Emerging opportunities in M&A

July 20, 2014

Draft for discussion purpose only
M&A Tools
Basic M&A Tools

M&A Tools

Merger / Amalgamation

Acquisitions

De-merger

Asset Purchase

Share Purchase

Slump Sale

Itemized Sale

Buy-back

Capital Reduction
Merger / Amalgamation

**Meaning**
- Merger of one company (A Co.) with another company (B Co.)
- Merger of two or more companies to form a new company

**Income Tax**
- Tax neutral subject to provisions of Sec 2(1B) if the ITA

**Companies Act**
- u/s 391-394 of the Companies Act, 1956 and / or section 230-232 of the Companies Act, 2013
- Approvals required - SEBI, Stock Exchange, High Court, IT Department, Regional Director, Official Liquidator and RoC

**SEBI**
- Compliance with SEBI Takeover Code to be ensured

**STAMP DUTY**
- States with specific entry/ States with litigation

**Key amendments in Companies Act, 2013**
- Auditor’s certificate now required even for unlisted companies that the accounting treatment provided in the Scheme is in conformity with Accounting Standards
- Notice for the shareholder’s and creditor’s meeting to be accompanied with the valuation report, if any
Short Form Merger

COURT APPROVAL NOT REQUIRED FOR MERGER BETWEEN:

- 2 or more Small Companies
- Parent and its Wholly Owned Subsidiary

Small Company means a non-public company having:

- Paid up share capital upto INR 50 lacs or as may be prescribed being not more than INR 5 crores; or
- Turnover as per last P&L a/c upto INR 2 crores or as may be prescribed being not more than INR 20 crores

No requirement of Auditor certificate to the effect that the accounting treatment is in conformity with Accounting Standards

Unpaid amount to dissenting shareholders and creditors shall become liability of transferee company

OPTION AVAILABLE TO FOLLOW NORMAL MERGER PROCESS AS WELL
Demerger

Meaning -
- Transfer of one or more undertakings of the demerged company (P Co.) to a resulting company (Q Co.)

Undertaking – includes part of undertaking or unit or division of undertaking or a business activity taken as a whole, but does not include individual assets and liabilities or any combination thereof not constituting a business activity.

Income Tax
- Governed by section 2(19AA) of the Income Tax Act, 1961
- A demerger is tax neutral subject to fulfillment of the specified conditions and if the transferred business constitutes an independent business undertaking

Companies Act
- Approval of the Official Liquidator is not required in a demerger
Slump Sale

Meaning -
- Transfer of “undertaking” for lump sum consideration without values being assigned to individual assets and liabilities

Capital Gains computation
- Capital gain = Slump Sale consideration minus Tax Net-worth of undertaking;
- Tax Net-worth: Book Value of Non-depreciable Assets + WDV of Depreciable Assets - Value of Liabilities
- Provisions relating to indexation not applicable

Stamp Duty
- Conveyance for immovable property

Companies Act
- Postal Ballot for listed companies

SEBI
- Intimation to be filed with Stock Exchange

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Buy Back

Shareholder

Buyback

Company

To return surplus cash to shareholders

To improve companies return ratios (EPS / RoA / RoE)

To stop the fall in stock price

To increase promoter’s holding

To rationalize the capital structure

To take advantage of undervaluation

To provide an exit route in case of illiquid shares

To raise the debt-equity ratio of the company

“Buy Back” is the repurchase of shares by a company
## Buy Back – Changes under the Companies Act 2013

<table>
<thead>
<tr>
<th>Provision</th>
<th>Companies Act 1956</th>
<th>Companies Act 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>MULTIPLE BUY BACK IN ONE FY</td>
<td>• There is ambiguity whether more than 1 buy back offer can be made in one year</td>
<td>• Not possible</td>
</tr>
<tr>
<td>BUY BACK THROUGH SCHEME</td>
<td>• Allowed under the scheme of arrangement</td>
<td>• Allowed under the scheme. However, the same has to comply with the buy back provisions</td>
</tr>
<tr>
<td>DEFAULT IN REPAYMENT OF DEPOSITS ACCEPTED</td>
<td>• Buy back prohibited in case of any default in repayment of deposits (including interest), redemption of debentures, etc</td>
<td>• Buy back is prohibited for 3 years from the remedy of default</td>
</tr>
<tr>
<td>CREATION OF CRR</td>
<td>• CRR to be created in case of buy back out of free reserves. Ambiguity existed whether free reserve would include securities premium or not</td>
<td>• CRR to be created in case of buy back out of free reserves or securities premium</td>
</tr>
<tr>
<td>APPLICATION OF SECURITIES PREMIUM</td>
<td>• No specific provision for buy back of securities</td>
<td>• Specific provision incorporated permitting application of securities premium for buy-back of securities</td>
</tr>
</tbody>
</table>

