Nishith Desai Associates

LEGAL AND TAX COUNSELING WORLDWIDE

MUMBAI SILICON VALLEY BANGALORE SINGAPORE MUMBAI BKC NEW DELHI MUNICH NEW YORK

# Mergers & Acquisitions in India

April 2016

© Copyright 2016 Nishith Desai Associates

# About NDA

Nishith Desai Associates (NDA) is a research based international law firm with offices in Mumbai, Bangalore, Palo Alto (Silicon Valley), Singapore, New Delhi, Munich and New York. We provide strategic legal, regulatory, and tax advice coupled with industry expertise in an integrated manner.

As a firm of specialists, we work with select clients in select verticals. We focus on niche areas in which we provide high expertise, strategic value and are invariably involved in select, very complex, innovative transactions.

We specialize in Globalization, International Tax, Fund Formation, Corporate & M&A, Private Equity & Venture Capital, Intellectual Property, International Litigation and Dispute Resolution; Employment and HR, Intellectual Property, International Commercial Law and Private Client. Our industry expertise spans Automotive, Funds, Financial Services, IT and Telecom, Pharma and Healthcare, Media and Entertainment, Real Estate, Infrastructure and Education. Our key clientele comprise marquee Fortune 500 corporations.

Equally passionate about philanthropy, social sector and start ups, our role includes innovation and strategic advice in futuristic areas of law such as those relating to Bitcoins (block chain), Internet of Things (IOT), Privatization of Outer Space, Drones, Robotics, Virtual Reality, Med-Tech and Medical Devices and Nanotechnology.

Nishith Desai Associates is ranked the 'Most Innovative Asia Pacific Law Firm in 2016' by the *Financial Times - RSG Consulting Group* in its prestigious **FT Innovative Lawyers Asia-Pacific 2016** Awards. With a highest-ever total score in these awards, the firm also won Asia Pacific's best 'Innovation in Finance Law', and topped the rankings for the 'Business of Law'. While this recognition marks NDA's ingress as an innovator among the globe's best law firms, NDA has previously won the award for 'Most Innovative Indian Law Firm' for two consecutive years in 2014 and 2015, in these elite *Financial Times* Innovation rankings.

Our firm has received much acclaim for its achievements and prowess, through the years. Some include:

**IDEX Legal Awards:** In 2015, Nishith Desai Associates won the "M&A Deal of the year", "Best Dispute Management lawyer", "Best Use of Innovation and Technology in a law firm" and "Best Dispute Management Firm". IDEX Legal recognized Nishith Desai as the Managing Partner of the Year in 2014.

**Merger Market** has recognized Nishith Desai Associates as the fastest growing M&A law firm in India for the year 2015.

**World Tax 2015 (International Tax Review's** Directory) recognized NDA as a Recommended Tax Firm in India

**Legal 500** has ranked us in tier 1 for Investment Funds, Tax and Technology-Media-Telecom (TMT) practices (2011, 2012, 2013, 2014).

**International Financial Law Review (a Euromoney publication)** in its **IFLR1000** has placed Nishith Desai Associates in Tier 1 for Private Equity (2014). For three consecutive years, IFLR recognized us as the Indian "Firm of the Year" (2010-2013) for our Technology - Media - Telecom (TMT) practice

**Chambers and Partners** has ranked us # 1 for Tax and Technology-Media-Telecom (2015 & 2014); #1 in Employment Law (2015); # 1 in Tax, TMT and Private Equity (2013); and # 1 for Tax, TMT and Real Estate – FDI (2011).

**India Business Law Journal (IBLJ)** has awarded Nishith Desai Associates for Private Equity, Structured Finance & Securitization, TMT, and Taxation in 2015 & 2014; for Employment Law in 2015

© Nishith Desai Associates 2016

**Legal Era** recognized Nishith Desai Associates as the Best Tax Law Firm of the Year (2013).

**ASIAN-MENA COUNSEL** named us In-house Community 'Firm of the Year' in India for Life Sciences Practice (2012); for International Arbitration (2011); for Private Equity and Taxation in India (2009). We have received honorable mentions in ASIAN-MENA COUNSEL Magazine for Alternative Investment Funds, Antitrust/Competition, Corporate and M&A, TMT, International Arbitration, Real Estate and Taxation and being Most Responsive Domestic Firm.

We have won the prestigious 'Asian-Counsel's Socially Responsible Deals of the Year 2009' by **Pacific Business Press.**

We believe strongly in constant knowledge expansion and have developed dynamic Knowledge Management ('KM') and Continuing Education ('CE') programs, conducted both in-house and for select invitees. KM and CE programs cover key events, global and national trends as they unfold and examine case studies, debate and analyze emerging legal, regulatory and tax issues, serving as an effective forum for cross pollination of ideas. Our trust-based, non-hierarchical, democratically managed organization that leverages research and knowledge to deliver premium services, high value, and a unique employer proposition has been developed into a global case study and published by John Wiley & Sons, USA in a feature titled 'Management by Trust in a Democratic Enterprise: A Law Firm Shapes Organizational Behavior to Create Competitive Advantage' in the September 2009 issue of Global Business and Organizational Excellence (GBOE).

**Please see the last page of this paper for the most recent research papers by our experts.**

# Disclaimer

This report is a copyright of Nishith Desai Associates. No reader should act on the basis of any statement contained herein without seeking professional advice. The authors and the firm expressly disclaim all and any liability to any person who has read this report, or otherwise, in respect of anything, and of consequences of anything done, or omitted to be done by any such person in reliance upon the contents of this report.

# Contact

For any help or assistance please email us on ndaconnect@nishithdesai.com or
visit us at www.nishithdesai.com

# Contents


**1. INTRODUCTION** **01**

I. Overview of the M&A Market 01
II. Conceptual Overview 01

**2. MERGERS AND AMALGAMATIONS: KEY CORPORATE AND SECURITIES LAWS CONSIDERATIONS** **04**

I. Company Law 04
II. Securities Laws 04

**3. ACQUISITIONS: KEY CORPORATE AND SECURITIES LAWS CONSIDERATIONS** **06**

I. Company Law 06
II. Other Securities Laws 09
III. Listing Regulations 13
IV. Insider Trading 13
V. CA 2013 16

**4. COMPETITION LAW** **17**

I. Anti - Competitive Agreements 17
II. Abuse of Dominant Position 17
III. Regulation of Combinations 17

**5. EXCHANGE CONTROL** **21**

I. Foreign Direct Investment 21
II. Indirect Foreign Investment 21
III. Investment in a holding company 22
IV. Overseas Direct Investment 23

**6. TAXES AND DUTIES** **26**

I. Income Tax Act, 1961. 26
II. Service Tax 33
III. Value Added Tax / Sales Tax 33
IV. Stamp Duty 34

**7. CONCLUSION** **35**

**ANNEXURE 1** **36**

**ANNEXURE 2** **38**


© Nishith Desai Associates 2016

# 1. Introduction

## I. Overview of the M&A Market

In the last few years, India had witnessed a substantial slowdown in the mergers and acquisitions (**"M&A"**) activity. In the year 2014, Indian companies were involved in transactions worth $ 33 billion whereas in the year 2015, the value of M&A activity saw a dip to $ 20 billion. It is forecasted that 2016 will see heightened global M&A activity and it is anticipated that the value of transactions would cross $ 30 billion easily.[1]

The election of the Modi led government has brought back tremendous faith in investor community. The coming year is expected to be a booming year in terms of M&A activity as the investor community has seen certainty in Modi led government's reform agenda and the policies have been largely formulated to encourage foreign investments. It is strongly believed that year 2016 will see a surge in M&A activity due to the new bankruptcy law, the faster pace of approvals initiated by the government as part of its ease of doing business in India campaign and the relaxation in Foreign Direct Investment norms.

Sectors such as IT-ITes, healthcare, energy, pharma, e-commerce and banking and financial services were the key sectors in 2015.

In 2015, inbound deals dominated the Indian M&A landscape with interest coming from US, German and Canadian bidders.

One can expect the increase in the M&A deals and activities in the upcoming time as both local and international investors and business houses are eyeing India with a hope of tremendous growth.

International factors such as decline in the crude prices and low inflation locally will also help the government to unleash flexible business policies to draw interest of the players in the India economy.

## II. Conceptual Overview

In the sections that follow, we provide an overview of certain laws that would be of significance to M&A in India. Mergers and acquisitions are modes by which distinct businesses may combine. Joint ventures are another way for two businesses to work together to achieve growth as partners in progress, though a joint venture is more of a contractual arrangement between two or more businesses.

### A. Mergers and Amalgamations

The term 'merger' is not defined under the Companies Act, 1956 (**"CA 1956"**), and under Income Tax Act, 1961 (**"ITA"**). However, the Companies Act, 2013 (**"CA 2013"**) without strictly defining the term explains the concept. A 'merger' is a combination of two or more entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but organization of such entity into one business. The possible objectives of mergers are manifold - economies of scale, acquisition of technologies, access to sectors / markets etc. Generally, in a merger, the merging entities would cease to be in existence and would merge into a single surviving entity.

The ITA does however defines the analogous term '*amalgamation*': the merger of one or more companies with another company, or the merger of two or more companies to form one company. The ITA goes on to specify certain other conditions that must be satisfied for an 'amalgamation' to benefit from beneficial tax treatment (discussed in **Part VI** of this Paper).

1. http://articles.economictimes.indiatimes.com/25-12-25/news/69300489_1_deal-value-deals-worth-inbound-deals



© Nishith Desai Associates 2016

Our laws envisage mergers can occur in more than one way, for example in a situation in which the assets and liabilities of a company (merging company) are vested in another company (the merged company). The merging company loses its identity and its shareholders become shareholders of the merged company. Another method could be, when the assets and liabilities of two or more companies (merging companies) become vested in another new company (merged company). The merging companies lose their identity. The shareholders of the merging companies become shareholders of the merged company.

The CA 1956 (Sections 390 to 394) and CA 2013 (Sections 230 to 234), deal with the schemes of arrangement or compromise between a company, its shareholders and/or its creditors. These provisions are discussed in greater detail in P**art II** of this Paper.

Commercially, mergers and amalgamations may be of several types, depending on the requirements of the merging entities:

Although, corporate laws may be indifferent to the different commercial forms of merger / amalgamation, the Competition Act, 2002 does pay special attention to the forms.

## i. Horizontal Mergers

Also referred to as a 'horizontal integration', this kind of merger takes place between entities engaged in competing businesses which are at the same stage of the industrial process.[2] A horizontal merger takes a company a step closer towards monopoly by eliminating a competitor and establishing a stronger presence in the market. The other benefits of this form of merger are the advantages of economies of scale and economies of scope. These forms of merger are heavily scrutinized by the competition commission.

## ii. Vertical Mergers

Vertical mergers refer to the combination of two entities at different stages of the industrial or production process. For example, the merger of a company engaged in the construction business with a company engaged in production of brick or steel would lead to vertical integration. Companies stand to gain on account of lower transaction costs and synchronization of demand and supply. Moreover, vertical integration helps a company move towards greater independence and self-sufficiency.

## iii. Congeneric Mergers

These are mergers between entities engaged in the same general industry and somewhat interrelated, but having no common customer-supplier relationship. A company uses this type of merger in order to use the resulting ability to use the same sales and distribution channels to reach the customers of both businesses.[3]

## iv. Conglomerate Mergers

A conglomerate merger is a merger between two entities in unrelated industries. The principal reason for a conglomerate merger is utilization of financial resources, enlargement of debt capacity, and increase in the value of outstanding shares by increased leverage and earnings per share, and by lowering the average cost of capital.[4] A merger with a diverse business also helps the company to foray into varied businesses without having to incur large start-up costs normally associated with a new business.

## v. Cash Merger

In a 'cash merger', also known as a 'cash-out merger', the shareholders of one entity receives cash instead of shares in the merged entity. This is effectively an exit for the cashed out shareholders.

2. 'Corporate Mergers Amalgamations and Takeovers', J.C Verma, 4th edn., 2002, p.59

3. 'Financial Management and Policy-Text and Cases', V.K Bhalla, 5th revised edn., p.1016

4. Ibid, note 4, at p. 59



© Nishith Desai Associates 2016

### vi. Triangular Merger

A triangular merger is often resorted to, for regulatory and tax reasons. As the name suggests, it is a tripartite arrangement in which the target merges with a subsidiary of the acquirer. Based on which entity is the survivor after such merger, a triangular merger may be forward (when the target merges into the subsidiary and the subsidiary survives), or reverse (when the subsidiary merges into the target and the target survives).

## B.Acquisitions

An 'acquisition' or 'takeover' is the purchase by one person, of controlling interest in the share capital, or all or substantially all of the assets and/or liabilities, of the target. A takeover may be friendly or hostile, and may be effected through agreements between the offeror and the majority shareholders, purchase of shares from the open market, or by making an offer for acquisition of the target's shares to the entire body of shareholders.

Acquisitions may be by way of acquisition of shares of the target, or acquisition of assets and liabilities of the target. In the latter case the business of the target is usually acquired on a going concern basis. Such a transfer is referred to as a 'slump sale' under the ITA and benefits from favourable taxing provisions vis-à-vis other transfers of assets/liabilities (discussed in greater detail in Part VI of this Paper). Section 2(42C) of the ITA defines slump sale as a *"transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales"*.

