Cross-border mergers in Asia Pacific: Steering towards the future

The Dbriefs M&A Tax series

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Agenda

- Regulatory framework for cross border mergers
  - Regulatory evolution
- Cross-border mergers – inbound and outbound
- Case studies
  - Including implications in India, Hong Kong, Singapore, and Australia
- Questions and answers

Regulatory framework for cross border mergers

Cross-border mergers in India

Regulatory evolution

1. Companies Act, 1956 permitted inbound merger
2. However, outbound merger was not permitted
3. Companies Act, 2013, replaced Companies Act, 1956 in a phased manner from August 2013
4. Companies Act, 2013, permits inbound as well as outbound mergers with effect from 13 April 2017

Companies Act, 2013, provides for a prior approval from RBI for any inbound/outbound merger

As per RBI Notification, FEMA compliant cross-border mergers deemed to have its prior approval

Cross-border mergers in India

Inbound mergers

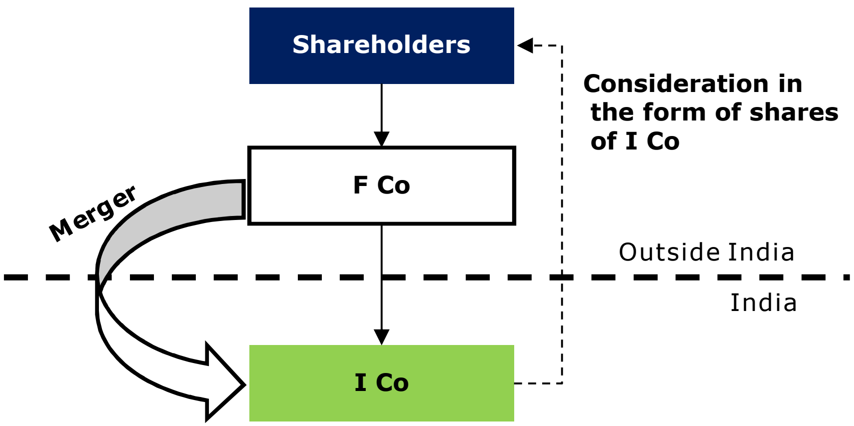
Broad mechanics

1. All properties and liabilities of F Co are transferred to I Co
2. I Co issues shares to shareholders of F Co

Key conditions for RBI's deemed approval

- Issue of shares by I Co to meet FEMA regulations on foreign investments in India
- Overseas borrowings/guarantees of F Co to conform with ECB norms in India within 2 years
  - I Co not permitted to repay such ECBs for 2 years
- Overseas assets of F Co to become assets of I Co
- Overseas assets/liabilities of F Co not permitted to be held by I Co under FEMA, to be sold/extinguished within 2 years
- Office of F Co outside India deemed to be office of I Co

Diagrammatic representation of an inbound merger



Key conditions for RBI's deemed approval (Cont'd)

- I Co can open bank a/c outside India for merger related transactions
- If F Co is a JV/WOS of I Co, then ODI regulations are to be complied

Cross-border mergers in India

Outbound mergers

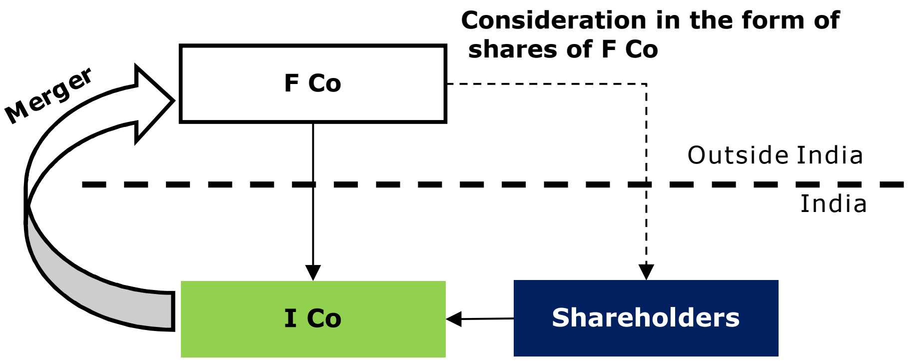
Broad mechanics

1. All properties and liabilities of I Co are transferred to F Co
2. F Co issues shares to shareholders of I Co

Key conditions for RBI's deemed approval

- India resident shareholders to comply with ODI regulations (including limits under LRS)
- Borrowings/guarantees of I Co to be repaid by F Co as per the merger scheme
  - Lenders in India to provide a NOC
- Indian assets of I Co to become assets of F Co
- Indian assets of I Co not permitted to be held by F Co under FEMA, to be sold within 2 years
- Office of I Co in India deemed to be office of F Co

Diagrammatic representation of an outbound merger



Key conditions for RBI's deemed approval (Cont'd)

- F Co can open bank a/c in India for merger related transactions

Polling question 1

How likely are you to explore a cross-border merger for your organization?

- Very likely
- Likely
- Unlikely
- Don’t know/not applicable

Case studies

Case study 1

Merger of an overseas WOS with the parent in India

Cross-border mergers

Merger of an overseas WOS with the parent in India

Considering that India permits inbound mergers, the feasibility of an overseas WOS merging with the parent in India would have to be evaluated from the perspective of

Countries which permit outbound merger

- Process as provided in corporate laws of the respective countries (along with India) to be adopted
- For e.g., Mauritius, Luxembourg, etc.

