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Mergers and acquisitions: The evolving Indian landscape



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Preface



Hiten Kotak

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Just recently, the largest ever FDI transaction in India was announced, with the Russian government owned Rosneft and its partners acquiring Essar Oil for 13 billion USD. This is indeed a watershed moment for India and a revalidation of global faith in the potential and attractiveness of its economy. With FDI inflows into India already hitting a high in the last fiscal year, this marquee transaction will only provide a fillip to India's already burgeoning M&A landscape.

There has been a spate of high-profile transactions in India in the last few years, whether domestic or international, and both inbound and outbound. With the government continually working towards reforms on all fronts, be it in its regulatory policies to attract foreign investors, providing an impetus to the manufacturing sector with Make in India, improving India's Ease of Doing Business rankings, or providing solace to the much-beleaguered infrastructure sector by paving the path for real estate investment trusts (REITs)/infrastructure investment trusts (InvITs), there is no looking back.

Ever since the Vodafone tax litigation took the Indian M&A landscape by storm in 2007, tax aspects surrounding any M&As in India came to the forefront—so much so that corporates have now started taking tax insurance to insulate themselves from the uncertainties and vagaries of interpretation of Indian tax laws. Of course, while the government is making strides in trying to deliver the comfort of certainty to the investor community (such as by issuing clarifications on various aspects of indirect transfers), it is also tightening the screws on various fronts—the renegotiation of India's tax treaties, the looming advent of General Anti-Avoidance Rules (GAAR) in 2017 and the adoption of Base Erosion and Profit Shifting (BEPS) action plans.

On an allied front, practically all laws which could impact M&A transactions are in a state of evolution. The relevance and impact of Ind AS on transactions cannot be undermined, and professionals and chief financial officer (CFOs) alike have to undergo much unlearning. Companies are still straddling two Companies Acts—1956 and 2013. Securities Exchange Board of India (SEBI) laws are continually being revamped to bring in additional safeguards for the minority investor community. Every transaction is now subject to public scrutiny—with the spectre of potential shareholder activism looming large, the interest of public shareholders in any transaction is of paramount importance.

Against this background, with family-run businesses still being more of a norm than the exception in India, and globalisation of the same becoming imperative, succession planning has never been as important as it is today. This will not only serve as a means to safeguard businesses from potential inheritance tax but also ensure that legacies do not die out, that they keep up with changing times, and that conflicts and business impact are minimal.

We have enjoyed putting together this publication, which covers various aspects of M&A in India, and hope you enjoy reading it!

Warm regards,
Hiten Kotak

A man in a dark suit and tie is standing and presenting to an audience in a meeting room. He is smiling and gesturing with his hands. The audience is seated at desks with laptops, and a whiteboard is visible in the background. The text 'Section 1' is overlaid on a red background in the top right corner.

Section 1

M&A – the Indian landscape

Chapter 1: M&A – a catalyst in the current scenario

Merger and acquisition (M&A) is the path businesses take to achieve exponential and not just linear growth and therefore continues to generate interest.

The Indian M&A landscape is no different. M&As have become an integral part of the Indian economy and daily headlines. Based on macroeconomic indicators, India is on a growth trajectory, with the M&A trend likely to continue.

The catalysts for M&A could be varied, but, almost invariably, inorganic growth is on top of the agenda. This is especially so since even with the government's efforts to improve ease of doing business in India, the gestation period for greenfield projects continues to be long, often rife with compliance with multiple regulations. Thus, for any business, inorganic growth through M&A continues to be an attractive option.

Some of the other catalysts for M&A could be:

- Desire to reduce dependence and hence either backward or forward integration by way of investing in another function of the supply chain
- Distressed sales, leading to a business potentially being available 'cheap'

Several other catalysts of M&A activity globally are mirrored by India Inc.:

- **Regulatory considerations:** Considerations such as an anti-trust regime are forcing sale of business to curtail market share. While anti-trust provisions have been an important part of any transaction overseas since fairly long, often impacting not only timelines but also deal mechanics, they are still nascent in India, largely because of the ticket size of the transactions. However, the global merger of Lafarge and Holcim faced a hurdle in India, with the Competition Commission of India finally setting the sale of Lafarge India as a prerequisite to the global deal consummation in India, thereby paving entry for other players into India's cement market.¹
- **Consolidation:** Several sectors in India are in consolidation mode—for instance, the renewable energy sector (Tata Power acquired Welspun Energy's assets in June 2016 in a deal valued at over 9,000 crore INR²), the banking sector (Kotak Mahindra acquired ING Vysya Bank in November 2014 in an all-stock deal valued at over 15,000 crore INR³), the telecom sector



1 Pillay, A. (2016, 5 February). LafargeHolcim announces divestment plan for Lafarge India assets. Livemint. Retrieved from <http://www.livemint.com/Companies/SGfrvxHUU3sXWmb0BilP9O/LafargeHolcim-announces-divestment-plan-for-Lafarge-India-as.html>

2 Singh, S., & Barman, A. (2016, 13 June). Tata Power acquires Welspun Energy's renewable assets for Rs 10,000 crore. The Economic Times. Retrieved from <http://economictimes.indiatimes.com/industry/energy/power/tata-power-acquires-welspun-energys-renewable-assets-for-rs-10000-crore/articleshow/52718618.cms>

3 BS Reporter. (2016, 21 November). Kotak buys ING Vysya in all-share deal. Business Standard. Retrieved from http://www.business-standard.com/article/companies/kotak-mahindra-bank-to-merge-with-ing-vysya-bank-114112000844_1.html

(in January 2016, Reliance Communications announced the acquisition of MTS India from Sistema in an all-stock deal⁴) and the insurance sector (HDFC Life and Max Life announced a merger in August 2016, close on the heels of HDFC Ergo's acquisition of L&T General Insurance in June 2016⁵).

- **Sale of non-core assets, mainly to reduce debt:** With rising debt levels, many corporate houses have been forced to put a 'for sale' tag on several prized assets. Consequently, some notable transactions have taken place: Reliance Infrastructure's sale of its cement assets to Birla Corp in a 5,000 crore INR deal announced in February 2016⁶ and Jaypee Group's sale of cement plants to Ultratech for a deal valued at over 16,000 crore INR (July 2016),⁷ not long after it sold power plants to the JSW Group in 2015. All these deals were primarily undertaken to reduce debt.
- **E-commerce sector:** India's e-commerce sector is a hotbed of activity. With large global players like Amazon and Uber taking on a dominant role with their deep pockets, the sector is now in consolidation mode, which has become an imperative need for survival for many. For example, TinyOwl got acquired by Roadrunnr⁸ and Jabong was acquired by the Flipkart-owned Myntra⁹ at significantly lower valuations than they once commanded.

Whatever the triggers for any M&A, the benefits are undeniable. Some of them are enumerated below:

- Economies of scale
- Operational synergies and efficiencies
- Access to new markets, be it new geographies, new products or new lines of business
- Access to foreign capital
- Newer technology
- Garnering market share

Of course, with the increase in M&A activity in India, the tax and regulatory environment is continually evolving, with either several challenges arising or new avenues opening up:

- **Changes in government regulations:** Almost all relevant corporate laws/regulations in India have been revamped in the last few years, be it the Takeover Code, delisting guidelines, Companies Act, Accounting, Competition Law, etc. Tax laws are continually evolving and so are Foreign Exchange Management Act (FEMA) regulations, impacting both inbound and outbound investments.
- **Shareholder activism:** Though activism against M&A activity is yet to pick up as much steam in India as it has globally, with Indian retail investors largely going by sentiments than fundamentals, proxy advisory firms are increasingly looking at transactions with a microscope and are advising shareholders. Crompton Greaves' deal structure to segregate its consumer products business (to bring in a strategic investor) into a separate entity, while still retaining control with itself, had to eventually be changed to vertically split the businesses. Arguably, shareholder sentiment, fanned by proxy advisory firms against the original deal structure, was a significant trigger.
- **Tax concerns:** Starting from 2007, when the Vodafone controversy erupted, India has witnessed several high-profile tax controversies surrounding M&A transactions, which were on account of withholding tax obligations on indirect transfer of capital assets situated in India. With the advent of the proposed GAAR in 2017, structuring of transactions is set to become more vexed. It is likely that tax indemnity negotiations between parties could get more involved, and, to achieve certainty, more taxpayers could approach tax authorities (such as the Authority for Advance Rulings) for clarity. Tax insurance cover is also likely to be on the rise, though, in the Indian context, it may still be elusive or very expensive.

4 Business Today staff. (2016, 14 January) Reliance Communications acquires Sistema's MTS India in all-stock deal. Business Today. Retrieved from <http://www.businesstoday.in/sectors/telecom/reliance-communications-acquires-sistema-india-unit-in-all-stock-deal/story/225554.html>

5 ET Bureau. (2016, 9 August). HDFC, Max group merge life insurance businesses to create company worth Rs 67,000 crore. Economic Times. Retrieved from <http://economictimes.indiatimes.com/insurance/news/hdfc-max-group-merge-life-insurance-businesses-to-create-company-worth-rs-67000-crore/articleshow/53606911.cms>

6 Pillay, A. (2016, 15 February). Reliance Infrastructure to sell cement business to Birla Corp for Rs4,800 crore. Livemint. Retrieved from <http://www.livemint.com/Companies/0JkZpmTLNrHB78wwJr1s3M/Reliance-Infrastructure-to-sell-cement-business-to-Birla-Cor.html>

7 PTI. (2016, 5 July) UltraTech Cement strikes deal with Jaypee Group to bag its cement assets for Rs 16,189 crore. The Economic Times. Retrieved from <http://economictimes.indiatimes.com/industry/indl-goods/svs/cement/ultratech-cement-strikes-deal-with-jaypee-group-to-bag-its-cement-assets-for-rs-16189-crore/articleshow/53048776.cms>

8 Sahay, P. (2016, 4 June) Roadrunnr acquires Tinyowl, rebrands as Runnr. Livemint. Retrieved from <http://www.livemint.com/Companies/ZtTIUh3lh4cBnPFZ6GaJ/Roadrunnr-acquires-Tinyowl-rebrands-as-Runnr.html>

9 Verma, S. (2016, 26 July) Flipkart's Myntra acquires Jabong in \$70 million 'discount' deal. Livemint. Retrieved from <http://www.livemint.com/Companies/iicvYFijqp9VRAX0ON46I/Flipkarts-Myntra-acquires-Jabong.html>

- **Funding restrictions:** Indian companies have several restrictions imposed on them for funding acquisitions, especially in case of share acquisitions, making leveraged buyouts in India difficult. Local bank funding for acquisition of shares is currently still permitted only in restricted circumstances. However, with the advent of newer instruments like masala bonds and listed non-convertible debentures (NCDs), fundraising is set to become easier. Further, the external commercial borrowings (ECB) policy is also under liberalisation. Given the emergence of clarity on pass-through taxation of REITs, InvITs and alternative investment funds, it is likely that more companies will use them as a means to raise funds, either to lower their existing debt levels or for acquisitions (unlike overseas listing of unlisted Indian companies which never really took off, though the FDI policy was amended to allow it).

India continues to be an investment destination, with few corporate houses having the muscle to do outbound acquisitions the scale of Tata Tea's acquisition of Tetley, Tata Steel's of Corus, Lupin's acquisition of Gavis or Motherson Sumi's multiple acquisitions. The newest addition to the list of Motherson Sumi's acquisitions is Finnish truck wire maker PKC Group. With the opening up of the economy and the government's thrust on various initiatives, such as Make in India and Digital India, inbound M&A activity is only going to be on the uptick.

In the following chapters, we will delve into various aspects of M&A, especially from an Indian tax and business perspective, which is ever evolving. Aspects like easier delisting norms via an acquisition, dual listing, full capital account convertibility, opening up funding avenues and a stable taxation system will go a long way in making India's M&A activity the stuff of global headlines.



Chapter 2: The global scenario

M&A industry worldwide: Latest statistics and trends

The era of volatility has made it inevitable for a business to grow only through organic means.

The global M&A highlights sourced from Dealogic¹⁰ suggest that after three consecutive year-on-year increases, global M&A dropped to 3.84 trillion USD in 2016 from 4.66 trillion USD in 2015 (an annual record high), namely a decline of 18% year-on-year. Although cross-border M&A was down by 3% globally year-on-year, China's outbound volume hit a record high (225.4 billion USD) as did US inbound M&A (486.3 billion USD). October 2016 was the biggest month on record for global M&A, with 600.8 billion USD.

As per the EMIS (a Euromoney Institutional Investor company) Report on Asia Markets,¹¹ in the first nine months of 2016, activity surged in India, with a total of 712 deals and an increase of 135 deals year-on-year. The report also suggests that, in Asian markets, the increase in the volume of deals was the highest in the IT and Internet sector; however, the increase in value of deals was the highest in the finance and insurance sector.

Interestingly, the withdrawn M&A volume of 606.4 billion USD was the highest total on record in the first half of 2016 and the second highest full year since 2009. Causes for the withdrawal of M&A deals include difficulty in justifying valuations, negotiation and contracting difficulties between parties, etc.

Macroeconomic trends

The world economy is divided between mature and emerging markets. The recent trend of an increase in buyers from emerging markets investing in mature markets can have a dynamic effect on the deals space. Due to the monetary easing policies of developed countries, banks and corporates have more funds which are deployed towards M&A activities. With the US Central Bank increasing rates in 2016, there is bound to be an impact on corporates' ability to undertake inorganic expansion.

Capital markets are always a key influencer in M&A activities. The action taken by Federal Bank of USA is likely to affect worldwide capital markets, which would have to embrace lot of volatility before things stabilise. The insecurity is intensified due to events such as Brexit, the ramifications of which cannot be gauged yet.



¹⁰ Dealogic. (2016). Key trends that shaped the markets in 2016. Retrieved from <http://www.dealogic.com/insights/key-trends-shaped-markets-2016/>

¹¹ EMIS. (2016). Emerging Asia: Greater China, India and Southeast Asia. Retrieved from <https://www.emis.com/php/dealwatch/reports?subp=>

Commodity prices have been under pressure, and the sector is expected to undergo a phase of consolidation. Further, uncertainty regarding the policies of Donald Trump, the new president of the world's largest economy, has been sending confusing signals to emerging markets.

Cross-border activity by India Inc. on the rise

Cross-border activities are fuelled by several factors such as strong domestic cash flows, availability of cheap

finance, dynamic global demand, requirements of new markets and upgraded technologies. In order to fulfil any or all of these company objectives, the processes of M&A are quintessential.

