

Cross-border mergers in India

Tax tangle



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Going global

Technology is doing wonders to create a common global economic platform. The entire world, including India, is gearing up to bring its tax and regulatory framework up to speed, while protecting individual interests. Over the past five years, we have seen a complete overhaul in the Indian accounting, tax and regulatory landscape in the form of the introduction of the Goods and Services Tax Act, 2017, Indian Accounting Standards (Ind AS), Income Computation and Disclosure Standards (ICDS), amendments to some of the most important tax treaties between India and Mauritius/Singapore, etc., and, now, the most-awaited reform in the form of cross-border mergers.

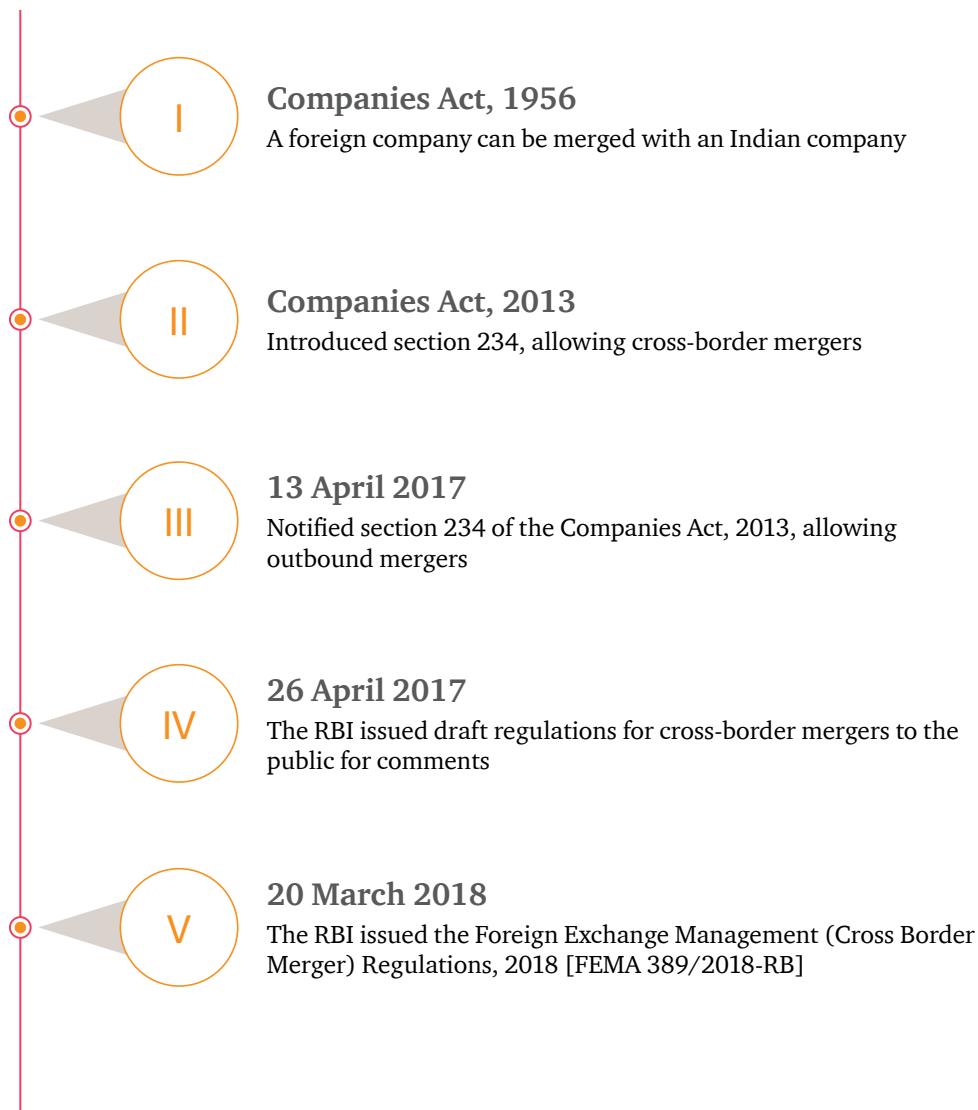
While, inbound mergers in India were always permitted under the Companies Act, 1956, the new Companies Act, 2013, paved the way for **outbound mergers** as well. This is in light of the suggestions made by the Expert Committee on Company Law in 2005 chaired by Dr Jamshed J Irani. The Reserve Bank of India (RBI) blessed the possibility of outbound mergers on 20 March 2018 and notified the key aspects to be taken care of in relation to cross-border mergers.

