Cross Border Mergers

Lesson 11

KEY CONCEPTS

■ Cross Border Mergers ■ Inbound Merger ■ Outbound Merger

Learning Objectives

To understand:

- Cross Border Mergers
- Benefits of Cross Border Mergers & Acquisitions
- Merger or Amalgamation of foreign company
- Taxation Aspect
- Cross Border Demergers

Lesson Outline

- Introduction
- Type of mergers – inbound and outbound
- Section 234 of Companies Act, 2013
- Drivers and returns behind cross border mergers.
- Valuation of cross border firm
- Regulatory, competition and taxation aspects
- Case Laws
- Post-merger performance evaluation
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

REGULATORY FRAMEWORK

- Companies Act, 2013
- The Companies (Compromises, Arrangements and Amalgamations) Rules, 2016
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
- Foreign Exchange Management (Cross Border Merger) Regulations, 2018
- Competition Act, 2002
- Insolvency and Bankruptcy Code, 2016
- Income Tax Act, 1961
- Foreign Exchange Management Act, 1999.

INTRODUCTION

A company in one country can be acquired by an entity (another company) from other countries. The local company can be private, public, or state-owned company. In the event ofthe merger or acquisition by foreign investors referred to as cross-border merger and acquisitions will result in the transfer of control and authority in operating the merged or acquired company. Assets and liabilities of the two companies from two different countries are combined into a new legal entity in terms of the merger, while in terms of acquisition, there is a transformation process of assets and liabilities of local company to foreign company (foreign investor), and automatically, the local company will be affiliated. Since the cross border M&As involve two countries, according to the applicable legal terminology, the state where the origin of the companies that make an acquisition (the acquiring company) in other countries refer to as the Home Country, while countries where the target company is situated refers to as the Host Country.

Benefits of Cross Border Mergers & Acquisitions

- Expansion of markets
- Geographic and industrial diversification
- Technology transfer
- Avoiding entry barriers
- Industry consolidation
- Tax planning and benefits
- Foreign exchange earnings
- Accelerating growth
- Utilisation of material and labour at lower costs
- Increased customers base
- Competitive advantage.

Challenges with Cross Border Mergers & Acquisitions

- Legal issues in different countries
- Accounting challenges

- Taxation aspects
- Technological differences
- Political landscape
- Strategic issues
- Overpayment in the deal
- Failure to integrate
- HR challenges.

Cross-border mergers and acquisitions have been rapidly ascending in quantum and value in recent years.

In the Indian context, a cross border merger refers to any merger, amalgamation or arrangement between an Indian company and foreign company in accordance with Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 notified under the Companies Act, 2013.

A cross border merger essentially helps in global expansion of companies. If India needs to be put on the global commercial map, it is imperative that a sound and stable legal framework pertaining to cross border mergers be devised. This is the rationale behind the introduction of section 234. The need for a cross border merger stems from the need for economic growth and achieving economies of scale.

Section 234 of the Companies Act, 2013 notified by the Ministry of Corporate Affairs provides the legal framework for cross border mergers in India. This has been brought into effect from 13th April, 2017, hence operationalising the concept of cross border merger.

The following laws, govern cross border mergers in India:

- Companies Act, 2013
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
- Foreign Exchange Management (Cross Border Merger) Regulations, 2018
- Competition Act, 2002
- Insolvency and Bankruptcy Code, 2016
- Income Tax Act, 1961
- The Department for Promotion of Industry & Internal Trade (DPIIT)
- Transfer of Property Act, 1882
- Indian Stamp Act, 1899
- Foreign Exchange Management Act, 1999 (FEMA)
- IFRS 3 Business Combinations.

In this lesson we shall holistically examine cross border mergers and would discuss issues such as their valuation, taxation, inbound and outbound mergers, etc.

TYPES OF MERGERS

The most popular types of mergers are horizontal, vertical, market extension or marketing/technology related concentric, product extension, conglomerate, congeneric and reverse. Recently, the concept of inbound and outbound mergers was also introduced in the Companies Act, 2013 as part of Section 234 of the Act.

Inbound Merger

An Inbound merger is one where a foreign company merges with an Indian company resulting in an Indian company being formed. Following are the key regulations which need to be followed during an inbound merger:

Transfer of Securities

Typically, the resultant company of the cross-border merger can transfer any security including a foreign security to a person resident outside India in accordance with the provisions of Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instrument) Regulations, 2019. However, where the foreign company is a joint venture/ wholly owned subsidiary of an Indian company, such foreign company is required to comply with the provisions of Foreign Exchange Management (Overseas Investment) Rules & Regulations, 2022.

Branch/Office outside India

An office/branch outside India of the foreign company shall be deemed to be the resultant company's office outside India for in accordance with the Foreign Exchange Management. In case of transfer of securities both Buyer as well as Target can use the service of a Tripartite whose job is to have Securities in the Books and doing all back-office operations (including valuation of the Securities).

