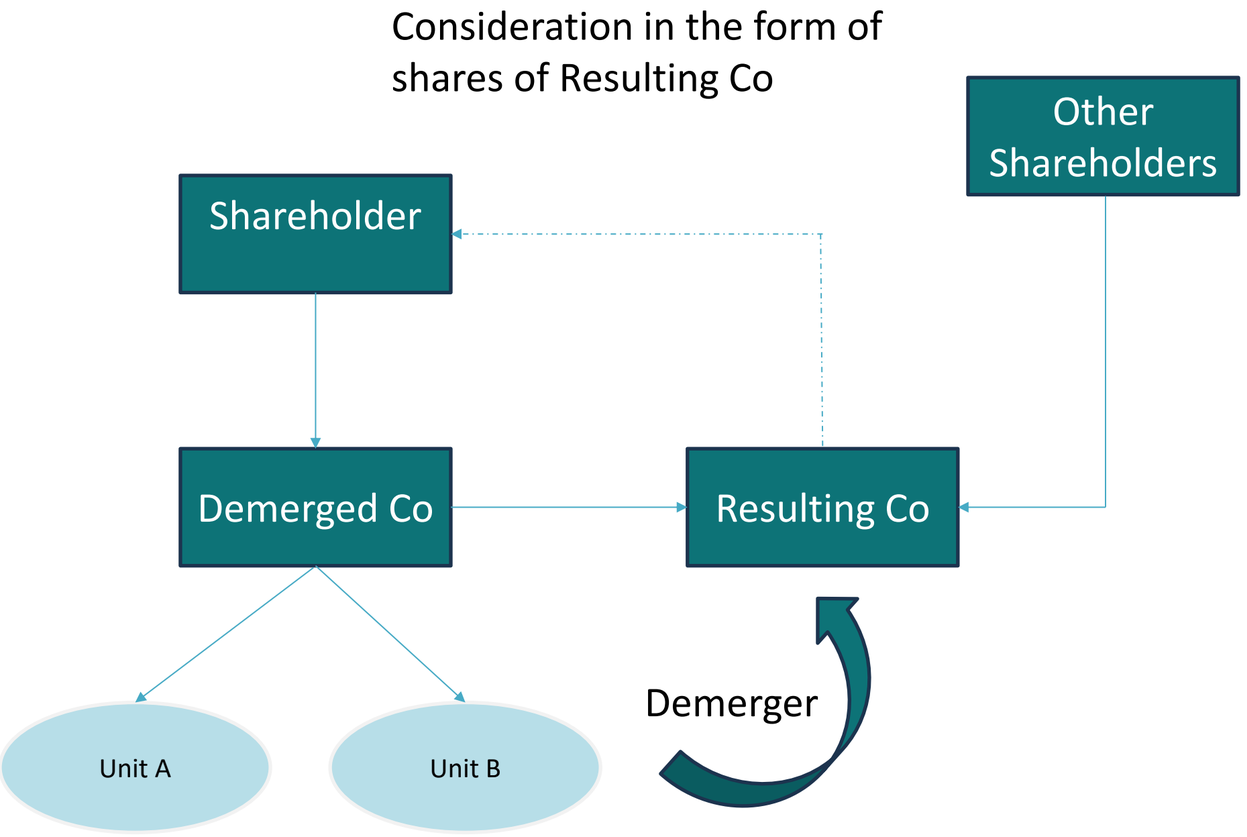
Merger- Tax Implications

Particulars	Taxability / Treatment
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 Provided 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 amalgamating company
Expense incurred in relation to amalgamation allowable in the hands of Transferee company	The transferee company is allowed as deduction of 1/5th of the expense every year for the period of five beginning from the year of amalgamation

Demerger- Definition and Conditions

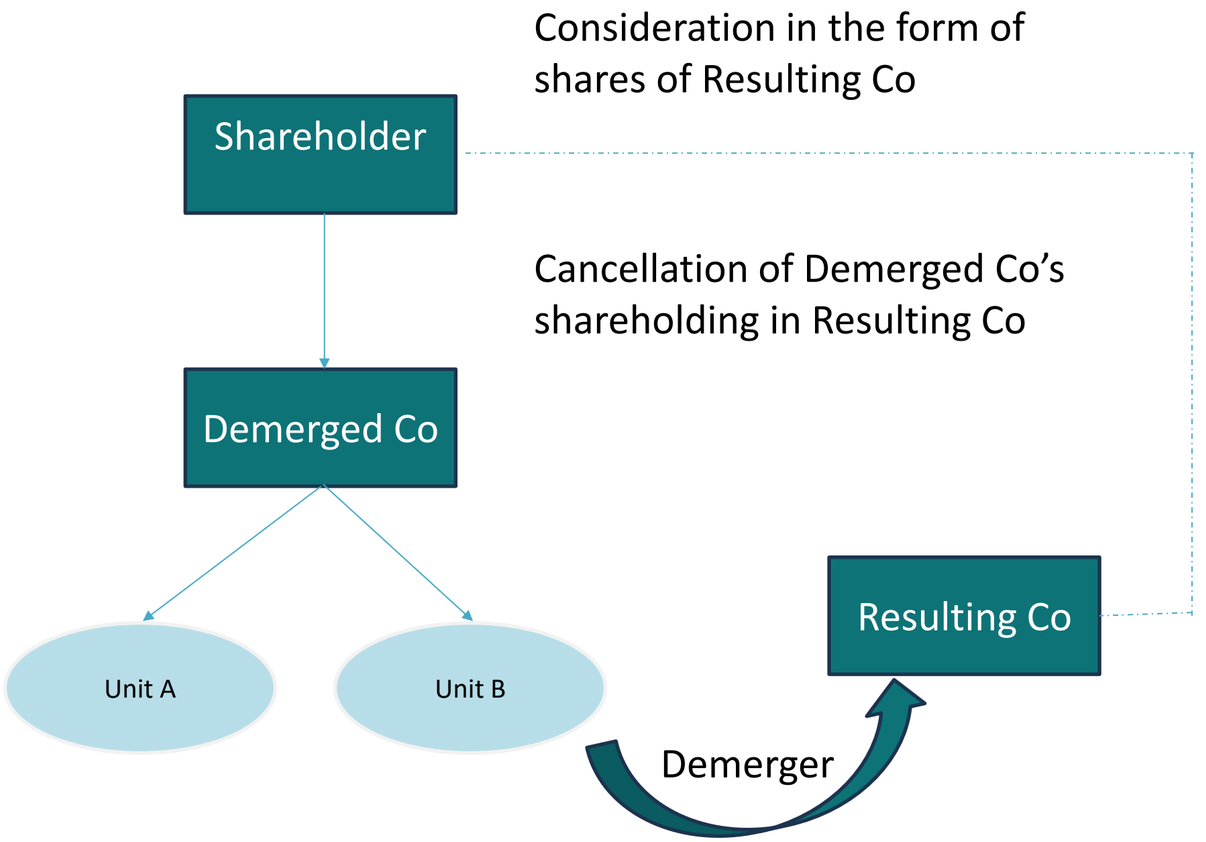
Meaning	**" Demerger"** means the transfer of one or more undertakings by the demerged company to any resulting company
Conditions to be satisfied for tax neutral demerger [Section 2(19AA)]	➢ Transfer of all properties & liabilities relatable to the **undertaking** being transferred by the demerged company to the resulting company **at book value**; ➢ Discharge of consideration by the resulting company by way of **issue of shares on proportionate basis** (except where resulting company itself is a shareholder of the demerged company); ➢ Issue of shares to the shareholders holding **not less than 3/4th shares (in value)** in the demerged company (other than the issue of shares already held by the resulting company or its nominees or its subsidiary); ➢ Transfer of undertaking **to be on a going concern basis**
Undertaking	**"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** [Explanation 1 to Section 2(19AA)]

