Motives and Innovative ways of Structuring and Accounting for Business combination

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April 22, 2017

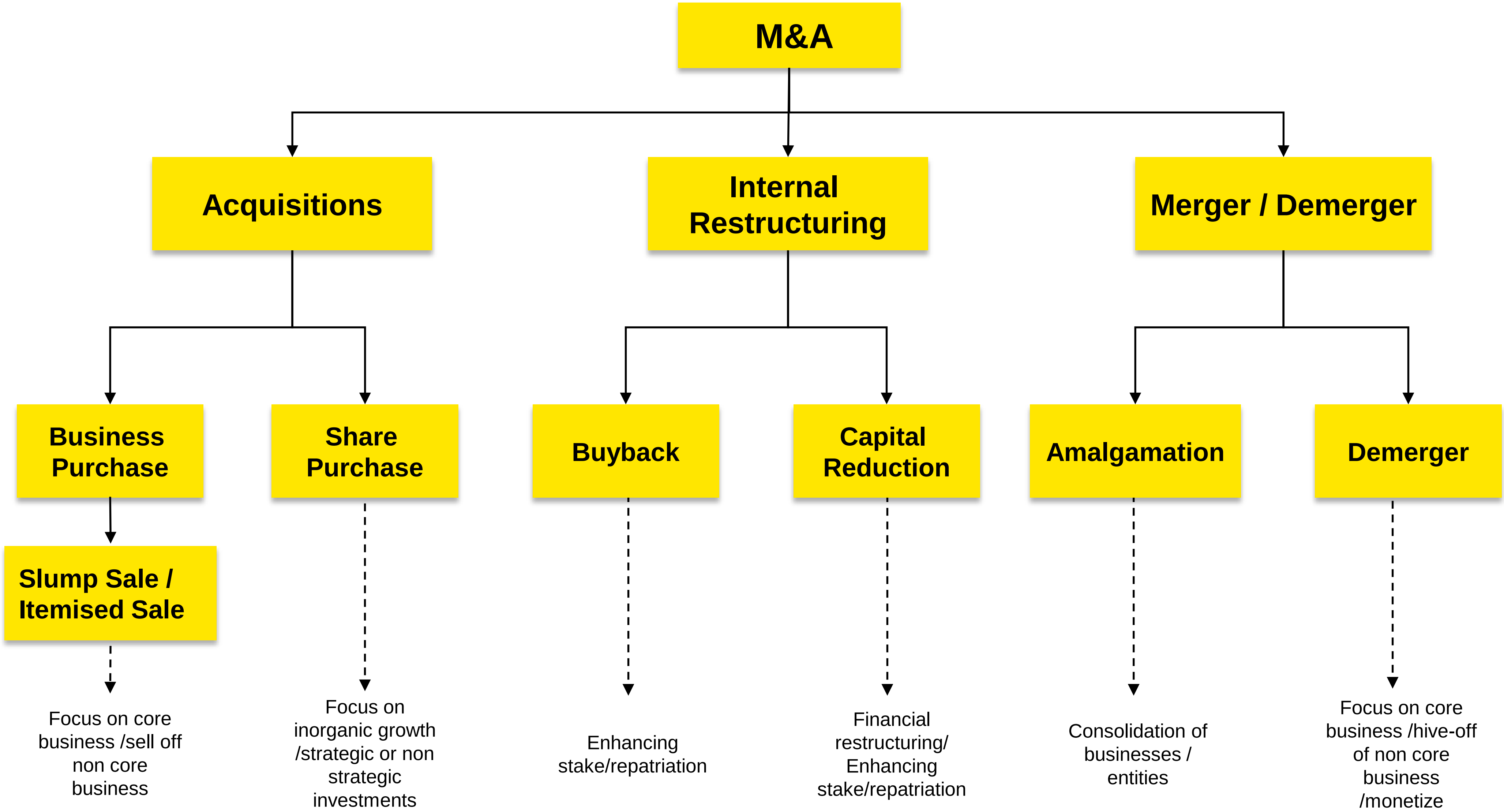
Building a better working world

*Intended for general guidance only

Content

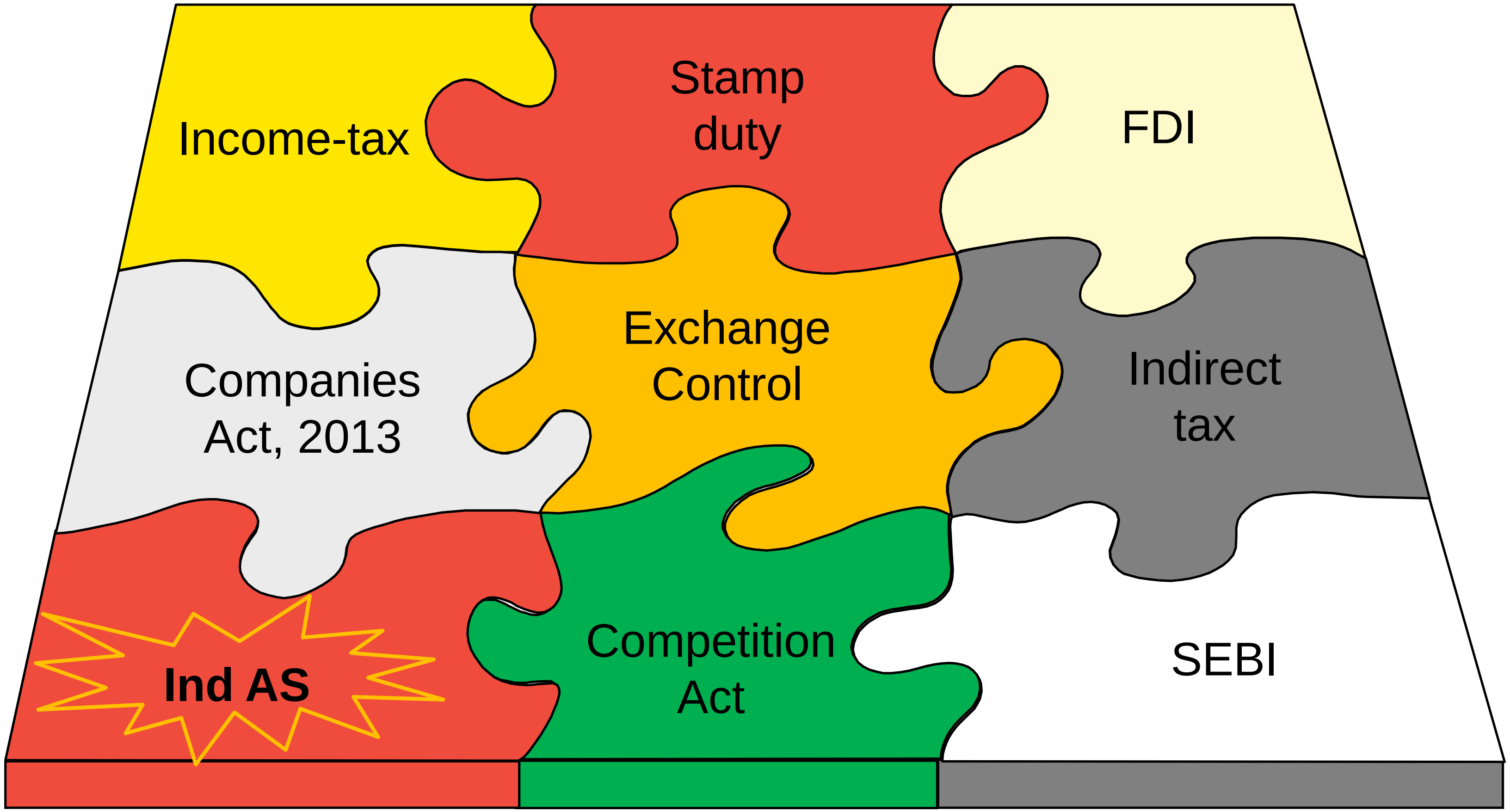
- Modes of M&A in India
- Indian laws impacting M&A
- Case Studies
- Ind AS 103 vs AS-14