Third quarter deals in India totalled 12.2 billion USD, the highest quarterly value in more than two years. Considering India Inc.'s cross-border activities in the nine months of 2016, the top two big-ticket deals in the arena of domestic, inbound and outbound activities are as follows:

Type	Acquirer	Target	Sector	Value (million USD)	Deal type	Stake (%)
Domestic	UltraTech Cement Limited	Jaiprakash Associates Limited	Manufacturing	2373.13	Acquisition	100
	Tata Power Renewable Energy Limited	Welspun Renewable Energy Private Limited	Energy and natural resources	1380.45	Acquisition	100
Inbound	The Yokohama Rubber Co. Ltd	Alliance Tire Group	Automotive	1,200.00	Majority stake	90
	Singapore Technologies Telemedia	Tata Communications Data Centre Private Limited	IT and ITes	616.00	Majority stake	74
Outbound	Indian Oil Corp. Ltd, Oil India Ltd and a unit of Bharat Petroleum Corp. Ltd	Tass-Yuryakh oilfield	Energy and natural resources	1286.76	Strategic stake	30
	Wipro Limited	Healthplan Services	IT and ITes	460.00	Acquisition	100

The Indian scenario and macroeconomics impacting India

As per the Credit Suisse Emerging Consumer Survey 2016,¹² India is at the top of the Emerging Consumer Scorecard, indicating a robust level of income expectations by the consumer and making India stand out in the emerging world.

Considering World Bank's Doing Business 2016 ranking, India has improved its global ranking, which clearly indicates the positive impact of various initiatives that the government has undertaken. The report specifically emphasises the improvement in the indicator of 'starting a business', which reflects the simplified process for initiating various start-ups and their rapid growth.

The regulatory reform of the Reserve Bank of India (RBI) allowing lenders (banks) to boost support for a debt

12 Kersley, R., & O'Sullivan, M. (2016). Credit Suisse Research Institute thought leadership from Credit Suisse Research and the world's foremost experts. Retrieved from http://www.ub.unibas.ch/digi/a125/sachdok/2016/BAU_1_6491744_2016.pdf

issued by a company to 50% from the erstwhile 20% has helped to enhance the credit rating of securities and spur the bond market. This regulatory reform would increase investor interest worldwide, and the increase in credit enhancement would inflate opportunities for the company to expand further. In addition, the opening up of the banking sector through the issuance of new banking licences, payment bank licences, etc., has provided a much-needed impetus to the financial sector and the overall economy.

Consolidation of banks, as suggested by the former RBI Governor, Raghuram Rajan, in the Report of the Committee on Financial Sector Reforms,¹³ is a clear measure to integrate banks with the global economy and aid them in achieving fuller capital account convertibility. The recent merger of State Bank of India (SBI) and its associate banks would increase SBI's asset base by five times more than that of the second-largest Indian bank, ICICI Bank, post-merger. In July 2015, a Press Information Bureau release by the Ministry of Commerce and Industry, Government of India,¹⁴ stated that there has been a 48% growth in FDI equity inflows after the launch of the Make in India campaign. This reaffirms the confidence of global investors in a resurgent India. In addition, it ensures that such initiatives lead to a positive growth environment.

In line with the above initiatives, the government has liberalised the FDI policy to increase the cap of FDI investments in various sectors. For example, the FDI cap in the insurance and pension sectors has been raised to 49%, and 100% FDI has been allowed both in railway infrastructure (excluding operations) and the defence sector. This has attracted large investments in the insurance and defence sector over the last 6–8 months.

Non-debt finance in the form of FDI pursuant to these liberalisations is an unseen advantage to the country.

The government recently took a bold demonetisation initiative that affected not just common people but also the economy to a great extent. It was an unflinching measure to merge the unorganised and organised sectors.

Due to demonetisation, banks have been flooded with funds. This surplus of funds with banks could lead to enhanced lending in high-growth sectors. Subsequently, increased lending may lead to reduced interest rates, bringing in multiple benefits such as lower cost of production to companies, higher profits and diversified growth. The manifold consequences of demonetisation could take growth in the Indian economy to new heights.

This favourable impact on India due to reforms in policy regimes could have a domino effect, leading to enhanced availability of resources for the country's future missions, including that of smart cities. In the World Economic Forum's Global Competitiveness Index, which ranks countries based on parameters such as institutions, macroeconomic environment, education, market size and infrastructure, India has jumped 16 notches to rank 39 among 138 countries.

Considering all the above initiatives, reforms, market trends, etc., it would be a conceivable dream for India to fulfil its funding requirement of around 1 trillion USD for infrastructure growth in sectors such as highways, ports and airways during the 12th Five-Year Plan (2012–17).

Let us look at the Indian M&A story in the next chapter and understand the typical modes of M&A transactions along with their regulatory framework.



13 *Planning Commission Government of India. (2008). A Hundred Small Steps: Report of the Committee on Financial Sector Reforms. Retrieved from http://planningcommission.nic.in/reports/genrep/rep_fr/cfsr_all.pdf*

14 *Press Information Bureau, Government of India, Ministry of Commerce and Industry. (2015). 48% growth in FDI equity inflows after Make in India. Retrieved from <http://pib.nic.in/newsite/PrintRelease.aspx?relid=123256>*

Chapter 3: M&A – the India story

Recent trends in Indian M&A

The Indian M&A landscape has witnessed several big-ticket deals in the past few years. At a time when Indian business houses are constantly looking at inorganic growth through acquisitions of other businesses, the M&A arena appears stronger than ever before now. Recently, a lot of consolidation in the form of mergers, share acquisitions and business acquisitions has been observed in telecom, cement, banking, power and insurance.

Modes for M&A transactions in India

i. Acquisitions

Acquisitions can either be in the form of share purchase, whereby controlling interest in the target is acquired, or it could be in the form of acquisition of a business undertaking. While share acquisition is an effective solution, where the acquirer seeks to acquire entire control over the target, it becomes inevitable for asset acquisition in cases where the acquirer wants to assume control of an identified business undertaking.

A share sale is usually for cash consideration to the shareholders of the target. In September 2016, Tata Power Renewable Energy Private Limited acquired shares of Welspun Renewable Energy Private Limited for around 1.4 billion USD (9,249 crore INR), thereby increasing its green energy portfolio by 1.14 GW.¹⁵

An acquisition of a business undertaking could be effected in various manners such as demerger of a business from the target, slump sale or slump exchange. In case of a typical demerger, the shareholders of the target are issued shares of the acquirer. In case of a slump sale/exchange, cash is paid or securities are issued to the target itself and not to its shareholders. The year 2016 has seen a number of such transactions, some of which are listed below:

- In May 2016, JSW Energy Limited (JSW), a listed company engaged in power generation, acquired 1 GW power plant from the heavily debt-laden Jindal Steel and Power Limited (JSPL) for 0.98 billion USD (6,500 crore INR) by way of slump sale by JSPL into its wholly owned subsidiary and share acquisition by a special purpose vehicle (SPV) of JSW.¹⁶



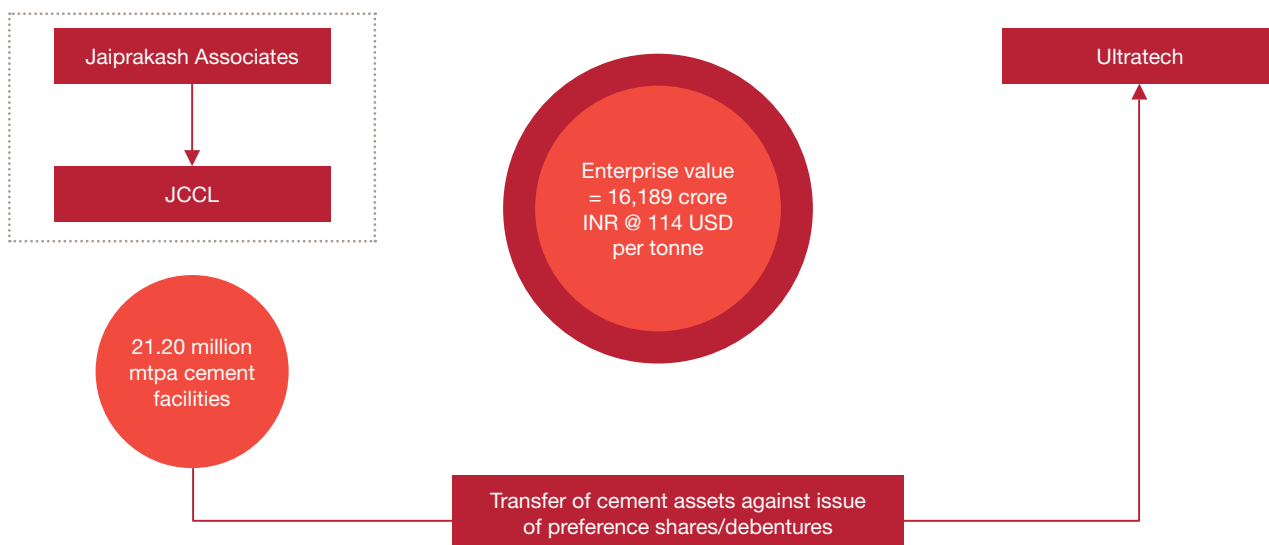
15 Tata Power Company Limited. (2016). Disclosure under Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, dated 12 June 2016. Retrieved from http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/DECCDF16_3AAA_47DC_9FCA_2BEB068B3251_080238.pdf

16 JSW Energy Limited. (2016). Disclosure under Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, dated 3 May 2016. Retrieved from http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/CF64CD6E_9522_4A2C_80C9_47DA675AAE2E_080046.pdf

- July 2016 saw a major consolidation in the cement sector by way of 'slump exchange' when the cement capacity of 21.20 million tonnes per annum owned by Jaiprakash Associates Limited (a part of the Jaypee

Group) was transferred to Ultratech Cement Limited, (the flagship cement arms of the Aditya Birla Group) for 2.4 billion USD (16,189 crore INR).¹⁷

Snapshot of acquisition of cement assets from Jaiprakash Group to Ultratech Cement



ii. Mergers

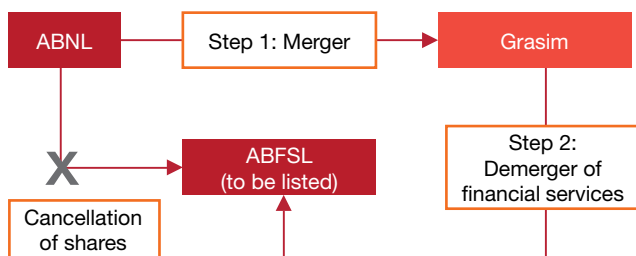
Simply put, a merger is a combination of one company into another, whereby the transferor company loses its existence upon merger with the transferee company. Various types of mergers include horizontal mergers (merger of companies involved in the same industry and in direct competition), vertical merger (merger of two companies operating in the same industry but at different level within the industry's supply chain) or

a conglomerate merger (where completely unrelated companies come together to achieve synergy benefits).

In a typical merger, the shareholders of the transferor company are allotted shares as consideration for their holding in the transferee company.

As recent as August 2016, an amalgamation of Aditya Birla Nuvo Limited (ABNL) with Grasim Industries Limited (Grasim), both being listed on stock exchanges, was announced in a bid to unlock shareholders' value and create a 9 billion USD (60,300 crore INR) consolidated enterprise. The entire arrangement would be undertaken in two steps as under:¹⁸

Snapshot of merger by consolidation and demerger of various business divisions of Aditya Birla Group



Last year, India's largest oil producing company, Cairn India Limited (Cairn), merged with the metals and mining giant Vedanta Limited (Vedanta) in an all-share deal amounting to 2.5 billion USD, whereby the public shareholders of Cairn would be allotted equity and preference shares of Vedanta.¹⁹

¹⁷ UltraTech Cement Limited. (2016). Disclosure under Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, dated 4 July 2016. Retrieved from http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/CA991FAC_A264_45DF_99FC_18604C14D22A_185136.pdf

¹⁸ Aditya Birla Nuvo Limited. (2016). Disclosure under Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, dated 23 August 2016. Retrieved from (http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/0CEC8BB4_42D8_4951_8B25_E8AC9D706B6A_184139.pdf)

¹⁹ Cairn India Limited and Vedanta Limited. (2016). Press Release dated 22 July 2016. Retrieved from http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/3915E1A5_7CB7_4782_8394_31AE8C31FE8E_171111.pdf

iii. Joint venture (JV)

A JV is a form of business arrangement whereby two or more companies having different capabilities or particular expertise come together to undertake a business venture. The rights and obligations, profit-sharing ratio, cost allocation and other commercial considerations of each JV are typically governed by the JV agreement mutually agreed upon between the joint venturers.

A recent deal between Reliance Communications Limited (RCom), a listed company, and Aircel Limited (Aircel), both engaged in the telecom sector, marked an alliance which would result in a combined asset base of 9.7 billion USD (65,000 crore INR). In this deal, the wireless telecom business of RCom will be transferred to Aircel and its subsidiary. The combined entity would be owned by RCom and the existing shareholders of Aircel.²⁰

Regulatory framework governing M&A transactions

i. Company law

An acquisition of shares is permissible with prior approval of the audit committee and board of directors. Share sale between related parties may also require prior shareholders' approval.

Previously, mergers or demergers were largely governed by sections 391-394 of the Companies Act, 1956. Recently, with effect from 15 December 2016, sections 230-240 of the Companies Act, 2013, were notified (except Section 234 of Companies Act, 2013), pursuant to which all the Schemes of Arrangement now require approval of the National Company Law Tribunal (NCLT) as against the High Court earlier. Procedurally, any scheme is first approved by the audit committee, the board of directors, stock exchanges (if shares are listed) and then by the shareholders/creditors of the company with a requisite majority (i.e. majority in number and 3/4th in value of shareholders/creditors voting in person, by proxy or by postal ballot). NCLT will give its final approval to the scheme after considering the observations of the Regional Director, Registrar of Companies, Official Liquidator, income tax authorities, other regulatory authorities (RBI, stock exchanges, SEBI, Competition Commission of India [CCI], etc.) and any other objections filed by any other stakeholder interested in or affected by the scheme.

ii. Income-tax Act, 1961

In case of a slump sale/sale of shares of an unlisted company, capital gains tax is chargeable at the rate of 20% or 30% on the resultant capital gains depending upon the period for which the undertaking/shares are held. In case of a sale of shares of a listed company, the capital gains arising on transfer of such shares on the stock exchanges would be exempt from capital gains tax or would be chargeable at the rate of 15% depending on the period for which such listed shares are held.

