Regulatory Framework Governing Mergers and Acquisitions in India

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1. Introduction

Parties to a merger or an acquisition may have their own ideas as to how the transaction is to be structured or carried out, or the rights and obligations of each party. However, in order for the transaction to be enforced or upheld in a court of law, thereby giving each party the assurance that the transaction itself would not be rendered immaterial, certain laws that are applicable to each transaction must be adhered to. In this chapter, we shall discuss the scope and applicability of some of these laws and the potential legal obstacles that may arise in course of mergers and acquisitions in India.

We have seen how, in Chapter 6, the importance of a consensus cannot be understated. While a consensus may be arrived at orally, it is imperative that the consensus be captured in a document in the form of an agreement. The two primary reasons for the documentation of a consensus are:

(a) Promises made by either party are often vague and must be reduced to specific rights and obligations in order to avoid ambiguity; and
(b) In the event that the parties to the merger or the acquisition become involved in a dispute regarding the merger or the acquisition, and are required to refer the dispute to adjudication (whether to a court of law or an alternative adjudicatory forum, such as an arbitration tribunal), much reliance will be placed upon the consensus to ascertain the intention of the parties.

The consensus would also be subject to a number of laws which may restrict or prohibit the operation of certain parts of the consensus. Further, even if the consensus is not prohibited or restricted, timely information must be provided to relevant regulatory authorities. In some cases, the consensus cannot be implemented without the sanction of a regulatory authority.

In this chapter, we provide an overview of some of the laws that are applicable to every or most forms of mergers and acquisitions. Please note that while this chapter provides a general guide to the provisions of law that would apply to mergers and acquisitions, it should not be taken as legal advice. The value of an experienced legal consultant to advise on the merger or acquisition process as well as the legal due diligence cannot be replaced by a guide.

The basis of a merger or an acquisition is the transfer of assets and/or liabilities from one entity to another, for reasons discussed elsewhere in this book. The transfer of assets and liabilities could take place in any number of ways:

(a) By the transfer of assets and/or liabilities from the target to the acquirer
(b) By the transfer of the entity owning the assets and liabilities in its entirety or in part, to the acquirer
(c) By the merger of the target entity into the acquiring entity

Each option has its own pros and cons, which are more pronounced when the target entity is a company. The pros and cons of each option is discussed in section 3 of this chapter.

In case of an acquisition, the deal is usually implemented by the sale and purchase of either the shares, business or the assets of the target company or the issue of shares of the target company in favour of the acquirer. A consensus relating to that transfer of shares, business or assets is usually

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encapsulated in a contract. Therefore, one must begin with the Indian Contract Act, 1872, as it lays the cornerstone for the basis of contract enforceability in India and what contracts are valid and what are not.

The transfer or issue of shares, are subject to the Indian Companies Act, 2013 which also contains specific provisions for the merger or amalgamation of companies. There are other ancillary matters involved in the M&A process, including information rights and appointment of directors, which are provided for in the Companies Act. It must be noted however, that the existing Companies Act, 2013 may be replaced shortly by the Companies Bill 2012, which is awaiting discussion and ratification in Parliament.

While the Contract Act and the Companies Act would be applicable in every instance of a merger or an acquisition of shares of a target company, there may be situations which bring other legislations into play. In certain cases which may have an adverse effect on competition, a specific merger or an acquisition may trigger the provisions of the Competition Act, 2002, along with its subordinate legislation. In cases of mergers and acquisitions of listed companies, the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 would also be triggered. A cross border acquisition would attract the provisions of the extant Policy on Foreign Direct Investment or the Overseas Direct Investment guidelines. This chapter would provide an overview of each of these abovementioned laws.

India has a plethora of laws, a number of which are restricted in their application to certain industry sectors. In certain cases, a merger or an acquisition of a target company operating within one of these industry sectors would be subject to the sector specific laws. For example, a concession granted by the Government of India in favour of a power generation company is likely to have a minimum requirement as to the percentage of shareholding that the promoters of the company may continue to retain. Given the multitude of sector specific laws, we have not delved into the same.

2. The Indian Contract Act, 1872

The Indian Contract Act defines a contract as an agreement that is enforceable by law. In other words, an agreement is not a contract until it has the sanction of law. That leaves us with the question as to what an agreement is. An agreement occurs when two or more people assent to undertake specific actions for each other. And that really, is the cornerstone of contract law- the consensus.

There are a number of instances where an agreement would not be given the sanction of law. These include cases where the agreement has been made on the basis of fraud, coercion, undue influence, misrepresentation, by the incapacity of one or more of the parties, or in cases where the subject matter of the contract is bad in law.

2.1. The Term Sheet

In a typical acquisition scenario, once the contact and preliminary talks with the target have been concluded, the acquisition model and basic conditions of the acquisition are determined. The model, basic conditions and often the business valuation is captured in a preliminary document which may be called a memorandum of understanding, memorandum of agreement, term sheet, heads of terms or a variation of the same. The object of a term sheet is not to bind the parties to the acquisition, but to ensure that the parties have a commercial understanding and continue concrete discussions and negotiations. This also gives an opportunity to the acquirer to undertake a detailed due diligence exercise.

The term sheet need not be detailed. Outlining the commercial understanding, including the number of shares to be issued or transferred, the valuation and certain important provisions would suffice. It must be ensured however, that the term sheet includes provisions on exclusivity and

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confidentiality. It would be counter-productive for the acquirer to continue its diligence and discussions with the target while the target itself is shopping for a better deal.

While a term sheet under Indian law is not binding by itself per se, a provision stating that the term sheet is binding is recommended. On numerous occasions, Indian courts have upheld such provisions and have enforced the binding nature of term sheets[1].

Other provisions that may be included in the term sheet are terms and conditions as to:

(a) conditions to be fulfilled prior to the execution of the acquisition agreement or the investment agreement or the merger scheme, as the case may be. Often, in case the acquirer is a foreign entity, prior approval may be required. Or the acquirer may require the target to prepare new financial statements, etc.
(b) who pays for the costs of the transaction. This is important as the costs of an acquisition may be substantial, involving payments to be made to financial, accounting and legal advisors, stamp duty, etc.
(c) the procedure to be followed in case of a dispute with regard to the term sheet. Usually, parties opt for an alternative dispute resolution mechanism, using negotiations or mediation in the first instance and arbitration in case the mediation or negotiation fails.

2.2. The Acquisition Agreement

Consider a scenario where the entire or substantial part of a company is to be acquired. In case of an acquisition of shares of a company, the consensus is typically captured in what is referred to as a share transfer or a share purchase agreement. The agreement contains specific provisions setting out the identity of the purchaser and the seller, the number of shares to be transferred and the price at which such shares are to be transferred. There may be price restrictions applicable in case the company is listed on a stock exchange, or if the either of the parties is non resident in India. We will discuss these price restrictions in sections 6 and 7 of this chapter respectively.

It is also important that the target company be made a party to the share transfer agreement. While this may seem counter-intuitive, since the company has no role to play in the formation of the consensus, the definitive procedural step for the transfer of shares lies in an action to be taken by the Company as further detailed in Section 3.1 of this chapter. Therefore, it would be advisable to bind the company to its obligations to honour the transfer of shares.

Often, the purchaser would require the vendor and the target company to undertake certain actions prior to the actual transfer of shares. These may include obtaining the necessary regulatory and other approvals, authorisations in favour of the signatories to the agreement, carrying out a detailed audit of the company, or actions to mitigate any risks that may have been discovered during the due diligence process. This is to ensure that at the time of the acquisition, the affairs of the company are in order and that the company is in good standing. These actions that the vendor and/ or the company are required to carry out to the satisfaction of the purchaser are specifically set out and are referred to as conditions precedent. Any actions to be carried out by the parties (including the company) post the transfer of shares is also set out as conditions subsequent.