Borrowings

The borrowings of the transferor company would become the borrowings of the resulting company. The Merger Regulations has provided a period of 2 years to comply with the requirements under the External Commercial Borrowings (ECB) regime. The end use restrictions are not applicable here. Cross Border Mergers require hedging of External Commercial Borrowings (ECB) as well. An External Commercial Borrowings (ECB) is an arrangement between Indian Buyer and Foreign Bank whereby Foreign Bank is funding to Indian Corporate via Foreign Currency Loan having specific amount, tenor. FEMA does permit hedging of loan taken from outside Bank in Indian Books.

Transfer of Assets

Assets acquired by the resulting company can be transferred in accordance with the Companies Act, 2013 or any regulations framed thereunder for this purpose. If any asset is not permitted to be acquired, the same shall be sold within two years from the date when the National Company Law Tribunal (NCLT) had given sanction. The proceeds of such sale shall be repatriated to India.

Opening of overseas bank accounts for resultant company

The resultant company is allowed to open a bank account in foreign currency in the overseas jurisdiction for a maximum period of 2 years in order to carry out transactions pertinent to the cross-border merger.

Outbound Mergers

An outbound merger is one where an Indian company merges with a foreign company resulting in a foreign company being formed. The following are the major rules governing an outbound merger:

Issue of Securities

The securities issued by a foreign company to the Indian entity, may be issued to both,persons resident in and outside India. For the securities being issued to persons resident in India, the acquisition should be compliant with the ODI Regulations. Securities in the resultant company may be acquired provided that the fair market value of such securities is within the limits prescribed under the Liberalized Remittance Scheme.

Branch Office

An office of the Indian company in India may be treated as the branch office of the resultant company in India in accordance with the Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016.

Other changes

a) The borrowings of the resulting company shall be repaid in accordance with the sanctioned scheme.

b) Assets which cannot be acquired or held by the resultant company should be sold within a period of two years from the date of the sanction of the scheme.

c) The resulting foreign company can now open a Special Non-Resident Rupee Account in terms of the FEMA (Deposit) Regulations, 2016 for a period of two years to facilitate the outbound merger.

Section 234 of Companies Act, 2013

Merger or amalgamation of company with foreign company. —

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."

A cross border merger explained in simplistic terms is a merger of two companies which are located in different countries resulting in a third company. A cross border merger could involve an Indian company merging with a foreign company or *vice versa*.

If the resultant company being formed due to the merger is an Indian company, it is termed an inbound merger and if the resultant company is a foreign company, it is an outbound merger. Cross border mergers play a vital role in the commercial growth of the economy. Companies Act, 1956 also dealt with cross border mergers. Sections 391-394 of the Companies Act, 1956 laid down provisions with respect to cross border mergers. However, under the Companies Act, 1956, only inbound mergers were permitted.

The term `transferee company' defined under section 394(4)(b) of Companies Act, 1956 included only Indian companies and hence transfers were not allowed to be made to foreign companies. Companies Act, 2013 brought about a significant change in this position.

Section 234 of the Companies Act, 2013 which was notified in December, 2017 has made provisions for both inbound and outbound mergers. It enables the Central government in consultation with the RBI to make rules pertaining to cross border mergers. In pursuance of the same, the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 (Merger Regulations 2018) have been notified and are effective from March 20, 2018, placed at ***Annexure A***.

Mergers which follow the Merger Regulations are deemed to be automatically approved by the RBI and do not require a separate approval. The Merger Regulations are a comprehensive set of rules which deal holistically with cross border mergers.

Cross border mergers are defined under the Merger Regulations as any merger, arrangement or amalgamation in accordance with the Companies (Compromises, Arrangements and Amalgamations) Rules 2016 ("Companies Amalgamation Rules") notified under the Companies Act, 2013.

A foreign company under the Merger Regulations means a company which is incorporated outside India. Similarly, an Indian company is one which is incorporated in India. Outbound investment is permitted only with companies incorporated in the countries mentioned in the Annexure-B of the Companies Amalgamation Rules.

The company which take over the assets and liabilities of the companies involved in the cross-border merger is called 'Resultant Company'. A Resultant Company may be either Indian or foreign.

Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016

Rule 25A of the Companies Amalgamation Rules reads as under:

"25A. Merger or amalgamation of a foreign company with a Company and vice versa.

1. A foreign company incorporated outside India may merge with an Indian company after obtaining prior approval of Reserve Bank of India and after complying with the provisions of sections 230 to 232 of the Act and these rules.

2. (a) A company may merge with a foreign company incorporated in any of the jurisdictions specified in *Annexure B* after obtaining prior approval of the Reserve Bank of India and after complying with provisions of sections 230 to 232 of the Act and these rules.

   (b) The transferee company shall ensure that valuation is conducted by valuers who are members of a recognised professional body in the jurisdiction of the transferee company and further that such valuation is in accordance with internationally accepted principles on accounting and valuation. A declaration to this effect shall be attached with the application made to Reserve Bank of India for obtaining its approval under clause (a) of this sub-rule.