As of now, since the tax law remains unchanged, a plethora of questions arising out of outbound mergers with reference to the provisions in the existing law would need to be addressed.

Under this manual, we have analysed certain trigger points considering illustrative corporate structures for evaluating cross-border mergers and have attempted to highlight the tax tangle and other issues surrounding the transactions.

Cross-border mergers: Indian and global perspective

Evolution in India



Global overview

Allowed

Ireland¹
Luxembourg¹
Netherlands¹
United Kingdom¹
Mauritius²
Cyprus^{1,3}
France^{1,4}
Sweden^{1,4}

Not allowed

UAE
South Africa
Japan
Australia
Canada
Singapore

Notes:

1. As per EU merger directives, EU member states can engage in cross-border mergers (both inbound and outbound) with other EU member states only.
2. Mauritian tax and regulatory provisions allowed cross-border mergers with other countries. However, in light of the recent budget amendments in Mauritius, cross-border provisions may also undergo changes.
3. Countries where inbound mergers are allowed.
4. Inbound and outbound mergers are both allowed, subject to certain conditions.

Key aspects

Tax



- Capital gains tax
- Corporate tax rate vs foreign branch tax rate
- Foreign tax credit and transfer of other credits (direct/indirect)
- Minimum alternate tax (MAT)
- Interest deductibility
- Special economic zones (SEZs)
- Carry forward of losses



Regulatory



- Eligibility
- Exchange control framework (migration/new structure)
- Treatment of borrowings and guarantees
- Procedural aspects (resolutions, court approval, approval of any other regulatory body)
- Valuation report
- SEZs
- Reporting obligations
- Assignment/transfer of licences/contracts/intellectual property



Inbound merger

Triggers

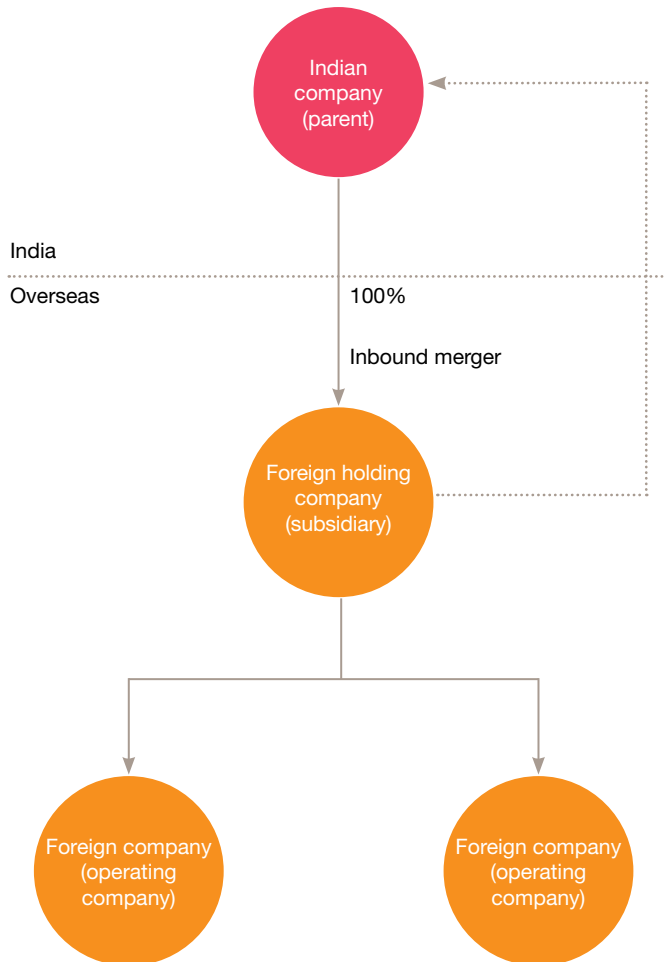
Consolidation of
overseas entities
(parent/subsidiaries)

