

Mergers and Restructuring

Key provisions under Companies Act, 2013

FICCI: Class room session

February 14, 2014

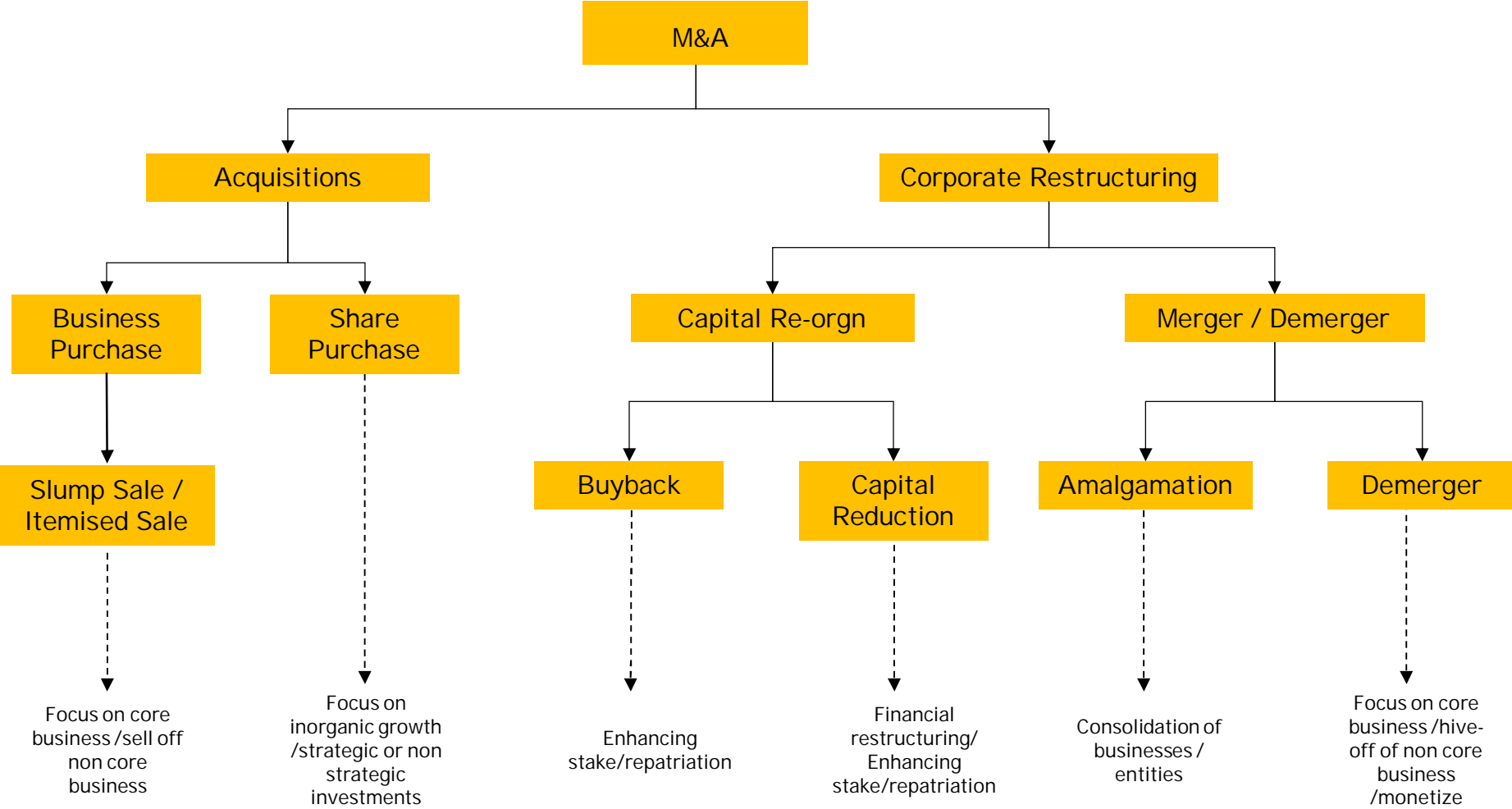
Speaker: Amrish Shah

Partner and National Leader
Transaction Tax Services,
Ernst & Young LLP

Email: amrish.shah@in.ey.com



Overview - Modes of M&A in India



Holding-Subsidiary Relationships

Partly
Notified

Existing provisions

- ▶ Subsidiary if more than half in nominal value of equity shares are held by such other company
- ▶ Subsidiary of a foreign company treated as Public Co if the foreign company were to be a public company under the Companies Act