An acquirer may also acquire a greater degree of control in the target than what would be associated with the acquirer's stake in the target, e.g., the acquirer may hold 26% of the shares of the target but may enjoy disproportionate voting rights, management rights or veto rights in the target.

Another form of acquisitions may be by way of demerger. A demerger is the opposite of a merger, involving the splitting up of one entity into two or more entities. An entity which has more than one business, may decide to 'hive off' or 'spin off' one of its businesses into a new entity. The shareholders of the original entity would generally receive shares of the new entity.

If one of the businesses of a company is financially sick and the other business is financially sound, the sick business may be demerged from the company.

This facilitates the restructuring or sale of the sick business, without affecting the assets of the healthy business. Conversely, a demerger may also be undertaken for moving a lucrative business into a separate entity. A demerger may be completed through a court process under the Merger Provisions or contractually by way of a business transfer agreement.

## C.Joint Ventures

A joint venture is the coming together of two or more businesses for a specific purpose, which may or may not be for a limited duration. The purpose of the joint venture may be for the entry of the joint venture parties into a new business, or the entry into a new market, which requires the specific skills, expertise or the investment of each of the joint venture parties. The execution of a joint venture agreement setting out the rights and obligations of each of the parties is a norm for most joint ventures. The joint venture parties may also incorporate a new company which will engage in the proposed business. In such a case, the byelaws of the joint venture company would incorporate the agreement between the joint venture parties.



© Nishith Desai Associates 2016

# 2. Mergers and Amalgamations: Key Corporate and Securities Laws Considerations

## I. Company Law

Sections 390 to 394 of the CA 1956 (the **"Merger Provisions"**) and Section 230 to 234 of CA 2013 govern mergers and schemes of arrangements between a company, its shareholders and/or its creditors. However, considering that the provisions of CA 2013 have not yet been notified, the implementation of the same remains to be tested. The currently applicable Merger Provisions are in fact worded so widely, that they would provide for and regulate all kinds of corporate restructuring that a company can possibly undertake, such as mergers, amalgamations, demergers, spin-off/hive off, and every other compromise, settlement, agreement or arrangement between a company and its members and/or its creditors.

### A. Procedure under the Merger Provisions

Since a merger essentially involves an arrangement between the merging companies and their respective shareholders, each of the companies proposing to merge with the other(s) must make an application to the Company Court[5] having jurisdiction over such company for calling meetings of its respective shareholders and/or creditors. The Court may then order a meeting of the creditors/shareholders of the company. If the majority in number representing 3/4th in value of the creditors and shareholders present and voting at such meeting agrees to the merger, then the merger, if sanctioned by the Court, is binding on all creditors/shareholders of the company. The Merger Provisions constitute a comprehensive code in themselves, and under these provisions Courts have full power to sanction any alterations in the corporate structure of a company. For example, in ordinary circumstances a company must seek the approval of the Court for effecting a reduction of its share capital. However, if a reduction of share capital forms part of the corporate restructuring proposed by the company under the Merger Provisions, then the Court has the power to approve and sanction such reduction in share capital and separate proceedings for reduction of share capital would not be necessary.

### B. Applicability of Merger Provisions to foreign companies.

Sections 230 to 234 of CA 2013 recognize and permit a merger/reconstruction where a foreign company merges into an Indian company. Although the Merger Provisions do not permit an Indian company to merge into a foreign company, the merger provisions under Section 234 of the CA 2013 do envisage this, subject to rules made by the Government of India. However, neither is Section 234 currently in force nor have any rules been formulated by the Government of India.

## II. Securities Laws

### A. Takeover Code

The Securities and Exchange Board of India (the **"SEBI"**) is the nodal authority regulating entities that are listed and to be listed on stock exchanges in India. The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers)

5. The High Court of each Indian State will usually designate a specific bench of the High Court as the Company Court, to which all such applications will be made. Upon the constitution and notification of the National Company Law Tribunal (NCLT), the competent authority for filing this applica- tion will be the NCLT and not the Company Court.



© Nishith Desai Associates 2016

Regulations, 2011 (the **"Takeover Code"**) restricts and regulates the acquisition of shares, voting rights and control in listed companies. Acquisition of shares or voting rights of a listed company, entitling the acquirer to exercise 25% or more of the voting rights in the target company or acquisition of control, obligates the acquirer to make an offer to the remaining shareholders of the target company. The offer must be to further acquire at least 26% of the voting capital of the company.[6] However, this obligation is subject to the exemptions provided under the Takeover Code. Exemptions from open offer requirement under the Takeover Code inter alia include acquisition pursuant to a scheme of arrangement approved by the Court.

## B. Listing Regulations

Prior to December 1, 2015, the listing agreement[7] entered into by a company for the purpose of listing its shares with a stock exchange prescribed certain conditions for the listed companies which they have to follow in the case of a Court approved scheme of merger/amalgamation/reconstruction. However, on September 2, 2015, the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (**"Listing Regulations"**) were notified and has been effective from December 1, 2015. The Listing Regulations provide for a comprehensive framework governing various types of listed securities under the Listing Regulations, SEBI has altered the conditions for the listed companies which they have to follow in the case if a Court approved scheme of merger/amalgamation/reconstruction has been altered. Following are the key changes that have been introduced by the Listing Regulation and table highlighting the comparison between the conditions prescribed under the listing agreement and Listing Regulation:

| Sr. No | Particulars | Listing Agreement | Listing Regulation |
|---|---|---|---|
| 1. | Filing of scheme with stock exchange | Listed companies have to file the scheme with stock exchange at least one month prior to filing with the Court.[8] | Listed companies have to file the scheme with stock exchange for 'observation letter' or 'no-objection'.[9] |
| 2. | Compliance with securities law | Listed companies shall ensure that the scheme does violate or override the provisions of any securities law/stock exchange requirements.[10] | Listed companies shall ensure that the scheme does violate or override or limit the provisions of any securities law/stock exchange requirements.[11] |
| 3. | Pre and post-merger shareholding | Listed companies have to disclose the pre and post-merger shareholding to the shareholders.[12] | The listed entity shall have to disclose the details with the stock exchange as per the disclosure requirements of stock exchange. [13] |
| 4. | Auditor's certificate | Listed companies have to file with a stock exchange an auditors' certificate to the effect that the accounting treatment contained in the scheme is in compliance with all the Accounting Standards specified by the Central Government in Section 211(3C) of the CA 1956.[14] | There is no corresponding provision under the Listing Regulation. |
| 5. | Corporate actions pursuant to merger | Listed companies have to disclose to public if the listed company is proposing to undergo acquisition, merger, de-merger, amalgamation, restructuring, scheme of arrangement, spin off or selling divisions of the company, etc.[15] | Listed companies have to disclose to Stock Exchange of all the events which will have bearing on the performance/operations of the listed entity as well as price sensitive information. [16] |

6. Regulation 3 read with Regulation 7 of the Takeover Code.
7. We refer to the Listing Agreement of the Bombay Stock Exchange as a standard since it is India's largest Stock Exchange.
8. Clause 24(f) of the listing agreement.
9. Regulation 37(1) of the Listing Regulation.
10. Clause 24(g) of the listing agreement.
11. Regulation 11 of the Listing Regulation.
12. Clause 24(h) of the listing agreement.
13. Regulation 69 (2) of the Listing Regulation.
14. Clause 24(i) of the listing agreement.
15. Clause 36(7) of the listing agreement.
16. Regulation 58 of the Listing Regulation.



© Nishith Desai Associates 2016

# 3. Acquisitions: Key Corporate and Securities Laws Considerations

## I. Company Law

### A. Acquisition of Shares.[17]

Acquisitions may be via an acquisition of existing shares of the target, or by subscription to new shares of the target.

#### i. Transferability of shares

Broadly speaking, an Indian company is set up as a private company or as a public company. Membership of a private company is restricted to 200 members[18] and a private company is required by the CA 2013 to restrict the transferability of its shares. A restriction on transferability of shares is consequently inherent to a private company, such restrictions being contained in its articles of association (the byelaws of the company), and usually in the form of a pre-emptive right in favor of the other shareholders. With the introduction of CA 2013, although shares of a public company are freely transferable, share transfer restrictions for even public companies have been granted statutory sanction. The articles of association may prescribe certain procedures relating to transfer of shares that must be adhered to in order to affect a transfer of shares. While acquiring shares of a private company, it is therefore advisable for the acquirer to ensure that the non-selling shareholders (if any) waive any rights they may have under the articles of association. Any transfer of shares, whether of a private company or a public company, must comply with the procedure for transfer under its articles of association.

17. Please note we have not addressed issues with respect to a non-Indian acquirer, which we have briefly addressed in our section on Exchange Control in Chapter V.

18. Not including employees and former employees.

#### ii. Squeeze Out Provisions

##### a. Section 395 of the CA 1956[19]

Section 395 envisages a complete takeover or squeeze-out without resort to court procedures. Section 395 provides that if a scheme or contract involving the transfer of shares or a class of shares in a company (the 'transferor company') to another company (the 'transferee company') is approved by the holders of at least 9/10ths (in value) of the shares whose transfer is involved, the transferee company may give notice to the dissenting shareholders that it desires to acquire the shares held by them. Once this notice is issued, the transferee company is not only entitled, but also bound, to acquire such shares. In computing 90% (in value) of the shareholders as mentioned above, shares held by the acquirer, nominees of the acquirer and subsidiaries of the acquirer must be excluded.

If the transferee already holds more than 10% (in value) of the shares (being of the same class as those that are being acquired) of the transferor, then the following conditions must also be met:

- The transferee offers the same terms to all holders of the shares of that class whose transfer is involved; and
- The shareholders holding 90% (in value) who have approved the scheme/contract should also be not less than 3/4th in number of the holders of those shares (not including the acquirer).
- The scheme or contract referred to above should be approved by the shareholders of the transferee company within 4 months from the date of the offer. The dissenting shareholders have the right to make an application to the Court within one month from the date of the notice, if they are aggrieved by the terms of the offer. If no application is made, or

19. Corresponding provisions of the CA 2013 have not yet been notified.


© Nishith Desai Associates 2016

the application is dismissed within one month of issue of the notice, the transferee company is entitled and bound to acquire the shares of the dissenting shareholders.

- Section 395 does not regulate the pricing of the offer made by the acquirer, and the powers of the court are limited if an objection is made by a dissenting shareholder. The court cannot direct the acquirer to pay a price that has not been offered. The Court would be guided by the fairness of the scheme including the valuation offered. However, if an overwhelming majority has approved the scheme, it would be a heavy burden on the dissenting shareholder to establish why his shares should not be compulsorily acquired.

- Section 395 of the CA 1956 provides that the 'transferor company' (i.e. the target) can be any body corporate, whether or not incorporated under Indian law. Therefore the target can also be a foreign company. However, a 'transferee company' (i.e. the acquirer), must be an Indian company.

### b. Section 236 of the CA 2013 (not yet notified)

Under the CA 2013, if a person or group of persons acquire 90% or more of the shares of a company, then such person(s) have a right to make an offer to buy out the minority shareholders at a price determined by a registered valuer in accordance with prescribed rules.[20] The provisions in the CA 2013 aim to provide a fair exit to the minority shareholders, as the price offered must be based on a valuation conducted by a registered valuer. However, it is not clear whether the minority shareholders can choose to retain their shareholding. However, the Companies Law Committee vide report dated February, 2016 has recommended that the references to the phrase 'transferor company' in Section 236, may be modified to a 'company whose shares are being transferred' or alternatively, an explanation be provided in the provision clarifying that Section 236 only applies to the acquisition of shares so as to clearly exclude amalgamations and mergers from the ambit of this provision.

### c. Scheme of capital reduction under section 100 of the CA 1956

Section 100 of the CA 1956 permits a company to reduce its share capital in any manner and prescribes the procedure to be followed for the same. The scheme of capital reduction under section 100 of the CA 1956 must be approved by, (i) the shareholders of the company vide a special resolution; and (ii) a competent court by an order confirming the reduction. When the company applies to the court for its approval, the creditors of the company would be entitled to object to the scheme of capital reduction. The court will approve the reduction only if the debt owed to the objecting creditors is safeguarded/provided for. What is interesting to note is that the framework for reduction of capital under section 100 has been utilized to provide exit to certain shareholders, as opposed to all shareholders on a proportionate basis. The courts have held that reduction of share capital need not necessarily be qua all the shareholders of the company.[21]

### d. Scheme of capital reduction under Section 66 of the CA 2013 (not yet notified)

The capital reduction requirements are more stringent under the CA 2013. In addition to giving notice to creditors of the company, the NCLT is required to give notice of the application for reduction of capital to the Central Government and the SEBI (in case of a listed company), who will have a period of three months to file any objections. Companies will have to mandatorily publish the NCLT order sanctioning the scheme of capital reduction.