3. The concerned company shall file an application before the Tribunal as per provisions of section 230 to section 232 of the Act and these rules after obtaining approvals specified in sub-rule (1) and sub-rule (2), as the case may be.

Explanation 1. For the purposes of this rule the term "company" means a company as defined in clause (20) of section 2 of the Act and the term "foreign company" means a company or body corporate incorporated outside India whether having a place of business in India or not:

Explanation 2. For the purposes of this rule, it is clarified that no amendment shall be made in this rule without consultation of the Reserve Bank of India.

(4) Notwithstanding anything contained in sub-rule (3), in case of a compromise or an arrangement or merger or demerger between an Indian company and a company or body corporate which has been incorporated in a country which shares land border with India, a declaration in Form No. CAA-16 shall be required at the stage of submission of application under section 230 of the Act.

(5) Where the transferor foreign company incorporated outside India being a holding company and the transferee Indian company being a wholly owned subsidiary company incorporated in India, enter into merger or amalgamation, –

(i) both the companies shall obtain the prior approval of the Reserve Bank of India;

(ii) the transferee Indian company shall comply with the provisions of section 233;

(iii) the application shall be made by the transferee Indian company to the Central Government under section 233 of the Act and provisions of rule 25 shall apply to such application; and

(iv) the declaration referred to in sub-rule (4) shall be made at the stage of making application under section 233 of the Act.

Rule 25A of the Companies Amalgamation Rules provides for the following:

- A foreign company is defined as a company incorporated outside India. The Companies Amalgamation Rules permit foreign companies to merge with an Indian company subject to obtaining prior approval of Reserve Bank of India and after complying with the provisions of sections 230 to 232 of the Act and the Rules.
- The Companies Amalgamation Rules, 2016 also mandates that the valuation should be conducted by valuers who are members of a recognised professional body and in accordance with the internationally accepted principles.
- Additionally, the following would also need to be fulfilled:
  - Merger of an Indian company is permitted only with a foreign company, which is incorporated in specified jurisdictions.
  - Burden is on the foreign company to ensure valuation is done 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;

Jurisdictions specified in clause (a) of sub-rule (2) of rule 25A [Annexure-B]

(i) Whose securities market regulator is a signatory to International Organization of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with SEBI, or

(ii) Whose central bank is a member of Bank for International Settlements (BIS), and

(iii) A jurisdiction, which is not identified in the public statement of 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 Financial Action Task Force to address the deficiencies.

Drivers and returns of Cross Border Mergers

BENEFITS OF CROSS BORDER MERGERS	RISKS ASSOCATED WITH CROSS BORDER MERGERS
● DIVERSIFICATION	● TAX IMPLICATIONS
● COST EFFECTIVENESS	● REGULATORY LANDSCAPE
● TECHNOLOGICAL ADVANCEMENT	● POLITICAL SCENARIO
● EFFICIENT DISTRIBUTION	

The trend of cross border mergers has increased recently. Cross border mergers have opened up vistas of opportunities. It enables an Indian company to utilise sophisticated levels of technical know-how offered by the foreign collaborator whereas enables the latter to utilise the large market and resources of India. The following are the benefits of entering into a cross border merger:

- **Diversification:** A merger often leads to product diversification, whereas a cross border in addition to offering diversification of products also leads to geographical diversification. This is extremely important for companies which want to make their global presence felt.
- **Achieving cost effectiveness:** When a company seeks to enter new markets, it takes some resources and money to build capacity. Having an existing infrastructure and resources in the new market helps in achieving cost effectiveness.

- **Technological advancement:** Mergers enable both the parties to use each other's intellectual properties hence enhancing technical know-how.
- **Distribution:** Cross border mergers help in creating a large distribution network transcending boundary.

However, with bouquets come brickbats, hence with the benefits also come risks associated with cross border mergers. Some of the risks posed by cross border mergers are:

- Despite Double Tax Avoidance Agreements, the tax implications in the host countries may prove to be complex and tedious. This may increase costs as a local professional is required to be hired.
- Regulatory landscape: The laws and regulations in the host country would be different and may be difficult to comply. An unusable regulatory landscape may pose risks to a cross border merger.
- Political scenario: It is essential to assess the political situation of the country before one enters into a merger with an entity belonging to that country. Unstable politics may lead to difficulties in carrying out business.

Valuation of Cross Border Firm

In cross border acquisitions, there can be factors important for considerations which are not considered at all in domestic acquisitions. Valuation is one such factor which changes with countries due to changes in exchange rate, stock market transactions and other macroeconomic developments.

Once identification has been completed, the process of valuing the target begins. A variety of valuation techniques are widely used in global business today each with its relative merits. In addition to the fundamental methodologies of Discounted Cash Flow (DCF) and multiples (earnings and cash flow), there are also a variety of industry-specific measures that focus on the most significant elements of value in business lines.