The actual transfer of shares takes place only when the conditions precedent have either been satisfied or have been waived by the purchaser. The process of transfer is governed by the Companies Act, 2013, which we will discuss in the next chapter.

The acquisition agreement must also contain clauses that set out the representations and warranties made by each of the parties, under what conditions would an event of default take place and the consequences of such events of default.

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[1] Most recently in *Real Lifestyle Broadcasting Pvt. v. Turner Asia Pacific Ventures Inc*, Co. Appl. No. 2076 of 2012 in Co. Pet. No. 20 of 2011, judgment dated February 22, 2013

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2.3. The Investment Agreement

Let us now consider a scenario where the acquisition of a company takes place by the issue of fresh shares. In such cases, the purchaser (here known as the investor) would typically take a minority position, as opposed to a controlling stake in the company. Usually, such acquisitions are for investment purposes only and the acquirer does not actively participate in the management of the company. The investment agreement would contain similar clauses to the acquisition agreement, except that the shares acquired would be by way of a subscription and issue of fresh equity, rather than a transfer of shares. Further, since the issue of shares is an action to be undertaken by the company and the share price is to be paid to the company, the role of the company is further enhanced in this case.

In addition to the clauses mentioned for an acquisition agreement, an investment agreement would also typically include provisions setting out how the company is to be jointly managed between the investor and the existing shareholders. These include veto rights in certain matters (known as affirmative voting rights), the rights of the investor to appoint board members, to inspect the documents of the company, etc. The investment agreement would also contain minority protection rights, including exit provisions.

Exit provisions are conditions under which a minority investor may sell its shares. An investor may choose to sell its shares in order to generate funds from the proceeds, or as a reaction to an event of default committed by the majority shareholder or the company. There are certain terms relating to exit provisions that are typically used in an acquisition agreement or an investment agreement. We will discuss each of these as follows.

2.4. Exit Provisions

A put option is the right or entitlement, but not the obligation, of a person to buy or sell an asset (which for our purposes comprises shares in the Company). Such options are created by contract (in this case, the Shareholders Agreement) and essentially represent contractual obligations of transacting parties. When the option is exercised by such shareholder, the other person (being the buyer) will be obligated to purchase the shares at a pre-determined price.

Put options are essentially exit rights available to private equity and venture capital investors in companies. Such investors invest in portfolio companies (that are usually unlisted) with a view to profiting from a subsequent floatation of the shares in the public markets thereby providing ample liquidity and exit opportunities. However, since listing of shares may not always be feasible, private equity and venture capital investors seek fallback exit options in their contracts with portfolio companies and their controlling shareholders. The first is a put option on the company, which requires the company or the majority shareholders to buy back the shares of the investor upon exercise of the option. However, under Indian company law, a buyback of shares by the company is subject to a number of limitations that reduce the attractiveness of such a put option on the company. Therefore, investors tend to insist on the second possibility, which is a put option on the controlling shareholders of the company, where the limitations applicable to a buyback by the company do not operate[2].

A call option is the reverse of a put option. It provides the holder of the option to purchase (or 'call' upon) the shares held by the other shareholders at a price either determined, or determinable at the time of the exercise of the option. This is typically used by majority shareholders when seeking to consolidate their holdings.

[2] Please note that under a conservative interpretation of SEBI Notification No. S.O 184(E)) dated 1 March 200, forward contracts, including put options are not enforceable in case of public companies.

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The call and the put options are occasions when one of the shareholders exit the company in favour of the other shareholders. However, a third party transfer, that is, a transfer of shares to an entity who is not a shareholder of the company is also possible. However, there may be restrictions placed on such third party transfers. For example, a promoter may insist that a strategic investor first offer its shares to the promoter in the event that the strategic investor chooses to exit the company. In case the offer made by the promoter is not agreeable to the investor, the investor is free to sell its shares to a third party. This is known as a right of first offer.

A variation of the right of first offer is the right of first refusal. In this case, the exiting shareholder obtains a firm offer from a third party transferee. This offer is then revealed to the non-exiting shareholder who may choose to match the offer, or ignore it. If the non-exiting shareholder matches the offer, then the exiting shareholder is constrained to sell its shares to the remaining shareholder. If not, a third party transfer is possible.

At the time of the third party transfer, there are two other mechanisms that often fine their way into an acquisition investment or an investment agreement. These are tag along rights (also known as a right of co-sale) and drag along rights. When a shareholder is selling its shares to a third party, the right of the other shareholders to sell its shares to the same third party investor at the same conditions and price is known as a tag along right. This right may be exercised even without the consent of the selling shareholder or the third party purchaser. This is typically used by minority shareholders who perceive the value of the company to be dependent upon the majority shareholder. Therefore, the exit of the majority shareholder may lead to a decline in the value of the company, hence the desire to exit along with the selling shareholder.

The converse of the tag along right is the drag along right. In this case, the third party purchaser may require to purchase more shares than selling shareholder holds. The drag along right requires that the non-selling shareholder would be constrained, upon instructions of the selling shareholder, to sell its shares to the third party purchaser at the same price and conditions. Similar to the tag along right, this right may be exercised even without the consent of the non-selling shareholder or the third party purchaser.

In a number of cases, where an investment is made, not for strategic purposes, but for the investor to seek a return on the appreciation of the share valuation. A number of agreements may include provisions for an initial public offering where the investor would be allowed to exit the company by way of an offer for sale to the public.

In the past section we have discussed the various types of contracts typically used in an acquisition and some of the important provisions in such contracts. Many of the changes in management of the company are encapsulated in these contracts. Do note that while similar documentation is requisite for a merger, the scheme of arrangement required is not in the nature of a contract. The merger process, the provisions of Indian company law relating to the actual transfer of shares and the changes in company management are discussed in the next section.

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3. Indian Companies Act, 2013

The vast majority of mergers and acquisitions take place by the transfer or issue of shares of companies, hence the importance of the Companies Act, 2013 and its provisions relating to the transfer and issue of shares cannot be understated. It is paramount to ensure that the procedures required for a proper transfer or issue of shares are met. A lack of knowledge of the legal requirements, or incorrect advice could prove fatal when the acquirer realises that the shares have not been acquired properly.

There are rare occasions, where an acquisition takes place by the transfer of assets and liabilities owned by a company and not by the transfer or issue of shares of a company, the Companies Act places a number of restrictions on the board of directors of the company. One of these restrictions is the sale, lease or disposal of the "whole, or substantially the whole, of the undertaking of the company, or where the company owns more than one undertaking, of the whole, or substantially the whole, of any such undertaking" without the consent of the shareholders of the company. In other words, in order to effect the transfer of the whole or substantially the whole of the assets and liabilities of a company, the shareholders of the company must, by a simple majority, consent to the transfer. A question may arise as to what is included in the term 'substantial'. The test to be applied is whether the business of the company may be effectively carried out after the transfer of assets have taken place. This means that even though the assets transferred may not be the whole of the assets of the company, nor substantially the whole, if the business of the company is reduced to a shell after the transfer, the consent of the shareholders would be required.

This section discusses the procedure to be followed and the key elements to ensure that a transfer or issue of shares takes place correctly.

Company law allows for free transferability of securities of a public company; except in specific circumstances that have been enumerated in the Companies Act. A public company cannot prevent registration of a transfer of shares. Conversely, an unlisted, private company may reject the registration of transfer of shares. However, there is no public market for an unlisted company in the sense that its securities are not available for trading on the stock exchange.

There are two types of share capital under Indian law- equity (equivalent to common stock) and preference (equivalent to preferred stock). The primary difference between the two types of shares under Indian law is the voting powers that are attached to each. Preference shareholders, under normal circumstances, cannot participate in shareholder meetings, nor can they vote on shareholder resolutions. Equity shares are equal in terms of voting rights and the right to dividend. However, equity shares with differential rights is also permitted for private companies. Therefore, for the purposes of the acquisition of a company, the transfer or issue of equity shares is the norm.