Overview - Modes of M&A in India



Indian laws impacting M&A

Newton Tax: Every action has a tax and regulatory reaction



Industry specific laws like Insurance, Telecom, Banking etc. should be considered

Key regulatory considerations on M&A

Income tax

- Tax neutrality
- Availability of tax exemptions/benefits
- Transfer of tax credits
- Step up in tax basis
- GAAR implications

Companies Act

- NCLT approval
- Approval of shareholders, creditors & other statutory authorities
- Post implementation procedures

Stamp duty

- Valuation of shares
- Indian Stamp Act vs. State Stamp Act
- Valuation of immovable property
- Set-off of stamp duty

SEBI & Stock exchange

- Listing of shares / New Co
- Stock exchange approvals
- Take-over code implications
- Filing compliances

Key regulations

Exchange control

- Issue of shares to non resident on merger
- FDI / RBI – Approval / automatic route
- Phasing out of FIPB

Cross border

- Host jurisdiction compliances
- Tax implications in host jurisdiction

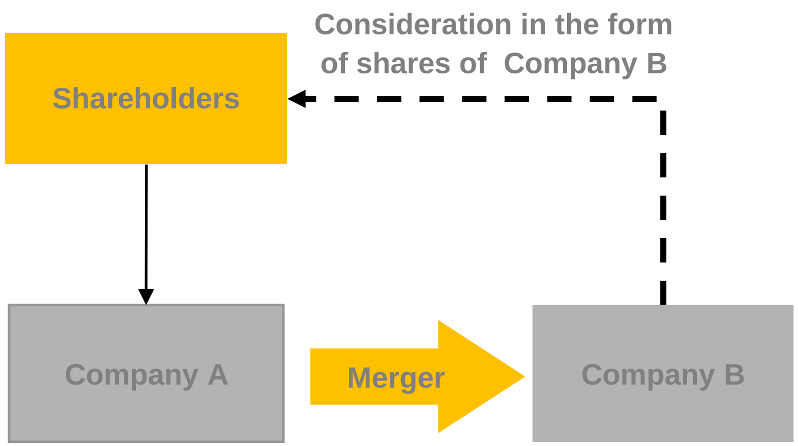
Accounting

- Impact under Ind AS 103
- Nature of transaction – Common control or otherwise

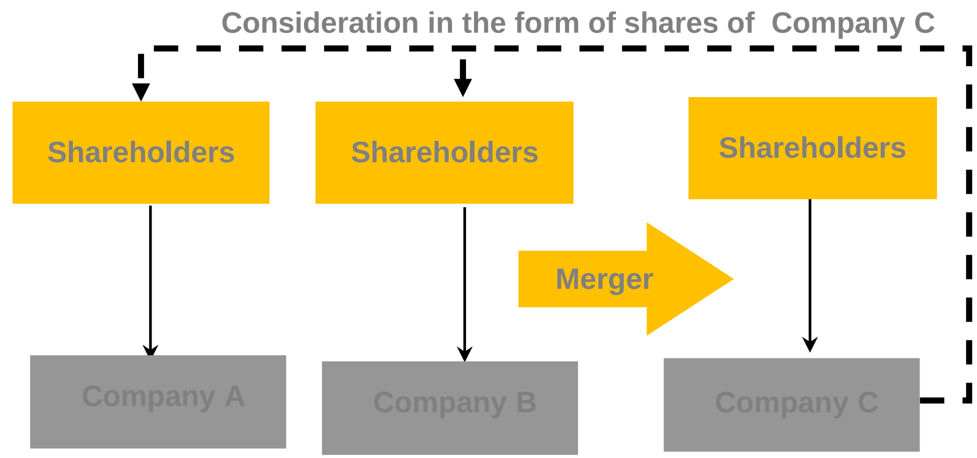
Other regulations

- Competition Act
- Indirect tax
- Insolvency & Bankruptcy Act
- Industry specific law

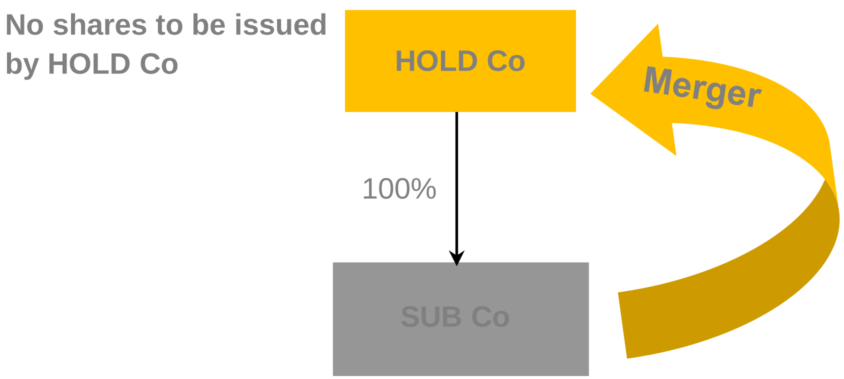
Domestic merger / amalgamation situations



