

M&A Hotline

April 21, 2017

PROVISION ENABLING CROSS-BORDER MERGERS NOTIFIED: INDIA FURTHER INTEGRATES INTO THE STREAM OF GLOBALIZATION

- Indian Ministry of Corporate Affairs notifies provision and relevant rules enabling inbound and outbound cross-border mergers;
- Outbound mergers allowed for the first time in India, but host jurisdiction needs to fulfill certain criteria;
- Prior approval of the Reserve Bank of India required for both inbound and outbound mergers;
- Paves way for structuring possibilities involving Indian companies in outbound cross-border mergers;
- Lack of clarity on permissibility of cross-border demergers.

INTRODUCTION

The Ministry of Corporate Affairs of the Government of India ("MCA") by way of a notification¹ has notified Section 234² of the Companies Act, 2013 ("Act") enabling cross-border mergers with effect from April 13, 2017. The MCA has also notified the Companies (Compromises, Arrangement and Amalgamation) Amendment Rules, 2017 ("Amendment") to make suitable changes to the Companies (Compromises, Arrangement and Amalgamation) Rules, 2016 ("Rules"), to operationalize the said provision.

In view of these notifications, an inbound merger (i.e., a merger of a foreign company into an Indian company with the Indian company as the surviving entity) as well as an outbound merger (i.e., a merger of an Indian company into a foreign company situated in certain permitted jurisdictions³ with such foreign entity as the surviving entity) is now possible. This is of course subject also to the host jurisdiction of such a foreign company permitting such schemes with an Indian company. It is important to note that implementation of the provision on cross-border merger fulfills one of the recommendations of the Expert Committee on Company Law under Dr. Jamshed J. Irani, which was constituted to suggest corporate law reforms in India.⁴

Such merger will be subject to approval of the Reserve Bank of India ("RBI"), India's central bank and administrator of exchange control regulations, and compliance with the provisions of the Section 230 to 232 of the Act.

Only recently, on December 7, 2016, merger related provisions of the Act (i.e. Sections 230-233, 235-240 of the Act) were made effective which replaced similar provisions of the Companies Act, 1956 ("1956 Act"). However, Section 234 (which enables cross-border mergers) was not brought into force. As a result, until now, Indian companies desirous of an outbound cross-border merger were unable to undertake such a transaction.

WHAT DOES THE NOTIFICATION ENTAIL?

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, amongst others, payment of consideration, including by way of cash or depository receipts or a combination of those. Further, it is important to note that a cross-border merger may be subject to multiple parallel scrutiny and will have to be approved by the RBI, the jurisdictional National Company Law Tribunal ("NCLT"), and if applicable the relevant sectoral regulator in India, and the relevant competent authority(ies) in the foreign jurisdiction, if necessary in such jurisdiction.

Section 234 also empowers the Central Government to frame rules in consultation with the RBI to deal with such mergers. In exercise of this power, the MCA has notified the Amendment, amending the Rules, with effect from April 14, 2017 by inserting a new Rule 25A to operationalize Section 234. Based on the new Rule 25A, the following are the mandated steps for Indian companies involved in a cross-border merger:

- Prior approval of RBI for undertaking any cross-border merger;
- Surviving entity to ensure valuation by a valuer who is a member of a recognized professional body in its jurisdiction and in accordance with internationally accepted principles on accounting and valuation. In this regard, a declaration is required to be submitted by the transferee company along with the application to RBI for obtaining its approval for the merger;
- Procedure as specified in Section 230-232 of the Act to be undertaken (similar to as applicable to a domestic merger);
- In case of outbound cross-border merger, foreign entity involved should be from a permitted jurisdiction.

Further, any cross-border merger under Section 234 will have to comply with the requirements as laid down in

Research Papers

India's Oil & Gas Sector– at a Glance?