However, consider the following case. A target company has been granted a concession by a state government for the construction of a highway, subject to the condition that the original shareholders (the promoters) shall retain control (51% of the equity share capital) of the target. In the course of discussions, it is found that the investment requirements of the company exceeds 49% of the equity share capital, based on the valuation of the target. In such cases, the investor may consider purchasing upto 49% of the equity share capital and the remainder of the investment to be used to subscribe to preference shares, or any other form of security instrument that the company is able to issue.

3.1. Transfer of shares

In case of transfer of shares, the following are the key elements to ascertain the title of the shares to be transferred:

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(a) Entry in the register of shareholders stating the date of issue and number of shares in favour of the seller; and
(b) Share certificates evidencing the number of shares issued in favour of the seller.

During the diligence process, it is important to ensure that these key requirements to determine title to shares are in order.

Let us now consider the actual transfer of shares. In section 2 of this chapter, we discussed the details of a share purchase agreement which provided that the acquirer and the seller have agreed to transfer shares at a given price subject to conditions precedent having being met. Let us assume that the conditions precedent have been met and parties proceed to the transfer of shares. This stage is referred to as a 'closing' or a 'completion' of the deal. In order to execute the proper transfer of shares, the following actions need to be taken under the provisions of the Companies Act, 2013:

(a) A meeting of the board of the target company to be called to complete the acquisition
(b) At the meeting, a share transfer form is to be filled out and signed by the acquirer and the seller and submitted to the company. The share transfer form is an instrument of transfer and a formal request to the company to effect the transfer of shares. Please note that the transfer of share is subject to stamp duty and therefore, the share transfer form is required to be stamped (revenue is required to be paid to the government).
(c) Upon receipt of the share transfer form, the board of the target company would update the register of shareholders to show that the shares were transferred from the seller to the acquirer.
(d) Simultaneously, the share certificates held by the seller would be endorsed to show that the shares are now held by the acquirer.
(e) Finally, the board must take on record, in the minutes of the meeting that the shares were transferred from the seller to the acquirer for an agreed price.

The execution of the above actions would effectively ensure that the shares have been transferred. The board resolution, taking on record the transfer of shares is important as, under Indian company law, the board of directors of a private company may refuse to register the transfer of shares. Conversely, shares in a public company are freely transferable and need not require the consent of the board.

Please note that the above requirements apply only to unlisted companies. There are certain restrictions and additional requirements on the transfer of shares of listed companies which are dealt with in section 6 of this chapter. Further, in case the acquirer is a non-resident, i.e. a foreign investor, the acquisition would be subject to India's extant FDI policy, outlined in section 7.

3.2. Issue of shares

A company may issue shares under the Companies Act, 2013. This necessitates a special resolution (having a majority of 75%) of the shareholders of the company. The constitutional documents of the company (articles and memorandum of association) must empower the company to issue shares. Shares may be issued at par, at premium or at a discount. The issue of shares is formally made on an application by the acquirer to the company, accompanied by the consideration to be paid for the issue of shares. While the end result for the acquirer is the same in the case of a transfer of shares or an issue of shares, the key difference lies in terms of the recipient of the consideration paid for the shares. In case of a transfer, the recipient of the share price is the exiting shareholder while in case of an issue, the recipient is the company. An issue of shares is more likely with young or low valuation companies with good growth prospects subject to diversification or capacity building. An issue of shares is also likely when the company is in need of funds to carry out its business. A transfer of shares is more likely in case of well-established companies.

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As mentioned earlier, every company is allowed to issue fresh shares provided that the constitutional documents of the company permit the same. The procedure for the issue of shares is similar to that of the transfer of shares, that is to say, the key requirements of an issue of shares are:

(a) The register of shareholders of the company be updated to reflect the number of shares which were issued to the acquirer, the date of issue and the price at which the shares were issued.
(b) Share certificates, bearing the identity of the acquirer, the number of shares, price and date, to be issued. Please note that, much like a share transfer form, a share certificate is required to be stamped.

While there is no requirement for a share transfer form, the process of issuing shares is similar to that of a transfer. At a board meeting of the company, the board accepts the application from the acquirer, along with the share consideration and in return the board issues the share certificates and updates the register of shareholders. It is imperative that the minutes of the meeting of the board reflect the issue of shares.

So far, we have considered cases where an acquirer purchases or subscribes to shares of a company, leading to the acquirer becoming a controlling or minority shareholder of the company. However, the merger of two companies is completely different scenario under Indian law.

3.3. Procedure for merger

Under the provisions of the Indian Companies Act, 2013, it is possible to merge or amalgamate two companies by way of a "compromise or arrangement between a company and its members". It must be ensured that the memorandum and articles of association of the companies proposed to be merged allow the same. If not, the articles and memorandum of association of the companies must be amended to allow a compromise or arrangement. The mechanism of a merger is vastly different from that of an acquisition. In a merger, the assets and liabilities of one of the companies (the transferor company) are transferred to the other (transferee) company and the shareholders of the transferor company are issued shares in the transferee company. The transferor company ceases to exist.

The Companies Act empowers the Tribunal to pass an order to sanction a scheme of arrangement for the merger of two companies. Much like the acquisition or investment agreement in case of an acquisition, the 'scheme' of merger is central in this case. A scheme of merger is prepared by the merging companies and approved by their respective shareholders in a special resolution. The approved scheme is then submitted to the Company Law Tribunal. Upon the issuance of an order by the Company Law Tribunal sanctioning the scheme, the merger is effected.

A scheme of merger typically contains the following details of the companies to be merged:

(a) A description of the two companies and a break up of their respective shareholding patterns
(b) A rationale of the merger
(c) Description of the transfer of assets, liabilities, contracts, receivables, employees, permits, licenses and legal proceedings, etc from the transferor company to the transferee company
(d) Number of shares to be issued to the shareholders of the transferor company. This is typically expressed as a ratio to the number of shares held by the shareholders of the transferee company.
(e) A description of the accounting treatment of the merger and the increase in share capital of the transferee company.

However, there are other considerations in cases where one or more of the companies to be merged are listed on a stock exchange. In such cases, approval of the stock exchange and the Securities and Exchange Board of India (SEBI) are also required in addition to the approvals from the shareholders and the Tribunal, which is applicable in all cases. Further, in a recent circular, SEBI

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has mandated that in addition to the 75% majority required for a special resolution, two-thirds of the public shareholding must also vote in favour of the merger.

The following is a list of activities (in chronological order) that must be undertaken in order to effect a merger for a listed company. In case of an unlisted company, no approval from the stock exchanges or SEBI is required.

(a) Issue notice for board meeting to approve draft Scheme. 3 copies of such notice to be sent to stock exchange(s) where the shares of the transferor company are listed (the "Stock Exchange") simultaneously. Fix a record date for determining the names of shareholders of the transferor company eligible for obtaining the shares of the transferee company. Period of notice of board meeting to directors to be provided as per articles.

(b) Hold board meeting to approve draft Scheme. Issue notice for board meeting for finalizing the Share Exchange Ratio & Scheme of Amalgamation. The decision of the Board and and notice for the next Board Meeting to be intimated to the Stock Exchange. The Board is required to in-principally approve the Scheme and appoint a Chartered Accountant as Valuer for recommending the share-exchange ratio and advocates for representing the matter on behalf of the Company before the Tribunal.

