MERGERS & ACQUISITIONS AND TAX ATTRACTIVENESS – AN ANALYSIS

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Abstract
In today's dynamic market conditions, the company come across with many opportunities and challenges to remain in this environment as alive and to ensure the perpetual succession of the company the companies adopt various strategies like mergers, acquisitions and corporate restructuring. These strategies not only increase the life of the companies but also provide the competitive edge over the competitors' but before adopting these strategies the companies have to take into consideration the scope of applicability of various taxes. With the help of this paper we are trying to provide the areas for special consideration for taxes. The tax implications are studied in terms of buyer and sellers, acquiring and acquired firms and shareholders perspectives. This paper provides a broad outline of tax advantages in legal perspective to the organization going for corporate restructuring form like mergers and acquisitions, buyout, takeover etc.

Key Words: Mergers, Acquisitions, Corporate restructuring, Share buyout.

Introduction

The terms mergers and acquisitions are often interchangeably used. However there are differences between the two terms. While merger means a unification of two entities into one, on the other hand acquisition means buying out the other organization and absorbs the same. Adoption of mergers and acquisitions leads to Cost cutting, efficient use of resources, tax advantage and avoidance of competition are few advantages which companies try to get by M&A deals. On the other hand the other hand the various advantage of tax

The Indian Income Tax Act 1961.It refers to amalgamations to mean merger of one or more companies with another company to form new company. There are different strategies of acquiring the business which we are trying to address in this research paper. The Indian laws starts its purviews with the transfer of capital assets in a scheme of amalgamation by the transferor company to the transferee companies it will attract the capital gain tax. However, if the amalgamated company is an Indian company, it is exempted from capital gain tax.

The transfer of capital assets by the amalgamating company will not be considered as transfers as to exempt the transaction from capital gain tax. The shareholders are also conferred exemption from capital gain tax. The shareholder will avail exemption as long as the two entities are Indian companies. However exemptions are not available when cross border M&A take place, unless the newly formed company after M&A is in Indian outfit. One of the major considerations will be the carry forward of tax losses to the acquired company so as to reduce the tax burden in the hands of the profit making acquirer company. Section 47 clearly indicates that amalgamation is not regarded as transfer.

Companies often undertake M&A to get the benefit of carry forward and set off of operating losses or tax credit

The condition insisted upon is that the acquirer should continue to operate the pre acquisition of the company. This will hold good in respect of cross border amalgamation

When the asset is acquired on amalgamation, the cost taken will have to be that of the amalgamating company, as provide under section 49(i)(iii) of the IT Act. Whether the tax incentives that encourage a merger activity are desirable or not, it is important to know what the impact is. The tax impact of properly structuring the disposition and acquisition of a company can have a very material impact on the economics of the transaction to both parties, there are numerous tax planning opportunities that allow each party to obtain it specific tax and economic objectives without harming the other party. This part deals with the implications of tax on shareholders of amalgamating company, implications on amalgamating and amalgamated companies.

Finance Act 1999 made amendments to avoid adverse tax implications in the case of demerger of companies. Transfer of capital assets by demerged company to a resulting resulting company is exempted under section 47VI (b). Transfer of shares are of an Indian company by a demerged foreign company to the resulting foreign company is exempt provided shareholders holding at least ¾ in value of the shares of the resulting company and the transfer is notable to capital against tax in the country where the demerged company is in corporate. This part summarize the work and there has been surprisingly little research question.

The provision of this clause clarifies that the provisions of sections 391 to 394 of the company act shall not apply in the case of such demergers. Transfer or issue of shares by the resulting company to the shareholders of the demerged company in consideration of the demerger of the undertake a king is exempt. The Indian tax act the individual and corporate level imposes an extremely complicated set of provisions for mergers and acquisitions; the tax system is certainly not neutral in this area. But dot axes really play a significant role in the merger decision.

M&A would raise some very pertinent issues and tax aspects, which we have tried to address in this paper , which were previously enjoyed by the acquired company in respect of its business incomes/expenses. How the gains from sale/transfer of the assets of the acquired company would be treated? And what about the allotment of shares in the acquirer company to shareholders of the acquired company? It will have impact on the two heads i.e. **Income from Profits & Gains of Business impacting** (Expense claims and exempt incomes) And **income under the head capital gains** arising from (transfer of capital assets of the acquired company and exchange of shares in the acquired company for share in the acquirer company.)

Methodology

Two ways of research have been used in writing this research paper

(a) Analytical research (b) Applied research

As far analytical is concerned materials and essential readings were made through different books and articles and application of mind was done to understand it in a better manner. In applied section we have tried to answer the question that arose in my mind in this regard.In this era of cyber age the potentiality of the intenet resources cannot be undermined.Consequently, researcher has referred to the intenet resources in the major portions of his paper. Researcher basically relied on internet to accomplish the paper. Reference has also made to newspapers .The researcher has tried to find out strategic implications of the decision of the board of directors for reconstruction of the companies. Further the researcher has tried to provide the basic concepts and introduction of these concepts, there use and significance in the deci-sion of the board as far as tax implications are concerned.

Objective Of The Paper

The objective of the paper is to understand the tax implications in the process of mergers and acquisitions of the companies.

M&A- Income Tax perspective

Through out the waves of mergers, there has been no shortage of explanations for the increase in the activity in the market for corporate control. Some explanations emphasize the positive role that mergers and takeovers play in the allocation of resources in society.For example,corporate acquisitions may lead to the replacement of a poor management team; they may facilitate the contraction of an industry in which no firm would voluntarily

Adopt reduction in size; they may generate synergies through the combination of complementary resources.