A classical amalgamation and demerger—i.e. amalgamation/demerger involving issuance of shares to shareholders to at least 3/4th in value of shares of the transferor company—is a tax-neutral transaction under ITA subject to the satisfaction of other specified conditions. This means that the amalgamation or demerger would not be subject to capital gains tax in the hands of the transferor company or transferee company as well as their shareholders. ITA also provides for continuity of business losses in the transferee entity subject to fulfilment of certain conditions.

iii. Securities laws

Any acquisition of shares of more than 25% of a listed company by an acquirer would trigger an open offer to the public shareholders. Any merger or demerger involving a listed company would require prior approval of the stock exchanges and SEBI before approaching NCLT. Further, under the Takeover Code, a merger or demerger of a listed company usually does not trigger an open offer to the public shareholders.

iv. Foreign exchange regulations

Sale of equity shares involving residents and non-residents is permissible subject to RBI pricing guidelines and permissible sectoral caps. A typical merger/demerger involving any issuance of shares to a non-resident shareholders of the transferor company does not require prior RBI/government approval provided that the transferee company does not exceed the foreign exchange sectoral caps and the merger/demerger is approved by the Indian courts. Issuance of any instrument other than equity shares/compulsorily convertible preference shares/compulsorily convertible debentures to the non-resident would require prior RBI approval as they are considered as debt.

20 Reliance Communications Limited and Maxis Communications Berhad. (2016). Media release dated 14 September 2016. Retrieved from (http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/FB01AEA1_F192_494F_A643_037210703A53_193849.pdf)

v. Competition regulations

Any acquisition requires prior approval of CCI if such acquisition exceeds certain financial thresholds and is not within a common group. While evaluating an acquisition, CCI would mainly scrutinise if the acquisition would lead to a dominant market position, resulting in an adverse effect on competition in the concerned sector.

vi. Stamp duty

The Indian Stamp Act, 1899, provides for stamp duty on transfer/issue of shares at the rate of 0.25%. In case the shares are in dematerialised form, there would be no stamp duty on transfer of shares. Conveyance of business under a business transfer agreement in the case of a slump sale is charged to stamp duty at the same rate as in the case of conveyance of assets. Typically, a scheme of merger/demerger is charged to stamp duty at a concessional rate as compared to conveyance of assets. The exact rate levied depends upon the specific entry under the respective state laws.

The road ahead

With the global economy slowing down while the Indian economy stays particularly resilient to the global downtrend and with increasing distressed assets in the Indian business environment, Indian business houses have been on the frontline of global and domestic M&A. The recent deals indicate an imminent need for consolidation in various sectors, sale of distressed assets by debt-laden Indian companies and simplification of widely dispersed group companies. Given the backdrop of a well-developed M&A legal and regulatory framework in India, the road ahead for the Indian M&A landscape seems to be brightly lit.



Chapter 4: What can go wrong in M&A deals

Synergy, sharpening business focus, growth and elimination of competition are some of the driving forces for any entity to undertake an acquisition.

In the case of a merger, the two merging companies will bring in synergies, leading to an increase of wealth of the original shareholders of the companies. However, to the dismay of the shareholders and other stakeholders such as employees and banks, the flaw in the logic and the assumptions used in arriving at this logic look fallible and becomes conspicuous only in hindsight.

In this chapter, we deal with the key themes of arriving at conclusions for increased shareholder value and trends to watch out for while evaluating these themes.

Backward/forward integration:

Many M&A transactions are based on the premise that it makes perfect logic to inorganically acquire key customers or key suppliers of the target enterprise as it gives the opportunity to add margins to the company with little incremental effort. More often than not, one can see front-end companies acquiring their back-end suppliers with the logic that the margin that the back-end company is making can be easily added and increased as well as cut down when it becomes a captive unit.

What can go wrong:

The managements of back-end businesses operating in the B2B domain are not only focused on maintaining high-end quality but very tight cost controls as well. They would try and squeeze out all costs wherever possible as industrial buyers have high availability of information and are often able to cut cost year on year. The auto industry is one such example where suppliers cut down the price per unit on a continuous basis. However, when the back-end supplier is acquired by a front-end company where the management is more focused on sales and marketing rather than cost controls, there is a likelihood of inefficiencies creeping in over a period of time. Even if there is no new inefficiency creeping in, the pace of innovation and continuous focus on cost controls does go down, leading to less than optimal realisation of planned synergies.

Eliminate competition/increase market share:

Many transactions are undertaken to increase market share and/or eliminate competition. These types of transactions, in our experience, do give the envisaged results, at least in short period of time. Increase in market share is often accompanied by reduction in overheads such as employee numbers, better bargaining with suppliers and more control over the customers and distribution channel.

What can go wrong:

This clearly is one of the safer bets as the acquirer knows the intricacies of the business being acquired. After the acquisition, the managements are often left with multiple products in their portfolio, with many of them competing against one another. Many managements faced with such a situation try and issue a death warrant for the weaker product rather than managing both the products, leaving a void for the competition to come and capture some market share which has been paid for. However, there are multiple examples where companies have managed to run both the brands successfully, a popular one being Coca Cola, where Coke still runs Coke and Thums Up as successful brands in India. It is clearly easy to cull a product or a brand and move ahead but managing brands and products which may end up competing with each other is a rather difficult thing to do. However, in industrial brands, many companies have been successful in following the strategy of pulling the plug on one of the products.

Entering into new areas/adjacent businesses:

Many managements faced with one or more of the following situations embark on a journey to enter new business areas.

- Too much free cash flow being generated in the main business
- Low growth rates in their main lines of business

An example of this would be tobacco companies that have over the last 30 years convinced themselves to venture into unrelated areas based on the above two reasons.

What can go wrong: This is clearly one of the most risky strategies. If history is any indicator of the trend, the results have been far less than satisfactory for many companies. However, when you have a sufficient amount of money being generated and a stable business, undertaking such kind of activities do provide excitement to the management in an otherwise mundane business ecosystem.

Almost everything can go wrong in such businesses. To start, the manager of the acquired business will always be compared with the manager of the stable business, and more often than not his results will not match up. Secondly, if the acquired business is small, it is unlikely to get much attention from senior management. More often than not, many such businesses in the stable company are not able to do well because either they get a stepmotherly treatment or the management is not able to fully comprehend what it is getting into.





For any business, transacting is extremely risky. This is because there could either be high losses or phenomenal returns, depending on what move is made (imagine if Yahoo had bought Google at 5 million USD when it was offered to them).

Many companies do not have an M&A strategy and would start evaluating whatever came their way. This is the first step to getting it all wrong. Most successful companies have a strategy that they follow. This business strategy is reevaluated every three to six months to help companies keep looking for what they want.

It is very important to keep your trusted advisors briefed early in the game as they give an independent third-party perspective. Many companies do engage advisors for limited tasks and that too sometimes in the end, leaving little scope for value addition.

Lastly, transacting is only the beginning. 'How and what you have done' will be known only after 2–3 years. Therefore, it is imperative to start planning for life after transactions before the ink dries up.

Section 2

M&A essentials



Chapter 5: Cross-border M&A – dissolving boundaries

Companies globally will continue to go after growth and value and India is no exception

These are challenging times for businesses, with economic and political volatility dominating headlines the world over. Brexit, a potential Grexit, a slowing Chinese economy and the growing threat of terrorism—all tend to contribute to a negative and gloomy investor sentiment. However, despite global volatility, CEOs are continuing to search for growth and value, as is evident by the uptick in M&A activity globally in the first half of 2016. Digital disruption, the need to acquire intellectual property and technology, and a globalised marketplace with a more mature consumer base will continue to drive cross-border deals, and India is no exception. In fact, with India marked out as a ‘bright spot’ in the global economy, with GDP growth that is likely to surpass China, a burgeoning consumer base and a government that seems committed to legislative reform to ease out doing business, it is likely that both inbound and outbound M&A activity in India will demonstrate a steady upward momentum in the foreseeable future.

A recap of the recent past

Cross-border deals propelled the Indian M&A market, accounting for two-thirds of the M&A activity in 2015. Outbound drove value due to a few big-ticket transactions in the pharmaceuticals and the oil and gas sectors. With large cap pharma companies having attained critical mass in India, increasing the pace of consolidation in overseas markets seems to be the preferred avenue for achieving growth in 2015. In the oil and gas sector, state-owned ONGC Videsh made a large acquisition in a Russian oil project with the stated strategic objective of adding high-quality international assets to its existing portfolio.

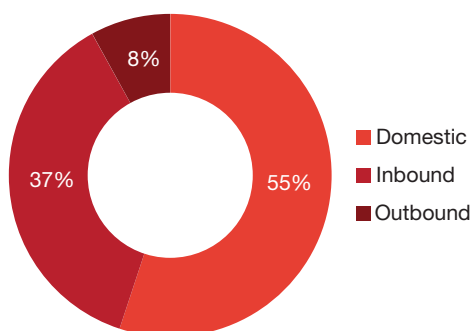
Technology, financial services and infrastructure were the most active sectors for inbound M&A activity. The year 2015 saw the growing dominance of social, mobile, analytics and cloud (SMAC) solutions which ensured a high deal volume in the technology space. There was increased inbound activity in the insurance sector, primarily due to the easing of the FDI cap to 49% from 26%.



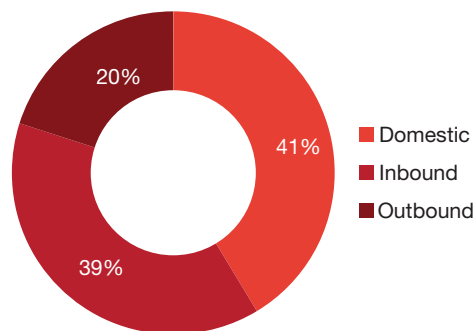
Strategic investments were also made in the payments solutions segment due to the increasing penetration of smartphones and the growing dependency on digital economy. In the infrastructure space, the focus was on clean energy in the power segment with some notable inbound acquisitions. The US continued to be the most active cross-border partner, followed by Japan and the UK.

Moving to 2016, the first half of the year saw a 12% increase in deal activity despite a fall in the number of deals. One of the top transactions in the outbound segment was Indian Oil Corp, Oil India and Bharat Petroleum Corp's acquisition of an overseas oilfield. The IT & ITeS space was again dominated by outbound transactions, with domestic players in the segment increasingly expanding to global markets.

Break-up of deals in 2014
(in terms of value)



Break-up of deals in 2015
(in terms of value)



Source: Thomson ONE data compiled for the period 1 January to 31 December

Outlook bright: A reformed and attractive FDI policy

The government has introduced several important regulatory changes in the last 12 months or so that will impact cross-border M&A. Radical changes have been announced by the government in the FDI policy in November 2015 as well as in June 2016, placing most sectors under the automatic approval route and creating headroom for the entry of foreign capital, especially in sectors such as real estate, defence and civil aviation which are capital intensive. Several other policy initiatives by the government, such as the Make in India campaign, development of smart cities and Digital India, are providing a favourable outlook for inbound investments into the country.



Sector	Regulatory relaxations and their outcome
Real estate	Entry barrier of a minimum investment of 5 million USD and minimum area of 20,000 square meters of development was removed, resulting in an inflow of private equity across asset categories.
Pharmaceuticals	Investment up to 74% is now permitted under the automatic route in brownfield pharmaceuticals to promote the development of the pharmaceutical sector.
Defence	Investment has been permitted through the government approval route in cases resulting in access to modern technology (condition of access to 'state-of-the-art' technology has been done away with).
Airlines and related sectors	100% investment in Indian-based airlines and to boost airport development, 100% FDI in existing airport projects is now permitted.
Trading of food products manufactured in India	100% investment under the government approval route for trading, including through e-commerce, is now permitted.

In addition to the above changes, the processes for establishment of offices in India have been simplified for defence, telecom, private security, and information and broadcasting. Where Foreign Investment Promotion Board (FIPB) approval and licence/permission from the concerned ministry/regulator has been granted, further RBI approval or security clearance may not be required. Further, 100% FDI has been permitted in limited liability partnerships (LLPs) under the automatic route where there are no FDI-linked performance conditions. Additionally, LLPs are being allowed to make downstream investments in another company or LLP in sectors in which 100% FDI is allowed under the automatic route.

These initiatives by the government have paved the way for some big-ticket deals, and the recent and robust provisions of the new Companies Act, 2013, aspire to open new and simplified avenues for mergers, acquisitions and other restructuring channels for India.

Cross-border mergers under the new Companies Act

The current laws only permit inbound mergers (foreign companies merging into Indian ones) and not the other way around. The Companies Act, 2013, proposes to allow both inbound and outbound cross-border mergers (these provisions are yet to be notified).

The liberalisation to promote outbound mergers is expected to help Indian companies in more ways than

one, by broadening the horizons for organic and inorganic growth through shareholding restructuring wherein ownership can be migrated to an international holding structure, facilitating overseas listing and providing exit routes to current investors in overseas jurisdictions.

However, corresponding amendments to the existing tax and exchange control regulations are essential. The current law does not address outbound mergers and tax implications where the consideration is in the form of depository receipts. One would need to also wait for the notification of 'specified jurisdictions' for cross-border mergers. This may restrict the scope of outbound mergers as well as inbound ones, which are currently allowed from any jurisdiction that allows cross-border mergers under its domestic laws. Also, the requirement for RBI approval will play a major role in such cross-border mergers.

Cross-border mergers	
Existing provisions	<ul style="list-style-type: none"> • Permit only inbound mergers • No restriction on jurisdiction
New provisions (not yet notified)	<ul style="list-style-type: none"> • Permit both inbound and outbound mergers • Consideration for merger could be in the form of cash or depository receipts • Restrictions on outbound merger— permissible only with notified jurisdictions

Further, the draft rules include a clarification that demergers are included within the definition of 'compromise/arrangement'. However, the section permitting outbound mergers from India specifically talks about mergers and does not use the term 'compromise/arrangement'. Hence, there is an element of doubt about whether or not outbound demergers will be permitted.

FDI norms would also need to address cross-border transactions from the perspective of issue of shares, depository receipts, sectoral guidelines, etc. A cross-border merger may have multiple implications, namely transfer of assets/loans, acquisition of new property, etc., which are not currently dealt with. The law needs to evolve to facilitate seamless transactions. For instance, on the merger of a foreign company into an Indian company, a loan/borrowing appearing in the books of the foreign company will get transferred to the Indian company. In such situations, it is unclear whether the loan/borrowing will get classified as an external commercial borrowing (ECB) and whether the provisions with respect to eligible borrower, lender and end use would apply. In the case of a merger of an Indian company into a foreign company, where assets are taken over by the latter, suitable provisions to prescribe the procedure, terms, etc., need to be incorporated. It is expected that the legislature will issue clarifications on the SEBI Takeover Code as well to bring about uniformity in the regulatory framework.