(c) Hold the Board Meeting to approve the draft Scheme and the Share Exchange Ratio. The decision of the Board and the Share Exchange Ratio to be intimated to the Stock Exchange

(d) Apply to the Stock Exchange(s) where the Shares of the Company are listed as well as SEBI for observations

(e) Upon receipt of observations from the Stock Exchange, apply to the Company Law Tribunal seeking directions for holding meeting of shareholders and creditors. A copy of the application made to the Company Law Tribunal must also be sent to the Regional Director appointed by the Central Government (the "Regional Director")

(f) The copy of the application sent to the Regional Director must be accompanied by a copy of the Memorandum and Articles of Association of both companies as well as a copy of the latest audited balance sheet of the transferee company

(g) Obtain order from the Company Law Tribunal convening the meeting of the meeting of shareholders and creditors and for publishing advertisements for the same

(h) Publish advertisements with respect to shareholders' meetings in accordance with the schedule given by the Company Law Tribunal

(i) Send printed notices of court convened meetings to the shareholders & creditors in accordance with the instruction of the Company Law Tribunal

(j) 3 copies of such notice to be sent to the Stock Exchanges. Such notices are required to be sent under postal certification. Further, the pre and post-merger capital structure and shareholding pattern must be set out in the explanatory statement accompanying the notice

(k) Prepare and file the affidavit for dispatch of notices and for publication of advertisements with the Company Law Tribunal. Such affidavit must be accompanied by original proof of dispatch and original proof of publication of advertisements

(l) Conduct the meetings of the shareholders and creditors in accordance with the instructions of the Company Law Tribunal. The outcome of the meeting and the minutes of the meeting must be intimated to the Stock Exchanges and the Securities Exchange Board of India.

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(m) Please note that this resolution that. more than 75% of the total shareholding and more than two thirds of the public shareholding in must vote in favour of the resolution. The result of the meeting may be decided by voting in person or by proxy.

(n) Within 7 days of the shareholders and creditors meeting, file the chairman's report with the Company Law Tribunal.

(o) Within 7 days of the filing of the chairman's report, file the company petition with the Company Law Tribunal for approving the Scheme.

(p) File Form No. 23 with the Registrar of Companies within 30 days from the date of the meeting.

(q) Obtain an order of admission of petition from Company Law Tribunal.

(r) The Company Law Tribunal would order a copy of the petition to be served to the office of the Regional Director and the Official Liquidator.

(s) Submit a Certified Copy of the Petition with the offices of the Regional Director, the Official Liquidator and the Registrar of Companies.

(t) The Registrar of Companies shall submit its report to the Regional Director who will make a separate study of the Scheme and file its report with the Registrar of Companies. The Registrar shall forward the report to the government counsel.

(u) The Company Law Tribunal shall issue an order approving the Scheme.

(v) File the Company Law Tribunal order with Registrar of Companies in Form No. 21 along with the payment of stamp duty, if applicable. The merger becomes effective once the Company Law Tribunal order is filed with the Registrar of Companies.

(w) Within 30 days of obtaining a copy of the order. Annex a copy of the order to every copy of the Memorandum of Association of the company issued after the certified true copy of the Company Law Tribunal order has been filed with the Registrar of Companies.

(x) Proceed with implementation of the approved Scheme as per the directions of the court by issuing suitable notices to shareholders, persons concerned and by allotting shares and taking over the business in terms of the approved Scheme.

(y) The transferee company is required to file Form No. 2 and Form No. 3 with the Registrar of Companies within 30 days of allotment.

3.4. Changes to the Company Management

Under Indian law, much like elsewhere in the world, a company is governed by two bodies, a general body of shareholders and the board of directors. A private company is required to have at least two directors while a public limited company is required to have a minimum of at least three directors. The board is appointed by the shareholders and each director remains in office while he enjoys the confidence of the shareholders.

However, in case of public companies or private companies being subsidiaries of public companies the board is divided into two parts. One third of the directors remain in power throughout while the remaining two-thirds retire by rotation. One-third of such directors retire at every annual general meeting of the shareholders. Usually, the same directors are re-appointed in the same annual meeting. Private companies do not have this requirement of directors retiring by rotation.

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In the case of a private company, apart from the minimum number of two directors to be appointed by the shareholders, the procedure for the appointment of directors is governed by the company's articles of association. If the articles do not provide otherwise, the directors are to be appointed in a general meeting of the shareholders.

An acquirer may require to be given the right to appoint a certain number of directors. Depending upon the amount of investment, the total number of directors and the negotiation with the existing shareholders, the number of directors appointed by the investor may vary. It is imperative that the provisions of the acquisition or the investment agreement relating to the management of the company are reproduced in substance in the articles of association of the company.

Every company is required to have articles of association which act as bye-laws relating to the manner and procedure in which the company is to be managed. When determining the rights of shareholders in a company, Indian courts will place a higher reliance on the articles of association of a company over a separate agreement entered into by the shareholders. Therefore, it is of paramount importance that upon the completion of an acquisition or a merger, the articles of association of the company are amended to reflect the new position of shareholders. These are generally referred to as restated articles of association and must be adopted by the shareholders by a special resolution, that is, adopted by atleast 75% of the voting rights held by the shareholders.

3.5. Reporting Requirements

A number of actions described above must be reported to the Registrar or Companies, the controlling authority for corporations in India. The reporting is done by the submission of pre-determined, numbered forms to the registrar, the formats for which are readily available. E-filing of these forms is possible. Some of the forms required to be filed in case of a merger or an acquisition are as follows:

(a) Form 2- for the allotment of shares
(b) Form 3- for the allotment of shares for a consideration other than cash (applicable to mergers)
(c) Form 5- for an increase in share capital
(d) Form 32- for the cessation or appointment of a director
(e) Form 49- for the alteration of articles of association

Please note that these are the reporting requirements under the Companies Act, 2013. There may be other reporting requirements to be made in the event that the merger or the acquisition falls under the provisions of the Takeover Code, the Competition Act or the Foreign Direct Investment Policy of India as set out in later sections of this chapter.

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4. Competition Act 2002

The Competition Act, 2002 deals with anti-competitive agreements and provides that any agreement entered into by business entity (ies) engaged in identical or similar trade of goods or provision of services, regarding any aspect/s of business which has the effect of causing an appreciable adverse effect on competition within India is regarded as anti-competitive agreement and is consequently considered void.

Agreements which may potentially restrict competition may be horizontal or vertical in nature. Horizontal agreements refer to agreements among competitors which are in the same market and the same stage of production. Vertical agreements are agreements amongst enterprises/ persons at different stages of the production chain in different markets with regard to production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, including tie-in arrangements, exclusive supply agreement, exclusive distribution agreement, refusal to deal and resale price maintenance may be considered anti-competitive if they similarly cause or are likely to cause appreciable adverse effect on competition in India and would thus be void. The provisions under the Act which prohibit anti-competitive agreements do not apply to agreements entered into by way of joint ventures if such agreement increases efficiency in production, supply, distribution, storage, acquisition or control of goods or provisions of services.