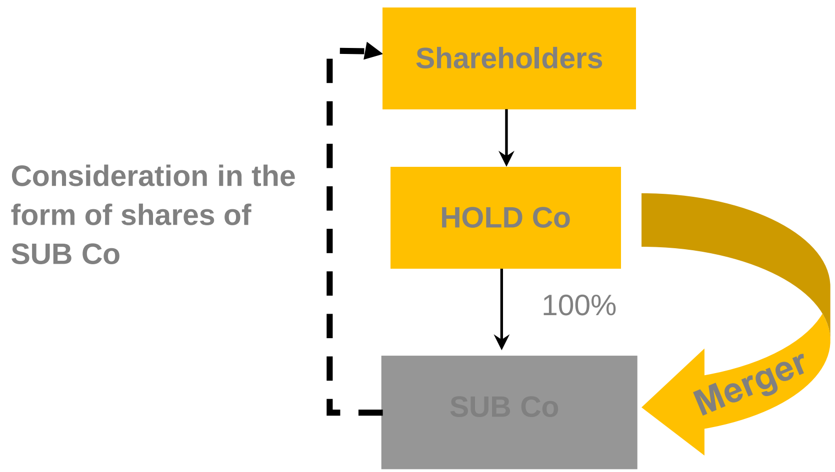
Merger of Company A with Company B



Merger of Companies A & B with Company C



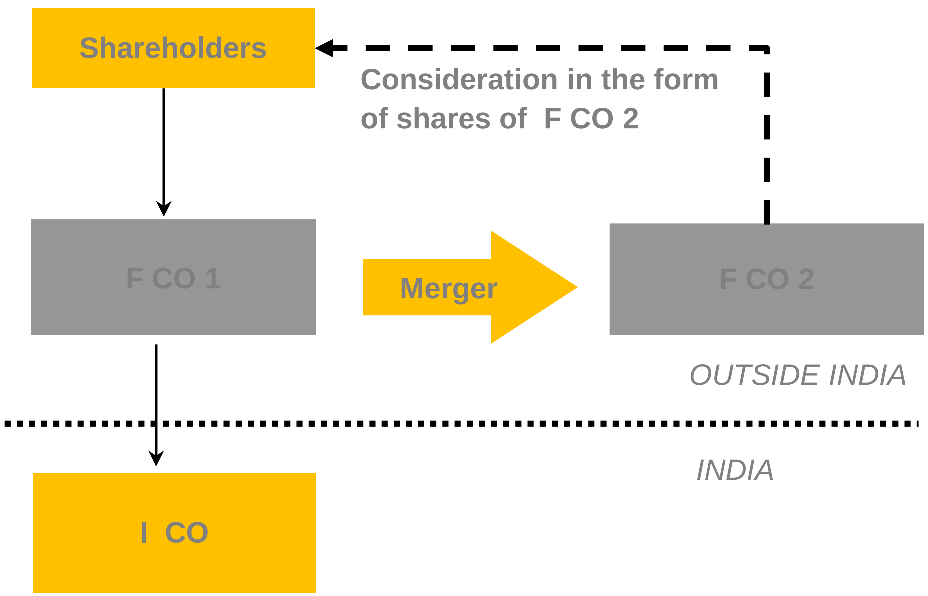
Merger of SUB Co with HOLD Co



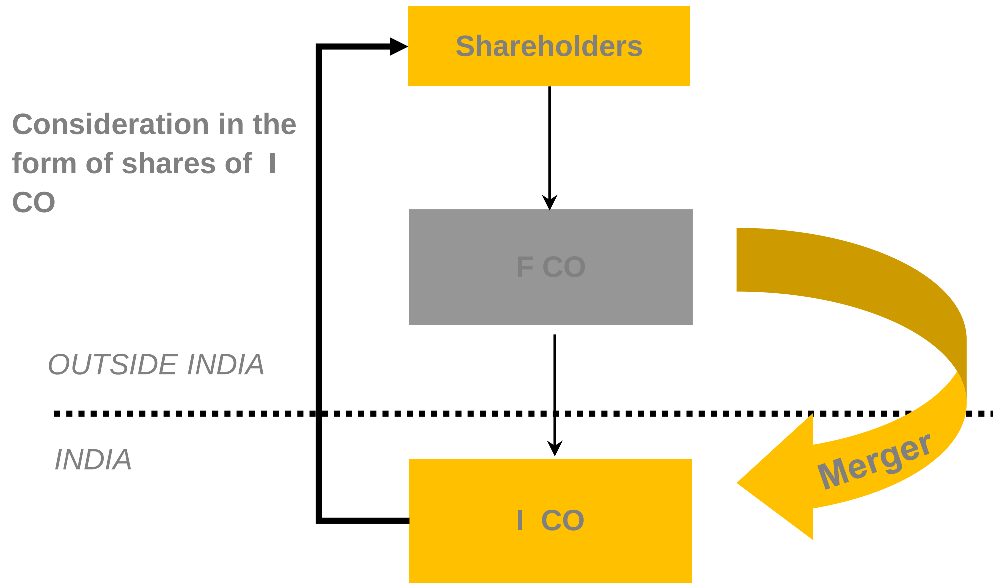
Merger of HOLD Co with SUB Co

Cross border merger situations

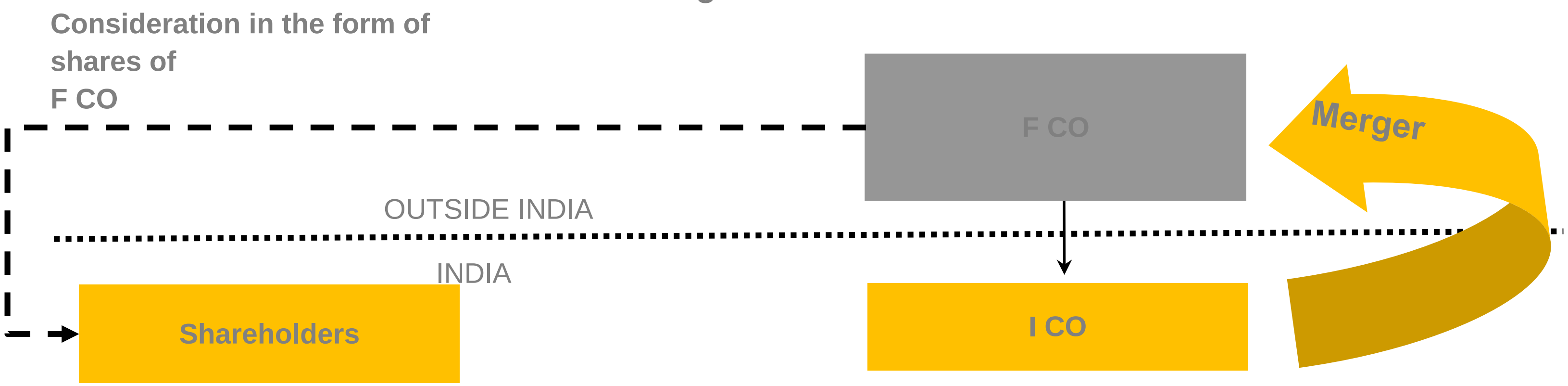