Other regulatory changes

Several other regulatory changes are expected to encourage M&A activity in India. The Companies Act, 2013, has simplified the process for a corporate reorganisation/arrangement by eliminating the High Court approval process and simplifying the procedure for arrangements between small companies, holding and subsidiary companies and other specified companies. The High Court has been replaced by a quasi-judicial body, NCLT, for corporate law purposes. The rules also offer certain guidance on the accounting treatment for demerger. Further, it is now specifically provided that listing is not mandatory on the merger of a listed company into an unlisted company, with an exit option provided to shareholders. Recently, a relaxation was issued for transfer of shares between residents and non-residents where it is commercially required to defer part consideration. Currently, transfer of shares or convertible debentures requires prior approval of RBI in case there is deferment of consideration, which has now been done

away with subject to the deferred consideration (not more than 25% of the total consideration) being settled within 18 months.

Tax: Much-needed clarity could boost M&A activity²¹

Several efforts are being made to simplify the tax regime of India, make it transparent, plug in the loopholes and thus reduce the uncertainty caused by litigation. GAAR is proposed to be effective from 1 April 2017. The Central Board of Direct Taxes (CBDT) has clarified that GAAR will not apply to any income arising from transfer of investments made before 1 April 2017. While there is clarity on investments made, GAAR continues to be applicable if a tax benefit is obtained on or after 1 April 2017 irrespective of the date on which the arrangement was made, bringing in an element of retroactivity. The amendments to the India-Mauritius, India-Singapore and India-Cyprus treaties correlate to the introduction of GAAR. While the amended treaties give India source-based taxation rights on capital gains arising on the sale of shares of an Indian company, it has been clarified that investments made prior to 1 April 2017 would be grandfathered. This provides much-needed clarity on inbound investments into India and investors can assess the tax impact holistically, especially considering a lower tax rate of 10% for non-residents on transfer of shares of an unlisted privately held company.

Similarly, indirect transfer rules notified by CBDT provide some degree of certainty on the computation of the fair market value of assets and the income attributable to assets located in India. However, some ambiguities remain in relation to the computation of income and reporting of transactions concluded prior to the date of applicability of the rules.

Every cross-border M&A activity requires a comprehensive understanding of regulatory requirements and evaluation from both foreign and domestic considerations. It shall be necessary to look at these aspects upfront and ensure that all related issues are well addressed or else there could be repercussions for the transacting parties and the entire purpose of the deal could be defeated in some cases. Thus, the necessity of performing a due diligence exercise on the target before proceeding with the deal/acquisition is evident. The following chapter discusses this aspect in further detail.

²¹ PTI. (2015, 28 January). Outbound deals dip in 2014; 35% rise in inbound transactions. *The Economic Times*. Retrieved from <http://economictimes.indiatimes.com/news/company/corporate-trends/outbound-deals-dip-in-2014-35-rise-in-inbound-transactions/articleshow/46043006.cms>

Chapter 6: Why due diligence

Due diligence is the process of evaluating a business situation diligently from various aspects before arriving at a decision. In a transaction scenario, due diligence helps the buyer in uncovering potential liabilities and discrepancies and thus enables the buyer to take an informed decision. There are various forms of due diligence depending upon the area/scope of coverage like financial due diligence, legal due diligence, commercial due diligence and tax due diligence. Other diligences may be performed in areas such as IT and human resources.

In the following paragraphs, we discuss in detail the importance of diligence from a tax perspective along with its methodology.

Acquisition of shares/business involves acquisition of inherent tax exposure of the target company or business so acquired pertaining to the period prior to acquisition. Tax due diligence helps in identifying the past, present and future tax liabilities of the target entity, including disclosed, undisclosed, realised and unrealised tax liabilities. This further helps to determine items of risk and exposure which may require adjustment to the purchase price, provide for tax warranties and indemnities in the sale agreement and strategise an appropriate acquisition and funding structure.

Taxes that may be covered in a tax due diligence exercise include income tax, withholding taxes and indirect taxes—namely customs duty, excise duty, service tax and value-added tax.

Types of tax due diligences

Typically, tax due diligence is of two types: Target due diligence and vendor due diligence.

- A target tax diligence or buy-side tax diligence is conducted by the buyer proposing to invest in the target company's business to assess the tax attributes of the target's business and factor in the same in valuation appropriately. It also assists the buyer in evaluating a tax-efficient acquisition structure to ring-fence the tax liabilities and leave them behind with the seller.
- A vendor tax diligence or sell-side diligence is conducted by the seller in order to assess their preparedness on the tax front before sell-off or fundraising through private equity. At the same, it serves as the basis in the negotiation process.



Approach and methodology

Tax due diligence typically involves reviewing financial statements, historical tax filings, tax computations, tax audit report, tax compliances such as withholding tax compliances, audit conducted by tax authorities for a specified period (say the last 2–3 years) and outstanding tax disputes status as on the closing. The process includes reviewing the tax position adopted by the target, adequacy of tax provisions made, status of tax holidays/incentives availed of by the target, and unabsorbed tax losses and depreciation. Thus, a tax due diligence enables the stakeholders to make informed decisions.

Benefits of tax due diligence

At the outset, tax due diligence helps in:

- Identification of inconsistencies in historical tax filings/compliances, if any, and quantification of tax exposure thereof
- Analysis of tax positions taken by the target and assessing their impact going forward
- Analysis of risk profile of ongoing litigations of the target company
- Assessment of availability of tax attributes (tax holiday, unabsorbed losses, etc.) of the target to the buyer
- Identifying underreported tax liabilities and ascertaining whether all tax liabilities are adequately provided for in the books
- Validating the representation made by the seller at the time of pre-deal negotiation
- Ascertaining representations, warranties and indemnities to be sought and adjustments to be sought for the purchase price on account of findings during due diligence
- Identifying if an alternate transaction structure is required where potential tax exposure in doing a transaction as per a given structure is significantly higher

Typical issues identified in the course of due diligence review which have a bearing on a transaction

Some of the typical tax issues that come across in a tax due diligence and have significant bearing on the transaction are as under:

• Recapture of past losses upon change in shareholding

Under the Indian tax regime, change in shareholding of a closely held company by more than 49% hampers its ability to carry forward unabsorbed tax losses (excluding depreciation) which were otherwise eligible to be carried forward for eight years.

While conducting the due diligence, it needs to assess whether there has been any change in the shareholding of the target in the past which has impaired its ability to carry forward the unabsorbed losses. Due diligence also enables the buyer in ascertaining the balance/unexpired period for which the tax losses can be carried forward by the buyer and in factoring the same in the valuation.

• Claim of tax holiday/incentives (Section 10AA, 80IA, etc.)

Under the Indian tax regime, tax holidays/incentives can be availed of for a specified period subject to the fulfilment of specified conditions. It is necessary to assess whether or not the conditions prescribed for availing of a tax holiday have been complied with by the target company, the correctness of such a tax holiday claim and the unexpired period for which the tax holiday can be claimed by the buyer so that the buyer can factor the same in valuation.

• Deemed dividend

Under the Indian tax regime, a loan by a closely held company to its shareholder/allied entities may be re-characterised as deemed dividend in the hands of the recipient triggering withholding tax liability on the target company. Thus, the aspect of advancement of loans to shareholder/allied entities needs to be examined during the due diligence exercise.

- **Withholding tax**

India also has a very comprehensive withholding tax regime which casts an obligation on the payer company to withhold taxes on specified payments to non-residents and on payments to residents which are chargeable to tax.

Sample checks of withholding tax compliances help in identifying inconsistencies in withholding tax filings/compliances of the target company.

- **Recoverability of tax refunds/credits**

Tax due diligence helps the buyer in ascertaining the quality and recoverability of tax refunds/tax credits like MAT credit being claimed as eligible to be carried forward by the target company.

- **Indirect tax liability on goods/services**

India has a comprehensive indirect tax regime involving service tax, value added tax (VAT), excise duty, custom duty, etc. Each business activity attracts a specific indirect tax levy. For instance, manufacturing attracts levy of excise duty, import/exports attract customs duty, which then become part of the final cost to the customer.

Through due diligence, the buyer gains an insight into the indirect taxes applicable on the target's business, status of compliances, tax exposure on account positions taken therein, difference between the industry practice and the positions adopted, etc.

Further, credit of taxes paid on input goods/services is allowed to be taken against the output tax payable. However, input credit for goods/services utilised for exempt services/goods is not allowed to be utilised for payment of taxes. In this regard, due diligence helps in assessing the eligibility of input credit utilised for the payment of output tax liability and in highlighting the potential exposure on account of ineligible input services.

- **Transfer pricing (TP) documentation**

It needs to be assessed whether the TP documentation has been duly prepared and maintained by the target company and whether the TP filings and other compliances prescribed under the income tax statute have been complied with within the prescribed timelines, failing which penalties may be levied on the target.

Tax diligence is an integral part of a transaction and has a significant bearing on the outcome of a transaction, namely final terms of the transaction, appropriate reps and warranties to be obtained, negotiation leverage and ultimate investment decision. It aids in the mitigation of any identified or unforeseen risks as well as in the identification of opportunities for both the acquirer and seller. Tax diligence will gain increasing importance in times to come with the advent of a new tax and regulatory regime such as GAAR and BEPS.

Based on the findings of a due diligence exercise, the parties may negotiate the commercials of the M&A transaction, which could range from debt-like adjustment to the agreed consideration or taking appropriate indemnities from the seller or creating an escrow mechanism. At times, this may also necessitate structuring a deal to ensure that the interest of the buyer is protected.



Chapter 7: Structuring deals

Selecting the optimum structure from a tax perspective is critical to the success of any transaction as it has a direct impact on the tax cost and other transaction costs like stamp duty, etc. Transaction structuring is a complex process and the parties must weigh the legal, tax and business considerations and accordingly construct the most mutually advantageous transaction structure.

Domestic structuring

Consolidation of business

Merger is an efficient option both for making acquisitions and consolidating existing business. For instance, recently, the domestic M&A space has been dominated by consolidation among start-ups, with the objective of strengthening their market position in a highly competitive market.

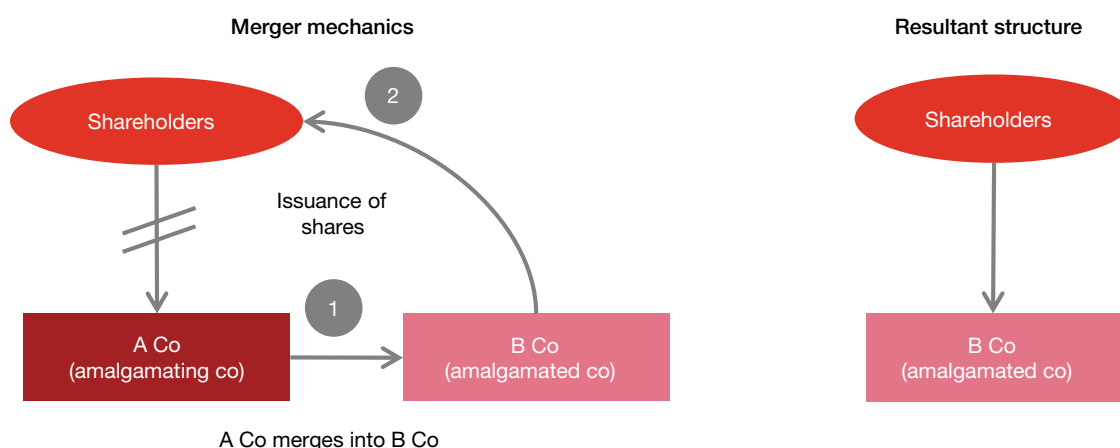
The concept of merger essentially involves the combination of two or more entities (amalgamating companies) into a single entity (amalgamated company). The consideration for merger is discharged by the amalgamated company to the shareholders of the amalgamating company and the same may be in the form of cash, shares, bonds, etc. (or a combination thereof). Further, for a merger to be effective in India, the approval of NCLT is required.

Under the Indian tax regime, various tax reliefs and benefits are available on merger (subject to satisfaction of the prescribed conditions), which makes the entire merger process tax neutral for stakeholders. Some of the tax reliefs/benefits available on merger are as follows:

- **For the amalgamating company:** No capital gain tax on transfer of assets by the amalgamating company to the amalgamated company.
- **For shareholders of the amalgamating company:** No capital gains tax implication in the hands of the shareholders of the amalgamating company provided the consideration for merger is discharged only through the issue of shares of the amalgamated company.
- **For the amalgamated company:** The amalgamated company can carry forward the amalgamating company's accumulated business losses and unabsorbed depreciation for set-off against future profits, subject to satisfaction of the prescribed conditions.

However, there are some key considerations which should be kept in mind while carrying out a merger:

- Approval from creditors/lenders on merger exercise
- Stamp duty cost on merger
- Time-consuming process that requires approximately 6–8 months
- Listed companies to ensure compliance with SEBI regulations



Hiving off: Divestment of business

Broadly, two options are available to an Indian company to hive off the business:

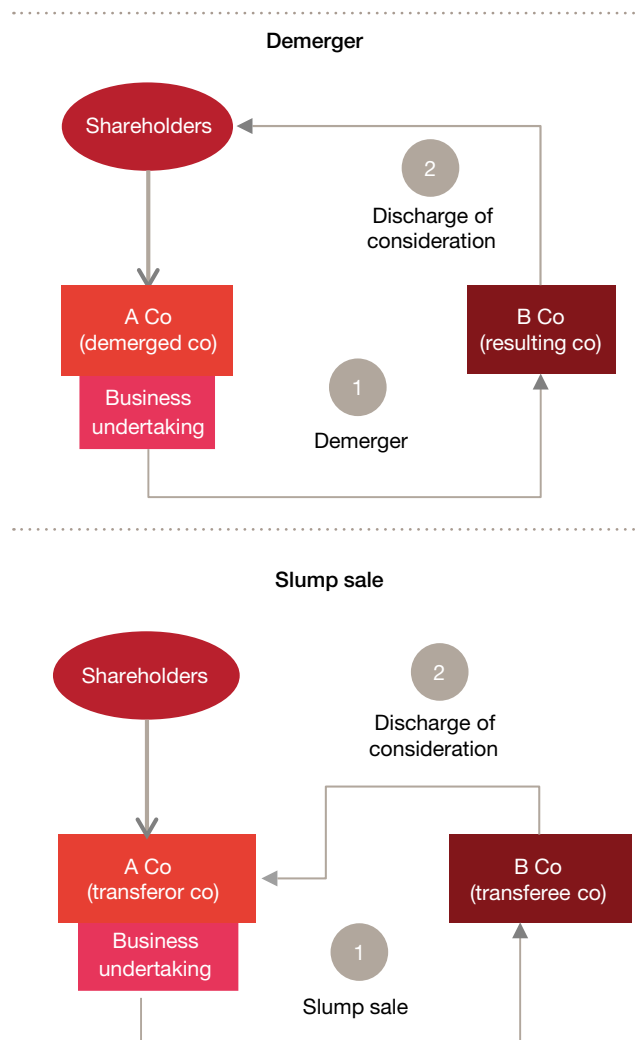
1. Demerger
2. Business sale

A company may sell/divest a particular line of business to unlock value for investors, focus on core business competencies, achieve dedicated management focus, etc.