4.1. Regulation of Combinations

With a view to preventing mergers or acquisitions (referred to as 'combinations' under the Competition Act), which would cause an appreciable adverse effect on competition within the relevant market in India, the Government of India has made suitable provisions in the Competition Act regulating mergers and acquisitions of enterprises (with exceptions in the case of public financial institutions/ FIIs/ Banks or VC funds). These provisions are found in the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (also known as the Combination Regulations). The term "acquisition" has been defined to mean directly or indirectly, acquiring or agreeing to acquire:

- shares, voting rights or assets of any enterprise;
- control over management or control over assets of any enterprise

In other words, acquisition means obtaining ownership and possession from another, whether it is the ownership or other rights. It could be done by acquiring control over the management or assets or by acquiring shares, voting rights or assets of that enterprise

Any merger or acquisition or two or more companies in India is referred to as a combination. However, in order to trigger the provisions of the Combination Regulations, the merger or the acquisition must exceed the prescribed threshold limits, which may be explained in the following table

<table>
<tr><td colspan="2"></td><td colspan="2">Value of combined assets (in INR billion)</td><td colspan="2">Combined turnover (in INR billion)</td></tr>
<tr><td rowspan="2">Where assets of the companies to be combined are only in India</td><td>In case of individual companies being combined</td><td colspan="2">15</td><td colspan="2">45</td></tr>
<tr><td>In case of a company being combined into a group</td><td colspan="2">60</td><td colspan="2">180</td></tr>
<tr><td colspan="2"></td><td>Total value of assets (in USD)</td><td>Assets in India (in INR)</td><td>Total turnover (in USD)</td><td>Turnover in India (in INR)</td></tr>
</table>

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Where assets of the companies to be combined are both in India and outside India	In case of individual companies being combined	750 million	7.5 billion	2.25 billion	22.5 billion
	In case of a company being combined into a group	3 billion	7.5 billion	9 billion	22.5 billion

For the purposes of calculating the assets and turnover of the entities to be merged, the turnover shall be determined by taking into account the values of sales of goods or services. The value of assets shall be determined by taking the book value of the assets, including brand value, value of goodwill, or Intellectual Property Rights etc. as shown in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed combination falls, as reduced by any depreciation.

A combination, which causes or is likely to cause an appreciable adverse effect on competition in the relevant market in India is prohibited. The Competition Commission of India must be notified of the proposal of entering into such a combination and failure to do so may lead to the imposition of a fine which may extend to one per cent of the total turnover or the assets of the combination, whichever is higher. This notification must be made within 30 days of the approval of the combination by the directors of the entity involved in the combination. However, the Commission may take upto 210 days to adjudicate upon whether the proposed combination would have an adverse effect on competition in the relevant market. During this 210 day period, the Commission is further required to formulate its initial opinion within 30 days of receipt of the notification. In the event that the Commission does not pass an order within the given 210 day timeframe, it would be deemed that the proposed combination would not have an adverse effect on competition in the relevant market.

In order to determine whether a combination has or likely to have appreciable adverse effect on competition in the relevant market the Commission would analyze all or any of the following factors, namely:

(a) Actual and potential level of competition through imports in the market
(b) Extent of barriers to entry in the market
(c) Level of combination in the market
(d) Degree of countervailing power in the market
(e) Likelihood that the combination would result in the parties to the combination being able to significantly and sustainable increase prices or profit margins
(f) Extent of effective competition likely to sustain in a market
(g) Extent to which substitutes are available or are likely to be available in the market
(h) Market share, in the relevant market, of the person or enterprise in a combination, individually and as a combination
(i) Likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market
(j) Nature and extent of vertical integration in the market
(k) Possibility of a failing business
(l) Nature and extent of innovation
(m) Relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition
(n) Whether the benefits of the combination outweigh the adverse impact of the combination, if any

4.2. Powers of the Competition Commission of India (CCI)

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As a response to the challenges brought on by globalization and the opening up of the Indian economy, a need was felt to establish an agency which would act as a control against anti-trust and monopolistic activities. India's anti- trust watch dog, Competition Commission of India (CCI), was established in the year 2003 by the Competition Act 2002. The CCI is a quasi-judicial body which adjudicates upon the provisions of the Competition Act. It may act based on its own knowledge, or on information or complaints received/ references made by the Central/ State Governments or Statutory Authorities.

The objects of the CCI are to:

- prevent practices having adverse effect on the Competition;
- promote and sustain competition in markets;
- ensure fair competition in India by prohibiting/preventing trade practices which cause appreciable adverse effect on competition;
- protect the interest of consumers;
- ensure freedom of trade carried on by other participants in markets in India;

The CCI is empowered to grant interim relief or any other appropriate relief/ compensation/ order imposing penalties etc. and may direct the Director General of the Commission to initiate investigation. In addition, it is also empowered to levy penalty for contravention of its orders, failure to comply with its directions, making false statements, and omission to furnish material information.

Upon the notification of a proposed combination, the CCI then makes inquiries into the accuracy of the disclosure, and whether the combination has or is likely to have an appreciable adverse effect on competition, and take appropriate steps to permit, modify or prevent such combination. Upon the issue of the final order, an appeal from an order of the CCI may be made within 60 days of the final order before the Competition Appellate Tribunal.

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5. Acquisitions of Listed Companies

As mentioned in Section 1 of this chapter, there are special laws that apply to listed companies. The primary agency for the governance of listed companies in India (in addition to the Registrar of Companies, as mentioned in section 3.5) is the Securities and Exchange Board of India (SEBI). It acts to protect the rights of investors and to develop and regulate the securities market in India.

In case of an acquisition of a listed company, the acquisition may take place either by an issue of shares, or by the transfer of shares by existing shareholders. Both of these scenarios have been dealt with by SEBI in various legislations. The key purpose of these legislations is to ensure that the rights of public shareholders are protected.

5.1. Preferential Issue of Shares

For a listed company, any issue of share may be made to all existing shareholders (a rights issue) or to the public (a further public offer) or to a specified entity or entities (a preferential issue). The issue of shares of a public listed company is governed by the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 (ICDR). The primary requirement of a preferential issue is the approval of the existing shareholders of the company, since the issue is being made to an entity in preference over the public or the shareholders.

In order to make a preferential issue of shares, a listed company must satisfy the following requirements:

(a) A special resolution must be passed by the shareholders of the company in favour of the preferential issue
(b) If the proposed allottees hold any shares in the company prior to the preferential issue, these share must be in dematerialised form. This requirement has been made to discourage preferential issues of shares to the promoters of the company who would typically hold shares in physical form
(c) The company must be in compliance with the requirements for being listed.
(d) The company must have been provided with the permanent account numbers of the proposed allottees

The special resolution to be passed by the shareholders must contain specific information relating to the preferential issue. The purpose of the preferential issue, the shareholding pattern of the company prior to and after the preferential issue and the proposal of the management of the company to issue share preferentially must necessarily form a part of the resolution to be passed. The company must also ensure that the price at which the shares are issued must be re-computed, if necessary, in accordance with the pricing guidelines laid in the ICDR and that, until payment for the recomputed price has been made by the proposed allottees, the shares proposed to be issued shall be locked in. In other words, after the preferential issue has taken place, in the event that the price for the shares is required to be recomputed and the recomputed price is higher than the original price of the shares paid, the allottees would not be allowed to transfer their shares until the additional payment has been made.

Within fifteen days of the passing of the special resolution by the shareholders, the preferential issue must be made. There are circumstances under which this fifteen day period may be relaxed, primarily in the event that the company or the allottees are required to seek government approval. For example, as we have seen in Section 4, in case of certain acquisitions, the approval of the CCI may be required. In certain other cases, the allottees may be required to make an offer to the public shareholders of the company, which will be discussed below in section 5.2. In such cases, the fifteen day period begins from the date on which the approvals have been granted and not the date of the special resolution.

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In the event that the allotment is not made within the fifteen day period a fresh special resolution must be passed by the shareholders.

There are considerations to be made with regard to the pricing of the shares to be allotted. An arbitrary pricing of the share may prove to be detrimental to the interests of the public shareholders. Since the shares are of a listed company, share prices would be guided by the stock markets. There are two mechanisms for determining the price at which these shares are to be allotted. The first is in the event that the company making the issue has been listed for atleast twenty six weeks. In such cases, the average of the weekly high and low of the closing prices of the shares quoted on the recognised stock exchange during the twenty six weeks preceding the relevant date and the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date must first be determined. The shares to be allotted on a preferential basis must be priced no less than the higher of the above two prices.