Merger of F CO 1 (holding I CO) with F CO 2



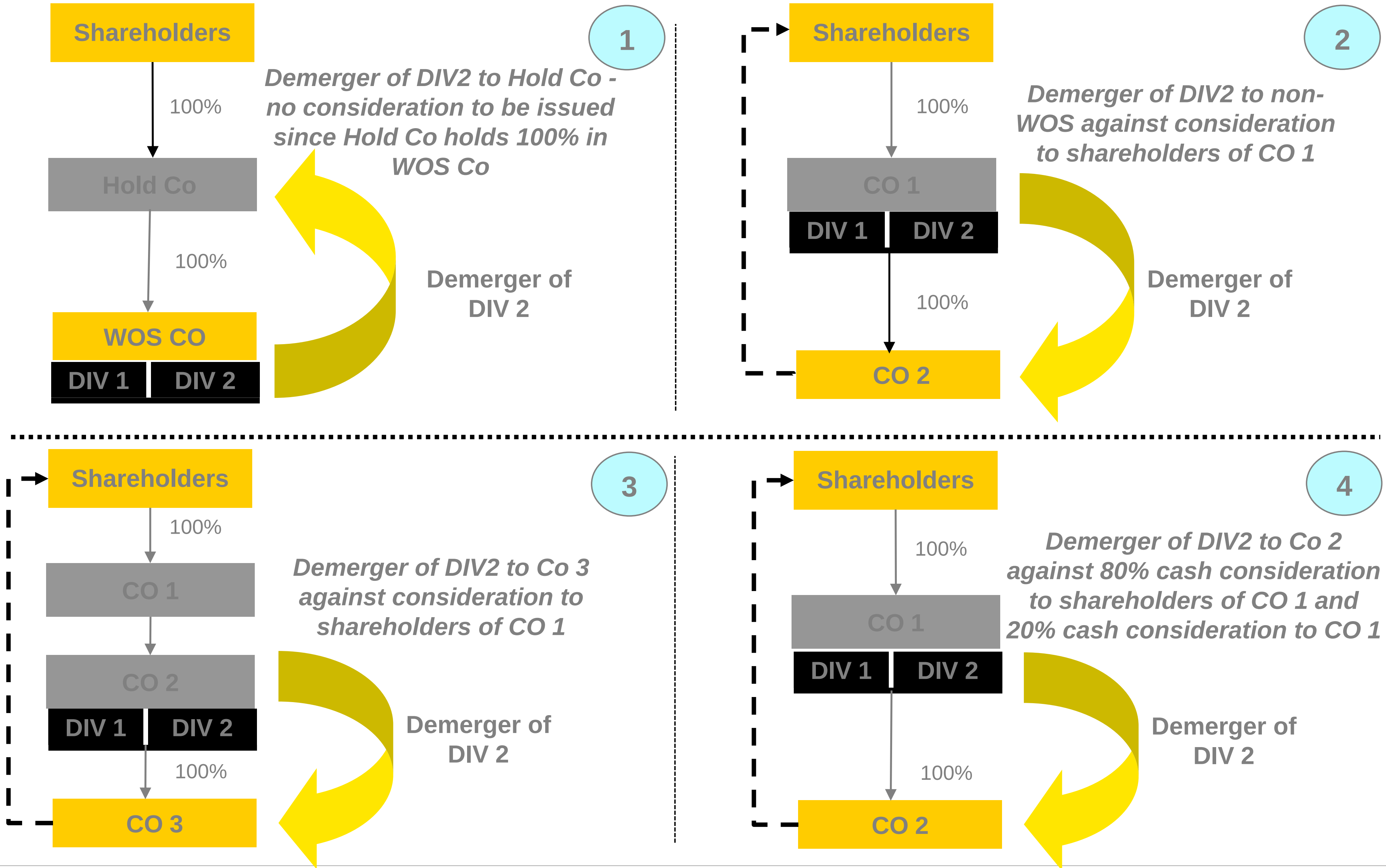
Merger of F CO with I CO



Merger of I CO with F CO



Domestic demerger situations



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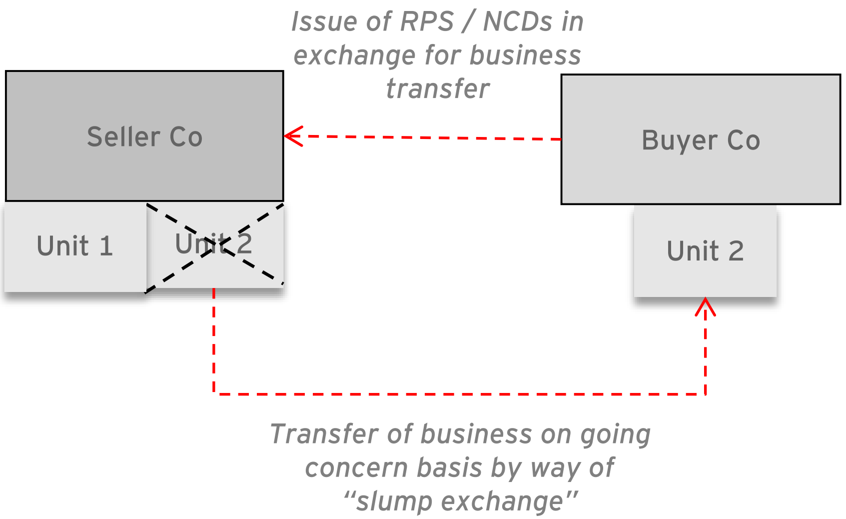
Case Study 1: Slump Exchange