Demerger- Illustrations



Non–Mirror shareholding Demerger

E.g. Piramal Pharma Limited



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

E.g.Aarti Industries

Demerger- Tax Implications

Particulars	Taxability / Treatment
In the hands of Demerged Company	No capital gains tax on transfer of assets provided ➢ Resulting company should be an Indian company [Section 47(vib)]
In the hands of Shareholders of Demerged Company	No capital gains tax on receipt of shares from the resulting company [Section 47(vid)]
Cost of Assets for Resulting Company: • Depreciable Assets • Capital Assets	= WDV of depreciable asset to be the same as WDV in the hands of Demerged Company = No specific provision for cost of Capital Asset required provided ➢ Resulting company should be an Indian company

Demerger- Tax Implications

Particulars	Taxability / Treatment
Period of holding of shared received on demerger by the shareholders	Includes period of holding of shares held in the demerged company
Period of holding of capital assets	Includes period of holding of capital assets held in the demerged 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

Stamp Duty Implication on Merger/Demerger

Stamp duty implication on merger/demerger

Under Article 25(da) of the Maharashtra Stamp Act, 1958, stamp duty payable on conveyance relating to amalgamation/demerger of companies.

- Article 25(da) of the Maharashtra Stamp Act provides for levy of stamp duty;
- 10% of the aggregate market value of the shares issued/allotted, subject to the higher of:
  - 5% of the true market value of the immovable property (located in the state of Maharashtra) transferred by Amalgamating Company to Amalgamated Company, and
  - 0.7% of aggregate of the market value of the shares issued/allotted and the amount of the consideration paid.

Subject to maximum of INR 50 crores

Whether SD applicable on merger/demerger of wholly owned subsidiary & holding companies ?

Slump Sale

Definition	➢ Slump sale is transfer of an undertaking/ business for a lumpsum consideration on a going concern basis without values being assigned to individual assets and liabilities being transferred
Tax Consideration	➢ Capital gains to be computed for the undertaking as under: • Sale consideration- Cost of Acquisition • Tax net worth of the undertaking will be considered as cost of acquisition ➢ Section 50B(2) of the IT Act provides that FMV on the date of transfer, shall be deemed to be the full value of consideration. FMV is to be regarded as higher of: • FMV1 : Derived based on Net Adjusted Assets Method • FMV2 : Calculation based on consideration(both monetary and non-monetary) received or accruing to the seller ➢ Net worth= Aggregate value of total assets of the undertaking (less) Book value of liabilities of such undertaking ➢ Long Term Capital Gains, if undertaking is held for more than 36 months, else short term ➢ Indexation benefit not available ➢ Revaluation to be ignored while computing the Net worth
Stamp Duty	➢ In Maharashtra two views may be possible on stamp duty. Stamp duty may be paid @3% on the market value of the business in Maharashtra. Alternatively, if the BTA provides that it is a creation of an obligation then applicable stamp duty would be 0.2%

Slump Sale

Key Issues

- Slump Sale Vs Slump Exchange
  - **Pre-amendment**

    "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
  - **Post-amendment** (effective AY 2021-22 onwards) "slump sale" means the **transfer** of one or more **undertakings, by any means,** for a lump sum consideration without values being assigned to the individual assets and liabilities in such sale

- **Whether slump sale be treated as succession for depreciation claim** – applicability of sixth proviso to section 32(1)?
- Whether tax holiday u/s 80-IA, 80-IB, etc. to continue in the hands of acquirer pursuant to slump sale?
- Whether accumulated losses and unabsorbed depreciation be eligible for carry forward in the hands of acquirer pursuant to slump sale?