Yet clearly there are also explanations that have negative implications for social welfare.The most obvious, ofcourse, isare duction in the level of competition in a market.The tax motive has also been mentioned frequently. To the extent that corporation and their shareholders reap windfall gains via tax reductions, the treasury may be unintentionally subsidizing takeover activity that must be paid for by others in the fiscal system. It is note worthy, however ,that combining firms may also facilitate more efficient behavior on their own part by reducing their taxes. For example removing tax losses may increase firm‘s incentive to invest, particularly when new investment brings large ,immediate depreciation deductions and investment tax credits that can only beused by the tax paying firm.

The Income Tax Act, 1961,primarily governs levy and collection of Income Tax in India,where in it is provided that tax is levied on a―person in respect of his taxable income‘.The Act prescribes five basic head of income.It is further pro-vided that every receipt must qualify under any of the five heads for it to be taxable; else the same cannot be taxed

Seller and Buyer perspective-Merger could be tax Neutral

Seller's perspective

1. There will be no tax for the amalgamating company or its shareholders.
2. The Cost of acquisition of new shares would be the same as the cost of acquisition of shares held in amalgamating company. The period of holding of shares also to be ascertained from the time shares were held in amalgamating company.

Buyer's perspective

1. Amalgamated organization can avail the tax benefit in relation to the accumulated losses and the unabsorbed depreciation of the amalgamating company, in the previous year in which the amalgamation was effected, subject to conditions mentioned in law.
2. Tax Benefits available as tax incentive for export oriented units, expenditure incurred on scientific research, acquisition of patent rights/copyrights, expenditure on prospecting for minerals and amortization of preliminary expenses related to Transferor Company will be available to transferee Company.
3. Depreciation/ amortization on assets will be available on proportion basis to the transferorand transferee.

Tax Concessions

Following tax concessions are available if an amalgamation fulfills the conditions of Section 2(1B) and the amalgamated company is an Indan company:

1. Non-chargeability of capital gain on the transfer of capital asset including shares held by a shareholder at the time of amalgamation
2. Eligibility of amalgamated company for the deduction in respect of any asset capital expenditure incurred on scientific research,
3. Eligibility of the amalgamated company for the deduction in respect of acquisitions of patents or copyrights
4. Similar deduction in respect of expenditure on know-how as provided.

5. Amortization of expenditure for obtaining telecom licence fees
6. Amortization of certain preliminary expenses
7. Amortization of expenditure on amalgamation
8. Amortization of expenditure on prospecting etc.for certain minerals.
9. Writing off bad debts
10. Deduction in respect of any expenditure for the purposes of promoting family planning as
11. Computation of written down value of the transferred fixed assets in the case of amalgamated company.
13. Benefit of carry forward and set off of accumulated losses and unabsorbed depreciation

Types of Acquisitions in India

Depending upon the business strategy,an entity may acquire:

- The entire business ,by way of:Merger/Amalgamation or Share buy-out
- A part of the business,being a unit or an undertaking,by way of Acquisition through a Demerger or Slumpsale

The Act seeks to extend tax neutral treatment to transactions of mergers and demergers.The tax neutrality is subject to fulfillment of prescribed conditions under the Act.

Merger orAmalgamation

For a merger to qualify as amalgamation' under the provisions of the IT Act,the definition highlights that the following conditions need to be satisfied:

Section 2(1B)of the IT Act defines amalgamation as,"Amalgamation in relation to one or more companies means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred as the amalgamating company or companies and the company with which they merge or which is formed as aresult of the merger, as the amalgamated company)in such a manner that:

All the property of the amalgamating company or companies immediately after the amalgamationbecomes the proper`ty of the amalgamated company by virtue of amalgamation.

(a) No prescribed time limit exists within which the property of the amalgamating company should be transferred to the amalgamated company.

b) The requirement that the shareholders holding seventy five percent (75%) in value of the shares in the amalgamating company to be shareholders in the amalgamated company applies to both preference and equity shareholders. However, it does not prescribe any minimum holding in the amalgamated company,nor does it stipulate for how long they should continue being shareholders in the amalgamated company.

c)The consideration to the shareholders of the amalgamating company can be a combination of cash and the shares in the amalgamated company.

In Central India Industries Limitedv .CIT,it was laid down that amalgamation is an arrangement where by the assets of two companies comes under the control of one company(which may or may not be any one of the original two companies),which has as its shareholders all,or substantially,all the shareholders of the two companies

Implications under the Income Tax Act,1961

Tax implications can be understood from the following three perspectives:

a) Tax concessions to the Amalgamated (Buyer) Company
b) Tax concessions to theAmalgamating (Seller) Company
c) Tax concessions to the shareholders of an Amalgamating Company.

a) Tax concessions to the Amalgamated Company

(i)If the amalgamating company has incurred any expenditure is eligible for deduction under sections35(5), 35A(6), 35AB(3), 35ABB, 35D, 35DD, 35DDA, 35E and/or 36(1)(ix), prior to its amalgamation

with the amalgamated company as per section 2(1B) of the Act and if the amalgamated company is an Indian company.

(ii)All the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of amalgamation.

(iii)Shareholders holding not less than ¾ in value of the shares in the amalgamating company or companies (other than shares held there in immediately before the amalgamation or by a nominee for the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of distribution of such property to the other company after the winding up of the first mentioned company(1975)99ITR211

Then the benefit of the aforesaid sections shall be available to the amalgamated company, in the manner it would be available to the amalgamating company had there been no amalgamation. Also under section72A of the Act, the amalgamated company is entitled to carry forward the unabsorbed depreciation and unabsorbed accumulated business losses of the amalgamating company provided certain conditions are fulfilled.

b) **Tax concessions to the Amalgamating Company** Any transfer of capital assets,in the scheme of amalgamation,by anamalgamating company to an Indian amalgamated company is not treated as transfer under section 47(vi) of the Act and so no capital gain tax is attracted in the hands of the amalgamating company.

c)**Tax concessions to the Shareholders of an Amgamating Company**

When the shareholder of an amalgamating company transfers shares held by him in the amalgamating company in consideration of allotment of shares in amalgamated company in the scheme of amalgamation, then such transfer of shares in not considered as transfer under section47(vii) of the Act and consequently no capital gain is attracted in the hands of the shareholder of amalgamating company.