We shall discuss a few valuation methods below:

- The DCF (Discounted Cash Flow) approach to valuation calculates the value of the enterprise as the present value of all future free cash flows less the cash flows due to creditors and minority shareholders.
- The P/E ratio is an indication of what the market is willing to pay for a currency unit of earnings. It is also an indication of how secure the markets perception is about the future earnings of the firm and its riskiness.
- The market-to-book ratio (M/B) is a method of valuing a firm on the basis of what the market believes the firm is worth over and above its capital, its original capital investment, and subsequent retained earnings. Like the P/E Ratio, the magnitude of the M/B ratio as compared with its major competitors, reflects the market's perception of the quality of the firm's earnings, management, and general strategic opportunities.

The completion of a variety of alternative valuations for the target firm aids not only in gaining a more complete picture of what price must be paid to complete the transaction, but also in determining whether the price is attractive.

REGULATORY, COMPETITION, ACCOUNTING AND TAXATION ASPECTS

Taxation of mergers and acquisitions in India

There can be different methods of asset acquisition. Irrespective of the method, the tax losses are not generally transferred to the buyer thereby remaining operating in the domain of the seller. When the undertaking is acquired via slump sale where the particular picking up of assets by the buyer is not possible, some of the tax benefits/ deductions of the undertaking are made available to the buyer.

If the transfer is made for inadequate consideration and the tax proceedings are going on against the transferor then the authorities have the power to claim the amount from the transferee on the completion of the proceedings, if the consideration for the transfer is found to be inadequate.

No GST is applicable to a slump sale, i.e., wherein all the assets, rights, property and liabilities are transferred to the transferee. On the other hand, in a situation where particular assets are bought, the GST rate pertaining to the asset is applicable.

When the acquisition is via sale of shares, Securities Transition Tax (STT) is payable by both the buyer and when the shares are sold through a recognized stock exchange, STT is imposed on purchases and sales of equity shares listed on a recognized stock exchange in India at 0.1 percent based on the purchase or sale price.

Where a foreign company transfers shares of a foreign company to another company and the value of the shares is derived substantially from assets situated in India, then capital gains derived on the transfer are subject to income tax in India.

Further, payment for such shares is subject to Indian Withholding Tax (WHT). Shares of a foreign company are deemed to derive their value substantially from assets in India if such Indian assets are valued at a minimum of INR100 million and constitute at least 50 percent of the value of all the assets owned by such foreign company. A tax neutral status is provided where the resultant company is Indian (inbound merger) given that the transfer occurs through a slump sale and shareholders continue holding three-fourths of the shares.

If the foreign company is the parent company and the subsidiary is in India then the merger of the foreign company with another foreign company makes the newly created company, the owner of the Indian company provided that 25% of the shareholders of the amalgamating company remain the shareholders of the amalgamated company as well. Such a situation warrants for tax exemptions.

Regulatory Aspect

We have seen the regulatory framework around cross border mergers in the sections above. Let us now see how other key legislations regulate cross border mergers:

- The Foreign Exchange Management (Non-Debt Instrument) Regulations, 2019 and Foreign Exchange Management (Overseas Investment) Regulations, 2022 are extremely important pieces of legislation for allowing foreign investment in India and hence prove to be pertinent to cross border mergers as well. In addition to this, the Reserve Bank of India (the RBI) has notified Foreign Exchange Management (Cross-Border Merger) Regulations, 2018 (the Cross-Border Regulation) under the Foreign Exchange Management Act, 1999. These Regulations specifically deal with cross border mergers and contain provisions pertaining to mergers, demergers, amalgamations and arrangements between Indian companies and foreign companies. These regulations also discuss the concepts of inbound and outbound investments. If the foreign company is a JV/WOS then it is required to adhere to the conditions mentioned in (Overseas Investment) Rules & Regulations, 2022. Further, if the inbound merger of the JV/WOS leads to the acquisition of a subsidiary of the JV/WOS, then it is required to comply with the ODI Regulations, specifically regulations 6 and 7. If in an outbound merger, shares are being acquired by a person resident in India, then such acquisition becomes subject to the ODI Regulations as prescribed by the RBI.
- **FDI Regulations:** Cross border mergers essentially lead to inflow of foreign direct investment in the country and hence would be required to comply with the same. Foreign Direct Investment or FDI as it is called in common parlance is an investment by an entity or person who is resident outside India in the capital of an Indian company. An Indian company for the purposes of FDI would be a company incorporated in India under the applicable Companies Act. FDI can only be made through equity shares (shares which entitle its holder to vote), fully, compulsorily and mandatorily convertible debentures (instruments issued against loans) and fully, compulsorily and mandatorily convertible preference shares (shares which do not give voting rights). The two routes through which foreign investors may enter the country are government approval and automatic route. In a cross-border

merger, the companies would have to comply with the FDI regulations as there would be inflow of foreign cash in the economy.

