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LEGAL AND TAX COUNSELING WORLDWIDE

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Globalizing India Inc.

A primer on outbound investments by Indian companies

April 2013

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We specialize in strategic legal, regulatory and tax advice coupled with industry expertise in an integrated manner. We focus on niche areas in which we provide significant value and are invariably involved in select highly complex, innovative transactions. Our key clients include marquee repeat Fortune 500 clientele.

Our experience with legal, regulatory and tax advice coupled with industry expertise in an integrated manner allows us to provide the complete strategy from the onset through to the full set up of the business and until the exits.

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Our research oriented approach has also led to the team members being recognized and felicitated for thought leadership. Consecutively for the fifth year in 2010, NDAites have won the global competition for dissertations at the International Bar Association. Nishith Desai, Founder of Nishith Desai Associates, was awarded the "Best Tax Lawyer of the Year" by Legal Era (2013). He was listed in the Lex Witness 'Hall of fame: Top 50' individuals who have helped shape the legal landscape of modern India (August 2011). Nishith Desai has been the recipient of Prof. Yunus 'Social Business Pioneer of India' – 2010 award. He has been voted 'External Counsel of the Year 2009' by Asian Counsel and Pacific Business Press and the 'Most in Demand Practitioners' by Chambers Asia 2009. He has also been ranked No. 28 in a global Top 50 "Gold List" by Tax Business, a UK-based journal for the international tax community.

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I. Introduction

The financial year 2012 witnessed a slew of acquisitions across diverse sectors of the economy in India despite global economic weakness, the on-going economic agonies, rising inflation, currency fluctuations and volatile stock markets. Though the market for mergers and acquisitions (M&A) dipped globally in 2011, the number and value of M&A deals remained comparable to the corresponding periods in 2010.

Indian companies also remained fairly active in this space. Global ambitions of Indian companies are reflected in their outbound investment activity. Outbound deals worth USD 27.25 billion was the key M&A trend in 2010, however the same was comparatively less at about USD 10 billion in 2011, a clear sign of global economic uncertainty and weakness in developed markets and. The figure improved in 2012 with outbound investments totaling to about USD 14 billion[1].

II. Accelerating growth through Outbound M&A

There are several strategic factors that have motivated India Inc. to become active in global markets and focus on making cross-border acquisitions to achieve the next level of growth. Apart from the fundamental commercial reasons, the trend of outbound investments gained momentum especially in the last decade and more particularly the later part of it. The trend was further accentuated because of the demand of the markets from companies to grow organically as well as inorganically across geographies, which along with easy availability of financing in the pre-global financial crisis era, made it all the more easy for companies to make investments across borders.

The following are some of the significant reasons why Indian companies have become active in cross-border investments:

I. Search for New Markets

One of the factors motivating India Inc. to look for assets abroad is to enter into new markets. It is quite difficult for a new firm to break into developed markets because those markets are already matured and the various relative competitive disadvantages (such as high start-up cost, establishing dealer network from scratch etc.) hinders entry of new firms into developed markets. These entry barriers get further accentuated for foreign firms who usually don't have local relationships which is almost always invariably critical for entering into new markets. Thus, entry through acquisitions is one of the relatively viable options for firms entering into new markets which provide the acquirer with a going concern with established relationships such as for e.g. branch network, customers, employees, brand value, revenue and in many cases profits, making acquisitions a preferred mode of entry for investors from foreign countries.

Another reason why firms are willing to enter into new markets may be to achieve higher profit margins or enter into markets where there may be achievable growth opportunities. For example, in case of Bharti's acquisition of Zain in Africa, wherein Zain, a telecom operator in Africa having a wide presence and market leadership position in many African mobile telecom services market, provided a respite to Bharti as Zain's profit margins were higher as compared to margins in a highly competitive telecom services market in India. Further, the relative low tele-density in Africa provided Bharti with a growth opportunity to implement its learning's and best practices from India, to a new growth market which was relatively less matured than the Indian telecom market.