Background / Transaction mechanics

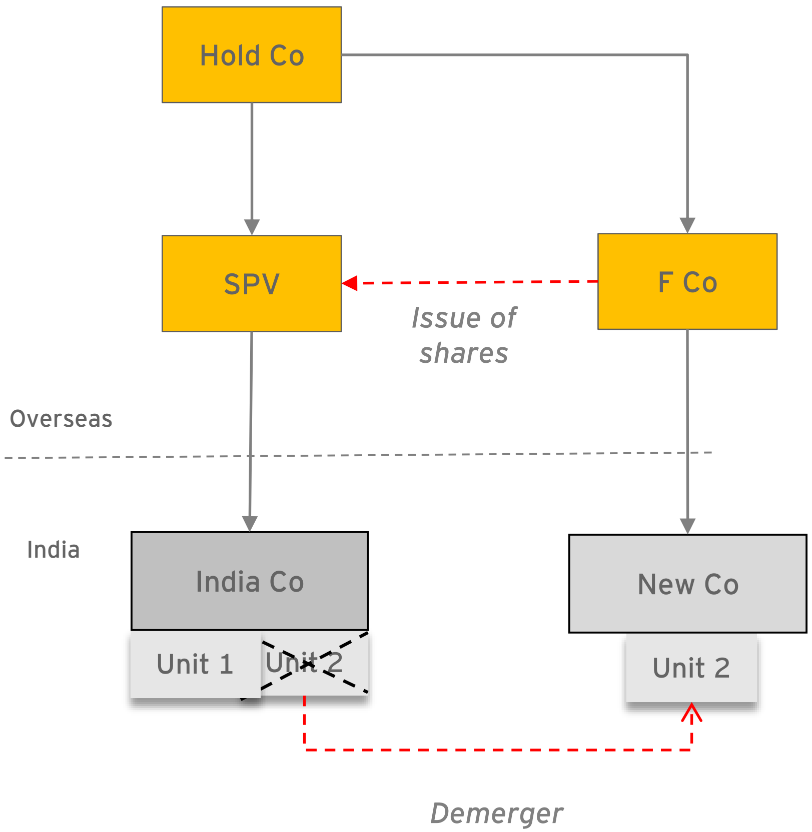
- Seller Co to transfer Unit 2 to Buyer Co on a 'going concern' basis
- Buyer Co to issue RPS / NCDs in exchange for business transferred
  - RPS / NCDs to be redeemed after an agreed period

Key Considerations

- IndAS and MAT impact to be evaluated
- Impact under GAAR
- Commercial rationale for slump exchange

Whether 'slump exchange' can be regarded as 'slump sale' and taxed under Section 50B of the Act?

Case Study 2: Issue of shares by Holding Company



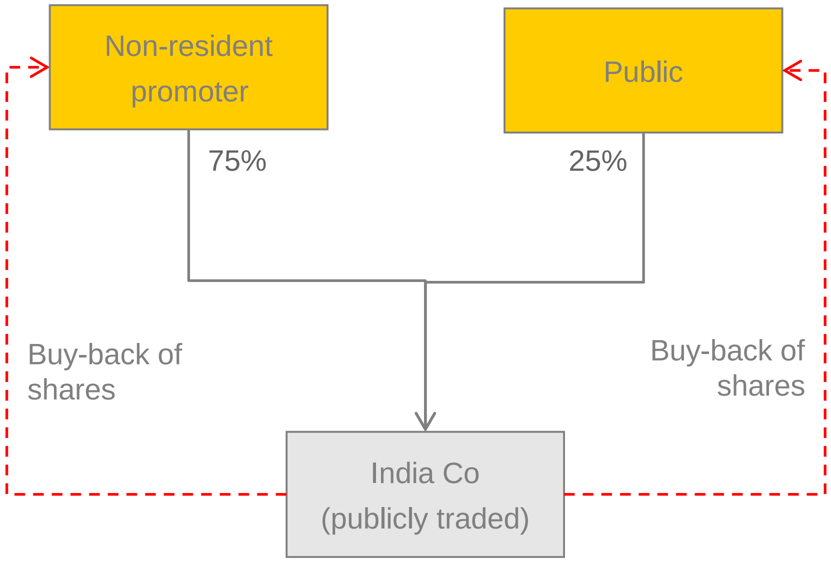
Background / Transaction mechanics

- Hold Co to incorporate Company in a tax efficient jurisdiction
- F Co to incorporate company in India (say New Co)
- India Co through NCLT approved scheme to demerge Unit 2 to India Co
- As a consideration for demerger, F Co to issue shares to SPV (ie shareholder of India Co)

Key Considerations

- Whether the 'demerger' would be regarded as tax neutral under Act?
  - Definition of resulting company includes F Co?
  - Cost of acquisition and period of holding of resulting company shares
  - Commercial rationale for demerger
- NCLT approval required
- Tax & regulatory implications in overseas jurisdictions to be considered
- Impact under GAAR

Case Study 3: Cash repatriation through buyback



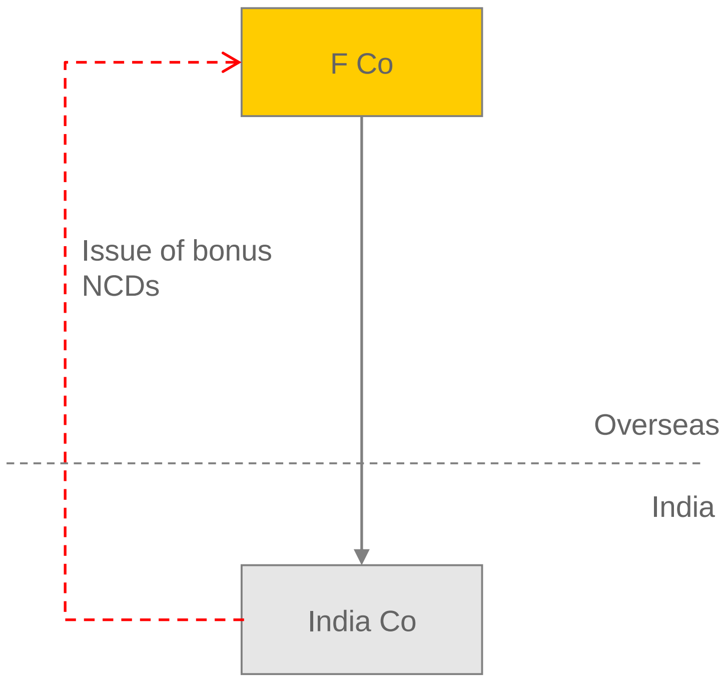
Background / Transaction mechanics

- Indian company is allowed to repurchase its shares to extent of up-to 25% of paid up share capital and free reserves
- Shareholders (including Promoters) can participate in tender offer through stock exchange