March 27, 2025

Artificial Intelligence in Healthcare

March 27, 2025

Real Estate Tokenisation

March 27, 2025

Research Articles

Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

Key changes to Model Concession Agreements in the Road Sector

January 03, 2025

Audio

CCI's Deal Value Test

February 22, 2025

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business

March 19, 2025

Sections 230-232 (requirements applicable to domestic transactions). This will include procedural requirements such as, for e.g., filing an application before the jurisdictional NCLT, conducting meeting of shareholders/creditors, notification to income tax authorities, other sectoral regulators etc.⁵, publication of advertisement in respect of the merger, etc.

Additionally, in line with Section 234, the Amendment requires that any further amendment to the relevant rules on cross-border merger should be undertaken only after consultation with RBI.

ANALYSIS

- **Structuring possibilities:** The move to operationalize the cross-border mergers provision of the Act and the corresponding Rules is a positive development which will open-up possibilities for domestic and foreign companies to undertake business transactions. It will be helpful not only in intra-group situations (for consolidation of holdings, innovative structuring through externalization/flipping of ownership, holding of intellectual property etc., to achieve commercial objectives) but also open opportunities to raise capital/diversifying ownership base/achieve other strategic objectives in case of inter-group transactions.
- **Position under the earlier 1956 Act:** As per Section 394(4)(b) of the 1956 Act, “a *transferee company*” does not include any company other than a company within the meaning of this Act, but “transferor company” includes any body corporate, whether a company within the meaning of this Act or not.” Simply put, a “transferee company”, i.e., the surviving or resultant entity, could only be an Indian company while a “transferor company”, i.e., the entity being merged, could include foreign companies as well. Consequently, under the 1956 Act, only inbound cross-border mergers were possible. Now, the legal framework has enabled even outbound cross-border mergers.
- **Separate amendments required to be made to exchange control regulations:** The Amendment makes an approval from RBI mandatory for Indian companies to undertake cross-border mergers. As per the provisions of the 1956 Act, in the case of permitted in-bound merger, assuming only equity securities were being issued, no such approval was required under the exchange control regulations unless the company operated in a sector under the approval route. It is expected that a concurrent amendment will have to be made to the exchange control regulations to put in place a regulatory framework to obtain RBI's approval for undertaking a cross-border merger.

On the merits of an approval requirement from RBI in case of cross-border merger, from a regulatory perspective, the rationale could be that since a cross-border transaction has the potential to alter the asset/liability profile of a country, such transaction should be regulated. However, considering the fact that India has been liberalizing the foreign direct investment/overseas investment regime, it may have been more appropriate to not have a prior approval requirement from RBI. This becomes more relevant especially in light of the protections available under the current legislative scheme, more particularly because:

- The statutory framework mandates MCA to consult RBI before amending the Rules. This provides an added avenue for RBI to lay down eligibility criteria, which it may deem appropriate, before a company is eligible to undertake a cross-border merger;
- Within the statutory and procedural framework, RBI gets an opportunity to present its objections, if any, before NCLT;
- The cross-border merger will be considered, and only if found appropriate, will be approved by a judicial body (i.e. NCLT). This not only lends credibility but also transparency to the process.

Also, further clarity may be required wherein the surviving entity (either in India or overseas) inherits loans/borrowings or immovable property, etc., by virtue of such cross-border merger, and its treatment under the Indian legal framework (for e.g., it is not clear at this stage if the surviving entity will become subject to the restrictions contained in the regulations concerning External Commercial Borrowings, etc., in such cases).

In light of the above, it is important for RBI to lay out a detailed regulatory framework elaborating the eligibility criteria and factors which will be considered from an exchange control perspective while considering a cross-border merger.

