Introduction

“Economic Liberalization in India” started from 1991 which aimed at integration of national economy with “market oriented globalised economy”. The real opening of the economy started with the industrial policy 1991 whereby “continuity with change” was emphasized and main thrust was on relaxation in industrial licensing, foreign investments, transfer of foreign technology, joint ventures etc.

Historically, capital has flown to countries offering better returns, protection and certainty in terms of policies and regulations. Recently, emerging markets are not just experiencing outbound deals; there is also a lot of hindrance by western firms in acquiring targets in these markets.1 “This will be the century of the emerging market”, Goldman Sachs, Chief Financial Officer, David Viniar, told investors. The whole concatenation depicting a shift of economic activities and capital flow constitutes the much talked about abstraction known as “Globalization”. Globalization is one of the serious challenges for tax policy makers, as the consequences of globalization are not restricted by the physical boundaries of countries and domestic legislation. With globalization Indian companies are looking forward to drive cost lower, innovate speedily and increase their international presence, which may help insulate from the vagaries of domestic market and to spread the risk.

United Nations Conference on Trade and Development (UNCTAD) Report on World Investment prospects survey 2009-11 states India would continue to remain among the top five attractive destinations for foreign investors during the next two years.2 Contemporaneous economic reforms by the Indian government and restructuring by Indian companies to attain global scale have resulted in sharp rise in merger and amalgamation activity in recent years. Progressive deregulation in sectors such as banking, insurance, power, aviation and housing, and policy rationalization in others, such as broadcasting, telecommunications and media, coupled with the government’s decision to exit non strategic areas through divestment/ disinvestment has further triggered cross border business reorganization.

According to survey, India is one of the top four markets for cross border reorganization. The top four includes greater China (49%), North America (29%), South East Asia (27%) and India (22%). However Asian bidders are concerned by issues of bribery and corruption and undisclosed liabilities in India.3 The World Investment Report 2000 categorically states that most of the growth in international production has been through cross border M&A’s rather than Greenfield Investment.4

Recent Cross Border Reorganisation

Cross Border M&A totals US$ 84.5 billion for year to date 2010, a 79% increase over the same period last year. By number of deals, cross border transactions are up just 6% for the year. A $10.7 billion bid for Zain Africa by Indian based telecom provider, Bharti Airtel and Norwegian Fertilizer producer Yara International’s proposed acquisition of US based Terra industries contributed to the cross border total, which accounts for 32% of world wide activity, compared to 24% last year at this time.5 India’s Reliance Industries sweetened its November offer to take control of

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2 http://www.forumfin.com/2010/03/03/foreign-cos-fees-for-work-sent-to-india-not-taxable-aar/aar
Lyondell Basell industries to US $ 14.5 billion.\(^6\) Last year Ford decided to put two iconic British brands Jaguar and Land Rover, on sale and Tata motors emerged as the preferred buyer. Tata motors will finally have access to the global market despite the ten year presence in the domestic car market. Tata Steel acquired the UK based Corus group for a reported US $ 12,000 million.\(^7\)

**Meaning**

In words of Justice Chandrachud; corporate reorganization is one of the means that can be employed to meet the challenges which confront business. A Cross border business reorganization is an arrangement between organizations in different countries. Such corporate combinations play an important role in the global economy as they facilitate free flow of capital across borders, enhance competition and globalised business.

Merger, Amalgamation, Acquisition, Joint Venture, Takeovers and Slump sale of assets are few methods of cross border reorganization. In common parlance, amalgamation is a corporate legal process by which one company is absorbed into another company or two or more companies are amalgamated into a new entity. A merger on the other hand is fusion or absorption of a company into another. For Indian tax purposes, both the terms “amalgamation” and “merger” are used synonymously.

International M&A may often necessitate the transfer of shareholding interest of foreign holding companies in its Indian subsidiary or Joint Venture companies. The multinational trade agenda and WTO have been facilitating easy and free flow of capital technology and money across the world, thereby enhancing cross border reorganization.

**Regulatory Framework**

Indian legal system regulates and governs various aspects of a cross border reorganization by a set of laws. The relevant laws that may be implicated in a cross border M&A are the Companies Act, 1956, the Foreign Investment policy of the Government of India along with the press notes and clarificatory circulars issued by the department of investment policy and promotion; Foreign Exchange Management Act, 1999 (FEMA) and regulations made thereunder, including circulars and notifications issued by the RBI from time to time, the Securities and Exchange Board of India Act, 1992 and regulations made thereunder (SEBI laws); Income Tax Act, 1961 and the Competition Act, 2002 etc.\(^8\)

**Company Law**

Cross border M&A, both the amalgamating company or companies and the amalgamated (i.e. survivor) company are required to comply with the requirements specified in Section 391-394 of the Companies Act, which, inter alia, require the approval of a High court and of the Central government. Section 394 and 394A of the Act set forth the powers of the High Court and provide for the court to give notice to the Central Government in connection with amalgamation of companies.\(^9\)

Pursuant to Section 394(4)(b) of the Companies Act the “transferee company” must be a company within the meaning of the Companies Act (i.e. an Indian company); however, a “transferor company” may be any body corporate, whether a company within a meaning of Companies Act or not. A “body corporate” includes a company incorporated outside India.\(^10\)