Key considerations

- No capital gains tax for non-resident where shares are held for more than 12 months
- Securities transaction tax (STT) at 0.1% of value of the shares bought back
- No Minimum Alternate Tax for non-residents
- BOD, Shareholders approval required via special resolution
- Impact on promoter shareholding post buyback
- Tax and regulatory implications in overseas jurisdiction
- Impact under GAAR
- Impact of Budget 2017 – Eligibility of exemption under S. 10(38) when acquisition of shares was also subject to STT

Case Study 4: Issue of Bonus NCDs through scheme



Bonus NCDs optically treated as "dividend" from investor perspective and provides cost effective funding to the company

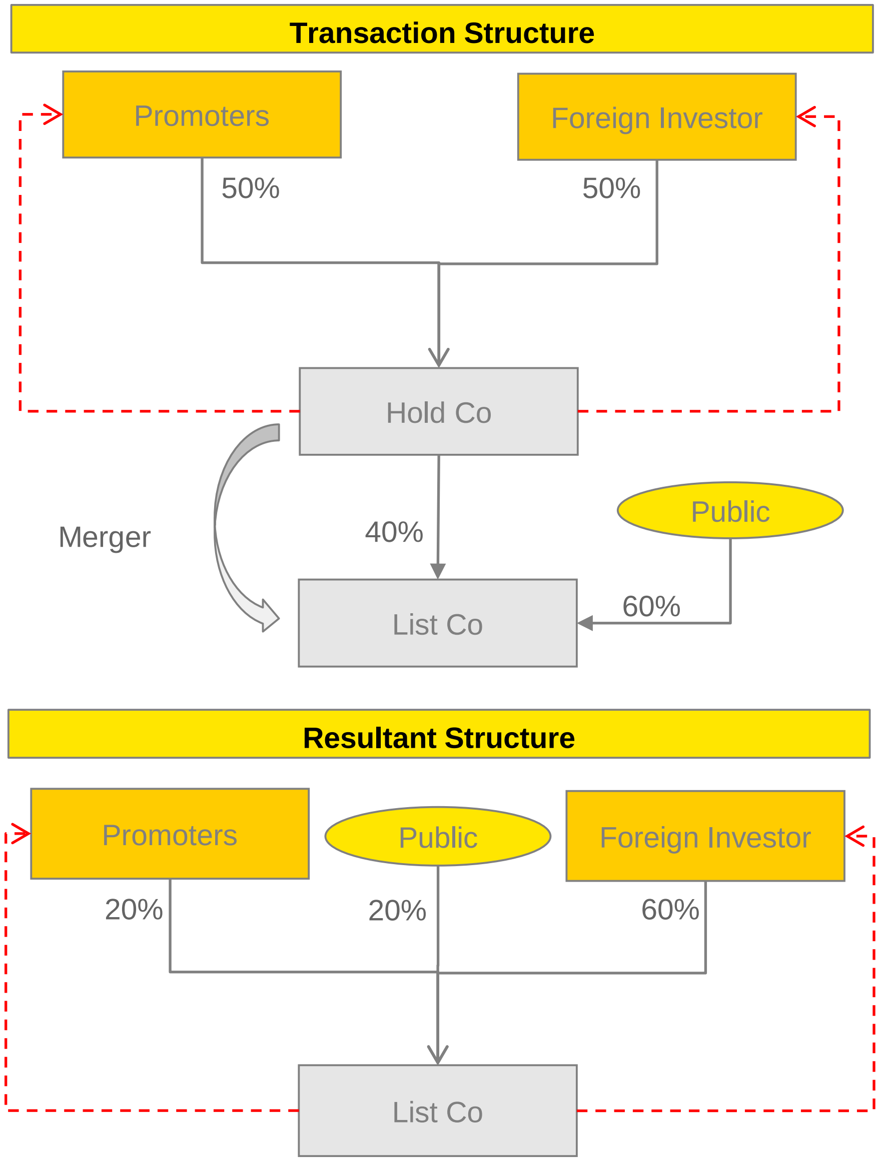
Background / Transaction mechanics

- India Co to reward its shareholders by issue of bonus NCDs through approved scheme of arrangement
- Terms of bonus NCDs to be appropriately structured keeping in perspective business plan:
  - Tenure of NCDs
  - Interest to be payable annually or on redemption
  - NCDs to be listed

Key Considerations

- Upfront DDT cost @20.36% on issue of bonus NCDs – However, tax break @ 34.61% on interest paid
  - Interest paid liable for applicable WHT (subject to Tax Treaty benefit)
  - PV of tax arbitrage benefit to be evaluated (i.e. upfront DTA cost vis-à-vis interest tax break)
- NCLT approval required
- Eligibility to claim Tax Treaty benefit
- Tax and regulatory implications in overseas jurisdiction
- Impact under GAAR
- Impact on Debt / Equity, EPS and other key ratios
- Impact of Budget 2017 – Introduction of thin-cap provisions under S. 94B