- **Takeover Code:** These come into picture, if the merger is happening with a listed company in India. If voting rights or control over the company is acquired then these regulations get triggered.

Competition Law

The Competition Commission of India (CCI) regulates the mergers in order to prevent the rise of monopolistic mergers. While mergers help in creating economies of scale and lead to increase in profits, they may also contribute to the creation of monopolistic structure. Hence mergers are made subject to the competition laws of the country.

The CCI has to assess and inquire into any merger which may have an adverse impact on the healthy competition in the market. While making such assessment as to the adverse effects the commission takes account of a number of factors such as actual and potential level of competition through imports in the market, extent of barriers to entry into the market, level of combination in the market etc.

Even a likelihood of causing of adverse impact is adequate for the competition commission to rule that the merger is creating an adverse impact. If the merged enterprise created post a cross-border merger possesses assets worth more than US $ 1.25 bn, or turnover more than US $ 3.75 bn; or the group to which the merged enterprise belongs possesses assets worth more than US $ 5 billion, or turnover more than US $ 15 billion then the competition commission is required to examine such combination.

Conflict of Jurisdictions is another such problem wherein whether or not the merger would affect the competition in the market positively or negatively would depend on the market situation which is unique to every country.

Accounting

In merger accounting, all the assets and liabilities of the transferor are consolidated at their existing book values. Under acquisition accounting, the consideration is allocated among the assets and liabilities acquired (on a fair value basis). Therefore, acquisition accounting may give rise to goodwill, which is normally amortized over 5 years.

Further, goodwill arising on merger will not be amortized; instead it will be tested for impairment. The accounting treatment of merger within a group is separately dealt with under the new Ind AS, which requires all assets and liabilities of the transferor to be recognized at their existing book values only.

The new IndAS are to be implemented in a phased manner. All listed companies and companies with net worth of INR 500 crore or more are required to adopt the Ind AS from 1 April, 2016. Companies with net worth of INR 250 crore or more are required to adopt Ind AS from 1 April, 2017. Other companies will continue to apply existing accounting standards.

Cross Border Mergers – Earnouts: Cross Borders Mergers are subject to earnouts. An earnout is a contingent consideration whereby Buyer of the Target would decide an amount which is to be paid provided certain contingent considerations to happen. Cross Border Mergers specially covering Information Technology (IT), Technological Mergers, Banking Mergers are subject to Contingent Considerations. Earnouts are divided into 3 types:

- Cash Earnouts
- Equity Earnouts
- Stock Compensation Earnouts.

Cross Borders Mergers – Carveouts: A Carve out is a Potential divestiture of a Business unit in which a parent

company sells minority interest of a Child Company to outside Investors. A Carveout allows a company to capitalize on a Business segment that many not be part of its core operations.

Example of Cross-border Mergers & Acquisitions

INFOSYS KALEIDOSCOPE

(4) Notwithstanding anything contained in sub-rule (3), in case of a compromise or an arrangement or merger or demerger between an Indian company and a company or body corporate which has been incorporated in a country which shares land border with India, a declaration in Form No. CAA-16 shall be required at the stage of submission of application under section 230 of the Act.

TATA- CORUS DEAL

This acquisition of Corus Group Plc by Tata Steel Limited (TSL), was the biggest overseas acquisition by an Indian company. TSL emerged as the fifth largest steel producer in the world after the acquisition. The acquisition gave Tata Steel access to Corus' strong distribution network in Europe.

Tata Steel had first offered to pay 455 pence per share of Corus, to close the deal at US$ 7.6 billion on October 17, 2006. CSN then counter offered 475 pence per share of Corus on November 17, 2006. Within hours of Tata Steel increasing its original bid for Corus to 500 pence per share, Brazil's CSN made its formal counter bid for Corus at 515 pence per share in cash, 3% more than Tata Steel's Offer.

Finally, an auction was initiated on January 31, 2007, and after nine rounds of bidding, TSL could finally clinch the deal with its final bid 608 pence per share, almost 34% higher than the first bid of 455 pence per share of Corus. The deal (between Tata & Corus) was officially announced on April 2nd, 2007 at a price of 608 pence per ordinary share in cash.

Indian Steel Giant Tata Steel Limited (TSL) finally acquired the Corus Group Plc (Corus), European steel giant for US$ 13.70 billion. The merged entity, Tata-Corus, employed 84,000 people across 45 countries in the world. It had the capacity to produce 27 million tons of steel per annum, making it the fifth largest steel producer in the world as of early 2007.

Tata Corus Deal Synergy

1. Tata was one of the lowest cost steel producers in the world and had self-sufficiency in raw material. Corus was fighting to keep its productions costs under control and was on the lookout for sources of iron ore.
2. Tata had a strong retail and distribution network in India and South East Asia and was a major supplier to the Indian auto industry and hence there would be a powerful combination of high quality developed and low cost high growth markets.
3. Technology transfer and enhanced R&D capabilities between the two companies that specializes in different areas of the value chain.
4. There was a strong culture fit between the two organizations both of which highly emphasized on continuous improvement and ethics, i.e. 'The Corus Way'with the core values and code of ethics, integrity, creating value in steel, customer focus, selective growth and respect for people etc. were strong synergies.