1 Grand Thornton Dealtracker: Providing M&A and Private Equity Deal Insights, 8th Annual Ed. (2012), available at: http://www.grantthornton.in/assets/Grant_Thornton_Dealtracker-Annual_Edition-2012.pdf

II. Need for New Technologies

Indian companies have traditionally spent low on research & development (R&D) which has restricted their access to the most advanced technologies in their respective fields. As the Indian economy grew and companies achieved a reasonable scale, they quickly realized that they need to invest in R&D in order to maintain their competitive edge. Since investments in R&D have a high gestation period, investments in R&D take a long time before they have a real impact on margins in the short to medium term. In order to fill this void, Indian companies started snapping up assets located in developed markets such as in Europe and North America. These types of acquisitions typically involve a company having proprietary technologies or carrying out research in the same field or a related field as that of acquirer, being acquired as such assets provide instantaneous access to advanced technologies and compliments the talent and existing setup of the acquirer.

III. Access to Natural Resources:

In the recent past, lot of Indian conglomerates have acquired foreign companies which have access to natural resources. Natural resources is usually a contentious issue and is a sensitive sector in many countries. As such, this sector is highly regulated. An acquisition of an already operating company makes it easy for an acquirer to establish itself in one of the most regulated sectors of most economies as compared to setting up their own operations and applying for all clearances and licenses required for commencing a greenfield project.

IV. Product & Market Diversification

Many domestic companies have a product or access to technology which is limited or which cannot be upgraded or which may not be upgraded in a short span of time. To address this gap, companies may acquire a target with product diversity and complementary range of products. Such an acquisition provides an acquirer ready access to an existing product range which it otherwise might not have had without investing in R&D. For instance, Mahindra recently acquired Ssanyong Motors, a South Korean automaker which has a portfolio of cars in the sports utility vehicle segment. Since, Mahindra is an important player in the SUV/MUV market, Ssanyong's portfolio will prove to be complementary for Mahindra as it will have immediate access to new geographies, platforms and vehicles, which otherwise would have required time, money and effort.

Another reason why Indian companies are making acquisitions abroad is to diversify their consumer base and provide their product offering in a variety of markets in order to protect them against the risk of dependence on a single market. An acquisition in a developed market not only ensures a relative stability in market demand, thus offsetting dependence on evolving markets. However, in the wake of globalization, the world economy has become so inherently integrated that more often than not, the underlying economic health of the global economy moves in tandem, thus in the process, limiting the benefits that companies from developing markets could derive from acquisitions in developed markets.

V. Rise of Global Finance

One of the greatest trends in the times of modern economy especially in the last two decades has been the advent of global finance and an active broad-based participation in the modern global economy by market participants/investors irrespective of their geographic location. The advancement in technology and connectivity have made it possible to transmit a high amount of data across the globe, providing access to information, resulting in higher participation in global financial markets. This increased access to information helped increase the appetite of the investors which made them willing to finance cross-border acquisitions which otherwise would not have been possible had there not been free flow of information.

VI. Attractive Assets available for Cheap:

The financial crisis prompted companies across the world to acquire assets located in developed markets at cheap valuations. Acquirers especially from the developing world utilized this opportunity to add to their portfolio, targets which had the technologies but were facing temporary financial pressure in the wake of the financial crisis. The impact of the financial crisis was felt more on the developed economies and less on the developing economies leading to the companies from the developing economies taking advantage of the opportunity by making acquisitions in developed economies.

VII. Vertical Integration

Companies in the developing economies are realizing that they need to be vertically integrated in order to improve efficiency, margins and ensure supplies. This trend has been especially seen in case of natural resources wherein companies have acquired mines in developed markets in order to ensure raw material supplies to produce final product. For e.g. Adani Group has acquired mines and ports in Australia in order to ensure uninterrupted supply of coal for its power plants. Vertical integration provides operational visibility and efficiency for a company. In a globalized world wherein raw materials are sourced from one country and production activities are undertaken in another it has resulted in companies scouting for cross-border acquisitions in order to vertically integrate their operations.

VIII. Regulatory Evolution

Regulatory approach towards cross border acquisitions has seen a tremendous shift in favor of cross-border investments due to a variety of reasons especially in the wake of globalization in developing countries. Regulators have over time become more open, and encouraging towards cross-border acquisitions especially in emerging economies like India, wherein the investment regulations for cross-border acquisitions have been considerably relaxed over the years. This regulatory evolution in developing countries coupled with easy availability of finance has resulted in increased cross-border investment activity from developing economies into developed economies.

IX. Bureaucracy and lack of single window clearance

For long, the Indian corporate world has been longing for a single window clearance agency for any industry to seek approvals for the commencement of business operations. With the ever increasing bureaucracy and political instability within the country, seeking approvals for green field projects sometimes become economically unviable and hence the Indian companies look for inorganic growth by way of acquisition of companies in countries where the regulatory systems are much more developed.