On the rare occasion that the company issuing the shares has not been listed for more than twenty six weeks, there is a separate mechanism to determine the price at which a preferential issue of shares may be made. In such cases, the following prices must be determined:

(a) the price at which equity shares were issued by the company in its initial public offer
(b) the value per share arrived at in a scheme of arrangement (refer section 3.3), pursuant to which the equity shares of the issuer were listed, if applicable;
(c) the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the period shares have been listed preceding the relevant date; and
(d) the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

In such cases, the price at which the preferential issue of shares is made must not be lower than the highest of the above four.

For the purposes of ascertaining the share price as mentioned above, the relevant date is taken as thirty days prior to the date of the shareholders meeting held to pass the special resolution.

20% of the shares allotted on a preferential basis to promoter or promoter group, shall be locked-in for a period of 3 (three) years from the date of allotment. The remainder of the shares allotted would be locked-in for 1 (one) year from the date of their allotment. In case the shares are allotted to non-promoters, the securities allotted on a preferential basis would be locked-in for a period of 1 (one) year from the date of allotment.

At the time of the allotment, the company is required to inform the depositories as to the lock-in. In case the shares allotted are in physical form, the company is required to stamp the share certificates as 'not transferable' indicating the period of non-transferability.

5.2. Takeover Code, 2011

Under certain circumstances, the allotment of shares as described under section 5.1 or the transfer of shares as described in sections 2.2 and 3.1 may attract the provisions of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 (Takeover Code). The provisions of the Takeover Code relating to the requirement of making an open offer pursuant to an acquisition of shares of a listed company is triggered in the following two events:

(a) An acquisition of 25% or more of the paid up share capital or voting rights of the company.

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(b) An acquisition of 5% or more in any financial year, where the acquirer already holds 25% or more of the paid up share capital or voting rights of the Target Company.

An open offer is the offer made by a potential acquirer to the public shareholders of the company. The purpose behind the concept of an open offer is that in case of a change of management of a listed company, the public shareholders must be given an opportunity to exit the company. An open offer is made by the acquirer for a minimum of 26% of the share capital of the company. Since, as an initial trigger, the open offer is to be made only when the shareholding of the acquirer hits 25%, the offer to purchase a further 26% would lead the acquirer to have a simple majority of 51% of the company. This would enable the acquirer to replace the board of directors and to change the management structure of the company.

However, in case the acquirer already holds 25% or more of the shareholding of the company, an increase in 5% of its shareholding in a financial year would also lead to an open offer, thus potentially increasing the acquirer's shareholding to atleast more than 56%. However, in reality, there are few shareholders who hold between 25% and 51% of the shares of a company. Such shareholders cannot participate in the management of the company, except on matters that require special resolutions. By agreement, such shareholders may potentially be able to appoint a minority number of directors on the board of the company.

This mechanism is typically used by majority shareholders who wish to consolidate their holdings. It also prevents large shareholders from making 'creeping acquisitions' i.e. acquisitions that build up the shareholding of the acquirer over time.

A key element of listed companies must also be noted here. Companies listed in India are required to have atleast 25% of their shares held by public shareholders. Any reduction of the public shareholding below 25% must be removed by a further issue of shares or transfer of shares to the public within a year of the reduction. While this provision is not particularly important for the purposes of acquisitions of listed companies, it does play a vital role in the open offer mechanism.

When making an open offer, an acquirer is ordinarily required to offer to purchase atleast 26% of the share capital of the company. However, if the offer were to be successful in its entirety, there may be a situation wherein the public shareholding may be reduced to below 25%. In such cases, the open offer may be made for a number of shares which would take the shareholding of the acquirer beyond the maximum permissible non -public shareholding limit, but the acquirer would be required to increase the public shareholding within one year of the open offer.

In case of a negotiated acquisition of a listed company, wherein the acquirer negotiates the takeover of the listed company from the existing controlling shareholders of the company, the acquirer and the selling shareholding typically enter into a share purchase agreement as described in section 2.2. However, due to confidentiality issues and given that the news of a potential takeover may trigger volatility in the share price, the company may not be made a party to the share purchase agreement. As there are no restrictions on the share transferability of public companies, therefore the company cannot refuse the registration of the transfer under the share purchase agreement, even if it is not a party to the agreement. The provisions of the Takeover Code are triggered at the time the share purchase agreement is signed. In order to carry out the open offer there a number of steps which are to be followed:

(a) At least three days prior to signing the share purchase agreement, the acquirer is required to appoint a merchant banker who will act as the manager for the open offer process
(b) Simultaneously with the signing of the share purchase agreement, a public announcement of the intention of the acquirer to takeover the company is required to be made. This public

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announcement must be made to SEBI, all Stock Exchanges and the registered office of the target.

(c) Within 3 days of the signing of the agreement, an escrow account is opened. This escrow account will hold the funds to be paid to public shareholders who accept the acquirer's offer

(d) Within 2 days of the opening of the escrow account, the acquire issues a detailed public statement which is to be sent to SEBI, all Stock Exchanges and the registered office of the target and published in all editions of any one English national daily with wide circulation, any one Hindi national daily with wide circulation, and any one regional language daily with wide circulation at the place where the registered office of the target company is situated and one regional language daily at the place of the stock exchange where the maximum volume of trading in the shares of the target company are recorded during the sixty trading days preceding the date of the public announcement. The detailed public statement contains basic details about the acquirer, the company and must contain a specific statement as to the creation of the escrow account

(e) Within 5 days of the detailed public statement being made, a draft letter of offer is to be filed with SEBI and a copy of the same is sent to the target company at its registered office address and to all stock exchanges where the shares of the target company are listed. The draft letter of offer must contain the following:
   i. Tentative schedule
   ii. Risk factors
   iii. Background of acquirers and pac
   iv. Background of company
   v. Offer price and financial arrangement
   vi. Terms and conditions of the offer
   vii. Procedure for acceptance and settlement
   viii. Documents for inspection
   ix. Declaration by the acquirer
   x. Form of acceptance - cum - acknowledgment

(f) SEBI shall review the draft letter of offer and make its observations, if any, within 15 days of the filing of the draft letter of offer. If SEBI does not send any observations within 15 days, it is deemed that SEBI has no observations to make.

(g) Within 7 days of SEBI observations the final letter of offer is to be issued to all shareholders, SEBI, Stock Exchanges and custodian of shares having underlying depository receipts (if any). Care must be taken to ensure that the observations of SEBI have been included in the final letter of offer

(h) An advertisement relating to the open offer is to be published in the same publications as the detailed public statement one day before the period for acceptance of the offer (tendering period) opens

(i) Tendering period opens 12 days after receipt of SEBI observations (5 days after dispatch of final letter of offer)

(j) Tendering period closes 10 days after opening

(k) Within 10 days of tender period closing, the escrow account is open and payments are released to shareholders. The acquirer then acquires the shares from the public shareholders.

(l) Within 5 days of payment to shareholders, a post offer advertisement is to be published in the same publications as the detailed public statement.

(m) Within 15 days of the expiry of the tendering period, the merchant banker appointed is to submit a report to SEBI confirming that the requirements of the open offer have been satisfied.

Under usual circumstances, the share purchase agreement entered into by the acquirer and the controlling shareholder may be completed only after the submission of the merchant banker's report.

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Since the acquisition of a listed company involves publicly traded shares, there are restrictions on the share price at which the open offer must be made. The pricing guidelines set out in Regulation 10 (1) of the Takeover Code provide for the pricing of shares which are frequently as well as infrequently traded shares. Therefore, in the event the shares of the Target Company are frequently traded, the acquisition price per share shall not be higher by more than 25% (twenty-five per cent) of the volume-weighted average market price for a period of 60 (sixty) trading days preceding the date of issuance of notice for the proposed *inter se* transfer, as traded on the stock exchange where the maximum volume of trading in the shares of the Target Company are recorded during such period.

However, if the shares of the Target Company are infrequently traded, the acquisition price shall not be higher by more than 25% (twenty-five percent) of the price determined taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies.