Debt/interest
servicing

Place of effective
management
(PoEM)

Capital repayment
and exit to joint
venture (JV)
partners





Tax tangle

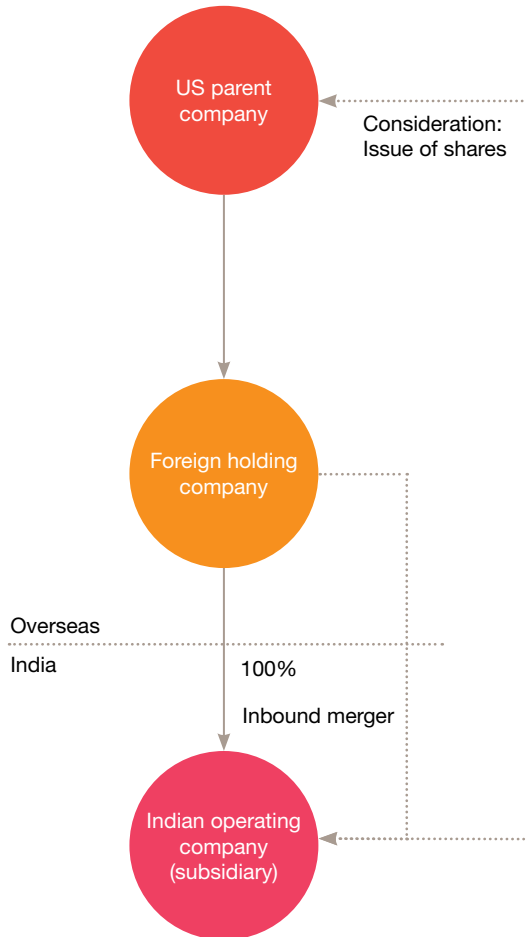


Indian company

- Receipt of assets/liabilities of a foreign company including its downstream investments, cash, etc.
- Extinguishment of shares of the Indian company held by the foreign company
- Whether the receipt of assets is to be construed as the receipt of dividend
- What would be the effective tax rate post-merger?

Foreign company

- Capital gains tax liability
- Tax and regulatory implications and compliances
- Can the distribution of assets be construed as distribution of profits?



Tax tangle

Indian company

- Receipt of assets/liabilities (debt) of a foreign holding company
- On the extinguishment of shares in the foreign holding company, the Indian operating company will have to issue shares to the US parent company
- Whether interest on foreign debt would be tax deductible

Foreign company

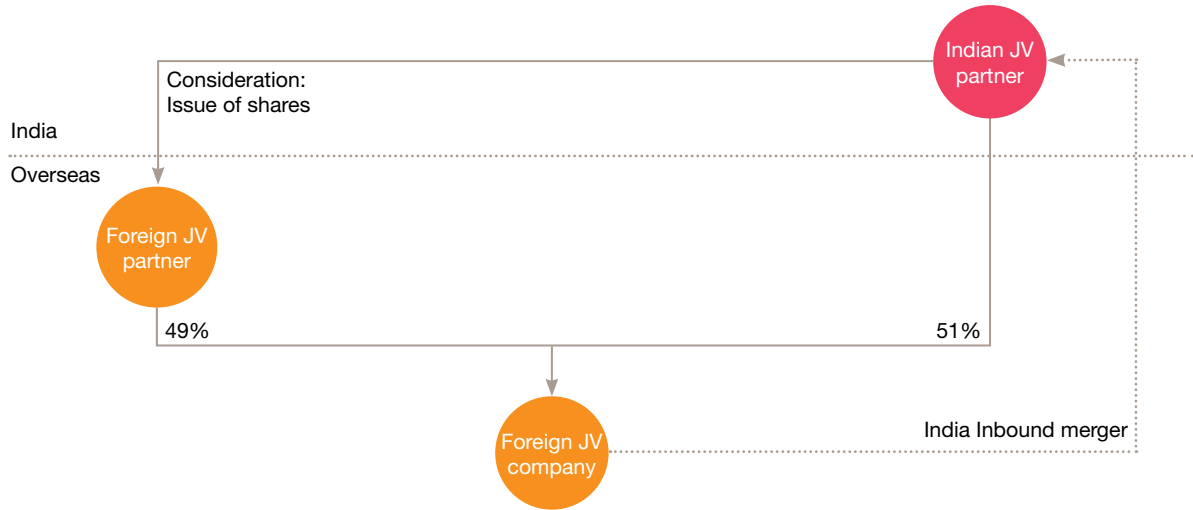
- Indirect transfer implications in India
- Future transactions to be covered by the India-US tax treaty
- RBI approval, if required