CASE LAWS

Vodafone International Holdings v Union of India *decision of 2012* was a landmark decision. This case pertained to taxation of transfer of shares between two non-resident companies by virtue of which the controlling interest of an Indian resident company was acquired. The Supreme Court clarified the doubt over imposition of taxes in such situations and shed light on the following:

- The parameters of tax planning
- Business entities are permitted to structure their transactions in such a way so as to reduce their tax

liability, in the absence of any law prohibiting them from doing the same

- Lifting of corporate veil
- Business transactions should be looked at holistically.

While commenting upon the creation of subsidiaries through the process of mergers and acquisitions, the SCsaid that "the legal position of any company incorporated abroad is that its powers, functions and responsibilities are governed by the law of its incorporation. No multinational company can operate in a foreign jurisdiction save by operating as a good local citizen. If the owned company is wound up, the liquidator, and not the parent company, would get hold of the assets of the subsidiary. The difference is between having power or having a persuasive position".

Cross-Border Demerger

In this case of ***Sun Pharmaceutical Industries Limited (19.12.2019),*** a scheme of arrangement under Section 230 - 234 of the Companies Act, 2013 in the nature of de-merger was filed before National Company Law Tribunal ("NCLT"), Ahmedabad Bench. The Scheme contemplated transfer of two specified investment undertakings of Sun Pharmaceutical Industries Limited to two overseas Resulting Companies, viz. Sun Pharma (Netherlands) B.V., and Sun Pharmaceutical Holdings USA Inc. Since, Petitioner Company is listed company having its shares listed on BSE Limited and National Stock Exchange of India Limited therefore the company sought the approval of the Stock Exchanges and SEBI which provided their no objection to the Scheme of Demerger. On presentation of Petition before NCLT meetings of equity shareholders and unsecured creditors were convened, whereby scheme was approved by majority of equity shareholders and unsecured creditors. However, Regional Director (North Western Region) took the following observation on scheme of demerger–

(i) Section 234 refers to cross border mergers and amalgamations and not to demergers.

(ii) Section 2 (19AA) of the Income Tax,1961 is violated and same will not amount to tax neutral transaction.

(iii) Company to comply with provisions of FEMA and RBI.

Petitioner company while replying to aforesaid observation held that, scheme of arrangement, either in the nature of merger or demerger and the petitioner demerged company has complied with the applicable frame work under FEMA and RBI guidelines. Hence, there was deemed approval of RBI to the Scheme.

While going through the provisions of Section 234 it is evident that same applies to cross border mergers of Indian companies with foreign companies and vice versa and the provisions mention only about the words ''Merger'' and/ or ''Amalgamation'' so the Section 234 do not provide for or rather restrict the demerger of the Indian Companies with foreign company. In addition to the above, Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 is silent on 'Demergers' and mentions only 'Mergers' and 'Amalgamations'. Moreover, Foreign Exchange Management (Cross Border Merger) Regulations, 2018 are applicable to the mergers and amalgamations of the Indian companies with the foreign companies only. Thus, the NCLT rejected the scheme.

Post-merger performance evaluation

Cross border mergers can be truly assessed only by evaluating the post-merger performance of the merged entities. The following parameters may be used to assess the post-merger performance:

- **Returns:** A comparative analysis of the returns being generated by the entity pre and post-merger should be carried out. If the merged entity is earning significantly higher returns than the merger is deemed successful.
- **Cash flow and operational efficiency:** If post-merger the cash flow significantly increases and this increased cash flow is put to use to obtain operational efficiency, this too shows that the newly created entity is performing well.
- **Stock market reaction:** If the stock market reaction to the announcement of merger is positive then the merger appears to be a positive step.

Practical Insights

Some practicalities which need to be kept in mind while entering cross border mergers are:

a) Conduct due diligence on the other firm.

b) Conduct a risk-benefit analysis before entering into the merger.

c) Valuation of both the firms is essential so as to predict the competition law treatment of the merger.

d) Make sure that when you enter into an outbound merger it is with a company from one of the prescribed jurisdictions.

e) Have an in-depth analysis of the host country's regulatory and political landscape ready before you take the decision of the merger.

ANNEXURE A

Foreign Exchange Management (Cross Border Merger) Regulations, 2018

Notification No. FEMA.389/2018-RB **Dated: March 20, 2018**

In exercise of the powers conferred by sub-section (3) of section (6) read with section 47 of the Foreign Exchange Management Act, 1999 (42 of 1999), the Reserve Bank makes the following regulations relating to merger, amalgamation and arrangement between Indian companies and foreign companies:

1. Short title and commencement

(i) These regulations may be called the Foreign Exchange Management (Cross border Merger) Regulations, 2018.