20. Section 236 of the CA 2013

21. Sandvik Asia Limited vs. Bharat Kumar Padamsi and Ors [2009]92SCL272(Bom); Elpro International Limited (2009 4 Comp LJ 406 (Bom))



© Nishith Desai Associates 2016

### e. New share issuance

Section 42, 62 of CA 2013 and Rule 13 of the Companies (Share Capital and Debenture) Rules 2014 prescribe the requirements for any new issuance of shares on a preferential basis (i.e. any issuance that is not a rights or bonus issue to existing shareholders) by an unlisted company. Some of the important requirements under these provisions are described below:

- The company must engage a registered valuer to arrive at a fair market value of the shares for the issuance of shares.[22]
- The issuance must be authorized by the articles of association of the company[23] and approved by a special resolution[24] passed by shareholders in a general meeting, authorizing the board of directors of the company to issue the shares.[25]A special resolution is one that is passed by at least 3/4ths of the shareholders present and voting at a meeting of the shareholders. If shares are not issued within 12 months of the resolution, the resolution will lapse and a fresh resolution will be required for the issuance.[26]
- The explanatory statement to the notice for the general meeting should contain key disclosures pertaining to the object of the issue, pricing of shares including the relevant date for calculation of the price, shareholding pattern, change of control, if any, and whether the promoters/directors/key management persons propose to acquire shares as part of such issuance.[27]
- Shares must be allotted within a period of 60 days, failing which the money must be returned within a period of 15 days thereafter. Interest is payable @ 12%p.a. from the 60th day.[28]
- These requirements apply to equity shares, fully convertible debentures, partly convertible debentures or any other financial instrument convertible into equity.[29]

### f. Limits on acquirer

Section 186 of CA 2013 provides for certain limits on inter-corporate loans and investments. An acquirer that is an Indian company might acquire by way of subscription, purchase or otherwise, the securities of any other body corporate upto (i) 60% of the acquirer's paid up share capital and free reserves and securities premium, or (ii) 100% of its free reserves and securities premium account, whichever is higher. However, the acquirer is permitted to acquire shares beyond such limits, if it is authorized by its shareholders vide a special resolution passed in a general meeting.

### g. Asset/ Business Purchase

As against a share acquisition, the acquirer may also decide to acquire the business of the target which could typically entail acquisitions of all or specific assets and liabilities of the business for a consideration. Therefore, depending upon the commercial objective and considerations, an acquirer may opt for (i) asset purchase whereby one company purchases all of part of the assets of the other company; or (ii) slump sale whereby one company acquires the 'business undertaking' of the other company as a going concern i.e. acquiring all assets and liabilities of such business.

22. Section 62 (1) (c)
23. Rule 13(2)(a) of the Companies (Share Capital and Debenture) Rules 2014
24. Rule 13(2)(b) of the Companies (Share Capital and Debenture) Rules 2014
25. Rule 13(1) of the Companies (Share Capital and Debenture) Rules 2014
26. Rule 13(2)(f) of the Companies (Share Capital and Debenture) Rules 2014
27. Rule 13(2)(d) of the Companies (Share Capital and Debenture) Rules 2014
28. Section 42(6)
29. Rule 13(1) of the Companies (Share Capital and Debenture) Rules 201432.


© Nishith Desai Associates 2016

Under CA 2013, the sale, lease or other disposition of the whole or substantially the whole of any undertaking of a company requires the approval of the shareholders through a special resolution.[30] The term "*Undertaking*" means an undertaking in which the investment of the company exceeds 20% of its net worth as per the audited balance sheet of the preceding financial year, or an undertaking which generates 20% of the total income of the company during the previous financial year. Further this requirement applies if 20% or more of the undertaking referred to above is sought to be sold, leased or disposed off.

An important consideration for these options is the statutory costs involved i.e. stamp duty, tax implications etc. We have delved into this in brief in our chapter on 'Taxes and Duties'.

# II. Other Securities Laws

## A. Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009

If the acquisition of an Indian listed company involves the issue of new equity shares or securities convertible into equity shares (**"Specified Securities"**) by the target to the acquirer, the provisions of Chapter VII (**"Preferential Allotment Regulations"**) contained in ICDR Regulations will apply (in addition to company law requirements mentioned above). We have highlighted below some of the important provisions of the Preferential Allotment Regulations.

### i. Pricing of the Issue

The Preferential Allotment Regulations set a floor price for an issuance. The floor price of shares is linked to the average of the weekly high and low closing price of the stock of the company over a 26 week period or a 2 week period preceding the relevant date.[31]

### ii. Lock-in

Securities issued to the acquirer (who is not a promoter of the target) are locked-in for a period of 1 year from the date of trading approval. The date of trading approval is the latest date when trading approval is granted by all stock exchanges on which the securities of the company are listed. Further, if the acquirer holds any equity shares of the target prior to such preferential allotment, then such prior holding will be locked in for a period of 6 months from the date of the trading approval. If securities are allotted on a preferential basis to promoters/ promoter group[32], they are locked in for 3 years from the date of trading approval subject to a limit of 20% of the total capital of the company. The locked-in securities may be transferred amongst promoter/ promoter group or any person in control of the company, subject to the transferee being subject to the remaining period of the lock in.

### iii. Exemption to court approved merger

The Preferential Allotment Regulations do not apply in the case of a preferential allotment of shares pursuant to merger / amalgamation approved by the Court under the Merger Provisions discussed above.

## B. Takeover Code

If an acquisition is contemplated by way of issue of new shares, or the acquisition of existing shares or voting rights, of a listed company, to or by an acquirer, the provisions of the Takeover

30. Section 180 of the CA 2013

31. ----------

32. The terms 'promoter' and 'promoter group' are defined in great detail by the Regulations, Generally speaking, promoters would be the persons in over-all control of the company or who are named as promoters in the prospectus of the company. The term promoter group has an even wider con- notation and would include immediate relatives of the promoter. If the promoter is a company, it would include, a subsidiary or holding company of that company, any company in which the promoter holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the promoter, etc.



© Nishith Desai Associates 2016

Code are applicable. The Takeover Code regulates both direct and indirect acquisitions of shares[33] or voting rights in, and control[34] over a target company.[35] The key objectives of the Takeover Code are to provide the shareholders of a listed company with adequate information about an impending change in control of the company or substantial acquisition by an acquirer, and provide them with an exit option (albeit a limited one) in case they do not wish to retain their shareholding in the company.

## i. Mandatory offer

Under the Takeover Code, an acquirer is mandatorily required to make an offer to acquire shares from the other shareholders in order to provide an exit opportunity to them prior to consummating the acquisition, if the acquisition fulfils the conditions as set out in Regulations 3, 4 and 5 of the Takeover Code. Under the Takeover Code, the obligation to make a mandatory open offer by the acquirer[36] is triggered in the following events:

### a. Initial Trigger

*If the acquisition of shares or voting rights in a target company entitles the acquirer along with the persons acting in concert* ***("PAC")*** *to exercise 25% or more of the voting rights in the target company.*

### b. Creeping Acquisition

*If the acquirer already holds 25% or more and less than 75% of the shares or voting rights in the target, then any acquisition of additional shares or voting rights that entitles the acquirer along with PAC to exercise more than 5% of the voting rights in the target in any financial year.*

It is important to note that the five per cent (5%) limit is calculated on a gross basis i.e. aggregating all purchases and without factoring in any reduction in shareholding or voting rights during that year or dilutions of holding on account of fresh issuances by the target company. If an acquirer acquires shares along with other subscribers in a new issuance by the company, then the acquisition by the acquirer will be the difference between its shareholding pre and post such new issuance.

It should be noted that an acquirer (along with PAC) is not permitted to make a creeping acquisition beyond the statutory limit of non- public shareholding in a listed company[37] i.e. seventy five per cent (75%).

### c. Acquisition of 'Control'

*If the acquirer acquires control over the target.*

Regardless of the level of shareholding, acquisition of 'control' of a target company is not permitted, without complying with the mandatory offer obligation under the Takeover Code. What constitutes 'control' is most often a subjective test and is determined on a case-to-case basis. For the purpose of Takeover Code, 'control' has been defined to *include:*

- Right to appoint majority of the directors;

33. The term 'shares' means shares in the equity share capital of a target company carrying voting rights and includes any security which would entitles the holder thereof to exercise voting rights. The term also includes all depository receipts carrying an entitlement to exercise voting rights in the target company. Therefore acquisition of depository receipts entitling the acquirer to exercise voting rights in the target company may trigger the open offer obligation.

34. The term 'control' includes the right to appoint the majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by the virtue of their shareholding or management rights or sharehold- ers agreements or voting agreements or in any other manner.

35. A 'Target Company' has been defined as a company and includes a body corporate or corporation established by a Central Legislation, State Legisla- tion or Provincial Legislation for the time being in force, whose shares are listed on a stock exchange.

36. See Annexure 2 for the meaning of persons acting in concert

37. Maximum permissible non-public shareholding is derived based on the minimum public shareholding requirement under the Securities Contracts (Regulations) Rules 1957 ("SCRR"). Rule 19A of SCRR requires all listed companies (other than public sector companies) to maintain public share- holding of at least 25% of share capital of the company. Thus by deduction, the maximum number of shares which can be held by promoters i.e. Maximum permissible non-public shareholding) in a listed companies (other than public sector companies) is 75% of the share capital.


© Nishith Desai Associates 2016

- Right to control the management or policy decisions exercisable by a person or PAC, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

Over time, the definition of 'control' has been subject to different assessments and has turned to be, quite evidently, a grey area under the Takeover Code. The Supreme Court order in case of SEBI vs. Subhkam Ventures Private Limited[38], which accepted an out-of-court settlement between the parties, had left open the legal question as to whether negative control would amount to 'control' under the Takeover Code. In fact, the Supreme Court had ruled that SAT ruling in this case (against which SEBI had appealed before the Supreme Court) which ruled that 'negative control' would not amount to 'control' for the purpose of Takeover Code, should not be treated as precedent. With no clear jurisprudence on the subject-matter, each veto right would typically be reviewed from the commercial parameters underlying such right and its impact on the general management and policy decisions of the target company. Given the Jet-Etihad deal[39], SEBI, recently indicated, its plans to introduce new guidelines to define 'bright lines' to provide more clarity as regards 'change in control' in cases of mergers and acquisitions.[40]

## ii. Indirect Acquisition of Shares or Voting Rights

For an indirect acquisition obligation to be triggered under the Takeover Code, the acquirer must, pursuant to such indirect acquisition be able to direct the exercise of such percentage of voting rights or control over the target company, as would otherwise attract the mandatory open offer obligations under the Takeover Code. This provision was included to prevent situations where transactions could be structured in a manner that would side-step the obligations under Takeover Code. Further, if:

- the proportionate net asset value of the target company as a percentage of the consolidated net asset value of the entity or business being acquired; or
- the proportionate sales turnover of the target company as a percentage of the consolidated sales turnover of the entity or business being acquired; or
- the proportionate market capitalisation of the target company as a percentage of the enterprise value for the entity or business being acquired;

is in excess of eighty per cent, on the basis of the most recent audited annual financial statements, then an indirect acquisition would be regarded as a direct acquisition under the Takeover Code for the purposes of the timing of the offer, pricing of the offer etc.

## iii. Voluntary Open Offer

An acquirer who holds between 25% and 75% of the shareholding/ voting rights in a company is permitted to voluntarily make a public announcement of an open offer for acquiring additional shares of the company subject to their aggregate shareholding after completion of the open offer not exceeding 75%.[41] In the case of a voluntary offer, the offer must be for at least 10% of the shares of the target company, but the acquisition should not result in a breach of the maximum non-public shareholding limit of 75%. As per SEBI's Takeover Code Frequently Asked Questions, any person holding less than 25% shareholding/voting rights can also make a voluntary open offer for acquiring additional shares.

38. SAT Appeal No. 8 of 2009, Date of decision: January 15, 2010

39. http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/sebi-clears-jet-etihad-deal.html?no_cach e=1&cHash=fa0e90046247a7f4ea-1dad57cba60bad

40. M&A : Sebi mulls 'bright line' rules to define control, available on http://ptinews.com/news/5935467_M-amp-A---Sebi-mulls---bright-line---rules-to- define-control-

41. Regulation 6 (1) of the Takeover Code.



© Nishith Desai Associates 2016

## iv. Minimum Offer Size

### a. Mandatory Offer[42]

The open offer for acquiring shares must be for at least 26% of the shares of the target company. It is also possible for the acquirer to provide that the offer to acquire shares is subject to a minimum level of acceptance.[43]

### b. Voluntary Open Offer[44]

In case of a voluntary open offer by an acquirer holding 25% or more of the shares/voting rights, the offer must be for at least 10% of the total shares of the target company. While there is no maximum limit, the shareholding of the acquirer post acquisition should not exceed 75%. In case of a voluntary offer made by a shareholder holding less than 25% of shares or voting rights of the target company, the minimum offer size is 26% of the total shares of the company.

## v. Pricing of the offer.

Regulation 8 of the Takeover Code sets out the parameters to determine offer price to be paid to the public shareholders, which is the same for a mandatory open offer as well as a voluntary open offer. There are certain additional parameters prescribed for determining the offer price when the open offer is made pursuant to an indirect acquisition. Please see **Annexure 2** for the parameters as prescribed under Regulation 8 of the Takeover Code. It is important to note that an acquirer is not permitted to reduce the offer price but an upward revision of offer price is permitted, subject to certain conditions.