III. Trends in Outbound Investments

Over the course of years Indian companies have become active in making acquisitions/investments abroad, which has particularly increased in the last decade. The tables below show the outflow of investments from India during the last four years from different routes in different sectors:

Table 1: Outflow of foreign investment from India including guarantees[2] (amount in USD millions)

2 Outward Indian FDI – Recent Trends & Emerging Issues, Address delivered by Shri. Harun R Khan, Deputy Governor, Reserve Bank of India at the Bombay Chamber of Commerce & Industry, Mumbai available at: http://www.rbi.org.in/scripts/BSSpeechesView.aspx?id=674#T1 (March 2, 2012).

Year	Equity	Loan	Guarantee Invoked	Total	Guarantee Issued
2008-2009	12477.14	6101.56	0.00	18578.70	3322.45
2009-2010	9392.98	4296.91	24.18	13714.07	7603.04
2010-2011	9234.58	7556.30	52.49	16843.37	27059.02
2011-12*	4031.45	4830.01	0.00	8861.46	14993.80
Total	35136.15	22784.78	76.67	57997.6	52978.31

** April 2011 to February 22, 2012; Source: Reserve Bank of India*

Table 2: Type of route under which investments made[3]

Year	Approval Route	Automatic Route	Total
2008-09	6	974	980
2009-10	4	690	694
2010-11	19	1187	1206
2011-12*	10	1123	1133

** April 2011 to February 22, 2012; Source: Reserve Bank of India*

Table 3: Sectors in which overseas investments made[4] (amount in USD billions)

Period	2008-09	2009-10	2010-11	2011-12*	Total
Manufacturing	10.18	5.35	5.04	2.74	23.31
Financial Insurance, Real Estate Business & Business Services	3.55	4.41	6.53	2.53	17.03
Wholesale & Retail Trade, Restaurants & Hotels	1.17	1.13	1.89	1.00	5.19
Agriculture & allied activities	2.38	0.95	1.21	0.41	4.94
Transport, Communication & Storage Services	0.31	0.38	0.82	1.34	2.85
Construction	0.35	0.36	0.38	0.37	1.46
Community, Social & Personal Services	0.39	0.18	0.70	0.18	1.45
Electricity, Gas & Water	0.14	0.84	0.10	0.04	1.19
Miscellaneous	0.12	0.11	0.18	0.10	0.51
Total	18.58	13.71	16.84	8.73	57.86

** April 2011 to February 22, 2012; Source: Reserve Bank of India.*

3 Ibid.

4. Ibid.

Table 4: Destinations for investments by Indian companies[5] (amount in USD billions)

Country	2008-09	2009-10	2010-11	2011-12*	Total
Singapore	4.06	4.20	3.99	1.86	14.11
Mauritius	2.08	2.15	5.08	2.27	11.57
Netherlands	2.79	1.53	1.52	0.70	6.54
United States of America	1.02	0.87	1.21	0.87	3.97
United Arab Emirates	0.63	0.64	0.86	0.38	2.51
British Virgin Islands	0.00	0.75	0.28	0.52	1.55
United Kingdom	0.35	0.34	0.40	0.44	1.53
Cayman Islands	0.00	1.53	1.52	0.70	6.54
Hong Kong	0.00	0.00	0.16	0.31	0.46
Switzerland	0.00	0.00	0.25	0.16	0.41
Other countries	7.65	3.19	2.65	1.23	14.71
Total	**18.58**	**13.71**	**16.84**	**8.86**	

** April 2011 to February 22, 2012; Source: Reserve Bank of India*

India's share of world cross-border deals

Indian companies have been galloping in making cross-border investments, especially in the last decade, however, as compared to other emerging economies, particularly the other members of the BRIC economies, it still has a lot of catching up to do since the total foreign investments made by companies from these economies is much more than companies from India. The following figure[6] shows a comparison of total cross-border deals executed by companies, in percentage terms, from BRIC economies:

Figure 1: Foreign investment by Indian companies as compared to other emerging economies.