As to the approval of the shareholders under Section 372A, if the investment by the Indian company in the foreign company exceeds 60% of the paid up share capital and free reserves of the Indian company or 100% of free reserves of the Indian company, whichever is more, than the Indian company is required to obtain the prior approval of the shareholders vide a special resolution.\(^11\)

Some cases have held that the transfer of shares in accordance with a scheme under section 391-6 of the act does not constitute a transfer for the purpose of the act.\(^12\) In the case of Moschip

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\(^6\) Reliance said to raise Lyondell Bid to US $ 14.5 Billion (Update 4) By Jonathan Keehner and John Duce- February 2nd 2010 05:25 EST


\(^10\) Section 394(4) of the Companies Act specifically states that the transferee company shall be a company as defined under the companies act and the transferor company can be a body corporate, which includes a foreign company.

\(^11\) An “arrangement” includes a reorganization of the share capital of the Company by the consolidation of shares of different classes, or by the division of shares in two shares of different classes or by both those methods. [Section 390(b) of the Companies Act, 1956.]

\(^12\) CIT v. Rashiklal Maneklal, 177 ITR 198; CIT v. Amin, 106 ITR 368, CIT v. MCTM Corporation, 22 ITR 524.
Semiconductor technology Limited, the High Court of the state of Andhra Pradesh, dealing with the amalgamation of an Indian company (as the transferee) and a foreign company governed by the laws of California (as the transferor), held that, under Section 1108 of the California Corporation Code and in contrast to the provisions of Indian law, the surviving company could be either a domestic company or a foreign company. In the above matter, the court observed that “in these days of liberal globalization, a liberal view is expected to be taken enabling such a scheme of arrangement for amalgamation between a domestic company and a foreign company and there is every need for suitable modification of the law in that direction.” The court also stated that a scheme involving a foreign and an Indian company would be subject to laws of both the countries. Notwithstanding the High Court’s dicta, currently in a merger or amalgamation of an Indian company and a foreign company, the transferee company (i.e. surviving entity) must be an Indian company.

The Companies bill, 2009 seeks to bring significant changes with respect to mergers and acquisitions. The proposed changes deal with the creation of a single forum for the approval of M&A’s shortening the merger process between two small companies or between the holding company and its wholly owned subsidiary company, merger of Indian companies with foreign companies and vice versa where the consideration may be discharged by way of cash or through Indian depository receipts or any combination thereof, etc. The bill has introduced the concept of purchase of minority shareholding in the company. Where an acquirer, who has acquired 90% or more shareholding in the company, desires to acquire balance shareholding in the company, the bill provides for notifying the company of the acquirer’s intention of acquiring the remaining shareholding in the company, and sets out the process for acquisition of the balance shareholding in the company. The bill has also introduced the concept of registered valuers for all valuations required to be done under any of the provisions of the bill.

Security Laws

If the issuing company is a listed company and makes a preferential allotment of shares to the acquirer, such an allotment would generally be exempt from the Public Offer provision of the SEBI (Substantial Acquisition and Takeovers) regulations. Section 1108 of the California Corporation Code and in contrast to the provisions of Indian law, the surviving company could be either a domestic company or a foreign company. In the above matter, the court observed that “in these days of liberal globalization, a liberal view is expected to be taken enabling such a scheme of arrangement for amalgamation between a domestic company and a foreign company and there is every need for suitable modification of the law in that direction.” The court also stated that a scheme involving a foreign and an Indian company would be subject to laws of both the countries. Notwithstanding the High Court’s dicta, currently in a merger or amalgamation of an Indian company and a foreign company, the transferee company (i.e. surviving entity) must be an Indian company.

Further upon completion of the acquisition and within 21 days from the issuance of shares to the shareholders of the target company, a detailed report in the prescribed format would have to be filed with SEBI. If the Indian company that is issuing its shares to the shareholders of the foreign company as consideration for acquiring shares of the foreign company is listed on the Stock exchange in India, then it will be required to comply with the guidelines for preferential allotment under the SEBI (Disclosure and Investment Protection) Guidelines, 2000. Securities Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 deals with the issue of specified securities and preferential allotment regulations.

After a global merger between Eaton Industries Inc. (EII) and Aeroquip Vickers (AVI), EII came to hold 51% shares in Vickers System International Limited (VSIL), a publicly listed company incorporated in India. It was held in Eaton Industries case that the SEBI Takeover Code would not get triggered since there was ample proof to suggest that there had been a merger of EII with AVI under the laws of the state of Ohio in the US and indirect acquisition of controlling interest of VSIL was purely a fallout and incidental to the global restructuring arrangement.