Demerger refers to the transfer of a business undertaking (i.e. all assets and liabilities relating thereto) by a transferor company to a transferee company. The consideration for demerger is discharged by the transferee company through issue of its shares to the shareholders of the transferor company on a proportionate basis. Further, demerger, like merger, is an NCLT-driven process and becomes effective only when the approval of the Tribunal is obtained and the order is filed with the Registrar of Companies.

Slump sale (or business sale) means the sale of a business undertaking for a lump sum consideration without values being assigned to individual assets or liabilities. It is generally executed by way of a business transfer agreement (BTA) between a buyer and a seller and no NCLT approval is required for the same. The consideration for slump sale is generally discharged by cash/issue of shares/bonds, etc.

Although both demerger and slump sale broadly achieve the same objective, their implications under the Indian tax and regulatory regime vary. Accordingly, it is important to analyse these implications before going ahead with the transaction.



Parameter	Demerger	Slump sale
Capital gains	No tax subject to fulfilment of prescribed conditions	Capital gains tax @20%/30% (long term/short term)
Carry forward of accumulated losses and unabsorbed depreciation	Can be carried forward by the resulting company in relation to transferred business undertaking	Can be carried forward only by the transferor company and not by the transferee company
Timelines	6–8 months	1–2 months
Stamp duty cost	Stamp duty is levied on the NCLT order effecting demerger at the applicable rate (the rate is dependent upon the state where the registered offices of the companies are situated)	Stamp duty may apply depending on the nature of assets transferred

Share acquisition

Share acquisition is probably the most conventional mode of acquiring another business. The target company stays exactly the same but with new ownership. However, there are some key considerations which should be kept in mind before acquiring the shares of a company. They are:

- **Capital gains tax**

No capital gains tax is levied where listed shares (long term) are sold on a recognised stock exchange, while the sale of shares of an unlisted company entails a capital gains tax implication @ 20%/30% (long term/short term). Further, where the transferor is a non-resident, the capital gains tax may be levied @10%/40% (long term/short term), subject to beneficial tax treatment provided under double tax avoidance agreement (DTAA).

- **Recipient tax**

Where the shares of an unlisted company are transferred at a value which is less than the fair value, tax @30% /40% (resident/non-resident) is imposed in the hands of the transferee on the excess of the fair value over the sales consideration.

- **Lapse of accumulated business losses (tax losses)**

Where shareholding of an unlisted company changes by more than 49% as a consequence of the transfer of its shares, its accumulated business losses lapse—i.e. the same cannot be carried forward for set-off in future years.

- **Stamp duty**

Stamp duty @0.25% is levied on transfer of shares if shares are held in physical form. However, no stamp duty is levied in case shares are held in electronic (dematerialised) form.

- **Mode of discharge of consideration**

Consideration for share acquisition can be discharged in cash, or kind or shares of the transferee company.

- **Compliance with other regulations (securities laws and foreign exchange control regulations, etc.)** needs to be undertaken, particularly where substantial shares of a listed company are transferred.

Cross-border structuring

As one of the fastest growing economies of the world and with increased collaboration with different countries, India's economic surge has led to more and more business transactions taking place. Multinationals are looking at India as their new growth engine, while Indian companies are consolidating their Indian operations and, at the same time, looking to expand their global footprint.

Against this backdrop, structuring cross-border transactions (i.e. inbound and outbound transactions) from the tax and regulatory perspective becomes a critical component to ensure that the structure is regulatory compliant and yields optimum returns to the organisation and investors. Transactions can be broadly broken down into cross-border transactions and domestic transactions.

Inbound structuring

The liberalisation of the FDI regime and opening up of almost all the sectors of the economy for complete foreign ownership has transformed India into one of the most open economies of the world and has led to increased entry of multinationals in various capital-intensive sectors such as infrastructure, insurance, power and pharmaceuticals.

Key considerations while investing in India

India has a very comprehensive tax regime and provides for source-based taxation for non-residents—i.e. the income of a non-resident accruing/arising in India is taxable in India (subject to treaty protection).

Thus, a non-resident planning to make acquisitions in India needs to consider the following:

- **Mode of acquisition (i.e. whether to acquire shares of the target or acquire the business of the target directly)**

- **Business purchase:** In case the business of the target is acquired by the buyer directly (through slump sale or business sale), the buyer may be eligible to claim tax amortisation on the acquisition cost.

- **Share purchase:** In case the buyer acquires the shares of the target, the acquisition cost is locked into the cost of shares of the target and, accordingly, tax amortisation of acquisition cost may not be available.

- **Tax outgo on future exit**

- Capital gains on the transfer of shares of an unlisted Indian company are taxable @10%/40% (depending upon the nature of capital gains, i.e. long term or short term), subject to treaty protection.

- **Choice of acquisition vehicle, i.e. whether to directly acquire the shares of the target company or acquire the shares through a SPV located in India or overseas**

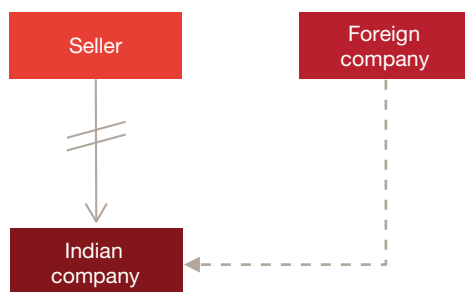
- India has signed DTAA's with various countries. Under certain DTAA's, India has given up its right to tax capital gains arising to the residents of such countries on the sale of the shares of an Indian company in favour of the other state. Thus, no tax is chargeable in India on capital gains arising on any alienation of the Indian investment made by a non-resident based in such a treaty-friendly jurisdiction. However, the Indian government has either concluded or is in the process of negotiation on amending the DTAA's to prevent treaty abuse.

- **Mode of funding (i.e. equity, compulsorily convertibles, optionally convertibles or debt)**

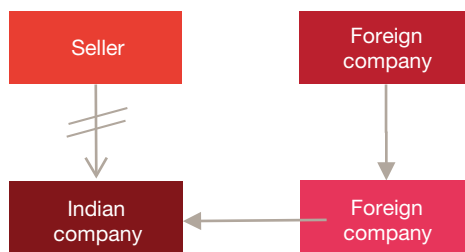
- While commercial drivers are the key to identify the funding instruments in any transaction, various other parameters should also be considered before choosing an optimal funding instrument:

- Quantum and end use
 - Flexibility of repayment
 - Mode of return on investment and the related tax aspects, including withholding tax implications in the source country
 - Other regulatory considerations in the target country and home country

Direct acquisition



Acquisition through an SPV



Outbound structuring

Indian regulators have over time become more open and encouraging towards cross-border acquisitions. Further, the Indian tax regime is very comprehensive with respect to outbound investments and taxes the global income of an Indian tax resident. Accordingly, the income earned by an Indian resident such as capital gains and dividends, from its overseas investment is taxable in India.

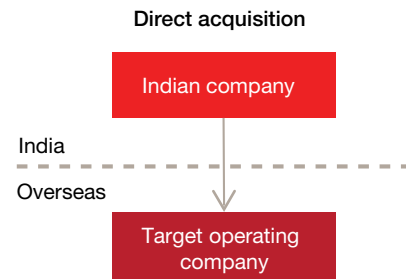
Key considerations while investing overseas

A. From an India perspective

- Taxability of income earned from such foreign investment in the form of dividend, interest, capital gains, etc.
- Compliance with overseas investment norms and regulatory regulations, (as applicable from time to time) such as the total financial commitment limit of 400% of net worth

B. From the target country's perspective

- Prevailing tax and regulatory regime of the target country
- Mode of acquisition (i.e. whether to acquire shares of the target or directly acquire business of the target)
- Choice of acquisition vehicle, i.e. whether to acquire the shares of the target company directly or through an SPV incorporated in the target country or some other overseas jurisdiction, which offers preferential tax treatment by virtue of a tax treaty with the country in which the target is located (subject to grandfathering provisions provided under the tax treaty)
- Tax laws of overseas jurisdictions
- Mode of funding (equity, preference or debt) depending on the tax and regulatory regime of the target country such as thin capitalisation norms
- Tax implications on future exit



Transaction activity is expected to remain high in the near future, driven by an amalgam of a positive economic outlook, strong capital markets, high investor confidence and improvements in the tax and regulatory regime. The tax and regulatory aspect is an important part of each transaction and it is always beneficial to explore the possibility of structuring one in a manner that ensures flexibility and efficiency.

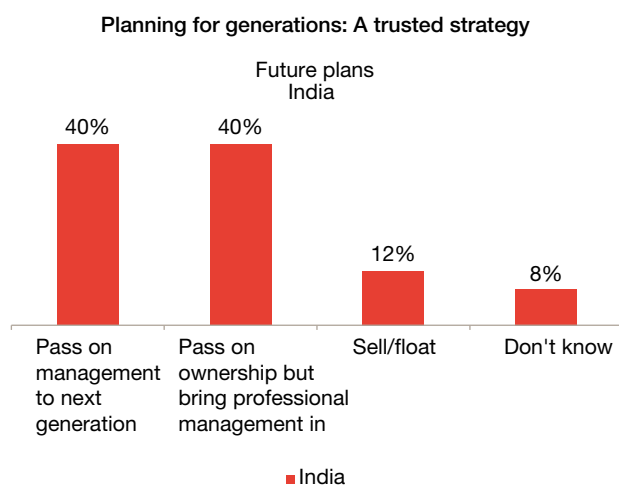


Chapter 8: Succession planning

In the previous chapter, we examined the different facets of domestic structuring. We now broadly look at another important structuring aspect that relates to the succession of business.

For any family-owned business, transition is a crucial aspect that every founder or owner should keep in mind while pursuing the strategic business objectives of growth, diversification, expansion or sale. In the present context, passing the baton is clearly a priority for family business owners since the succession can make or break a family business and can have serious implications on the family as well. Thus, a structured approach in determining the transition plan and its communication to stakeholders is essential for managing the succession and survival of the family business and family from generation to generation.

Whether selling the business, keeping the business in the family or transitioning leadership to identified heirs or a non-family stakeholder, the issues are immense and certainly not simple. The business, emotional, legal and technical issues to deal with this are complex and challenging, as a result 95% of family businesses do not survive the third generation of ownership.²² PwC's Family Business Survey revealed that although about two-thirds of Indian family businesses have thought about a succession plan, only 15% of them are well documented and robust. This is a significant gap since the survey also throws up an interesting statistic, i.e. 40% of family businesses are looking at passing on management control to the next generation in the near future.²³



Nearly half of the survey respondents pointed out that succession planning is one of the main priorities for success and survival.

Benefits of a robust family succession plan using a trust

Many challenges are unique to family businesses because of the emotional ties between family members, hesitation on communication, generation gap, mistrust, etc. Hence, defining, developing and implementing a succession plan which specifies how uncertainties relating to succession will be handled is crucial. Planning efforts towards succession should be an ongoing process rather than a distinctive event.

In terms of ownership and governance protocols for family members, typically, a trust or similar entity form becomes pivotal to the succession plan since it can provide a good balance between owners' desires, professional management, responsible business decision matrix and healthy family dynamics.

The following are some of the key benefits of succession planning under a trust structure for continuing business legacy and smooth transition of the business from the hands of one generation to another:

1. Continuity planning

Consolidation of ownership and control under a trust allows the founder/owner and the family to set a clear vision and ensure commitment from the next generation of family members. This results in continued planning from one generation to another, resulting in harmony between goals, objectives, targets, etc., between generations, thereby reducing conflicting objectives/interests between family members.

2. Generational change

Family-owned firms can struggle to keep pace with global megatrends like demographic shifts and digital technology without the involvement of the new generation. At the same time, the current generation may not always have confidence in the ability of the new generation to take over the business, and may also have limitations relating to their ideas of change and growth. This calls for professionalisation of the family firm by introducing external talent, leading to better governance and a more rigorous decision-making process in areas like finance, wealth management and personal expenses.

²² PwC presentation for family businesses and risk protection

²³ PwC India. (2016). PwC India Family Business Survey 2016. Retrieved from <http://www.pwc.in/publications/family-business-survey-2016.html>

3. *Conflict management*

A trust would lay out specific protocols governing decision making and, in the case of any difference of opinion or deadlock, the process to manage the conflict. This ensures that the business does not suffer even during a phase where family members are not aligned.

4. *Security of family/personal assets*

A trust structure can also facilitate ring-fencing of family assets, protecting them from a creditor's claims as well as providing safeguards against claims from family members upon disability, divorce/partition, etc.

5. *Pooling and simplicity*

A trust also serves as a means for pooling of assets and funds under a common control. This can provide heirs the benefit of property without loss of control and helps to avoid the probate or court process in the event of death. It can also simplify asset holding for legal heirs in multiple jurisdictions.

Key tax aspects to succession planning by way of a trust structure

A trust can either be settled as a specific trust where the entitlement of its beneficiaries is fixed, or as a discretionary trust where the beneficial interest is not determined upfront and will get determined by the trustees at a later date or on happening of a certain event, etc. Further, any trust can either be revocable or irrevocable, where under the irrevocable trust, the settlor/contributory does not have the power to terminate the trust or have whole or part of trust assets or income re-transferred or control there upon re-assumed by the settlor/contributory. It is pertinent to note that any capital assets transferred under an irrevocable trust are not liable to capital gains tax in the hands of the contributory. However, such exemption is not available for transfer of capital assets to revocable trusts.

The trustee of a specific trust can be assessed to tax as a representative of the beneficiaries. In such a situation, the income of this specific trust is taxable in the same manner and to the same extent as the respective beneficiaries would have been taxed. Tax authorities can also make a direct assessment on the beneficiaries to recover tax payable on the income of the specific trust.

Where the income of a specific trust is assessed in the hands of the trustee and such income includes profits and gains of business or profession, the income will be liable to tax at the maximum marginal rate.

In the case of a discretionary trust, the income of the trust is taxable in the hands of the trustee at the maximum marginal rate.

The provisions of dividend distribution tax and minimum alternate tax are not applicable to trusts. Further, in the case of family trusts, where beneficiaries and settlors are eligible relatives, the provisions of deeming income on account of receipt of any sum of money or immovable property or other specified properties for inadequate or nil consideration are technically not applicable.

