Critical aspects and compliances issues of CORPORATE RESTRUCTURING

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Need For Restructuring

- Opening up of the Indian economy
- Impetus for foreign investment
- Interest of foreign companies in exploring business relationships with India
- Panacea for corporate turbulences
- Tax planning tool
- Back door listing
- Commercial advantages
Advantages

Strategic Synergies

- Growth in market share.
- Diversification
- Product range width
- Global platform
- Market penetration
- Enhancement of technical know how

Financial Synergies

- Available liquidity
- Capital Structure flexibility
- Tax and cost advantages
Regulatory Framework

- Companies Act, 1956
- Takeover Code
- Income Tax Act
- Fact Specific Regulations
- Sales Tax Provisions
- Stamp Duty Provisions
What is Merger/Amalgamation?
Concept of Merger / Amalgamation:

- Sections 390 to 396A of the Companies Act, 1956 facilitates compromise, arrangement or reconstruction of a business.

- The terms “merger” and “amalgamation” are synonymous.

- In amalgamation, the undertaking, i.e. property, assets and liability of one or more company (amalgamating company) are absorbed by an existing or a new company (amalgamated company).

- The amalgamated company issues consideration to the shareholders of the amalgamating company in form of shares.

- The amalgamated company is dissolved without the process of winding up.
**Definition:**

- The expression “amalgamation” is not defined in the Companies Act, 1956.
- Section 2 (1B) of the Income Tax Act defines “amalgamation” as under:

  “Amalgamation”, in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company...”

**Conditions:**

- All properties to be transferred to the amalgamated company
- All liabilities to be transferred to the amalgamated company
- Shareholders holding at least 3/4th in value of shares of the amalgamating company should become shareholders of the amalgamated company
What is De-merger?
Definition of “Demerger”:

- Section 2(19AA) of the Income Tax Act defines “demerger” as under:
  “demerger”, in relation to the companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertakings to any resulting company ......”

Conditions:
- All properties/liabilities of transferred undertaking become properties/liabilities of resulting company
- The transfer of properties/liabilities is at book value
- Discharge of consideration by issue of shares to shareholders of demerged company on proportionate basis
- Shareholders holding 3/4th or more in value of shares in the demerged company become shareholders in resulting company
- Transfer of undertaking is on a “going concern basis”
What is slump sale?
**Concept of “Slump Sale”:**

- Slump sale means sale of an undertaking for a lumpsum consideration without assigning values to the individual assets and liabilities it comprises of.

- The term “undertaking” includes “part of the undertaking” but whatever undertaking is transferred, it must constitute as a business unit to be carried on without any interruption.

- The consideration for such transfer may be discharged by transferee company in any mode.

- Consideration is received by transferor company and not its shareholders.

- The cost of acquisition of undertaking can be apportioned on the assets forming part of the undertaking at values as determined by independent valuers.
Slump Sale

Concept of “Slump Sale”:

- Cost so apportioned by the transferee company will be considered for depreciation under section 32 of the Income Tax Act as regards depreciable assets.

- Other pertinent aspects:
  - Not subject to High Court approval
  - Lesser time frame
  - Simple to implement

- Consideration for transfer of undertaking is subject to commercial negotiations and can be structured in a tax efficient manner.
Issues considered by Court in a Scheme of Arrangement

- Compliance with the Provisions
- Protection of interest - creditors and shareholders
- Reasonable arrangement
- Scheme in consonance with public interest
Substantive Issues
What is the difference b/w Appointed Date & Effective Date?

**Appointed Date:** date on which assets and liabilities of the transferor company vest in and stand transferred to the transferee company

- Accounts on the appointed date form the basis for valuation of shares and determination of share exchange ratio
- Appointed date relevant for the purpose of assessment of income of the transferor and transferee companies

**Effective Date:** date on which scheme is complete & effective, i.e. certified copy of the High Court order is filed with Registrar of Company or the last of the approvals obtained

- From the effective date amalgamation becomes effective and transferor company stands dissolved
Substantive issues

• Whether it is mandatory to obtain Valuation Report?

• Can a scheme be sanctioned without power to amalgamate in the memorandum of association?

• Whether increase of authorized share capital be increased under the Scheme?

• Whether object clause of the Transferee Company be changed through the Scheme?

• Whether name of the amalgamated company be changed to that of amalgamating company under the Scheme u/s 391-394?

• Whether Registered Office of the Transferee Company be changed under the Scheme?
Substantive issues

- Whether paid-up share capital of a Company be reduced under the Scheme?

- Can preference shares be issued under a Scheme of Arrangement/Amalgamation?

- Can debentures be issued under a Scheme of Arrangement/Amalgamation?

- Can shares with differential voting rights be issued under a Scheme of Arrangement/Amalgamation?
Substantive issues

- Is it possible to convert status of a company from Private Limited to Public Limited and vice-versa?