SEBI has directed, vide Circular dated 15th April, 2010, the modification of the listing agreement focusing on certain deviations from accounting standards commonly carried out as part of scheme of mergers. Japanese drug maker, Daiichi Sankyo Companies Limited, which owns India’s biggest drug firm, Ranbaxy Laboratories Limited, has won the open offer price war with Hyderabad based Zenotech Laboratories Limited in a Supreme Court. India’s Apex Court has struck down ruling by the Securities Appellate Tribunal (SAT), thus allowing DAIICHI to launch an open offer for a 20% stake in Zenotech Laboratories Limited, which owns India’s biggest drug firm, Ranbaxy Laboratories Limited, has won the open offer price war with Hyderabad based Zenotech Laboratories Limited in a Supreme Court. India’s Apex Court has struck down ruling by the Securities Appellate Tribunal (SAT), thus allowing DAIICHI to launch an open offer for a 20% stake in Zenotech Laboratories Limited.
at Rs. 113.62 per share. The Takeover Regulations Advisory committee under the chairmanship of C. Achuthan, in its report to the SEBI has proposed sweeping changes on critical issues, including the open offer trigger, offer size, indirect acquisition, exemption from open offer obligations, calculating the offer prize and competing offers. The renewed Takeover Code would have certain changes such as increasing the period for making a competing bid, prohibiting acquirers from being represented in the board of Target Company, and permitting any competing acquirer to negotiate and acquire the shares tendered to the other competing acquirer, at the same price that was offered by him to the public. Vedanta’s Takeover offer for Cairn energy has raised some questions because it comes in wake of impending changes to a SEBI Takeover Regulations that may make it potentially difficult for the acquirers to structure transactions.

The various ways of restructuring which has tax implication is explained herein:

**Sale of shares**

Capital gains and security transaction tax- the sale of shares is subject to capital gains tax in India. Additionally, Securities Transaction Tax (STT) may be payable if the sale transaction for the equity shares is through a recognized stock exchange in India. The STT has to be paid by the purchaser/ seller of the securities. Nonresident investors are entitled to benefit from currency fluctuation adjustments when calculating long term capital gains on a sale of shares of an Indian company purchased in foreign currency. In case the transaction is liable to STT, long term capital gains arising on transfer of equity shares are exempted from tax.

Transfer taxes: the transfer of shares (other than those in dematerialized form) is subject to transfer taxes i.e. stamp duty.

**Sale of Assets**

**Slump Sale:** The sale of a business undertaking is on a slump sale basis when the entire business is transferred as a going concern for a lump sum consideration. Consideration in excess of the net worth of the business is taxed as capital gains. A slump sale is generally not subject to Vat or sales tax in India, as the sale is of entire business and not of individual assets or goods. This position has been upheld by various courts in India. Transfer taxes: the transfer of assets by way of a slump sale would attract stamp duty.

**Itemized sale:** This happens when individual assets or liabilities of a business are transferred for a separately stated consideration.

**Capital Assets:** The tax implication for the transfer of capital assets (including net current asset other than stock in trade) depend on their eligibility for depreciation. In a case of asset on

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17 Report Of The Takeover Regulations Advisory Committee under the Chairmanship of Mr. C. Achuthan, July 19, 2010 www.sebi.gov.in/commercialreport/tracreport.pdf
22 Section 2(42C) of Income Tax Act, 1961.
23 Explanation 1 to section 2(19AA) of Income tax Act, 1961 defines the term “undertaking” in the context of merger to include “any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual asset and liabilities or any combinations thereof not constituting a business activity.”
24 Shri Ram Sahay v. CST (1963) 14 STT (ALD), Coromandel fertilizers Limited v. State of A. P. (112 STC 7)
which no depreciation is allowed, consideration in excess of the cost of acquisition and improvement is chargeable to tax as capital gains. In case of asset on which depreciation has been allowed\textsuperscript{25}, the consideration is deducted from the tax return down value of the block of assets, resulting in a lower claim for tax depreciation subsequently. If the unamortized amount of respective block of assets is less than the consideration received, or the block of asset ceases to exist (i.e. there are no assets of that category), the difference is treated as short term capital gains. If all the assets in a block of assets are transferred and the consideration is less than the unamortized amount of the block of assets, the difference is treated as a short term capital loss and could be set off against capital gains arising in up to 8 succeeding years.

**Stock in Trade:** Any gains or shortfalls on the transfer of stock in trade are considered as business income or loss. Business losses can be set off against income under any head of income arising in that year. If the current year income is not adequate, business losses can be carried forward to set off against business profits for eight succeeding years.

**Intangibles (Goodwill and Brands among others):** The tax treatment for intangible capital assets would be identical to that of the tangible capital asset, as already discussed.

**Transfer taxes:** It would be identical to those under slump sale with respect to itemized sale.

**Liabilities:** Gains or transfer of liabilities are taxable as business income in the hands of transferor.

**Merger and Amalgamation**

Under the Income Tax Act, 1961 a non resident is taxed in India, inter alia, on income that is “deemed to accrue or arise in India”. This deeming provision in Section 9(1) is intended to tax income earned by a non resident through “business connection” in India or through any asset or source of income in India of thorough the transfer of any capital asset situated in India. The current legislation provides for taxation of gains arising out of transfer of the legal ownership of the capital asset in the form of sale, exchange, relinquishment, extinguishment of any right wherein or compulsory acquisition under any law. Section 9\textsuperscript{26} deems gains arising from transfer of capital assets situated in India to accrue or arise in India. In the cross border transfer involving transfer of shares normally the situs of the capital asset provides the safe guide to decide as to which of the contracting states has the power to tax such income subject to the relevant tax treaty. India may have treaties with any of the country under Indian tax laws.\textsuperscript{27}

The DTAA provides for the chargeability based on receipt and accrual, residential status. As there is no clear definition of income and taxability thereof which is accepted internationally, an income may become liable to tax in two countries. If the two countries do not have DTAA, domestic law of the country will apply. In case of India Section 91 of the IT Act will apply The Income Tax officer has the power to determine the reasonable amount of profit accruing or arising in India if it appeared to him that a resident has transferred his Indian source income. Article XXIV of GATT specifically recognizes regional arrangements as an exception to the multilateral system. The concept of levy of tax on a transfer of beneficial ownership in a cross border transfer is not provided for in the current tax legislation, but the revenue authorities are of the view that in a cross border transaction the value of the transaction includes valuation for the Indian entity as well and, accordingly, the overseas entity which has a business connection in India.