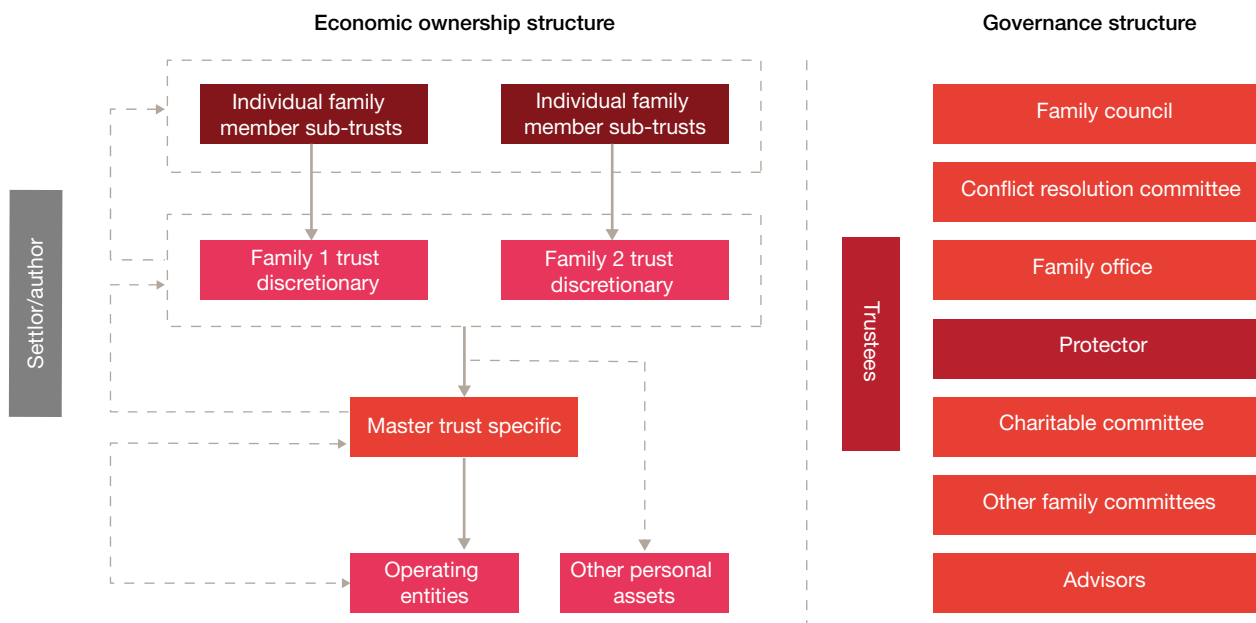
Taxation of a trust remains a complex exercise since the laws and related jurisprudence have not fully evolved on various aspects, such as taxation on distribution of regular income by the trustee to the beneficiaries, transfer of beneficial interest, transfer of trust property and carry forward of losses in business incurred by the specific trust by the beneficiaries.

With globalisation of businesses, families have also become multinational, making it important to plan for tax consequences and compliance issues in the hands of beneficiaries. This becomes even more complex when there are residents or citizens in multiple jurisdictions, leading to the wealth and business of the family to be located in multiple jurisdictions.

Owners of family businesses need to plan for a commercially optimal and tax-efficient solution to transfer the ownership of their business and wealth. The following factors are crucial in designing a trust that is tax optimal for the owner and beneficiaries:

- Achieving a pass-through status or a single-level of taxation,
- Figuring out the mode of settlement of assets into a trust to achieve tax neutrality and retain the tax attributes of the assets settled such as the cost basis and period of holding,
- Ascertaining stamp duty costs incurred in transferring assets to a trust,
- Exchange control regulations in specific cases of an offshore trust or domestic trust having foreign trustees or beneficiaries.

Typical trust structure



A typical family-owned business, with more than one family constituent, should have a two-tier trust structure where consolidation of the family wealth and control can be achieved under a 'master trust'. The business should be tailored to incorporate an appropriate governance structure that ensures consensus of all family members and stakeholders and deals appropriately with conflict situations. This would also ensure that individual family constituents cannot unilaterally deal with common family assets and provide benefits of consolidation of control. The family and sub-trusts would typically be set up as discretionary trusts and would be customised to meet individual requirements of each family situation.

To conclude, a suitably designed and customised trust structure that blends strategic objectives with the tax, regulatory and legal aspects can enable the achievement of objectives of succession planning much better than a 'will' and provide the benefit of flexibility and certainty to all members of the family. Families that have dealt with succession planning issues structurally have typically ensured the survival and sustainability of the business and wealth through generations.



Section 3

Developments impacting M&A transactions



Chapter 9: Treaty under metamorphosis – recent developments

1. Background

The Double Taxation Avoidance Agreement (DTAA), popularly known as 'tax treaties', are bilateral agreements entered into between two countries to promote economic trade and investment by eliminating double taxation of the same source of income. DTAA applies in cases where a taxpayer resides in one country and earns income in another.

The objective of DTAA is to provide for the tax claims of two governments which are both legitimately interested in taxing a particular source of income, either by assigning to one of the two the whole claim or by prescribing the basis on which tax claims are to be shared between them.

In most of the countries, including India, the provisions of DTAA generally override the provisions of the taxing statute of a particular country, subject to fulfilment of certain conditions. However, under section 90(2) in the Indian tax regime, it is clear that the taxpayer has the option of choosing to be governed either by the provisions of a particular DTAA or the provisions of the local tax laws, whichever are more beneficial to him.

A favourable taxation regime for capital gains under certain DTAs between India and countries such as Mauritius, Singapore and Cyprus has encouraged a lot of foreign investment into India and these countries have always remained a favoured destination for making investments in India.

DTAs with these countries provided residence-based taxation on capital gains arising from sale of shares of an Indian company which at times resulted in long-drawn litigations. The Indian tax authorities challenged the substance and residential status of investor entities on the basis that the investments were merely made for availing tax treaty benefits.

Thus, to put an end to the double non-taxation of capital gains on investments from such countries, DTAs have been amended to provide source-based taxation as mentioned below in more detail:

2. Recent amendments in Mauritius, Singapore and Cyprus DTAA with India

Amendments in India-Mauritius and India-Singapore DTAA

- As a part of the efforts to clamp down on treaty abuse, the governments of India, Mauritius and Singapore have revised their DTAs.

As per the amended DTAA with Mauritius and Singapore, while India shall have the right to tax capital gains arising from the alienation of the shares of an Indian company acquired on or after 1 April 2017, investments made before 1 April 2017 have been grandfathered and will continue to enjoy the benefits of the erstwhile provisions of the respective DTAA and will not be subject to capital gains tax in India.

For investments made after 1 April 2017, the following provisions will apply:

- On alienation of shares of an Indian company between 1 April 2017 and 31 March 2019: The tax rate on such gains shall not exceed 50% of the domestic tax rate in India. However, to avail this benefit, the investors need to fulfil the 'Limitation of Benefits' clause.
- On alienation of shares of an Indian company post 1 April 2019: Gains on such sale would be fully taxable in India.

Further, the revised DTAA between India and Mauritius also provides for a lower withholding tax rate of 7.5% on interest payments, provided that the recipient is the beneficial owner of such interest income. The withholding tax rate for interest payments under the India-Singapore DTAA continues to be 15%.

Amendments in the India-Cyprus DTAA

As a part of the efforts to clamp down on treaty abuse, the DTAA between India and Cyprus was similar to the DTAA with Mauritius and Singapore, with India giving up the taxing right on sale of shares of Indian companies and Cyprus not taxing such income under its tax laws.

However, in 2013, the Government of India had notified Cyprus as a 'notified jurisdictional area' (NJA) with regard to the lack of effective exchange of information by Cyprus tax authorities to the Indian tax authorities under the exchange of information provisions under the India-Cyprus DTAA.

Declaration of Cyprus as an NJA led to several uncertainties, including uncertainty on withholding tax implications in India on payment to Cypriot entities. To provide clarity to the investor community and put an end to all uncertainties, the officials of both the countries re-negotiated the DTAA to provide for source-based taxation of capital gains and retrospectively rescinded the notification that classified Cyprus as an NJA.

As per the amended DTAA, while India shall have the right to tax capital gains arising from the alienation of the shares of an Indian company acquired on or after 1 April 2017, investments made before 1 April 2017 have been grandfathered and will continue to enjoy the benefits of

the erstwhile provisions of the India-Cyprus DTAA and not be subject to capital gains tax in India.

However, there is no change in the withholding of tax rate on interest payment, with the same continuing to be withheld at the rate of 10%.

3. Impact on M&A due to change in treaty

The recent changes in tax treaties fulfil the government's agenda of tax rationalisation by addressing the issue of double non-taxation and treaty abuse and may significantly reduce the tax litigations and bring more certainty and clarity on the tax implications for investments made through these countries. It is also pertinent to note that a lower withholding tax rate at the rate of 7.5% on interest in the India-Mauritius tax treaty is likely to gain more attention from the investor community for debt-related transactions.

It would be interesting to know the impact of GAAR (proposed to be with effect from 1 April 2017), which provides overarching powers to tax authorities, including overriding DTAA, in case a transaction lacks commercial substance. Thus, substance parameters will become increasingly relevant once the GAAR provisions become effective.



Chapter 10: GAAR – testing the substance of arrangement

1. Background: Judicial and codified GAAR

Codification of GAAR as a part of domestic tax law of the country has been a long-drawn international debate. The core reason behind this debate has been a difference of opinion in interpreting and implementing the tax laws. One school of thought suggests ‘substance over form’, whereas the other suggests ‘respecting the form’ where a transaction is otherwise within the four corners of the law. There has been considerable discussion on these two principles.

Certain judicial precedents by the Apex court of the country like McDowell in the 1980s, Azadi Bachao Andolan in the early 2000s and Vodafone in 2012 have paved way for the codification of GAAR under the Indian tax regime.

2. Purpose and scope: Including grandfathering provisions

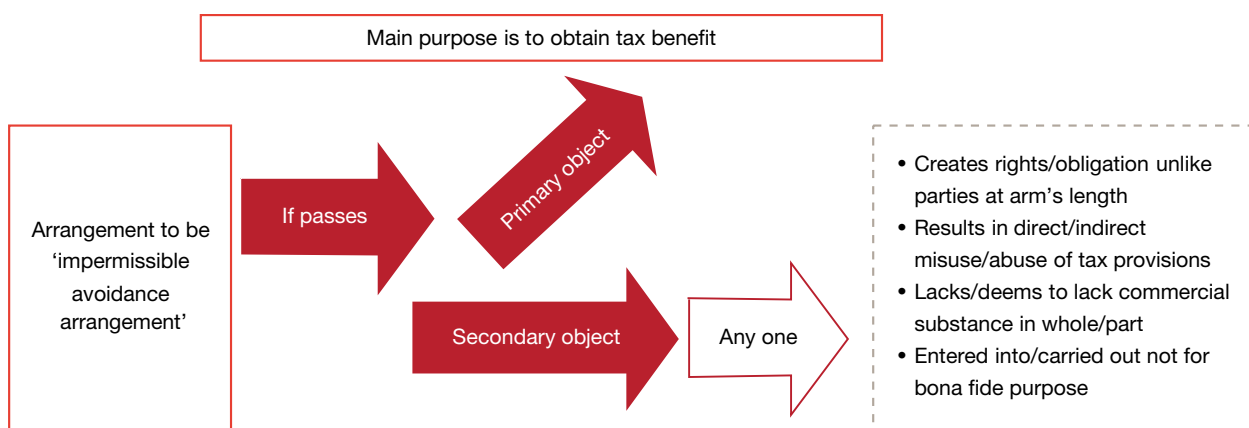
The most important aspect of the codified GAAR, as opposed to the judicial GAAR, is that the onus in general would be on the taxpayer to prove his bona fides. GAAR is seen as a tool to equalise the tax levy amongst various citizens of the country. Therefore,

not paying taxes even through legitimate tax planning may not be acceptable under the GAAR regime if the primary objective thereof is to avoid tax.

In India, GAAR was finally codified as a part of Indian Income-tax Act vide Finance Act, 2012, which was then omitted and replaced with the reworded provisions vide Finance Act, 2013. The applicability of the said provisions has been deferred after its introduction and presently, it is to come into force in financial year 2017–18.

The Indian GAAR would apply only where the tax benefit (to all the parties in aggregate) from an arrangement²⁴ in a relevant year exceeds 30 million INR. GAAR also prescribes the grandfathering provisions. The income earned as a result of transfer of investments made prior to 1 April 2017 is grandfathered. However, any tax benefit which may arise to any taxpayer after 1 April 2017 as a result of an arrangement entered into at any time shall be covered under the GAAR provisions. Further, the provisions of GAAR under the Indian tax law has an overriding effect over tax treaty benefits.

Under Indian GAAR, as codified under its tax law, an arrangement entered into by the taxpayer may be declared to be an impermissible avoidance arrangement on fulfilment of certain conditions.



24 Defined under the provisions but with a very wide scope

Therefore, in view of the above, 'commercial substance' is of utmost importance while defending GAAR application in the taxpayer's case by the tax authorities. Further, the

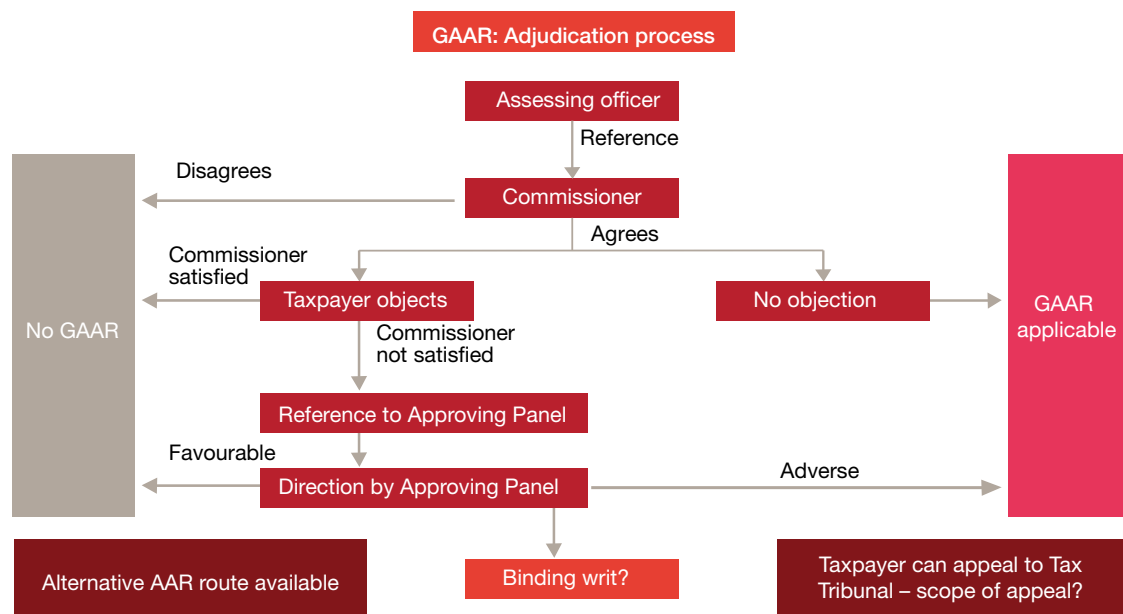
critical aspects based on the provisions prescribed with respect to commercial substance can be summarised as below:

Sr. no.	Cases where arrangement shall be deemed to lack commercial substance:
1.	Substance or effect of the arrangement as a whole is inconsistent with or differs significantly from the form of its individual steps
2.	Does not have a significant effect upon business risks
3.	Without any substantial commercial purpose
4.	Involves: <ol style="list-style-type: none"> Round-trip financing Accommodating party Disguising the value, location, etc.