5 Ibid.

6. Indian Takeovers abroad: Running with the bulls - Are Indian firms really going to take over the world, The Economist (March 3, 2012) available at: http://www.economist.com/node/21548965

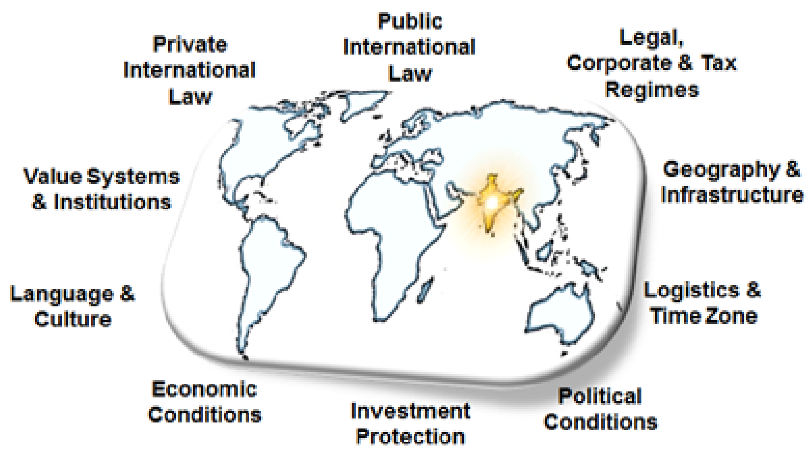
IV. Strategy for Outbound Acquisitions

While developing the strategy for outbound acquisitions, it is necessary to integrate a number of intrinsic and extrinsic factors. Globalization strategists have identified certain basic, input and structural strategies that are key drivers of globalization.

The following strategy matric provides an overview of the basic elements that have to be factored into a company's globalization strategy.[7]

Globalization will require strategies for sourcing, logistics, marketing, product development and management. Strategies for ownership and finance will determine funding models, access to capital and lay down the framework for extraction of profits and return on investment. Public affairs strategy also plays an important role in the manner in which businesses connect with institutions and policy makers. The importance of human capital of course can never be understated since along with technology, it allows for effective integration of all factors.

The above factors, intrinsic to the functioning of a business, will determine the operational strategy of an enterprise. In a globalized setting a number of extrinsic factors impact the decision making process. Each of these factors vary from country to country and there is hence a need for integration of global systems.



7 Inspiration from Richard D. Robinson, Internationalization of Business, Dryden.

Factors such as geography, infrastructure, time zone, political conditions, safety of investments, economic certainty, language and culture have a significant bearing on the strategy for globalization. Value systems and institutions are also becoming increasingly important from a long term perspective, in order to have the support of stakeholders. Ultimately, any chosen business strategy has to be executed within the constraints of legal and regulatory norms and compliances. At the same time it is necessary to factor in global tax costs and plan to extent possible within the framework of law.

Each country in the world presents its own challenges and opportunities which need to be understood while implementing a globalization strategy.

V. Indian exchange control regulations

I. ODI Regulations

An Indian Party that wishes to acquire or invest in a foreign company must comply with the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 (the "**ODI Regulations**").

The ODI Regulations are an extension of the process of liberalization initiated by the Government of India in the late 1990s. The regulations contain detailed provisions governing investments made as well as to be made by an Indian company in a foreign company by grant of 'general permission' to make a 'direct investment outside India' in bona fide business activities, subject to compliance with the regulations. The term 'direct investment outside India' has been defined as *'investment by way of contribution to the capital or subscription to the Memorandum of Association of a foreign entity or by way of purchase of existing shares of a foreign entity either by market purchase or private placement, or through stock exchange, but does not include portfolio investment'.* An Indian company is not permitted to make any direct investment in a foreign entity engaged in real estate business or banking business without the prior approval of the RBI[8].

The Indian party may choose to fund the aforesaid investment out of balances held in the EEFC account, by way of drawing funds from an authorized dealer subject to certain limits, or using the proceeds of an ADR/ GDR issue. There are several routes available to an Indian company which intends to invest in a foreign company. The key routes normally utilized in such transactions are described below:

i. Direct Investment in a Joint Venture/Wholly Owned Subsidiary

An Indian company is permitted to invest in a joint venture ("**JV**") or a wholly owned subsidiary ("**WOS**") of upto 400%[9] of the net worth of the Indian company as on the date of the last audited balance sheet without seeking the prior approval of the RBI, subject to the following conditions being fulfilled:

a. The direct investment is made in an overseas JV or WOS engaged in bona fide business activity.

b. The Indian company is not on the RBI's caution list or under investigation by the Enforcement Directorate.

c. The Indian company routes all the transactions relating to the investment in the JV or the WOS through only one branch of an authorized dealer to be designated by it.

d. The Indian company files the prescribed forms with the RBI.