Free reserves to include securities premium for buy back of shares
Reduction in share capital

**Creditors interest affected**
- Extinguish or reduce any liability towards unpaid share capital
- Pay off any paid up capital in excess of wants of the company

**Creditors interest NOT affected**
- Extinguish or reduce any paid up capital which is lost or unrepresented by available assets
- Write-off Securities Premium Account / Capital Redemption Reserve
| No specific provision that the Articles of Association should authorize the Capital Reduction |
| Capital Reduction not allowed in case of arrears in the repayment of deposits or interest thereon |
| Tribunal to give notice for all capital reductions to the Central Government, RoC, SEBI and Creditors |
| Above recipients to make representation within 3 months from the date of receipt of the notice |
| ✓ On lapse of above period – No objection presumed |
| Auditor certificate to the effect that the accounting treatment is in conformity with Accounting Standards - filed with Tribunal by listed as well as unlisted company |
| Specific power of the Tribunal to order the addition of words “and reduced” not provided |
Cross Border Merger

MAJOR BOOST TO CROSS BORDER M&A

Merger of Indian Company into Foreign Company and vice-versa covered

Central Government to make rules with RBI and notify the countries having jurisdiction over Foreign Company

Prior approval of RBI required

Payment in cash or Depository Receipts ("DRs") or partly in cash and partly in DRs

<table>
<thead>
<tr>
<th>Companies Act 1956</th>
<th>Companies Act 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Only a Foreign Company was allowed to merge with an Indian Company</td>
<td>A foreign company can merge with an Indian Company and vice versa</td>
</tr>
</tbody>
</table>
Trigger Points for M&A Opportunities
Trigger Points for M&A Opportunities

- IPO Planning
- MAT paying company / Accumulated MAT credit
- Bad / Hidden Assets
- High capital base
- Cash Trap
- Family Arrangement
- Multiple corporate layers - DDT leakage
- Revival of sick companies
- Planning for entry/exit of PE
- Loss making entities within group

M&A Opportunities
Possible Opportunities

1. PE Entry Planning
2. PE Exit Planning
3. Pre-IPO Structuring
4. Divestment Planning
5. Tax/MAT Saving Opportunities
6. Succession Planning
Entry Planning

Proposed PE investment

Target Company

Business X  Business Y  Non-core Assets

Possible Options

- Option 1: Segregation of unrelated businesses / non-core/ surplus assets and creation of a specific SPV for PE investment

- Option 3: Promoter shareholding rationalisation
  Restructuring of promoter shareholding with the objective of consolidation of stake may be necessary prior to PE investment – Use of Investment Company/ LLP/ Family Trust as a holding vehicle to be analysed

Key Challenges/ Issues

- Diversified businesses in a single entity
- Non-Core/ Surplus assets in the target entity
- Highly fragmented promoter shareholding - PE may require consolidation of shareholding prior to investment
- Diversified risk profile for each business
- FDI sectoral caps
Exit Planning

**Proposed buyback of PE investor**

- **PE Investor**
  - Investor company to offer its shares for buyback
  - Mauritius
  - India

- **Operating Company**
  - Payment of consideration for buyback of shares

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**Possible Options**

- **Exit to PE – Purchase of shares by New Co followed by merger of New Co with Target Co**
  - Buyback tax mitigated since the transaction is structured as a share purchase rather than a buy-back

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**Key Challenges / Issues post Sec 115QA**

- Introduction of buyback tax w.e.f June 2013
- Consideration less issue price of shares to be taxed @ 22.66%
- Tax on Indian target company and hence no treaty benefit available

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Pre-IPO Structuring

Proposed IPO of Operating Company

PE Investor          Indian Shareholders

Operating Company

Business X Business Y Non-core Assets

Possible Options

- **Option 1** - Hive off of non core assets/unrelated business
  
  Any business division which is not ripe for listing may need to be segregated prior to IPO

  Surplus/ Non-core assets which would not derive value in the listed entity may be segregated for separate sale - Value enhancement for current stakeholders

- **Option 2** - Net-worth enhancement
  
  Fair value mergers can help reflect true value of tangibles and intangibles thereby enhancing the net worth without creation of a revaluation reserve

- **Option 3** - Balance Sheet Rightsizing
  
  Planning for write-off of loss assets/probable losses against existing reserves to protect future profitability

- **Option 4** - Merger of group companies with related businesses

Key Challenges / Issues

- Non-core/ Surplus assets may need to be segregated prior to going public
- Balance Sheet does not reflect the true underlying value of the assets
- Impact on profitability of any write-offs/impairment losses in future
- Consolidation of related businesses
Divestment Planning

Proposed divestment of business division

PE Investor → Indian Shareholders → Operating Company → Buyer → Sale of Division Z

