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Tax Landscape for Mergers & Acquisition in India

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Abstract: *The paper aims to review, summarize and discuss various established tax laws dealing with mergers and acquisitions (M&A) in India, and provides thereby highlight 'painful' tax regime that hinders the M&A process in India. The major observations include, higher valuation inbound-deals had delayed or failed due to weak financial infrastructure, erratic nature of government officials and political intervention, and the newly elected government has aimed to attract higher inflow of investment from other developed and emerging markets by easing investment rules and offering tax holidays. The study eventually would help policy makers, M&A advisors, legal consultants and investment bankers in assorted issues, and private equity firms and multinational firms intending to invest in Indian business.*
Keywords: *Acquisitions, Mergers, Financial laws, Tax regime, International business;Regulatory Laws*

I. INTRODUCTION

After decades of reduced activity since independence,Mergers and Acquisitions(M&A) in India have grown strongly since a series first-generation reforms. The M&A activity now stands at a record high of $70 billion (Figure: 1). Experts claim that the increased M&A activity was driven by structural reforms that the government has announced in the past couple of years. The reforms agenda followed by the government by enacting a series of measures such as Make in India, Skill India, Start-up India and other entrepreneurship initiatives. The radical changes to welcome M&A deals have been directionally positive, collectively meaningful and resounds with the government's pledge to enable growth and stability.However, the Indian M&A sector remains highly regulated and the process more time consuming and cumbersome. The delay in getting approvals, ambiguity in rules, pending cases in courts etc. portray a dismal picture of the Indian Tax regime related to M&As The purpose of this paper is to explain and present various institutional laws that refer to mergers and acquisitions (M & As) in India and recommend a few guidelines for institutions and multinational managers participating in foreign investment and acquisition dealsfor making India, an investor friendly country.

The principal regulator for M&A's in India include the SEBI (Securities and Exchange Board of India), RBI (the Reserve Bank of India), and the Foreign Investment Promotion Board and the Competition Commission of India. Primarily the laws governing M&A's are based on the Companies Act 1956 which further refined in 2013, FEMA Act 1999,SEBI Act 1992, and circulars/government orders/regulations thereunder. The Indian Income Tax Act, 1961 coversnumerous provisions related to the taxation of different categories of mergers and acquisitions. Indian laws related to the 'Merger' is generally done using a scheme of arrangement under Sec. 391-3941 of the Indian Companies Act, 1956, Sec 230 to 232 of the Companies Act,2013. 'Demerger' related laws are conducted using a scheme of arrangement under the Companies Act performed under high court supervision (in both cases). Income Tax laws covers merger/demerger under Sec.2[19AA] of Income Tax act as a transfer pursuant to a scheme of arrangement under Sections 391-394 of the Companies Act, 1956. M&A related share purchases are taxed based on the liability factor (for example, any liability to a tax on the capital gains) under Sec.56(2) of the Income Tax act. Liability& SEBI defined security transaction tax/stamp duties. For M&A related asset sale, Sec 45 & 48 of Income Tax act determines the tax calculation.

II. KEY INSTITUTIONAL LAWS RELATED TO MERGERS & ACQUISITIONS

Companies Act 1956, 2013

During the initial day's provision under Company Act 1956 were used to govern the M&A deals,especially those under Sec 390 to Sec 396 defined the ways in which the M&A arrangement to be made.Later, as globalization took strength, these laws required enactment and Indian policy makersincorporated substantial changes forming a newer version -Companies Act 2013. Company Act 2013 defined under Chapter XV (Compromises, arrangements & amalgamations) broadly defines the ways for consolidation and reorganization.Arrangement includes a reorganization of the company's share capital by the consolidation of sharesof different classes or by the division of shares into shares of different classes, or by both of those methods. Sec 231 of the act ['Merger and amalgamation of companies'] lists laws for schemes involving a merger, where under the scheme the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company, it is a merger by absorption, or where the undertaking,property and liabilities of two or more companies, including the company in respect of which thecompromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, it is a merger by formation of a new company. The Sec 234 deals with Merger or amalgamation of company with foreign company. Sec 235 & 236 details about the share purchases & Sec 237 explain the governmental powers related to the amalgamation of companies.

A key feature in Company Act 2013 is the proposal for the formation of the National Company Law Tribunal (NCLT) &National Company Law Appellate Tribunal ('NCLAT'). In Jun 2016, Indian government notified the constitution of National Company Law Tribunal and in exercise of powers conferred under Sec 408 - 410 of the Companies Act 2013. NCLT formation supposed to bring some landmark changes to the way M&A is executed in India. NCLT has powers to allow single window settlement of disputes, speedy disposal of cases, and offers a wider reach (11 branches). With the new law in place, and with the constitution of NCLT, it is expected that the M&A deal makers can get a speedy and efficient disposal of the matters.