New provisions

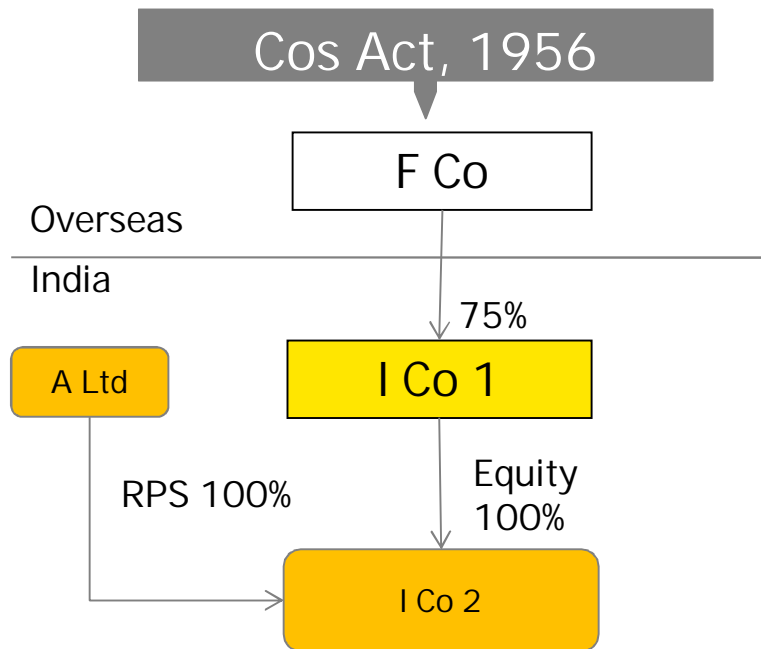
- ▶ Subsidiary if the holding company
 - ▶ exercises or controls more than one half of the total share capital either on its own or together with one or more of its subsidiary companies - No differentiating between equity or preference share capital (with or without voting rights) or
 - ▶ Controls the composition of the Board of Directors
- ▶ Implications on aspects including intercompany transactions, financial reporting, consolidation of financials etc
- ▶ No specific provision for treating subsidiary of a foreign public company as deemed Public Co

Definition of "control" similar to SEBI Takeover code i.e right to appoint majority of directors or by controlling the management and policy decisions (like management rights, voting agreements etc)

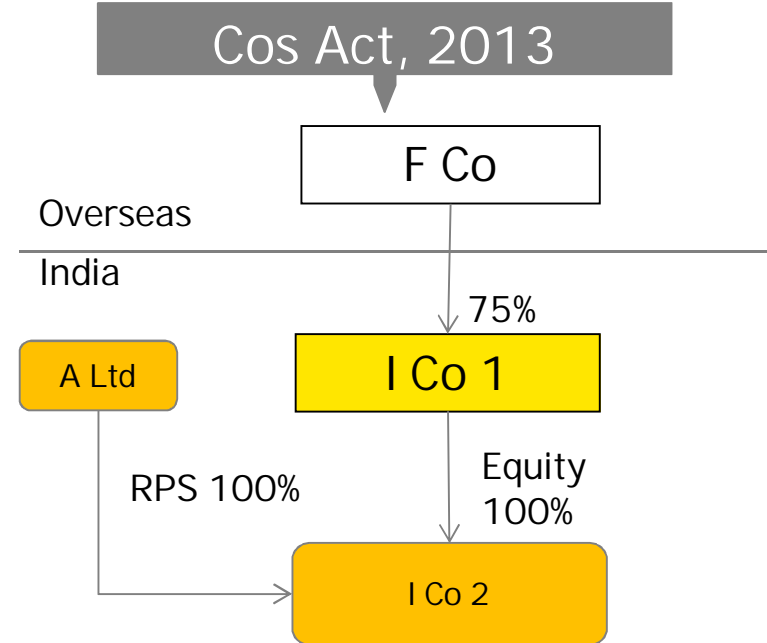
1. Likely impact of change in definition of subsidiary on income tax
 - Section 2(1B), 2(41A) – May be impacted
 - Section 79, 115JB, 47(iv) / (v), 115(1A) – May not be impacted
2. Impact on Reg 2(1)(q)(2)(i) and Reg 10(1)(a)(iii) of the SEBI Takeover Code
3. Impact of affirmative voting rights / veto rights, convertible instruments, shares with differential voting rights?
4. Exchange control regulations need to be factored