Countries which do not permit outbound merger

- Restructuring to be evaluated in absence of specific enabling provisions
- For e.g., Australia/Singapore/ Hong Kong

Case study discussed in the next slide explore indicative implications that could arise

Cross-border mergers

Merger of an overseas WOS with the parent in India (Cont'd)

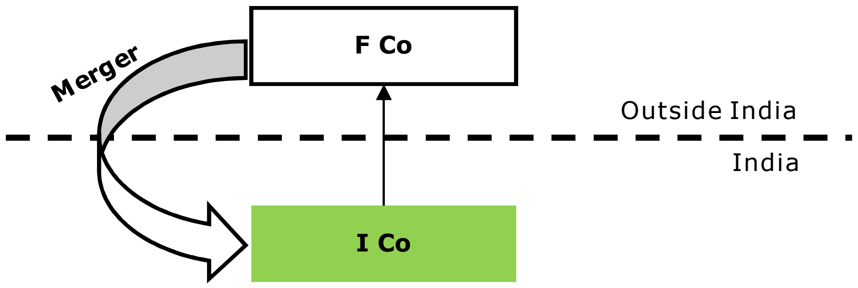
Background

- F Co is a WOS of I Co outside India
- F Co is incorporated in Australia/Singapore/ Hong Kong

Broad mechanics

- Upon coming into effect of a scheme of merger and with effect from Appointed Date, all properties and liabilities of F Co are transferred to I Co
  - As F Co is a WOS of I Co, no new shares would be issued by I Co
- F Co to initiate dissolution/liquidation proceedings as prescribed in local corporate laws
  - F Co to be dissolved/liquidated

Diagrammatic representation

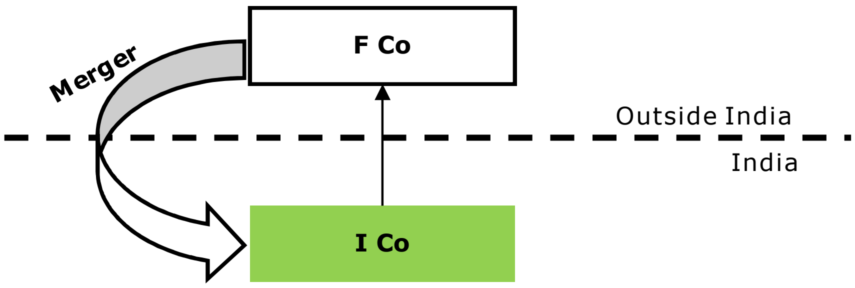


Cross-border mergers
India

Key implications in India

1. RBI approval to be obtained, if any conditions of deemed approval are not met
2. NCLT approval to be obtained
3. ODI regulations to be complied for transfer of shares and step down subsidiary of F Co, if any
4. Borrowings/guarantee of F Co moved to I Co – compliance with ECB/trade credit norms within a period of 2 years – No remittance for repayment of liability from India within 2 years
5. Asset/security not permitted to be acquired/held by I Co under FEMA to be sold within 2 years from the date of sanction of NCLT
6. Office outside India of F Co shall be deemed to be office outside India of the I Co
7. Valuation of I Co and F Co to be undertaken as per internationally accepted principles

Diagrammatic representation



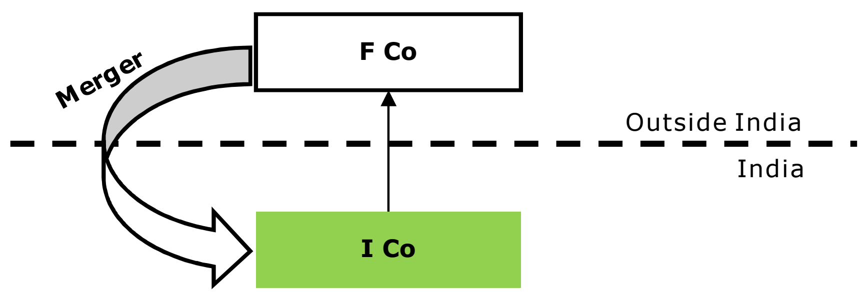
Cross-border mergers

Hong Kong

Key implications in Hong Kong (HK)

1. Cross-border amalgamation is not viable in HK, thus the transaction would generally be regarded as business transfer pursuant to liquidation
2. I Co may need a HK branch to house the assets
3. FMV is a common basis of consideration in business transfer but NBV may be accepted for internal restructuring
4. No gains or losses shall be derived if the transfer of all assets, property or liabilities is carried out at NBV. In case FMV basis is adopted by the HK Inland Revenue Department (HKIRD), it may be possible to argue that the gain, if any, is capital in nature
5. Balancing adjustment is required on the tax base of the transferred tax depreciable assets and may trigger clawback of taxes
6. Profit on the transfer of trading stock is subject to HK profits tax (HKPT)
7. Transfer of certain HK stock/debentures/property is subject to HKSD
8. Tax loss of the liquidated company (F Co), if any, will be forfeited

Diagrammatic representation



Key implications in Hong Kong (Cont'd)

