CROSS BORDER MERGER NOW PERMITTED BOTH WAYS

The Ministry of Corporate Affairs, Government of India (MCA) has notified Section 234 of the Companies Act, 2013, "2013 Act" which permits two-way cross border merger by way of notification dated 13 April, 2017. Further, MCA has now inserted rule 25A stating 'Merger and Amalgamation of a Foreign Company with a Company[1] **and vice versa**' in the previous Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 "2016 Rules", by its notification dated 13.04.2017.

Following are the highlights of the aforesaid notification:

Two-way Cross Border Merger permitted:

Earlier, a Foreign Company incorporated outside India could merge with an Indian Company (inbound merger). The new notification has now permitted outbound merger whereby, an Indian Company may merge with a Foreign Company incorporated in the following permitted jurisdictions by stating the following:

> *In exercise of the powers conferred by sub-section (3) of Section 1 of the Companies Act, 2013 (18 of 2013), the Central Government hereby appoints the 13th day of April, 2017 as the date on which the provisions of section 234 of the said Act shall come into force.*

Jurisdiction where an Indian Company can merge with a Foreign Company:

i. A jurisdiction whose securities market regulator is a signatory to the Multilateral Memorandum of Understanding of the International Organization of Securities Commission or to the Bilateral Memorandum of Understanding with the Securities and Exchange Board of India.

ii. Jurisdictions whose central bank is a member of the Bank of International Settlements.

iii. Jurisdictions not identified in the public statement of the Financial Action Task Force (**FATF**) for deficiencies relating to anti-money laundering or combating

[1] Company means a Company as defined in Clause (20) of Section 2 of the Companies Act, 2013.

terrorism financing or jurisdictions without sufficient progress in addressing the deficiencies or not having committed to action plan developed with the FATF to address the deficiencies.

Countries like the USA, UK, Russia, Germany, France, Japan, China, Singapore, Mauritius, etc. will fall within the definition of eligible jurisdictions.

Consideration:

The newly notified Section 234 provides that the provisions of Chapter XV (Compromises, Arrangements and Amalgamations) of the Act shall apply, *mutatis mutandis* (with appropriate changes), to an inbound or outbound cross-border merger. The provision envisages a scheme of amalgamation providing for payment of consideration, which may be done either by way of cash or depository receipts or a combination of both.

Valuation and Procedure:

The transferee company shall be required to ensure that valuation is conducted by valuers who are members of a recognized professional body in the jurisdiction of the transferee company and further, such valuation shall be in accordance with internationally accepted principles on accounting and valuation.

A declaration to this effect would be required to be attached with the application made to RBI for obtaining approval in case of outbound merger. Under the provisions of the 1956 Act, in the case of permitted inbound merger, no such approval was required under the exchange control regulations unless the company operated in a sector categorized under the approval route.

Further, the concerned Indian Company will be required to file an application with the National Company Law Tribunal **("NCLT")** as per provisions of Section 230 to 232 of the Act and the new rules after obtaining necessary approval from RBI.

Analysis:

Under the provisions of the previous act i.e. the Companies Act, 1956, the transferee company could only be an Indian entity. The introduction of Section 234 in the 2013 Act is a welcome step as it will enhance business opportunities by enabling merger of an Indian company with a Foreign Company.

1. **Tax Implications:**

However, the tax implications incase of outbound merger are yet to be analyzed. Currently, Section 47(vi) of the Income Tax Act, 1961 ("**ITA**") exempts from tax any transfer of capital assets by a transferor company by way of a scheme of amalgamation wherein the resulting company is an Indian company. Merger of an Indian Company with a Foreign Company of permitted jurisdiction will involve transactions falling under capital gains. In the absence of such relief in case of outbound merger, the capital gains arising from these mergers may result in tax liabilities in the hands of the shareholders of the transferor company. Provisions for relief in terms of exemptions in capital gains in outbound mergers may follow in the current Income Tax Laws in future.

2. **Amendment required in Exchange Control Laws:**

The previous laws, where only inbound merger was permitted did not require prior permission from RBI unless the company operated under a sector specified under approval route. It would be pertinent to mention that India has been taking steps to liberalize Foreign Direct Investment **("FDI")** regime. In this context, an approval route seems to be a contradiction to the same. A simultaneous amendment in the Exchange Control Laws is required to put together a framework to facilitate outbound mergers.

3. **Clarification regarding External Commercial Borrowing Regulations, etc.:**

More clarification is required for a case where a transferee company inherits loans of the acquired company. It is not clear if the surviving entity will become subject to the restrictions contained in the regulations concerning External Commercial Borrowings, etc.

4. **<u>Consideration in Outbound Merger:</u>**

Payment of consideration to shareholders of merging company by way of Depository Receipts **("DR")** where an Indian Depository Receipt **("IDR")** is issued by a foreign company may be challenging as it will involve the Central Government's intervention in form of Companies (Issue of Indian Depository Receipts) Rules, 2004, not to mention the RBI and SEBI restrictions. This makes IDR a complex form of security. The same questions could arise if merger payments are made by way of Debentures (convertible, redeemable etc.), foreign currency external commercial borrowings (ECBs) made out in favour of Indian shareholders, deferred payment agreements, share swaps and payments through masala bonds.

5. **<u>Ambiguity in Categorization as Permanent Establishment:</u>**

In the event where such merger takes place, the operations of the Indian transferor company will be carried out by the surviving foreign entity, either directly or through a branch. Therefore, it is pertinent to note that this may easily cause ambiguity if the tax authorities categorize the resulting presence in India as a Permanent Establishment (**"PE").** This may lead to complex litigation and dispute if such an entity is treated as a **"PE"** by tax authorities. This may, however, be obviated if the entity taking over the Indian company applies to do business in India under the automatic or approval route.

6. **<u>Changes in the current Laws:</u>**

The current laws pertaining to merger are not fully equipped to tackle the nuances that will be brought forth by this enabling provision that has been notified by MCA. For instance, the current inbound merger requires the presence of participation of various intermediaries, meeting of stakeholders of the company, an application to be made in a prescribed form and manner and final sanction of merger by the tribunal having authority. The process and the provisions specific to outbound merger need to be delineated by the Ministry of Corporate Affairs and the SEBI (where relevant) as the existing procedure is more suited to inbound merger, where the transferee is an Indian Company per se.

Thus, in the light of the above, it is imperative to note that the change will require further amendments in other laws including Regulations under the Companies Act, Income Tax Laws, FEMA and rules thereunder, etc.

Notifications:

- Commencement of Section 234 of the 2013 Act: (Click here)

- Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2017 (Click here)

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