\textsuperscript{25} Section 50 of Income Tax Act, 1961

\textsuperscript{26} Section 9 of the Income Tax Act, 1961 – income deemed to accrue or arise India.

\textsuperscript{27} Section 90 of Income Tax Act, 1961 : AGREEMENT WITH FOREIGN COUNTRIES

(1) The Central Government may enter into an agreement with the Government of any country outside India:

(a) For the granting of relief in respect of income on which have been paid both income-tax under this Act and income-tax in that country, or

(b) For the avoidance of double taxation of income under this Act and under the corresponding law in force in that country, or

(c) For exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or

(d) For recovery of income-tax under this Act and under the corresponding law in force in that country, and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

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Amalgamation is merger of one or more companies with another or merger of two or more companies to form a new company, in such a way that all assets and liabilities of the amalgamating company becomes assets and liabilities of the amalgamated company and shareholders not less than 75% in value of the shares in the amalgamating company or companies become the shareholders of the amalgamated company.28

In the case of Commissioner of Income tax v. Mrs. Grace Collis & Another29 the supreme court has held that, “extinguishment of any right in any capital asset” under the definition of “transfer” would include the extinguishment of the right of the holders of shares in an amalgamating company, which would be distinct from and independent of the transfer of capital assets itself. Hence, the right of the shareholders of the amalgamating company in the capital asset i.e. the shares, stands extinguished upon the amalgamation of the amalgamating company with the amalgamated company and this constitutes a transfer under section 2(47) of the IT Act.

Benefits of taxation in respect to cross border mergers and amalgamations under Income Tax Act, 1961:

No tax is to be charged on capital gain arising on scheme of amalgamation.

Section 47(vi): Any transfer in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company is an Indian company.

Section 47(via): Any transfer in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company if:

(i) At least 25% of shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company.

(ii) Such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.

Section 47(vii): any transfer by a shareholder in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company if:

(i) The transfer is made in contravention of the allotment to him of any share or shares in the amalgamated company.

(ii) The amalgamated company is an Indian company.

Section 79: carry forward and set off of losses in case of a company not being the company in which the public are substantially interested, no loss incurred in a any year prior to the previous year shall be carried forward and off against the income of previous year unless –

(a) on the last day of the previous year the shares of the company carrying not less than 51% shares of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than 51% of the voting power on the last day of the year or years in which the loss was incurred.

Section 72A(2): provisions relating to carry forward and set off accumulated loss and unabsorbed depreciation allowances in amalgamation or demergers.

No tax exemption is provided under the IT Act, 1961, in case of amalgamation of an Indian co. into a

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

(i) All the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of amalgamation.

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

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

29 (2001) 248 ITR 323 (SC)
foreign company wherein the resultant amalgamated company is a foreign company. The test of residence is based on either place of effective management or place of central control and management. It is therefore argued that a company incorporated outside India will be treated as resident in India if its “place of effective management” is situated in India.

With the Ruling in the case of CIT v. Visakhapatnam Port trust\(^{30}\), the Judiciary reemphasized the importance of international tax jurisprudence aligned with OECD standard modules, while interpreting tax matters in Indian courts. In Deputy Commissioner of Income Tax v. ITC\(^{31}\) it was held that interpretation of a DTAA must be in consonance with the principle of international law.

**Direct Tax Code**

The Finance Act 2007 and 2008 have brought amendments to provisions of income tax with retrospective effects in order to increase tax revenues from cross border M&A transactions.\(^{32}\) The growing international transaction has led to numerous tax disputes in the world. So international tax jurisprudence requires legitimate tax planning.\(^{33}\) In 1935, the House of Lord’s famously observed in IRC v. Duke of Westminster\(^{34}\) that “every man is entitled to order his affairs” in order to minimize his liability to tax. It was ruled that while tax avoidance is legal, tax evasion is not. Traditionally, India followed Westminster rule that tax avoidance is legal and that a citizen is entitled to the benefit of the letter of the law, even if result is manifestly contrary to its spirit. This seems rather well established, until Justice Chinappa “concurring” opinion in Mc Dowell v. CTO that the “ghost” of the duke of Westminster must be “exorcised” and that any device intended to avoid tax liability is illegal.

The revenue authorities are exploring the possibility of generating tax from cross border reorganization resulting in the transfer of beneficial interest of the Indian company. This is on the basis of substance theory that the country has a right to claim tax on the profit generated from the business carried out in India. By introducing DTC, Government widens scope of anti abuse provisions in IT Act.\(^{35}\)

Under 1961 Act, foreign Companies were regarded as “Resident of India” only if their control and management was wholly situated India. The DTC has modified this and now a foreign company will be treated as “Resident of India” if its control and management is wholly or partly situated in India.Treating a foreign company as “Resident of India” would have serious tax implications as its world income would be taxable in India.\(^{36}\) Moreover it would be subject to Dividend Distribution Tax etc.