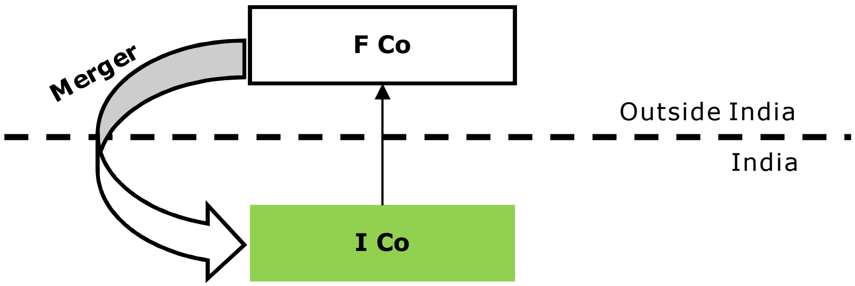
9. Transferee should be entitled to claim tax depreciation based on the transfer value of the assets
10. Notice requirements for cessation and commencement of employment, business transfer, and liquidation
11. Tax clearance should be obtained prior to proceeding with legal procedures regarding liquidation

Cross-border mergers
Singapore

Key implications Singapore

1. Cross border mergers not permitted under Singapore law
2. So the option would be to liquidate F Co so that all the assets and liabilities can flow back to I Co
3. Buy Back and capital reduction may not give the same result as F Co will continue to exist and operate
4. There should be no adverse Singapore tax impact on liquidation on the assumption that the transferred assets do not include Singapore immovable properties. Transfer of immovable properties would attract stamp duties
5. Alternatively, it could be possible for I Co to set up a new branch and the assets of F Co can be transferred to the new branch. However, any tax losses would be lost and would not be available for utilisation by the branch

Diagrammatic representation



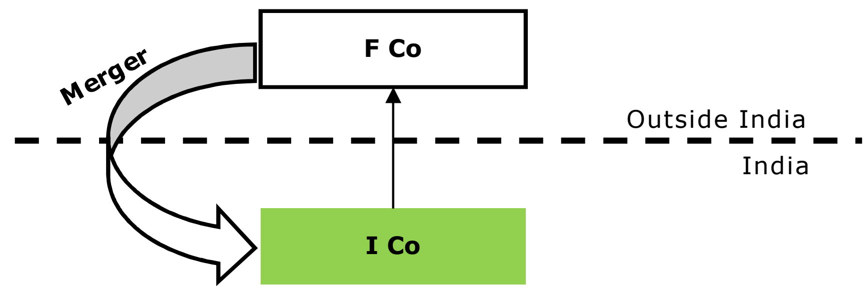
Cross-border mergers
Australia

Key implications Australia

From an Australian tax and legal perspective, the transaction could be viewed as follows

1. The transfer of F Co's business to I Co would likely give rise to taxable gains and/or deductible losses in F Co. However, capital gains tax rollover relief may be available for certain assets. Goods and services tax and stamp duty implications may also arise on the transfer of F Co's business
2. F Co would likely recognize a receivable from I Co for the sale of its business
3. The receivable could be distributed by F Co to I Co prior to, or as part of, liquidation. This may take the form of a return of capital and/or dividend. To the extent that some part of the distribution is characterized as a dividend, Australian withholding tax consequences will need to be considered (especially where the dividend is not fully franked)

Diagrammatic representation



Case study 1A

Merger of an overseas parent with the WOS in India

Cross-border mergers

Merger of an overseas parent with the WOS in India

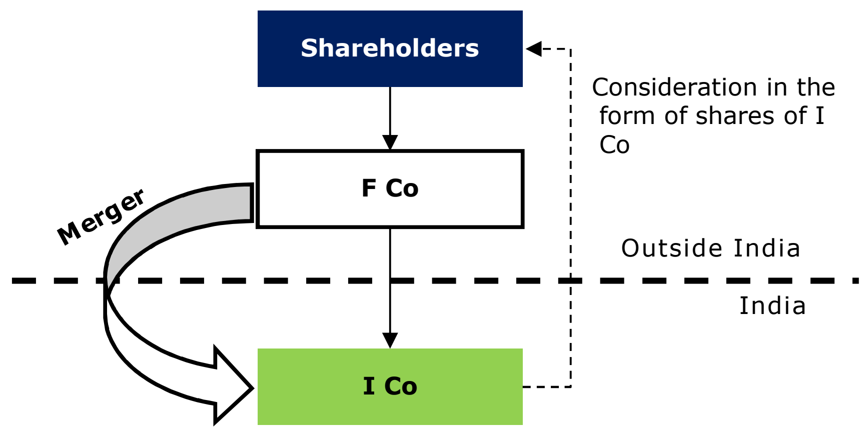
Background

- I Co is a WOS of F Co
- F Co is incorporated in Australia/Singapore/ Hong Kong and has shareholders in respective countries
- F Co does not have any assets or liabilities except shares held in I Co

Broad mechanics

- Upon coming into effect of a scheme of merger and with effect from Appointed Date, all shares held by F Co in I Co to be extinguished
  - I Co will issue new shares to shareholders of F Co on merger
- F Co to initiate dissolution/liquidation proceedings as prescribed in local corporate laws
  - F Co to be dissolved/liquidated