Usually, in case of open offers being triggered by the signing of a negotiated share purchase agreement, the open offer price is the same as the share price negotiated with the controlling shareholder.

5.3. Reporting Requirements

Apart from the above mentioned disclosures involved in the open offer process, it must be noted that the Parties would be required to make the following disclosures under Chapter V of the Takeover Code to the stock exchanges where the shares of the Target Company are listed and to the Securities and Exchange Board of India ("**SEBI**"):

(a) Disclosure of every acquisition of shares in excess of 2% of the shares of the Target Company where the acquirer holds more than 5% of the shares; and

(b) Annual disclosure of the aggregate shareholding of the promoters of the Target Company and of shareholders holding more than 25% of the shares of the Target Company.

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6. Cross Border Acquisitions

Ever since India gained independence, the nation's socio-economic development programmes have strived to achieve economic self-reliance and social equity. There is a near unanimity among political parties on economic reforms in India. With the benefits flowing from the economic reforms undertaken by successive governments in the country, this political consensus has broadened on a national scale.

Extended reforms in almost every sector have ensured macro-economic stabilization in the country. Some of these reforms have been in the form of opening up of the Indian economy to foreign investment as well as allowing Indian investments overseas. This has arguably led to a rise in M&A activity in India. This section discusses the regulatory aspects of cross border acquisitions in India.

6.1. Investments into Indian companies under the Foreign Direct Investment Policy

With the economy clearly charting the course of global integration and international competitiveness over the last decade, there has been substantial flow of Foreign Direct Investment (FDI) in various core sectors of the economy. FDI has gained importance globally as an instrument of international economic integration. FDI policies along with trade policies have, in fact, become the focus of liberalization efforts in almost every country.

In India, the primary objective of the FDI policy is to invite and facilitate foreign investment to achieve faster economic growth. The policy guidelines of the Government of India for FDI in India are reviewed on an ongoing basis taking into account the economic requirements of the country. The regulations have been structured to identify the industrial sectors, with or without sectoral caps, for investments, to minimize the procedural formalities and finally to introduce an automatic route for foreign investors to bring in investment by merely informing the RBI.

The provisions, which apply only to entry of FDI, emanate from the Foreign Exchange Management Act, 1999 (FEMA) and the rules and regulations framed thereunder. The route to foreign investment has been made easier as the thrust is more on the management of foreign investment rather than on regulation as was prevalent under its predecessor regulation, Foreign Exchange Regulation Act (FERA), 1973. India's foreign investment regulations are two pronged, one relates to the authorisations or licenses required by a foreign investor, and the other deals with the relationship between the subsidiary or joint venture company and its foreign parent company or investor, as the case may be (profit repatriation, royalties, etc.).

Basic Regulations Governing the entry by Foreign Investors

The basic rules regulating possible entry by foreign investors are as follows:

- No investment is permitted in a few sensitive sectors such as atomic energy and tobacco.
- Specific approval is required in a few sectors such as power exchanges. Approvals are not automatic in these sectors and they are accorded on a case-to-case basis on merit.
- In all other sectors, foreign investment is allowed on an automatic basis up to the permissible limit set for a sector, i.e., it does not require prior approval of the Government of India, and the investment is required to be notified within a specified period.
- Investments, once approved and implemented as per the approval conditions, are valid permanently and qualify for future repatriation of profits and capital.
- Approvals can follow one of the two routes, namely the Automatic route or the Approval route.
- The government, from time to time, notifies "sector specific guidelines for FDI" delineating the percentage of FDI permitted in specified sectors/activities. The guidelines also specify if the foreign investment would fall under the automatic or approval route. In the sectors/ activities not listed in the guidelines, FDI is permitted up to 100 per cent under the automatic route, subject to the applicable sectoral rules/regulations.

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The automatic route applies to all proposals that are completely in line with the investment guidelines prescribed for the sector. No prior approval is necessary for investments under the automatic route. However, the name of the collaborators, details of allotment, copy of the foreign collaboration agreement, the original foreign inward remittance certificate from the authorized dealer and other specified information are to be provided to the RBI within a specified period. Automatic route extends to all proposals:

- Where the proposed investment is within the specified ceilings prescribed for automatic route;
- Subject to sectoral norms, FDI in Special Economic Zones (SEZs), Export Oriented Units (EOUs), Electronic Hardware Technology Park (EHTP), Software Technology Park (STP) and Industrial Parks;

FDI activity not covered under the automatic route requires prior government approval and is considered by the Foreign Investment Promotion Board, Department of Economic Affairs, Ministry of Finance (FIPB) on a case-to-case basis. Prior approval of the Government of India is necessary for foreign investment with respect to sectors in which foreign investment can only be by prior government approval as per the notified sectoral policy.

Apart from the ceiling on the amount of foreign investment that may be made in a company, depending upon the sector, there may be other

An issue or transfer of shares to a foreign resident must be made within 180 days of receipt of the share purchase funds. Upon the expiry of the 180 day period, the share purchase funds must be returned immediately. Further, there are restrictions upon the price at which shares may be issued to a non-resident investor. If the shares are of a listed company, then the pricing guidelines of the ICDR and the Takeover Code would be applicable. In case of unlisted companies, the share price must be based on the fair valuation of shares as per the discounted free cash flow method.

6.2. Investments from Indian companies under the Overseas Direct Investment Policy

Indian residents, including companies are permitted to make overseas investments or financial commitments in the form of corporate guarantees, loans without requiring approval, provided that such investment does not exceed 400% of the net worth of the resident. For the purposes of calculating net worth, only the paid up capital and free reserves of the resident company are taken into account.

Overseas investments by Indian residents are also subject to the following restrictions:

(a) The Indian party should not be on the Reserve Bank's Exporters caution list / list of defaulters to the banking system or under investigation by any investigation / enforcement agency or regulatory body;
(b) The transfer of funds must be routed through an authorised dealer bank designated by the Indian investor;
(c) For acquisitions of value in excess of USD 5 million, valuation of the shares of the company shall be made by a Category I Merchant Banker registered with SEBI or an Investment Banker / Merchant Banker outside India registered with the appropriate regulatory authority in the host country;
(d) For acquisitions of less than USD 5 million, the valuation may be carried out by a Chartered Accountant or a Certified Public Accountant;

In terms of the regulatory aspects of Indian investments overseas, the laws of the investee country must also be taken into account.

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6.3. Tax concerns and double taxation avoidance agreements

The Government of India, under section 90 of the Income-tax Act, has been authorized to enter into Double Taxation Avoidance Agreements (DTAAs) with other countries. The object of such DTAAs is to evolve an equitable basis for the allocation of the right to tax different types of income between the 'source' and 'residence'. These DTAAs generally provide for relaxation in the taxation rates at which the resident of a State which is a party to such tax treaty may be taxed on the income generated by him in the other contracting State. Thus, the assessee is not taxed in two States for the same income generated in one of the contracting States. This approach to cross border taxation has been widely acknowledged to promote international trade and cross border investments. For example, a non-resident, under the income tax law, becomes liable to tax in India in respect of income arising here by virtue of it being the country of source and then again, in his own country in respect of the same income by virtue of the inclusion of such income in the 'total world income' which is the tax base in the country of residence. Tax incidence, therefore, becomes an important factor influencing the non-residents in deciding about the location of their investment, services, technology etc.

These DTAAs follow a near uniform pattern in as much as India has guided itself by the UN model of tax treaties. The DTAAs allocate jurisdiction between the source and resident country. Wherever such jurisdiction is given to both the countries, the DTAAs prescribe maximum rate of taxation in the source country, which is generally lower than the rate of tax under the domestic laws of that country. The resident country agreeing to give credit for tax paid in the source country avoids the double taxation in such cases, thereby reducing tax payable in the resident country by the amount of tax paid in the source country.