7 Although banking business is a prohibited business under the ODI regulations, Indian banks can set up JVs/WOSs abroad provided they obtain approval from the RBI under the ODI regulations and also under the Banking Regulation Act, 1949.

9 This ceiling is not applicable where the investment is funded out of balances held by the Indian party in its Exchange Earners' Foreign Currency (EEFC) account.

However, investment by an Indian company engaged in the financial sector can invest in a JV or WOS in the financial sector subject to the following additional conditions being fulfilled:

a. The Indian company has earned net profit during the previous three financial years from the financial services activities;

b. The Indian company is registered with the regulatory authority in India for conducting financial services activities;

c. The Indian company has obtained approval from concerned regulatory authorities both in India and abroad for making such investments;

d. The Indian company has fulfilled the prudential norms for capital adequacy.

ii. Investment in company listed overseas

A person resident in India (being an individual or a listed Indian company) may invest in an overseas company listed on a recognized stock exchange, or in rated bonds or fixed income securities issued by a listed company. If the investment is made by an Indian listed company, the quantum of investment is limited to 50% of the net worth of such Indian company as on the date of its last audited balance sheet.

iii. Swap or Exchange of Shares

An Indian company can invest in a foreign company which is engaged in a bona fide business activity in exchange of ADRs/GDRs issued to the foreign company in accordance with the ADR/GDR Scheme. In order to be eligible for investment under this route, the Indian company must already have made an ADR/GDR issue, and such ADRs/GDRs must be listed on a stock exchange outside India. The ADR/GDR issue must be backed by a fresh issue of underlying equity shares by the Indian company, and the underlying shares must be valued by an investment banker, or as per the valuation procedure prescribed in the regulations. If the investment is made by way of remittance from India in an existing company outside India, the valuation of shares shall be done by a Category I Merchant Banker registered with the SEBI where the investment is more than USD 5 million and by a certified Chartered Accountant or Certified Public Accountant where the investment is less than USD 5 million.

vi. Investment by Individuals

Under the ODI Regulations, there are limits on individuals owning shares in foreign companies. An individual may inter-alia invest upto a maximum amount of USD 200,000 in equity and in rated bonds / fixed income securities of overseas companies as permitted in terms of the limits and conditions specified under the liberalized remittance scheme, modified from time to time (LRS Scheme)[10]. Remittance under the LRS Scheme is permitted for any permitted current or capital account transactions or a combination of both. Under the LRS Scheme, the funds remitted can be used for various purposes such as purchasing objects, making gifts and donations, acquisition of employee stock options and units of mutual funds, venture funds, unrated debt securities, promissory notes, etc.

Further, general permission has been granted to individuals to acquire foreign securities:

- as a gift from any person resident outside India,
- under Cashless Employees Stock Option Scheme issued by a company outside India, provided it does not involve any remittance from India,

10 http://rbidocs.rbi.org.in/rdocs/notification/PDFs/06MR010712F.pdf

- by way of inheritance from a person whether resident in or outside India,
- under ESOP Schemes, if he is an employee, or, a director of an Indian office or branch of a foreign company, or, of a subsidiary in India of a foreign company, or, an Indian company in which foreign equity holding, either direct or through a holding company/Special Purpose Vehicle (SPV), is not less than 51 per cent,
- if they represent qualification shares for becoming a director of a company outside India not exceeding 1 % of the paid up capital of the overseas company , provided the consideration for the acquisition does not exceed USD 20,000 in a calendar year, and
- if they are rights shares.

Any person intending to make any investments other than those specifically covered under the ODI Regulations must obtain the prior approval of the RBI.

v. Acquisition of a foreign company through bidding or tender procedure

Where an Indian Company proposes to participate in bidding or tender process for acquiring a company outside India, the authorized dealer in India may allow remittance towards earnest money deposit or bid bond guarantee on its behalf for participation in bidding or tender process.

Upon the Indian Company winning the bid, the authorized dealer may allow further remittances towards acquisition of the foreign company, subject to ceilings in Regulation 6 of ODI Regulations, i.e. upto 400% of the net worth of the Indian Company and the Indian Company shall make the necessary filings with the RBI.