- Whether meeting of the creditors and members of the Transferee Company be dispensed with on the ground that the Transferor Company is a profit making wholly owned subsidiary?

- Can minority shareholders be exited out under a scheme of arrangement?
Can a Partnership Firm be merged with a company?

- Sec 390(a) of Act defines company for Sec 391-393 as a company liable to be wound up under this Act.

‘Company liable to be wound up’ –

all co.’s to which provisions of winding up applies & Part X of the Act deals with winding up of an unregistered company.

Unregistered Co. as per Sec 582(b) includes any partnership firm, association or co. consisting of more than 7 members at the time of presenting the petition. (minimum 8)

CLC Corporation and Spentex Industries Ltd. (Co. App. (Main)15/2005) Partnership Firm to be treated as an Unregistered Company.
Can a Foreign Company be merged with an Indian Company?

- Sec 394(4)(b) of the Companies Act, 1956 (“the Act”) defines-
  
  - Transferee company to include any co. within the meaning of this Act.
  - Transferor company to include any body corporate, whether a co. under this Act or not.

- Foreign Co. can be a transferor company but cant be a transferee company

[Moschip Semiconductor Technology Ltd., (2004) 120 Comp Cas 108 (AP)]

- California based company was merged into an Indian Company.
- No separate dissolution of Foreign Co. is required – only laws of California to be complied with.
Is Stamp Duty payable on mergers/de-mergers?

- Every instrument for transfer of property, whether movable or immovable, attracts stamp duty prescribed in Schedule-I of the Indian Stamp Act, 1899 (“Stamp Act”)

- Instrument attracts duty not the transfer/conveyance

- In order to create a valid charge for levy of stamp duty on conveyance, the following ingredients must exist; (i) there should be an instrument of transfer, and (ii) the property, whether movable or immovable, should be transferred inter-vivos between the parties

- It is also pertinent to note that stamp duty is a State subject. The applicability is determined on two grounds the State/states(s) in which the registered office of the Companies is situated and the situs of the properties being transferred under the Scheme.

...Contd.
Stamp Duty

- Whether order of the Court for amalgamation is an instrument of conveyance under the Stamp Act or not?

  Maharashtra, Gujrat, Karnataka, Rajasthan, Chattisgarh, Madhya Pradesh, Andhra Pradesh, West Bengal—have included the orders passed u/s 394 of the Companies Act in the definition of ‘Conveyance’.

- **Hindustan Lever Vs. State of Maharashtra (2004) 1 CLJ 148 (SC)** - held that order of the Court is an instrument constituting a transfer inter-vivos and therefore, falls within the ambit of the definition of conveyance

- **Madhu Intra Limited V. Registrar of Co. [2005] 58 SCL 160 (CAL)** - Transfer by operation of Law – No stamp duty if not included in state Stamp Act. If the State Stamp Act provides for stamp duty on order u/s 394, only then stamp duty otherwise no duty
**Stamp Duty**

- *Delhi Towers Limited vs. G.N.C.T. of Delhi [(2010) 159 Comp Cas 129 (Del)]* it was held that the order of the High Court under section 394 of the Companies Act constitutes an instrument by virtue of which the assets and liabilities of the transferor/demerged company are transferred and vested in the transferee/resulting company disregarding the fact that there is no specific entry in the schedule-I of the Delhi Stamp Act and hence, made such order exigible to stamp duty.

- Stamp duty in Delhi on instrument of conveyance for transfer of property is 3% on the consideration set forth in the instrument and in case of transfer of immovable property, and additional transfer duty of 3% of the consideration amount shall be applicable

- The Allahabad High Court in the case of *[Hero Motors Limited vs. State of Uttar Pradesh (2009) 2 AWC 1336]* vide order dated 23.01.2009, held as under:
“...... the scheme of arrangement sanctioned by the Court is a conveyance and an instrument within the meaning of Sections 2 (10) and 2 (14) of the Indian Stamp Act as applicable in Uttar Pradesh.

......a scheme of arrangement involves transfer of business of a going concern. The consideration of transfer under a scheme of arrangement would be the shares allotted by the transferee company to the shareholders of the transferor company. The valuation of the shares would therefore be the consideration upon which stamp duty would be payable at the rate provided for conveyance of movable property. A going concern or an undertaking transferred under a scheme of arrangement would therefore be ‘movable property’. In view of the aforesaid discussion, I am of the opinion that the scheme of arrangement is covered by Article 23 (b) of Schedule 1-B of the Indian Stamp Act as applicable in U.P.”
**Stamp Duty**

- Notification No. 1 dated January 16, 1937, issued by the Finance Department, Central Board of Revenue, provided for remission of stamp duty chargeable on instruments evidencing transfer of property in cases, where the transfer of properties is between a parent company and its subsidiary company, where the transferor is the beneficial owner of not less than 90% of the issued share capital of the transferee or vice-versa.

