India

Parul Jain and Shefali Goradia

Nishith Desai Associates

The acquisition (from the buyer's perspective)

1 Are there differences in tax treatment between an acquisition of stock in a company in your jurisdiction and the acquisitions of business assets and liabilities and, if so, what are those differences?

There are differences in tax treatment between an acquisition of stock as opposed to the acquisition of business assets and liabilities. They are explained below.

Acquisition of stock

The acquisition of stock may be attractive to a buyer if the selling company contains valuable assets. This would also avoid stamp duty payable on transfer of assets. Further, it may be possible to carry forward unabsorbed losses and depreciation of the selling company in certain situations.

In the case of acquisition of stock, the shareholder(s) would realise capital gain, but in the case of acquisition of assets, the selling company would realise capital gain or business income.

The transfer of shares attracts stamp duty at the rate of 0.25 per cent. This rate is less than the rate of stamp duty that is levied on the transfer of other assets, which varies from state to state.

A share sale is VAT exempt, but an asset sale may be subject to VAT. This may be an absolute cost to a buyer if it cannot recover all of its input VAT.

However, the buyer will generally take on the tax or other liabilities of the seller. The liabilities are transferred to the buyer's group and could include secondary liability for tax owed by other members of the seller's group.

Acquisition of business assets

Tax relief may be available to the buyer in the form of amortisation of the price paid for intellectual property and other intangible fixed assets. If the buyer wants to achieve step-up in cost basis, then it would be preferable to structure the transaction as an acquisition of assets since the assets acquired can be booked at the price paid for acquiring them. The buyer will generally not take on the tax or other liabilities of the seller.

2 In what circumstances does a purchaser get a step up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

In the case of an asset purchase, the buyer has the benefit of recording assets at the consideration paid to acquire them and hence can achieve step-up in basis in the business assets to that extent. This may however not be possible in case of a 'slump sale', where assets and liabilities of a business are transferred as a block without assigning individual values to the same.

Further, in the case of a stock purchase, since the acquirer pays to acquire stock of the company, he acquires the assets at the seller's book value, and would not be able to achieve step-up in basis in the business assets of the target company.

However, post acquisition, it may be possible to revalue the acquired assets and achieve step-up in basis in the assets to that extent.

Under the India Income Tax Act, 1961 (ITA) the following intangible assets are eligible for depreciation:

- know-how;
- patents;
- copyrights;
- trademarks;
- licences;
- franchises; or
- any other business or commercial rights of similar nature.

Though goodwill is treated as an intangible asset for accounting purposes, it does not confer any exclusive rights. As such, it may be difficult to categorise it under any of the intangible assets listed above, or in the residual category of 'any other business or commercial rights of a similar nature'. Hence, it may be difficult to claim depreciation on any amount paid towards, or characterised as goodwill.

3 Is it preferable for an acquisition to be executed by an acquisition company established in your jurisdiction or by an acquisition company established outside your jurisdiction? Explain why.

It would be preferable for an acquisition by way of purchase of stock to be executed by an acquisition company established outside India if the buyer is looking at an exit by way of reselling the acquired shares. This is especially so if the shares of the Indian company are held through a foreign company, in which case the foreign company shares can be sold off without triggering any capital gains tax liability in India.

Further, if the shares of the Indian company are held through a tax-favourable jurisdiction in Mauritius or Cyprus, sale of shares of the Indian company may not trigger capital gains tax in India provided certain conditions are met.

If both the acquiring and the target company are situated in India, it may entail a further layer of dividend distribution tax of 14.025 per cent at the time of remittance of dividends by the target company to the acquiring company, and then again at the time of remittance of dividends by the acquiring company to its shareholders. In addition, sale of shares of the target company by the acquiring company would attract capital gains tax in India.

4 Are company mergers or share exchanges common forms of acquisition in your jurisdiction? Explain why.

Company merger is a common form of acquisition in India. This is because merger of two Indian companies or of a foreign company into an Indian company is tax exempt in India. Share exchanges may not be a common form of acquisition since the acquisition may not be tax exempt in India.