It is provided that even income arising from Indirect Transfer of capital asset in India, would be deemed to accrue or arise in India.\(^{37}\) The DTC continues present position regarding Business Reorganization that they should be tax neutral. One important beneficial provision is that the successor will be allowed the benefit of accumulated losses of the predecessor of business provided stipulated conditions are satisfied. The DTC also would abolish distinction between long and short term capital gains, as well as security transaction tax (a tax levied on stock exchange transactions).

The CBDT – Circular No. 333 dated 2nd April, 1982 that in case of conflict in the provisions of the agreement for tax avoidance of double taxation and the Income Tax Act, the provisions contained in the Agreement for DTAA will prevail. Neither the treaty nor the Code shall have a preferential status by reason of it being treaty or law; and (b) the provision which later in time shall prevail. In effect, the accepted principle under International Taxation and current law that treaty provisions will override the Income Tax act has been altered. As the DTC would be later in time than most of treaties, it will override such treaties.\(^{38}\) This will cause great hardship to many Indian and foreign companies having cross border transactions and result in considerable tax litigations.

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30 (1983) 144 ITR 146 (A.P.)
31 ITA No.s 970, 971 and 973/Cal/1998
34 (1936) AC 1.
38 Section 258 of the DTC
Controlled Foreign corporations (CFCs) recommendation of the Kelkar working Committee report on Tax reforms in India brought an international tax concept in India. A provision including taxation of CFC income is proposed for the first time in DTC. Under these provisions, passive income earned by a foreign company controlled directly or indirectly by a resident in India, if such income is not distributed to shareholders, will be deemed to have been distributed and be taxable in India in the hands of resident shareholders as dividend received from the foreign company.

The DTC would introduce a GAAR to deal with specific instances where a taxpayer enters into an arrangement, the main purpose of which is to obtain a tax benefit and the arrangement is entered into or carried on in a manner not normally employed for bona fide business purposes, is not at arm's length, abuses the provisions of the DTC or lacks economic substance. The proposed GAAR does not distinguish between tax mitigation and tax avoidance, with the result that any arrangement to obtain a tax benefit could be deemed to be an impermissible avoidance agreement. Central Board of Direct Taxes issue guidelines to provide for the circumstances and thresholds under which GAAR could be invoked. Further the Dispute Resolution Panel would be made available when the GAAR is invoked against a taxpayer.

A general treaty override would render India's tax treaties redundant and would violate the spirit and intent of Vienna conventions; the revised discussion paper indicates that DTC would be amended to provide for a limited tax treaty override; i.e. it would apply only when the GAAR or CFC provisions are invoked or when branch profits tax is levied.

Foreign Exchange Laws

The Foreign Direct Investment Policy of India needs to be followed when any foreign company acquires an Indian company. FDI is completely prohibited in certain sectors such as gambling and betting, lottery business, atomic energy, retail trading and agricultural or plantation activities.

Inbound Cross Border M&A in India and FEMA Laws

It has been observed that overseas companies find it far more economical to acquire existing setups rather than opt for organic growth e.g. the beginning of 2007 saw the signing of the largest Inbound deal in India's history, Vodafone's $11.1 billion acquisition of a controlling interest in Hutchison Essar. Foreign investment in India i.e. investment in India by a “person resident outside India” (“non-resident”) is governed by FEMA 20. For the purpose of FEMA 20, investment in India by a non-resident can be in respective schedules as under:

Investment under foreign Direct Investment scheme (“The FDI Scheme”); Investment by Foreign institutional investors (“FIs”) under the Portfolio Investment Scheme; Investment by NRIs/OBCs under the portfolio Investment Scheme; Purchase and sale of shares by NRIs/OBCs on non-repatriation basis; Purchase and sale of securities other than shares and convertible debentures of an Indian company by a non-resident.

Regulation of Outbound Crossborder M&A Transactions under FEMA Laws

There are only certain special circumstances under which an Indian company is permitted to make investments in a foreign company. An Indian party is not permitted to make any direct investment in a foreign entity engaged in real estate business banking business without the prior approval of RBI. Routes available to an Indian company which intends to invest in a foreign company are:

Direct Investment in Joint Venture/Wholly Owned Subsidiary; Without seeking prior approval

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40 “Revised Discussion Paper on Direct Taxes Code” issued Deloitte India Tax Alert 18 June 2010
41 “Ready Reckoner on Investing in India”, http://dipp.nic.in/
42 “Policy On Foreign Direct Investment In India”, www.sethassociates.com/policy-on-foreign-direct-investment.html
43 The term “person resident outside India” is defined as meaning “a person who is not resident in India” under Section 2 (w) of FEMA. “Person” is defined under Section 2 (u) of FEMA. Section 2 (v) of FEMA defines “person resident in India”.
44 Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.
45 Regulation 5 of FEMA 19 [Foreign Exchange Management (Transfer and Issue of any foreign security) Regulations, 2000.]
of RBI subject to conditions stated in Regulation 6 FEMA 19; Regulation 6 (3) FEMA 19 provides Direct Investment must be made only from sources stated;\textsuperscript{47} Investment in a foreign company by ADR/GDR share swap or exchange;\textsuperscript{48} RBI approval in special cases;\textsuperscript{49} Direct Investment by capitalization; Transfer by way of sale of shares of a JWC/WOS;\textsuperscript{50} Pledge of shares of joint ventures and Wholly Owned subsidiaries.\textsuperscript{51} Obligation of Indian Parties, provided under Regulation 15 FEMA 19 can also be stated.