Holding-Subsidiary Relationships

FEMA Impact



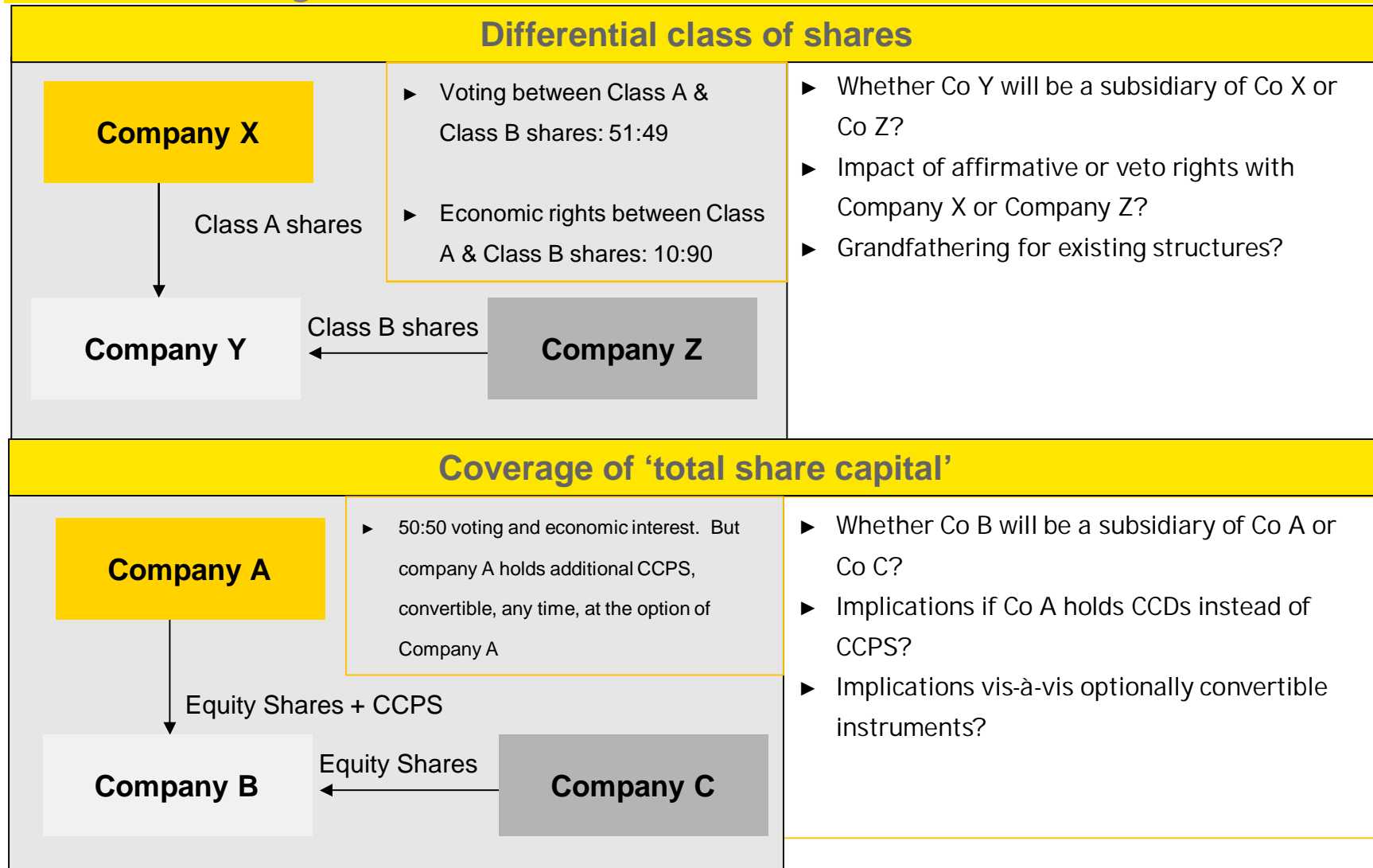
Computation of indirect foreign investment in I Co 2 – 75% ?



Computation of indirect foreign investment in I Co 2 ??

Holding-Subsidiary Relationships

Case study



Voting rights for preference shares

Not
Notified

Existing provisions

- ▶ Preference share holders can vote:
 - ▶ on resolution which directly affect rights attached to preference shares
 - ▶ Winding up or repayment/reduction of share capital
 - ▶ based on dividend due and unpaid for different periods
 - ▶ Date specified for payment in AOA or other instruments
 - ▶ If not specified, immediately next day of the period
 - ▶ Cut-off date provided
 - ▶ Aforesaid provisions applicable only to public companies and its subsidiaries
 - ▶ Voting rights of preference shares of private companies governed by AoA

New provisions

- ▶ Preference shareholders to acquire general voting rights, if dividends unpaid for 2 years
 - ▶ Concept of due and unpaid removed
 - ▶ No cut-off date for calculation of 2 years
- ▶ No specific exemption to private companies
 - ▶ Company Act may override provisions of AoA

Several provision of Income tax Act linked with “voting power” discussed in Next slide

Mitigation thoughts?