VI. Indian corporate laws

The Companies Act, 1956, the legislation governs the Indian companies and activities to be done by such an Indian company. There are no specific provisions under this legislation which governs the activities of an Indian company outside India. However, Section 372A of the Companies Act allows an Indian company to make investments into another body corporate[11] by way of acquisition of shares upto an amount not exceeding 60% of its paid-up share capital and free reserves or 100% of its free reserves, whichever if more, without the consent of its shareholders. If the consideration payable towards the acquisition of shares is more than the stated limit, the Indian Company is required to obtain a shareholders' approval by way of a special resolution[12]. It is also pertinent to note that this provision is only applicable to a public limited company or to a private limited company which is a subsidiary of a public limited company[13].

VII. Indian Competition Act, 2002 ("Competition Act")

The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 ("Combination Regulations") have come into effect from June 1, 2011 to supple-

11 Body corporate is defined under Section 2(7) of the Companies Act which includes a company incorporated outside India but does not include (a) a corporation sole, (b) a co-operative society registered under any law relating to co-operative societies, and (c) any other body corporate which the Government may, by notification in the Official Gazette, specify.

12 Special Resolution, as described in Section 189 of the Companies Act means a resolution where consent of 3/4th of the shareholders is required to be passed.

13 Section 372A(8).

ment Sections 5 and 6 of the Competition Act. Under the provisions of the Competition Act, the Competition Commission of India ("**CCI**") has been conferred with extra-territorial jurisdiction to fulfill its mandate of eliminating practices having an appreciable adverse effect on competition in India. This essentially means that every acquisition that involves the acquirer or the target, wherever incorporated having assets or a turnover in India in excess of the prescribed thresholds shall be subject to scrutiny by the CCI.

"Combination", for the purposes of the Competition Act means:

a. an acquisition of control, shares or voting rights or assets by a person;

b. an acquisition of control of an enterprise where the acquirer already has direct or indirect control of another engaged in identical business; or

c. a merger or amalgamation between or among enterprises;

that exceed the 'financial thresholds' prescribed under the Competition Act.

Financial thresholds.

'Financial thresholds' prescribed under the Competition Act for determining 'combinations' are as follows:

For Parties in India	For Parties world-wide	For the Group* in India	For the Group world-wide
Assets INR 15 billion (approx USD 333 million) or Turnover INR 45 billion (approx USD 1 billion)	Assets USD 750 million or Turnover USD 2,250 million AND In India Assets INR 7.5 billion (USD approx 167 million) or Turnover INR 22.5 billion (approx USD 500 million)	Assets INR 60 billion (approx USD 1.3 billion) or Turnover INR 180 billion (approx USD 4 billion)	Assets USD 3 billion or Turnover USD 9 billion; AND In India Assets INR 7.5 billion (approx USD 167 million) or Turnover INR 22.5 billion (approx USD 500 million)

Mandatory reporting

Section 6 makes void any combination which causes or is likely to cause an appreciable adverse effect on competition in India on competition within India. Accordingly, Section 6 of the Act requires every acquirer to notify the CCI of a combination within 30 days of the decision of the combination or the execution of any agreement or other document for acquisition and seek its approval prior to effectuating the same.

The Combinations Regulations mandate CCI to form a prima facie opinion on whether a combination has caused or is likely to cause an appreciable adverse effect on competition in India within the relevant market in India, within 30 days of filing. The combination will become effective only after the expiry of 210 days from the date on which notice is given to the CCI, or after the CCI has passed an order approving the combination whichever is earlier.

Exempt enterprises

An enterprise whose shares, control, voting rights or assets are being acquired has assets of the value of not more than INR 250 crores (approx. USD 56 million) in India or turnover of the value of not more than INR 750 crores (approx. USD 160 million) in India is exempt from the provisions of Section 5 of the Competition Act till March 4, 2016.