Case study 5: Exit for PE investor



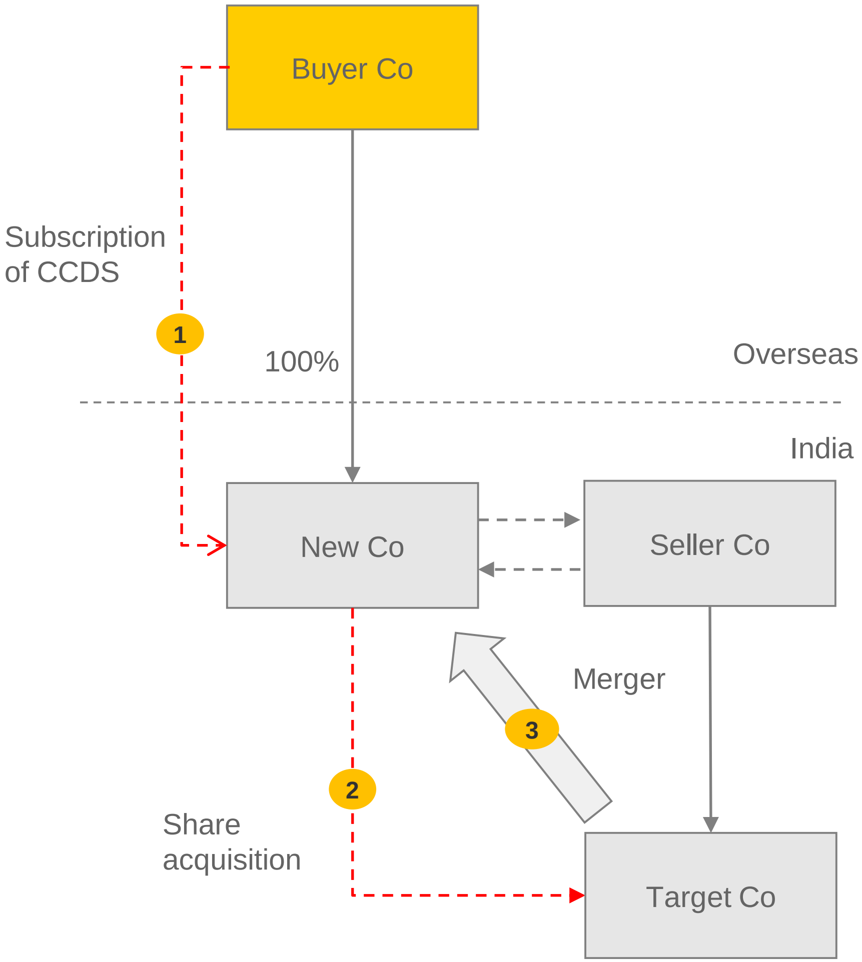
Background / Transaction mechanics

- Hold Co to merge with List Co
- List Co to issue shares to Promoters and Foreign PE as a consideration for merger

Key Considerations

- Create liquidity for investor – Feasible for them to exit from List Co business at any time
- Minimal tax leakage to investor on exit from List Co business in future
- Exit at Hold Co level would result into cash trapped at H Co level – There could be DDT / capital gains tax leakage
- Impact of Budget 2017 - Eligibility of exemption under S. 10(38) when acquisition of shares was also subject to STT

Case study 6: Leveraged Business acquisition



Background / Transaction mechanics

- Buyer Co to incorporate New Co and infuse funds via CCDs
- New Co to acquire entire shareholding of Target Co from seller
- Merger of Target Co with New Co

Key Considerations

- Availability of interest deduction?
  - Impact of Budget 2017 – Introduction of thin-cap provisions under S. 94B
  - Commercial rationale to be justified
  - Appointed date of merger
- Eligibility to claim Tax Treaty benefit to be evaluated
- Tax implications in overseas jurisdiction
  - BEPS impact for hybrid instruments (BEPS Action Plan 2)
- Eligibility to claim depreciation on goodwill?
- Approval requirement for New Co from FDI/ exchange control perspective?
- Impact under GAAR

Innovative Structuring – Treaty impact

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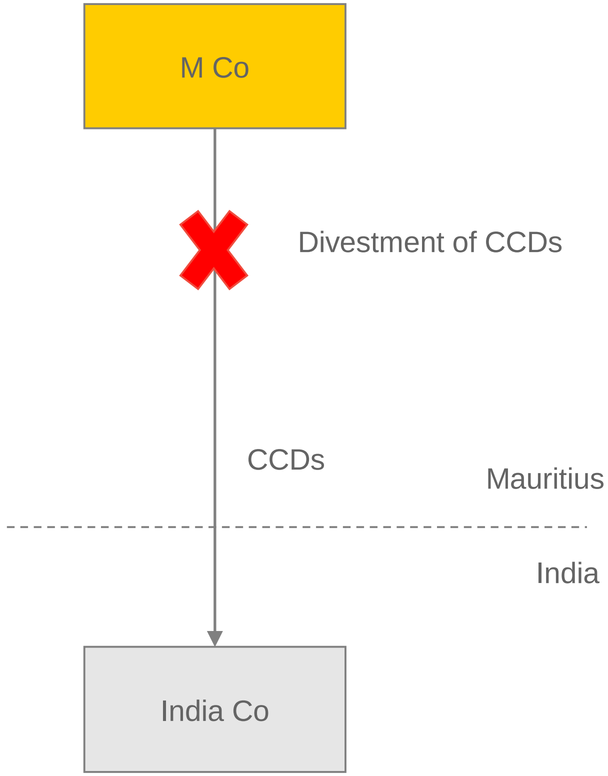
Mauritius Protocol – Capital gains impact

- India and Mauritius signed the Protocol for amending the IM treaty on 10th May 2016 (Notified on 10 August 2016)
  - With this Protocol, India obtains taxation rights on capital gains in a phased manner

Timing of investment	Nature of provision	Tax implications
Investments made upto March 31, 2017 and sold at any point of time	Grandfathering provisions	➢ Not taxable in India, subject to treaty benefits ➢ Pre-Protocol scenario to continue to apply
Investments made on or after April 1, 2017 and sold on or by March 31, 2019	Transitionary provisions	➢ Taxable at 50% of applicable domestic tax rates ➢ Subject to fulfillment of LOB conditions
Investments made on or after April 1, 2017 and sold on or after April 1, 2019	Future provisions	➢ Taxable in India at applicable domestic rates

Case study 7: Investment through instruments other than shares in Indian Unlisted Co (Post 31 March'17)