5 Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

No, there is no rollover benefit where consideration is paid by way of shares.

6 Are documentary taxes such as stamp duties payable on the acquisition of stock or business assets and, if so, what are the rates and who is the accountable person? Are any other transaction taxes payable?

Stamp duty

Stamp duty is paid on the transfer of shares or assets at the rate of 0.25 per cent.

In merger transactions, stamp duty must be paid on the court decree, which acts as an instrument through which the assets are transferred. Shares of the merged company are issued to the shareholders of the merging company. Stamp duty on transfer of shares is not leviable if the shares are in a dematerialised form.

In asset acquisitions, stamp duty is levied on the conveyance under which assets are transferred at the rates specified under the relevant State Stamp Act which may vary from 4 per cent to 12 per cent depending on the respective State Stamp Acts.

The relevant stamp duty legislations do not make a specific party liable for the payment of stamp duty. However, it is customary for the buyer to pay stamp duty on corporate transactions.

Securities transaction tax

A securities transaction tax (STT) is levied on a purchase and sale, entered into on a recognised stock exchange, of shares and other securities in a company. STT is levied on the transaction value at the following applicable rates:

- In a sale of equity shares, which is settled by actual delivery, STT is levied at the rate of 0.125 per cent on both the buyer and the seller.
- For a sale of equity shares settled other than by way of actual delivery or transfer, STT is levied at the rate of 0.025 per cent on the seller of equity shares.

A seller of derivatives on a recognised stock exchange is subject to STT of 0.017 per cent.

On asset acquisitions, central sales tax (CST) or value added tax (VAT) is likely to arise if the transaction involves a transfer of assets situated in India:

- CST is applicable to inter-state transfers.
- VAT is applicable to intra-state transfers. However, VAT is still at an early stage of development in India and has not yet been fully implemented by all states.

A merger or demerger may be construed as transfer of a business as a going concern in some states and may be subject to CST or VAT. The seller is liable to pay the VAT or CST in a corporate transaction. The applicable CST rate is 4 per cent and the applicable VAT rates may range between 0 per cent to 12.5 per cent.

7 Do net operating losses survive a change in control of the target? If not, are there techniques for preserving them?

For a private limited company or a company not listed on a stock exchange, no loss incurred by the company can be carried forward and set off against its income unless 51 per cent of shareholders who beneficially held the voting power on the last day of the tax year in which the loss was incurred, continue to be the beneficial shareholders of the company on the last day of the tax year in which the loss is proposed to be carried forward and set off.

However, there are certain exceptions when operating losses may survive a change in control of the target. This can happen if the acquisition is structured by way of a merger. Certain conditions would, however, be required to be satisfied by the acquirer as well as the target company before the carry forward of losses may be allowed.

8 Does an acquisition company in your jurisdiction get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? If so, please outline. Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved in your jurisdiction?

Banking regulations in India do not permit banking companies to finance acquisitions. Although an Indian company would be allowed to borrow from persons other than banking companies, it is restricted from financing purchase of its own shares.

An Indian company is permitted to claim tax relief in the form of amortisation of expenses incurred wholly and exclusively for the purposes of merger. However, there would be restrictions on deductibility in cases where the interest payment has been made to a related party (foreign or otherwise) to the extent that the interest amount is considered to be excessive or unreasonable.

Withholding taxes on interest payments cannot be avoided, unless the money is borrowed from a Cyprus entity, in which case the interest withholding rate comes down from 20.91 per cent (as per ITA) to 10 per cent (as per the India–Cyprus double taxation avoidance treaty).

Debt pushdown is generally not possible in India in the case of shares and asset acquisition. However, debt pushdown may be possible if the acquiring company merges with the target company and hence all the liabilities of the acquiring company get transferred to the target company.

9 What protections are generally sought in your country for stock acquisitions and business asset acquisitions? How are these documented?

