Key considerations in M&A Tax and Regulatory

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CHARTERED ACCOUNTANTS

Key considerations for M&A – *Tax and Regulatory*

About Us

Headquartered in **Gurgaon** with branches in **New Delhi, Mumbai, Pune, Bangalore, Hyderabad** and **Singapore**

500+ Employees from accounting, tax, secretarial, legal & management background

Over 40 years of industry experience

1,000+ Customers from more than 30 Countries

Strong Media Presence including views shared on several international and domestic tax and regulatory matters

Ranked Consistently in **International Tax Review's World Tax and World Transfer Pricing** Guides (2017-2023)

VIRTUAL TOUR OF OUR OFFICE

Recognition

- Ranked Consistently in **International Tax Review's World Tax** and **World Transfer Pricing GUIDES (2017-2023)**
- Nominated consistently in Indian **Transfer Pricing Firm award category in Asia Tax Awards** by International Tax Review **(2016-2022)**

Amit Maheshwari

- Recognized as one of the **top tax practitioners advising on Indian Tax Laws, in the ITR's Expert Guides 2022**.
- Recognized as a **TAX LEADER** in **World Tax Controversy Leaders Guide 2021**
- Recognized as **TRANSFER PRICING EXPERT** in **2018, 2019 and 2021 listed by Euromoney**
- Nominated as **ASIA TRANSFER PRICING PRACTICE LEADER** of the Year in **Asia Tax Awards** by **ITR** in 2017

Services (1/2)

Transaction & Set-up Advisory

- India Entry Strategy and Set-up Advisory
- Business Structuring
- Permanent Establishment Advisory
- Green Feld and Brown Field Manufacturing Set-up
- Insolvency and Bankruptcy Advisory
- Outbound Expansion
- Valuation

Transfer Pricing

- Transfer Pricing Documentation
- Global Benchmarking
- Representation and Litigation
- Inter-company Agreements
- Country-by-Country Reporting (CbCR)

Corporate Tax

- Tax Returns
- Direct and Indirect Tax Compliance
- Tax Compliance
- Cross-border Taxation
- Withholding Tax Matters
- Effective Tax Rate Management
- Tax Health-check and Diagnostic review
- FATCA and CRS Compliance
- ICDS Impact Analysis
- Tax Provisioning Services

Advisory

- Cross-border Transaction Advisory
- ESOP Advisory
- ERP Advisory and Implementation
- GAAP Conversion
- Permanent Establishment Advisory
- Digital Transformation

Services (2/2)

Assurance

- Statutory and Tax Audit
- Special Audits
- Forensic Audit
- Limited Reviews
- Attestation Services
- Financial Reporting
- Financial Due Diligence
- Component Audit

Human Capital

- Professional Employer on Record
- Global Mobility Solutions
- Succession Planning
- Tax Return and Advisory
- Representation and Litigation
- Expat Tax and Regulatory Compliances

Bookkeeping and Payroll

- Bookkeeping
- Month End Closing
- Assistance to Statutory Auditors
- Payroll Management
- Implementation of Procedures and Controls

Outsourcing Solutions

- Tax Preparation and Review
- Audit – Annual, Single Audit, Internal, EBP Audit
- Payroll Management
- Retirement Plan Audit
- Bookkeeping
- SOC and HITRUST
- Global Transfer Pricing
- UK VAT & SALT
- Financial diligence

Agenda

- Modes of M&A
- Indirect Transfers
- Mergers and Demergers
- Challenges in a business transfer
- Foreign Direct Investment Guidelines
- Representations, Warranties and Indemnities
- Equity Roll overs
- Competition Commission of India
- Insolvency and Bankruptcy Code

Modes of Executing M&A transactions in India

Amalgamation

When two or more companies join together to form a new entity or one or more entities are absorbed by a third entity.

Share Sale

The acquirer purchases whole or part of the voting power of the target company.

Slump Sale

Transfer of one or more units or undertakings of a business for a lump-sum consideration.

Asset Sale

The buyer acquires one or more of the specific assets from the target company for specific values assigned to such assets.