Capital Re-organization

Buy Back of Shares

Definition	➢ Corporate action in which a company buys back its shares from the existing shareholders usually at a price higher than market price ➢ When a company buys back its own shares, the number of its shares outstanding in the market reduces.
Tax implications	➢ The Finance Act, 2024, made amendments to taxation of buyback, which will apply to buybacks undertaken on or after October 1, 2024. Previously, under Section 10(34A) of the Income Tax Act, buyback proceeds were exempt from tax in the hands of shareholders, and companies paid a buyback tax under Section 115QA. ➢ However, under the amended provisions, the exemption under Section 10(34A) has been removed, and Section 115QA will no longer apply. The buyback proceeds will now be treated as dividends under Section 2(22)(f) and taxed in the hands of shareholders.

Capital Reduction

Definition	➢ Capital Reduction is the process of decreasing a company's shareholder equity through share cancellations and share repurchase
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. The taxation shall be as under : • Distribution to shareholders on capital reduction is deemed as dividend to the extent to which the company possesses accumulated profits, whether capitalized or not • Distribution in excess of the accumulated profits – such excess amount over the cost of acquisition of shares shall be taxable as capital gains in the hands of shareholders

Capital Reduction

Illustration

Following are the data for consideration:

- Equity Capital (Includes bonus shares of Rs 50,000 issued out of reserves) – Rs 2,00,000
- Reserves – Rs 50,000
- Cash – Rs 2,50,000

The company reduces the share capital by Rs 1,50,000 by giving cash to the shareholder.

In this scenario, Rs 1,00,000 is the deemed dividend u/s 2(22)(d) and the same shall be liable to tax in the hands of shareholders at the rate of 25.17% (In case of Company) and at the rate of 35.88% (In case of Individuals)

Remaining Rs 50,000 shall be taxable as capital gain in the hands of shareholder.

Fair value of consideration – Rs 50,000

Cost of acquisition – Rs 10,000 (assumed)

Capital Gain – Rs 40,000

Capital Gain shall be chargeable at the rate of 14.95%. (Assuming long term)

Transfer Of Shares Within The Group

Transfer Of Shares Within The Group

Impact on Losses due to change in substantial shareholding

As per Sec 79 of Income-tax Act, 1961, Availability of carry forward and set off of losses (incurred in any year prior to the year of change) against income of the year of change in shareholding will be lost, if the following conditions are satisfied:

- There is change in shareholding of a company (not being a company in which public are substantially interested)
- Shareholders beneficially holding not less than fifty-one percent of the voting power on the last day of the year(s) in which loss was incurred do not continue to beneficially hold shares carrying not less than fifty-one percent of the voting power on the last day of the year of change

Exceptions to Section 79

A company where a change in the shareholding takes place in a year pursuant to:

- A resolution plan approved under the Insolvency and Bankruptcy Code, 2016;
- The death of a shareholder;
- Transfer of shares by way of gift to any relative from the shareholder
- Any change in shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of the foreign company subject to the condition that 51% of the shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.
- The benefit of carry forward of losses incurred by the eligible start-ups during the specified period under section 79 has been aligned with the time period as prescribed under section 801AC (to 10 years from 7 years)

Section 79 shall not apply to widely held companies

Transfer Of Shares Within The Group

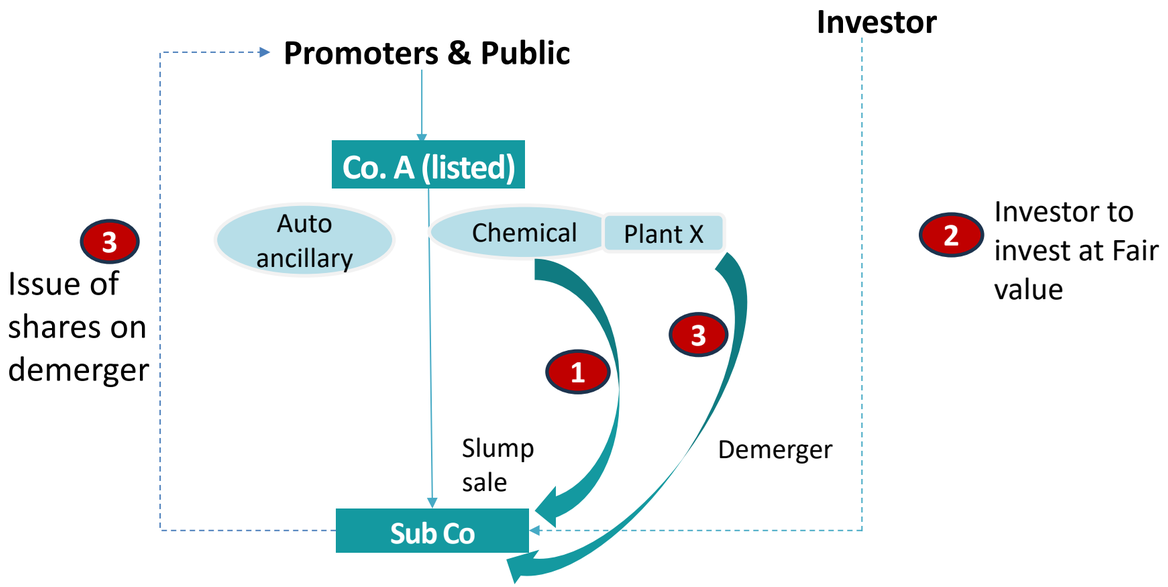
Section 56(2)(x) and 50CA

- As per Section 56(2)(x) of Income-Tax Act 1961, in case any shares or securities are transferred at a value that is less than the Fair Market Value, the difference shall be charged to tax in the hands of the buyer
- Fair market value under the Income-Tax Act for the purpose of secondary sales of shares shall be computed in the following ways:
  - In the case of a listed company, it shall be listed price
  - In the case of an unlisted company, it shall be computed using the formula prescribed under Rule 11UA (i.e., Book Value)
- If transfer is made below fair value, then capital gain tax implications in the hands of transferor u/s 50CA