Tax representations are sought from the target entity with respect to any pending tax litigations against the company and estimates of any tax demands which may be initiated against the company. If the target company is claiming a tax holiday, a representation that the tax holiday is legitimate is also claimed. In the case of acquisition of assets, the acquirer may seek representations that there is no lien on the assets and that the seller is the legal owner of the assets. The representations form part of an asset/share acquisition agreement.

Post-acquisition planning

10 What post-acquisition restructuring, if any, is typically done in your country and why?

Post-acquisition, all Indian entities are consolidated under a single company. The present tax system makes multi-tier holding structures tax inefficient. Besides the corporate tax, dividends declared at the level of each company are subject to dividend distribution tax (DDT). No credit is available in India for the DDT paid by the subsidiary in the hands of the parent shareholder. Further, gains earned on transfer of shares held in each subsidiary will be taxable in the hands of the parent. In view of this, it is more tax efficient to consolidate all operations under a single company if possible. If there are different businesses under different corporate structures, they can be merged into a single company or held directly from outside India, as parallel holdings. If the holding company is located in a tax favourable jurisdiction such as Mauritius, it is advantageous to hold shares of each Indian company directly, to enjoy the capital gains tax exemption on sale of shares in India.

Common post-acquisition restructurings include:
- merger;
- transfer of assets between group companies; and
- introduction of local debt.

Merger
Merger (also known as amalgamation) of two Indian companies where the resultant company is a company incorporated in India is tax exempt, provided the following conditions are satisfied.
- All properties of the merging company are transferred to the merged company.
- All liabilities of the merging company are transferred to the merged company.
- At least 75 per cent in value of the shareholders of the merging company become shareholders of the merged company.

The merger of Indian companies requires approval of the High Court and takes anywhere between four and six months.

Transfer of assets between group companies
Subject to satisfaction of the following conditions, any transfer of a capital asset (including shares) by a subsidiary company to a holding company and vice versa is exempt from tax under ITA:
- The whole of the share capital of the subsidiary company is held by the holding company or vice versa.
- The transferee company is an Indian company.

Introduction of local debt
It is common to structure inter-company borrowings to draw out funds from cash-surplus companies and use them in expanding businesses. Considering the impact of DDT, it may be efficient to use funds by way of inter-company debt.

Transfer pricing
It may be useful to note that transfer pricing regulations do not apply to transactions between two Indian residents. There are certain disallowances for unreasonable payments made to related parties.

11 Can tax neutral spin-offs of businesses be executed in your country and, if so, can the net operating losses of the spun-off business be preserved?

Subject to satisfaction of the conditions listed above, it is possible to execute tax neutral spin-offs in India. Spin-offs are also known as demergers. Demerger transactions are exempt from capital gains tax, subject to fulfilling, among other things, the following conditions:
- all properties of the demerged company are transferred to the resulting company;
- all liabilities of the demerged company are transferred to the resulting company;
- at least 75 per cent in value of the shareholders of the demerged company become shareholders of the resulting company;
- the properties and liabilities being transferred in a demerger are transferred at book values;
- the transfer is on a going concern basis; and
- the resulting company is an Indian company.

Subject to the satisfaction of certain conditions, the accumulated losses and unabsorbed depreciation of the demerged company can be carried forward and set off as the accumulated losses and unabsorbed depreciation of the resulting company.

12 Is it possible to migrate the residence of the acquisition company or target company from your country without tax consequences?

Indian corporate law does not recognise migration of the companies. An Indian company cannot merge into a foreign company though it is possible for a foreign company to merge into an Indian company. An Indian company is regarded as an Indian tax resident unless its control and management is situated wholly outside India.

13 Are interest and dividend payments made out of your country subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

Indian companies are subject to corporate tax of 33.66 per cent (all rates are exclusive of surcharge and education levy). In addition, Indian companies are required to pay dividend distribution tax at the rate of 14.025 per cent when dividends are distributed to their shareholders. However, once the dividends distribution tax is paid by the Indian company, the shareholder is not taxed on the receipt of the dividends, irrespective of its residential status.