The Press Notes are announced by Ministry of Commerce and Industry. The ministry issued Press note 2, 2009 and Press Note 3, 2009, which deals with calculation of foreign investment in downstream entities and requirement for Foreign Investment Promotion Board (FIPB) approval in relation to transfer of ownership or control in sectoral cap companies. These Press Notes raised certain key issues, including with respect to the downstream investment. In March 2000, The Ministry of Finance came out with Guidelines for Overseas Business acquisitions by Indian companies engaged in Information Technology, Pharmaceuticals, Biotechnology, Entertainment software through ADR/GDR stock swap.\textsuperscript{52}

**Competition Law**

The Competition Act, 2002 embodies the principles laid down under Article 38 and Article 39 of the Constitution of India, which state that the motive behind all economic activities must be to honour the common good, and prevent concentration of wealth.\textsuperscript{53}

Anti-competitive agreements can either be in vertical or in horizontal combinations. Vertical restraints include cartels, bid-rigging etc. Horizontal restraints can be in the form of tie-in arrangements, refusal to deal and maintenance of resale price.\textsuperscript{54} The Competition Act, 2002 has overridden the Monopolies and restrictive Trade Practices Act, 1969 in India, which provides for regulations to curb restraints and promote fair competition in the market.

Section 3 of the Competition Act, 2002 governs anti-competitive agreements and prohibits: “agreements involving production, supply, distribution, storage, acquisition or control of goods or provision of services, which cause or are likely to cause an ‘appreciable adverse effect on competition’ in India.”

The Act prohibits the abuse of dominant position by an enterprise.\textsuperscript{55} It defines ‘combination’ by providing threshold limits in terms assets and turnover, rendering it a little restrictive in scope.\textsuperscript{56} The Competition Act prohibits enterprises from entering into agreements that cause or are likely to cause an “appreciable adverse effect on competition within the relevant market in India”.\textsuperscript{57}

Globalization and the growth in such cross border mergers have thrown up major challenges to competition authorities around the world.\textsuperscript{59}

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\textsuperscript{47} Regulation 10 FEMA 19.  
\textsuperscript{48} Regulation 8 FEMA 19.  
\textsuperscript{49} Regulation 9 FEMA 19  
\textsuperscript{50} Regulation 16 FEMA 19  
\textsuperscript{51} Regulation 17 FEMA 19  
\textsuperscript{52} http://finmin.nic.in/the_ministry/dept_eco_affairs/index.html  
\textsuperscript{53} The Preamble of The Competition Act, 2002 - An Act to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto.  
\textsuperscript{55} Section 4 of the Competition Act, 2002  
\textsuperscript{56} Section 5 of the Competition Act, 2002  
\textsuperscript{57} Section 6 of the Competition Act, 2002  
Commission of India is still finding its feet in so far as trade regulation in the country is concerned. The control of mergers is one such aspect which the Commission shall encounter in the near future. The powers of merger review of CCI thus impacts the feasibility of certain deals. The Competition Act, 2002 has been inspired by the UNCITRAL Model Law and the US Anti-Trust Laws. But since the market conditions are very different in India, the US anti-trust law and European community merger control regulation concepts may not be interpreted or applied in the same way.

Case Study

E*Trade Mauritius Case:
The Authority of Advance Rulings has issued its ruling in the matter of E*Trade Mauritius Case; and the Ruling essentially follows the decision of the Supreme Court in Azadi Bachao Andolan. Under domestic law, the gains from this transfer (gains arising through the transfer of a capital asset situate in India) would be chargeable under Section 9 of the Income Tax Act. Having a tax residency certificate in Mauritius, the applicant claimed the benefit of Article 13(4) of the Indo-Mauritius DTAA. Under Azadi Bachao case, the applicant would clearly be entitled to the benefit of the DTAA; and the gains would be taxable only in the residence country, Mauritius.

The Revenue however contended before the AAR, that “there is scope and sufficient reason to infer that the capital gain from the transaction arises in the hands of the US entity which holds the applicant company. In other words, the beneficial ownership vests with the US company which according to the department has played a crucial role in the entire transaction. Though the legal ownership ostensibly resides with the applicant, the real and beneficial owner of the capital gains is the US Company which controls the applicant and the applicant company is merely a façade made use of by the US holding Company to avoid capital gains tax in India.”

The AAR analysed the decision in Azadi Bachao, and ruled, “...the Supreme Court found no legal taboo against ‘treaty shopping’ ... if a resident of a third country, in order to take advantage of the tax reliefs and economic benefits arising from the operation of a Treaty between other countries through a conduit entity set up by it, the legal transactions entered into by that conduit entity cannot be declared invalid. The motive behind setting up such conduit companies to do business through them in a country having beneficial tax treaty provisions was held to be not material to judge the legality or validity of the transactions.”