Tax & Regulatory Implications

Direct Taxes

- Income Tax Act, 1961: Levy on Total Income

Indirect Taxes

- Goods & Services Tax (GST), 2017

Other Regulations

- FEMA, Act 1999 - Exchange Control Regulations
- Stamp Duty Act, 1899 - Duty on Unlisted Share Transfer
- SEBI laws and regulations in case of listed companies
- Insolvency and Bankruptcy Code, 2016
- Competition Act, 2002

Tax Implications on several modes of M&A

Basis	Asset Sale	Slump Sale	Share Sale
Meaning	Under this method, there is a sale of all or part of the assets with values assigned individually to each one of them.	It is the transfer of one or more units of a business as a sale for lump sum consideration without being values assigned to individual assets or liabilities.	Share sale refers to the sale of the interest in the capital of the entity.
Taxability for seller under income-tax laws	Depreciable assets: Capital gains on depreciable capital assets is taxable as short-term capital gains at ordinary rates which can go up to 35%.	Amount of capital gains is determined as sale consideration less cost of acquisition (no step-up cost is allowed). The tax rate is 20% on long term capital gains.	The capital gains arising due to the sale of shares is taxable in the hands of the shareholders at the rate of 10% with no step-up cost. In case of non-resident, tax treaty benefits can be explored.

Tax Implications on several modes of M&A

Basis	Asset Sale	Slump Sale	Share Sale
Taxability for seller under income-tax laws	Non-depreciable capital assets (like Land): Capital gains taxed at 20% (with step-up cost) if held for more than 2 years* Transfer of Stock is taxed as business income.	Fair Market Value (FMV) of the capital assets on the transfer date will be considered the full value of consideration. Rule 11UAE of the Income-tax Rules, 1962. Cost of acquisition = Net Worth of the Undertaking (the total value of assets of an undertaking or division, less the value of its liabilities	Discussed in the previous slide
Section 281 certificate	Requirement to obtain a no-objection certificate ("NoC") from the income-tax authorities in case any tax litigation is pending.	Requirement to obtain a no-objection certificate ("NoC") from the income-tax authorities in case any tax litigation is pending. There is no explicit guidance on whether "undertaking" will be covered under section 281. Buyers in many cases still ask for the same as a proxy from the accountants to cover any pending litigation risks.	Not required.

Tax Implications on several modes of M&A

Basis	Asset Sale	Slump Sale	Share Sale
GST laws	• GST is applicable on movable assets. It ranges between 0 to 28% depending on nature of goods. • Credit of GST so paid is ordinarily allowed as set-off.	GST not applicable and GST credit can be carried forward by the buyer.	GST not applicable
Stamp duty laws	Stamp duty is applicable on immovable property. The duty rates vary from state to state.	Stamp duty is applicable on immovable property. The duty rates vary from state to state.	Applicable on a certain percentage of the sale consideration.
Tax loss carryforward	Not allowed	Not Allowed	Ordinarily not permissible. **(except where the change in shareholding does not exceed 49%)**
MAT Credit carryforward	Not allowed. Minimum alternate tax (MAT) Credits remain with existing entity	Not Allowed	Carryforward is allowed

Tax Implications on several modes of M&A

Basis	Asset Sale	Slump Sale	Share Sale
Items to be taken over	Specific Assets (cherry picking is allowed)	Assets along with liabilities of a particular unit of a business. However, it is not necessary that all liabilities pertaining to undertaking need to be transferred, provided what is being transferred qualifies as 'going concern'.	No specific transfer of any business assets. Change in Business ownership only to the extent of **shareholding transferred.**
Valuation requirements	The assets are to be valued at fair value and the consideration for the same should not be lower than said FV. In case of immovable property, the stamp duty valuation is considered instead of fair value.	• Fair Market Value (FMV) of the capital assets on the transfer date will be considered the full value of consideration. Rule 11UAE of the Income-tax Rules, 1962 outlines the calculation method for determining the fair market value of capital assets in a slump sale. • Applicable to immovable property	In case of equity shares, consideration can't be less than the book value of the share. Exchange controls require consideration to be higher than FV if the transfer is from resident to non-resident and vice-a-versa. However, this is neutral when the transfer is between non-residents only.