## vi. Competitive Bid/ Revision of offer/ bid.

The Takeover Code also permits a person other than the acquirer (the first bidder) to make a competitive bid, by a public announcement, for the shares of the target company. This bid must be made within 15 working days from the date of the detailed public announcement of the first bidder. The competitive bid must be for at least the number of shares held or agreed to be acquired by the first bidder (along with PAC), plus the number of shares that the first bidder has bid for. Each bidder (whether a competitive bid is made or not) is permitted to revise his bid, provided such revised terms are more favourable to the shareholders of the target company.[45] The revision can be made up to three working days prior to the commencement of the tendering period.

## vii. Take Private Mechanism

The SEBI regulations on delisting prescribe the method and conditions for delisting a company, which earlier could only be undertaken by the promoter of the company. Recently, the SEBI notified the SEBI (Delisting of Equity Shares) (Amendment) Regulations, 2015 (**"Amended Delisting Regulations"**). The Amended Delisting Regulations now allow an acquirer[46] to initiate delisting of the target.

Further, SEBI has also amended the Takeover Code[47] wherein it inserted Regulation 5A to incorporate the changes introduced in the Amended Delisting Regulation. Pursuant to Regulation 5A, now an acquirer may delist the company pursuant to an open offer in accordance with the Delisting Regulations provided that the acquirer declares upfront his intention to delist. Prior to the inclusion of Regulation 5A, an open offer under the Takeover Regulations could not be clubbed with a delisting offer, making it burdensome for acquirers to delist the company in the future.

The Takeover Code provided for a one year cooling off period between the completion of an open offer under the Takeover Regulations and a delisting offer in situations where on account of the open

42. Regulation 7 (1) of the Takeover Code
43. Regulation 19
Regulation 7 (2) of the Takeover Code
44. Regulation 20.
45. As defined under Takeover Code
46. Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2015
47. Regulation 7(5) of the Takeover Code


© Nishith Desai Associates 2016

offer the shareholding of the promoters exceeded the maximum permissible non-public shareholding of 75% as provided under the Securities Contract Regulation Rules.[48] This restriction is not affected by Clause 5A in that the acquirer will continue to be bound by this restriction if the acquirer's intent to delist the company is not declared upfront at the time of making the detailed public statement.

# III. Listing Regulations

On September 2, 2015, the Listing Regulations were notified and have been effective from December 1, 2015. The Listing Regulations provide for a comprehensive framework governing various types of listed securities.

Regulation 30 of Listing Regulations deals with disclosure of material events by the listed entity whose equity and convertibles securities are listed. Such entity is required to make disclosure of events specified under Part A of Schedule III of the Listing Regulations. The Listing Regulations divide the events that need to be disclosed broadly in two categories. The events that have to be necessarily disclosed without applying any test of materiality are indicated in Para A of Part A of Schedule III of the Listing Regulation. Para B of Part A of Schedule III indicates the events that should be disclosed by the listed entity, if considered material.

48. We refer to the Listing Agreement of the Bombay Stock Exchange as a standard since it is India's largest Stock Exchange.

# IV. Insider Trading

## A. Securities and Exchange Board of India Act, 1992 read with SEBI (Prohibition of Insider Trading) Regulations, 1992, now replaced with SEBI (Prohibition of Insider Trading) Regulations, 2015

Under the SEBI Act, 1992, the penalty for insider trading is at least INR 10, 00,000 and may extend to INR 25, 00, 00, 000 or three times the amount of profits made out of insider trading, whichever is higher.[49] Recently, SEBI replaced the two-decade old SEBI (Prohibition of Insider Trading) Regulations, 1992 with the SEBI (Prohibition of Insider Trading) Regulation, 2015 (**"PIT Regulations"**) which are much more extensive in their outreach and scope. In respect of a listed company (or a company that is proposed to be listed), the PIT Regulations prohibit:

i. an insider from communicating unpublished price sensitive information (**"UPSI"**),

ii. any person from procuring UPSI from an insider, and

iii. an insider from trading in securities[50] when in possession of UPSI. Therefore the PIT prohibit, the provision as well as the receipt of UPSI.

49. For the purpose of these Regulations the term 'securities' does not include units of mutual funds

50. Regulation 2(g) of the PIT Regulations



© Nishith Desai Associates 2016

## i. Who is an Insider?

Under the PIT Regulations, an 'insider'[51] is a person who is (i) a connected person; or (ii) in possession of or having access to UPSI.

**Connected Person:** A connected person is one who is directly or indirectly associated with the company (i) by reason of frequent communication with its officers; or (ii) by being in a contractual, fiduciary or employment relationship; or (iii) by holding any position including a professional or business relationship with the company whether temporary or permanent that allows such person, directly or indirectly, access to UPSI or is reasonably expected to allow such access.

Therefore, any person who has any connection with the company that is expected to put him in possession of UPSI is connected. Persons who do not seemingly occupy any position in a company but are in regular touch with the company will also be covered. Certain categories of persons are all deemed to be connected, such as 'immediate relatives'[52], a holding, associate or subsidiary company, etc.

## ii. What is Unpublished Price Sensitive Information?[53]

UPSI means any information relating to a company or its securities, directly or indirectly, that is not generally available, and which upon becoming available is likely to materially affect the price of the securities. It includes: financial results; dividends; change in capital structure; mergers, demergers, acquisitions, delistings, disposals and expansion of business and such other transactions; changes in key managerial personnel; and material events in accordance with the Listing Agreement. The term 'generally available'[54] means information that is accessible to the public on a non-discriminatory basis.

## iii. Defenses/ Exceptions

The communication of UPSI by an Insider and the procurement of UPSI by a person from an insider is permitted if such communication, procurement is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.

The following are valid defenses available to a person who trades in securities when in possession of UPSI:[55]

| | |
|---|---|
| **General** | An off-market transaction between promoters who<br>▪ were in possession of the same UPSI (without being in breach of Regulation 3) and<br>▪ both counterparties made a conscious and informed trade decision. |
| **Specifically for non-individual insiders** | ▪ Individuals who executed the trade were different from individuals in<br>▪ possession of UPSI and were not in possession of such UPSI; or<br>▪ Chinese wall arrangements were in place and there was no leakage of information and the Regulations were not violated; or<br>▪ Trades were made pursuant a trading plan. |

51. Regulation 2(f) of the PIT Regulations, a spouse of a person, parent, sibling, and child of such person or of the spouse, any of whom is dependent financially on such person, or consults such person in taking decisions relating to trading in securities
52. Regulation 2(n) of the PIT Regulations
53. Regulation 2 of PIT Regulations
54. Regulation 4(1) of PIT Regulations
55. Regulation 3 (3) of PIT Regulations


© Nishith Desai Associates 2016

## iv. Trading Plans

A key change in the framework of insider trading regulations is the introduction of trading plans. Typically, 'insiders' who are liable to possess UPSI round the year are permitted to formulate trading plans with appropriate safeguards. Every trading plan must cover a period of at least year, must be reviewed and approved by the compliance officer of the company and then publicly disclosed. Trading cannot begin for a period of 6 months after the plan is publicly disclosed. Trading plans are a defense and do not provide absolute immunity from investigation under the PIT Regulations.

## v. Due-Diligence Carve-Out

The PIT Regulations contain a specific carve-out for communication and procurement of information (due-diligence conducted) in connection with transactions involving mergers and acquisitions.[56] Therefore, based on whether or not a transaction entails making an open offer under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (**"Takeover Code"**), information may be communicated, provided, allowed access to or procured on the following conditions:

| | |
|---|---|
| **Open Offer Obligation under TakeoverCode** | Where the board of directors of the company is of the informed opinion that the proposed transaction is in the best interest of the company. |
| **No Open Offer Obligation under Takeover Code** | Where the board of directors of the company is of the informed opinion that the proposed transaction is in the best interest of the company. Information that constitutes UPSI is disseminated to be made generally available at least 2 trading days prior to the proposed transaction being effected in such form as the board of directors may determine. |

Therefore, as long as the board is of the informed opinion that the transaction is in the best interest of the company, due –diligence may be lawfully conducted. In case, a particular transaction does not entail making an open offer to the public shareholders, the board of directors would be required to cause public disclosures of the UPSI prior to the proposed transaction to rule out any information asymmetry in the market. Additionally, a duty has been cast on the board of the company to cause the parties to execute confidentiality and non-disclosure agreements for the purpose of this provision. Therefore, introduction of this provision under the Regulations has amply clarified that the communication or procurement of UPSI for the purpose of due-diligence shall be permitted, subject to the conditions set out in the Regulations.

## vi. Disclosures

A significant aspect of the insider trading norms is disclosure requirements for different categories of persons involved in the affairs of the company. It is important to bear in mind that going forward, every promoter, key managerial personnel and director of a company would be required to disclose to the company his holding of securities of the company as on date of appointment/date of notification of the PIT Regulations i.e. May 15, 2015. More importantly, every promoter, employee or director would be required to make continual disclosures (within 2 trading days of such transaction) in case the traded value of securities over a calendar quarter exceeds the monetary threshold of INR 10,00,000 or such other value as may be specified. The Company is required to notify the stock exchanges in case such transactions by the promoter, employee or director exceeds this monetary threshold or in case of any incremental changes after such disclosure within two days of receipt of such information. These records will be required to be maintained by the company for at least five years.

## vii. Code of Conduct and Fair Disclosures

The Board of every company is required to formulate and publish a code of practices and procedures to be followed for fair disclosure of UPSI in accordance with the principles set out in Schedule A to the Regulations. Schedule A of the Regulations sets out certain minimum standards such as equality of access to

56. ----------



© Nishith Desai Associates 2016

information, publication of policies such as those on dividend, inorganic growth pursuits, calls and meetings with analysts, publication of transcripts of such calls and meetings etc. Additionally, the Board of directors of every listed company and market intermediary shall formulate a code of conduct to regulate, monitor and report trading by its employees and other connected persons.

### viii. Compliance Officer

The PIT Regulations have enhanced the role of a compliance officer's role with respect to monitoring and regulating trading by employees and connected persons, in particular monitoring and approving trading plans. The PIT Regulations prescribe specific qualification criteria have been set for a compliance officer who shall report to the board of directors of the company or the head of the organization, as the case may be.

### ix. Pre clearance of trades

A condition may be imposed on the insiders that they can deal in the securities of the company only after obtaining a prior approval in accordance with the procedure and policy prescribed by the company in that regard. In addition, it may also be prescribed that a pre-approved trade will have to be undertaken within the stipulated time period, failing which the approval would lapse.

### x. Notional trading windows

Usually, trading is closed during the trading windows are closed to eliminate any risk of insider trading and monitor compliant trading within a company during – (i) declaration of financial results (quarterly, half-yearly and annually) (ii) declaration of dividends (interim and final) (iii) issue of securities by way of public/rights/ bonus etc. (iv) any major expansion plans or execution of new projects (v) amalgamation, mergers, takeovers and buy-back (vi) Disposal of whole or substantially whole of the undertaking (vii) Any changes in policies, plans or operations of the company. The time-frame for such re-opening of trading windows has been set to 48 hours (which was earlier 24 hours) after the UPSI becomes generally available.

### xi. Chinese Walls

To prevent the misuse of confidential information the organization / firm shall adopt a 'Chinese Wall' policy which separates those areas of the organization / firm which routinely have access to confidential information, from those areas which deal with sale / marketing / investment advice or other departments providing support services.

In order to monitor Chinese Wall procedures and trading in client securities based on UPSI, the organization/ firm shall restrict trading in certain securities and designate such list as restricted / grey list. Securities of a listed company shall be put on the restricted / grey list if the organization / firm is handling any assignment for the listed company and is privy to PSI.

## V. CA 2013

Section 195 of the CA 2013 prohibits all persons including any director or key managerial personnel of a company from engaging in insider trading.

However, communications required in the ordinary course of business or profession or employment or under any law are an exception. This section does not distinguish between a listed or unlisted company or even between a private or a public company whereas SEBI Insider Regulations are applicable only on the listed public companies. It will be interesting to see how this section will be applied to a private company, which is usually run by the founders/shareholders and where there is no market determined price readily available.


© Nishith Desai Associates 2016

# 4. Competition Law

The Competition Act, 2002(**"Competition Act"**) replaced the Monopolies and Restrictive Trade Practices Act, 1969, and takes a new look at competition altogether. The Competition Act primarily covers (i) anti-competitive agreements (Section 3), (ii) abuse of dominance (Section 4), and (iii) combinations (Section 5, 6, 20, 29, 30 and 31).

The Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (**"Combination Regulations"**) govern the manner in which the Competition Commission of India (CCI) will regulate combinations which have caused or are likely to cause an appreciable adverse effect on competition (**"AAEC"**) in India.

## I. Anti - Competitive Agreements

The Competition Act essentially contemplates two kinds of anti-competitive agreements – horizontal agreements i.e. agreements between entities engaged in similar trade of goods or provisions of services, and vertical agreements i.e. agreements between entities in different stages / levels of the chain of production, in respect of production, supply, distribution, storage, sale or price of goods or services. Anti-competitive agreements that cause or are likely to cause an AAEC within India are void under the provisions of the Competition Act. A horizontal agreement that (i) determines purchase / sale prices, or (ii) limits or controls production supply, markets, technical development, investment or provision of services, or (iii) shares the market or source of production or provision of services, by allocation of geographical areas/type of goods or services or number of customers in the market, or (iv) results in bid rigging / collusive bidding, are presumed to have an AAEC.