- The said Notification now stands withdrawn in Delhi vide notification number No. F.l( 423 )/Regn.Br./HQ/Div.Com./1O/ 266 dated 1\textsuperscript{st} June, 2011.
Back Door Listing through Scheme:

- Listing of a company without IPO ever
  
  **A Ltd.** (Listed Company)      **B Ltd.** (Listing through Scheme)

Activity A  Activity B  Activity B

Compliance of Circular of SEBI (CFD/SCRR/01/2009/03/09) dated September 3, 2009
**What do stock exchanges normally consider?**

- Entry norms compliance
- Pre & Post Scheme shareholding pattern & financial statements
- Net worth post merger
- Continuous listing requirements – Clause 40A
- Resumed trading price after cooling off period – at discretion of stock exchanges – **In re: EICL case, CP No. 247/2007**
- Continuous follow up required
- Lock in requirements
- Placing the Information Memorandum on website-post approval of the Scheme
“Tax Considerations”
**Merger / Amalgamation**

**Key tax implications:**
Accumulated business loss and depreciation of the amalgamating company owning an industrial undertaking, hotel or of a banking company shall be deemed to be the accumulated loss and depreciation of the amalgamated company or specified bank for the previous year in which the amalgamation is effected subject the fulfillment of the following conditions by the amalgamated company:

- [Section 72A]

  ✓ hold continuously for a minimum period of five years from the date of amalgamation at least three-fourths in the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation
  ✓ continue the business of the amalgamating company for a minimum period of five years from the date of amalgamation
  ✓ fulfil 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
**Merger / Amalgamation**

**Key tax implications:**

- **Rule 9C** of the Income-tax Rules prescribes the following further conditions for carry forward or set off of accumulated loss and unabsorbed depreciation in case of amalgamation:
  - the amalgamated company shall achieve a level of production at least 50% of the installed capacity of the amalgamating industrial undertaking before the end of the four years from the date of amalgamation and the said minimum level of production should continue till the end of five years from the date of amalgamation
  - the Central Government has powers to relax the above condition in case of genuine difficulty faced by the amalgamated company
  - a certificate in Form No. 62 of the Income-tax Rules, duly verified by an accountant shall be furnished to the assessing officer in this regard
**Key tax implications:**

- The benefit of carry forward and set off of accumulated losses and unabsorbed depreciation of the **amalgamating company** owning an industrial undertaking would be available to the amalgamated company only if the following additional conditions are fulfilled:
  
  ✓ the amalgamating company should have been engaged in the business for at least three years during which the accumulated loss has occurred or the unabsorbed depreciation has accumulated, and
  
  ✓ the amalgamating company has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation.
• Whether service industry (say, hospitals) can be considered as an “industrial undertaking”?

• Would issuance of bonds / debentures alongwith the shares of the amalgamated company as consideration would be in consonance with the provisions of Section 47(vii) (b) of the Income Tax Act?

✓ Section 47(vii) held not applicable where the shareholder of the amalgamating company is allotted bonds or debentures in exchange of shares in the amalgamating company - CIT vs. Gautam Sarabhai Trust : 173 ITR 216 (Guj.)

✓ On amalgamation, rights of shareholder of the amalgamating company in the capital asset, i.e., the shares stand extinguished, resulting in a transfer under section 2(47) of the Income Tax Act.- CIT vs. Mrs. Grace Collis and Ors. : 248 ITR 323 (SC)
Certain key Tax Issues

- What if a private company having losses merges with another company - whether section 72A will override section 79?

[The provisions of section 79 of the Income Tax Act would not apply in a situation where a private company/company in which public are not substantially interested merges into another company, in which case provisions of section 72A of the Income Tax Act should be applicable.

The provisions of section 72A being specifically related to amalgamations, would cover all cases of amalgamation and override all other provisions to the extent contrary to the provisions of that section. The section also contains a non-obstante clause overriding all other provisions of the Income Tax Act.

The provisions of section 72A were enacted for the objective of promoting better utilisation of resources to make the country globally competitive will have to be construed in a liberal manner to further that objective.

If the provisions of section 79 are interpreted in a manner so as to override the provisions of section 72A of the Income Tax Act, it would result in denial of the benefit of carry forward and set off of losses in all cases of mergers of a private company with another company, which intention is not suggested or supported from any provisions of the Income Tax Act or any other provisions and aids which can be used for interpretation of that section]
Certain key Tax Issues

- Whether the benefit of deduction under section 80HHA, 80-IA, 80IB, 10B, 10AA etc of the Income Tax Act would be available to the amalgamated company for the unexpired period?