Foreign companies are taxed at:
- 41.82 per cent (on net basis) on their business income where they have a permanent establishment in India; and
- 20.91 per cent (on gross basis) for interest received on monies lent in a foreign currency. This rate will be 41.82 per cent (on net basis) for interest received on monies lent in Indian rupees.

No concessions are available from these withholding taxes except under a relevant double tax avoidance treaty.

14 What other tax efficient means are adopted for extracting profits from your jurisdiction?

Besides structuring debt financing, it is possible for the Indian companies to return monies to a shareholder by way of buy-back or redemption of shares. Shareholders are taxed on capital gains on buy-back of shares by the Indian companies. Such capital gains can be avoided if the shareholder is situated in a country with which India has a favourable tax treaty. Payouts to shareholders on buy-back of shares are specifically carved out from the definition of 'deemed dividends'. Buy-back of shares is

Update and trends

The Indian government has introduced an attractive regime called the Special Economic Zone (SEZ) regime. SEZs are duty free enclaves and units set up in a SEZ benefit from a package of direct and indirect tax incentives combined with an integrated infrastructure for export production and quick approval mechanisms. Briefly, these incentives include tax holiday for a period of 15 years, exemption from minimum alternate tax, exemption from customs and excise duty, and much more.

subject to certain corporate law conditions.

Disposals (from the seller's perspective)

15 How are disposals most commonly carried out in your jurisdiction – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

Generally, if the buyer is an Indian resident company, business assets are transferred on a 'slump sale' or 'going concern' basis. Such asset transfer would trigger capital gains in the hands of the transferor company as opposed to the shareholders. If the business is more than three years old, it will be regarded as long-term capital gains, which is taxed at the favourable rate of 22.44 per cent. If the shareholders are looking to exit, sale may be structured as stock-sale. There are very few rollover benefits. Hence, in case of stock-sale, the shareholders would pay tax at the rate of 22.44 per cent if shares have been held for more than 12 months. This tax would become payable even if the consideration is paid partly or wholly in the form of stock of buyer. The above rates may change if the gains are taxable in the hands of a non-resident.

Where the Indian company shares are held through a foreign company, it is preferable to sell the foreign holding company, especially if the buyer is also a foreign company. Sale of shares by a non resident of a foreign holding company would not trigger Indian taxes.

16 Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax in your country? Are there special rules in your country dealing with the disposal of stock in real estate, energy and natural resource companies?

Please see the answer to question 15 for the first part. There are no special rules under Indian tax law for disposal of stock in real estate, energy or natural resource companies.

17 If a gain is taxable on the disposal either of the shares in the local company or on the disposal of the business assets by the local company, are there any methods for deferring or avoiding the tax? Please outline.

The following are some of the provisions of the Indian ITA, which may reduce or defer tax consequences for both resident as well as non-resident shareholders.

Section 54EC

Any capital gain arising from the transfer of a long-term capital asset (original asset) when reinvested within a period of six months from the date of such transfer into a long-term specified asset, shall be exempt from tax under the ITA. For the purpose of section 54EC of the ITA, a long-term specified asset is defined to mean any bond redeemable after three years that may be issued by the National Bank for Agriculture and Rural Development or by the National Highways Authority of India, or the Rural Electrification Corporation or the National Housing Bank or by the Small Industries Development Bank of India.

Section 115

ITA provides special provisions relating to taxation of certain incomes of non-resident Indians. Section 115F of the ITA stipulates that capital gains earned on transfer of foreign exchange assets are not taxable in certain circumstances provided that if the assessee invests the whole or any part of the net consideration in any 'specified asset', or in any savings certificates (together referred to as 'new asset'), within a period of six months after the date of transfer of the original foreign exchange asset. Importantly, the new asset must be held for a period of three years to avail of such exemptions.

Nishith Desai Associates

Contacts: Parul Jain parul@nishithdesai.com
Shefali Goradia shefali@nishithdesai.com

93 B, Mittal Court
Nariman Point
Mumbai 400 021
India

Tel: +91 22 6669 5000
Fax: +91 22 6669 5001
Website: www.nishithdesai.com