On the other hand, vertical agreements, such as tie-in arrangements[57], exclusive supply or distribution agreements, etc., are anti-competitive only if they cause or are likely to cause an appreciable adverse effect on competition in India.

## II. Abuse of Dominant Position

An entity is considered to be in a dominant position if it is able to operate independently of competitive forces in India, or is able to affect its competitors or consumers or the relevant market in India in its favor. The Competition Act prohibits an entity from abusing its dominant position. Abuse of dominance would include imposing unfair or discriminatory conditions or prices in purchase/sale of goods or services and predatory pricing, limiting or restricting production / provision of goods/services, technical or scientific development, indulging in practices resulting in denial of market access etc.

## III. Regulation of Combinations

The Combination Regulations are the key regulations through which the CCI regulates combinations such as mergers and acquisitions. Under Section 32 of the Competition Act, the CCI has been conferred with extra-territorial jurisdiction. This means that any acquisition where assets / turnover are in India (and exceed specified limits) would be subject to the scrutiny of the CCI, even if the acquirer and target are located outside India.

57. A tie-in arrangement would include any agreement requiring a purchaser of goods, as condition of such purchase to purchase some other goods. A classic example of this on a global scale may be Microsoft's bundling of its web browser Internet Explorer along with the Windows operating system, limiting Netscape's web browser, Navigator, from having a significant presence in the market.



© Nishith Desai Associates 2016

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

- an acquisition of control, shares or voting rights or assets by a person;
- an acquisition of control of an enterprise where the acquirer already has direct or indirect control of another engaged in similar or identical business; or
- a merger or amalgamation between or among enterprises; that exceed the 'financial thresholds' prescribed under the Competition Act.

## A. Financial thresholds

Competition Act prescribes financial thresholds linked with assets / turnover for the purposes of determining whether a transaction is a 'combination', and CCI approval is required only for combinations.

Recently, vide notification dated March 4, 2016, the CCI has increased the thresholds for the purposes of section 5 of the Competition Act. A transaction that satisfies any of the following tests is a combination:-

An acquisition where the parties to the acquisition, i.e. the acquirer and the target, jointly have:

- **Test 1:** India Asset Test and India Turnover Test - in India (i) assets higher than INR 2,000 crore; or (ii) turnover higher than INR 6,000 crore; or
- **Test 2:** Global Asset Test and Global Turnover Test - Total assets in India or outside higher than USD 1 billion of which assets in India should be higher than INR 1,000 crores; or (ii) total turnover in India or outside is higher than USD 3 billion of which turnover in India should be higher than INR3,000crores; OR

The acquirer group[58] would have –

- **Test 1:** India Asset Test and India Turnover Test - in India (i) assets higher than INR 8, 000 crores; or (ii) turnover higher than INR 24,000 crores; or
- **Test 2:** Global Asset Test and Global Turnover Test - (i) Total assets in India or outside higher than USD 4 billion of which assets in India are higher than INR 1,000 crores; or (ii) total turnover in India or outside is higher than USD 12 billion of which turnover in India should be higher than INR 3,000 crores.

## B. Small Company Exemption

On March 4, 2016 vide a notification, the CCI has increased the de-minimis thresholds for small companies. Now an exemption has been granted to companies which have assets of less than INR 350 crores or turnover of less than INR 1,000 crores in India (**"SME Exemption"**). However, this exemption is only valid for a period of five years and is available until March 04, 2021.

## C. Pre-Filing Consultation

Any enterprise which proposes to enter into a combination may request in writing to the CCI, for an informal and verbal consultation with the officials of the CCI about filing such proposed 'combination' with CCI. Advice provided by the CCI during such pre-filing consultation is not binding on the CCI.

## D. Mandatory Reporting

Section 6 makes void any combination which causes or is likely to cause an AAEC 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

58. A 'group' for the above purposes would mean two or more enterprises which, directly or indirectly, are in position to –

i Exercise of not less than 50% or more of the voting rights in the other enterprise; or

ii Appoint more than fifty per cent of the members of the board of directors in the other enterprise, or iii Control the management or affairs of the other enterprise



© Nishith Desai Associates 2016

other document for acquisition and seek its approval prior to effectuating the same.

The CCI must form a prima facie opinion on whether a combination has caused or is likely to cause an AAEC 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.

## E. Multiple tranches

In order to ensure that all the combinations arising from small individual transactions which otherwise in isolation may not qualify the financial thresholds but along with inter-connected or inter-dependent transactions may qualify the financial thresholds are notified to CCI, Combinations Regulations provide that in a situation where the ultimate intended effect of a business transaction is achieved by way of a series of steps or smaller individual transactions which are inter-connected or inter-dependent on each other, one or more of which may amount to a combination, a single notice, covering all these transactions, may be filed by the parties to the combination.[59] Further, Combinations Regulations were amended in 2014, wherein a provision was inserted which mandates companies to notify CCI if the substance of the transaction and any structure of the transaction(s), comprises a combination, and that has the effect of avoiding notice in respect of the whole or a part of the combination shall be disregarded.

## F. Exceptions to Filing

Schedule I to the Combination Regulations specifies certain categories of transactions which are ordinarily not likely to have an AAEC 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 as long as the total shares or voting rights held by the acquirer directly or indirectly is less than 25% of the total shares or voting rights of the company, and as long as control is not acquired.
- Acquisition of not more than 5% shares or voting rights in any financial year (on a gross basis) by an acquirer or its group, if (a) the acquirer or its group already hold 25% or more of the shares or voting rights of the acquired enterprise but do not hold 50% or more shares of voting rights of the acquired enterprise either prior to or after such acquisition and (b) joint or sole control is not acquired.
- Acquisition by an acquirer who 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.
- An acquisition of assets unrelated to the business of the acquirer, or acquired solely as an investment or in the ordinary course of business, other than an acquisition of a substantial business operation.
- Acquisitions of stock-in-trade, raw materials, stores and spares, trade receivables and other similar current assets (in the ordinary course of business).
- Acquisitions of shares or voting rights pursuant to a bonus or rights issues, or buyback of shares, not leading to acquisition of control.
- Acquisition of shares or voting rights or assets within the same group, except where the acquired enterprise is jointly controlled by enterprises that are not part of the same group.
- Merger or amalgamation: (i) of holding and subsidiary company and/ or (ii) of companies which are majority held by the same group. However, the merger or amalgamation must not lead to the transfer of joint control to sole control. A share subscription, financing facility or any acquisition by a public financial institution, foreign institutional investor, bank or venture capital fund pursuant to any loan or investment agreement, would not qualify as a combination that will be regulated by the CCI, and such transactions are exempt from the Combination related provisions under the

59. Regulation 9(4)



© Nishith Desai Associates 2016

Competition Act. However, the public financial institution, FII, bank or venture capital fund is required to notify the CCI of the details of the acquisition within 7 day of completion of the acquisition.

- Impact on transactions involving listed companies. In combination involving listed companies, a primary transaction may trigger notification with CCI and subsequent open offer obligation under the Takeover Code. In cases where clearance from the CCI is not received within the statutory time period required to complete the open offer as prescribed under the Takeover Regulations, then as per the Takeover Code, SEBI may direct the acquirer to pay interest to shareholders for the delay beyond the maximum period within which the tendering shareholders are required to be paid.


© Nishith Desai Associates 2016

# 5. Exchange Control

## I. Foreign Direct Investment

India's story with respect to exchange control is one of a gradual, deliberate and carefully monitored advance towards full capital account convertibility. Though significant controls have been removed and foreign companies can freely acquire Indian companies across most sectors, these are subject to strict pricing and reporting requirements imposed by the central bank, the Reserve Bank of India (**"RBI"**). Investments in, and acquisitions (complete and partial) of, Indian companies by foreign entities, are governed by the terms of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (the **"FI Regulations"**) and the provisions of the Industrial Policy and Procedures issued by the Secretariat for Industrial Assistance (SIA) in the Ministry of Commerce and Industry, Government of India.

The FI Regulations segregate foreign investments into various types: foreign direct investments (FDI), foreign portfolio investments (FPI), investments by non-resident Indians (NRI) on portfolio basis, or on non-repatriation basis, foreign venture capital investments.

### A. Foreign Direct Investment (FDI)

Schedule 1 of the FI Regulations contains the Foreign Direct Investment Scheme (**"FDI Scheme"**), and sets out the conditions for foreign direct investments in India. Annex A of the FDI Scheme sets out the sectors in which FDI is prohibited. This list includes sectors such as lottery, gambling , defence etc. A foreign investor can acquire shares or convertible debentures[60] in an Indian company upto the investment (or sectoral) caps for each sector provided in Annexure B to the FDI Scheme. Investment in certain sectors requires the prior approval of the Foreign Investment Promotion Board (**"FIPB"**) of the Government of India, which is granted on a case to case basis. As per Press Note 6 of 2015, any foreign equity inflow that requires prior FIPB approval and is above INR 3,000 crores requires a prior approval of the Cabinet Committee on Economic Affairs.

### B. Portfolio Investment Scheme

Foreign portfolio investors registered with the SEBI as per the SEBI (Foreign Portfolio Investment) Regulations, 2014 and non-resident Indians (**"NRI"**), are permitted to invest in shares / convertible debentures under the portfolio investment scheme. This scheme permits investment in listed securities through the stock exchange.

### C. Foreign venture capital investors ("FVCI")

An FVCI registered with the SEBI can invest in Indian venture capital undertakings, venture capital funds or in schemes floated by venture capital funds under the terms of Schedule 6 of the FI Regulations. One of the important benefits of investing as an FVCI is that an FVCI is not required to adhere to the pricing requirements that are otherwise required to be met by a foreign investor under the automatic route[61] when purchasing or subscribing to shares or when selling such shares.

## II. Indirect Foreign Investment

Foreign investment may be direct or indirect. Generally speaking (and subject to certain exceptions) if an Indian

60. A foreign investor may also subscribe to preference shares. However, in order to fall under the automatic route, the preference shares / debentures must be compulsorily convertible into equity, failing which the investment will be treated as a debt and the External Commercial Borrowings (ECB) policy will be applicable.

61. The 'automatic route' generally means that investments do not need to any permissions / approvals under the FDI Scheme.



© Nishith Desai Associates 2016

investing company is "owned"[62]or "controlled"[63]by "non-resident entities"[64], then the entire investment by the investing company into the subject downstream Indian investee company would be considered as indirect foreign investment.

# III. Investment in a holding company

Foreign investment, whether direct or indirect, into a non-operational company, including a holding company, requires prior approval of the FIPB.

## A. Acquisition of rights shares/ bonus shares

A non-resident may subscribe to shares issued on a rights basis by an Indian company provided that the offer of shares does not result in increase in the percentage of foreign equity permitted for such company, and the price at which the shares are offered to the non-resident is not less than the price offered to the resident shareholders. A non- resident may also acquire bonus shares under the FI Regulations. The rights/bonus shares will however be subject to the same conditions as those applicable to the original shares.

## B. Issue of Shares under merger/ amalgamation / demerger

A transferee company may issue shares to the shareholders of a transferor company under a scheme of merger or amalgamation approved by an Indian court, provided that the sectoral caps mentioned above are not exceeded.

## C. Issue of shares against import of capital goods and pre-operative/pre- incorporation expenses

Indian companies can issue and allot equity shares/ preference shares to a person resident outside India under the automatic route against import of capital goods/ machineries / equipment (including second-hand machineries) and pre-operative/pre- incorporation expenses (including payments of rent, etc.) subject to compliance with the conditions prescribed.[65] Further, equity shares/ convertible preference shares/ convertible debentures can be issued by a company against any other funds payable by it provided that: (i) such shares/ debentures should be issued in accordance with the foreign exchange laws, and (ii) the shares issued shall be subject to the applicable tax laws and the conversion to equity should be net of applicable taxes.

## D. Issue of partly-paid up shares, warrants and other optionally convertible instruments

Currently, only equity shares, compulsorily convertible preference shares and compulsorily convertible debentures and warrants are permitted under the FDI route as eligible instruments. As per the Budget Speech of 2016, it has been proposed to expand the scope of permitted eligible instruments. While such additional instruments have not been detailed, it seems that optionally convertible instruments (preference shares and/ or debentures) or redeemable instruments (preference shares and/ or debentures) may be permitted under the FDI route. This is likely to be a major shot in the arm for FDI investments into India, since it provides further flexibility in terms of structuring of investments in a manner which is optimized for the investor and the investee from a regulatory perspective.

62. A company is considered to be owned by resident Indian citizens and Indian companies, if more than 50% of the equity interest in it is beneficially owned by resident Indian citizens and Indian companies(which are owned and controlled by resident Indian citizens).

63. A company is considered to be controlled by resident Indian citizens and Indian companies, , if resident Indian citizens and Indian companies, (which are owned and controlled by resident Indian citizens), have the power to appoint a majority of its directors.

64. "Non-resident entity" means a 'person resident outside India' as defined under FEMA 1999.

