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ASSOCHAM INDIA

New dimensions in M&A regulatory framework

2012

Contents

Foreword

With the liberalisation in the FDI policies in the past many years, Mergers and Acquisitions (M&As) and alliance talks are heating up in India and growing at a tremendous pace.

The policies included opening the country for international trade and investment thus allowing the investors across the globe to enter the Indian market without restricting them to any particular type of business. The list of past and anticipated M&As in India covers every size and variety of business providing platforms for small companies being acquired by the bigger ones.

Today the market is witnessing increased number of high value Mergers & Acquisitions like Bharti Airtel deal with Zain Africa and more and more business houses are moving towards consolidations.

Indian companies have acquired foreign companies in diverse sectors from auto to hospitality to telecom from CY 2000 to CY 2012.

In such dynamic economic state of affairs, a comprehensive Competition Act is the need of the hour and presents a bigger challenge and opportunity to both the corporate and professional world.

Against this backdrop, ASSOCHAM is actively involved in showcasing related programmes to bring updated knowledge and policy guidelines for the industry and all stakeholders. ASSOCHAM and Grant Thornton are bringing out this souvenir for the benefit of participants and practitioners.

I wish all the best and success for the conference and assure that such knowledge based events shall continue to be held for the benefit of all segments of the industry and commerce.

D.S. Rawat
Secretary General
Assocham

Foreword

A constantly evolving regulatory framework is a contributing to increased M&A transaction activity in India. Though there have been discussions on the failure of M&A transactions, access to technology, capital and scale will keep driving dynamic organisations to consider M&A as a key strategic tool.

The growing number of transactions and substantially higher deal sizes are resulting in changes in regulations, which lead to a more mature and robust framework that supports M&A transactions while protecting the rights of shareholders.

The latest amendments proposed under the Finance Act 2012, Takeover Code and CCI rules are a step-forward in this direction. Introduction of taxability of indirect transfer of shares of an Indian company to negate the Supreme Court verdict in the case of Vodafone with retrospective effect, introduction of transfer pricing provisions on transfer of shares or any internal reorganisation including exchange/ transfer of shares between the group companies, introduction of General Anti Avoidance Rules (GAAR) are just a few examples of the government endeavour to regulate such kind of transactions which could lead to nil tax costs in a transaction.

In our understanding, the new tax provisions may dither mergers and acquisitions for some time as more clarity on the laws and their applicability is awaited, however, we believe that in the longer run the companies while undertaking any transaction may start factoring the tax costs as part of the transaction and continue to do their business.

With this backdrop, we are pleased to be a part of Assocham's endeavour to apprise the industry of the changes in the regulatory structure for M&As. This report provides insights to the M&A scenario in India and other major countries of the world along with our analyses on various recent changes in the regulatory framework.

We do hope you would find this publication useful and look forward to your views and feedback.

Munesh Khanna
Senior Partner
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1 Global M&A landscape