Further, the major consequences of invoking GAAR provisions against the taxpayer could be as follows:

- Disregarding corporate structure
- Disregarding or re-characterising any step in, or a part of or the whole arrangement
- Disregarding any accommodating party or treating the parties to the arrangement as one and the same person
- Recharacterising the place of residence or situs of an asset or transaction, reallocating the accrual, receipt or expenditure amongst the parties to the arrangement

3. Reporting and compliances



4. Is India prepared: Uncertainty in certainty/ambiguity around GAAR

Due to the wide scope and prescription of qualitative conditions, GAAR, by its very nature, has the potential to create a significant degree of uncertainty and litigation. GAAR provisions give tax authorities wide powers. Further, on application of GAAR to a particular case, the tax consequences will be determined in a manner which is deemed appropriate to tax authorities.

Thus, due to involvement of such inherent uncertainty under the GAAR provisions, it becomes critical to put in place adequate safeguards to ensure judicious application of GAAR, which should be ensured by the government by prescribing detailed guidelines for its application by tax authorities. The statute itself provides that the GAAR provisions will be applied in accordance with the prescribed guidelines. As a welcome move, CBDT has recently come up with certain clarifications vide its Circular No. 7 of 2017 (dated 27 January 2017). The table below prescribes some of the key aspects clarified by the CBDT and its analysis:

Sr. no.	CBDT clarification	Observation
1	Provisions of GAAR and SAAR can co-exist and are applicable in a particular situation.	Subject to other answers like commercial justification, High Court order, etc.
2	In case tax avoidance is not sufficiently addressed by the LOB article of the tax treaty, then GAAR can be invoked.	Sufficiency in addressing tax avoidance through LOB could reduce litigation. It may be relevant to note in this regard that LOBs prescribe a qualitative condition of substance. Providing some clarifications in an illustrative form would certainly go a long way in clarifying any doubts.
3	GAAR will not interplay with the right of the taxpayer to select or choose the method of implementing a transaction.	Testing qualitative condition to invoke GAAR, with this guidance in the backdrop, may result in differing interpretations.
4	GAAR shall not be invoked merely on the grounds that the entity is located in a tax-efficient jurisdiction. If the jurisdiction of foreign portfolio investors (FPIs) is finalised based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply.	Substantiation of commercial considerations on the part of the tax payer is going to be of paramount importance under the GAAR regime. CBDT should have clarified this aspect for all types of taxpayers and not just FPIs.
5	<ul style="list-style-type: none"> Grandfathering provisions would apply to shares acquired post 1 April 2017 as bonus or as a result of split up or consolidation if out of grandfathered holdings. Grandfathering will be available to shares received post 1 April 2017 upon conversion of compulsorily convertible instruments purchased prior to 1 April 2017. 	-
6	Lease contracts and loan arrangements are, by themselves, not 'investments' and hence grandfathering is not available.	CBDT has relied on the accounting definition of the term 'investment' to mention that it would include assets held for earning income by way of dividends, interest, rentals and capital appreciation.
7	GAAR will not apply if Authority for Advance Ruling (AAR) holds the arrangement as permissible.	-

Sr. no.	CBDT clarification	Observation
8	GAAR will not apply where an authority such as the court and NCLT has explicitly and adequately considered tax implications while sanctioning an arrangement.	Going forward, it would be interesting to see what CBDT means by 'consideration of tax implications'.
9	Admissibility of a claim under a treaty or domestic tax law for different years is not a matter to be decided through GAAR provisions.	-
10	There are different approval stages established which should work as an adequate safeguard to ensure that GAAR is invoked only in deserving cases.	-
11	If an arrangement is disregarded or re-characterised pursuant to application of GAAR, then necessary consequences would follow.	CBDT should have clarified whether GAAR provisions could expand the scope of charging provisions, scope of taxable base, etc.
12	Existence of an arrangement for a period of time would only be a relevant factor and not a sufficient factor to determine the commercial substance of an arrangement.	-
13	In the event of a particular consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of another participant will not be made.	
14	As far as the threshold of 30 million INR is concerned, it would be (i) vis-à-vis tax benefit obtained under Indian tax laws only (ii) per year and (iii) vis-à-vis an arrangement and therefore not with respect to single tax payer only.	-
15	If the principle CIT and approving panel have held arrangements to be permissible in one year and if facts and circumstances remain the same, then GAAR will not be invoked for that arrangement in a subsequent year.	-
16	Penalty proceedings would continue as per the relevant provisions under the IT Act in this regard.	-

Clarifications by CBDT are always welcome; however, it would go a long way if illustrative and case-based guidance is also provided. For an example, it would be critical to have clarity under certain practical situations narrated below:

- Where consolidation of entities happens at a group level through amalgamation and where losses of certain entities are set-off against the profits of other entities
- Where a private limited company is converted into an LLP and its profits are distributed thereafter
- Where shares of the listed company are gifted by a company (holding majority of stake) to another individual where controlling interest post transfer shifts in favour of the individual
- Where Company A,²⁵ with substantial reserves, gets merged into a newly set-up Company B²⁶ and the merged entity (a newly set-up company) is converted into an LLP. The amalgamating entity could not have fulfilled the monetary limits as prescribed vide section 47.

To sum up the discussion on GAAR, it may still be pertinent to take note of certain key recommendations by the Shome Committee²⁷ which are critical in the field of mergers and acquisitions: -

1. Tax mitigation should be distinguished from tax avoidance
2. A negative list for the purpose of invoking GAAR, illustrated below, should be specified –

- a. Selection of one of the options offered in law. For instance:
 - ii. Payment of dividend or buy back of shares by a company
 - iii. Setting up of a branch or subsidiary
 - iv. Setting up of a unit in an SEZ or any other place
 - v. Funding through debt or equity
 - vi. Purchase or lease of a capital asset
 - b. Timing of a transaction, for instance, sale of property in loss while having profit in other transactions
 - c. Amalgamations and demergers (as defined in the Act) as approved by the High Court
4. GAAR should not be invoked on intra-group transactions (i.e. transactions between associated persons or enterprises) as this may result in a tax benefit to one person, with the overall tax revenue staying unaffected either by actual loss of revenue or deferral of revenue.
 5. Where only a part of the arrangement is impermissible, the tax consequences of an 'impermissible avoidance arrangement' will be limited to that portion of the arrangement only.

Further, guidance addressing such recommendations would go a long way to avoid undue litigation which may otherwise create a lot of uncertainty in the field of M&As.

²⁵ Section 47(xiii b) non-compliant company, i.e., turnover and fixed assets are in excess of prescribed monetary limits

²⁶ Section 47(xiii b) compliant company, i.e. turnover and fixed assets are below prescribed monetary limits

²⁷ Expert Committee on GAAR set -up by the Ministry of Finance

Chapter 11: REITs and InvITs redefining the funding strategy

1. Introduction to REITs/InvITs

Infrastructure and real estate are the two most critical sectors, which are the growth drivers of every developing economy. Estimates suggest that top notch infrastructure and robust real estate can boost India's GDP growth by 1–2%²⁸ every year. India has great potential and scope to improve its infrastructure and thereby propel its growth rate.

In order to seize the opportunity, SEBI introduced InvIT regulations and REIT regulations for infrastructure and real estate projects respectively.

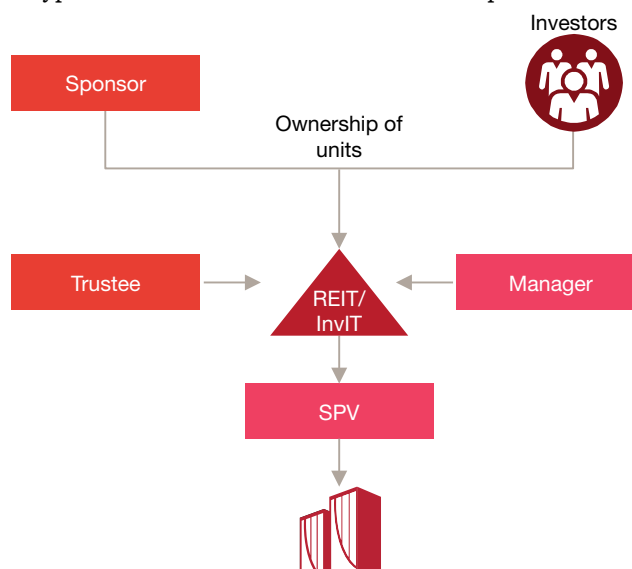
What is a REIT/InvIT? In common parlance, an InvIT or a REIT is a SEBI-registered investment vehicle that owns and operates infrastructure/real estate assets and allows institutional/retail investors to earn stable low-risk income produced through ownership of infrastructure assets/commercial real estate.

What's in it for developers/sponsors? A sponsor/developer is required to swap his properties/assets or holdings in SPVs, holding the assets to the REIT/InvIT in consideration of the units of the REIT/InvIT. These units are to be offered to the public, generating liquidity for the sponsors/developers. The REIT/InvIT model provides an opportunity to monetise existing assets and reduce debt.

What's in it for the Investors? Globally, REITs/InvITs have been the key drivers for development of the real estate/infrastructure sector as they provide a platform to retail and institutional investors to invest in such projects. Since the platform is regulated, it reduces the inherent risk in such assets and gives the investors an opportunity to invest in a stable return-generating instrument with low risk to capital. A REIT/InvIT, being a listed platform, provides an easy entry and exit to new as well as existing investors.

2. Typical REIT/InvIT structure

A typical REIT/InvIT structure in India is depicted below:



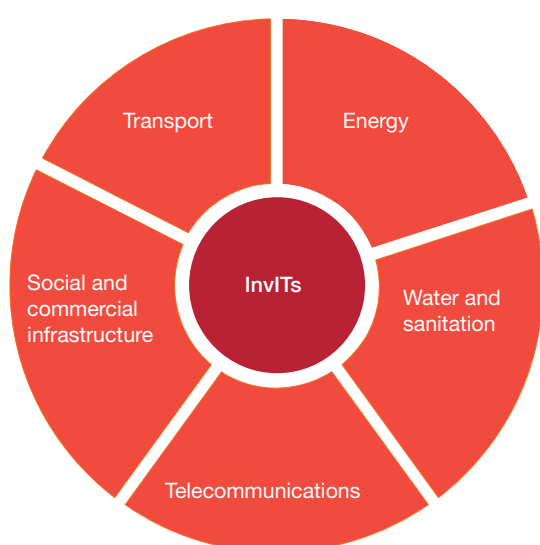
The brief description of parties involved in a REIT/InvIT structure is given below:

- **Sponsor:** A sponsor is akin to a promoter in an initial public offer (IPO). Typically, a sponsor is a developer who owns real estate/infrastructure assets and the one who sets up the REIT/InvIT.
- **Trustee:** A trustee is an independent person who manages the REIT/InvIT on behalf of the unit holder, in accordance with SEBI regulations.
- **Manager:** A manager is an entity who manages the assets and investments of the REIT/InvIT and undertakes operational activities for them.



28 Address by Shri S. S. Mundra, Deputy Governor, Reserve Bank of India at 'Citi's Investor Summit: India poised for higher growth' in New Delhi on 17 November 2014.

Further, SEBI, REIT and InvIT regulations have specified the sectors which will qualify for a REIT/InvIT. A REIT would typically hold rent-generating real estate assets. On the other hand, eligible sectors²⁹ which qualify for InvIT would include:



3. Tax implications/aspects

In the recent past, various tax reforms have been announced for REITs/InvITs. The government has been proactive in making the necessary amendments in the Indian Income-tax law to ensure that REIT/InvIT regulations are at par with the world standards and ensure effective REIT/InvIT listings in India. A brief overview of the tax incidence in the hands of various stakeholders is as under:



A. In the hands of the sponsor/developer (on set up of a REIT/InvIT)

Income stream	Resident/non-resident
Swap of shares of companies (holding assets) to the REIT/InvIT	Exempt
Swap of assets to the REIT/InvIT	Taxable

B. In the hands of the REIT/InvIT

Income stream	From SPVs (owning property)	Direct ownership of property by REIT/InvIT
Rent	Taxable at SPV	<ul style="list-style-type: none"> • Pass-through for REITs (Tax incidence on Unit holders) • Taxable for InvITs
Dividend	Pass-through to the unit holders	NA
Interest	Pass-through	NA
Capital gains	Taxable	Taxable

29 Notification of the Ministry of Finance dated 7 October 2013 vide F. No. 13/6/2009-INF.

C. In the hands of unitholders (including sponsors)

Income stream	Resident	Non-resident
Rent from REIT	Taxable at applicable rates	Taxable at applicable rates (subject to tax treaty)
Rent from InvIT	Exempt	Exempt
Dividend	Exempt	Exempt
Interest	Taxable at applicable rates (Withholding tax @ 10%)	Withholding tax @ 5% (final tax under domestic law)
Capital gains on sale of units on the floor of stock exchange (subject to Securities transaction tax)	Long-term: ³⁰ Exempt Short-term: Taxable @ 15% plus Surcharge + education cess Minimum alternate tax (MAT ³¹) applicable (for companies)	Long-term: Exempt Short-term: Taxable @ 15% plus Surcharge+ education cess (subject to tax treaty)

Globally, InvITs /REITs have existed for more than 50 years. Over the years, they have become a preferred mode of investment and have gained vastly in terms of their market capitalisation. With the government providing a

much-needed boost for REITs and InvITs in the regulatory and tax field, the market for these investment vehicles is expected to grow at a rapid pace in the future and can help in accelerating the growth of the Indian economy.



³⁰ Units held for more than 36 months will be considered as long term.

³¹ MAT will be chargeable at the rate of 18.5% (plus applicable surcharge and cess).

Chapter 12: BEPS – impact on M&A

BEPS: Impact on M&A

The Organisation for Economic Cooperation and Development (OECD) initiated the BEPS action plan on the back of the following underlying themes:

- Effective focus on substance
- Need for transparency (of the global operations of a multinational entity)
- Emphasis on clear alignment of taxation with location of economic activity and value creation
- Update of double tax treaties and domestic tax laws
- Requirement for certainty for both business and governments

The BEPS action plan is already gaining significant momentum, and governments across the world are amending their domestic tax laws to incorporate and reflect some of these guidelines. This chapter focuses on how BEPS, and the changes in tax law that it may effect, will impact M&A.