Sebi Act 1992

SEBI Act focus on the functions and powers of SEBI which is the national securities market regulator. It provides the takeover code and regulates the sale/acquisition of high percentage shares. SEBI Insider Trading Regulations limits dealing in shares a listed company based on insider information and monitors the leakage of price sensitive information in any M&A deals.

The Indian Income Tax Act, 1961

Income Tax Act (IT Act) provide tax benefits for amalgamations, merger and demerger and slump sale. Based on this law satisfying certain conditionsM&A deals can claim tax benefit on capital gains. Sec 2 (1B)in particular refers to items related to the M&A. Tax department can impose capital gain taxes on sale of sale shares. Sale shares will be considered as long term capital if and only if its held for more than a year after its purchase, else these will be taxed at 10% of its gain.

The Competition Act, 2002

Competition Act aims to regulate various forms of business reorganizations including mergers, demergers, stake sales etc. In particular Sec 5 and Sec 6 of Competition Act covers the M&A deals. CCI regulates any anti-competitive conduct outside or insider India if it affects the Indian market in an opposing manner. The Competition Act (2002) list out the merger control thresholds for any M&A deals. This threshold undergone a major look up and India government in 2016, announced some changes via a notification. The government agency introduced a new target based exemption for any required approval from the Competition commission of India (CCI). Earlier the exemption period of 5 years was for any enterprises with assets less than □ 2.5 Billion & turnover less than □ 7.5 Billion. Now this revised to□ 3.5 Billion and □ 10 Billion respectively.

III. FOREIGN EXCHANGE MANAGEMENT ACT, 1999 (FEMA,1999)

FEMA is introduced to deal with foreign exchange in order to facilitate external trade and payments. Foreign exchange is the system used to convert one national currency into another and its transfer thereof. To strengthen the control on foreign exchange a new law called Foreign Exchnage Regulation Act (FERA 1973) was enact3ed in 1973. Its main objective was to ensure proper utilization of foreign exchange. The violation of this law was considered as a criminal offence. Later this law modified into a new act Foreign Exchange Management Act in 1999. FEMA 1999, had many changes including making any violation of this under Indian civil laws. FEMA has multiple sections and each section describe substantive provisions applicable to an individual, a company, person residing in India, person residing out of India, nonresident Indians, person of Indian origin etc.

Cross Border Tax Issues

In the era of globalizationcross border deals are much common. Indian industry is growing and quickly achieving a global stature. Many companies are now entering into cross border deals. Foreign investment are greatly sought by the government. But still those entering into cross-border M&As often highlights tax issues are as a major concern. Sec 90(2) of the Income Tax Act generally governs the M&A taxation. However, many M&A deal makers often complain about the double taxation problem. Double taxation often results when two different jurisdictions seek to tax the same sum of money or income or the same legal entity. This is the reason why many countries are entering into bilateral treats avoiding double taxation. India has a Double Taxation Avoidance Agreements with Mauritius, Singapore, Cyprus and Netherlands to limit their taxing jurisdictions voluntarily through self-restraint. Thus Double taxation avoidance agreement or Sec 90(2) of income tax act whichever benefits the entity, is considered in such cases.

During M&A taxation issue for cross border deals one case that caught global new headlines was that of Vodafone International vs Union of India. In a landmark ruling by Supreme Court of India. The case is all about the argument by the Indian revenue authorities that Indian authorities can tax the gains made out of the indirect transfer of assets in India to an entity located in the Cayman Islands by Vodafone's Dutch subsidiary. The Supreme Court ruled in favor of Vodafone stating that the provisions in the law did not cover such transactions within its scope.

Prevailing Ambiguities

Considering the growth target and to be a global leader, India need to do a lot to increase the investor confidence as well as ease of doing business in India. This include clearing some bottlenecks in Indian tax laws that still exists.