Scenario 3

Exit/collaboration

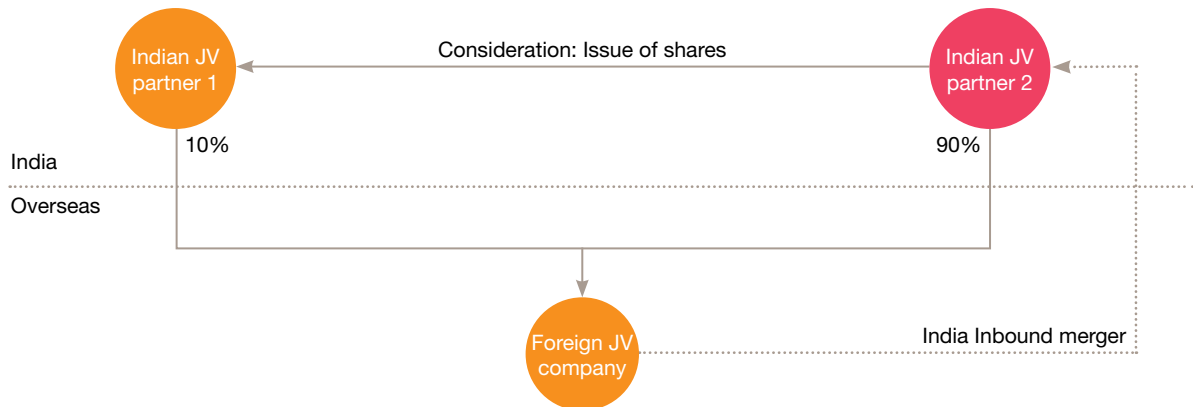
Inbound merger



Scenario 4

Exit/collaboration

Inbound merger



Outbound merger

Triggers

Consolidation of
entities (parent/
subsidiaries)