M&A deals have never been straightforward. The intricacy and complexity are only going to increase in a post-BEPS environment, and BEPS is probably going to cause a fundamental overhaul in the M&A and deals landscape. Transaction processes are set to change and this may just be the beginning of a new norm.

Primarily, BEPS is going to impact all aspects of a transaction process—starting with due diligence, transaction structuring and valuation, extending to operation and maintenance of the transaction structure, consolidation and integration, and finally to reporting and compliance.

Let us look at some specific issues around BEPS and M&A transactions:

Inheritance of aggressive structures:

BEPS may compel business buyers to relook diligence procedures—for instance, detailed processes may need to be carried out to determine if any aggressive tax structures are being inherited as a part of the acquisition. Reputational risk is of paramount significance and this will be increasingly considered in the overall risk assessment. Adequate upfront knowledge of aggressive tax structures and of potential consequences are likely to be factored in the valuation.

Tax treaty and substance:

Action 6 (treaty abuse) and Action 7 (permanent establishment or PE) will become very relevant, especially for private equity players, funds, etc. Increased levels of substance at the fund and holding structure level will be a key factor, the absence of which might restrict access to tax treaties. Companies will need to shed light on how decision-making and management functions are carried out, and demonstrate how such structures meet business purpose and commercial rationale tests. This might increase the operational costs of maintaining these structures. Further, a more expansive definition of PE fund management activities could trigger taxable business presence concerns.

Hybrid financial instruments:

The benefits of deal financing and tax credits may be impacted given Action 2 (hybrid mismatch arrangements) and the narrowing of relief under Action 4 (interest deductions).

Operations model planning:

Operating models will have to undergo changes based on the place of actual economic activity and value creation. Allocation of profits to various functions in the value chain and ability to claim special incentives (such as patent box or other schemes supporting research and innovation) will need to be given a closer look under Actions 8–10 (TP). Separately, operational policy integration and review of structures post acquisition will be imperative to achieve overall M&A objectives.

Overall transparency:

Enhanced and complex compliance and reporting obligations will be necessary under Action 13 (country-by-country reporting). Processes and technology will need to be put in place to capture detailed data, leading to more management time and costs.

In summary, some of the key focus areas for an M&A transaction against the backdrop of BEPS are:

- Detailed tax due diligence procedures will be needed to assess tax risks broadly—for instance, consider reputational risks due to increased focus by media, politicians, etc.

- Impact on existing operations as well as holding or financing structures will need to have a re-examined more closely. Operational policy integration of structures post acquisition will also be an important consideration.
- Organisations will need to bear in mind any possible restrictions on hybrid mismatches and interest deductions, including any changes in the target's overall supply chain, as this might impact valuation and tax profile.
- Certainty through advance pricing agreements or mutual agreement procedures may become important—this will give the buyer more comfort. However, aligning transaction deadlines with these processes could pose a challenge.



Chapter 13: Indirect transfers – lifting the veil

Indirect transfer is a term that gained India attention in the early half of this decade. In tax parlance, indirect transfer means transfer of interest in a foreign entity which derives its value substantially from Indian assets, with the transfer of such interest being subject to tax in India. It was against the backdrop of the Supreme Court's decision in the case of Vodafone³² that indirect transfer provisions were introduced in the Indian Income-tax Act, 1961, in the year 2012 with retrospective applicability from 1 April 1962.

The provisions clarified that shares or interest in a company or entity registered or incorporated outside India shall be deemed situated in India if the share or interest derives, directly or indirectly, its value substantially from the assets located in India. Indirect transfer covers within its ambit not just shares in a company but also right to management or control in relation to an Indian company.

While the objective of introducing these provisions seemed to be to protect the tax base from highly abusive tax planning structures, the provisions raised several apprehensions in the minds of foreign investors regarding the stability and predictability of the Indian tax regime, given that the provisions were to be implemented retrospectively. Further, these provisions were considered to be draconian given their wide scope and lack of clarity on various aspects such as applicability and valuation.

Based on the recommendations of the expert committee, the Finance Act, 2015, made certain amendments to provide clarity in relation to these provisions. Further, in this regard, the valuation rules were recently notified.

The Finance Act, 2015, clarified that the share or interest of a foreign company or entity shall be deemed to derive

its value substantially from Indian assets (tangible or intangible) only if the value of Indian assets as on the specified date exceeds the amount of:

- 100 million INR; and
- Represents at least 50% of the value of all the assets owned by the foreign company or entity.

For the purpose of valuation of assets, the Act considers the fair market value of assets on the specified date without reduction of liabilities.

The specified date shall be either the immediately preceding accounting period end prior to the transfer or the date of transfer. The date of transfer shall be considered as the specified date only where the book value of the assets of the foreign company on the date of transfer exceeds the book value of the assets as at the end of the immediately preceding accounting period by more than 15%.

These provisions ensure that transactions where the value of Indian assets is not substantial compared to that of the global assets of the foreign company are not chargeable to tax in India.

Further, express relief has been accorded to minority shareholders and cross-border amalgamations/demergers subject to meeting certain prescribed conditions.

CBDT recently issued a circular³³ clarifying that the applicability of provisions of indirect transfer to FPIs. However, after the issue of the circular, in view of the representations received from FPIs, foreign institutional investors (FIIs) and other stakeholders, the operation of the circular was kept in abeyance until the representations were considered and examined.



³² Vodafone International Holdings B.V. v Union of India & Another [2012] 341 ITR 1 (SC)

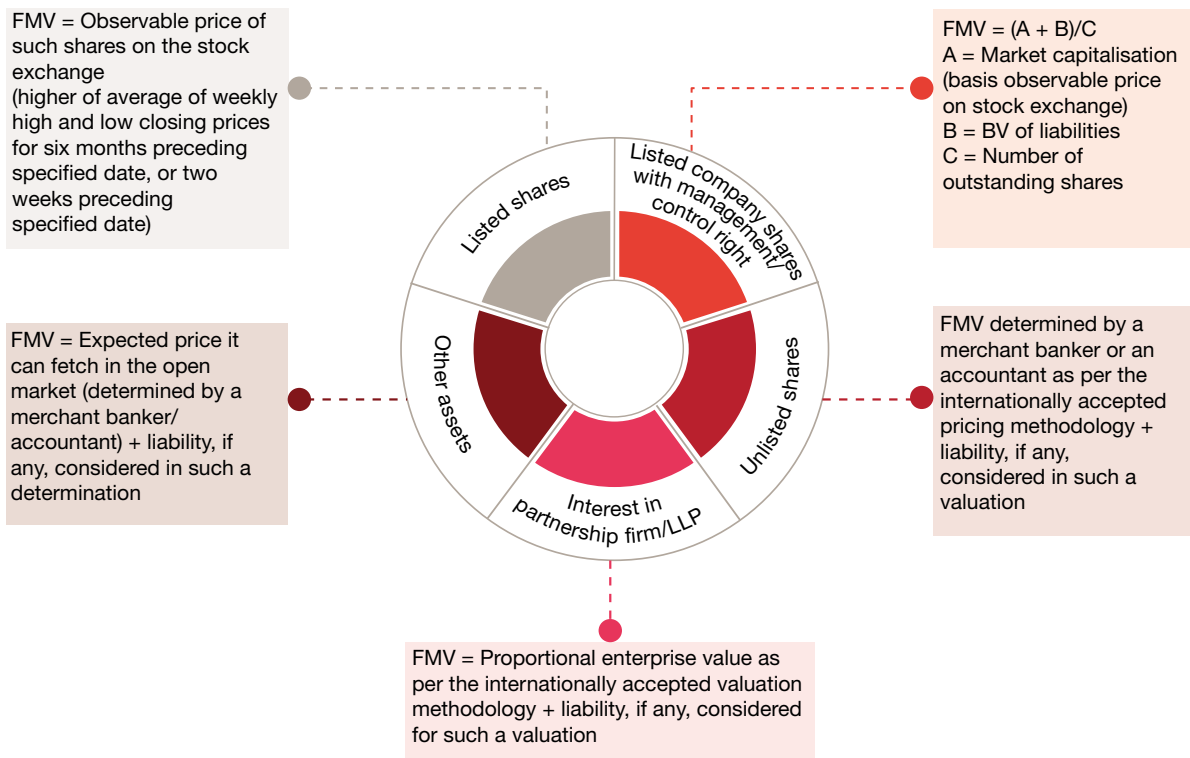
³³ Circular No. 41 of 2016, dated 21 December 2016

Glimpse of valuation rules

The valuation rules notified by CBDT prescribe the methods of computation of the following:

- Fair market value (FMV) of assets of Indian company/ entity and the foreign company/ entity
- Income attributable to assets located in India

The FMV of the assets of an Indian entity shall be computed in the following manner:³⁴

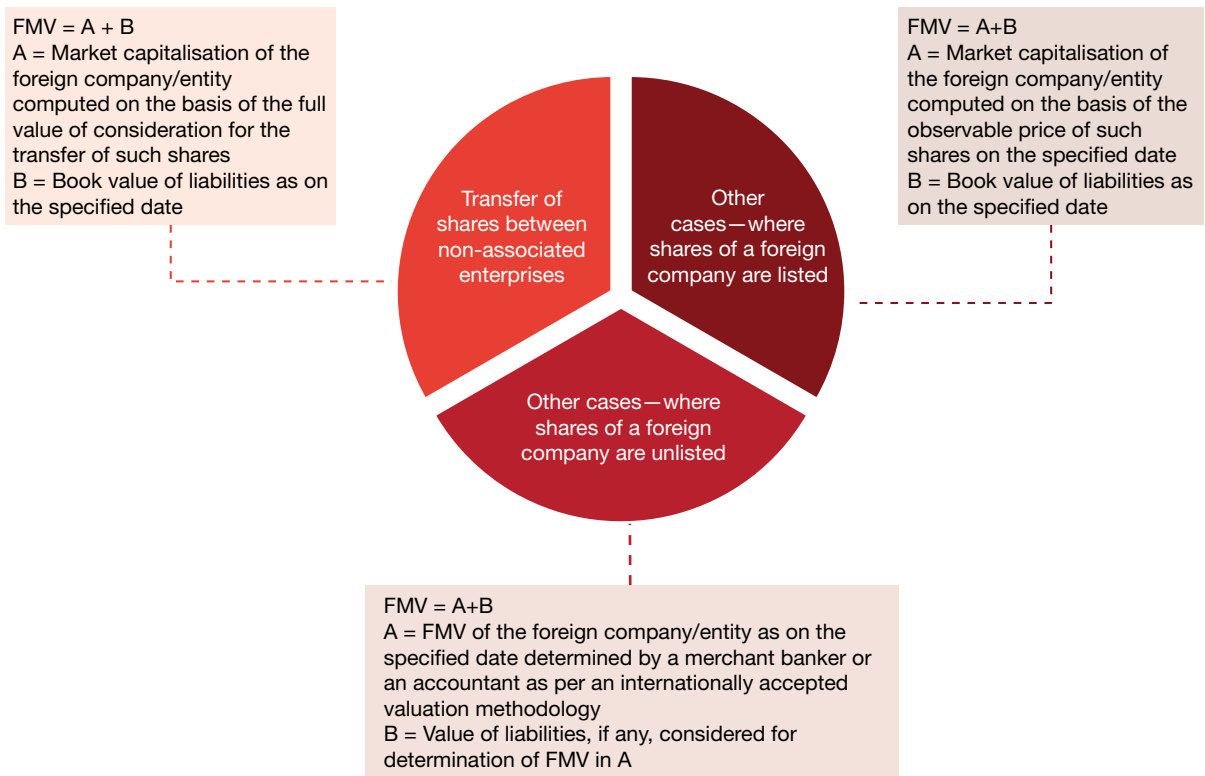


To determine the fair value of shares/interest of Indian company/entity, all assets and business operations of such company/entity located in India as well as abroad shall be considered.

The value of Indian assets as determined above shall be required to be converted into foreign currency based on the telegraphic transfer buying rates of such currency on the specified date.

³⁴ Notification S.O. 2226(E) dated 28 June 2016

The FMV of the assets of a foreign entity shall be computed in the following manner:³⁵



Method of determination of income attributable to assets located in India

The income from indirect transfer is taxable in India only to the extent of income as is reasonably attributable to assets located in India.

In this regard, the income attributable to assets located in India would be computed using the following formula:

$$A \times B / C$$

A = Income from the transfer of share of or interest in the company or entity, computed in accordance with the provisions of the act as if such share or interest was located in India

B = FMV of the assets located in India on the specified date from which the share or interest as referred to in 'A' derives substantial value, to be computed in accordance with Rule 11UB of Income Tax Rules

C = FMV of all the assets of the company or entity as on the specified date computed in accordance with Rule 11UB of Income Tax Rules

It may be noted that where the above information is not provided by the seller of the foreign company, tax authorities shall determine the income attributable to assets located in India in such manner as they deem suitable.

In pursuance of the valuation rules stated above, the taxability of indirect transfer confers responsibility on the Indian concern and the transferor company to comply with certain reporting requirements.

35 Notification S.O. 2226(E) dated 28 June 2016

Reporting:

Reporting requirements of Indian concern

The Indian concern is required to furnish the prescribed information electronically to tax authorities within 90 days from the end of the financial year in which transfer of the share/interest takes place. Where the transaction has the effect of directly or indirectly transferring the rights of management or control in relation to the Indian concern, the information shall be furnished within 90 days from the date of the transaction.

Further, the Indian concern shall be required to maintain certain documentation in relation to the transaction for a period of not less than 8 years from the end of the relevant assessment year in which the transaction takes place.

Reporting requirements of the seller

The seller of the foreign company which derives substantial value from assets located in India shall be required to file its return of income in India.

Additionally, the seller of the foreign company shall obtain an accountant's certificate in prescribed form,

providing the basis of the apportionment in accordance with the formula and certifying correct computation of income attributable to assets located in India. This certificate shall be filed along with the return of income.

The amendments relating to indirect tax provisions and recently prescribed valuation rules bring in much-needed clarity on the tax provisions relating to indirect transfers in India. However, there are a few points which may require further clarification from the legislature/CBDT—namely the definition of the book value of liabilities, which excludes equity share capital, securities premium and reserves, and which is silent on the treatment of preference share capital, applicability of the rules in the computation of income and reporting thereof for transactions concluded prior to the applicability of the rules, maintenance of documentation by the Indian concern and reporting by foreign concern where treaty benefits are available, etc.

The significant changes being made in the indirect transfer provisions are a welcome move to boost the confidence of foreign investors and a step in the right direction for navigating towards a non-adversarial tax regime in consonance with the global policy.



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