65. http://rbidocs.rbi.org.in/rdocs/notification/PDFs/1CAP74300611.pdf



© Nishith Desai Associates 2016

As per the current exchange control regulations, partly paid shares[66] can be issued to non-residents if (i) pricing of partly paid shares is determined up front and at least 25% of the total consideration amount is paid up front; and (ii) the remaining amount is invested within a period of 12 months of issuance. As regards the issuance of share warrants, the following conditions must be complied with: (i) pricing and conversion formula / price is required to be determined up front and 25% of the total consideration is required to be paid up front; and (ii) the remaining amount is required to be brought in within a period of 18 months. Further, the price at the time of conversion should not be less than the fair value of the shares as calculated at the time of issuance of such warrants.

It must also be noted that only companies in which investment can be made under the automatic route can issue partly paid shares or warrants. For companies under the approval route, prior FIPB approval will be required to issue partly paid shares or warrants.

### E. Pricing under the automatic route

Acquisition of shares of an Indian company by a person resident outside India under the automatic route may only be made in accordance with the pricing requirements provided in the FDI Regulations. The price of shares issued to non- residents cannot be less than the fair value of shares as determined as per any internationally accepted pricing methodology for valuation of shares on arm's length basis, or if the Indian company is listed, the price cannot be less than the price calculated in accordance with the SEBI guidelines.

### F. Foreign Technology Collaborations

Payments for foreign technology collaboration by Indian companies are allowed under the automatic route subject to compliance without any limits.

### G. ADR/GDR

An Indian company may also issue American Depositary Receipts / Global Depositary Receipts to foreign investors in accordance with the new Depository Receipts Scheme, 2014 (**"DR Scheme"**). For a comprehensive analysis of the above- mentioned scheme.[67]

## IV. Overseas Direct Investment

An Indian company that wishes to acquire or invest in a foreign company outside India 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 1990s. The regulations contain detailed provisions governing investments 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 capitalor 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'.*

66. Only equity shares can be issued on partly paid basis, preference shares debentures must be fully paid.

67. http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/newsid/2682/html/1.html?no_cache=1



© Nishith Desai Associates 2016

The Indian party may choose to fund the aforesaid investment out of balances held in Exchange Earner's Foreign Currency account, by drawing funds from an authorized dealer subject to certain limits, or using the proceeds of an ADR/GDR issue.

## A. 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"**) upto 400 %[68]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:

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

Overseas direct investment cannot be made in the real estate business or banking business. Further, investment in the financial services sector is subject to special requirements.

## B. Investment by way of capitalization of exports, or fees royalties etc., due to the Indian company

The ODI Regulations permit a company to invest in an entity outside India by way of capitalization of amounts due to it from the investee company, for sale of plant, machinery, equipment and other goods/ software, or any fees, royalty, commissions or other entitlements due to it for transfer of technical know-how, consultancy, managerial or other services.

68. 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.

A special case is carved out for a software exporter who wishes to start a software company overseas – the Indian exporter is permitted to receive shares upto 25% of the value of exports in the overseas company by filing an application with the authorized dealer.

## C. Transfer of shares

An Indian company may sell the securities of an overseas JV/WOS which has been in operation for a year provided that the following conditions, inter alia, are fulfilled:

- The sale does not result in any write off of the investment made;
- The sale should be through the stock exchange on which the securities of the overseas JV/WOS are listed. Where the shares of the JV/WOS company are not listed, the sale price of the shares should not be less than the fair value of the shares as determined by a certified Chartered Accountant or Certified Public Accountant;
- The exiting Indian seller does not have any dues from the JV/WOS.

The securities of the JV/WOS may also be pledged by the Indian company as security, to avail of fund/ non-fund based credit facilities for itself or for the JV/ WOS.

## D. Guarantee by Indian party

Loan and guarantee can be extended to an overseas entity only if there is already existing equity / CCPS participation by way of direct investment.

In case, however, the overseas entity is a first level step down operating subsidiary of the Indian party, guarantee may be issued by the Indian party on behalf of such step down operating subsidiary provided such guarantee is reckoned for the purpose of computing the total financial commitment of the Indian party.

In case, the overseas entity is a second or subsequent level step down operating subsidiary of the Indian party, guarantee may be issued by the


© Nishith Desai Associates 2016

Indian party on behalf of such step down operating subsidiary with prior approval of the RBI provided such Indian party holds indirect stake of not less 51% in the step down operating subsidiary and guarantee is reckoned for the purpose of computing the financial commitment of the Indian party.[69]

## E. Investment by Individuals

Under the ODI Regulations, there are limits on individuals owning shares in foreign companies. An individual may inter-alia invest 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 (upto a maximum amount of USD 2,50,000 per annum). The Liberalized Remittance Scheme was introduced in 2004 to simplify and liberalize the foreign exchange facilities available to resident individuals. Remittance under the Scheme is permitted for any permitted current or capital account transactions or a combination of both. 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., under this Scheme. Further, general permission has been granted to individuals under the ODI Regulations 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;
- 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;
- as part/full consideration of the professional services rendered to the foreign entity or lieu of director's remuneration; 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.

Further, a resident individual (single or in association with another resident individual) can make overseas direct investment in the equity shares and compulsorily convertible preference shares of a JV/WOS outside India subject to certain conditions. Some of these conditions are listed below:

- The JV or WOS abroad should be engaged in a bona fide business and should not be engaged in the real estate, banking business or financial services activities.
- The JV/WOS should be an operating entity only and not a step down subsidiary. Further, resident individuals cannot acquire a step down subsidiary.
- Resident individuals will have to get the valuation certificate from a certified valuer registered with the appropriate valuation authority in host country.
- At the time of investments, the permissible ceiling shall be overall ceiling prescribed from the resident individual under the Liberalized Remittance Scheme.

69. https://rbi.org.in/Scripts/FAQView.aspx?Id=32



© Nishith Desai Associates 2016

# 6. Taxes and Duties

## I. Income Tax Act, 1961.

The ITA contemplates and recognizes the following types of mergers and acquisitions activities:

- Amalgamation (i.e. a merger which satisfies the conditions mentioned below[70] )
- Demerger or spin-off;
- Slump sale/asset sale; and
- Transfer of shares.

The ITA defines an 'amalgamation' as the merger of one or more companies with another company, or the merger of two or more companies to form one company. The ITA also requires that the following conditions must be met by virtue of the merger, for such merger to qualify as an 'amalgamation' under the ITA:

- all the property of the amalgamating company(ies) becomes the property of the amalgamated company;
- all the liabilities of the amalgamating company(ies) become the liabilities of the amalgamated company; and
- shareholders holding not less than 75% of the value of the shares of the amalgamating company become shareholders of the amalgamated company.

### A. Tax on Capital Gains

i. Section 45 of the ITA levies tax on capital gains arising on the transfer of a capital asset . Section 2(47) of the ITA defines the term 'transfer' in relation to a capital asset[71] to include:

ii. The sale, exchange or relinquishment of the asset; or

iii. The extinguishment of any rights therein; or

iv. The compulsory acquisition thereof under any law; or

v. In a case where the asset is converted by the owner thereof into, or is treated by him as, stock–in–trade of a business carried on by him, such conversion or treatment; or

vi. Any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882; or

vii. Any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever), which has the effect of transferring, or enabling the enjoyment of, any immovable property.

viii. Further, under Section 9(1)(i) of the ITA, capital gains arising to a non-resident is considered taxable in India if they are earned directly or indirectly through the transfer of a capital asset situated in India.

If a merger or any other kind of restructuring results in a transfer of a capital asset (as defined above) for a resident or a capital asset that is situated in India for a non-resident, it would lead to a taxable event.[72]

70. Section 2(1B)

71. Section 2 (14) defines 'capital asset' as property of any kind held by an assessee whether or not connected with his business or profession, but excludes (a) stock in trade, consumable stores or raw materials held for the purposes of his business or profession, (b) personal effects, i.e. movable property held for personal use, and (c) certain agricultural land.

72. Capital gains characterization under the ITA also depends on accounting treatment of the transferred asset as 'capital asset', frequency of sale, period of holding etc. In case the asset is held as a trading asset and is transferred as part of business, income arising may also be categorized as 'business income' under the ITA.



© Nishith Desai Associates 2016

## i. Capital Gains Tax Implications for Mergers

Section 47 of the ITA sets out certain transfers that are exempt from the provisions of Section 45 (the charging provision for tax on capital gains) and such transfers are exempt from tax on capital gains. The relevant exemptions are provided below:

- *for an amalgamating company (transferor)*

Section 47(vi): The transfer of a capital asset in a scheme of amalgamation by the amalgamating company to the amalgamated company is exempt from tax on capital gains, provided the amalgamated company is an Indian company.[73] Please note that for this exemption to be applicable to a merger, it is essential that the merger falls within the definition of 'amalgamation' provided above. Special exemptions have also been included in case of amalgamations involving banking companies.[74]

- *for a foreign amalgamating company (transferor) in connection with transfer of shares in an Indian company*

Section 47(via): When a foreign holding company transfers its shareholding in an Indian company to another foreign company as a result of a scheme of amalgamation, such a transfer of the capital asset i.e. shares in the Indian company, would be exempt from tax on capital gains in India for the foreign amalgamating company, if it satisfies the following conditions: (a) At least 25% of the shareholders of the amalgamating foreign company continue to be the shareholders of the amalgamated foreign company, and (b) such transfer does not attract capital gains tax in the country where the amalgamating company is incorporated. It may be noted that while the definition of 'amalgamation' under Section 2(1B) requires that 75% (in terms of value of shares) of the shareholders of the amalgamating company should become the shareholders in the amalgamated company, this section specifies 25% of the number of shareholders as the corresponding figure. The above provisions also indicate that an Indian company may not amalgamate into a foreign company without attracting capital gains tax liability in India.

- *shareholders of the amalgamating company*

Section 47(vii): Transfer by the shareholders of amalgamating company, in a scheme of amalgamation, of shares of the amalgamating company (the capital asset) as consideration for the allotment of shares of the amalgamated company, is exempt from tax on capital gains, provided that the amalgamated company is an Indian company.[75] The exemption from tax on capital gains would only be to the extent that the transfer is for the consideration for shares of the amalgamated company. If any consideration other than shares of the amalgamated company, such as cash or bonds, was paid to the shareholders of the amalgamating company, it may be considered liable to tax on capital gains.[76]
If any of the conditions specified above are not satisfied (including the conditions specified in the

73. This section only requires that the amalgamated (or the surviving) company must be an Indian company. The amalgamating company may be an In- dian company or a foreign company. In this connection it is useful to note that the meaning of the term 'company' under the Companies Act differs considerably from the meaning under the ITA. Under the Companies Act, 'company' would generally refer to an Indian company (unless specifically provided otherwise). Under the ITA, the term 'company' has a much broader meaning and inter alia includes an Indian company and a foreign body corporate (i.e. including a foreign company).

74. Sections 47(viaa), 47(vica), 47(vicb) of the ITA

75. In this scenario, the shareholders get shares of the amalgamated company in exchange for their shareholding in the amalgamating company, and the amalgamating company is dissolved. It should be noted that the term transfer is used here in the context of the definition of this term under the ITA, which includes the extinguishment of any right in a capital asset. So if the rights of the shareholders in the shares of the amalgamating company are extinguished, it would amount to a transfer (which is exempt from capital gains tax if the conditions specified are complied with).

76. The Gujarat High Court, in CIT v. Gautam Sarabhai Trust, [1988] 173 ITR 216( Guj) had held that a shareholder receiving any other property other than shares by virtue of a marger would not qualify for the exemption under Section 47(vii).



© Nishith Desai Associates 2016

definition of 'amalgamation'), the transfer of capital assets in a merger would be subject to tax on capital gains.

- *for the shareholders/interest holders of a foreign amalgamating company in relation to indirect transfer tax*

The Finance Act, 2015 has added Sections 47(viab) and 47(vicc) to the ITA by which transfer by the shareholders, in a scheme of amalgamation, of shares/interests of a foreign amalgamating company (the capital asset) that derive their value 'substantially' from Indian assets[77] as consideration for the allotment of shares of the amalgamated company, is exempt from tax on capital gains, if it satisfies the following conditions: (a) At least 25% of the shareholders of the amalgamating foreign company continue to be the shareholders of the amalgamated foreign company, and (b) such transfer does not attract capital gains tax in the country where the amalgamating company is incorporated.

Capital gains tax implications for demergers. The term 'demerger' in relation to companies is defined by Section 2(19AA) of the ITA to mean the transfer, pursuant to a scheme of arrangement under the Merger Provisions by a demerged company of its one or more undertakings, to any resulting company, in such a manner that:

- All the property of the undertaking[78], being transferred by the demerged company, immediately before the demerger becomes the property of the resulting company by virtue of the demerger;
- All the liabilities[79] relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- The property & the liabilities of the undertaking/ undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
- The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;
- The shareholders holding not less than 3/4ths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or its subsidiary) become shareholders of the resulting company(ies) by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;
- The transfer of the undertaking is on a going concern basis;
- The demerger is in accordance with the conditions, if any, notified under subsection (5) of section 72A by the Central Government in this behalf.