Exceptions to filing. Deviating from the strict interpretation of Section 6 of the Competition Act, which requires all combinations to be notified to the CCI, Schedule I to the Combination Regulations specifies certain categories of transactions which are ordinarily not likely to have an appreciable adverse effect on competition in India and therefore would not normally require to be notified to the CCI which inter alia include:

- Acquisitions of shares or voting rights as an investment or in the ordinary course of business in so far as the total shares or voting rights held by the acquirer directly or indirectly does not exceed 25% of the total shares or voting rights of the company.
- An acquisition of additional shares or voting rights of an enterprise by the acquirer or its group, not resulting in gross acquisition of more than 5% of the Shares of such enterprise in a financial year, where the acquirer or its group, prior to acquisition, already holds 25% or more shares but does not hold 50% or more of the shares of the enterprise, either prior to or after such acquisition. Provided that such acquisition does not result in acquisition of sole or joint control of such enterprise by the acquirer or its group.
- Consolidation of holdings in an entity where the acquirer already had 50% or more shares or voting rights except in cases where the transaction results in a transfer from joint control to sole control.
- A merger or amalgamation of two enterprises where one of the enterprises has more than 50% shares or voting rights of the other enterprise, and/or merger or amalgamation of enterprises in which more than 50% shares or voting rights in each of such enterprises are held by enterprise(s) within the same group. Provided that the transaction does not result in transfer from joint control to sole control.
- An acquisition of assets unrelated to the business of the acquirer other than an acquisition of a substantial business operation.
- Acquisitions of stock-in-trade, raw materials, stores, current assets (in the ordinary course of business).
- Acquisitions of bonus or rights shares, not leading to acquisition of control.
- Combinations taking place entirely outside India with insignificant local nexus and effect on markets in India.

VIII. Taxation In India

The Income Tax Act, 1961 ("ITA") governs the taxation of income in India. ITA imposes tax on residents and non-residents. Persons resident in India are taxed on their global income whereas, non-residents are generally taxed only on income generated in India, or accruing on behalf of a source that is resident in India.

I. Corporate Residence

A company is said to be resident in India if it is an Indian company or if the control and management of its affairs is situated wholly in India. An 'Indian company' is defined to mean a company formed and registered under the Indian Companies Act, 1956 and includes certain other categories. The principal requirement under the definition is that the registered office or the principal office of the company should be situated in India.

A company is deemed to be non-resident for the purposes of taxation under the ITA if it is even partially controlled or managed outside of India and it is not an 'Indian company'. Therefore a foreign company is wholly controlled and managed in India, it may be treated as a tax resident of India.

Indian Courts have indicated that control and management would rest where the head and brain of the company is situated i.e. situs of the meeting of the board of directors of the company. Under Indian corporate laws, control and management of a company vests with the board of directors as a whole and not with any one individual on the board. Relying on UK jurisprudence, Indian Courts have taken a view that the place of 'control and management' refers to the place where the central management and control actually resides i.e. where the head and brain of the company are situated. It has been held that this would not mean where one or more of the directors normally reside but where the board of directors actually meets for the purpose of determination of key issues relating to the company. These decisions may be those pertaining to the expansion or contraction of business (territories), raising of finances and their appropriation for specific purposes, the appointment and removal of staff etc.

In this regard, it is pertinent to note that criteria such as residency of the director or the shareholders of the Company are not relevant in the determination of location of central control and management for the reasons set out below.

The Direct Taxes Code Bill, 2010 ("DTC") currently pending before the Indian Parliament has proposed a new test for residency of a company stating that a company is resident in India if it is either an Indian company or a company if its place of effective management ("POEM"), at any time in the year, is in India.

The DTC has further defined POEM to mean the place where the board of the company or its executive directors make their decisions or in cases where the board routinely approve the commercial and strategic decisions made by executive directors or officers of the company, the place where the executive directors or officers of the company perform their functions.

The OECD Model Tax Convention has described POEM as "the place where key management and commercial decisions, that are necessary for the conduct of the entity's business as a whole, are in substance made." According to the OECD, an entity may have more than one place of 'management' but it can have only one POEM at any one time.

II. Taxation of Indian companies

Companies resident in India are subject to corporate tax of 30% on business profits derived on a worldwide basis.[14]

Long term capital gains (from sale of long term capital assets) are taxed at a lower rate of 20%, while short term capital gains (from sale of short term capital assets) are taxed at the ordinary corporate tax rate. Capital assets such as shares shall be treated as long term if they are held for a period exceeding 12 months. Otherwise they will be treated as short term capital assets. For other capital assets, the relevant holding period is 36 months.

The ITA exempts payment of tax on income received by way of dividends distributed by a domestic company in the hands of the receiver, choosing to replace it with an alternative tax levied on the company distributing such profits. However, this exemption is applicable only to domestic companies.
Income received in the form of dividends from a company other than a domestic company is chargeable to tax in the hands of the Indian recipient.