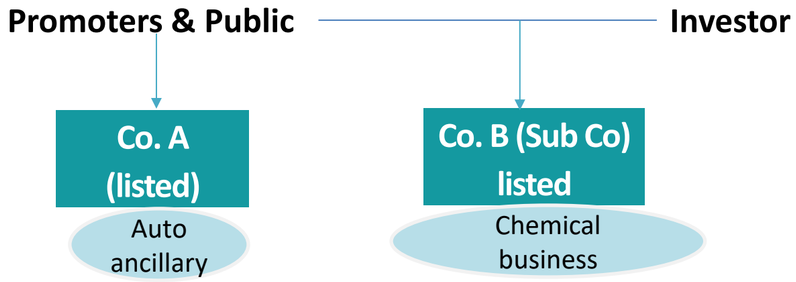
Case Studies

Case Study 1

Pre restructuring



Post restructuring



Facts:

- Co A, listed entity, is in the businesses of Auto Ancillary and Chemical
- Co A intended to get investment from Private Equity (PE) only for the Chemical business. Hence, Co A decided to carve out the Chemical business as separate entity with the below objectives:
  - To implement the structure for the investment in the minimum possible time
  - Co A intended to unlock the Chemical business value by listing it separately
  - Provide an exit mechanism for the PE investor

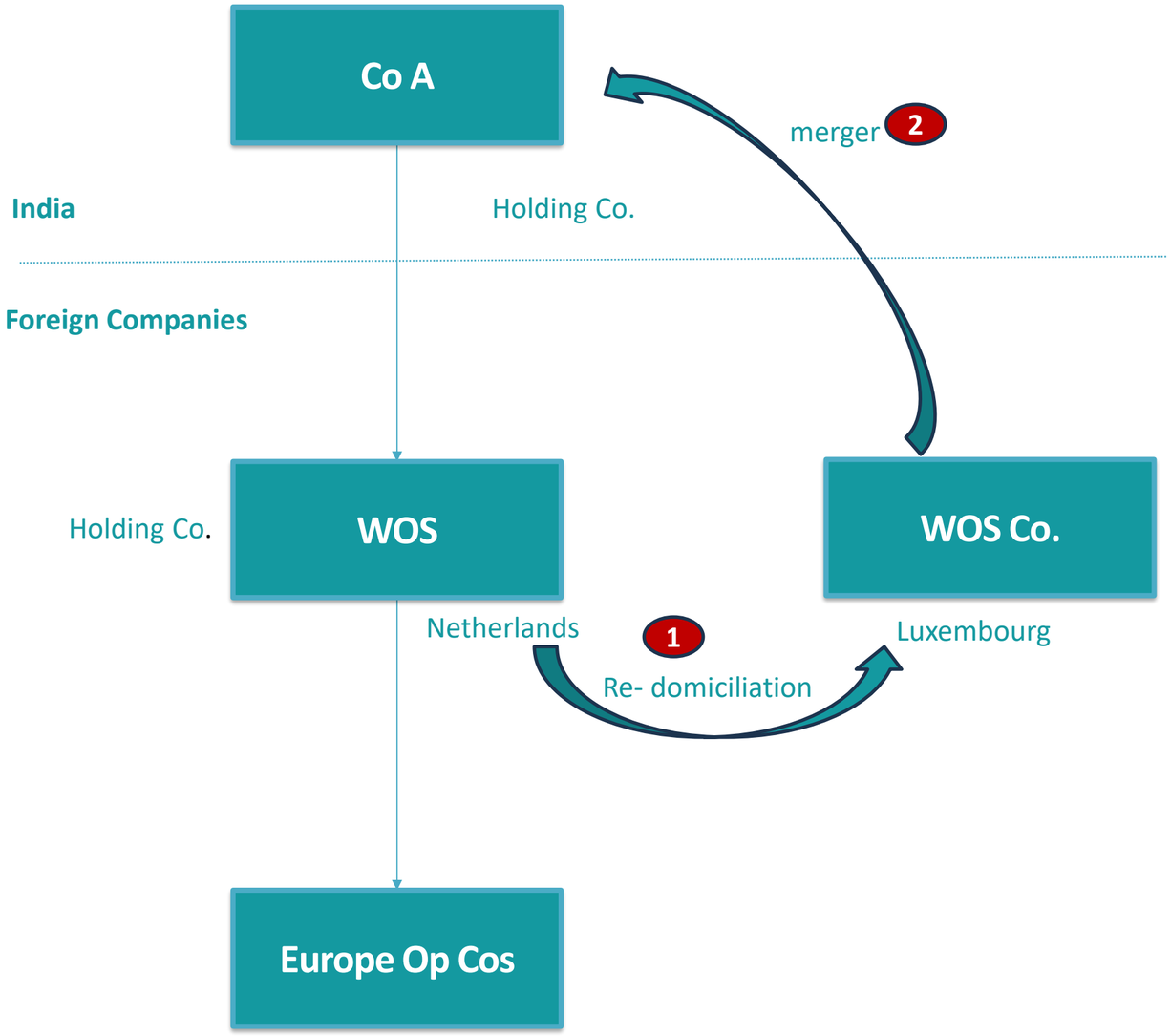
Steps:

1 : Co A to transfer its Chemical business to its wholly owned subsidiary (Sub Co) on a slump sale basis at book value for cash consideration. However, a small part of the Chemical business (say Plant X) to be kept in Co A.

2 : The PE investor to invest in the Sub Co at a fair value of the Chemical business

3 : In the second leg of the transaction, Co A to demerge the Plant X to the Sub Co through a court approved demerger. Pursuant to the demerger, the Sub Co to issue its shares to the shareholders of Co A as consideration and the Sub Co to be listed as a separate entity.