Possible Options

- Option - Slump Exchange of Division Z prior to sale
  Transfer of business Z as a going concern to WOS at fair value for share consideration followed by sale of shares to buyer. Based on judicial precedents possible to take a view that slump exchange is not taxable

Key Challenges / Issues

- Transfer of a business undertaking is taxable under section 50B – Capital gains tax liability on excess of sale consideration over book value
**Tax/MAT Saving Opportunities**

**Company**

- **Op Co 1** (MAT paying)
- **Op Co 2** (Normal tax paying)

**Possible Options**

**MAT Saving opportunities**
- Option – Merger of a MAT paying company with a normal tax paying company

**Tax Saving Opportunities**
- Option - Merger of loss making subsidiaries with profit making subsidiaries
  Streamlining of the group structure along with savings in tax outflow for the Group
Succession Planning

Prevalent Holding Structures

- Individual promoters
  - Promoter Companies
  - Operating Company

Key Issues

- Potential DDT leakage at multiple levels
- Potential MAT exposure on any future divestment of stake even post listing
- Impact of Estate duty, if levied in future
- Prohibition on multiple investment company layers under the New Companies Act 2013
- Inflexibility in succession planning
- Compliance burden under NBFC/ CIC regulations
- No value consolidation in a single vehicle
- Administrative costs of multiple companies
**Succession Planning**

### Possible Target Structure

- **Individuals**
- **Family Trust(s)**
- **Operating Company**

### Key Benefits

#### Succession planning aspects
- Provides flexibility in succession planning
- Regulate participation of bloodline/non-bloodline family members
- Provides flexibility to include future generations as beneficiaries
- Managing the ownership & administration of the family business
- Providing for a framework for internal governance
- Regulating ‘third party entry’ into family business
- Valuation on exit of members from the ownership structure
- Effective deployment of family resources

#### Tax aspects
- No DDT on dividend distribution by Trust
- No Minimum Alternate Tax (‘MAT’) on Trusts
- No capital gains on distribution of assets to the beneficiaries

**Tax effective pass through holding vehicle addressing concerns of succession planning**
<table>
<thead>
<tr>
<th>No.</th>
<th>Trigger Points</th>
<th>Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Multiple corporate layers - DDT leakage</td>
<td>Elimination of intermediate companies</td>
</tr>
<tr>
<td>2</td>
<td>PE investment / JV with new partner</td>
<td>Transaction structuring</td>
</tr>
<tr>
<td>3</td>
<td>Accumulated MAT Credit</td>
<td>Accelerate utilization of MAT Credit</td>
</tr>
<tr>
<td>4</td>
<td>Divestment of stake in Listed Co.</td>
<td>Reduce MAT liability</td>
</tr>
<tr>
<td>5</td>
<td>Bad / Hidden Assets</td>
<td>Balance sheet right-sizing</td>
</tr>
<tr>
<td>6</td>
<td>Value appreciation in investment</td>
<td>Cost Step-up</td>
</tr>
<tr>
<td>7</td>
<td>High capital base</td>
<td>Conversion of equity into loan</td>
</tr>
<tr>
<td>8</td>
<td>Revival of sick companies</td>
<td>Realigning the capital structure</td>
</tr>
<tr>
<td>9</td>
<td>Loss making entities within group</td>
<td>Reduction in group’s effective tax rate</td>
</tr>
<tr>
<td>10</td>
<td>a) Consolidation of various entities including partnership firms</td>
<td>Merger of Partnership firm with Company</td>
</tr>
<tr>
<td></td>
<td>b) Corporatisation of personal assets without triggering section 56 / section 50C implications</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Acquisition of business / companies</td>
<td>Tax efficient acquisition structures / debt push-down structures</td>
</tr>
</tbody>
</table>
### Section 2(76) - Definition of Related Party under the Companies Act, 2013

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>KMP / Relative</td>
<td>KMP or Relative of an Affiliates Company</td>
</tr>
<tr>
<td>Firm where Director / Manager or Relative is a Partner</td>
<td>Private or public firm where Director/Manager or Relative is a Partner</td>
</tr>
<tr>
<td>Private CO where Director / Manager is a Member / Director</td>
<td>Private company where Director/Manager is a Member or Director</td>
</tr>
<tr>
<td>Public CO where Director / Manager is a Director or holds &gt;2% of PSC with Relatives</td>
<td>Public company where Director/Manager is a Director or holds &gt;2% of PSC with Relatives</td>
</tr>
<tr>
<td>Director / Relative</td>
<td>Director or Relative of an Affiliates Company</td>
</tr>
<tr>
<td>Holding Co / Subsidiary Co / Associate Co / Fellow Subsidiary</td>
<td>Holding company or Subsidiary / Associate Company / Fellow Subsidiary</td>
</tr>
<tr>
<td>Any Person, on whose advice, etc Director / Manager to act</td>
<td>Any Person on whose advice, etc Director/Manager to act</td>
</tr>
<tr>
<td>Any other person as prescribed – Director / KMP of holding co or his relative</td>
<td>Any other person as prescribed – Director/KMP of holding co or his relative</td>
</tr>
<tr>
<td>Body corporate whose Board / MD / Manager accustomed to act on advice, etc of Director / Manager</td>
<td>Body corporate whose Board/MD/Manager accustomed to act on advice, etc of Director / Manager</td>
</tr>
</tbody>
</table>
## Related Party Transactions > the specified amount = Special Resolution