14 All Indian tax rates mentioned herein are exclusive of surcharge and education cess.

For the financial year 2012-2013, via Section 155BBD of the ITA, dividends received by an Indian company from a foreign company in which the Indian company holds 26% or more in nominal value of the equity share capital of the company is taxed at a lower rate of 15% (excluding surcharge and cess).

India currently does not have any participation exemption or thin capitalization regime.

Resident companies are taxed on their worldwide income including any interest earned from foreign sources. Such interest is taxable at the ordinary corporate tax rate of 30%.

Indian companies may claim double tax relief under an applicable tax treaty with respect to taxes withheld outside India. Further the ITA also grants unilateral relief to residents in cases where they derive income from a country with which no tax treaty exists.

III. Disclosure of offshore assets

The Finance Act, 2012 amended Section 139 of the ITA to require all Indian residents to disclose all their overseas assets, whether in companies, partnerships or otherwise. This includes financial interests or even a signing authority in any offshore account. The return has to be filed regardless of the Indian resident having taxable income in the relevant financial year. Corresponding modifications have also been brought out in the tax filing forms so as to allow for the information to be provided to the tax authorities in India.

VI. Anti-avoidance

A number of judicially created anti-avoidance rules have developed in India over the years. India has traditionally followed the form over substance principle unless the taxpayer's arrangement involves a sham or a colourable device.

With effect from April 1, 2013, India proposes to implement a new general anti avoidance rules (GAAR) to counter abusive transactions referred to as 'impermissible avoidance arrangements'. Under GAAR the tax authorities have the power to disregard entities in a structure, reallocate income and expenditure between parties to the arrangement, alter the tax residence of such entities and the legal situs of assets involved, treat debt as equity and vice versa. In doing so, the tax authorities may also deny tax benefits even if conferred under a double taxation avoidance agreement.

The expression 'impermissible avoidance arrangement' has been defined very broadly to mean any arrangement where the main purpose (or one of the main purpose) is to obtain a tax benefit and which contains any of the following elements: (i) non-arm's length transactions, (ii) misuse or abuse of the ITA, (iii) non - bona fide purpose, or (iv) lack of commercial substance.

Recently, the 'Shome Committee', an advisory committee appointed by the Indian Prime Minster has recommended that the GAAR provisions be deferred for a period of 3 years on administrative grounds. The Committee has also recommended that the scope of GAAR be narrowed down and that specific safeguards should be included to address taxpayer concerns.

Interestingly, the Shome Committee has also recommended that GAAR should not be applied to outbound investments by Indian companies, since this may be covered under the proposed controlled foreign corporation regulations. It should be noted that the recommendations made by the Shome Committee are not binding on the government.

A number of specific anti avoidance rules also exist under Indian tax law to cover various arrangements including arrangement involving transfer of assets by a resident to a non-resident where a resident continues to enjoy the benefit of income arising from such assets.

Comprehensive transfer pricing regulations allow for adjustment of income and expenses in the case of non-arm's length transactions. While transfer pricing provisions generally apply in the case of international transactions, it may also apply in a limited context with respect to certain domestic transactions.

The DTC Bill pending before the Indian Parliament also proposes to introduce a controlled foreign corporation ("CFC") regime as per which the attributable income of a CFC would be taxed as income of the Indian resident. Under the proposed legislation, a CFC is defined to have the following attributes.

i. It is a tax resident of a foreign counry, where its actual amount of tax paid, under the law of that country or territory would be less than half of what it would have been subject to under the DTC, if it was a domestic company;

ii. Its shares are not traded on any stock exchange recognised by law of such territory;

iii. One or more persons, resident in India, individually or collectively exercise control over the foreign company;

iv. It is not engaged in any active trade or business;

v. The specified income of the foreign company exceeds two and a half million rupees.

In its current form, the proposed CFC legislation does not have any provisions for claiming credit against foreign taxes.

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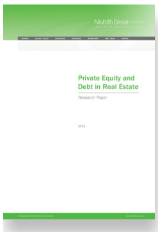

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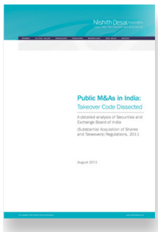

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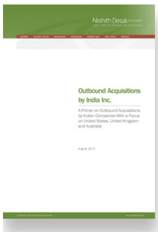

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