Section 2(19AAA) of the ITA defines the term "demerged company" to mean a company, whose undertaking is transferred, pursuant to a demerger, to a resulting company. Section 2(41A) defines a "resulting company" to mean one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is

77. Explanation 6 proposed to be added to Section 9(1)(i) of the ITA by the Finance Bill, 2015 clarifies that the term 'substantial' would mean the foreign shares/interest would need to derive at least 50% of their value from Indian assets.

78. The term 'undertaking' would include any part of an undertaking, any unit or division of an undertaking or a business activity as whole, but does not include individual assets or liabilities which do not constitute a business activity.

79. The term 'liabilities' would include liabilities and specific loans/ borrowings incurred or raised for the specific business activity of the undertaking. In case of a multipurpose loan, such value of the loan will be included, that bears the same proportion as the value of the demerged assets to the total assets of the company.



© Nishith Desai Associates 2016

transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company.

The ITA contains certain tax beneficial provisions in the case of a demerger. If the demerger fulfills the conditions listed above, the transfer of assets by the demerged company to a resulting company, which must be an Indian company, is exempted from capital gains tax under Section 47(vib) of the ITA.

Further, in case of a demerger of a foreign company, whereby both the demerged and resulting companies are foreign, but the assets demerged include or consist of shares in an Indian company, the transfer of these shares is exempt from capital gains tax in the hands of the demerged company under Section 47(vic) of the IT Act, if the following conditions are satisfied:

- The shareholders holding at least three fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
- Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

However, since both the demerged and the resulting companies in the aforesaid example are based outside India, hence the provisions of the CA 1956/ CA 2013 (as the case may be) would not be applicable.

As in the case of a merger, a specific exemption provision covering demergers in an 'indirect transfer' situation i.e. Section 47(vicc) has been added by the Finance Act, 2015 whereby any transfer of a foreign company's shares, that derive their value 'substantially' from Indian assets, as part of a demerger would be exempt from capital gains tax in the hands of the demerged company if the following conditions are satisfied:

- The shareholders holding at least three fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

### ii. Computation of Capital Gains Tax

Income chargeable to tax as capital gains is computed by deducting the following from the value of the consideration received – (a) expenditure incurred wholly and exclusively with such transfer, and (b) cost of acquisition of the capital asset and any cost of improvement of the capital asset. Section 49(1) (e) provides that the cost of acquisition of assets transferred by way of a scheme of amalgamation that are covered by the exemptions under Section 47 mentioned above would be deemed to be the cost of acquisition of the assets by the amalgamating company. Similarly, Section 49 (2) provides that the cost of acquisition for a shareholder, of shares of the amalgamated company, is deemed to be the cost of acquisition of the shares of the amalgamating company.

## B. Capital gains tax implications on transfer of shares

### i. Long Term and Short Term Capital Gains

If a capital asset is held by an assessee for not more than 3 years immediately prior to the transfer, such capital asset would be a short term capital asset. If the capital asset is held for more than 3 years, then it is a long term capital asset. Any other capital asset would be a short term capital asset. However, vide the Budget Speech of 2016, it has been proposed that in case of sale of shares of unlisted companies, the holding period for an investment to qualify as long term capital asset be reduced to 2 years from the earlier qualifying period of 3 years. Further, in case of shares of a company/ security listed on a stock exchange, it would be a short term capital asset if it is held by the assessee for a period not exceeding 1 year. This distinction



© Nishith Desai Associates 2016

is important as the rate of capital gains tax on transfer of short term capital assets and long term capital assets differs. In the example mentioned in the paragraph above, if X sold the shares of B-Co, the period of holding of such shares for X would commence on the date X acquired shares in A-Co, and not the date of allotment of shares in B-Co.

Long-term capital gains realized on the transfer of listed shares of Indian companies on the floor of a recognized stock exchange in India are exempt from taxation in India, provided such transaction is subject to securities transaction tax (**"STT"**) as further discussed below. Long-term capital gains arising on transfer of listed shares of Indian companies off the recognized stock exchange in India or arising to a non-resident on transfer of shares of an unlisted public company will be chargeable to tax at a rate of 10% (excluding surcharge and education cess

but without indexation benefits). The Finance Bill, 2016 has reduced the long-term capital gains tax with respect to shares of private companies by non-residents to 10% (excluding surcharge and education cess). Please note that capital gains arising to a non-resident from the transfer of shares or debentures in an Indian company would not have indexation benefits, but such gains would be computed in the applicable foreign currency denomination.

Short-term capital gains realized on the transfer of listed shares of Indian companies on the floor of a recognized stock exchange in India are subject to tax at a rate of 15% (excluding surcharge and education cess), provided such transaction is subject to STT. Short-term capital gains on the transfer of an Indian security that is listed but not subject to STT, or is unlisted are added to the gross total income are subject to tax at applicable rates.

All transactions entered into on a recognized stock exchange in India will be subject to STT, which is levied on the transaction value. In the case of sale of equity shares on a delivery basis, STT is generally levied at the rate of 0.125% on the value of the transaction on both the buyer and seller of the equity shares.

Further, India has entered into tax treaties with several jurisdictions that allow for allocation of taxation rights in a cross-border situation. In case where a non-resident is resident of a jurisdiction with a beneficial tax treaty with India (such as Mauritius or Singapore), subject to fulfillment of other requirements, they may claim benefits under the tax treaty to neutralize capital gains tax exposure in India.

Moreover, in case shares of any company are transferred to a resident company or partnership firm or if shares of an Indian company are transferred to a non-resident company or partnership firm at a price which is below the 'fair market value'[80] , the transferee would be subject to tax under the head 'income from other sources' under the ITA and the difference between the consideration and the fair market value would be added to its gross total income and taxed at applicable rates.[81]

## ii. Capital Gains Tax Implications for a Slump Sale

A slump sale is a transaction by way of 'sale' as a result of which the transferor transfers one or more of its undertakings on a going concern basis for a lump sum consideration, without assigning values to the individual assets and liabilities of the undertaking.[82] For the purpose of computing capital gains, the cost of acquisition would be the 'net worth' of the undertaking on the date of the transfer.[83] The 'net worth' of the undertaking shall be determined by calculating the difference between the aggregate value of total assets and aggregate value of total liabilities as per the books of accounts of the seller. Further, for the purpose of such calculation, the aggregate value of total assets shall be,—

80. Calaculated on the basis of 'net asset value' under the Income Tax Rules, 1962.

81. However, this liability may be neutralized for a non-resident if it is resident in a jurisdiction with which India has entered into a beneficial tax treaty.

82. Section 2(42C) of the ITA.

83. Section 50B of the ITA



© Nishith Desai Associates 2016

- in the case of depreciable assets, the written down value of the block of assets determined in accordance with the ITA;
- in the case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD, nil; and
- in the case of other assets, the book value of such assets.

If the undertaking, which is being sold under slump sale was held by the transferor Indian company for more than 36 months, the capital gains realized on such sale would be taxed as long term capital gains, i.e. at the rate of 20% (exclusive of surcharge and education cess). If however, the undertaking were to be held for 36 months or less by the transferor Indian company, the capital gains realized would be taxed as short term capital gains, i.e. at the rate of 30% (exclusive of surcharge and education cess).

A slump sale is useful in situations when it would not be feasible to go through the process of amalgamation or demerger under the Merger Provisions. Further, it is also a useful restructuring tool in case of transactions such as externalizations as an undertaking may be transferred by an Indian company at 'net worth' to another Indian company in a tax neutral manner. Time taken for a slump sale is substantially less than the time taken for merger.

It would also be useful to note that the definition of 'slump sale' under the ITA uses the term 'sale'[84] specifically and excludes any other type of transfer as defined under the ITA. Therefore, the transfer of an undertaking in consideration for issue of securities of the transferee or any other property other than cash should be tax neutral in India.[85]

Capital gains tax implications for an asset sale (itemized sale). In an asset sale, the acquirer only purchases the assets of the seller. This does not amount to the transfer of the business as a going concern and specific values are attributed to each of the assets. The capital gains tax payable by the seller will depend on the period that the seller has held each of the assets that are transferred. This method of acquisition is usually used where the acquirer does not want to acquire the liabilities of the seller, and more so if the acquirer believes that the seller has not disclosed certain liabilities or there is a distinct possibility that unforeseen liabilities could arise in the future.

If the asset, which is being sold was held by the transferor Indian company for more than 36 months, the capital gains realized on such sale would be taxed as long term capital gains, i.e. at the rate of 20% (exclusive of surcharge and education cess). If however, the asset was to be held for 36 months or less by the transferor Indian company, the capital gains realized would be taxed as short term capital gains, i.e. at the rate of 30% (exclusive of surcharge and education cess).

Further, if shares of an Indian unlisted company are transferred to a resident or to a non-resident at less than its 'fair market value'[86] , the transferee would be subject to tax under the head 'income from other sources' under the ITA and the difference between the consideration and the fair market value would be added to its gross total income and taxed at applicable rates in the hands of transferee.[87]

Applicable surcharge on companies would be 5% if income is between INR 1-10 crores and 10% if income exceeds INR 10 crores. Further, an education cess of 3% would be applicable after surcharge.

Please note that any cross-border transaction between related parties that is liable to tax under the ITA would also be subject to 'transfer pricing' requirements under Indian law, mandating the transaction to be undertaken at an 'arm's length price' and other documentation requirements.

84. The term 'sale' is defined as a transfer of property in consideration for cash under the Sale of Goods Act, 1930.

85. Upheld by the Bombay High Court in CIT v. Bharat Bijlee Limited, [2014] 364 ITR 581 (Bombay).

86. Computable under the Income Tax Rules, 1962.

87. However, this liability may be neutralized for a non-resident if it is resident in a jurisdiction with which India has entered into a beneficial tax treaty.



© Nishith Desai Associates 2016

## C. Tax on Business Income - Carry Forward of Losses.

Section 72A of the ITA provides that in case of amalgamation of a company owning an industrial undertaking[88] with another company, the accumulated loss and the unabsorbed depreciation of the amalgamating company is deemed to be the loss / allowance for depreciation, of the amalgamated company. The amalgamated company would then be entitled to carry forward such loss and depreciation, and set off such amounts against its future profits.

However for this entitlement, the following conditions must be satisfied:

The amalgamated company:

- Holds 3/4ths of the book value of the fixed assets which it acquired from the amalgamating company continuously for a period of five (5) years from the date of amalgamation;
- Continues to carry on the business of the amalgamating company for a minimum period of five (5) years from the date of amalgamation. This would imply that if the amalgamating company were engaged in more than one business prior to amalgamation, the amalgamated company would be required to carry on all of those businesses; and
- Fulfills such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

Further, the amalgamating company:

- has been engaged in the business, in which the loss occurred or depreciation remained unabsorbed, for 3 or more years; and
- has held continuously, on the date of amalgamation, at least 3/4ths of the book value of the fixed assets held by it 2 years prior to the date of amalgamation.

Section 72 A (4) of the ITA provides a similar benefit for demergers. However, in the case of a demerger, the company does not need to satisfy any conditions similar to those applicable to mergers. In the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall:

- where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;
- where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

In a case where these conditions are not met, the ITA provides for a disallowance for carry-forward and set-off of losses where there is a substantial change in ownership. Section 79 of the ITA provides that in order for a company to claim carry-forward and set-off of losses for a particular assessment year, 51% of the voting power of the company must be beneficially held during that assessment year by the same shareholders who held such voting right during the year in which loss was incurred. However, this provision shall not be applicable in a case where there is a change in shareholding of an Indian company, that is a subsidiary of a foreign company, as a result of amalgamation or demerger of a foreign company, subject to the condition that fifty-one per cent shareholders of the amalgamating or demerged

88. Industrial undertaking means an undertaking engaged in manufacture or processing of good, manufacture of computer software, generation/dis- tribution of electricity/power, telecom-munications services etc. This does not cover undertakings in the software service sector and certain other service sectors.



© Nishith Desai Associates 2016

foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.[89]

Further, domestic transfer pricing rules have also been introduced under the ITA by which expenses may be disallowed in case of transactions between related parties.

### D. Transfers declared void under Section 281

Where there are assessment proceedings or tax litigations under the ITA pending on any person, including a company, any charge created on or transfer envisaged of any assets of such person shall be considered void as per Section 281 of the ITA –

1. if it is not made for adequate consideration and there is a notice of the pendency of such proceeding or, as the case may be, with a notice of such tax or other sum payable by such person; or

2. if it is not made with the previous permission of the Assessing Officer.

A certificate under Section 281 is key in a merger or acquisition situation in a case where the transferor has pending tax litigations under the ITA at any level.

## II. Service Tax

In an asset purchase or a slump sale, where the object is to acquire the business of the seller, there may be a covenant in the asset purchase agreement that the seller will procure that its employees accept offers of employment with the acquirer. Part of the consideration payable to the seller may be contingent on the number of employees who join the acquirer. It is possible that such a covenant could amount to the provision of manpower recruitment services by the seller on which service tax at the rate of 15% (including surcharge and education cess) may be payable as per Finance Bill, 2016..

89. Special exemptions are also provided in case of death of a shareholder, gift of shares to relatives.

## III. Value Added Tax / Sales Tax

Value added tax (**"VAT"**) or sales tax, as the case may be, may be payable on a purchase of movable assets or goods of the target by the acquirer. Most Indian states have in the last few years replaced their state sales tax laws with laws levying VAT on the sale of goods. We have analyzed some of the relevant provisions of the Karnataka Value Added Tax Act, 2003 (**"KVAT"**), in connection with the sale of goods in an asset purchase.