- Whether the benefit of deduction under the said sections would be available to the amalgamating company for part of the year, if the appointed date of amalgamation falls in the middle of the tax year?

[Refer: section 80-IA(12); Sub-section 12A inserted in section 80-IA vide Finance Act, 2007, w.e.f, 1.04.2008 provides that sub-section (12) shall not apply to any enterprise or undertaking which is transferred in a scheme of amalgamation or demerger on or after the 1st day of April, 2007]
Certain key Tax Issues

- Whether the scheme of arrangement approved by the High Court can be considered as instrument for avoidance of tax?

  [Refer: ACIT vs. TVS Motors Co. Ltd. : ITA No. 491 / Mds/ 2008 dated 9.04.2009- where the scheme has been sanctioned, it cannot be argued that there is any motive to avoid tax]

- Whether a scheme of demerger for ‘nil’ consideration could be sanctioned under the provisions of the Income Tax Act and Indian Corporate Law?

  [The Gujarat High Court in the case of Vodafone Essar Gujarat Limited (Guj. HC) [Company Petition No. 183 & 254 of 2009] rejected the scheme of demerger. The High Court further held that the scheme was nothing but a device /conduit having the sole purpose of avoiding and evading taxes including income tax, stamp duty, registration charges and VAT. It was observed that the purpose, being tax avoidance, was explicit from the facts that different accounting treatments are accorded to transferor companies having a positive net worth in comparison to ones which have negative net worth with an intention to maximize tax avoidance]
Other Important Aspects

• FIPB/RBI Issues

• Labour Issues

• Excise Issues

• NBFC Issues
Ministry of Corporate Affairs, Government of India (“MCA”) has issued General Circular No. 53 of 2011, with guidelines for the Regional Directors (“RDs”) and Registrar of Companies (“ROCs”), in the matter of scheme of arrangement / amalgamation under section 391-394.

In order to streamline the procedure, guidelines along with timelines are issued for strict compliance.
**Guidelines to RDs/ROCs for Schemes u/s 391-394:**

Timelines prescribed under the guidelines are as under:

- **On receipt of notice from Court, RD should make an entry in register/electronic form. In case the petition is filed with ROC in Form 61 same can be monitored directly from the system.**

  - **RD shall send mail to ROC within 3 days.**

  - **ROC should furnish his report online to RD within 7 days.**

  - **RD should then send a letter to local branch of Law Ministry/Assistant Solicitor General requesting for nomination of an advocate.**

  - **RD should send a letter to Company within 5 days to provide material of valuation and Chairman’s report and the same should be finalized within a week’s time thereafter.**
Guidelines to RDs/ROCs for Schemes u/s 391-394:

Timelines prescribed under the guidelines are as under:

- The finalized affidavit should be sent to Standing Counsel for signature and should not take more than 5 days after which it should be filed in Court registry.

- ROCs should examine the matter and send a report to RDs. RD should consider the same before finalizing their comment.
Issues to be examined by RDs

- Whether companies forming part of scheme are sensitive sectors categories companies?
- Whether any of the companies are listed on any STX? If so, NOC from STX is submitted?
- Whether any NRI/foreign interest in the Companies?
- Whether the companies or its directors have contravened any provisions of Act?
- Whether the companies involved have been inspected u/s 209A?
- Whether Valuation report submitted, if so share exchange ratio is as per report and accounting principles?
- Whether transfer of Employees and their interest is protected?
- Whether Accounting Treatment clause is as per AS-14 and in tune with provisions of section 211(3A)/211(3C) of the Act?
**Issues to be examined by RDs**

- Whether **meeting** of class of shareholders/creditors is conducted?
- Whether details of **related party transactions** are furnished?
- Whether **consideration** is made in cash other than of shares?
- Whether provisions of **buy back** is attracted?
- Whether any **reduction of share capital** is involved?
- Whether **authorized share capital** of transferee company is sufficient?
- Whether any foreign entity is involved and **necessary approvals** obtained?
- Whether compliance of **FEMA/RBI Guidelines** has been done?
- Whether any qualification has been made by **Statutory Auditor**?
- Whether a listed company is merging with an **unlisted company**?
- Whether the **promoters holding** in listed company is increased?
- Whether the companies have come up with the schemes under principle of ‘**Single Window Clearance**’, approval from High Court has been obtained?
Issues to be examined by ROCs

- Filing Position.
- Investor Grievances.
- Inspection / Investigation / Technical Scrutiny.
- Pending Prosecution.
- Furnishes comments on the scheme.
Role of Company Secretaries in Restructuring:

- Conceptualization
- Ground work for the restructuring
- Follow up with the regulatory authorities
- Replies to queries of regulatory authorities
- Post approval compliances
- Level playing field in the era of NCLT
THANK YOU

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