Advantages and Disadvantages

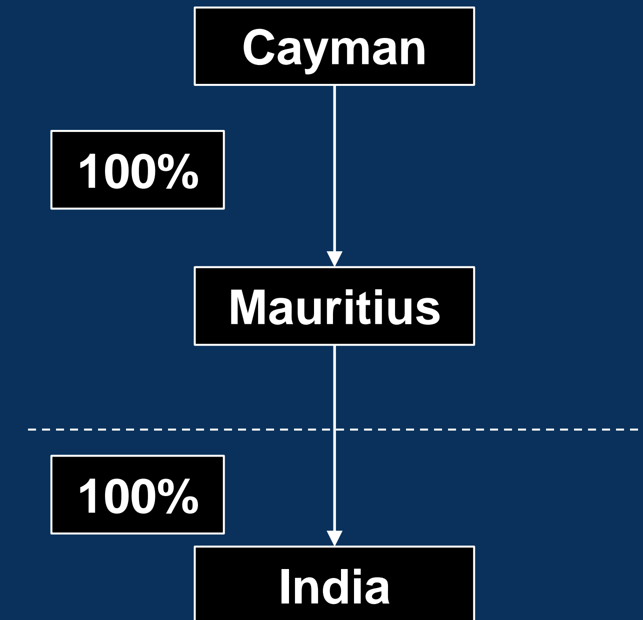
Basis	Asset Sale	Slump Sale	Share Sale
Advantages	• Specific assets that are identified by the business can be sold. • No approval from the court/tribunal required. • Liabilities can be left behind	• The slump sale allows continuity of business even after selling particular unit of the entity. • No approval from the court/approval required. • All liabilities of the unit transferred are done away with.	• Transfer of shares of a company is comparatively easier. • Generally, no approval from the court or any other authority is required. • Carry forward of tax losses allowed (subject to the change in shareholding does not exceed 49%).
Disadvantages	The seller is subjected to capital gains tax on the sale of capital assets which may come to be higher as tax on individual assets need to be paid.	The buyer assumes all the liabilities of the seller on purchase in a slump sale.	The existing entity continues to exist and thus, all historical and past liabilities ordinarily remains.

Indirect Transfer Provisions

Capital gains in relation to Indirect Transfer (introduced in the year 2012)

- Taxing the sale of shares located outside India on the basis that through such a sale, indirectly, underlying Indian assets are being transferred and hence, the same ought to be taxable in India.
- The substantial value threshold:
  - INR 10 crores~USD 1.2 million
  - Assets sold must represent at least 50% of the value of all the assets
- Facts:
  - Cayman Co. holds 100% investment in Mauritius Co.
  - Substantial value of shares of Mauritian Co. is derived from the shares of Cayman co.
  - Cayman co. sells the stake in the Mauritius co.
- Are there going to be any tax implications in India?

Since the value of Mauritius co. is derived substantially from Indian co., the sale of such shares shall be taxable in India due to the indirect transfer provisions.