(ii) They shall come into force from the date of their publication in the Official Gazette.

2. Definitions

In these Regulations unless the context requires otherwise, -

(i) 'Act' means the Foreign Exchange Management Act, 1999 (42 of 1999);

(ii) 'Companies Act' means The Companies Act, 2013;

(iii) 'Cross border merger' means any merger, amalgamation or arrangement between an Indian company and foreign company in accordance with Companies (Compromises, Arrangements and Amalgamation) Rules, 2016 notified under the Companies Act, 2013;

(iv) 'Foreign company' means any company or body corporate incorporated outside India whether having a place of business in India or not;

Explanation: for the purpose of outbound mergers, the foreign company should be incorporated in a jurisdiction specified in Annexure B to Companies (Compromises, Arrangements and Amalgamation) Rules, 2016;

(v) 'Inbound merger' means a cross border merger where the resultant company is an Indian company;

(vi) 'Indian company' means a company incorporated under the Companies Act, 2013 or under any previous company law;

(vii) 'NCLT' means National Company Law Tribunal as defined under the Companies Act, 2013 or rules framed thereunder;

(viii) 'Outbound merger' means a cross border merger where the resultant company is a foreign company;

(ix) 'Resultant company' means an Indian company or a foreign company which takes over the assets and liabilities of the companies involved in the cross border merger;

(x) The words and expressions used but not defined in these Regulations shall have the same meanings respectively assigned to them in the Act.

3. Save as otherwise provided in the Act or rules or regulations framed thereunder or with the general or special permission of Reserve Bank, no person resident in India shall acquire or transfer any security or debt or asset outside India and no person resident outside India shall acquire or transfer any security or debt or asset in India on account of cross border mergers.

Explanation: Cross Border Mergers pending before the competent authority as on date of commencement of these regulations shall be governed by these Regulations.

4. Inbound merger: A merger or amalgamation of foreign company with an Indian company

1. the resultant company may issue or transfer any security and/or a foreign security, as the case may be, to a person resident outside India in accordance with the pricing guidelines, entry routes, sectoral caps, attendant conditions and reporting requirements for foreign investment as laid down in Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017.

   Provided that

   (i) where the foreign company is a joint venture (JV)/ wholly owned subsidiary (WOS) of the Indian company, it shall comply with the conditions prescribed for transfer of shares of such JV/ WOS by the Indian party as laid down in Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004;

   (ii) where the inbound merger of the JV/WOS results into acquisition of the Step down subsidiary of JV/ WOS of the Indian party by the resultant company, then such acquisition should be in compliance with Regulation 6 and 7 of Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004.

2. An office outside India of the foreign company, pursuant to the sanction of the Scheme of cross border merger shall be deemed to be the branch/office outside India of the resultant company in accordance with the Foreign Exchange Management (Foreign Currency Account by a person resident in India) Regulations, 2015. Accordingly, the resultant company may undertake any transaction as permitted to a branch/office under the aforesaid Regulations.

3. The guarantees or outstanding borrowings of the foreign company from overseas sources which become the borrowing of the resultant company or any borrowing from overseas sources entering into the books of resultant company shall conform, within a period of two years, to the External Commercial Borrowing norms or Trade Credit norms or other foreign borrowing norms, as laid down under Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000 or Foreign Exchange Management (Borrowing or Lending in Rupees) Regulations, 2000 or Foreign Exchange Management (Guarantee) Regulations, 2000, as applicable.

   Provided that no remittance for repayment of such liability is made from India with in such period of two years; Provided further that the conditions with respect to end use shall not apply.

4. The resultant company may acquire and hold any asset outside India which an Indian company is permitted to acquire under the provisions of the Act,rules or regulations framed there under. Such assets can be transferred in any manner for undertaking a transaction permissible under the Act or rules or regulations framed thereunder.

5. Where the asset or security outside India is not permitted to be acquired or held by the resultant company under the Act, rules or regulations, the resultant company shall sell such asset or security within a period of two years from the date of sanction of the Scheme by NCLT and the sale proceeds shall be repatriated to India immediately through banking channels. Where any liability outside India is not permitted to be held by the resultant company, the same may be extinguished from the sale proceeds of such overseas assets within the period of two years.

6. The resultant company may open a bank account in foreign currency in the overseas jurisdiction for the purpose of putting through transactions incidental to the cross border merger for a maximum period of two years from the date of sanction of the Scheme by NCLT.

5. Outbound merger: A merger or amalgamation of Indian company with a foreign company

1. a person resident in India may acquire or hold securities of the resultant company in accordance with the Foreign Exchange Management (Transfer or issue of any Foreign Security) Regulations, 2004.
2. a resident individual may acquire securities outside India provided that the fair market value of such securities is within the limits prescribed under the Liberalized Remittance Scheme laid down in the Act or rules or regulations framed there under.
3. An office in India of the Indian company, pursuant to sanction of the Scheme of cross border merger, may be deemed to be a branch office in India of the resultant company in accordance with the

   Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016. Accordingly, the resultant company may undertake any transaction as permitted to a branch office under the aforesaid Regulations.
4. The guarantees or outstanding borrowings of the Indian company which become the liabilities of the resultant company shall be repaid as per the Scheme sanctioned by the NCLT in terms of the Companies (Compromises, Arrangement or Amalgamation) Rules, 2016.