The above are only few out of the various tax concessions available to the aforementioned categories of the assesses due to M&A transactions.

In the following discussions, wherever applicable, appropriate inputs are given in case of specific requirements relating to acquisitions by foreign entities. Where an Indian target entity is sought to be acquired by a foreign entity, it may be noted that the corporate laws permit only domestic companies to be amalgamated.So the foreign acquirer have to create a local special pur-pose vehicle (SPV) in India to give effect the amalgamation with the Indian company and moreover the SPV avails the tax benefits on amalgamation under the Act since the same are subject to the amalgamated company being an Indian company.

Specific conditions for foreign companies to avail tax concessions on Merger/ De-Merger

In the case of foreign companies holding shares of Indian companies,on amalgamation or de-merger of the foreign company with another foreign company,the transfer of shares would enjoy exemption from capital gain tax, subject to the followingconditions:

(a) Atleast 25% shareholders of the amalgamating foreign company75%of shareholders of the demerged company continue to remain shareholders of the amalgamated foreign company/resulting foreign company and

(b) Such transfer does not attract tax on capital gains in the country of incorporation of the amalgamated company. Amalgamation when effective:– Date of amalgamation Every scheme of

amalgamation provides for a transfer date from which the amalgamation is effective i.e.,the Appointed Date‘. The effective date ‗is the date when the amalgamation actually takes place after obtaining the jurisdictional Court Approval and furnishing of the relevant documents with the Registrar of Companies. The effective date thus differs from the appointed date.To illustrate, the management of two companies have agreed that the merger shall be effective January1,2007(the appointed date).However, the merger may be completed say,on October 31,2007(the effective date).

For purposes of income-tax, the appointed date mentioned in the Scheme,and not the date of receiving the last approval for the amalgamation,should be considered

For the period between the appointed date and the effective date,the amalgamating company would carry on business as trustee of amalgamated company. During such period, provisional tax filing with adequate disclosure is required to be made.

Tax Implications on Mergers and Acquisitions

Mergers and acquisitions (M&As) are an accepted strategy for corporate growth.While they may create value, mitigate agency problems associated with a firm's free cash flow,enhance the firm's market power,or help in utilise tax credits.The tax impact of properly structuring the disposition and acquisition of a company can have a very material impact on the economics of the transaction to both parties.,there are numerous tax planning opportunities that allow each party to obtain its specific tax and economic objectives without harming the other party.

Capital Gains

Capital Gains refer to the spread between the cost of acquisition and sale price resulting From the transfer‗of a capital asset during the financial year.The spread is again where the sale price exceeds the cost of acquisitions and such gain is liable to tax in the hands of the transferor, unless other wise agreed. These changes were heralded,inter alia,through the abolition of the managing agency system,the passage of the MRTP Act 1969, the nationalization of the banking system in1969 and the announcement of new provisions granting tax relief in the Finance Bill for 1967.

Implications To Shareholders Of Amalgamating Company

Capital gains tax liability on the shareholders of the amalgamating company

Shareholders of an acquired corporation can receive many forms of payment when they sell their shares as part of a merger or acquisitions. Such receipts may be deemed taxable or non taxable. If it is taxable, then the shareholders must pay capital gains taxes on their gain .

The question whether allotment of shares, debentures, or payment of cash etc.to the shareholders of the merging company attracts liability to the capital gains is debatable. One view is that this results in the exchange of shares in merging company for the shares in merged company.Therefore, it would attract liability to capital gains tax.The contrary argument is that there can Be no liability to capital gains tax because there is no exchange of shares there are in effect two separate transactions. Definition of Transfer under the Act is quite wide and includes the sale, exchange or relinquishment of a capital asset or a right there in.Capital asset is defined to include property of any kind whether fixed or circulating, movable or immovable, tangible or intangible. It expressly excludes stock-in-trade, consumables; personal effects (exceptjewellery); specified agricultural land and specified gold bonds The income tax Act,1961 contains special provisions for some type of amalgamation and provides for some tax reliefs subject to

certain conditions. The tax relief relates to development rebate and development allowance. The finance Act,1967 extended the sphere of reliefs in tax matters in relation to anamalgamation. Under the Act, as amended, the issue of shares by the transferee company to the shareholders of the amalgamating companies will not by itself give rise to aliability to capital gain tax. The shares in the transferee company will be treated as the same as the shares in the amalgamating companies. It further appears that no part of the value of the shares received by shareholders in exchange under a scheme of amalgamation may be considered as dividend.Cancellation of shares of the merging company takes place when the company ceases to exist. Such cancellation of shares does not amount to transfer since the shares are extinguished. The expression―extinguishment of rights therein in the This process pre supposes the relinquishment of shares in amalgamating company held by shareholders there of.It is important to determine whether this constitutes a transfer under section 2(47) of the ITAct, which would be liable to capital gains tax. According to judicial prece-dentsinthisregard,including decisions of the Supreme Court till recently, this transaction did not result in a―transfer ‖asen vis aged by section2(47).

In the case of **Commissioner of Income Tax v. Mrs.Grace Collis and Another**,the SC has held that"extinguishment of any rights in any capital asset"under the definition of"transfer"would include the extinguishment of the right of a holder of shares in anamalgamating company,which would be distinct from and independent of the transfer of the capital asset itself.Hence,the rights of shareholder of the amalgamating company in the capital asset,i.e.the shares,stands extinguished upon the amalgamation of the amalgamating company with the amalgamated company and this constitutes a transfer under Section 2(47)of the ITAct. The provisions of Section 45 relating to capital gains will not apply to any transfer by a shareholder when a shareholder in the scheme of amalgamation transfers the shares held by him in the amalgamating company if the following conditions are satisfied

a) The transfer is made in consideration of allotment to him of shares in the amalgamated company; and

b) The amalgamated company is an Indian company.