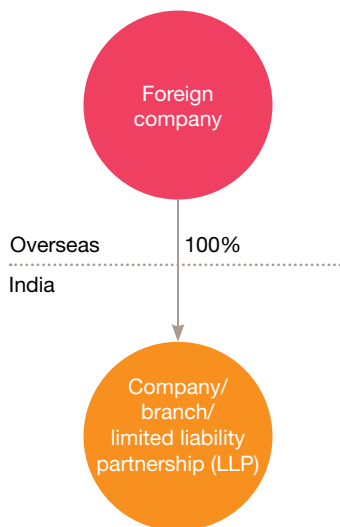
Debt/interest
servicing

Externalisation
and strategic
partnerships

Capital repayment
and exit of JV
partners

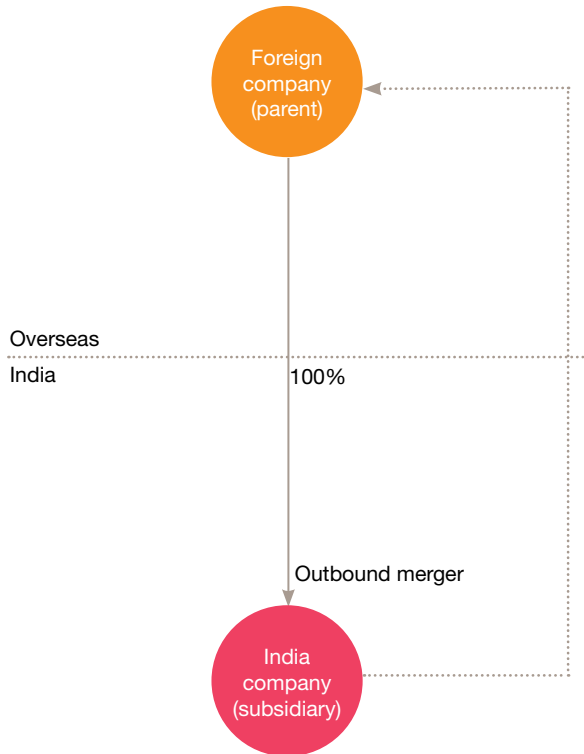


Entity structures



Particulars	Company	Company	Branch	LLP
Tax rate	29.1%*	34.9%	43.7%	34.9%
Profit before tax (PBT)	1,000	1,000	1,000	1,000
Less: Tax	291	349	437	349
Distributable profits after tax	709	651	563	651
Less: Dividend distribution tax (DDT) @ 20.56%	146	134	NA	NA
Surplus cash	563	517	563	651
Total tax cost	437	483	437	349
Effective tax rate (ETR) (in %)	43.7%	48.3%	43.7%	34.9%

*Note: Applicable for domestic companies having total turnover/ gross receipts of up to INR 250 crores in the FY 2016-17.



Tax tangle

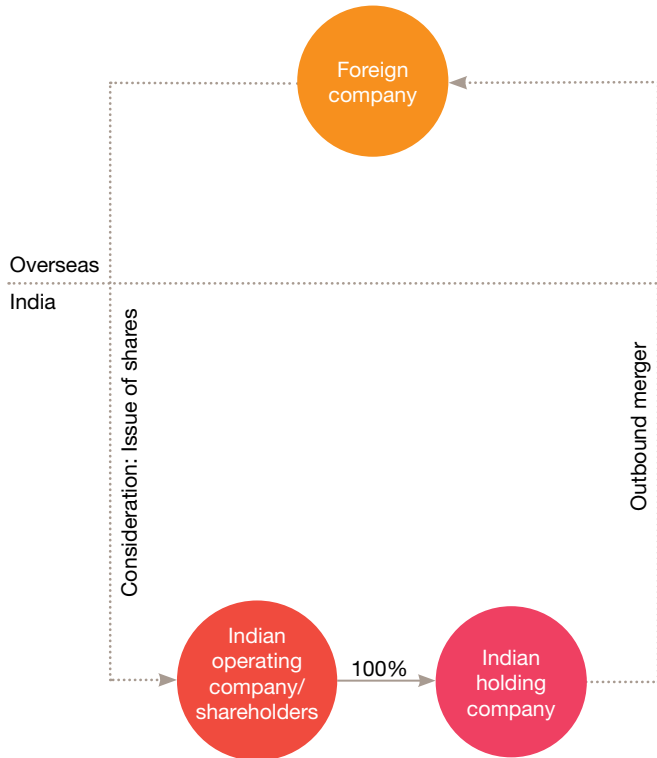


Indian company

- Transfer of assets/liabilities/business of the Indian company to its foreign parent
- Extinguishment of the foreign company's holding in the Indian company
- Whether a merger results in the distribution of free reserves to the foreign company
- Whether FEMA allows activities undertaken by the Indian company to be continued in its branch

Foreign company

- Extinguishment of shares held in the Indian company
- Receipt of the Indian company's business/assets/liabilities/free reserves



Tax tangle



Indian company

- Indian operating company/shareholders to receive shares of the foreign company
- Transfer of assets/liabilities of the Indian holding company to the foreign company