Diagrammatic representation



Key implications in India

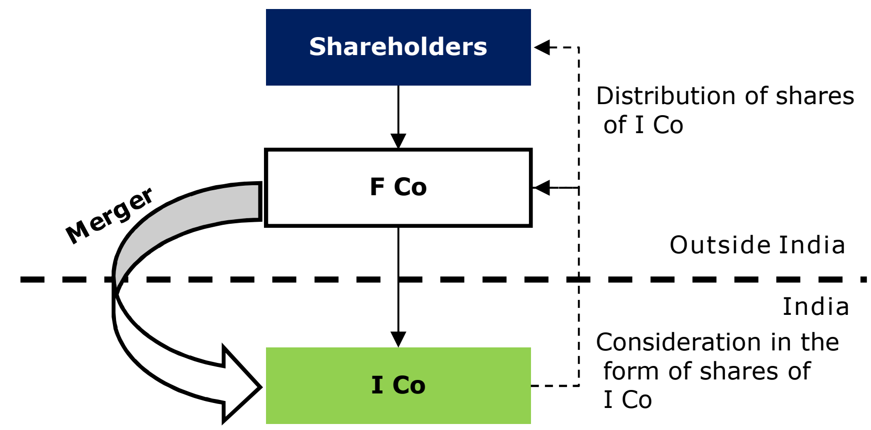
1. NCLT approval to be obtained
2. FEMA norms for foreign investments in India (e.g., FDI norms) to be complied with (including sectoral caps, if any) by shareholders of F Co
3. Tax exemption u/s 47(vii) should be available to shareholders of F Co
4. Valuation of I Co and F Co to be undertaken as per internationally accepted principles

Cross-border mergers
Hong Kong

Key implications in Hong Kong

1. From a HK perspective, it will be regarded as if
   - F Co distributes shares of I Co to shareholders pursuant to liquidation

Diagrammatic representation

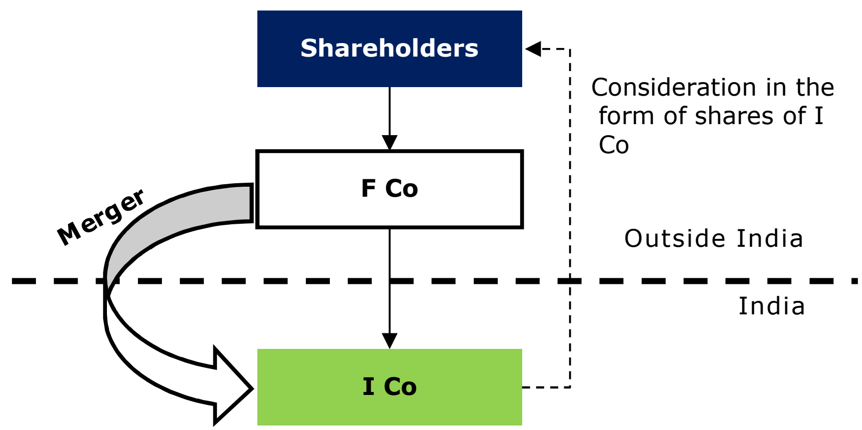


Cross-border mergers
Singapore

Key implications in Singapore

1. Cross border mergers not permitted in Singapore
2. F CO would have to be liquidated and the assets (i.e., shares of I Co) would be deemed to be distributed to shareholders
3. No adverse Singapore tax impact upon liquidation as the distribution of shares of I Co (in specie or otherwise) does not include Singapore immovable properties

Diagrammatic representation



Cross-border mergers
Australia

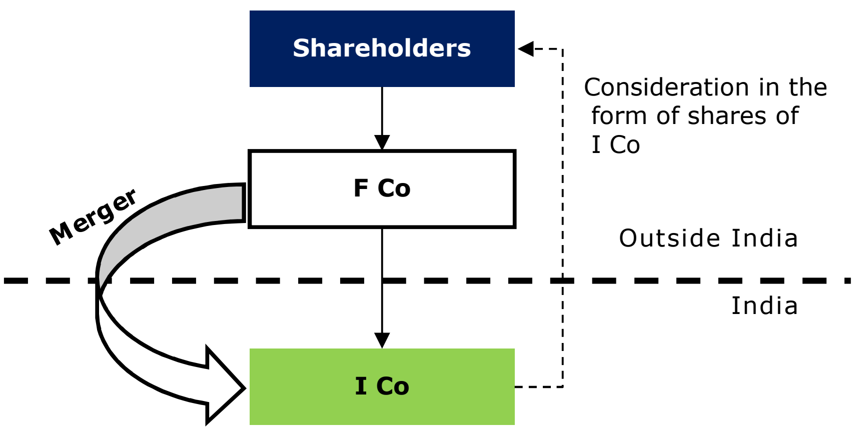
Key implications in Australia

From an Australian tax and legal perspective, the transaction could be viewed as F Co making an in-specie distribution of I Co's shares to its shareholders prior to, or as part of, liquidation. In such circumstances

1. F Co is deemed to have disposed of its shares in I Co. This may prima facie give rise to a taxable gain or deductible loss to F Co. However, a participation exemption may be available to reduce any capital gain that would otherwise arise. To the extent that any capital gain is reduced under the participation exemption, the gain may be designated as conduit foreign income

2. The in-specie distribution of I Co's shares may take the form of a return of capital and/or dividend. To the extent that some part of the distribution is characterized as a dividend, Australian withholding tax consequences will need to be considered in the case of non resident shareholders (especially where the dividend is not fully franked and not designated as conduit foreign income); or included in assessable income in the case of Australian resident shareholders

