Mergers & Acquisitions –
A Strategic Tax Perspective

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Sri Bhagwan Mahaveer Jain College of Engineering

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Private Limited
Business re-organizations or consolidations typically trigger on account of strategic business objectives
> Acquisitions, Amalgamation (Merger) or Demerger

Tax implications depend on the structure and transactions effected
> A proactive consideration of tax implications could provide opportunities for tax optimization

Any “transfer”, unless specifically exempted, attracts capital gain tax. However, subject to conditions,
> specified reorganization schemes, such as amalgamations (merger) or de-mergers are exempted from the levy of such tax
While business objectives drive re-organizations, tax considerations matter…

Target could provide opportunities for tax optimization

- Share acquisition or reverse mergers – preservation of tax losses
- Asset acquisition – Step-up in asset base
- Horizontal & Vertical mergers – supply chain and transaction tax planning
- Financial merger – arbitrage on account of debt and tax depreciation
Acquisitions
Acquisition

Share Purchase Vs Asset Purchase

- Preservation of tax attributes of Target (Accumulated losses, Foreign Tax Credits, incentive entitlements etc.)
- Obtaining “step-up” in asset value
- Migration of Intangibles
- Taxation of Seller
- Discharge of consideration “share swap or cash or combination”
- Strategies for profit repatriation
## Seller’s Perspective

<table>
<thead>
<tr>
<th>Nature of Share</th>
<th>Long-term capital asset (&gt;12 months)</th>
<th>Short term capital asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity share of a listed company subject to Securities Transaction Tax (STT)</td>
<td>Exempt</td>
<td>11.33%</td>
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<tr>
<td>Any other share</td>
<td>22.66% (with indexation) Listed securities @ 11.33% (without indexation)</td>
<td>33.99%</td>
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</tbody>
</table>
Structuring a Share Acquisition

Buyer’s Perspective

- Price paid for the shares would be the buyer’s cost of acquisition of the shares
  - Financing costs could be included as part of acquisition cost if appropriately structured.
- Preservation of tax losses
  - In case of unlisted companies, the change in shareholding cannot be in excess of 49% vis-à-vis the shareholding in the year in which the losses were incurred, inorder to protect carry-forward benefits.
- Cost effective as compared to an asset deal because of stamp duty implications on immovable property.
- Cross-border acquisition through use of an overseas intermediate company could provide tax efficiencies.
Structuring an Asset Acquisition

### Seller’s Perspective

<table>
<thead>
<tr>
<th>Nature of Asset</th>
<th>Long-term capital asset (&gt;36 months)</th>
<th>Short term capital asset</th>
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<tbody>
<tr>
<td>All assets (tangible or intangible) other than shares</td>
<td>22.66%</td>
<td>33.99%</td>
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<tr>
<td>Includes a slump sale (i.e. transfer of an undertaking or a business activity taken as a whole)</td>
<td>Business in existence for &gt;36 months will qualify as LT</td>
<td>Depreciable assets are short term assets.</td>
</tr>
</tbody>
</table>

Asset sale likely to attract transaction taxes (VAT/CST). Slump sale of the whole business not liable to VAT. Immovable property transfer liable to stamp duty.
Structuring an Asset Acquisition

**Buyer’s Perspective**

- Slump sale – sale of an undertaking as a whole
  - Cost base step-up
  - Identification of intangible assets along with cost
    - Select intangible assets eligible for depreciation
  - Funding costs generally deductible for tax purpose
  - Goodwill (if any) not eligible for amortization for tax benefits
Mergers & Demergers
Amalgamation

- Mean a merger of one or more companies into another company, or the merger of two or more companies to form a new company.

- Tax neutral subject to conditions:
  - All property and liabilities of the transferor company (undertaking) before the **amalgamation** will be vested in transferee company.
  - At least 75 % Shareholders of the transferor to become shareholders of the transferee, other than shares already held by the transferor in the transferee.
  - Excludes cases involving:
    - acquisition of the property of one company by another pursuant to purchase of such property;
    - distribution of property to another company due to winding up of transferor.

*(Intent to ensure effective pooling of resources and continuation of business.)*
Merger could be tax neutral

- Seller’s perspective
  - No tax for the amalgamating company or its shareholders
  - Cost of acquisition for new shares received would be the same as the cost of acquisition for shares held in amalgamating company. The period of holding of shares also to be reckoned from the time shares were held in amalgamating company
Merger could be tax neutral

- **Buyer’s perspective**
  - Amalgamated entity can avail the tax benefit in relation to the **accumulated losses and the unabsorbed depreciation** of the amalgamating company, in the previous year in which the amalgamation was effected, subject to prescribed conditions.
  - Tax Benefits in the nature of tax incentive for export oriented units, expenditure for scientific research, acquisition of patent rights/copyrights, expenditure on prospecting for minerals and amortization of preliminary expenses pertaining to transferor company will be available to transferee company.
  - Depreciation on assets – both intangible and tangible will be proportionately available to the transferor and transferee.
Merger – Carry forward of losses

- Companies owning an industrial undertaking, ship, hotel or a banking company or a public sector company engaged in the business of operation of aircraft only qualify.

- Amalgamating Company
  - Has been engaged in the business for three or more years;
  - Has held 3/4ths of the book value of fixed assets as held by it two years prior to the date of amalgamation.

- Amalgamated Company:
  - Holds for five years from date of amalgamation 3/4ths of the book value of fixed assets of the amalgamating company.
  - Continues the business of the amalgamating company for five years from the date of amalgamation.

- If conditions satisfied the losses are deemed the losses of the previous year in which the amalgamation happens
Demerger

- Mean transfer of one or more undertakings, pursuant to a scheme of approved arrangement, to any resulting company

- The re-organization is tax neutral subject to conditions:
  - Conditions of transfer of assets and shareholding criteria post demerger are similar to amalgamation
  - Transfer of assets to be on going concern basis
  - Assets to be valued at the book value before the demerger
  - In accordance with conditions if notified by CG.
Cross-border M&A
Establishment of a holding company in an intermediary jurisdiction may be preferred vis-à-vis a direct investment on account of the following:

- Deferral of India tax on foreign sourced dividend income
- Option to lower the host country withholding tax if any
- Flexibility on financing options
- Redeployment of foreign earning for future overseas acquisitions / investment
Cross Border Acquisition

- Criteria for selecting an intermediary jurisdiction
  - No/ low corporate tax
  - No/ low dividend withholding taxes
  - Tax treaty network with India and the jurisdiction in which target company exists
  - Favorable tax credit regime (tax sparing and credit for underlying taxes)

- Select jurisdictions for locating holding company for India outbound structures
  - Cyprus, Mauritius, Netherlands, Singapore, UAE
Cross Border Mergers

- No India tax in cross-border merger/dememerger if resulting company is Indian company
- The following need careful consideration
  - Transfer pricing implications
  - FEMA and regulatory procedures
Supply Chain Tax Planning (Transaction Taxes)
Supply Chain Tax Planning

- While transaction tax implications are minimal during a reorganization (except in case of itemized asset transfer), transaction taxes are a critical element to consider while evaluating the design of the merger or acquisition structure.
- Appropriate structuring could provide for tax credits and cash flow efficiencies.