- **Additional approval requirement:** For certain sectors, a prior approval from the sectoral regulator / licensing authority(ies) may also be required (for e.g. a prior approval of the Insurance Regulatory and Development Authority (IRDA) may be required for undertaking a cross-border merger involving an Indian insurance company).
- **Lack of clarity on cross-border demergers:** While it was possible for a foreign company to transfer its undertaking/ business to an Indian company under the 1956 Act, as Section 394 applied to demergers as well as mergers, Section 234 of the Act only refers to “*mergers and amalgamations*” without any express mention of demergers. While a literal interpretation of Section 234 will lead to such demergers being disallowed, the objective behind the new provisions is to lay down a forward looking law to facilitate cross-border mergers.⁶ As a result, there is lack of clarity over the question of permissibility of a foreign company demerging its business undertaking to an Indian company or *vice versa* under the Act.
- **No provision for fast-track mergers:** Under Section 233 of the Act (applicable to domestic transactions), a mechanism has been provided for a fast-track process for mergers between two or more small companies, or between holding companies and their wholly-owned subsidiaries or between other class of companies which may be prescribed, whereby a relatively simple and shortened process for merger may be followed without approaching NCLT. This has been included with the aim of securing faster approvals for mergers and amalgamations for effective restructuring of companies to give a fillip to the Indian economy.⁷

While Section 234 provides that the provisions of the entire Chapter XV (Compromises, Arrangements and Amalgamations) of the Act shall apply, *mutatis mutandis*, i.e., with appropriate changes, to the merger of an Indian company with a foreign company, the scope of this section has been restricted by Rule 25A. This is because Rule 25A only refers to compliance with Section 230 to 232 of the Act and makes it mandatory for the transferee company to file an application before the NCLT, without affording the benefit of Section 233 of the Act. As a result, it does not allow a wholly-owned foreign subsidiary to merge with its Indian holding company (or a wholly-owned Indian subsidiary merging with its foreign parent company) to avail of the benefit of this fast-track process.

■ **Tax neutral treatment of inbound mergers:** 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. A similar tax exemption has also been provided to the shareholders of the transferor company under Section 47(vii) where shares of the transferor company are transferred in consideration for the issue of shares in the resulting company, provided that the resulting company is an Indian company. Thus, the ITA provides tax exemption to the capital gains arising to the transferor company and its shareholders in the case of inbound mergers by treating such mergers as being tax neutral (subject to certain conditions being met).

■ **Taxation issues in case of outbound mergers:** The tax neutral treatment afforded by the above mentioned Section 47(vi) and Section 47(vii) of the ITA is limited to capital gains which arise on inbound mergers. Since the applicable tax regime does not extend this benefit to outbound mergers, tax payers opting for an outbound merger will suffer from a disadvantage as these mergers will be considered as taxable transactions. Consequently, the capital gains arising from these mergers may result in tax liabilities in the hands of the shareholders of the transferor company as well as at the corporate level. This lack of tax neutrality may limit the attractiveness of outbound mergers in India, despite the Act now allowing such mergers.

Another major tax issue which may arise in the context of outbound mergers is a risk of the foreign resulting company being considered to have a Permanent Establishment ("PE") in India. This is because once such a merger is completed, the operations of the Indian transferor company will be carried out by the surviving foreign entity, either directly or through a branch. Consequently, there is a significant risk that the tax authorities may characterize the India presence of the surviving foreign entity as constituting a PE in India. This may result in business profits earned by the surviving entity from its operations in India being taxed in India at the rate of 40% (exclusive of surcharge and cess).

Lastly, Indian tax authorities may be concerned at what they may perceive to be an erosion of the Indian tax base as a result of outbound mergers. This may lead to the tax authorities raising a disproportionate number of objections against sanction to such mergers. Since India does not yet have dedicated anti-inversion tax rules, we may see the tax authorities resorting to anti-abuse provisions such as the General Anti-Avoidance Rule ("GAAR") to challenge structuring involving outbound mergers.⁸

■ **A few additional thoughts:** Considering the requirements for a foreign entity to conduct business in India, an outbound merger of an Indian operating entity may not be practical. Additionally, a reconciliation of accounting principles/systems prevalent in the jurisdictions involved may pose a challenge. Further, any involvement of a listed company in any of the jurisdictions may present additional and unique complexities.