Diagrammatic representation



Case study 2

Merger of I Co with F Co

Cross-border mergers

Merger of I Co with F Co

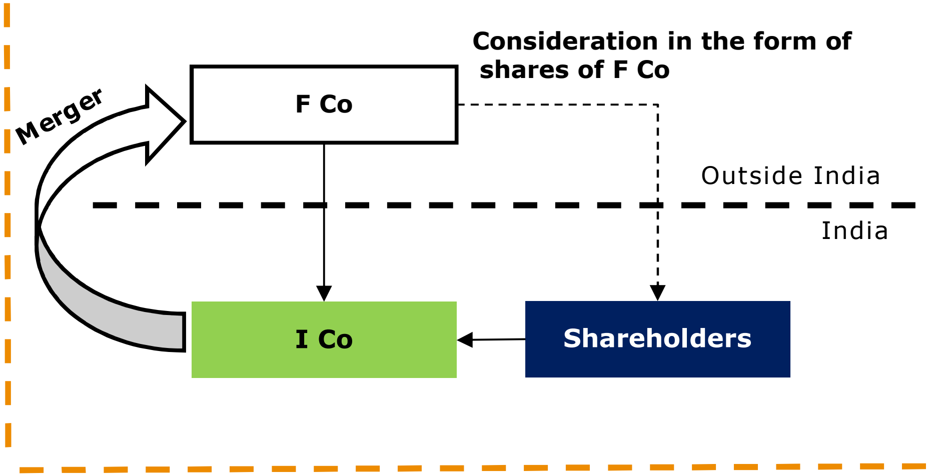
Background

- I Co is a JV between F Co and Indian shareholders
- F Co is incorporated in Australia/Singapore/ Hong Kong

Broad mechanics

- Upon coming into effect of a scheme of merger and with effect from Appointed Date, all properties and liabilities of I Co are transferred to F Co
  - F Co to issue new shares to shareholders of I Co (except to itself) in consideration of the merger
  - F Co to apply to AD/RBI for opening of a BO/PO/LO in India
- Subject to compliance with local laws, F Co to acquire the properties and liabilities of I Co as a normal purchase and issue shares as consideration

Diagrammatic representation

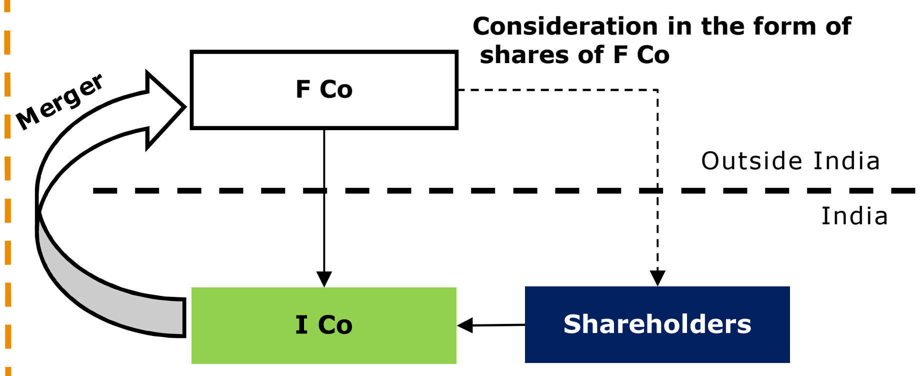


Cross-border mergers
India

Key implications in India

1. RBI approval to be obtained, if any conditions of deemed approval are not met
2. NCLT approval to be obtained
3. ODI regulations to be complied for shares to be held in F Co by resident Indian shareholders (including limits under LRS)
4. Office in India of I Co shall be deemed to be BO in India of the F Co
5. Borrowings/guarantees of I Co to be repaid by F Co as per the merger scheme
   - Lenders in India to provide a NOC
6. Indian assets of I Co not permitted to be held by F Co under FEMA, to be sold within 2 years
7. No specific exemption available for merger of I Co with F Co - taxable transaction in the hands of shareholders of I Co (capital gains) and I Co (capital gains, lapse of losses, and MAT credit, etc.)
8. Valuation of I Co and F Co to be undertaken as per internationally accepted principles