These DTAAs give the right of taxation in respect of income of the nature of interest, dividend, royalty and fees for technical services to the country of residence. However, taxation in the source country has to be limited to the rates prescribed in the tax treaty. The rate of taxation is on gross receipts without deduction of expenses. So far as income from capital gains is concerned, gains arising from transfer of immovable properties are taxed in the country where such properties are situated. Gains arising from the transfer of movable properties forming part of the business property of a 'Permanent Establishment' or the 'Fixed Base' are taxed in the country where such Permanent Establishment or the Fixed Base is located. Different provisions exist for taxation of capital gains arising from transfer of shares. In a number of DTAAs, the right to tax is given to the State of which the company is resident. In some others, the country of residence of the shareholder has this right and in some others, the country of residence of the transferor has the right if the shareholding of the transferor is of a prescribed percentage.

So far as the business income is concerned, the source country gets the right to tax only if there is a 'Permanent Establishment' or a 'Fixed Place of Business' there. Taxation of business income is on net income from business at the rate prescribed in the relevant Finance Act.

Income derived by rendering of professional services or other activities of independent character are taxable in the country of residence except when the person deriving income from such services has a Fixed Base in the other country from where such services are performed. Such income is also taxable in the source country, if the person's stay exceeds 183 days in that financial year.

Income from dependent personal service, i.e. from employment is taxed in the country of residence unless the employment is exercised in the other State. Even if the employment is exercised in any other State, the remuneration will be taxed in the country of residence if –

- The recipient is present in the source State for a period not exceeding 183 days;
- The remuneration is paid by a person who is not a resident of that State; and
- The remuneration is not borne by a Permanent Establishment or a Fixed Base.

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DTAAs also contain clauses for non-discrimination of the national of a contracting State in the other State vis-à-vis the nationals of that other State. The fact that higher rates of tax are prescribed for foreign companies in India does not amount to discrimination against the Permanent Establishment of the non- resident company. This has been made explicit in certain DTAAs such as the one with U.K. Provisions also exist for mutual agreement procedure which authorizes the competent authorities of the two States to resolve any dispute that may arise in the matter of taxation without going through the normal process of appeals etc. provided under the domestic law. Another important feature of some DTAAs is the existence of a clause providing for exchange of information between the two contracting States which may be necessary for carrying out the provisions of the DTAA or for effective implementation of domestic laws concerning taxes covered by the tax treaty. Information about residents getting payments in other contracting States necessary for proper assessment of total income of such individual is thus facilitated by such DTAAs.

It may sometimes happen that owing to reduction in tax rates under the domestic law, after coming into existence of the treaty, the domestic rates become more favourable to the non-residents. Since the object of the DTAAs is to benefit the non-residents, they have, under such circumstances, the option to be assessed either as per the provisions of the treaty or the domestic law of the land.

In order to avoid any demand or refund consequent to assessment and to facilitate the process of assessment, it has been provided that tax shall be deducted at source out of payments to nonresidents at the same rate at which the particular income is made taxable under the DTAAs. For example, as a result of amendments made, exempting dividend income from taxation, no deduction of tax is required to be made in respect of such income.

6.4. DTAA with Mauritius

Mauritius is a traditional hub through which foreign investment in India is routed because of it being a tax haven State. Mauritius has firmly established itself as the principal source of foreign fund flows into India accounting for more than a third of the aggregate FDI flows into India over the past 12 years and a third of aggregate actual inward remittance. The reason for this is that the Agreement provides for attractive tax benefits for investing shareholders as it provides for no Indian withholding tax on capital gains tax on transfer of shares in the Indian company.

Additionally, the Mauritius Government charges its resident company with negligible rate of tax and therefore the company set up in Mauritius for investing in India gains from both the sides, in the sense that they do not pay tax for the income generated by them from investing activities carried out in India and also save tax in the home country, i.e. Mauritius.

It is apparent from the above that there are substantial benefits arising from investing through Mauritius. As of now, there is nothing to indicate that the tax authorities in India have started questioning the use of Mauritius entity and also there is no indication of any change being suggested by the Ministry of Finance in India. It also may be pointed out that in several treaties, which India has entered into with other countries; there are special provisions for anti-treaty shopping. No such anti-treaty shopping provision exists in the case of Indo-Mauritius DTAA.

The significant terms of this Agreement between India and Mauritius include Article 13, which provides the manner of taxation of capital gains. Article 13 of the Agreement provides that gains from the alienation of immovable property may be taxed in the State in which the property is situated. Gains derived by a resident of a contracting State from the alienation of movable property forming part of the business property of a Permanent Establishment, which an enterprise of a contracting State has in the other contracting State or of movable property pertaining to a Fixed Base available to a resident of a contracting State in the other contracting State for the purpose of performing independent personal services including such gains from the alienation of such a Permanent Establishment may be taxed in that other State.

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In terms of Circular no. 682 dated March 30, 1994 issued by the Central Board of Direct Taxes ("CBDT") under section 90 of the Income Tax Act 1961, the Government of India clarified that the capital gains of any resident of Mauritius by alienation of shares of an Indian company shall be taxable only in Mauritius according to taxation laws of Mauritius and will not be liable to tax in India. This circular prompted many FIIs, which were resident in Mauritius to invest huge amounts of capital in shares of Indian companies with expectations of making profits by sale of such shares without being subjected to tax in India.

Incidentally, this clarification came at a time when many foreign companies were planning to invest in India to take advantage of the liberalisation process started by the Government in the year 1991. The impact was so huge that companies, which were planning to invest in India, incorporated a subsidiary in Mauritius for the purpose of investing in India to avail the benefit of low dividend taxation and zero capital gains for taxation in India.

These companies incorporated in Mauritius for the purpose of investing in India were shell companies with no business of their own and were allegedly also controlled and managed from a country other than Mauritius. Since benefits of the Indo-Mauritius Agreement are available only to those persons who are 'resident' in either of the country, doubts were raised whether these FIIs, which were incorporated in Mauritius to invest in India but being managed from a country other than Mauritius, were 'resident' in Mauritius. These doubts were however clarified in 2000 by the Finance Minister. It was stated that the views taken by some of the Income tax officers pertained to specific cases of assessments only and did not represent or reflect the policy of the Government of India with regard to denial of tax benefits to such FIIs. This move was intended to put the FIIs proposing to invest in India at a comfort level from taxation point of view.

To further clarify the position, the CBDT issued Circular No. 789 dated April 13, 2000 which provided that if the certificate of residence has been issued by the Mauritius authorities, such certificate shall constitute sufficient evidence for accepting the status of residence as well as beneficial ownership for applying the Agreement accordingly. The circular was to be applicable to proceedings which are pending at various levels.

However, with the Supreme Court of India's decision on the Hutch-Vodafone case, there may be wide sweeping changes to the extant tax policy insofar as it applies to M&As outside India. As part of a global transaction, Vodafone acquired the shares of a company based in the Cayman Islands which was hitherto owned by Hutchison and Vodafone. The Indian tax authorities were of the view that since the consideration paid for the shares included capital gains arising out of Indian assets, namely Hutchison Essar Limited, an Indian subsidiary of the Cayman Islands entity. In 2012 the Supreme Court disagreed with the Indian tax authorities, holding that the transfer of shares of a non-resident entity would not give rise to an incidence of capital gains tax in India. In May 2012, four months after the Supreme Court judgement, the Indian income tax authorities passed an amendment with retrospective effect which would effectively bring such transactions under the purviews of Indian income tax laws. While this move has brought on mostly negative reactions, a review petition of the Supreme Court judgement is presently pending and the apex court of the country would have the opportunity to review the May 2012 amendment. In the event that the amendment is upheld by the Supreme Court, cross border acquisitions involving Indian entities would have to be viewed in a different light.

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