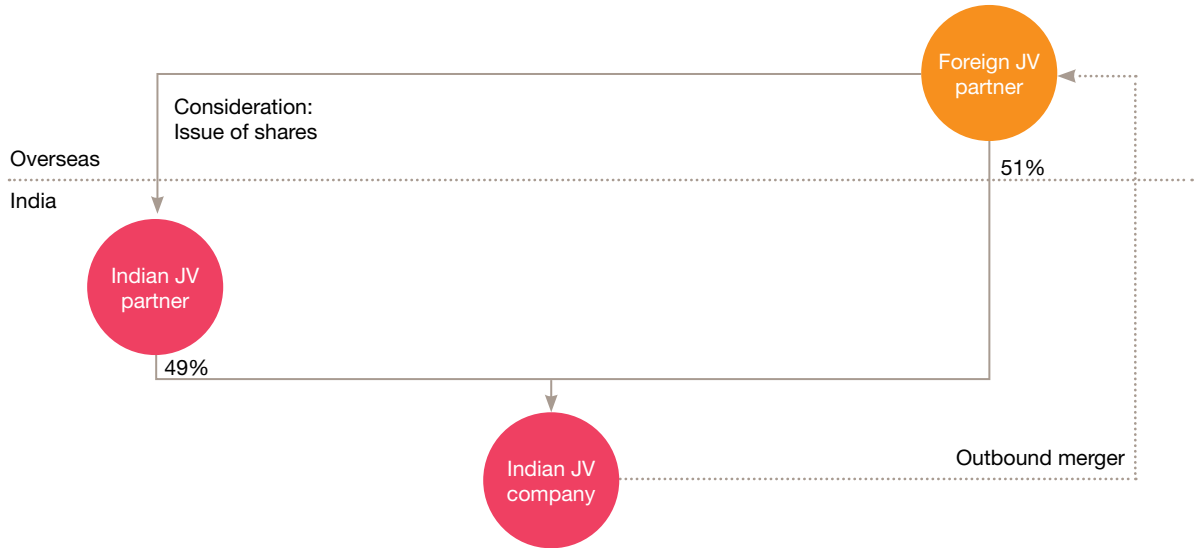
Foreign company

- Foreign company to issue shares to Indian operating company/shareholders
- Receipt of the Indian company's business/assets/liabilities/free reserves



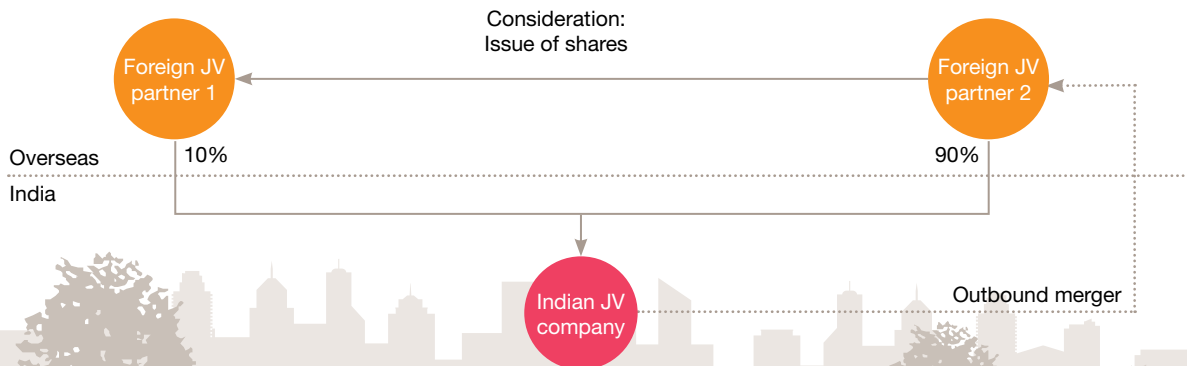
Scenario 3 Exit/collaboration

Outbound merger



Scenario 4 Exit/collaboration

Outbound merger



Relevant regulatory aspects



Relevant regulatory aspects

Indian branch

Branch of the foreign company in India:

Permissibility:

Normally, the branch office should be engaged in the activity in which the parent company is engaged, in particular:

- Export/import of goods
- Rendering professional or consultancy services
- Carrying out research work in which the parent company is engaged
- Promoting technical or financial collaborations between Indian companies and parent or overseas group companies
- Representing the parent company in India and acting as buying/selling agents in India
- Rendering services in IT and developing software in India
- Rendering technical support to the products supplied by the parent/group companies.
- Representing a foreign airline/shipping company

