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The Analysis of Merger and Acquisition under various Indian Laws

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Abstract

The process of merger and acquisition was a very lengthy process to adhere with back days in the corporate world which have now gained substantial importance; due to which the process involved has also been organised by governmental bodies in an efficient way. The concept of Merger and Acquisition was initiated by government for financial organisations for restructure of their organisations that was opened up by the economic reform since 1991. The trend of merger and acquisition has been changing over time with involvement of various laws in the process to make it efficient. The current study would analyse the various laws prevalent in governing mergers and acquisition and their applicability.

Keywords: Mergers and acquisition, company law, securities law, competition law, income tax act, goods and service tax

INTRODUCTION

"Wide diversification is only required when investors do not understand what they are doing."

—Warren Buffett

A growing business is defined by its recognised products and services offered by the company. It can also be recognised by way of expansion in aspects of work force, customer base, resources and substantial increase in profits and revenues of the company. Mergers and acquisitions come into play for multiplicity of a growing business. While mergers are defined as unification of two or more entities by a way of arrangement or agreement between the entities to form a single entity for the purpose of getting financial aid or restructuring the organisational structure of the company. Merger and Acquisition in India has been governed by the legislation of the Companies Act, 2013 primarily, which has control over companies' established structure and transaction relating to M&A. The Companies Act of 2013 contains legislative regulations governing mergers and acquisitions that involves companies, their members, and creditors for arrangement. Under Competition Act, 2002, Sections 5 and 6 are the operational and substantial provisions for regulation of merger in India. In merger control, the Competition Commission of India (CCI) plays a supervisory rather than an adjudicatory function. Whereas SEBI's involvement in the Market of Securities is to put up guidelines and regulations. While the transactions of M&A are involved under the Second amendment of SEBI (Substantial Acquisition of Shares and Takeovers). Whereas, under the Income Tax Act, 1961, it deals with provisions relating to taxation of varied types of

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mergers and acquisitions. There are some requirements under Income Tax act that need to be fulfilled to meet the criteria required to be a tax neutral company after M&A.

M&A are governed by various statutes of the law including Companies Act, 2013; Competition Act, 2002; Takeover Code by SEBI; Income Tax Act, 1961, and GST Laws. In this study aims to discuss about the various laws and regulations that governs M&A in India by following stages:

- *Stage I: Analysis of Merger under Law:* Discussing Mergers under Company Law, Securities Law and Competition Law.
- *Stage II: Analysis of Acquisition of Law:* Discussing acquisition under Company Law, Securities Law, Income Tax Act and Goods & Services Tax.

STAGE I: ANALYSIS OF MERGER UNDER LAW

The term Merger refers to two or more business entities combining to become one big entity, it may include merging the assets and liabilities of both the entities and just merging for the achievement of efficient organizational operations for both the businesses. There are different types of mergers for the specific needs of both the entities such as: *(1)Horizontal Mergers* which refer to Merger of two separate entities engaged in the same line of competing business; *(2) Vertical Mergers* refers to two separate entities merging which are involved in different stages of production or industrial process; *(3) Congeneric Mergers* refers where two separate entities are in related industry sector but tend to offer different products; *(4) Conglomerate Merger* refers to merger involving two separate entities of different line of business to merger for utilization of each other’s financial resources or to increase the debt capacity; *(5) Triangular Merger* refers to the merger of a company to its subsidiary company or the other way around for the reasons of regulation and taxation.

Reasons for M&A

Nowadays, Merger and acquisitions take place for varied reasons: the most common ground for two companies to merge, is to create synergies by combining both the company’s assets by reducing cost or increasing revenues. Economies of scale creates cost of synergies while market share creates revenue synergies. Other way to M&A takes place is higher growth by company’s acquiring target, company’s capabilities without having risk to develop themselves. Strong market power by merging with other company gives them advantage of influencing prices and gain power over the market share. Diversification by a cyclical industry by acquiring a non-cyclical industry enables to lesser market risk. Tax benefits are always looked by a company while acquiring other company such as when the company faces tax losses, its tax liability reduces which can ultimately avoid taxes.