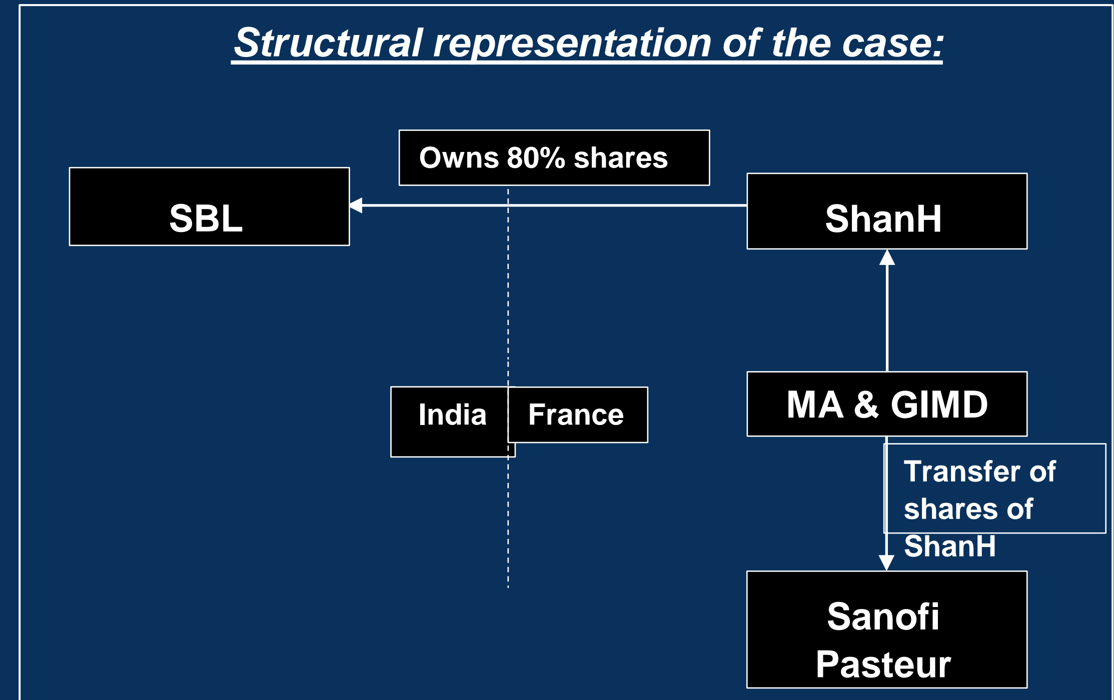
Tax Ruling - Sanofi Pasteur Holding SA

Facts of the case:

- ShanH is a JV of two French entities, MA and GIMD. ShanH holds 80% shares in the Indian entity SBL.
- Sanofi sought to buy share capital of ShanH from MA/GIMD.
- MA/GIMD sought an advance ruling on the taxability of share transfer in India.
- AAR held to tax such gains under *Article 14(4) of the India-France DTAA* by virtue of indirect transfer of shares of SBL.
- Further, a writ petition was filed before the Andhra Pradesh High Court.

Revenue's Contentions:

- MA and GIMD are legal and beneficial owners of SBL shares.
- MA and GIMD realized the gains from transfer of shares *(representing participation of more than 10% in the capital).*
- Thus, gains are chargeable to tax under *Article 14(5) of the India-France DTAA (the DTAA)*



Sanofi Pasteur: *Sanofi Pasteur Holding SA*
MA: *Meriuex Alliance*
GIMD: *Groupe Industrial Marcel Dassault*
ShanH: *ShanH SAS*
SBL: *Shanta Biotechnics Limited*

**[2013] 30 taxmann.com 222 (Andhra Pradesh)*

Tax Ruling - Sanofi Pasteur Holding SA

Assessee's Contentions:

- ShanH is a JV and was not designed for ***tax avoidance***.
- ShanH has commercial substance in SBL and is legal and beneficial owner of SBL shares.
- France has the right to tax capital gain as per Article 14(5) of the DTAA.

{Article 14(4) provides that where shares being transferred derive its value substantially from property situated in another state, gains shall be taxable in other state.

Article 14(5) provides that gains from the transfer of shares (other than covered in Article 14(4)) representing a participation of at least 10% in a company resident of a State shall be taxed in that State.

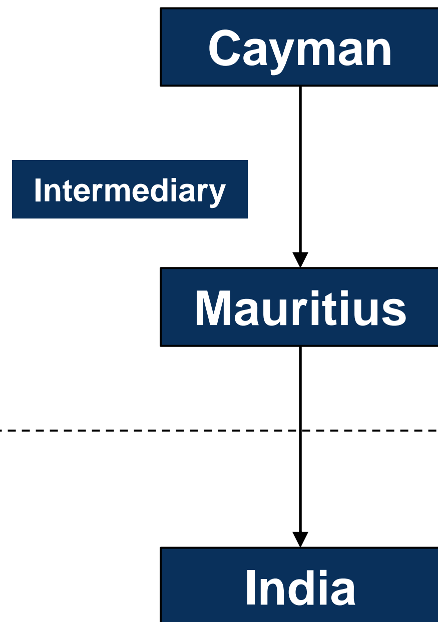
Article 14(6) provides that gains (other than covered in other articles) shall be taxable in the state of which the transferor is resident.}

High Court's Ruling:

- The High Court upheld the view of the assessee.
- It was held that the retrospective amendment vide Budget 2012 ***had no impact on the DTAA.***
- Hence, gains shall be taxed in France as per the literal interpretation of Article 14(5) of the DTAA.
- *Hence, the retrospective amendment of bringing the indirect transfer of shares within the tax net had no impact on the DTAA.*
- SLP filed in the Supreme Court by the ITD, later withdrawn in 2022.