- ▶ Coupon rate of preference shares to be substituted by premium payable on redemption?

- ▶ Whether preference shareholders can waive right to dividend and / or right to vote either as part of terms of issue or otherwise?
- ▶ Whether dividend can be paid by way of issue of further preference shares ?

Voting rights for Preference shares

Likely tax impact



Before default			After default		
Particulars	Share Capital	Voting %	Particulars	Share Capital	Voting %
Equity Shares by A	500	50%	Equity Shares by A	500	5%
Equity shares by B	500	50%	Equity shares by B	500	5%
Preference shares by C	4,500	-	Preference shares by C	4,500	45%
Preference shares by D	4,500	-	Preference shares by D	4,500	45%

Section 79 – Carry forward of losses

- ▶ Would Carried forward business losses lapse beyond the date of default ??

Section 40A(2) – Related party

- ▶ Related party originally covered (on the basis of $\geq 20\%$ voting rights) may become a non-related party when equity shareholding is compared with larger base of voting power

Section 47(xiii)/ (xiv) – Corporatization of firm / proprietary concern

- ▶ Capital gains tax exemption on corporatization of firm/ proprietary concern into a company may be withdrawn

Restriction on Multi-layered structures



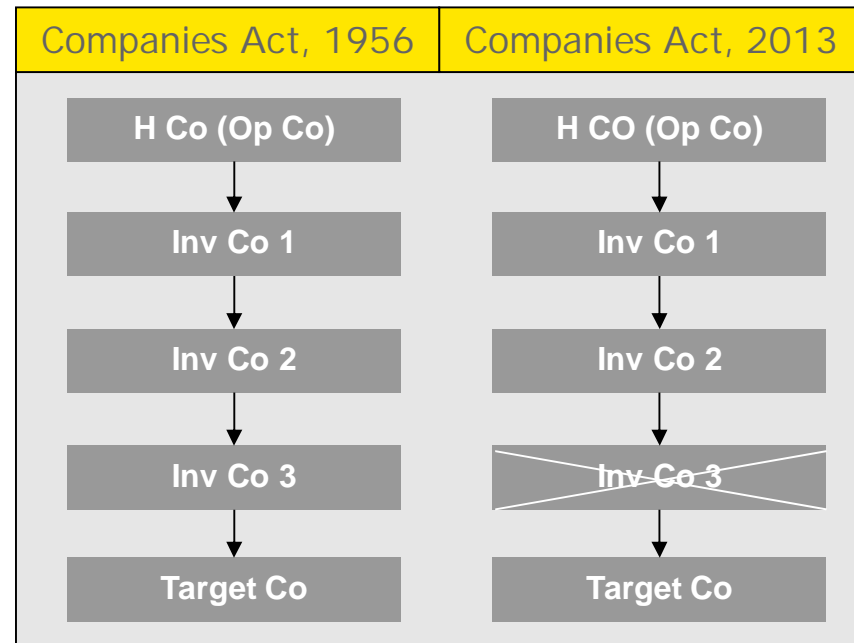
Existing provisions

- ▶ No restriction on layered investments

New provisions

- ▶ Maximum 2 layers of investment companies permissible
- ▶ Exceptions
 - ▶ Outbound acquisition with existing structures
 - ▶ Statutory requirements
 - ▶ Prescribed otherwise by CG

“Investment company” means a company whose principal business is the acquisition of shares, debentures or other securities



Discussion points

1. Clarity on the definition of “principal business”?
2. Will restriction apply to Overseas Hold Co investing in India?
3. Impact on existing structures?
4. Could affect fund raising
5. Infrastructure companies may get impacted

Mitigation thoughts

- ▶ Investment through “operating cum investment companies”??
- ▶ Intermittent hold co structures through LLP?