Under Company Law

The provisions of company law govern mergers between companies, its investors, and creditors by understanding of an arrangement or agreement for regulation of corporate restructuring. There are specific provisions mentioned in the Companies’ act, 2013 for the regulation of merger:

- Under Section 231 r.w section 230, the NCLT has power to enforce an arrangement for a company with respect to the supervision of the arrangement’s implementation; power to suggest modification in such arrangement if necessary; if the tribunal is not satisfied with such modification in respect implementation of arrangement, it can order for winding up of the company under Section 275.
- Under Section 233, a wholly owned company can merge with its subsidiary who both have paid up capital of less than 100 million with the approval from registrar, shareholders, creditors, and official liquidator for a fast-track merger.
- Under Section 234, with prior approval of RBI, an Indian company could merge with a foreign company if it incorporated in a permitted jurisdiction, that the valuation must be done by a recognized body in respect with accounting standards, and the procedure must be followed prescribed under Companies act, 2013.

Joint Application

When more than one firm is participating in a scheme, the application may be filed as a joint application at the discretion of the companies concerned. However, where the registered offices of the firms are in different states, two tribunals will have jurisdiction over those corporations, necessitating the filing of a second petition.

Process

- It must be ensured that the firms undergoing merger have the power to undergo amalgamation in the object clause of their Memorandum of Association, even if this is not an impediment.
- A draught scheme of amalgamation must be drafted and approved by each company's board of directors.

Under Securities Law

The securities and exchange board of India is a governing authority for listed stock exchange on BSE or NSE.

- The SEBI Regulations, 2011 **(Takeover Code)** regulate the acquisition of shares, voting rights and control where an acquirer should acquire 25% or more of the voting rights or control by making an obligatory offer to the target company's shareholders. Further, acquiring offer must not be less than 26% of the voting rights [1].
- SEBI, Under **Listing Regulations** has certain set criteria for Listed companies to grant approval for Merger; reconstruction is by making an application before National Company Law Tribunal [1]. The listed company must file draft scheme of merger with the relevant stock exchange to seek a letter of non-objection before filing under NCLT [2]. The listed company should ensure that the provisions under security law must not get violated under the scheme of merger [3]. The listed company must file the arrangement of shareholding pattern both pre and post analysis with the relevant stock exchanges [4]. The listed company has an obligation to disclose any information that might affect the performance, operation or prices of the stocks [5].

Under Competition Law

In India, Merger regulation is governed by Sections 5 and 6 of the Competition Act, 2002, that are substantive and operative provisions of the act, whereas Sections 29 to 31 of the CCI (Procedure regarding the transaction of business relating to combinations) Regulations, 2011 ("Combination Regulations") sets out the time-based procedural requirements in relation to mergers. Competition Commission of India (CCI) performs a regulatory role in governing the merger of any company rather performing an adjudicatory role.

If D and E are two of India's top cement companies in the industry and join together to form a merged entity; this may have a major negative impact on the prevalent competition established in the cement industry since a large quantity of competition may be reduced because of this transaction. This is a decision that must be made by the CCI. The act contains substantive and procedural elements that require the CCI to conduct this evaluation. On an appellate level, the NCLAT (formerly the Competition Appellate Tribunal) established Section 53-B of the act to hear appeals. Prior to the act's revision in 2007, merger notice was regarded as an "optional proposal", which meant that the parties were free to inform after the transaction had been completed. The control regime for merger mandated the parties involved to filing of notification due to the change in 2007. Suspensory requirement compels parties to notify the CCI of the nature of their planned transaction or combination immediately after getting the approval by the company's board of directors and not to execute such plan before receiving the approval of CCI.