Case Study 2



Facts:

- Co. A, listed entity, having a wholly owned subsidiary (WOS) in Netherlands, which in turn was owning operating entities in Europe
- Netherlands entity is a holding company with no operations.
- Co. A intends to eliminate the Netherlands entity, so that it can own the Europe entities directly
- Regulations in Netherlands do not allow cross border merger with a non-European country

Steps:

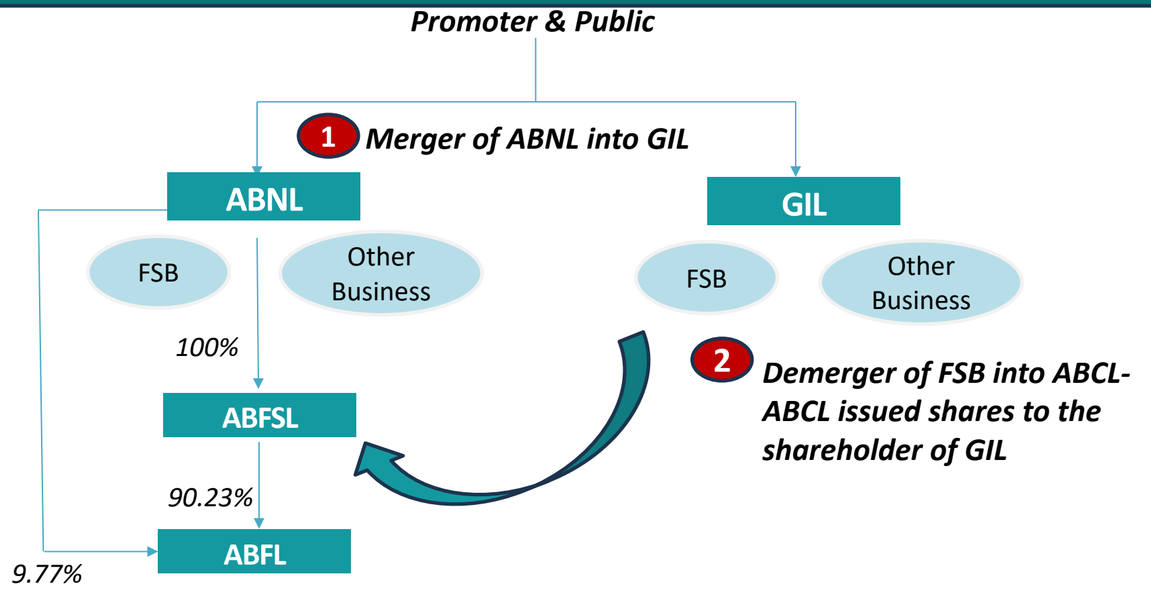
1 : WOS in Netherlands to be re-domiciled to say Luxembourg

2 : post the re-domiciliation Luxembourg entity to be merged with the Indian entity

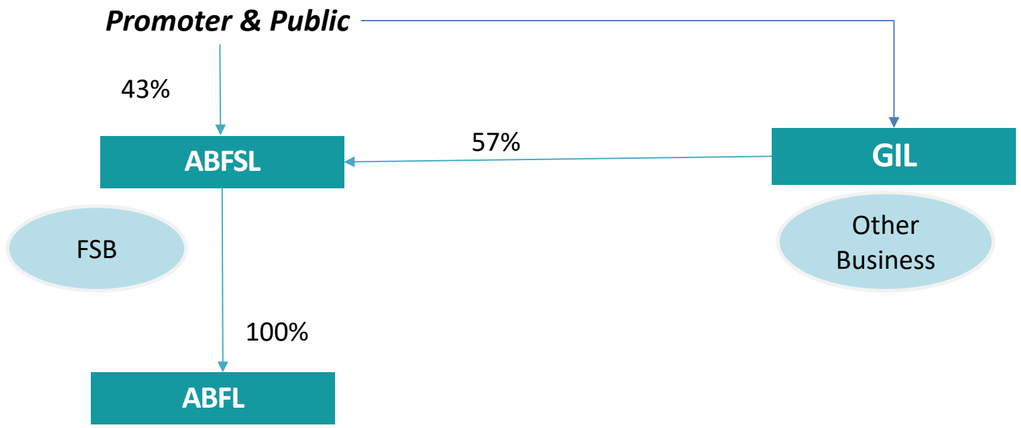
Issues for considerations:

- Whether re-domiciliation is taxable in India and Netherlands?
- Whether inbound merger is taxable in India and Luxembourg?

Case Study 3



Post restructuring:



Facts:

- Aditya Birla Nuvo Limited (ABNL) was in financial service business (FSB).
- ABNL acquired FSB from Birla Global Finance in 2005
- ABNL's subsidiary, Aditya Birla Financial Service Limited (ABFSL) held a 90.23% stake in Aditya Birla Finance Limited (ABFL)
- The remaining 9.77% of ABFL was directly held by ABNL

Steps:

A composite scheme was filed to implement the below

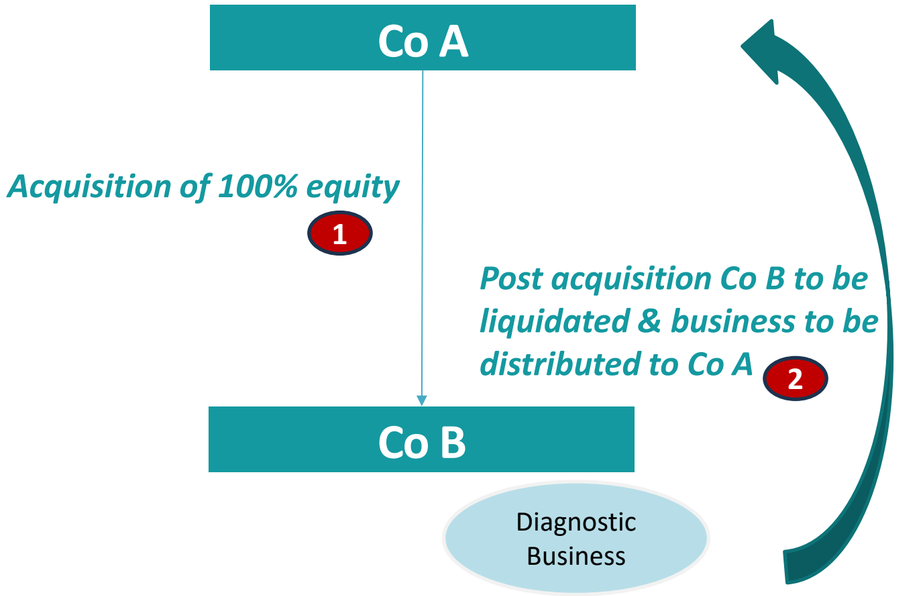
1 : Merger - ABNL merged into GIL w.e.f. Day 1

2 : Demerger - FSB was then demerged into ABFSL along with shares held in ABFL of 9.77% w.e.f. Day 2

Issues for considerations:

- Whether transfer of FSB along shares will qualify for business undertaking test under the provisions of Income-tax Act and hence a tax neutral demerger ?
  - Transfer of investment undertaking vs. transfer of business along with certain investments in shares
- Whether issue of shares on demerger be treated as deemed dividend u/s 2(22)?
- Can tax authorities examine the case post approval by NCLT?

Case Study 4



Facts:

- Co A and Co B are in Diagnostic business
- Co A intends to acquires Co B and exploring the option to get a cost step up on the assets of Co B on the acquisition

Steps:

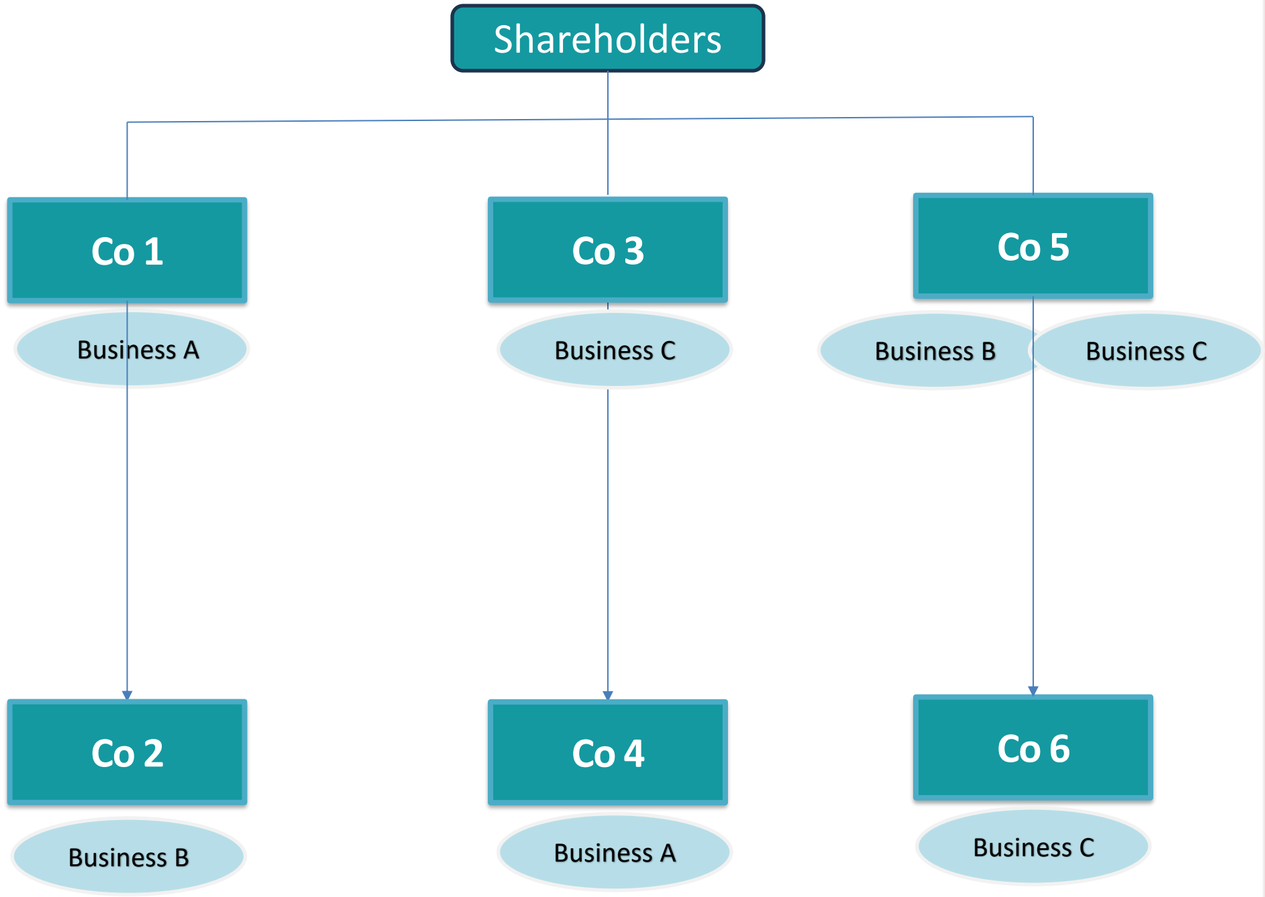
1 : Co A to acquire 100% of equity shares of Co B

2 : Co B to be liquidated under voluntary liquidation regulation and the business along with the assets and liabilities to be distributed to Co A

Issue for considerations:

- Taxation on liquidation?