The question is whether in the absence of or on failure to satisfy the conditions specified in Section 47(vii),a shareholder receiving shares in the amalgamated company is liable to capital gains tax. No such tax would be payable unless amalgamation involves was a transfer within in the meaning of section2(47).As a matter of Definition of transfer in section 2(47) denotes that the asset should continue to exist.

[2001]248ITR323(SC)Section47(vii)transfer ,in relation to a capital asset, includes,— (i) the sale, exchange or relinquishment of the asset; or (ii) the extinguishment of any rights there in; or (iii) the compulsory acquisition there of under any law;or (iv) in a case where the asset is converted by the owner there of into,or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment;][or]

[(iva) the maturity or redemption of a zero coupon bond; or][(v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act,1882(4 of 1882);or]

[(vi) any transaction (whether by way of becoming a member of, acquiring shares in,a co-operative society,company or other association of persons or by way of any agreement or fact even in the absence of Section47(vii) of the Act, a shareholder

need not pay any capital gains tax, since anamalgamation does not involve exchange or relinquishment of the assets or the amalgamation of any right there in or the compulsory acquisition under any law. It does not involve any exchange either within the legal meaning of that term.In the Act ‚neither the word" exchange "nor" relinquishment" is defined. Thus merger does not involve an exchange‘.The merger does not involve relinquishment of an asset because relinquisment postulates the continued existence of the asset.

Amalgamation doesnot involve an exchange or relinquishment of shares by amalgamating company as held in CITv.RasikLalManekLal·

B) Implications On Amalgamating Company

Capital gains tax implication for the amalgamating (transferor) company

There will be no capital gains tax on transfer of acapital asset by the amalgamating company to the amalgamated company in the scheme of amalgamation if the amalgamated company is an Indian company.

Charge of capital gains arises in respect of profits or gains arising from transfer of capital assets. Income is to be computed from the consideration for transfer. In other words if there is no consideration, capital gains can not arise.In case of merger, properties and liabilities of merging companies in the merged company by virtue of a court sanctioned scheme The consideration for such vesting flows directly to the shareholders in the form of cash, equity shares and the like.Thus so far as company is concerned, since it would not receive any consideration, no capital gains would arise in the hands of company.

Any arrangement or in any other manner what so ever) which has the effect of transferring, or enabling the enjoyment of, any immovable property:

There will be no capital gains tax on transfer of a capital asset by the amalgamating company to the amalgamated company in the scheme of amalgamation if the amalgamated company is an Indian company.

Exemption from capital gains tax to a foreign amalgamating company for transfer of capital asset, being shares in an Indian company

There will be no Capital gain on transfer of shares held in an Indian company in a scheme of amalgamation by the amalgamating foreign company to the amalgamated foreign company if the following conditions are satisfied.

a.At least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company,

b.Such type of transfers does not attract capital gain tax in the country in which the amalgamating company is incorporated.

In line with this approach, the Revenue authority recently issued notices to some companies who were engaged in deals in the recent past.

Exchange / Sale of Shares

(i)In relation to Amalgamation

Shareholders of the target company would become the shareholders of the amalgamated company by receiving shares in place of their existing shareholding. Basically such an exchange is transfer‘. However, Act does not regard it as a transfer, where the exchange is in consideration of allotment of shares in the amalgamated company and such company is an Indian company. Whereas interestingly any cash or other benefit given, fully or partially, in exchange for the shares would result in taxable capital gains.

(ii)Post Amalgamation Computation Of Capital Gains Tax On Disposal Of The Shares Of Amalgamated Company:

This section contemplates a situation in which shareholders of the amalgamating company, having acquired the shares in the amalgamated company as a result of

the amalgamation, now decide to sell off such amalgamated company's shares
Accordingly, when these shareholders sell their shares in the amalgamated company, for computing the capital gains that would accrue to them as a result of the sale,the cost of acquisition would be the costo f their shares in the amalgamating company.
Also the period of holding for determining long term or short term gains would begin from the date the shares were acquired by the shareholders in the amalgamating company.

Implicationson Amalgamated Company

a) Cost of Acquisition, where a capital asset became the property of amalgamated company in a scheme of amalgamation, the cost of acquisition of the said asset to the amalgamated company shall be the cost for which the amalgamating company acquired it.

b) Written down value in the hands of amalgamating company.
Where in the scheme of amalgamation, any block of assets is transferred by the amalgamating company to the amalgamated company being an Indian company, then the actual cost of the block of assets in case of amalgamated company shall be written down value of the block of assets as in the case of amalgamating company for the immediate proceedings as reduced by the amount of depreciation actually allowed in relation to the previous year. Explanation2(B)tosection 43(6),while computing the actual cost of the transferred assets in the hand of the amalgamated company ,depreciation actually allowed to the amalgamating company has to be reduced from the actual cost to the amalgamating company, in pursuance to this explanation However, depreciation remaining unabsorbed in the hands of amalgamating company is not to be reduced as depreciation actually allowed because the amalgamating company would cease to exist on amalgamation and therefore, it cannot carry forward such unabsorbed depreciation.

Carry forward and Set off of accumulated losses and unabsorbed depreciation
Companies often undertake M&A to get the benefit of carry forward and set off of operating losses or tax credit. The condition insisted upon is that the acquirer should continue to operate the pre acquisition business of the company.Unabsorbed losses and unabsorbed depreciation of the amalgamating company can be claimed by the amalgamated company

Other than the asset values for purposes of depreciation as discussed above,the following may also be noted: Depreciation for the year in which amalgamation takes place.

