Bill allows merger of Indian companies with foreign firms

Rajesh Bhayani / Mumbai August 12, 2009

The Companies Act Amendment Bill, which was tabled in Parliament in the Budget session that adjourned last week, has proposed to allow Indian companies to merge with overseas companies, a move that could introduce greater flexibility in cross-border merger and acquisitions (M&As).

At present Sections 391-394 of the Companies Act, 1956, allow only foreign companies to merge with Indian ones. The Bill has introduced Section 205 that also allows the reverse and stipulates that payment to shareholders of listed Indian companies being merged can be in the form of cash, shares or Indian Depository Receipts (IDRs) issued by the overseas companies.

The amendment was first suggested in 2005 by an expert committee on company law chaired by Tata Sons Director J J Irani. The report had stated that "both contract as well as court-based mergers between an Indian company and a foreign company, where the foreign company is the transferee, needs to be recognised in Indian law. The committee recognises that this would require some pioneering work between various jurisdictions in which such mergers and acquisitions are being executed/created".

If this amendment goes through, it will meet a key demand of many multinational companies investing in India.

Legal experts said the merger of an Indian company with a foreign one can help structure M&A deals in many ways. For example, if an overseas company has acquired another foreign company that has a subsidiary in India, the new provision will allow the acquirer to merge the Indian operations with itself, instead of retaining it as a separate entity.

Similarly, if the Indian subsidiary is incurring losses, the overseas company may prefer to merge the Indian subsidiary with itself to gain maximum tax benefits by offsetting losses of the subsidiary against its profits.

The provision may also make it easier for promoters of Indian companies to raise funds abroad by setting up listed entities abroad and merging their Indian operations with them.

"Outbound mergers would provide greater flexibility in legal and tax structuring. Such mergers may be required on account of better valuations available outside India," said Nishchal Joshipura, head of M&A at Nishith Desai Associates.

The proposed amendment in the Companies Act says, "The provisions shall apply … to schemes of mergers and amalgamations between companies registered under this Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the central government". Not all countries allow the merger of local companies with foreign entities.

Joshipura, however, said the amendment will not help if it is not in sync with other Indian laws. For example, if an Indian company with assets in India is merged with a foreign company, it may attract the provisions of the Indian Income Tax Act because it could be considered a "permanent establishment" of the foreign company in India.

Further, like inbound mergers, outbound ones will also be required to be made tax-neutral. From an exchange control perspective, outbound mergers could lead to a situation in which a foreign company would own Indian assets without any presence in India, a move that could require regulatory approvals.

The Irani Committee had also recommended that the amendment follow international best practices and be made with suitable changes to the tax and foreign exchange legislations and IDR provisions.