Allowability of put-call option



Existing provisions	<ul style="list-style-type: none">▶ Put - Call option for shares of a public company prohibited▶ View taken that Put - Call option for shares of a private company allowed
New provisions	<ul style="list-style-type: none">▶ Contract for transfer of shares between two or more persons will be enforceable▶ Possible to take a view that put-call option agreements legalized for both public and private companies

Recent SEBI notification allowing put-call option to be included in share transfer agreements – Provided stipulated conditions are satisfied

Sale of Undertaking

Notified

Existing provisions

- ▶ Sale/lease/disposal of whole / substantially the whole of undertaking possible through ordinary resolutions
 - ▶ Applicable only to public companies or their subsidiaries
 - ▶ Term “undertaking” and “substantially the whole of undertaking” not defined

New provisions

- ▶ Special resolution required for sale/lease/disposal of whole or substantially the whole undertaking
- ▶ Definitions of “undertaking” and “substantially the whole of undertaking”
 - ▶ Undertaking defined as undertaking which
 - ▶ Investment of the Company > 20% of net worth of preceding financial year; or
 - ▶ Generates 20% of total income of preceding financial year
 - ▶ “Substantially the whole of undertaking” implies 20% or more of value of undertaking as per audited balance sheet of preceding financial year

1. Applicability extended to private companies as well i.e. private companies are also required to pass special resolution

2. The definition of undertaking does not align with definition under Income tax Act

3. Investment in shares – covered under “undertaking”?

Cross border mergers



	Companies Act, 1956	Companies Act, 2013
Existing provisions	<ul style="list-style-type: none"> ▶ Permits only inbound mergers ▶ Silent on manner of discharge of consideration ▶ No restriction on jurisdiction 	
New provisions	<ul style="list-style-type: none"> ▶ Permits both inbound and outbound mergers ▶ Requirements relating to Notified Foreign Jurisdiction (NFJ) ▶ Compliance with prescribed rules ▶ Consideration to shareholders of merging entity could be in form of cash or depository receipts 	

- ▶ No tax exemption prescribed for outbound mergers, both for Transferor Co and its shareholders - Need to align tax laws in sync with amendments in Company law.
 - ▶ Possibility to take tax neutrality position for Transferor Co?
- ▶ Non tax neutral in case consideration for merger in cash or depository receipts - Not satisfying conditions under tax law
- ▶ FEMA regulations to be aligned

1. Potential tax efficient cash repatriation and exit. Requirement of RBI approval
2. Inbound mergers to also require RBI approval
3. Could facilitate overseas listing
4. Impact of the provision based on jurisdictions to be notified by the Government
5. Outbound demerger - Only merger and amalgamation specifically allowed??

Exemption from Court process

Not
Notified

Existing provisions

- ▶ No provisions for exemption from court process for corporate reorganisations like amalgamation, demerger, etc under Sec 391 to Sec 394 of Companies Act, 1956
- ▶ Currently, exemption availed by transferee entity involving merger of a WOS into itself

New provisions

- ▶ Option to following companies to undertake corporate reorganisations like amalgamation, demerger, etc. without Court process
 - ▶ Between two or more small companies
 - ▶ Between Holding Company and WOS
 - ▶ Other prescribed class of companies
- ▶ Procedure involves
 - ▶ Prior notice required to ROC, OL and persons affected by scheme of both companies before shareholders' meetings and their objections / suggestions to be placed before shareholders
 - ▶ Meeting notice to be sent to Registrar and Official Liquidators inviting suggestion / objections to scheme
 - ▶ Approval from $\geq 90\%$ shareholders and $\geq 90\%$ of creditors (value)
 - ▶ On CG's or any other person's application, Tribunal may decide if regular Court process should be followed



1. Tax neutrality in absence of court process?

2. Tax neutrality of demerger??

3. Would Court(s) continue to have jurisdiction till NCLT(s) are formed?

4. Is auditor's certificate on compliance with accounting standards required even if no Court process involved?

Restriction on Treasury shares



Existing provisions

- ▶ On merger of WOS with its parent, new shares in lieu of shares held by parent itself may be allotted to a trust, which will hold such shares for parent's benefit