Typically an amalgamation would take place during the course of a taxable year.Depreciation is allowable on a pro-rata basisto both the amalgamating and the amalgamated company in the ratio of number of days for which they use the assets.

(i) Unabsorbed Depreciation For Prior Years The conditions for claiming carry forward and set off of unabsorbed depreciation are same as for unabsorbed business losses.

(ii) Treatment of unabsorbed Business Losses and depreciation
Subject to prescribed conditions,the unabsorbed business losses and depreciation of the amalgamating company can be carried forward and set-off against profits of future years of the amalgamated company.

The conditions are specified for both the amalgamating and amalgamated companies.These are restrictive and rigid.For instance, the benefit is available inrespect of anamalgamating company only in specified sectors, notably the service sector not being part of the list.

The Finance Bill, 2007, has extended the benefit of carry forward and set-off of accumulated business losses/depreciation to a public sector undertaking engaged in the business of operation of aircraft with one or more public sector undertakings engaged in similar business.This proposal is intended to facilitate the merger of Indian Airlines and Air India.

Acquisition of a part of Business (Demerger)

A demerger is a reorganization of a company where the assets and liabilities of an undertaking or part of anundertaking are transferred to one or more additional entities,viz. Resulting companies.[44]This transaction would not be regarded as transfer' provided the prescribed conditions under the Act are fulfilled. While there are no specific provisions under the companies act governing the demergers, transactions of this nature are effected through schemes of compromise or arrangement under dated October9,1967issuedbyCBDTS.72A(7) (b)—unabsorbed depreciation ‖means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be,which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or amalgamating company or demerged company,as the case may be, under the provisions of this Act, if there organisation of business or amalgamation or demerger had not taken place.] .

De-merger means transfer in pursuance to the scheme of arrangement under section 391 to 394 of the CompaniesAct,1956 by a Demerged Company of one or more of its undertaking to a Resulting company.The transfer should be in such a manner that

a) All the property of the undertaking of demerged company immediately before the demerger,become the property of Resulting Company
b) All the liabilities relatable to the undertaking immediately before the demerger,become the liabilities of Resulting Company
c) The transfer of properties and liabilities is at values as per the books of account
d) Resulting Companies issues its shares to the shareholders of demerged company on a proportionate basis in consideration of such transfer ;and
e) Shareholders holding not less than75% in value of its shares Indemerged company.(other than shares already held there in by or through nominees, of Reconstructed company or its subsidiary) become the shareholders of Restructured company.The following additional conditions are also to be satisfied

Transfer of the undertaking of the demerging Co.is on a going concern basis;

De-merger is in accordance with the conditions, if any,notified by the Central Government.(No conditions are notified so far).Mere acquisitions of assets or property of an undertaking of a company by another company is not contemplated as demerger'under the Act. Properties and liabilities for this purpose, have also been defined.

Tax impact in the hands of De-Merged Company & its Shareholders

Gains on transfer of capital assets–Not liable to tax Any transfer of a capital asset by the de-merged company to the resulting company under the Scheme of de-merger is exempt from capital gains tax, if the resulting company is an Indian company.

Issue/Allotment of shares–Not liable to tax

Under the Scheme of demerger, the shareholders of demerged company are issued shares in the resulting company on a proportionate basis.

Ak into amalgamation, the Act provides that any transferor issue of shares by the

resulting company to the shareholders of demerged company in consideration of the demerger would not be liable to tax in the hands of the shareholders under the head capital gains.

The cost of acquisition of shares in the resulting company shall be the amount, which bears to the cost of acquisition of shares held by the shareholder in the demerged company, same proportion as the net book value of the assets of the undertaking bears to the net worth of the demerged company immediately before such demerger.

Tax Impact On The Resulting Company Issue/Allotment of shares-whether liable to Dividend Distribution Tax

Pursuant to a demerger, distribution of shares by the resulting company to the shareholders of the demerged company (regardless of a reduction of capital in the demerged company) shall not be treated as deemed dividend' . Accordingly,the resulting company will not be liable to any DDT on such issue of shares.

Asset Values

(i) Actual Cost Of Assets

Under the Scheme of demerger, all the assets and liabilities of the demerged company (relating to the undertaking or division) are transferred to the resulting company at book value. In consideration of acquisition of such assets, the resulting company issues shares to the shareholders of the demerged company.Actual cost' is defined as cost of the assets to the owner reduced by cost met directly or indirectly by any other person or authority. Accordingly, the cost of the assets acquired by the resulting company would be the fair value of shares issued to the shareholders of the demerged company.

In order to prevent step up without recognition of gain, the cost of the capital asset in the hands of resulting company is restricted to mean the cost actually incurred by the demerged company as if the demerged company had continued to hold the capital asset for the purposes of its own business.

(ii)Cost Of Depreciable Assets

In the Scheme of demerger, all the assets (including depreciable assets) of the demerged company (relating to the firm) are transferred to the resulting company.
The WDV of the block of assets acquired by the resulting company would be the WDV of such assets of the demerged company immediately prior to the demerger

(iii)Depreciation Claims

Depreciation under Act is allowed at prescribed rates with reference to WDV of the specified block of assets.

(iv)Depreciation in the year of Demerger

In the year of demerger, depreciation is allowable on prorata basis to the demerged and resulting company in the ratio of number of days for which they use the assets.

Expenses in Connection With Demerger

Similar to the allowance for claim of the expenses on amalgamation, the resulting company may claima deduction of 1/5 th of the expenditure incurred wholly and exclusively for the purpose of demerger, over a period of 5 successive years, beginning from the previous year in which the demerger takes place.