Inbound and Outbound – Through Intermediary

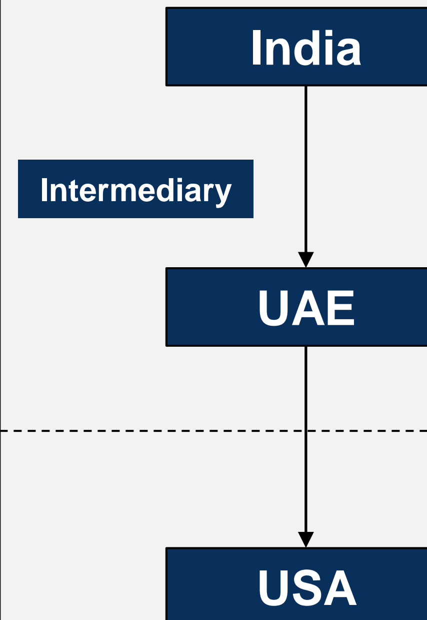
❑ **Inbound acquisition**



Main issues

- POEM implications
- Round Tripping
- Restrictions on subsidiaries

❑ **Outbound acquisition**



Main issues

- Treaty benefits
- Ease of doing business in overseas jurisdiction
- Fund repatriation
- Transfer Pricing (Thin Capitalisation)
- Deductibility of interest
- Corporate Guarantee

Mergers and Demergers

❑ **Elements of a Merger**	❑ **Elements of a Demerger**
Merger of companies • All assets and liabilities of the transferor company are transferred to the transferee company • At least 75% of shareholders (value-wise) of the transferor company become shareholders of the transferee company • No bar on which kind of shareholders Amalgamating and Amalgamated Company • Capital Gains – Exempt Transfer • Transfer of capital assets by Transferor to Transferee – Amalgamated Co – Indian co. – Exempt • Transfer of shares by shareholders of amalgamating co on extinguishment in exchange for shares of amalgamated co.	Demerger of an undertaking • All properties and liabilities of the undertaking are transferred to the resulting company at the book values • Resulting co issues Shares as consideration on a proportionate basis • At least 75% of shareholders of the demerged co become shareholders of the resulting co • the transfer of the undertaking is on a going concern basis “Undertaking" shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Carry forward of Losses

- Accumulated losses and unabsorbed depreciation* are allowed to be carried forward in the books in case of merger.

- The amalgamation must be of a company owning an "industrial undertaking" or a hotel or a ship, with another company.

- Industrial undertaking means an undertaking engaged in manufacture or processing of good, manufacture of computer software, generation/distribution of electricity/ power, telecommunications services etc.

Unabsorbed depreciation takes place when one is unable to absorb a portion of depreciation in their book of accounts. Such a situation can take place when one's profits are not enough to balance depreciation.

- **Certain conditions that needs to be fulfilled**:
  - The amalgamated company hold ¾th of the book value of the fixed assets acquired for 5 yrs.
  - Amalgamated company carries on same business as that of amalgamating company for a period of 5 yrs.
  - The old company was in the business whose loss and depreciation were unabsorbed for the last 3 yrs.
  - Amalgamating company was holding ¾th of the same fixed assets it was holding for last 2 yrs.

Challenges in a Business Transfer

Determining Cost of Acquisition of the ‘Undertaking’

- The transfer of business is considered as a “Slump Sale”.
- Taxability is determined as per Section 50B of the Act.
- The cost of acquisition of an undertaking is taken to be its “Net Worth” without the benefit of Indexation.
- Form 3CEA duly signed by a Chartered Accountant needs to be submitted by the seller along with their tax return to certify that the net worth has been calculated in accordance with the provisions of the Act.
- Net worth needs to be determined as on the date of transfer as held by certain rulings of the court.
- The treatment of **negative net worth** has been a subject of contrary views of courts. Some jurisprudences held that it should be ignored and the cost shall be taken as Nil while the others decided that the negative net worth can’t be ignored.
- Another section 50D is important here which states that where value of consideration is not ascertainable as on the sale date, market value of capital asset shall be deemed to be full value of consideration in such case.