Diagrammatic representation

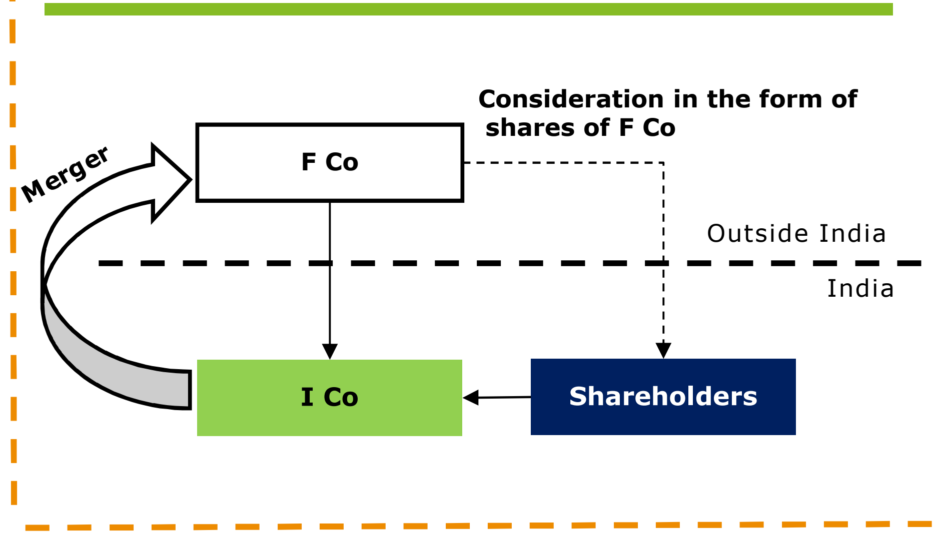


Cross-border mergers
Hong Kong

Key implications in Hong Kong

1. Technically, F Co should be able to claim tax depreciation based on the transfer value of the assets
2. F Co may consider to lodge an offshore claim on the income generated from Indian operations, however, the associated expenses will not be deductible for HKPT purpose

Diagrammatic representation

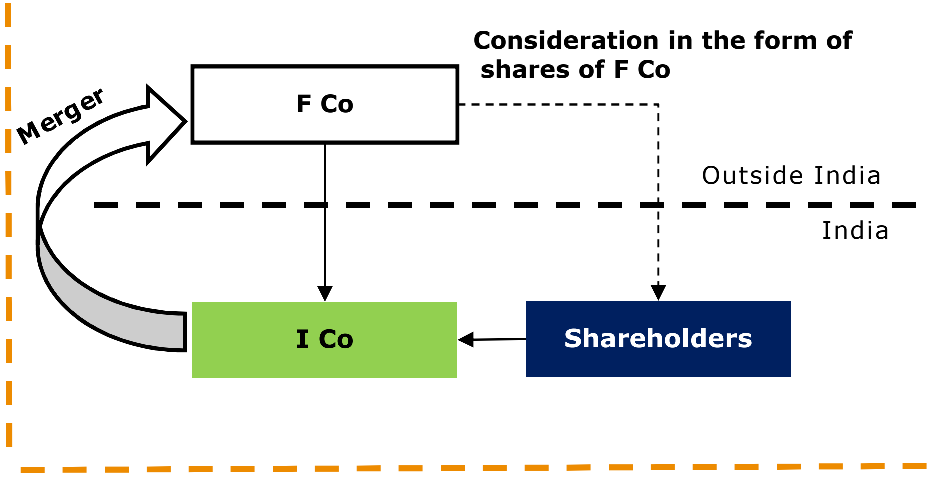


Cross-border mergers
Singapore

Key implications in Singapore

1. Merger of I Co with F Co not possible under Singapore laws
2. F Co will regard this as acquisition of business of I Co and as consideration issue shares to the shareholders of I Co
3. No adverse Singapore tax implications

Diagrammatic representation



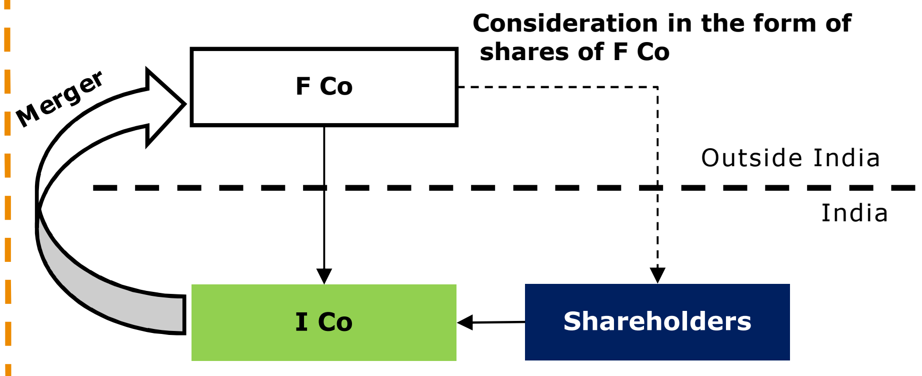
Cross-border mergers
Australia

Key implications in Australia

From an Australian tax and legal perspective, the transaction could be viewed as follows

1. F Co acquires the business of I Co. F Co should appropriately determine the tax cost base of the assets acquired. Australia's controlled foreign company regime should be considered to determine whether any income/gains of I Co may be attributable to F Co
2. F Co would likely recognize a payable to I Co for the acquisition of I Co's business
3. However, I Co directs F Co to issue shares to I Co's shareholders (excluding F Co) in satisfaction of the payable between F Co and I Co

Diagrammatic representation



Polling question 2

How has been your experience in carrying out a cross border merger for your organisation?