Vodafone Case:
The whole controversy in the case of Vodafone is about the taxability of transfer of share capital of the Indian entity. Generally the transfer of shares of a non-resident company to another non-resident is not subject to tax in India. But the revenue department is of the view that this transfer represents transfer of beneficial interest of the shares of the India company and hence, it will be subject to tax.

On the contrary Vodafone’s argument is that there is no sale of shares of the Indian company and what it had acquired is a company incorporated in Cayman Islands which in turn holds the Indian entity. Hence, the transaction is not subject to tax in India.

The transaction created on “real link” between India and Vodafone so as to bring the consideration to tax in line with the effects doctrine which is the principle of international law which postulates that state can impose liabilities on a non resident if the nonresident conduct its operation in such a manner which affects the state.

Though the Mumbai High Court did not pronounce a ruling on merits, it has made observations that there was a prima facie transfer of ‘controlling interest’ in the Indian company as a result of the sale of the Cayman entity’s shares. In their opinion this was prima facie a capital asset situated in India. Hence, capital gains tax has to be paid in India. However, the Court left the question of chargeability of the transaction for the tax department to determine in normal course.

The ruling will impact future global M&A transactions involving assets situated in India. Accordingly, the tax implications on account of transfer of an indirect controlling interest in any Indian subsidiary/joint venture pursuant to a global

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60 Ben Rayment, Christopher, David Bailey, ‘Editor’s Introduction’, (2009), Competition Law Journal, Vol
61 The Competition Act, 2002 represents a clean break with the former competition law regime: a modern competition law inspired by the laws on restrictive agreements and dominant firm conduct, as well as merger regulation, in jurisdictions with long-standing enforcement records, most notably the European Union.
62 A.A.R. No.826 of 2009; Available at http://rulings.co.in/it-rulings/ruling/display/
restructuring/reorganization would need to be examined carefully.64

**Star India Private Limited Case:**

In this case, three Star TV companies incorporated in the British Virgin Islands decided to amalgamate with the Star TV Indian entity, known as Star India Pvt. Ltd. [“STPL”]. The reason offered was that it was to the commercial advantage of Star TV to consolidate its holdings in one company. Before the AAR, the Revenue argued that approving this merger would have adverse consequences on the Revenue, and more importantly that the AAR should itself decline to answer the question since the transaction was designed to avoid tax. The power of the AAR to answer a reference is circumscribed by s. 245R of the ITA, which provides that the “Authority shall not allow the application” where the question raised in the application relates to a “transaction which is designed prima facie for the avoidance of income tax”.

The authority held a dicta that: “A design to avoid the tax within the meaning of clause (iii) of the proviso to Section 245 R(2) apparently covers such of the transactions which are sham or nominal or which would lead to the inescapable inference of a contrived device solely with a view to avoid the tax. The corollary thereto is that there is no real and genuine business purpose other than tax avoidance behind such transaction.” In this case, the test was satisfied by the business purpose of consolidating various entities into one entity, which achieves “synergies of operation and enhanced operational flexibility.”

**Dana Corporation Case:**

A recent ruling by India’s Authority of Advance Rulings (AAR) to Dana Corporation (Applicant) on the issue of whether a transfer of shares held in Indian companies to a group company under a US reorganization plan would be taxable under the provisions of Indian Tax Laws (ITL). The AAR held that the transaction should not be taxable in India under the provisions of the ITL, as there was no consideration payable on the share transfer. In the absence of any consideration, it is not possible to compute the taxable capital gains and the subsequent tax liability. The AAR also held that even though the transfer was an international transaction between associated enterprises (AE), as there was no income arising, transfer pricing (TP) provisions could not be applied to determine the taxable gain based on arm’s length principles.65

India’s Authority for Advance Rulings (AAR) in the case of Amiantit International Holding Limited 66 also ruled on 23 February 2010 that a proposed transfer of shares in an Indian company between two nonresidents would not be subject to capital gains tax. The ruling also reaffirms that India’s transfer pricing provisions do not apply where income is per se not liable to tax.

The Timken Company’s case67 is a landmark judgment setting at rest the controversy MAT is not applicable to a foreign company with no presence or PE in India. The Authority concluded that provisions of MAT will not apply to foreign companies because the definition of ‘Company’ in section 2(17) in the context of section 115JB should be read to exclude foreign company.

**Comparative Study**

There has been many recent developments in the competition and taxation laws of various countries. The tax is a deciding factor for any cross border reorganization and so all the countries should try to have a favorable tax environment. US international tax reform proposals limit company’s ability to defer tax on foreign earnings until repatriated. UK and Japan reforms made participation exemption for foreign source income. German tax reforms had tightening of thin capitalization / earnings stripping rules.

**United States**

US have a well established set of rules governing the cross border reorganization activities. The two primary relevant federal securities laws in US that has to be complied, are the Securities Act of 1933 (the “Securities Act”) and the Securities Exchange Act of 1934 (the “Exchange Act”), including the rules and regulations promulgated by the Securities and Exchange Commission (the “SEC”).

The anti-trust laws consist of Clayton Act and Shearman Act which prohibits unreasonable restraint of trade, attempts to monopolize and monopolization.