Remittances:

No restrictions



Foreign branch

Branch of an Indian company outside India:

Permissibility:

Normal business activities of the Indian entity

Remittances:

The total remittances made under this sub-regulation by the Indian entity to all such accounts in an accounting year shall not exceed:

- 15% of the average annual sales/income or turnover of the Indian entity during the last two financial years or up to 25% of the net worth, whichever is higher, where the remittances are made to meet initial expenses of the branch or office or representative; and
- 10% of such average annual sales/income or turnover during the last financial year where the remittances are made to meet recurring expenses of the branch or office or representative.



Indian company vs branch vs LLP

Particulars	Company	Branch	LLP
Liability upon the parent company	The liability of the foreign company is limited to the extent of its shareholding in the subsidiary company.	The liability of the branch office in India shall be considered as the liability of the foreign company.	The liability of the foreign company is limited to the extent of its capital contribution in the LLP.
Responsibility of directors/designated partners	The directors of the Indian company are responsible for compliance under Companies Act, 2013.	The directors of the foreign company are responsible for all compliance.	The designated partners are responsible for all compliance.
Decision making	<ul style="list-style-type: none"> By the board of directors and in certain cases with the approval of the shareholders Conducting an annual general meeting (once a year) Holding a minimum of four board meetings in a year Maintenance of statutory registers and minutes book, etc. 	<ul style="list-style-type: none"> The authorised representative acts on the instruction of the board of the foreign company. No requirement to conduct board meetings, annual general meeting/ maintain statutory registers in India. 	<ul style="list-style-type: none"> The conduct of the affairs of the LLP and any decision to be undertaken are governed by its LLP agreement. There is no mandatory requirement for holding a minimum number of meetings of the partners of the LLP, maintaining statutory registers.
Contribution to corporate social responsibility (CSR)	Companies meeting the prescribed threshold are required to contribute 2% of the average net profits of the preceding three years towards CSR.	CSR is applicable even to foreign companies having branch offices in India which meet the prescribed threshold.	Not applicable
Appointment of a company secretary	Private companies having a paid up share capital of 5 crore INR or more are required to appoint a full-time company secretary.	Not applicable	Not applicable

Cross-border mergers: Text of relevant sections of the Companies Act, 1956, and the Companies Act, 2013

Companies Act, 1956

Section 394: Provisions for facilitating reconstruction and amalgamation of companies

394(4)(b): 'Transferee-company' does not include any company other than a company within the meaning of this Act; but 'transferor-company' includes any body corporate, whether a company within the meaning of this Act or not.

Companies Act, 2013

Section 234: Merger or amalgamation of a company with a foreign company

Explanation: '...foreign company means any company or body corporate incorporated outside India, whether having a place of business in India or not.'

PwC team

Mumbai

Hiten Kotak
National Leader, M&A Tax
hiten.kotak@pwc.com

Alok Saraf
Partner
alok.saraf@pwc.com

Falguni Shah
Partner
falguni.shah@pwc.com

Hemal Uchat
Partner
hemal.uchat@pwc.com

Nilesh Mody
Partner
nilesh.mody@pwc.com

Rekha Bagry
Partner
rekha.bagry@pwc.com

Yogesh Dharnidharka
Partner
yogesh.dharnidharka@pwc.com

New Delhi

Ashutosh Chaturvedi
Partner
ashutosh.chaturvedi@pwc.com

Amit Bahl
Partner
amit.bahl@pwc.com

Annu Gupta
Partner
annu.gupta@pwc.com

Praveen Bhambani
Partner
praveen.bhambani@pwc.com

Prerna Mehndiratta
Partner
prerna.mehndiratta@pwc.com

Hyderabad

Janardhan Rao
Partner
janardhan.rao@pwc.com

Bengaluru

Ganesh Raju
Partner
ganesh.raju@pwc.com

Aditya Narwekar
Partner
aditya.narwekar@pwc.com

Amithraj AN
Partner
amithraj.an@pwc.com

Chengappa Ponnappa
Partner
chengappa.ponnappa@pwc.com

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