- Simple
- Complex
- Neither simple nor complex
- Don’t know/not applicable

Case study 3

Demerger of unit 2 of F Co with I Co

Cross-border mergers

Demerger of unit 2 of F Co with I Co

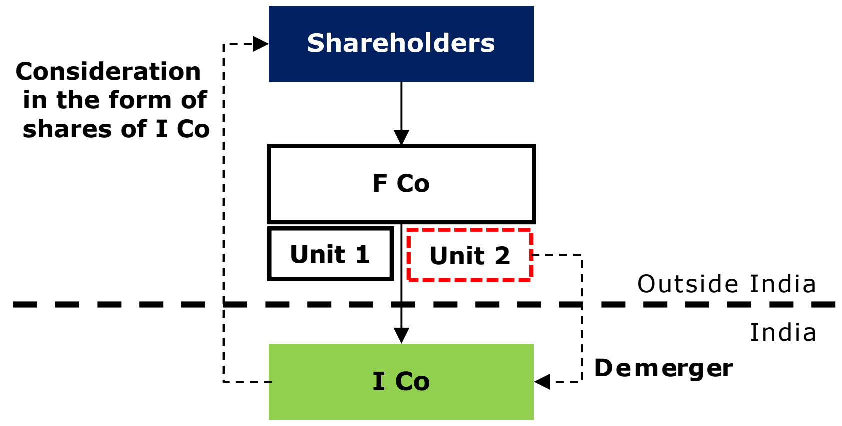
Background

- I Co is a WOS of F Co
- F Co is incorporated in Australia/Singapore/ Hong Kong and has shareholders in respective countries

Broad mechanics

- Upon coming into effect of a scheme of demerger and with effect from Appointed Date, all properties and liabilities of Unit 2 of F Co are transferred to I Co
  - I Co to issue new shares to shareholders of F Co in consideration of the demerger
- Subject to compliance with local requirements, F Co to transfer all properties and liabilities of Unit 2 as a normal sale; shareholders of F Co to receive shares in I Co as consideration

Diagrammatic representation

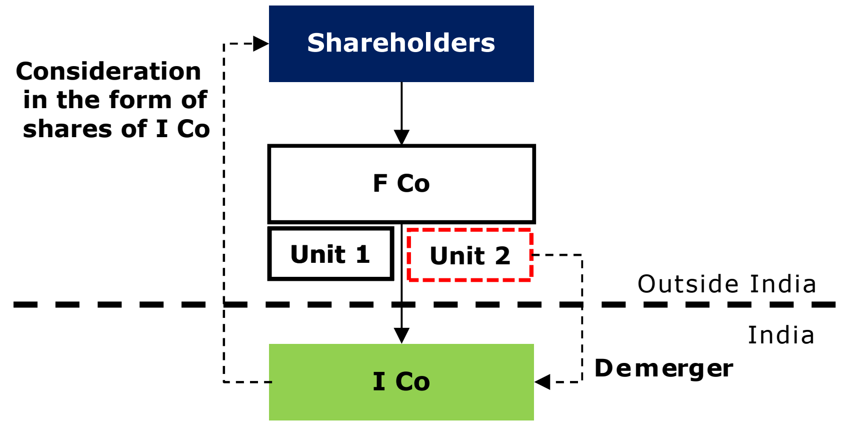


Cross-border mergers
India

Key implications in India

1. RBI approval to be obtained, if any conditions of deemed approval are not met
2. Is cross border demerger permitted under Companies Act, 2013
   - NCLT approval to be obtained
   - No precedent as on date
3. FEMA norms for foreign investments in India (e.g., FDI norms) to be complied with (including sectoral caps, if any)
4. Borrowings/guarantee of Unit 2 moved to I Co - compliance with ECB/trade credit norms within a period of 2 years - No remittance for repayment of liability from India within 2 years
5. Asset/security of Unit 2 not permitted to be acquired/held by I Co under FEMA to be sold within 2 years from the date of sanction of NCLT
6. Office outside India of Unit 2 shall be deemed to be office outside India of the I Co

Diagrammatic representation



Key implications in India (Cont'd)

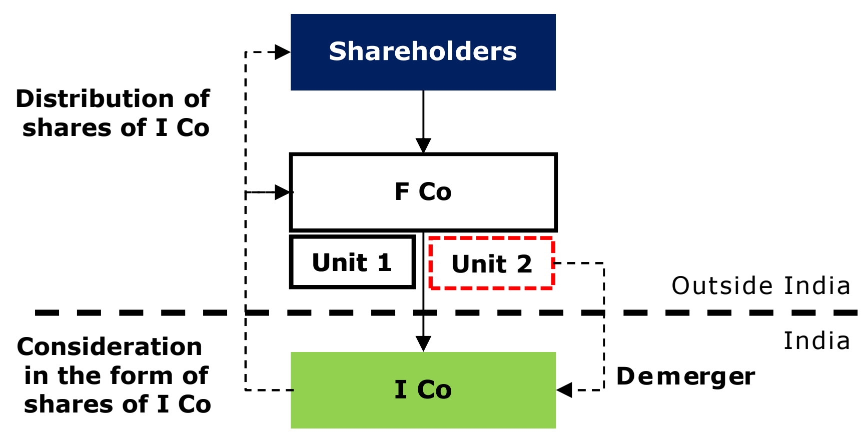
7. Issue of shares to shareholders of F Co should be tax neutral u/s 47(vid)
8. Valuation to be undertaken as per internationally accepted principles

Cross-border mergers
Hong Kong

Key implications in Hong Kong

1. Same as discussed in Scenario #1 (except, liquidation would not happen in this case)
2. Pursuant to a tripartite arrangement between I Co, F Co and F Co's shareholders, shares received directly by F Co's shareholders from I Co would be regarded as F Co having distributed shares of I Co to shareholders