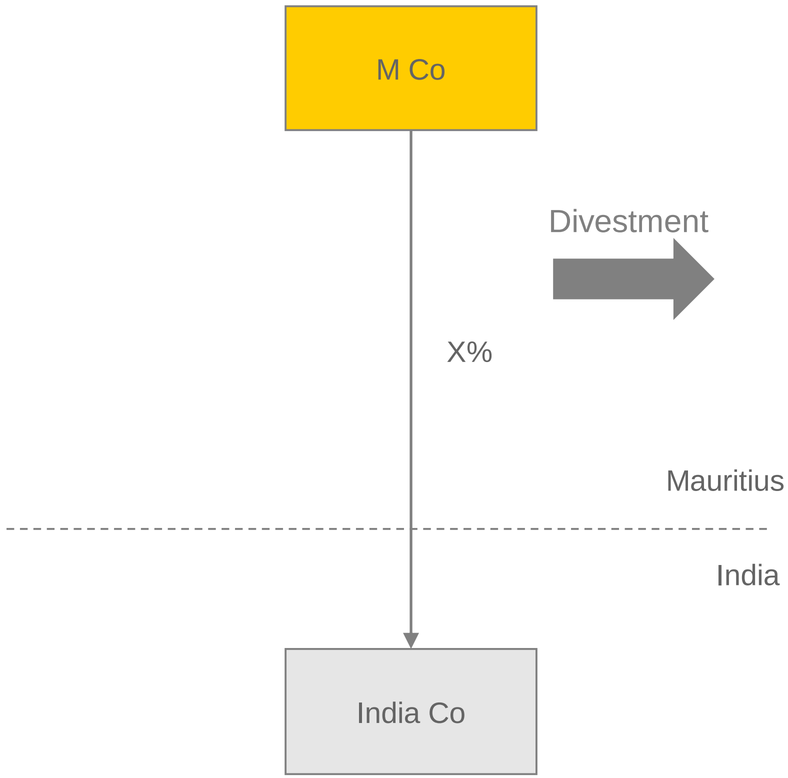
Background / Transaction mechanics

- Investment after 1st April 2017 could be made through instruments other than shares, say compulsorily convertible debentures ("**CCDs**") to be issued by India Co
- Subsequent exit can be made by M Co by sale of CCDs

Key Considerations

- Eligibility to claim Tax Treaty benefit
- Tax and regulatory implications in overseas jurisdiction
- Impact under GAAR

Case study 8: Conversion of shares into partly paid shares through scheme



Background / Transaction mechanics

- Conversion of existing shares into partly paid shares via scheme of arrangement under Section 230 to 234 of Companies Act, 2013
  - Follow on funding can be made to service balance obligation towards unpaid portion of the shares
  - No fresh shares issued
- At the time of divestment, M Co to transfer shares in I Co to third party

Key Considerations

- Need to consider whether time limit for conversion of partly paid to full paid (within 12 months) and other restrictions are applicable
- Eligibility to claim Treaty benefit
- Tax and regulatory implications in overseas jurisdiction
- Legal and commercial feasibility
- Impact under GAAR

Stamp duty

Stamp duty – Court order entry

- Order of amalgamation and demergers are subject to stamp duty

- Following states have specific entries -
  - Maharashtra
  - Gujarat
  - Rajasthan
  - Andhra Pradesh
  - Madhya Pradesh
  - Karnataka
  - West Bengal
  - Tamil Nadu (not yet notified)

Case Study

Background

- Company A
  - Registered office - Maharashtra
  - Immovable property in Maharashtra – Approx. value INR 100 crores

- Company B
  - Registered office - Maharashtra
  - Immovable property in Maharashtra – Approx. value INR 90 crores

- Proposed to merge Company A and Company B

Key considerations

- How will stamp duty be computed on the Proposed Merger?

- Possible avenue to minimize stamp duty implications?

Business Combination
Indian GAAP vs IndAS

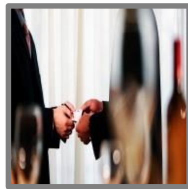
Identifying a business combination

BUSINESS COMBINATION

- Transaction or event in which acquirer obtains CONTROL over one or more BUSINESSes

CONTROL

- Power over the investee
- Exposure, or rights to variable returns
- Ability to use its power over the investee to affect the amount of investor returns



BUSINESS

- Integrated set of activities and assets
- Capable of being conducted and managed to provide return
- Returns include dividends and cost savings.

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Business Combination
Indian GAAP vs IndAS

Area	Indian GAAP	Ind-AS
Scope	No comprehensive standard covering all business combinations. AS 14 deals only with amalgamation	Ind-AS 103 deals with both amalgamations and acquisitions except formation of joint venture and acquisition of assets which do not constitute business
Accounting for common control transactions	No standard differentiates between common control and other business combinations but AS 14 allows use of pooling of interest method for accounting of amalgamation in the nature of merger	**Appendix C of Ind-AS 103** deals with accounting for Business Combinations involving entities under common control. It requires the same to be accounted for using the pooling of interest method.
Acquisition Date	The date of amalgamation / acquisition mentioned in the court scheme is the acquisition date	The date on which the acquirer effectively obtains control of the acquiree is the acquisition date
Accounting for assets and liabilities taken over	Under purchase method, the acquired assets and liabilities are recognised at their existing book values or consideration is allocated to individual assets and liabilities based on their acquisition date fair values.	Under purchase method, the acquired identifiable assets, liabilities and contingent liabilities are recognised at fair value.

Business Combination
Indian GAAP vs IndAS

Area	Indian GAAP	Ind-AS / IFRS
Consideration	Consideration for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the acquirer to the shareholders of the acquiree. While it is required that non-cash elements of consideration should be included at fair value, it is also stated that the value of any securities (forming part of consideration) fixed by statutory authorities may be taken to be their fair value.	The cost of acquisition is the amount of cash or cash equivalents paid, plus the fair value of other purchase consideration given. The fair value of securities issued by the acquirer is determined at the date of exchange.
Non-controlling interest	Minority interest is valued at its proportionate share of historical book value of net assets and presented outside shareholders' equity	Non-controlling interest is stated either at acquisition-date fair value or at non-controlling interest's proportionate share of acquiree's identifiable net assets and included within shareholders' equity
Accounting for goodwill / bargain purchase	Under AS 14, excess of consideration paid over the net assets acquired is recorded as goodwill and is amortised to profit or loss over a period not exceeding 5 years. In case of bargain purchase, the difference is recorded as capital reserve.	As per **Ind-AS 103**, on acquisition date, acquirer will recognise the excess as goodwill and subsequently it would be recorded as cost less impairment losses. Amortisation of goodwill is prohibited. Bargain purchase should be recognised immediately in OCI and accumulated as capital reserve.

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Thank you.

Disclaimer

The objective of this presentation is to facilitate discussions at a conceptual level. This presentation should not be construed as an opinion and a detailed technical evaluation would need to be carried out in light of complete facts and information. Our comments are based on the current practice and interpretation of the provisions of the applicable laws and regulations as on the date of our comments; they are not binding on any authorities / regulators and there can be no assurance that the authorities / regulators will not take a position contrary to our comments.

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