An example (Negative Net worth):

Sale consideration – USD 1000

Total assets – USD 700
Total Liabilities – USD 1100

Net worth – Negative USD 400

Capital gains calculation:

Sale consideration	– USD 1000
Less: Net worth	**NIL**
Capital gains	USD 1000

Challenges in a Business Transfer

Goodwill V. Non-Compete

- Treatment of excess paid over the net worth can be characterized either as goodwill or as non-compete fees.
- An important thing to note is that, under a slump sale transaction none of the assets should be assigned individual values otherwise the transaction be considered as itemized sale of assets.

❑ **Treatment of goodwill under the Act**

- The buyer cannot claim depreciation on depreciation and needs to pay taxes on excess depreciation claimed.

❑ **Treatment of Non-compete fees under the Act**

- Depreciation may be claimed or treated as a revenue expense.
- The seller is required to pay tax as business income.

Challenges in a Business Transfer

Certificate under Section 281

- Section 281 of the Act outlines that certain transfer shall be deemed void.
- It applies when a charge is created on the assets or transfer of an asset is made during the pendency of the assessment proceedings or tax litigations under the Act.
- A certificate is required to be obtained from the tax officers.
- This is a very crucial consideration under M&A to avoid any future dispute or further litigations.
- In some cases, even where there is no litigation, buyers may insist for an Accountant's certificate in proxy (except in cases of group transactions).

Foreign Direct Investment (FDI)

- Investments by non-residents in Indian companies governed by Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.

Non-debt Instruments includes:

- All investments in equity instruments in all incorporated entities
- Capital participation in LLP
- All instruments of investment recognized in the FDI Policy notified from time to time
- Investments in units of AIFs, REITs and InvITs
- Investment in units of mutual funds of Exchange-Trade Fund which invest more than 50% in equity
- Junior-most layer of securitization structure
- Acquisition, sale or dealing directly in immovable property
- Others as specified by the government

Equity Instruments include:

- equity shares
- convertible debentures
- preference shares
- share warrants

Foreign Direct Investment (FDI) Conditions/Restrictions

- FDI means equity investment in an unlisted Indian company or 10% or more in the shares of a listed Indian company.
- Few of the sectors where FDI is not permitted includes manufacturing of cigars or tobacco, lottery, gambling and betting business.
- The FDI can be done by two routes namely automatic and government.
- Issue of shares under a scheme of merger or amalgamation approved by an Indian court is allowed subject to sector-specific caps.

Pricing guidelines

The shares cannot be issued to a non-resident for a price less than:

- In case of listed companies – As per SEBI
- In case of Unlisted companies, for a price determined by a CA or SEBI registered merchant banker

Representations and Warranties – Due Diligence Issues

Sellers' and target warranties (from warrantor)

- Given that the buyer is a stranger to the business, the warrantor, being in the know, assures the buyer of their veracity.
- The warrantor further assures the buyer of its legal capacity and authority to enter into the contract and the absence of any restrictions under contract, law or judicial pronouncements to do so.
- An **important representation provided by the warrantor** relates to the clear and marketable title to the assets or shares being sold as well as the authority of the warrantor to make such a sale.
- Another important representation is with respect to the financial health of the company as depicted in the financials.

❑ **From the buyer:**

- Represent and warrant as to their legal capacity and authority to enter into the contract without any restrictions.

Indemnities – Due Diligence (DD) Issues

Indemnification

- At the time of DD exercise, the buyer may seek specific indemnities arising out of the matters discovered during the DD. Where material issues are uncovered during a DD.
- Indemnification would also be sought for any inaccuracy, breach or misrepresentation of any warranties, fraud, gross negligence, or wilful misconduct on the part of the Seller or for any excluded liabilities.
- The buyer may choose to require the warrantor to resolve or mitigate the issues prior to the transaction or, in some cases, even choose to walk away. These are also known as conditions precedent and conditions subsequent.

Other Risk Protection Measures - DD Issues

Insurance

- Certain risks could be classified as relatively low or medium risk items. The buyer in those cases, may look to insure those based on DD report and feedback from the professionals involved in DD.

Valuation Adjustments

- To cover some liabilities like a certain tax demand, the buyer may look to adjust the same in the valuation if not addressed through CPs/CSs.