STAGE II: ANALYSIS OF ACQUISITION UNDER LAW

The term Acquisition refers to one person purchasing the share capital or substantial assets or liabilities of the interested target company to issue new shares by acquiring target company. Acquisition by an acquirer may be hostile or friendly in nature and might be a structured arrangement by way of making an offer for acquisition of the preferred target shares by the shareholders. Transfer can also be done through a slump sale wherein business is being acquired on going concern basis [6]. A demerger is supposed to be a form of acquisition where in one entity is split into two or more entities for the reason of financial crisis or any other business-related aspects providing restructuring or sale of that business entity by way of business transfer agreement. Joint ventures are considered as two or more business entities join to fulfil some specific skills, expertise, or investment by both the entities involved in joint venture by setting up either a new company or joining in with the existing one. An agreement is laid out to set the basic framework for the joint venture company and as the bylaws are incorporated for enforceability of such framework for the company.

Under Company Law

- Any Indian company after acquisition of any certain company can establish it as a private or a public company. A private company does not face a restriction on transferability of shares by central government but is governed under articles of association of the company with a form of pre-emptive rights of the shareholders. Public company faces the transferability of shares which is statutorily authorised [7]. The AOA prescribes the process of transferability of shares waving the rights of pre-emptive shareholders with compliance under the bylaws mentioned in articles of association.
- An acquirer of 90% or more of the shares of the amalgamating company must notify the company of their motives to buy the remaining equity shares with the fair amount of offer to minority shareholders by the value obtained by registered valuer [8].
- An unlisted company holding at least 75% of voting rights for acquisition can make an offer with a compromise application or file an arrangement before NCLT. On such approval, minority shareholders will be mandated to sell the shares to the acquirer [9].
- An acquirer who is incorporated in India can acquire security of other corporate bodies by way of purchase, subscription up to 60% of its paid-up share capital and a 100% of the acquirer's securities and free reserves. Acquisition of shares can be only of such limit of acquirer until a special resolution is passed by the authorized shareholders [10].
- An acquisition of assets or purchase of business can be done buy an acquirer depending upon the corporate objectives of the acquirer. Purchase of assets can be done by a one company purchasing all assets of other company or one can acquire business undertaking of other company's business on going concern basis via slump sale. The acquisition of such nature by way of a special resolution requires authorisation of the shareholders over purchase limit of 20% of the acquirer company's net worth [11].

Under Securities Law

- The provision of takeover code applies to both indirect or direct acquisition of shares, control or voting rights over a target company. Takeover code notifies the listed company shareholders of the nature of change in control or acquirer substantial acquisition by a way-out option if they do not want to retain their shares.
- An acquirer is mandated to make an offer for acquisition of shares to all the shareholders and provide them with the option to exit [12].
- Acquisition of control can be regulated by the acquirer with making a mandatory obligated offer to take control of the target company before acquisition.
- In a mandatory offer [13], share acquisition of the target company must be for at least 26% of their shares. Where in a voluntary offer [14], acquirer holding 25% voting rights or control can offer for least 10% of their shares and maximum up to 75% of the target company's share.
- After an indirect acquisition, an open offer can be made to public shareholders for IPO before determining the offer prices laid down under the Regulation 8 of the Takeover code.

- Other than acquiror person is permitted to make a competitive bid within 15 days for acquisition of shares after public announcement of the first bidder. Bidders are permitted to revise the bids that are more profitable for the shareholders of the target company [15].

Under Income Tax Act, 1961

ITA recognises mergers and acquisitions by way of certain conditions to qualify as amalgamation under income tax act. All the property and the liabilities of the amalgamating company become the property of amalgamated company. Shareholders of the amalgamating company holding not less than 75% of shares become the shareholder of amalgamated company except in case of subsidiary merging into parent company.