1. As per the prevailing tax regime in India, earn out linked payments (sharing profits with promotors – which is very common in M&As) are taxed on the entire consideration. This create tax burden on the sellers which are not in proportion with the cash sellers receive. A proper tax treatment considering international laws are required here.
2. Any M&A deal will have a non-complete payment part (for e.g., not to compete on the sale of shares or assets of your business). Indian laws are vague in this subject. Getting a clarity whether such payments will be taxed or not. A clear notification in this regard will help the recipient to calculate the effective savings after tax.
3. Minimum alternate tax or MAT is imposed on resident/nonresident Indian corporations. However, MAT is not payable for a 'sick 'industrial company till its net worth equals the accumulated losses. This provision is applicable to manufacturing sector M&As, however for the services sector this benefit is not made available yet. This point need to be prioritized by policy makes since much of the M&A actions is happening in the services sector.
4. Vodafone case and knee jerk reaction by government authorities saw the amendment of Sec. 9(1) if the Income Tax Act (2012). An addedexplanation to strengthen the government tax power was included which stated offshore capital asset would be taxed if it substantially derives its value (directly or indirectly) from assets situated in India. The retrospective effect and the amendment validity from the assessment year 1962-63, meaning several foreign investments will now be open to taxation, especially those completed in the last five years since the February 2007 caused wide spread concern. Further, the scenario was aggravatedas there is no clarity around the term "substantially"!
5. M&A industry also faces challenge in the form of getting tax clearance certificates prior to any planned asset transfer. Tax clearance is mandated by this law and hence any transactions done without the certificate will be nullified as per the law. Obtaining such certificate is a cumbersome process and time consuming.
6. In the Finance bill 2016, Sec. 2 (42A) of the Income Tax act was amended to fast track M&A deals. The amendment however provides wider powers to 'Assessment officer' which may be subject to interpretation and may cause disputes/legal hurdles
7. To many M&A tax laws less ambiguous and straight a General Anti-Avoidance Rule (GAAR) is getting implemented from March 2017. This rule mainly targets the tax avoidance/evasion issues. However, GAAR provides discretionary powers and such stronger powers make the implementing authorities tasks prone to interpretations and disputes
8. Livemint newspaper in its 11th Aug 2015 issue detailed the 'tax horrors' that kept insurers away from M&A deals in India. The chances of dispute related to the taxation in cross border deals are quite high in India and insurers are reluctant to take such a risk. The paper reported Allianz SE to American International Group Inc. (AIG) are unwilling to offer tax-liability coverage in India's cross-border mergers and acquisitions market due to this.Tax indemnity insurance is a must for M&A deals involving cross-border transactions since this insurance will cover buyer or seller from any additional tax payments that may arise in the due process.

Many companies like Nokia, Vodafone, Cadbury, Cairn etc. are involved in tax disputes with authorities. Claims for the nonpayment of taxes totaling about $10 billionis pursued by Tax department.As can be seen, a number of laws and regulations have recently been amended or are likely to be in a moderately short period. Such changes could lead to diverse decisions on the part of the authorities in the years to come, to the extent that the interpretations may lead disputes and court cases.

Figures And Tables

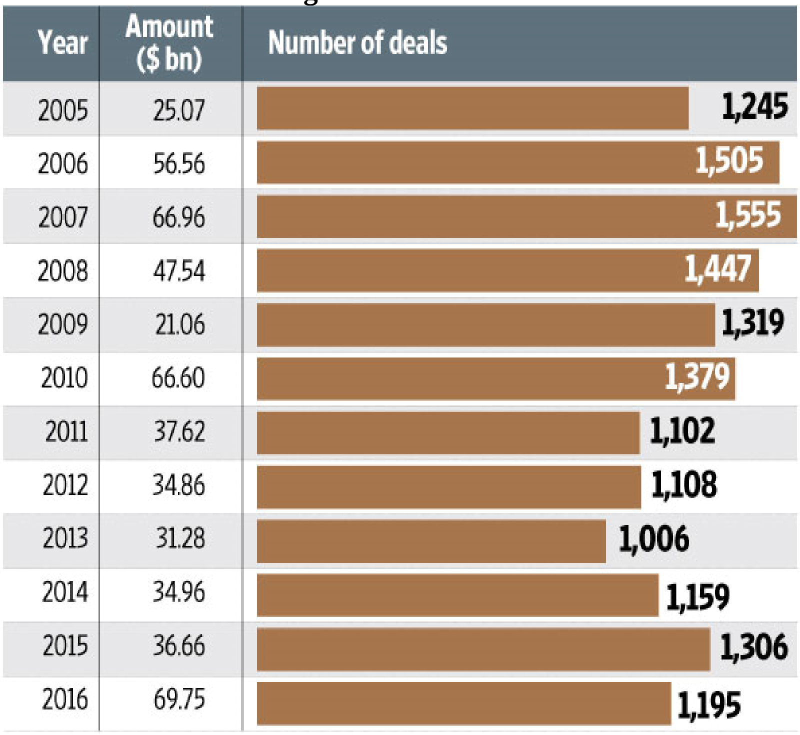

Figure: 1

(**Source:** Livemint.com)

IV. CONCLUSION

M&A activities are speeding up considering India's consistent track record of growth fueled by large scale domestic consumption and attractive middle class consumers. There is a need to ensure the regulatory framework is well suited to attract more investments from M&As and prosper the booming economy to much higher levels. India's tax system is undergoing significant changes. Positive changes and much needed provisions were added to tax laws and framework. Tax administration's efforts to broaden the tax base, increase the tax revenues and combat the tax evasion must be continued. However, the taxation policies need to be fair and practical. A more fine-tuned laws to address concerns like ambiguous points, more interpretative terms, fast tracking approval procedures and speedy resolution of disputes – will make India a global player in M&A market.

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