Case Study 5



Objective:

- To have a separate company for Business B which would enable investment from potential investors

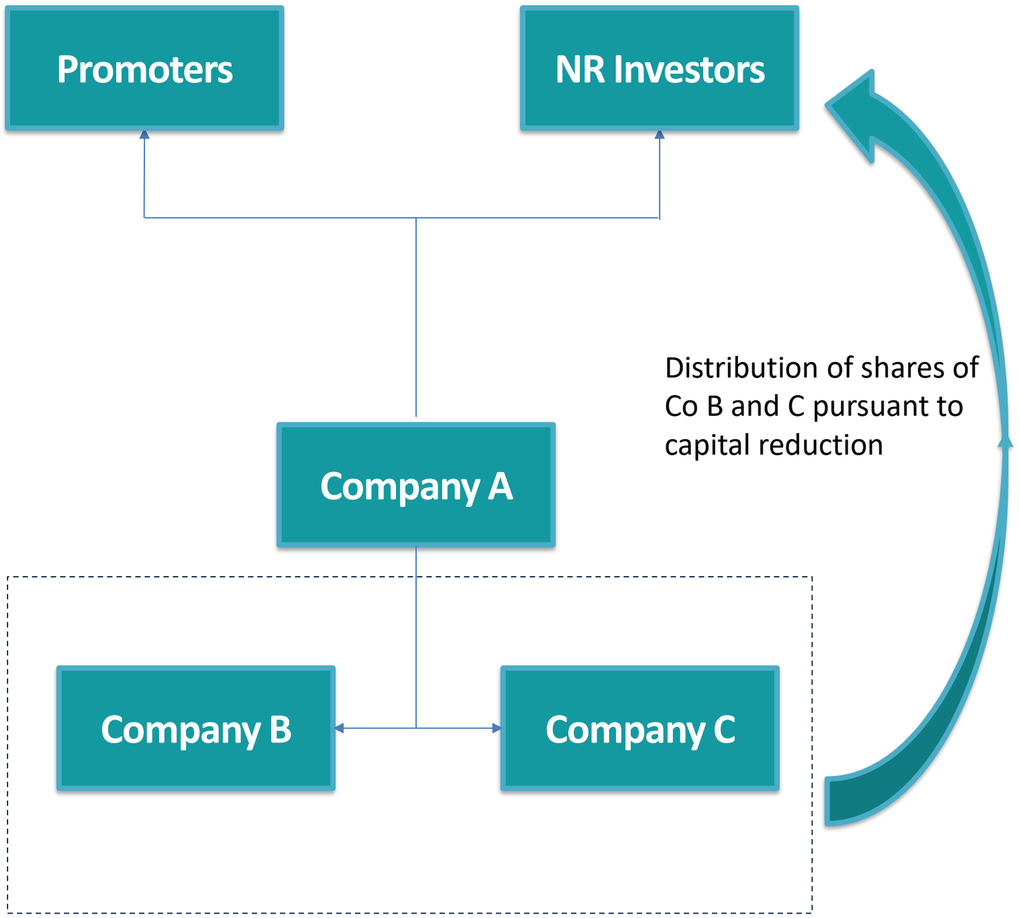
Steps (illustrative):

1 : Co. 2 shall be transferred below Co. 5
2 : Business C shall be transferred from Co. 5 by way of slump sale to Co. 3
3 : Co. 6 shall be transferred below Co. 3

Issues for considerations:

- applicability of Section 79 on transfer of a company
- Valuation - Whether to transfer at fair value or 56(2)(x) value? How to deal with immovable property in a company?
- Slump Sale Vs Demerger
- Transfer of a company Vs Merger
- If there is an existing Investor in one of the company - How to get the desired cap table
- What if the promoters are willing to fund Business B at current value and bring the new Investors later at a higher value

Case Study 6



Facts:

- Promoters and NR investor are owning Co. A
- Co. A owns Co. B and Co. C

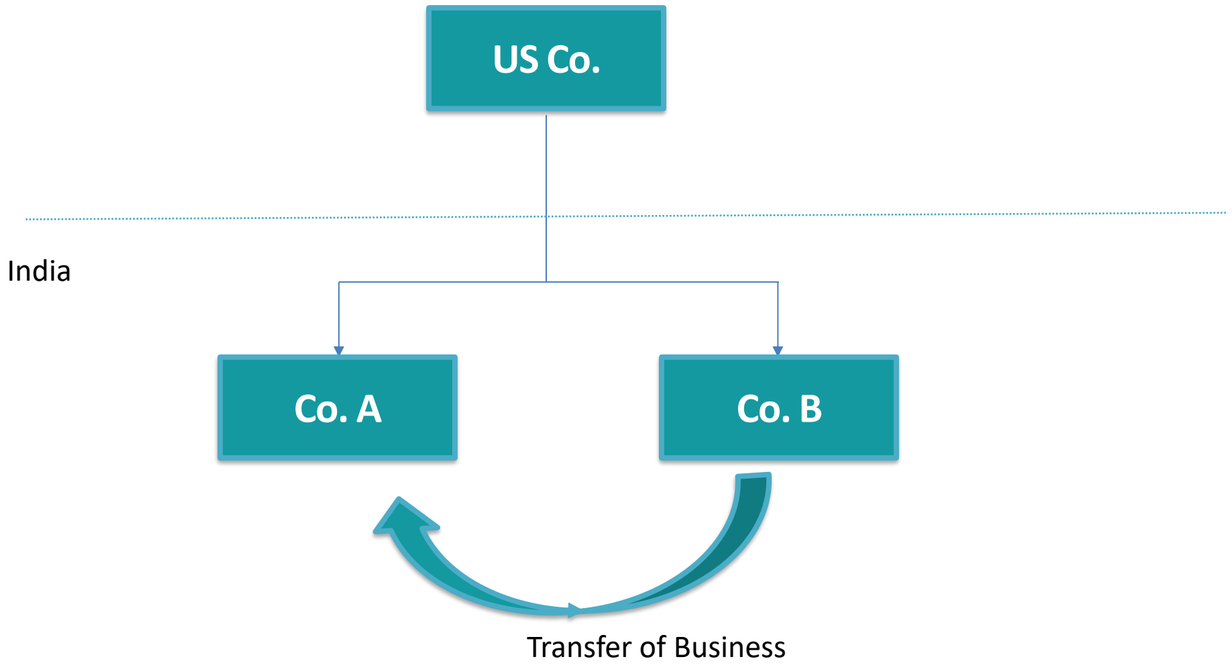
Steps:

1 : Distribution of shares of Co. B and Co. C through a capital reduction scheme by Co. A to Investors. The capital reduction was performed by reduction of share capital and securities premium

Issues for consideration:

1 : Is it possible to use the securities premium account for capital reduction?
2 : Is selective capital reduction possible?
3 : Tax implication on capital reduction?

Case Study 7A



Facts:

- US Co. owning Co. A & Co. B in India with businesses in both the companies

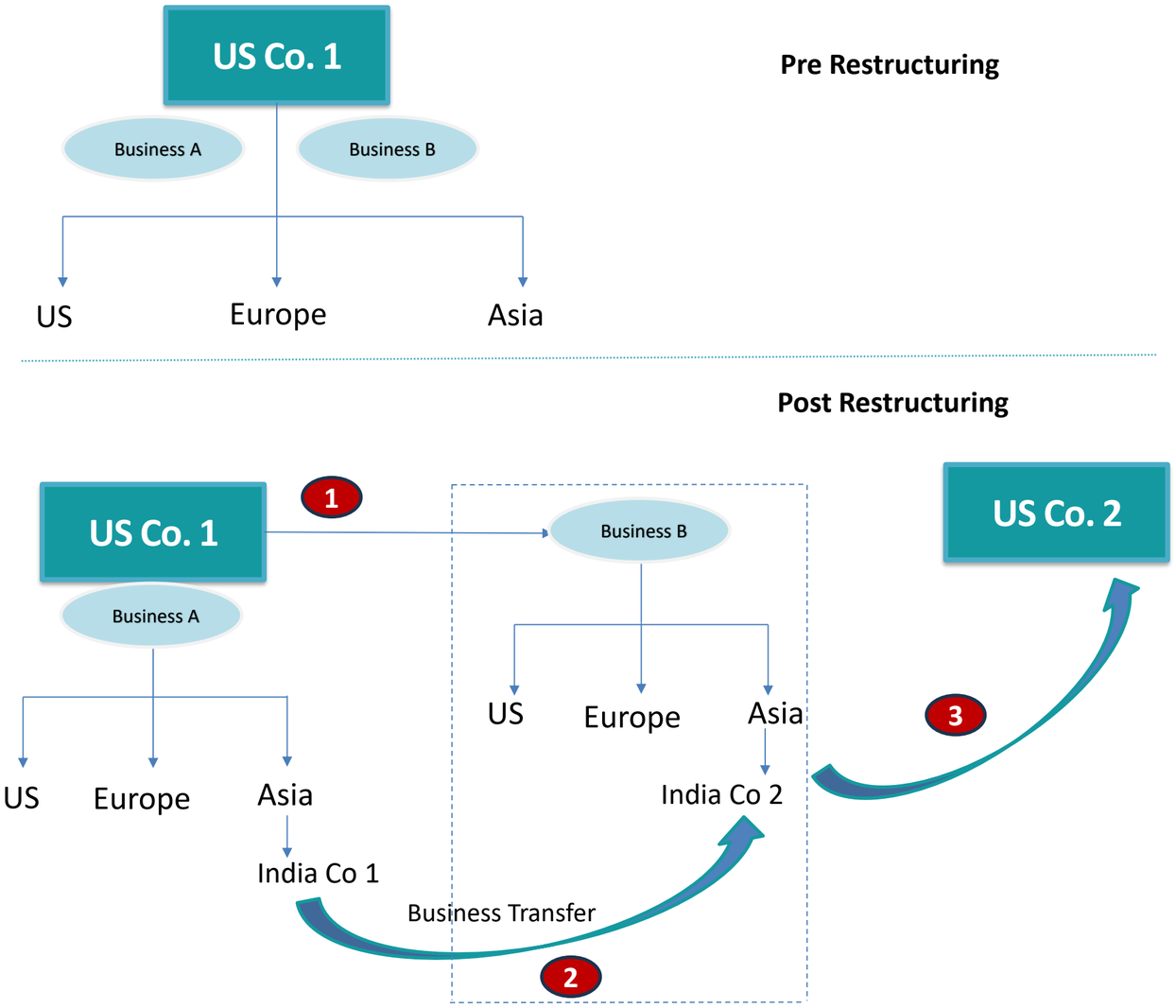
Steps:

1 : Co. B to transfer its business to Co. A

Issue for consideration:

1. : Whether transfer pricing (TP) would apply?

Case Study 7B



Facts:

- US Co. 1 had agreed to transfer its Business B to US Co.2 at a fair value (both are not related parties)
- Given that the transfer of Business B from US Co.1 to US Co.2 will be done at a fair valuation, the fair value of Indian business B could be higher than Book value.

Steps:

1 : Business B to be carved out across the globe by replicating the structure under US Co. 1

2 : The Indian business B will be transferred by a slump sale arrangement from India Co 1 to India Co 2, a new company, at 11UAE value (Book value)

3 : US Co. 1 will transfer the entire Business B structure to US Co. 2 at fair value

Issue for consideration:

1. : Whether TP would apply?

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