New provisions

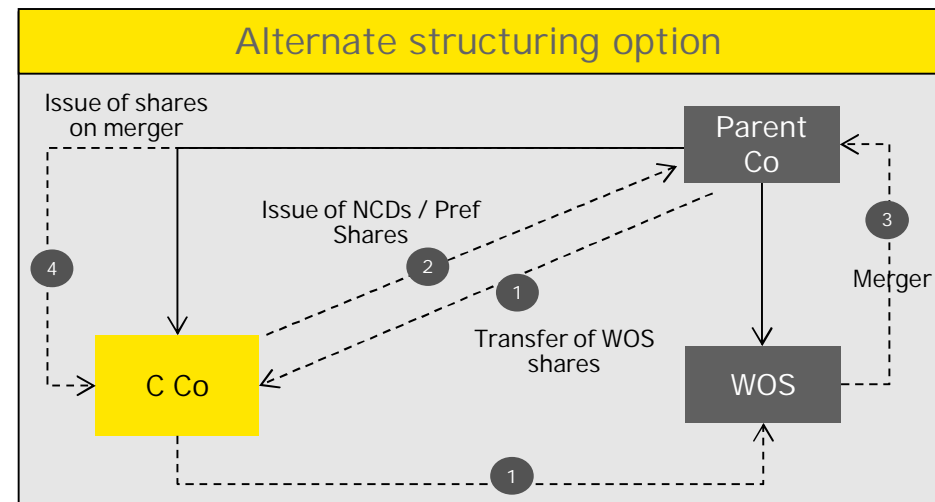
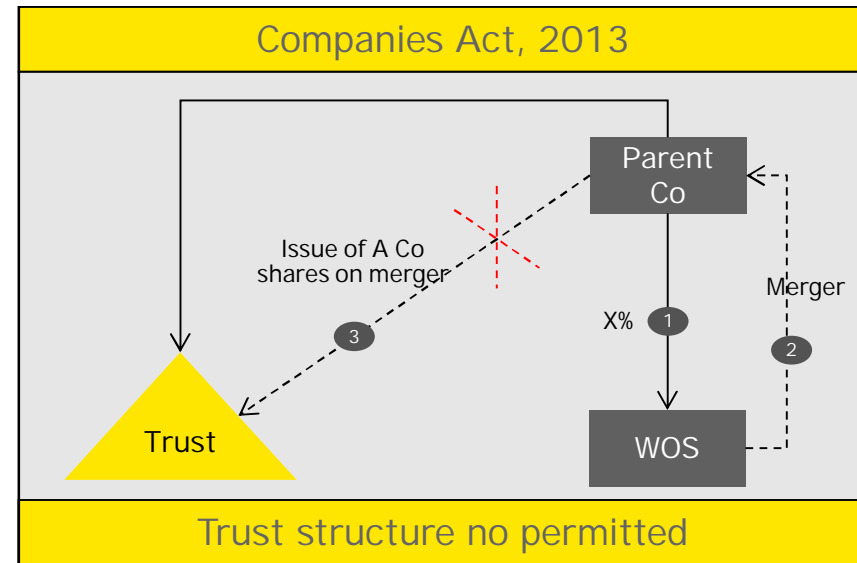
- ▶ Prohibits companies from holding shares in the name of trusts either on its behalf or on behalf of any subsidiaries or associate companies
- ▶ Provision likely to be effective prospectively

1. Negates the dual advantage available earlier to

- ▶ Indirectly hold such shares to provide access to liquidity;
- ▶ Allowing promoters to retain a controlling stake

2. Accounting impact of possible goodwill impairment

Alternate structuring options could be evaluated



Merger of Listed Co into Unlisted Co

Not
Notified

Existing provisions

- ▶ No specific provisions governing merger of listed company with unlisted company
- ▶ Enabled promoters to indirectly control voting rights
- ▶ Ready source of liquidity

New provisions

- ▶ On merger of listed company with unlisted company, the transferee company shall remain an unlisted company until it becomes a listed company
- ▶ Provisions are applicable for both merger as well as demerger
- ▶ Provision for an exit route for shareholders of the transferor company
- ▶ Payment of value of shares and other benefits in accordance with pre-determined price formula or as per prescribed valuation
- ▶ Payment/ valuation should not be less than what has been specified by SEBI

1. Indirect way of minority squeeze-out / delisting?

2. Interplay with SEBI Delisting regulations??

3. Impact on tax neutrality of amalgamation if more than 25% shareholders opt for exit route?

Acquisition of Minority Shareholding

Not
Notified

Existing provisions

- ▶ Provisions exist for acquisition of shares from dissenting shareholders
- ▶ Various conditions applicable - practically considered difficult to achieve

New provisions

- ▶ Where the shares of a company (Transferor Co) is being transferred to another company (Transferee Co) and shareholder $\geq 90\%$ in value consent to such acquisition, the Transferee Co may give notice to the dissenting shareholder to acquire their shares
 - ▶ Transferee Co can give notice to the dissenting shareholders within 2 months after the expiry of 4 months of offer
 - ▶ Transferee Co shall be bound and entitled to acquire shares within 1 months from date of notice unless Tribunal (on application) thinks otherwise.
- ▶ In the event of an acquirer becoming registered shareholder of $\geq 90\%$ of the issued equity share capital by virtue of amalgamation, share exchange, conversion of securities etc.
 - ▶ The acquirer shall notify their intention to buy the remaining equity shares of minority shareholders
 - ▶ Such offer to remain open for 1 year
 - ▶ Minority shareholders may or may not sell their shares to the majority
 - ▶ Further, the minority shareholders entitled to offer their shares suo motu
 - ▶ Valuation by registered valuer in accordance with prescribed rules

Would enable promoters to achieve full control as well as provide exit to minority even after the company is delisted?