   Provided that the resultant company shall not acquire any liability payable towards a lender in India in Rupees which is not in conformity with the Act or rules or regulations framed thereunder.

   Provided further that a no-objection certificate to this effect should be obtained from the lenders in India of the Indian company.
5. The resultant company may acquire and hold any asset in India which a foreign company is permitted to acquire under the provisions of the Act, rules or regulations framed thereunder. Such assets can be transferred in any manner for undertaking a transaction permissible under the Act or rules or regulations framed thereunder.
6. Where the asset or security in India cannot be acquired or held by the resultant company under the Act, rules or regulations, the resultant company shall sell such asset or security within a period of two years from the date of sanction of the Scheme by NCLT and the sale proceeds shall be repatriated outside India immediately through banking channels. Repayment of Indian liabilities from sale proceeds of such assets or securities within the period of two years shall be permissible.
7. The resultant company may open a Special Non-Resident Rupee Account (SNRR Account) in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016 for the purpose of putting through transactions under these Regulations. The account shall run for a maximum period of two years from the date of sanction of the Scheme by NCLT.

6. Valuation of companies involved in cross border merger

The valuation of the Indian company and the foreign company shall be done in accordance with Rule 25Aof the Companies (Compromises, Arrangement or Amalgamation) Rules, 2016.

7. Miscellaneous

1. Compensation by the resultant company, to a holder of a security of the Indian company or the foreign company, as the case may be, may be paid, in accordance with the Scheme sanctioned by the NCLT.
2. The companies involved in the cross border merger shall ensure that regulatory actions, if any, prior to merger,with respect to non-compliance,contravention, violation, as the case may be,of the Act or the Rules or the Regulations framed thereunder shall be completed.

8. Reporting

1. The resultant company and/or the companies involved in the cross border merger shall be required to furnish reports as may be prescribed by the Reserve Bank, in consultation with the Government of India, from time to time.

9. Deemed approval

1. Any transaction on account of a cross border merger undertaken in accordance with these Regulations shall be deemed to have prior approval of the Reserve Bank as required under Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.
2. A certificate from the Managing Director/Whole Time Director and Company Secretary, if available, of the company(ies) concerned ensuring compliance to these Regulations shall be furnished along with the application made to the NCLT under the Companies (Compromises, Arrangements or Amalgamations) Rules, 2016.

LESSON ROUND-UP

- Cross border merger is a recent trend and a very profitable one. If Indian companies have to make their presence felt globally, it is essential for India to have a sound legal framework pertaining to cross border mergers.
- The recent merger regulations, section 234 and the Companies Amalgamation Rules are a step towards strengthening this legal regime. Apart from the company law, other legislations such as tax and competition laws also play a key role in perpetuating cross border merger transactions.
- Section 234 of the Companies Act, 2013 notified in 2017 is the key legal provision governing cross border mergers.
- Companies Amalgamation Rules and sections 230-234 of the Companies Act, 2013 regulate the procedure of mergers.
- Foreign Exchange Management (Cross Border Merger) Regulations, 2018, have brought the concept of outbound merger in the country as well.
- Discounted cash flow, private equity and market to book ratios are some of the ways in which a cross border firm may be valued.
- Apart from companies Act, other considerations such as tax and competition laws also play a major role in cross border mergers.

GLOSSARY

Foreign company : means company incorporated outside India.

Indian company : means company incorporated under Companies Act, 2013.

Inbound merger : is a merger wherein as a result of the merger of a foreign entity and an Indian entity an Indian company is formed.

Outbound merger : is one wherein as a result of the merger of a foreign entity with an Indian entity a foreign company is formed.

Cross border merger : means any merger, amalgamation or arrangement between an Indian company and foreign company under the Act.

Resultant Company : means an Indian company or a foreign company which takes over assets and liabilities of the companies involved in a merger.

Earnout : is a contingent consideration agreed between both Buyer and Seller at the time of acquisition. It is subject to P&L Impact at the time of Books Close.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. What is a cross border merger? Explain the legal regime in India around a cross border merger?
2. What are the changes brought about by the Foreign Exchange Management (Cross Border Merger) Regulations, 2018. Critically analyse the same.
3. Explain the tax implications and the accounting parameters associated with cross border mergers?
4. Discuss the taxation of cross border mergers in India.
5. Mention the jurisdictions specified in Rule 25A of Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

LIST OF FURTHER READINGS

- Guide to Companies Act by A Ramaiya 18th Edition, Lexis Nexis
- Companies Act, 2013 - Bare Act

PART II

VALUATION