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TAXATION ASPECTS IN CROSS BORDER MERGERS

Owing to the favorable regulatory regime in India and considerations such as diversification, competition and access to growing markets, cross border mergers involving Indian companies is expected to go up in volume and size.

Merger (amalgamation) is essentially an arrangement whereby one or more existing companies merge their identity into another existing company or form a distinct new entity. In a merger the undertaking comprising of property, assets and liabilities, of one (or more) company(ies) are absorbed by and transferred either to an existing company or a new company. Simply put, the transferor integrates with the transferee and the former loses its entity and dissolves without winding-up. This paper touches upon certain taxation related aspects of note in cross border mergers.

Regime under Companies Act, 2013.

Company law in India is undergoing an overhaul with the advent of the new Companies Act, 2013 ('**2013 Act**'). However, certain sections of the 2013 Act are yet to come into force and the provisions relating to mergers covered in Sections 230 to 240 are yet to be notified. Until then, this court driven process will continue to be governed by Section 391-396A of the Companies Act, 1956 and the Companies (Court) Rules, 1959 ('**1956 Act**').

*Permissible Cross Border Mergers***.** While the 1956 Act prohibited mergers of Indian companies with foreign companies, the reverse was allowed. The 2013 Act however allows the merger of Indian companies with foreign companies (incorporated in foreign jurisdictions notified by the Central Government), provided prior RBI approval is obtained. Under the new regime, Inbound, Outbound and Global cross border mergers are permitted.

Taxes and Concessions under Income Tax Act, 1961 ('IT Act').

In terms of Section 47(vi) of the IT Act, transfer of any capital asset is generally subject to capital gains tax in India. However, certain types of mergers enjoy tax-neutrality with respect to capital gains taxes under Indian tax law as is dealt with below.

Inbound Mergers. In an inbound merger, a foreign company merges with an Indian company and the amalgamated entity is an Indian company. Amalgamation enjoys tax-neutrality with respect to transfer taxes and both the amalgamating company transferring the assets and the shareholders transferring their shares in the amalgamating company are exempt from tax. To achieve tax-neutrality for the amalgamating company transferring the assets, the amalgamated company should be an Indian company and the amalgamation should be as per Section 2(IB). In an amalgamation as per Section 2(IB) of the IT Act, all the properties and liabilities of the merging companies immediately before the amalgamation should become the properties and liabilities of the amalgamated company, and 75% of the shareholders of the amalgamating companies have to remain the shareholders of the amalgamated company as well. Additionally, to achieve tax-neutrality for shareholders of the amalgamating company, the entire consideration should comprise of shares in the amalgamated company.

Outbound Mergers. An outbound merger is one where an Indian company merges with a foreign company and the amalgamated entity is a foreign company. The IT Act presently grants tax exemptions on mergers if the transferee is an Indian company but does not recognize a situation where the transferee is a foreign company. Therefore, with the introduction of cross-border mergers under the 2013 Act, corresponding changes would have to be made in the IT Act.

Global Mergers. A global merger takes place when a foreign company holding controlling stake (of more than 51%) in an Indian company merges with another foreign company, resulting in the transfer of shares of the Indian company to such other foreign company. Such a scheme is exempt from tax in India if 25% shareholders of the amalgamating company continue to be shareholders of the amalgamated company, and the transfer does not attract capital gains tax in the country in which the amalgamating company is incorporated.

Certain other Taxation Aspects.

*Carry forward of losses***.** Amalgamated companies have the privilege of setting off depreciation and carry forward of unabsorbed/accumulated losses against its accrued profits. The same is however not available to public companies where shareholders carrying 51% voting rights on the last date of the year in which set off is sought are different from shareholders carrying 51% voting rights on the last date of the year in which the given loss was incurred by the company. Carry forward of losses is applicable only for the sectors that are specifically provided under the IT Act or notified by authorities.

*GAAR***.** The General Anti Avoidance Rules ('**GAAR**') under the Finance Act, 2013, is slated to come into force in India with effect from April 1, 2017. Once implemented, it will grant discretion to tax authorities to scrutinize arrangements and invalidate them as an 'impermissible avoidance agreement' ('IAA') where they lack commercial substance, resulting in denial of the tax benefit under the provisions of the Act or tax treaty. An IAA is an arrangement the main purpose of which is to obtain a tax benefit and which either, creates rights and obligations that are not ordinarily created between persons dealing at arm's length, *or* results in the misuse or abuse of tax provisions, *or* lacks commercial substance, *or* is not for a bona fide purpose.

GAAR's provisions would extend to all taxpayers irrespective of their residential or legal status (i.e. resident or non-resident, corporate entity or non-corporate entity). These provisions will apply only if tax benefit arising to all parties to the arrangement exceeds Rs 30 million in the relevant financial year.

Stamp Duty & Registration. The transfer of assets, particularly immovable properties, requires registration with state authorities and payment of stamp duty for purposes of authenticating transfer of title. Stamp duty rates differ from state to state and range from 5% to 10% for immovable properties and from 3% to 5% for movable properties. The same is calculated on the amount of consideration received for the transfer or the market value of the property transferred (whichever is higher). Some state stamp acts contain special beneficial provisions pertaining to stamp duty on court-approved mergers.

Value Added Tax (VAT). Implications of VAT in court-approved mergers vary from state to state. Most states stipulate that the transfer of properties, etc., between the merging entities by way of a court-approved merger attracts VAT till the date of the High Court order. In the absence of such provision, courts have held the effective date of the merger to be the day the merger scheme becomes operative and not the date of the order of the court. In such cases, VAT has been held as not applicable on the transfer of properties between the merging entities during the period from the effective date of merger till the date of the order of the jurisdictional High Court.

Conclusion.

Apart from GAAR related implications as already discussed, the other aspects where parties involved in an amalgamation have to be cautious about include, incidence of tax occurring in the case of indirect transfers (i.e. transfers of foreign securities which derives substantial value from underlying Indian assets), and undervaluation of shares. In order to mitigate some of these tax risks, parties can obtain advance rulings or nil withholding tax certificates from tax authorities, negotiate and incorporate tax specific indemnities in their deal documents, and take the necessary tax insurance to cover potential tax risks.