- Under Section 45 of ITA, Transfer of Capital assets lead to arising **taxation on their capital gain** which includes Assets sale, exchange or relinquishment; Compulsory acquisition; in case of conversion of assets by owner; any commercial transaction leading to effect of transferring enabling enjoyment of property; zero coupon bond redemption.
- Under Section 47 of ITA, provides exemption from tax on capital gains after merger of the entities such as transfer of assets in merger gives merged company exemption from tax on capital gain (Both the Entities should be incorporated in India [16]); Transfer of shareholding from a foreign to an Indian company to another foreign company gives rise to exemption from tax for Indian company if the merged foreign company holds 25% of shareholders in amalgamated foreign company and if the amalgamated company is incorporated outside the jurisdiction of the amalgamating company [17]; Transfer by shareholders to an amalgamated company for consideration of allotment of shares would be exempted from tax from capital gains [18]; Transfer of shares of a foreign amalgamating company by shareholders that drive 50% value from assets of the Indian company tends to be exempted from tax on capital gains [19].

Under Goods and Service Tax

GST law regime was introduced in replacement of Indirect Tax which came in force on 1st July 2017. Now, under such regime there were two branches of tax levied which is Central GST known as CGST and State GST known as SGST on all inter-state supplies of goods and services with the inclusion on imports of goods and services under Trade and Commerce course. There are certain Rates that are established by Government for better unform functionality of GST that is fixed as 5, 12, 18, and 28%. Under purchase of an asset, the GST rate will vary depending upon the type of asset being sold. Under Slump Sale Transactions, no GST would be applicable as business is excluded from the ambit of GST as it is neither good nor services. Under Shares, it is excluded from GST as shares comes under the ambit of securities law and there would no GST levied upon Shares transfer in case of two companies merging or demerging.

CONCLUSION

The present study has laid down a bare-bones analysis on the topic of Merger and Acquisitions as established in the Indian economy by comparison with various aspects of different legislations in force. The authorities referred to in the present analysis include the Companies Law, Competition Act, Income Tax Act, various security laws as established by SEBI and even includes a small explanation of the Goods & Services Tax. The aim of the research work was to study the interaction between the concept of M&A and the various authorities cited to analyze the interplay between the models. It can be concluded that the concerned authorities have done their best to build a detailed and clear system to support merger and acquisitions in India with the aim of increasing the ease to do business in the country. However, no matter how detailed or concise a system, there would always exist loopholes and gaps left behind which may be exploited by malicious individuals. The true test of the authorities would be to fill such gaps and loopholes by addressing them appropriately whenever highlighted and ensure that the use of their powers do not unduly or unjustly interfere with the process of Mergers and Acquisitions.

Abbreviations

Abbreviation	Full Form
&	And
AOA	Article of Association
CCI	Competition Commission of India
GST	Goods and Services Tax
IPO	Initial Public Offering
ITA	Income Tax Authority
M&A	Merger and Acquisition
NCLT	National Company Law Tribunal
r.w	Read with
SEBI	Securities & Exchange Board of India

REFERENCES

1. Regulation 3 r.w Regulation 7 under the Takeover Code.
2. Regulation 37(1) of the Listing Regulation.
3. Regulation II of the Listing Regulation.
4. Regulation 69(2) of the Listing Regulation.
5. Regulation 51 of the Listing Regulation.
6. Section 2(42c) of the Income Tax Act.
7. Section 58(4) of Companies Act, 2013.
8. Section 236 of Companies Act, 2013.
9. Section 230 of Companies Act r.w Rule 3 of the company rules.
10. Section 186 of Companies Act, 2013.
11. Section 180 of Companies Act, 2013.
12. Regulation 3,4 and 5 of the Takeover Code.
13. Regulation 7(1) of the Takeover code.
14. Regulation 7(2) of the Takeover code.
15. Regulation 20 of the Takeover Code.
16. Section 47(vi) of the Income Tax Act, 1961.
17. Section 47(via) of the Income Tax Act, 1961.
18. Section 47(vii) of the Income Tax Act, 1961.
19. Section 47(viab) of the Income Tax Act, 1961.