Diagrammatic representation



Cross-border mergers
Singapore

Key implications in Singapore

1. I Co can acquire the business of Unit 2 from F Co for a consideration

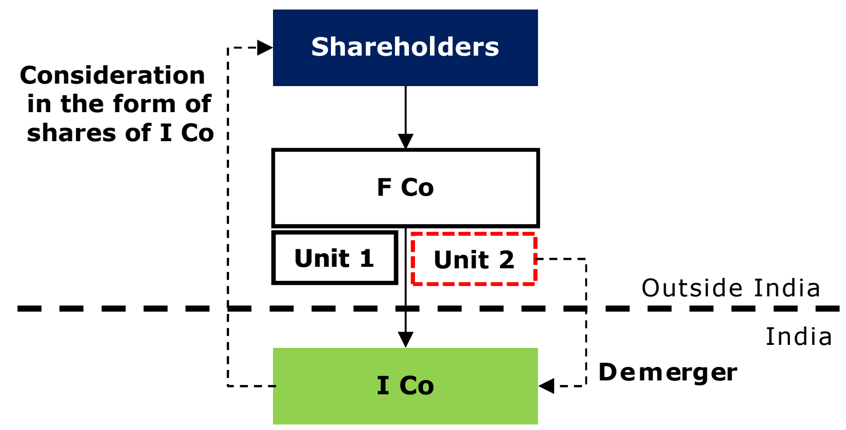
2. Pursuant to a tripartite arrangement between I Co,
F Co and F Co's shareholders, shares received directly by F Co's shareholders from I Co would be regarded as F Co having distributed shares of I Co to shareholders

3. There is no concept in Singapore Income Tax as "sale of business" and each asset would have to be ascribed a value at the time of transfers. Generally, transfers are done at market value but if it is within the same Group it can be done at net book value. Any gains on transfer of revenue assets (inventory, receivable, etc.) would give rise to taxable revenue gains

4. Tax losses, if any, would continue to remain with F Co and would not be eligible for any transfer

5. Such business transfers would attract a GST unless the "Transfer of business as a going concern" rules are satisfied

Diagrammatic representation



Cross-border mergers
Australia

Key implications in Australia

From an Australian tax and legal perspective, the transaction could be viewed as follows

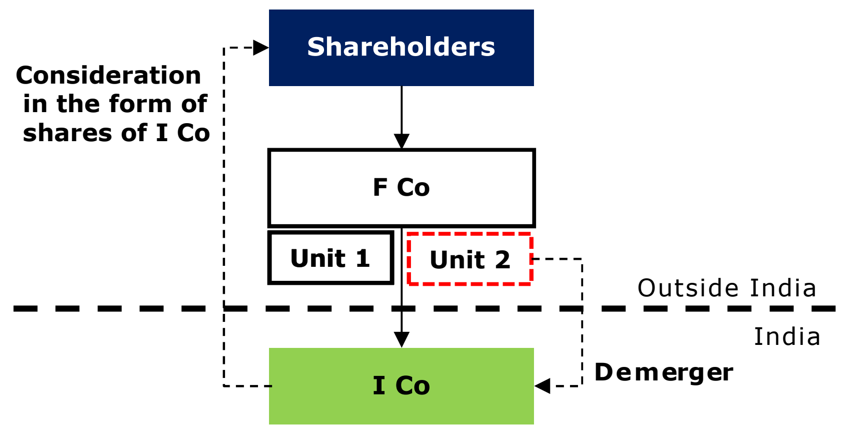
1. The transfer of F Co's Unit 2 business to I Co would likely give rise to taxable gains and/or deductible losses in F Co. However, capital gains tax rollover relief may be available for certain assets. Goods and services tax and stamp duty implications may also arise on the transfer of F Co's Unit 2 business
2. Pursuant to a tripartite arrangement between I Co, F Co and F Co's shareholders, receipt of shares directly by F Co's shareholders from I Co, pursuant to spin off of Unit 2 would be regarded as an in-specie distribution of I Co's shares to its shareholders

   a) F Co is deemed to have disposed of its shares in I Co. This may prima facie give rise to a taxable gain or deductible loss to F Co. However, we note that

      i. No gain or loss should arise if the distribution is made shortly after the shares are issued

      ii. A participation exemption may be available to reduce any capital gain that would otherwise arise. To the extent that any capital gain is reduced under the participation exemption, the gain may be designated as conduit foreign income

Diagrammatic representation



Key implications in Australia (Cont'd)

iii. Demerger relief may be available

Stamp duty implications may also arise on the distribution of I Co's shares.

b) The in-specie distribution of I Co's shares may take the form of a return of capital and/or dividend. To the extent that some part of the distribution is characterized as a dividend, Australian withholding tax consequences will need to be considered in the case of non resident shareholders (especially where the dividend is not fully franked and not designated as conduit foreign income); or included in assessable income in the case of Australian resident shareholders

Points to ponder

Points to ponder

- No tax exemptions available for outbound mergers/demergers from India perspective
- Exposure of constituting a Permanent Establishment in India for the foreign company on completion of an outbound merger
  - Also, impact on tax losses, MAT credits, tax holiday, if any, claimed by Indian company in such cases
- As per RBI’s conditions for deemed approval, borrowings of a foreign company, post merger with Indian company, shall not be repaid by Indian company for a period of two years – whether this would be commercially acceptable?
- Implications of the terms “compromise/arrangement/demerger” not specifically included in section 234 of the Companies Act

Questions and answers

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