CONCLUSION

The notification of the provision on cross-border merger and the Amendment is a welcome development. Although there remain a few issues as highlighted above, cross-border mergers will present an additional structuring avenue for undertaking corporate transactions in an efficient and flexible manner. Further, such a move should improve the accessibility of companies to access capital in overseas market. However, considering the involvement of multiple agencies and laws (primarily RBI and NCLT in India, and the competent authority, if applicable, and the laws of the relevant foreign jurisdiction), the timelines and implementation will have to be calibrated in order to achieve the commercial objective.

Internationally, cross-border mergers have remained a relatively uncommon phenomenon; however, they have received some traction in multilateral single markets like the European Union, where a formal legal framework for undertaking cross-border mergers was introduced in 2005⁹ and migration of companies is possible due to recognition within the legal and tax framework. Based on the learnings in the European Union, it appears to be a success although certain scope of improvement exists.¹⁰ It is important that MCA and RBI analyze the available knowledge internationally on implementation of legal framework for regulating cross-border mergers and fine-tune the domestic legal framework. One can be cautiously optimistic that cross-border mergers may turn-out to be an efficiency enhancing avenue for corporates in India.

– Shashwat Sharma, Aditya Shukla, Simone Reis & Ruchi Biyani
You can direct your queries or comments to the authors

¹ Notification Dated April 13, 2017 [F. No. 1/37/2013 CL.V] available at: http://www.mca.gov.in/Ministry/pdf/section234Notification_14042017.pdf

² Section 234 of the Act reads as follows:

"(1) The provisions of this Chapter unless otherwise provided under any other law for the time being in force, shall apply mutatis mutandis 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: Provided that the Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this section.

(2) Subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or vice versa and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose. Explanation.—For the purposes of sub-section (2), the expression "foreign company" means any company or body corporate incorporated outside India whether having a place of business in India or not."

³ In case of outbound cross-border merger, a permitted jurisdiction will mean the surviving entity is located in a jurisdiction which is:

(i) whose securities market regulator is a signatory to the International Organisation of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to a bilateral Memorandum of Understanding with SEBI; **OR**

(ii) whose Central Bank is a member of the Bank of International Settlements (BIS); **AND**

(iii) a jurisdiction, not identified in the public statement of the Financial Action Task Force (FATF) as:

a) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; **OR**

b) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the FATF to address the deficiencies. (Emphasis Supplied)

⁴ Report of the Expert Committee on Company Law (2005) available at

<http://www.mca.gov.in/MinistryV2/report+of+the+expert+committee+on+company+law.html>

⁵ As per Section 230(5) of the Act, the notice for meetings shareholders and creditors of the merging companies must also be sent to the RBI, SEBI, income tax authorities, the Competition Commission of India, respective stock exchanges (if companies are listed) and other concerned sectoral regulators who are likely to be affected by the scheme of merger to enable them to make representation before the NCLT within 30 days from date of receipt of notice.

⁶The need to have a forward looking law in respect of mergers and amalgamations was also expressed by the Expert Committee on Company Law headed by Dr. Jamshed J. Irani.

⁷Please refer to the Statement of Objects and Reasons of the Act.

⁸The Central Board of Direct Taxes released Circular No 7 of 2017 on January 27, 2017 which, among other things, clarified that where any court or authority such as the NCLT "explicitly and adequately" considers the tax implication of an arrangement, while giving its sanction, GAAR will not apply to such an arrangement. The wording of this clarification gives room to the tax authorities to invoke the GAAR provisions even in the case of mergers which receive sanction of the NCLT. For our hotline on this Circular please click this link (http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/indias-tax-regulator-issues-clarifications-regarding-the-implementation-of-the-gaar-provisions.html?no_cache=1&cHash=4ef51b100%372ec0707ac3af0ad4bf508).

⁹Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies.

¹⁰Study on the Application of the Cross-Border Mergers Directive conducted for the Directorate General for the Internal Market and Services, The European Union *available at*: http://ec.europa.eu/internal_market/company/docs/mergers/131007_study-cross-border-merger-directive_en.pdf

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.