Buyback

Not
Notified

Existing provisions

- ▶ No offer of buyback shall be made within a period of 365 days reckoned from the date of the offer of buyback made pursuant to board resolutions
- ▶ Arguably, multiple buybacks within a Financial year possible with shareholder resolutions

New provisions

- ▶ No buyback offer shall be made within a period of one year from the date of the closure of the preceding buyback offer
 - ▶ Only one buyback per financial year
- ▶ Buyback through court approved scheme also needs to comply with buyback conditions (including cooling period of one year)
- ▶ Change on definition of free reserves
 - ▶ Mention of exclusion of share application money removed
 - ▶ Certain classes of reserves excluded - Unrealised / notional gains, revaluation of assets etc

To curb the practice of repatriating money without payment of tax, buy-back tax was introduced

- ▶ 20% of distributed income (ie consideration less amount received by the company for issue) on buy back of unlisted shares subject to tax)

1. Cooling period of one year and the applicability of specified restrictions to court- approved buyback will significantly affect transactions and do away with flexibility of repatriation of returns
2. Essential for Companies Act, 1956 and tax laws to be aligned... Whether court driven buyback falls under the ambit of buyback tax ambit?

Conversion of LLP into Company

Not
Notified

Existing provisions

- ▶ As per legal view, Part IX of Companies Act, 1956 does not seem to be permitting conversion of LLP into company
- ▶ Only partnership firm, societies, etc. can be converted into company

New provisions

- ▶ Specifically provides for conversion of LLP into Company
- ▶ Additional requirements:
 - ▶ Secured creditors consent/ NOC to be obtained
 - ▶ Publish notice in the newspapers about registration as a Company
 - ▶ File an affidavit from all members/ partners to provide that in the event of registration as company, necessary documents shall be submitted to the earlier authority for dissolution as LLP/ partnership/ society etc

Unlike succession of firm by a company, there are no specific provisions under the Indian tax laws for exempting transfer of assets by LLP to a Company

1. Tax exemption on transfer of assets from LLP to Company whether taxable? Ambiguous i.e.
 - ▶ Whether tax exemption pertaining to a firm should be applicable to a LLP also?
 - ▶ Whether succession of LLP by a company results in "transfer"?
2. Carry forward of losses incurred by LLP on succession by Company??

Restriction on usage of Share Application Money

Not
Notified

Existing provisions

- ▶ Share application money could be used for any purpose by the issuing company prior to issue of shares

New provisions

- ▶ For issuing equity securities by way of a private placement, the key compliances are:
 - ▶ Shareholders will need to pass a special resolution for issue of equity securities.
 - ▶ Equity securities will have to be allotted within 60 days of receipt of share application money.
 - ▶ If the company is unable to allot the equity securities within the 60 day period the company will have to **return the share application money within 15 days of expiry of the 60 day period.**
 - ▶ If the share application money is not returned within the prescribed 15 day period the company will have to pay **interest** on the share application money **@ 12% p.a.**
 - ▶ Until allotment of equity securities, the share application money is to be **kept in a separate bank** account with a scheduled bank.
 - ▶ **The share application money can only be used for adjustment against allotment of securities or for repayment if securities are not allotted.**
 - ▶ No further private placement offer will be made unless any outstanding private placement offer is completed or withdrawn/ abandoned by the company.

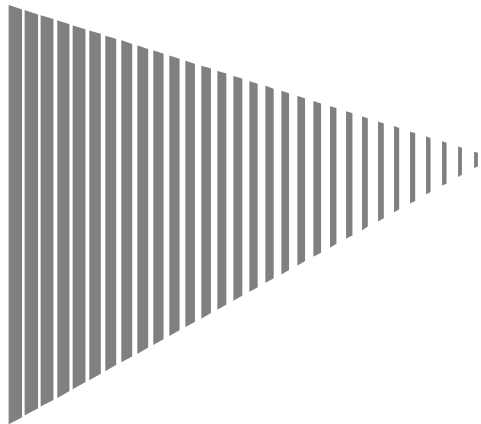
1. Ability to utilize share application money as a funding option restricted
2. Possible to use "Debenture Application money" instead of share application money?? To be evaluated in light of Indian exchange regulations, especially in case of cross border investments

Questions?

Information in this publication is intended to provide only a general overview of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be a substitute for professional advice. Ernst & Young, LLP accepts no responsibility for any loss arising from any action taken or not taken by anyone using this material.

This presentation contains limited information in summary form and is therefore intended for general guidance only. It is not expected to be a substitute for detailed research or the exercise of professional judgment. Neither Ernst & Young, LLP nor any of its affiliates can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this presentation.