Treatment Of The Accumulated Loss And Unabsorbed Depreciation

The accumulated loss and unabsorbed depreciation of the undertaking of the demerged company as belonging to the resulting company would be determined as under Accumulated loss and unabsorbed depreciation directly related to the undertaking or the division transferred of the demerged company would be deemed to be those of the resulting company;

Where the accumulated loss and unabsorbed depreciation is not directly relatable to the undertakingor the division transferred, then the same would be allocated to the resulting company on a proportionate basis,viz.,in the proportion of

the assets of the undertaking retained by the demerged company and transferred to the resulting company.The portion of accumulated losses/unabsorbed depreciation so allocated to the resulting company would be deemed to be those of the resulting company.The term accumulated loss and unabsorbed depreciation have been defined to mean so much loss or depreciation which remains to be allowed,if demerger had not taken place. It may be noted that unlike amalgamation, there is no provision relating to demerger which requires that the undertaking transferred should continue to be owned by resulting company.

Continuing Benefits In The Hands Of The Resulting Company

The provisions relating to continuity of tax holidays in case of demerger of specified undertakings/industria lundertakings are similar as prescribed in the case of merger/amalgamation.

Slump Sale

A number of companies are going for restructuring in order to increase their profitability. In restructuring exercise the companies sell off their unprofitable business activities or the business activities as a whole along with their assets and liabilities.The term slump sale means transfer of one or more undertakings by way of sale for a lumpsum consideration,without values being assigned to the individual assets and liabilities. Undertaking'may either be a part of the undertaking or a unit that can be regarded as abusiness activity in itself.

A.Tax impact on theTransferor company

Gains on transfer of the undertaking' Liable to tax Any profit and gain arising from the slump sale in the previous year,is chargeable to income tax as capital gains arising from the transfer of the undertaking.(Section.50B provides for special provision for computation of capital gain in case of slump sale) Where the undertaking is owned and held by the transferor for 36 months or less immediately preceding the transfer,the undertaking would be regarded as short term capital asset and the gains taxed accordingly.In other cases,the undertaking would be regarded as a long term capital asset even though such undertaking may have acquired certain assets which are held for less than 36 months.

The benefit of indexation of cost of acquisition is not available in case of transfers regarded as slump sale.The gain on transfer is computed by deducting the net worth (Net worth is the aggregate value,as per books,of the total assets as reduced by the total liabilities of the undertaking.)

The value of depreciable assets is determined as the written down value as per the Act,with book value being considered for other assets.Any upward or downward re-evaluation of assets is ignored;like wise,contingent liabilities are also ignored of the undertaking from the sale consideration.

The value of depreciable assets is determined as the written down value as per the Act,with book value being considered for other assets.Any upward or downward re-evaluation of assets is ignored;like wise,contingent liabilities are also ignored.

In a multiple undertaking entity which does not maintain undertaking wise financial records,computing the ne tworth may pose considerable difficulty.

Assets value

The value of the block of depreciable assets is reduced by the tax WDVof the assets sold as part of the undertaking.Besides,the transferor may continue to avail the benefit of carry forward and set off of unabsorbed business losses and unabsorbed depreciation.

B.Tax impacton the acquirer (transferee) company

Value of assets acquired

Cost of individual assets acquired by way of a lumpsum price

There is no specific provision for breakdown of the lumpsum price into separate asset value for determining individual asset cost in the hands of transferee. It is judicially accepted that the lumpsum price may be apportioned between the various assets on the basis of fair market values of the assets determined by acompetent valuer.It may also be noted that the Act does not mandate maintaining symmetry in the methods to be followed by the transferor and transferee while attributing values to individual assets.

The connected issue of allocation of any proportion of the lumpsum consideration towards goodwill and the claim of depreciationon the same will be dependent on the terms of the slump sale and the interpretation of tax law allowing depreciation on intangibles.

C.TreatmentOfUnabsorbedBusinessLossesAndDepreciation

The benefit of unabsorbed business losses and unabsorbed depreciation relating to the undertaking transferred shall not be available to the transferee company.

D.ExpensesIncurredOnPurchaseOfTheUn-dertaking

The Act specifically provides for deductibility in the hands of the transferee of the expenditure incurred wholly and exclusively for the purpose of amalgamation or demerger.In the absence of any similar provision for acquisition of a undertaking by way of slumpsale,The WDV of the block of assets determined in accordance with the provisions contained in sub clause(c)(i)(C)ofS.43(6)oftheAct.The expenditure may not be deductible and be treated as capital expenditure.

E.Tax Deduction For Interest On Borrowing Any borrowing by the acquirer to acquire a running business shall be treated as aborrowing for the purpose of business and interest of such borrowing therefore would be tax deductible. The deduction of interest is allowed in the year in which the withholding tax on such interest is paid. Interest in the nature of premium payable on redemption of bonds is deductible over the duration of such bonds.

In across border financing from a country with which India has entered into a Double Tax Avoidance Agreement , suitable structures may be used to leverage the rate of tax with holding on interest payable overseas leading to a reduction in tax liability in India as a result of the deductibility of interest.

Share Buyout

Acquisition by purchase of shares is the simplest form of reorganisation.It involves takeover without following the Court procedure under section 391-394 of the Companies Act.The shares are sold and registered in the name of the purchasing company or on its behalf. The selling shareholders receive either cash compensation or shares in the acquiring company as consideration for their shareholding.

Typically, a foreign company buysout the shares of Indian company from the shareholders of the Indian company.Where the foreign company acquires100% of the shares in the Indian Company, it results in the Indian company becoming a wholly owned subsidiary of the foreign company.The relevant tax implications are as under:

A. **Gains On Transfer Of Shares-Taxability in the hands of the Shareholders**

The consideration for exchange of shares in the target company flows directly to the shareholders in the form of cash,equity shares,and the like.Any non cash consideration in lieu of the shares transferred is taken at the fair market value.The exchange of shares would trigger a taxable gain,short-term or long-term,in the hands of the shareholders who would be liable to pay tax accordingly based on

the period of holding of the shares transferred.