Withholding certain payments

- Buyers may also look to transfer certain payments to Escrows e.g. pending regularization of certain regulatory defaults.

Roll over of equity and Private Equity

Rollover Equity refers to the exit proceeds reinvested by a seller into the equity of the newly formed entity post-acquisition.

This becomes more important in Private equity investments.

Why is it preferred?

PE firms prefer or require equity rollovers for a variety of reasons.

First, using rollover equity aligns the financial interests of the purchasing PE firm and the founders, while also helping bridge valuation gaps.

Second, rollover equity may also be viewed as "cheaper" than paying additional cash, especially if the underlying business was priced using an aggressive enterprise value.

Taxation of Roll over equity is ambiguous in India as Real Income theory could be applied in favour of non-taxation

Insolvency and Bankruptcy Code

- The provisions of the Insolvency and Bankruptcy Code, 2016 (IBC) is applicable on stressed assets meaning companies undergoing insolvency or under liquidation.

- It is applicable to Companies and LLP where the amount of default exceeds approx. USD 1,20,000.

- The Corporate Insolvency Resolution Process can be initiated by the following in case of commitment of default by Corporate Debtor:

  - Financial Creditor
  - Operational Creditor
  - Corporate Debtor

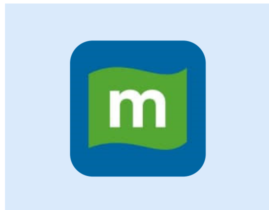
- **<u>Main issues</u>**

  - Write back of old loans – taxable or not? – In India, there is no explicit guidance on it.
  - Carry forward of business losses and unabsorbed depreciation
  - The continued clash between tax authorities and the insolvent target.

Acquisition under IBC – Case Study

- LEA member firm client. Helped them in acquiring a pharma API company under IBC.
- Issues due to Press Note 3 – restriction on Chinese investment
- Funding of the acquisition keeping in mind the foreign exchange restrictions
- The DD exercise led to findings of several liabilities (tax exposure ~ 150 mn USD) and risk associated to the aspects of withholding, inventory write-offs, exchange fluctuations, interest expense, depreciation, ongoing and past litigations, etc. Insights were available on the savings available as well concerning business losses and unabsorbed depreciation.
- The order of the concerned Tribunal provided several reliefs to the corporate debtor notably, carry forward of all losses, no tax implication for write-offs of large liabilities (both revenue and capital in nature), a clean slate i.e. the assets free from all past tax litigations.
- Presently, the Indian tax departments are still not very receptive
- The taxability of write-offs is a vexed issued

Media



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Budget 2023: What Startups CFOs want

Finance leaders in startups want simplification of the regulations and overall tax regime by introducing tax incentive schemes to augment the development and growth of more start-ups.

ETCFO • January 30, 2023, 08:47 IST

By: Amit Maheshwari

There are several expectations of finance leaders from the upcoming Budget on 1st February 2023 in order to propel the growth of startups.

Budget 2023 : Key Tax Highlights

The start-ups have been given the benefit of carry forward of losses from the current 7 years to 10 years from the date of incorporation of the same. Also, the time period on income tax benefit to companies registered as start-ups has increased to 31st March, 2024.

ETCFO • February 02, 2023, 09:22 IST

BY: Amit Maheshwari

The budget proposes several measures in the form of tax incentives to support the country's overall economic growth.

From the personal tax

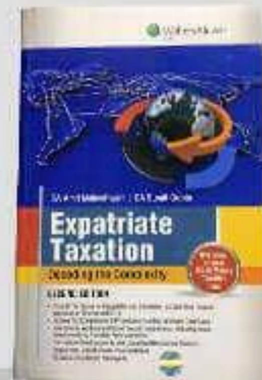
Recognition

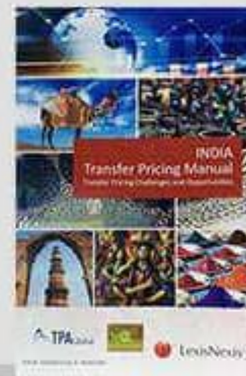
Authored by Partners

Expatriate Taxation - Decoding the Complexity

NRI Regulations – Decoding the complexity

India Transfer Pricing Manual- Transfer Pricing Challenges and Opportunities





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