Under the KVAT, VAT is payable on a 'sale' of goods.[90] The term 'sale' is defined to inter alia include a transfer of property in goods by one person to another in the course of trade or business for cash, deferred payment or other valuable consideration etc. Therefore, the sale must be in the course of trade or business in order to attract VAT. Since the seller would usually not be in the business of buying or selling the assets proposed to be acquired, and the sale of a business does not amount to a sale of goods, it could be said that a transfer of goods in connection with the sale of the business of the seller, is not a sale attracting VAT under the KVAT. However this argument may be applied only in the case of a slump sale where the business is transferred as whole and not in the case of an itemized sale of assets.

The law pertaining to VAT is state specific and the argument stated above regarding non-applicability of the VAT law to an asset sale, may not be applicable in other Indian States. For example, the Maharashtra

Value Added Tax Act, 2002 defines the term 'business' to include any transaction in connection with the commencement or closure of business.

Therefore, a slump sale of a business could attract VAT. However an argument can be raised that a slump sale transaction would not attract VAT.

90. The term 'goods' generally includes all kinds of movable property (other than actionable claims, stocks, shares and securities)



© Nishith Desai Associates 2016

# IV. Stamp Duty

Stamp duty is a duty payable on certain specified instruments / documents. Broadly speaking, when there is a conveyance or transfer of any movable or immovable property, the instrument or document effecting the transfer is liable to payment of stamp duty.

## A. Stamp duty on court order for mergers/demergers

Since the order of the Court merging two or more companies, or approving a demerger, has the effect of transferring property to the surviving /resulting company, the order of the Court may be required to be stamped. The stamp laws of most states require the stamping of such orders. The amount of the stamp duty payable would depend on the state specific stamp law.

## B. Stamp duty on share transfers

The stamp duty payable on a share transfer form executed in connection with a transfer of shares is 0.25% of the value of, or the consideration paid for, the shares. However, if the shares are in dematerialised form, the abovementioned stamp duty is not applicable.

## C. Stamp duty on shareholder agreements/joint venture agreements

Stamp duty will be payable as per the state specific stamp law.

## D. Stamp duty on share purchase agreements

Stamp duty may be payable on an agreement that records the purchase of shares/debentures of a company. This stamp duty is payable in addition to the stamp duty on the share transfer form.

## E. Transaction costs for asset purchase vs. share purchase

Transaction related costs, are generally higher in the case of an asset purchase as compared to a share purchase. This is primarily because in a share purchase, there would usually be no incidence of sales tax/value added tax/service tax, which may be levied on different aspects of an asset purchase.

Further, the rate stamp duty is also usually higher in an asset purchase, and as discussed above is dependent on the nature of the assets transferred.

The stamp duty on a transfer of shares is 0.25% of the consideration payable for the shares, which rate is usually far less than the stamp duty rates applicable for transfer of movable/immovable assets.



© Nishith Desai Associates 2016

# 7. Conclusion

As Dale Carnegie[91] said "Flaming enthusiasm, backed by horse sense and persistence, is the quality that most frequently makes for success". A quote that holds good for M&A in India, and a credo to which Indian companies seem to subscribe given their successes to date in completing acquisitions. There is little to stop Indian companies that desire to be global names for playing the merger and amalgamation game globally. With a plethora of financing options, this aspiration has become a reality for many corporate houses, who can now boast of having the best in the industry under their wings. Indian companies have often surpassed their foreign counterparts in corporate restructuring both within and beyond the national frontiers. Mergers and acquisitions are powerful indicators of a robust and growing economy. The legal framework for such corporate restructuring must be easy and facilitative and not restrictive and mired in bureaucratic and regulatory hurdles. The biggest obstacle in the way of completing a merger or an amalgamation remains the often long drawn out court procedure required for the sanction of a scheme of arrangement.

The recommendations of the JJ Irani Report are of particular significance in this regard. The Report has recommended that legal recognition to 'contractual merger' (i.e., mergers without the intervention of the court) can go a long way in eliminating the obstructions to mergers in India. The report also recommended that the right to object to a scheme of merger/ acquisition should only be available to persons holding a substantial stake in the company.

As George Bernard Shaw[92] is reputed to have said "we are made wise not by the recollection of our past, but by the responsibility for our future", and the future of India is bright indeed.

Team M&A

91. November 24, 1888 – November 1, 1955.

92. July 26, 1856 – November 2, 1950, Nobel Prize for Literature 1925.



© Nishith Desai Associates 2016

# Annexure 1

## I. Meaning of 'Persons Acting in Concert'

Regulation 2(1) (q) "person acting in concert" means, - persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.

Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be persons acting in concert with other persons within the same category, unless the contrary is established,—

i. a company, its holding company, subsidiary company and any company under the same management or control;

ii. a company, its directors, and any person entrusted with the management of the company;

iii. directors of companies referred to in item (i) and (ii) of this sub-clause and associates of such directors;

iv. promoters and members of the promoter group;

v. immediate relatives;

vi. a mutual fund, its sponsor, trustees, trustee company, and asset management company;

vii. a collective investment scheme and its collective investment management company, trustees and trustee company;

viii. a venture capital fund and its sponsor, trustees, trustee company and asset management company;

ix. a foreign institutional investor and its sub-accounts;

x. a merchant banker and its client, who is an acquirer;

xi. a portfolio manager and its client, who is an acquirer;

xii. banks, financial advisors and stock brokers of the acquirer, or of any company which is a holding company or subsidiary of the acquirer, and where the acquirer is an individual, of the immediate relative of such individual:

Provided that this sub-clause shall not apply to a bank whose sole role is that of providing normal commercial banking services or activities in relation to an open offer under these regulations;

xiii. an investment company or fund and any person who has an interest in such investment company or fund as a shareholder or unit holder having not less than 10 per cent of the paid-up capital of the investment company or unit capital of the fund, and any other investment company or fund in which such person or his associate holds not less than 10 per cent of the paid-up capital of that investment company or unit capital of that fund:

Note: For the purposes of this clause`associate' means:

i. any immediate relative of such person;

ii. trusts of which such person or his immediate relative is a trustee;

iii. partnership firm in which such person or his immediate relative is a partner; and

iv. members of Hindu undivided families of which such person is a coparcener.



© Nishith Desai Associates 2016

# II. Qualifying Persons under the Takeover Code include

i. immediate relatives;

ii. persons named as promoters in the shareholding pattern filed by the target company in terms of the listing agreement or these regulations for not less than three years prior to the proposed acquisition;

iii. a company, its subsidiaries, its holding company, other subsidiaries of such holding company, persons holding not less than fifty per cent of the equity shares of such company, other companies in which such persons hold not less than fifty per cent of the equity shares, and their subsidiaries subject to control over such qualifying persons being exclusively held by the same persons;

iv. persons acting in concert for not less than three years prior to the proposed acquisition, and disclosed as such pursuant to filings under the listing agreement; and

v. shareholders of a target company who have been persons acting in concert for a period of not less than three years prior to the proposed acquisition and are disclosed as such pursuant to filings under the listing agreement, and any company in which the entire equity share capital is owned by such shareholders in the same proportion as their holdings in the target company without any differential entitlement to exercise voting rights in such company.



© Nishith Desai Associates 2016

# Annexure 2

## I. Regulation 8

The highest negotiated price per share of the target company under the agreement triggering the open offer;

i. The volume-weighted average price paid or payable for acquisitions, by the acquirer or person acting in concert with him, during the fifty-two weeks immediately preceding the date of the public announcement;

In case of indirect acquisition the fifty-two weeks immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain is considered;

ii. the highest price paid or payable for any acquisition, by the acquirer or by any person acting in concert with him, during the twenty-six weeks immediately preceding the date of the public announcement;

In case of indirect acquisition the twenty-six weeks immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain shall be considered;

iii. the volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded;

iv. In case of indirect acquisition the sixty trading days immediately preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain shall be considered; the per share value computed for any indirectly acquired target company in cases where the proportionate net asset value, proportionate sales turnover and proportionate market capitalization of the indirectly acquired target company as a percentage respectively, of the consolidated net asset value consolidated sales turnover and the enterprise value entity or business being directly acquired is in excess of fifteen per cent, on the basis of the most recent audited annual financial statements.

v. where the shares are not frequently traded, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies; and

In case of indirect acquisition, (f) above shall not be considered to determine the offer price and instead the following parameter will be considered:

*"the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, between the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, and the date of the public announcement of the open offer for shares of the target company made under these regulations".*



© Nishith Desai Associates 2016

The following research papers and much more are available on our Knowledge Site: www.nishithdesai.com

**Fund Structuring and Operations**

July 2016

**E-Commerce in India**

July 2015

**The Curious Case of the Indian Gaming Laws**

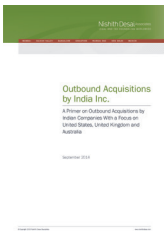
September 2015

**Corporate Social Responsibility & Social Business Models in India**

March 2016

**Joint-Ventures in India**

November 2014



**Outbound Acquisitions by India-Inc**

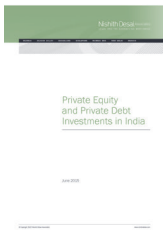
September 2014

**Internet of Things**

April 2016

**Doing Business in India**

June 2016



**Private Equity and Private Debt Investments in India**

June 2015

# NDA Insights

| TITLE | TYPE | DATE |
|---|---|---|
| Thomas Cook – Sterling Holiday Buyout | M&A Lab | December 2014 |
| Reliance tunes into Network18! | M&A Lab | December 2014 |
| Sun Pharma –Ranbaxy, A Panacea for Ranbaxy's ills? | M&A Lab | December 2014 |
| Jet Etihad Jet Gets a Co-Pilot | M&A Lab | May 2014 |
| Apollo's Bumpy Ride in Pursuit of Cooper | M&A Lab | May 2014 |
| Diageo-USL- 'King of Good Times; Hands over Crown Jewel to Diageo | M&A Lab | May 2014 |
| Copyright Amendment Bill 2012 receives Indian Parliament's assent | IP Lab | September 2013 |
| Public M&A's in India: Takeover Code Dissected | M&A Lab | August 2013 |
| File Foreign Application Prosecution History With Indian Patent Office | IP Lab | April 2013 |
| Warburg - Future Capital - Deal Dissected | M&A Lab | January 2013 |
| Real Financing - Onshore and Offshore Debt Funding Realty in India | Realty Check | May 2012 |
| Pharma Patent Case Study | IP Lab | March 2012 |
| Patni plays to iGate's tunes | M&A Lab | January 2012 |
| Vedanta Acquires Control Over Cairn India | M&A Lab | January 2012 |
| Corporate Citizenry in the face of Corruption | Yes, Governance Matters! | September 2011 |
| Funding Real Estate Projects - Exit Challenges | Realty Check | April 2011 |



© Nishith Desai Associates 2016

# Research @ NDA

**Research is the DNA of NDA.** In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Research has offered us the way to create thought leadership in various areas of law and public policy. Through research, we discover new thinking, approaches, skills, reflections on jurisprudence, and ultimately deliver superior value to our clients.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our *"Hotlines"*. These *Hotlines* provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our *NDA Insights* dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction.

We regularly write extensive research papers and disseminate them through our website. Although we invest heavily in terms of associates' time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

Our research has also contributed to public policy discourse, helped state and central governments in drafting statutes, and provided regulators with a much needed comparative base for rule making. Our *ThinkTank* discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

As we continue to grow through our research-based approach, we are now in the second phase of establishing a four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. The center will become the hub for research activities involving our own associates as well as legal and tax researchers from world over. It will also provide the platform to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research reports.

Please feel free to contact us at
**research@nishithdesai.com**

© Nishith Desai Associates 2016

Nishith Desai Associates

LEGAL AND TAX COUNSELING WORLDWIDE


MUMBAI

93 B, Mittal Court, Nariman Point
Mumbai 400 021, India

tel +91 22 6669 5000
fax +91 22 6669 5001

SILICON VALLEY

220 S California Ave., Suite 201
Palo Alto, California 94306, USA

tel +1 650 325 7100
fax +1 650 325 7300

BANGALORE

Prestige Loka, G01, 7/1 Brunton Rd
Bangalore 560 025, India

tel +91 80 6693 5000
fax +91 80 6693 5001

SINGAPORE

Level 30, Six Battery Road
Singapore 049 909

tel +65 6550 9856

MUMBAI BKC

3, North Avenue, Maker Maxity
Bandra–Kurla Complex
Mumbai 400 051, India

tel +91 22 6159 5000
fax +91 22 6159 5001

NEW DELHI

C–5, Defence Colony
New Delhi 110 024, India

tel +91 11 4906 5000
fax +91 11 4906 5001

MUNICH

Maximilianstraße 13
80539 Munich, Germany

tel +49 89 203 006 268
fax +49 89 203 006 450

NEW YORK

375 Park Ave Suite 2607
New York, NY 10152

tel +1 212 763 0080





© Copyright 2016 Nishith Desai Associates