B. Tax Implications On The Company After Change In Shareholding

B.1. Treatment Of Unabsorbed Losses

A change in shareholding in certain circumstances disen-titles a closely held company from carrying forward and
Setting off its losses. The Act provides that in case of a company not being a company in which public are substantially interested,where a change in shareholding has takenp lace in a previous year,no loss incurred in any year prior to such previous year shall be carried forward and set off against the income of the previous year unless on the last day of that previous year and on the last day of the previous year in which the loss was incurred, the shares of the company Carrying not less than51% of the voting power was beneficially held by the same person.

The exceptions to the above rule are:
(a) Where a change in shareholding takes place on account of the death of a shareholder,or transfer shares by way of gift to any relative of the shareholder;or (b) Any change in the shareholding of an Indian company, being a subsidiary of a foreign company, arising as a result of amalgamation or de-merger of the foreign company provided that 51% of the shareholders of the amalgamating or de-merged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.The provision applies to all losses, including losses under the head of capital gains'.However,it does not affect the set off of unabsorbed depreciation.

C. Assets Value

There would not be any change in cost of assets pursuant to the share buyout.

D .Depreciation Claims

Unabsorbed depreciation would be carried forward and be eligible for set off, not withstanding any change in the shareholding pursuant to the buyout. Further, there would not be any change in the depreciation claim to be made in the year of the share buyout.

E.Expenses Incurred OnTransfer Of Shares The expenses incurred on buyout of the shares may have to be treated as capital expenditure.

F.Takeover code

Where the Indian company is a listed company, the foreign company would have to make a public offer for the acquisition of the shares under the guidelines prescribed under the SEBI Takeover Code.

Mergers ,Acquisitions & Companies Act 2013 – Key provisions and Impact Analysis

The key provisions relating to mergers,compromises and arrangements in the2013 Act and an impact analysis of these provisions have been outlined below:

Fast–track Mergers

As in some overseas jurisdictions, the companies act 2013 has introduced the new concept of fast track mergers/demergers.Which provides the option of a simplified and fast track merger/demerger steps,which can be used for the following:

- 1.Merger of two or more specified small companies
- 2.Merger between holding company and its wholly owned subsidiary
- 3.Such other types of companies as may be prescribed in the above mentioned two points,the merger will have to be approved only by Central Government.

Approval Process

In the approval process,the schemes approved by the boards of directors of companies required to be sent to the Registrar of Companies and the Official Liquidator for their suggestions or objections within 30 days. Then the approved scheme wit suggestion and objections will be considered in the meetings of shareholders or creditors, and will have to be approved by the :

Shareholders holding 90% of the total number of shares in a general meeting.

Majority of creditors (representing 9/10 in value) in a meeting convened with 21days' notice. Currently, under the 1956 Act, the criterion of " Physical presence and voting"is essential for the conduct of shareholders' and creditors'meetings. But the same concept of "present and voting"has not been included in the 2013 Act.

After the approval of merger scheme, it is required to be filed with the Official liquidator,Registrar of Company and the Central Government. If there is no objection from the side of govt. then it is finally approved. But, in case of objections from the registrar of company or Official Liquidator, the scheme may be referred by the Central Government to NCLT (National Company Law Tribunal) for considering the scheme under the normal process of a merger.If it is mandated that the scheme is to be considered a normal merger,the company is at risk of the merger being considered a normal merger process instead of a fast track merger.

Impact Analysis

This provision is a new change to the long processes involved generally.This may help to reduce the administrative burden of the prevailing system, reduce the time frame in completing a merger and may reduce the costs of smaller companies that fall within upper limits.

Cross-border Mergers

The flow of transactions in a Cross-border Merger,could be internal (non-residents investing in India) or external (Indian business making investments in foreign countries). However, prevailing laws only permits internal mergers (foreigncompanies merging with Indian ones) and not the external mergers.The 2013 Act proposes to allow internal and external crosss border mergers between Indian companies and foreign companies.It provides for the merger of an Indian company into a foreign one,whether its place of business is in India or in certified jurisdictions (to be notified by the Central Government from time to time), depending upon the approval of the proposed National Company Law Tribunal and RBI's approval.The purchase consideration of a merger,which will also be subject to the approval of the RBI, it could be in cash or depository receipts,or partly in cash and partly in depository receipts.

Impact Analysis

Inclusion of cross-border mergers in company law 2013 is expected to help Indian companies in more ways than one, including in the following:

- Restructuring their shareholdings,In which the companies change ownership to an international share holding structure.
- Facilitating listing of companies, which may have Indian assets in foreign authority.
- Providing exit routes to current investors in foreign authority.

Cross-border mergers could have pioneer importance in plotting India on the global M&A , since corporate deals have fallen through or failed to meet their desired objectives in the past due to the lack of such provisions in the companies act 1956.

Mergers of listed Companies with unlisted Companies

The 1956 Act does not contain any specific provision regarding the merger of a listed company with an unlisted one.It is usually assumed that shares issued pursuant to the merger of a listed company with an unlisted one (or vice versa) required to be listed on the stock exchanges where the transferor company was listed. There have been situations, however, where the resulting company has continued to be unlisted after the demerger.

The Companies Act 2013 sets out formal guidelines and provides an option to a transferee company to remain unlisted or apply for listing, provided the shareholders of the merged listed company are offered an exit option. It also provides that provision should be made by the NCLT for

an exit route for the shareholders of a transferor company who decide to opt out of the transferee company by making payment equivalent to the value of the shares and other benefits, in accordance with a predetermined price or after a valuation report is formed.

Impact Analysis

An analysis of the new provisions of act brings some new aspects like attempts made to codify the existing practice while providing more clarity on valuation requirements. A specific provision in the 2013 Act, will encourage companies to go with this option as an alternative or in addition to the Delisting Guidelines. It is important to have a seemless interplay between SEBI's delisting regulations and these provisions listed a bove, especially in light of the requirements of delisting regulations, where minority shareholders effectively determine their own exit price. It is essential for implementation that the provision of the companies act 2013 should align with SEBI and Ministry of Corporate Affairs be aligned to suit the requirements.