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64 “Cross Border Transactions- An Indian tax and regulatory update” a report by Deloitte.
65 “India issues advance ruling on capital gains tax implications of an intra group share transfer” by E&Y published on 17 December 2009 as International Tax Alert.
66 A.A.R. No. 817/2009; Available at http://rulings.co.in/it-rulings/ruling/display/.
67 A.A.R. No. 836/2009; Available at http://rulings.co.in/it-rulings/ruling/display/.
The Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the “HSR Act”) is the statute governing the procedural aspects of the government’s right to review of mergers and acquisitions. The Department of Justice (“DOJ”) and the Federal Trade Commission (“FTC”), the primary administrative agencies responsible for U.S. antitrust law enforcement, temper their enforcement efforts by employing a reasonableness test that considers “the degree of conflict with foreign law or articulated foreign economic policies”.

Internal Revenue Code of 1986, as amended (Code), is provided by the federal government, generally by the Internal Revenue Service (IRS) in revenue rulings, revenue procedures, private letter rulings, announcements, notices and Treasury Department regulations, and by the courts. This code provides for tax laws in US. Section 267 of their internal revenue code (IRC) exempt US corporate entity in some cases relating to taxation aspect relating to a merger and acquisition.

A U.S. target is taxed on income of a foreign subsidiary on receipt of a dividend from the subsidiary, but under the Subpart F rules, Subpart F income earned by a controlled foreign corporation (CFC) may be currently included in the income of the U.S. target that is a U.S. Shareholder of the CFC, even if the income is not distributed by the CFC. A U.S. shareholder is a U.S. person that owns stock that is at least 10 percent (by vote) of the foreign corporation. A U.S. target may be subject to taxation and interest charges resulting from owning stock in a passive foreign investment company (PFIC).

**Singapore**

Income is taxed in Singapore in accordance with the provisions of the Income Tax Act (Chapter 134) and the Economic Expansion Incentives (Relief from Income Tax) Act (Chapter 86). Singapore has also signed a Comprehensive Economic Cooperation Agreement (“CECA”) with India. This CECA governs trades in goods and services, promotion of bilateral investments and cooperation in various other areas.

The draft legislation for the amalgamation of companies has been put forward in the Income Tax (Amendment) Bill 2009, which has yet to be enacted. The proposed tax framework only applies to a qualifying amalgamation. Singapore transfer pricing guidance is very similar to the Organization for Economic Cooperation and Development (OECD) transfer pricing principles.

**United Kingdom**

Finance Act 2009 and Corporation Tax Act 2009, which are likely to have a considerable impact on U.K. acquisition structuring. The existing Treasury consent regime (whereby certain transactions involving a foreign body corporate may be unlawful without prior consent) is replaced with a reporting requirement for large transactions from 1 July 2009. Minor changes have been made to the U.K. controlled foreign company (CFC) rules from 1 July 2009 over a two-year transitional period.

Where an acquisition is effected by the purchase of shares in exchange for the issue to the seller of shares or loan stock in the purchaser, the gain may be rolled over into the new shares or loan stock, thus enabling the seller to defer the U.K. capital gains tax liability. U.K.’s controlled foreign companies (CFC) legislation is designed to prevent U.K. companies from accumulating profits offshore in low-tax countries.

In EU Deferral of tax on capital gains on the capital assets transferred and shared received in qualifying transaction. But such relief can be claimed only when the asset become connected with local permanent establishment of the amalgamating company. Apart from this, domestic law will be effective in connecting with carry forward of losses.

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European competition law is governed primarily by Articles 85 and 86 of the Treaty Establishing the European Community. Article 85 is designed primarily to achieve the same goal as the Sherman Act in U.S. legislation insofar as it prohibits all agreements and concerted practices that affect trade among E.U. members and which have as their main objective the prevention, restriction or distortion of competition. Article 86 is designed to meet the policy objectives of the Clayton Act in that it prohibits the abuse of a dominant market position through unfair trading conditions, pricing, limiting production, tying and dumping.  

So, India has followed the footsteps of the developed economy by tax reforms and other regulatory developments. US, UK and Singapore seems to have a friendly environment for mergers and acquisitions by Indian companies.

Conclusion

“Marriage of two lame ducks will not give birth to a race horse.” Any acquisition whether one where an Indian company acquires a foreign company or where a foreign company acquires an Indian company, cannot be accomplished unless the procedural requirements prescribed by the law of the land are fulfilled. With the recent global trends of M&A and India being a favorite destination, the country may regain the status of being the “Golden Bird”. Even the wholly European Takeover of Arcelor by Mittal steel, orchestrated by Indian born Lakshmi Mittal, drew the local support of the Indian government, with the Indian Commerce Minister Kamal Nath publicly imploring the French Government to recognize that “Globalization is not just a one way street”. The foreign company under New Economic Policy of the government and foreign exchange laws has been allowed to acquire a controlling interest an Indian company. Merely acquiring substantial shares in an Indian company cannot be said to be against public interest or public policy. So the proposed acquisition by Reliance Industries of Lyondell Basell and Bharti Airtel of Zain Telecomm headlines a frenzy of cross border reorganization in Indian economy. It is a national pride for the developing world countries to acquire a foreign firm.

George Bernard Shaw said, “we are made wise not by the recollection of our past, but by the responsibility to our future” and the future of India is bright indeed with the tax reforms and a good regulatory framework.

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