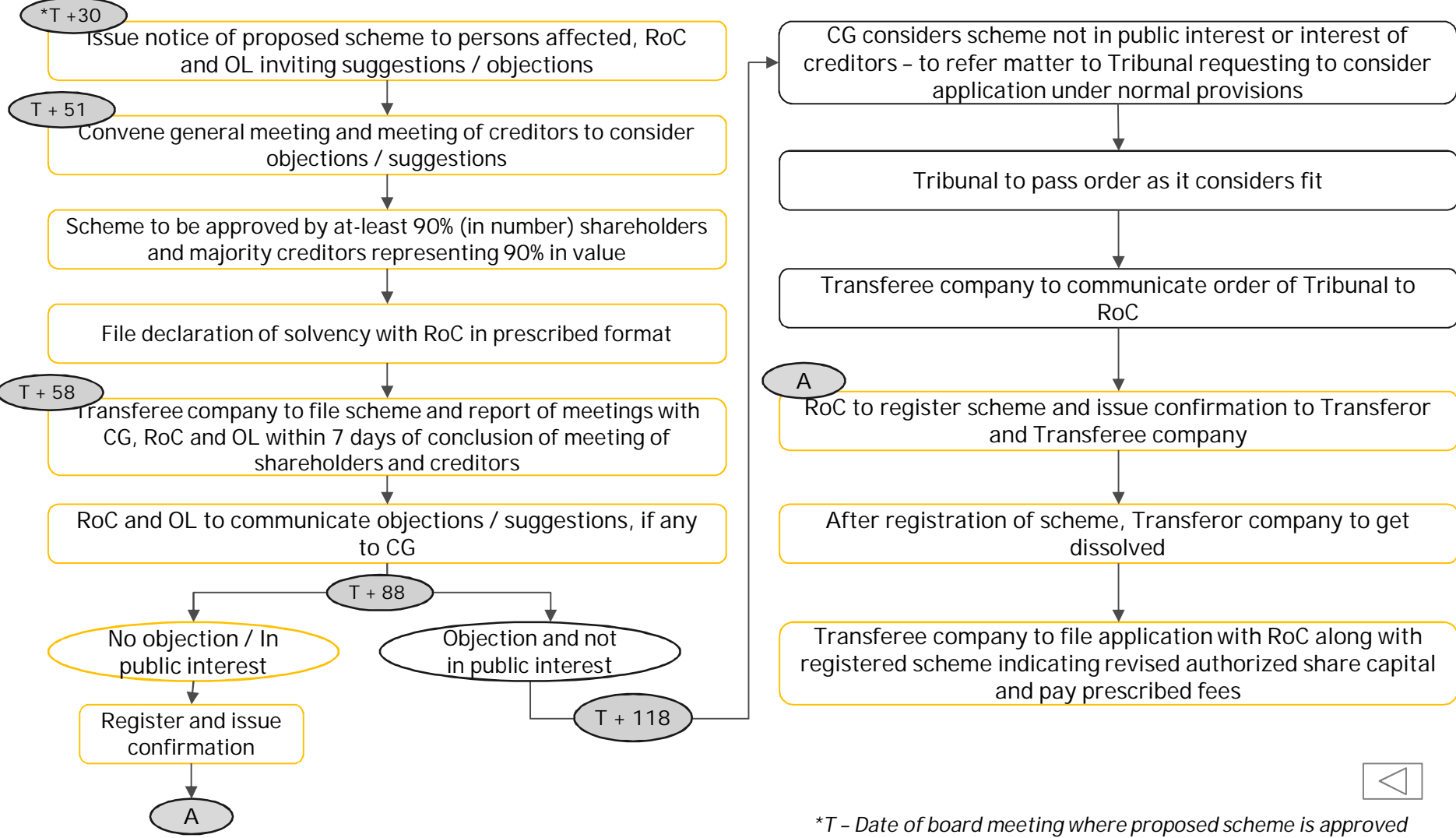
Thank You



Building a better
working world

- ▶ This presentation contains information in summary form and is therefore intended for general guidance only. It is not expected to be a substitute for detailed research or the exercise of professional judgment. We cannot accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this presentation. Detailed facts and circumstances would need to be examined prior to providing specific advice.
- ▶ Comments mentioned herein, are based on our understanding and interpretation of the legislations, and are not binding on any of the regulators/authorities and there can be no assurance that the regulators/authorities will not take a position, contrary to our comments.

Annexure – Specified Companies exempted from court process



*T - Date of board meeting where proposed scheme is approved