Minority Buyout

The companies act 2013 has introduced an exit mechanism for minority shareholders.The Act grants access to the acquirer or person holding 90% or more of the issued equity share capital of the target company (listed or unlisted) by the way of amalgamation, conversion share exchange, , securities or for any other reason to acquire shares from minority shareholders subject to some compliances. Such an acquirer, person or a group of people will notify minority shareholders about their intention of buying the remaining equity shares.And minority shareholders may also off load their shares to majority shareholders.

Impact Analysis

The price mechanism for the minority buyback in case of a listed company will be the price according to the regulation of Security Exchange Board of India,but it is required to be carried out by a registered valuer.A registered valuer will provide a valuation report to the board of directors of a company, justifying the methodology of arriving at such a purchase price.Hence compulsory valuation by a registered valuer becomes essential. On the other hand, the shares of minority shareholders should be acquired by majority shareholders and not by the company and that will stop outflow of funds in the hands of the majority shareholders.

Mergers, Acquisitions and Companies Act 2013-Issues and Challenges

- The 2013 Act tries to simplify the overall process of acquisitions, mergers and restructuring, facilitate domestic and cross border mergers and acquisitions, and there by, making indian firms comparatively more attractive to investors. While some of the changes to look at the conceptual level include merger/demerger processes, cross border and fast track mergers between small companies and holding companies, subsidiaries and provisions related to minority shareholders' protection and exits,among others,a lot still needs to be done in terms of provision of increased clarity on some critical areas and the over all inter play of the 2013 Act with other laws.
  - The company's act 2013 provides for the constitution of the National Company Law Tribunal as the single authority for all schemes relating to restructuring. However, NCLT is yet to be constituted and become operational. Difficulties in implementation of provisions relating to restructuring will be a gap for restructuring till the MCA provides clarity on these issues.
  - There is no clarity on the aspect that fasttrack mergers will be allowed prior to NCLT becoming operational.Under prevailing tax laws, there is no need for a company to seek the approval of a court to prove the tax neutrality of a merger or demerger. However, clarity will be required in the case of fast track mergers involving non-court approved schemes.

- In case of cross border mergers, notification of the" specified jurisdictions'for crossborder mergers and the amendment of Exchange Control Regulations is yet to be made.This notification is important as it may restrict the scope of out bound mergers as well as inbound ones ,which are currently allowed from any jurisdiction that allow crossborder merger sunder their domestic laws.
- In case of merger of listed firm with unlisted firm, in a merger,practical issues may arise on the applicable date of valuation of shares (e.g.the appointed date,the effective date etc.) and procedures for compensating shareholders if the NCLT process consumes considerable time and in case of any disputes on the exit price determined on the basis of the valuation, the redressal mechanism for such disputes needs further clarity.
- The provision virtually recognize minority squeeze out as a legal option. However, there is not much clarity on whether this is a mandatory exit mechanism and a scenario where one minority shareholder desires to exist would the acquirer be forced to buy out all.

Conclusion

Several different ways that a companies may reduce taxes through merger or acquisitions and the tax benefits can accrue at the both the corporate and the shareholder level.In these transactions, taxes are a critical element to consider while evaluating the design of the merger or acquisition structure

The Indian Income Tax act at the individual and corporate level imposes an extremely complicated set of provisions for mergers and acquisitions;the tax system is certainly not neutral in this area.Tax issues have a major impact on the successful completion of transactions and post deal integration. Early involvement and development of a tax efficient plan/structure will maximize the return on deal.

A M&A transaction present a unique opportunity to implement tax planning and create substantial synergies which are unlikely to have been taken into account when evaluating the merger. These opportunities are therefore all upside.Similarly, if not planned and implemented properly,a mergercan create huge costs which were also not planned.

Prior to formal deals,letters of intent or commencement of due diligence, corporate should have developed a tax strategy that meets deal objectives. This strategy should include an identification of alternative tructures and a high level understanding of potential tax issues and opportunities.

The Indian corporate sector has also accelerated the trend of M&A for repositioning to seize the opportunities and meet the challenges in the emerging scenario.The underlying object of corporatere structuring is efficient and competitive business operations by increasing the marketshare, brand power and operational synergy.Indian companies are gearing up for global size operations.ˁSize of a company'has acquired central place as a strategy of survival and growth in the competitive economy.

There is no reason why the company and Income tax laws should not be harmonized.M&A will be easier if the time consuming processes under company law, like approaching the Company Law Board and the High Courts for approval,are either eliminated or made less cumbersome than at present.

The direct tax code seeks to simplify and rationalize the scheme of taxation with respect to amalgamations,demergers and other forms of business reorganizations as also the sale of businesses.

The major legal battles including the Vodafone dispute which would decide the fate of a large chunk of Foreign Direct Investments into India is much awaited and the challenge lies in balancing the interest of the investors and the revenue authorities.

The boom in cross borde rmergers and acquisitions has given new urgency to understand and manage the complex tax consequences of international expansion. There are very little globally accepted norms regarding tax law legislations.With India occupying an increasingly important place on the world stage, there is a need for India to mature in relation to administration of tax laws.

The new direct tax code that the Government is planning to introduce, to replace the current Income tax Act,Is expected to emphasize transparency and tax payer-friendliness.

No doubt that The CompaniesAct 2013 is an important legislation of recent years. It was in the making for almost a decade, in order to make the 1956 act more relevant to the changing economic and business needs.By this article we has analyzed the impact of some of the new provisions introduced by the act in respect of Corporate Restructuring in case of Mergers and Acquisitions.The changes proposed by the act and its implementation in many ways determine the effectiveness of company act2013.

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