<table>
<thead>
<tr>
<th>Transaction with Related Party</th>
<th>SR required if</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale, purchase or supply of goods/materials directly/through appointment of agents</td>
<td>&gt;25% of annual turnover</td>
</tr>
<tr>
<td>Selling/buying of property</td>
<td>&gt;10% of net worth</td>
</tr>
<tr>
<td>Leasing of property of any kind</td>
<td>&gt;10% of net worth or &gt;10% of turnover</td>
</tr>
<tr>
<td>Availing/rendering of services directly/through appointment of agents</td>
<td>&gt;10% of net worth</td>
</tr>
<tr>
<td>Appointment to any office or place of profit in the company, its subsidiary or associate company</td>
<td>&gt;INR 2.5 lacs as remuneration per month</td>
</tr>
<tr>
<td>Remuneration for underwriting subscription of securities or derivatives</td>
<td>&gt;1% of the net worth</td>
</tr>
</tbody>
</table>

Relevant in case of companies having PSC < INR 10 crores - others covered even otherwise

Applicability of limits to be ascertained at what stage of the transaction? Net worth and turnover to be calculated as on which date?
Section 188 – Related Party Transactions – Applicable w.e.f. 1st April 2014

Transaction with related party?

- YES
  - Specified Transactions ?
    - NO
      - No action required
    - YES
      - Specified Transactions ?
        - NO
          - No action required
        - YES
          - Transactions in ORDINARY COURSE OF BUSINESS ?
            - NO
              - No action required
            - YES
              - Arm’s Length Price ?
                - NO
                  - Transactions > specified amount;
                    OR
                    PSC > = 10 Crores
                  - YES
                    - Audit committee approval, if applicable
                  - NO
                    - Only Board and Audit Committee Approval
              - YES
                - Audit committee approval, if applicable

As per the draft notification issued by MCA on 24th June, 2014 for public comments, the above provision should not apply to a private company.
Section 186 – Prohibition on making investments through more than two layers of Investment Companies

Prohibition on making investments through more than 2 layers of investment companies, subject to certain exemptions for foreign acquisitions and requirement of multi-layered structure as per any law.

Investment company defined to mean a company whose principal business is acquisition of shares, debentures, or other securities.

Investment Company  
Investment Company

Third Layer

Investment Company  
Investment Company

Second Layer

Investment Company  
Investment Company

First Layer

Operative Company
Section 185 – Loan to Directors – Manning of ‘any other person director is interested in’

<table>
<thead>
<tr>
<th>Lending company</th>
<th>Any Director and any Partner / relative of such director</th>
</tr>
</thead>
<tbody>
<tr>
<td>Holding company</td>
<td>Any Director and any Partner / relative of such director</td>
</tr>
<tr>
<td>Firm</td>
<td>In which such director / relative is a partner</td>
</tr>
<tr>
<td>Private company</td>
<td>In which such director is a member / director</td>
</tr>
<tr>
<td>Body Corporate</td>
<td>At a general meeting of which not less than 25% of the total voting power may be exercised or controlled by such director(s)</td>
</tr>
<tr>
<td></td>
<td>BODs / MDs / manager, whereof is ‘accustomed to act’ in accordance with directions / instructions of Board / director(s) of lending co</td>
</tr>
</tbody>
</table>

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### Exceptions to section 185

#### Exception provided in the section

| Loan to Managing / Whole Time Director | • As a part of conditions of service extended to all employees; or  
• Pursuant to scheme approved by members by a Special Resolution |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary course of business with interest</td>
<td>• Interest to be charged at a rate not less than bank rate declared by RBI</td>
</tr>
</tbody>
</table>

#### Exception provided in the Rules and draft notification

<table>
<thead>
<tr>
<th>Loan / guarantee / security provided to WOS</th>
<th>• If used for principle business activities of WOS</th>
</tr>
</thead>
</table>
| Guarantee / security provided to subsidiary | • If used for principle business activities of subsidiary  
• only on loans provided by banks / financial institutions |
| Private companies | • having borrowings from banks / FIs / body corporate lower of 2x of paid up share capital or Rs. 50 Crores; and  
• in whose share capital no other body corporate has invested |
Thank You

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