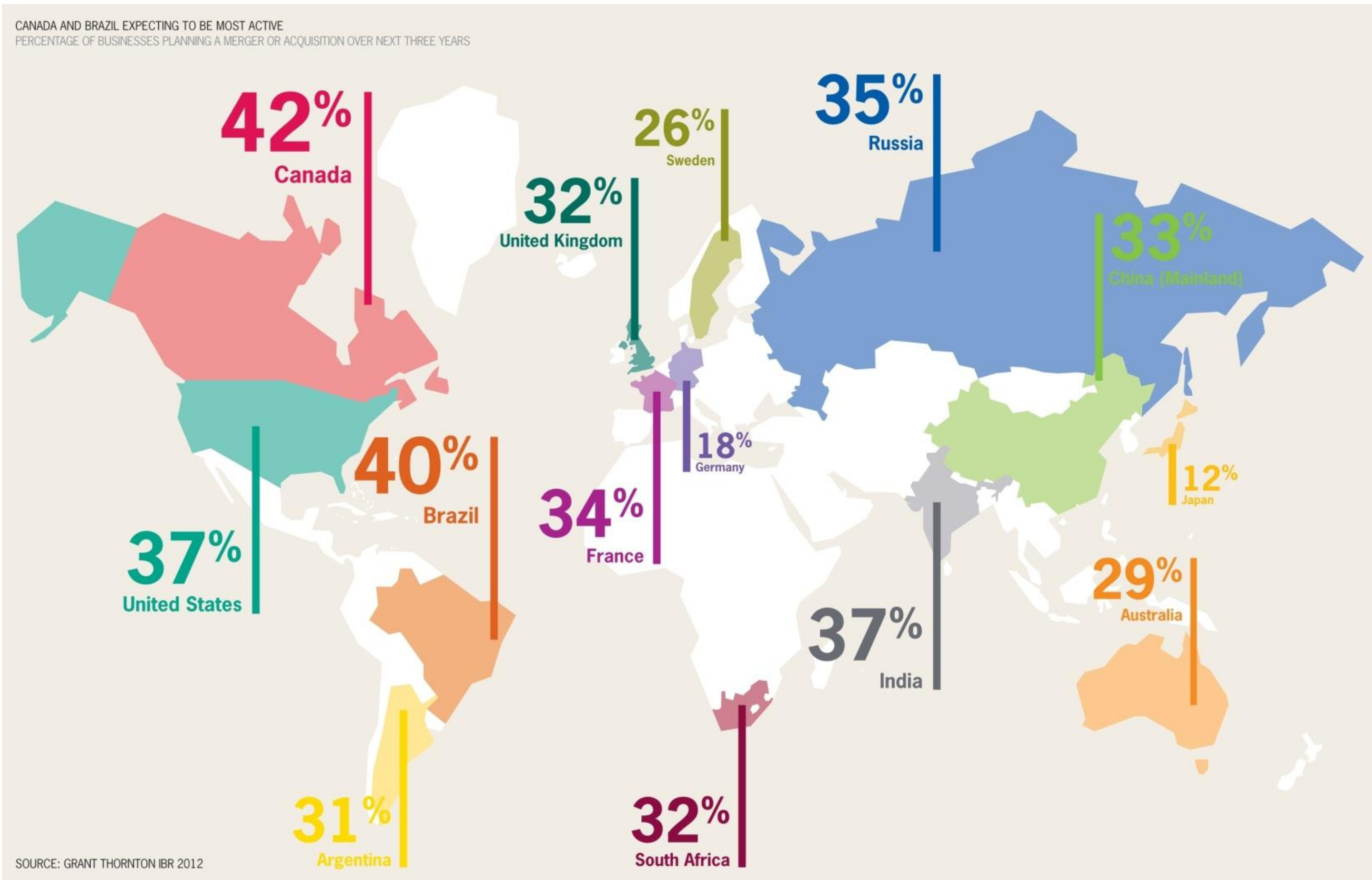
Global M&A landscape

Despite the on-going global economic challenges, the latest results of the Grant Thornton International Business Report (IBR) indicate that dynamic businesses have retained last year's renewed appetite for M&A activity.

The revival in M&A activities, that emerged in last year's survey, is still in evidence and is an indication that many corporates, who have successfully plotted their way through the global downturn, are now seeking to invest the cash resources built up over a period of limited M&A activity.

Domestic M&A remains notably high on business owners' agendas. There are also some interesting trends regarding their interest in overseas expansion which no doubt reflects the particular market conditions within individual regions globally.

With recent positive economic data from the US and impressive growth continuing to be experienced in the BRIC countries, the global economy is undoubtedly entering a new phase. To take advantage of this, enterprising corporates appreciate that M&A remains a vital strategic tool to enable them to benefit from these trends.



Global M&A landscape

Acquisition rationale

Whilst the target location for M&A activity may be evolving and changing, for many, the reason for engaging in M&A remains the same. Either access to geographical markets (63%) or building scale (57%) remain the likeliest motivation to participate, indicating that M&A remains the simplest and most effective way for businesses to gain a footprint and build scale in new geographies.

> M&A activity is being driven by growth hungry companies in a tepid economic environment, the ageing population of the Western world and strong access to funding. In general, mid-market corporates that have emerged from the last few years relatively unscathed are commanding significant premiums as competition for good businesses increases.

Domestic vs cross-border expansion

The headline of continued interest in M&A indicates that many businesses have growth through M&A well and truly on their agenda. Of additional interest are the geographies in which this M&A activity will be taking place in the coming years.

For obvious reasons, such as knowledge of the local market forces and drivers, a domestic acquisition remains the most likely option for many companies. 85% of acquisition minded businesses stated that they expect their acquisitions to be domestic compared to 33% who are looking at cross-border transactions.

Scenario in Americas and Europe

Globally, North America (91%) and, perhaps surprisingly, the BRIC countries (90%) continue to place the most importance on making acquisitions within their own borders, though the results illustrate that Japan's businesses have the greatest appetite (94%) for domestic acquisition.

Many other regions remain discreet about stating whether they expect to exit in the future. Interestingly, Latin America (24%) is the region showing most interest, with a significant number of Brazil's business owners (40% up from 22%) stating that they are looking to exit within the next three years.

This may reflect the general feeling of confidence within that region. Business owners appear to be riding this wave of optimism and hence expect to realise value from the forecast growth in the coming years.

Businesses in Europe place proportionally more emphasis on expanding overseas (44%) compared to wanting to acquire within their own country (75%). This may reflect a relatively mature and sophisticated M&A market as well as the lack of economic growth within that region when compared to the growth and opportunities available in emerging markets.

Global M&A landscape

UK businesses (17%) remain upbeat about selling their business within the next three years and claim to be almost twice as likely to seek a buyer than their mainland European counterparts (8%).

Whilst this may be a surprising outcome given the macro economic issues facing the UK, the result may be influenced by a wider appreciation of exit options amongst UK businesses and the effects of a highly mature private equity (PE) market, which has made substantial investments into UK businesses over recent years.

BRIC economies

Within the BRIC economies, there appear to be two distinct themes. Whilst all see value from domestic acquisitions, indicating an increasingly vibrant and exciting local M&A market, only India (29%) and China (26%) show real enthusiasm to expand overseas.

Clearly, at present businesses in these economies are more focused on expanding domestically, a situation we expect to change.

Summary

Overall the data is thought-provoking in the context of the global macroeconomic background and the impact this is having on different regions.

Across the world M&A remains high on the agenda for companies in all territories and it remains a key strategic tool to drive growth and build scale. Certainly, in the eyes of businesses, it remains the most effective way to enter a new territory.

Acquisitive growth is very much on the agenda for Indian business leaders as they continue to focus on driving value.

Organic versus inorganic

Beyond geographical considerations, the most important issue for companies moving into a new stage of international growth is whether to grow organically, or whether to be more aggressive and grow via acquisitions or joint ventures. On the organic side, the launch of new products is a particularly strong driver of international growth and is especially relevant for technology markets.

Meanwhile, the development of existing products can also be of central importance, particularly in consumer driven sectors, as companies look to adapt their ranges to work in new geographies. However, while organic expansion remains the key for many businesses, others recognise the fact that they need to accelerate their growth plans through inorganic routes such as M&As.

Some will seek to gain a head start by allying themselves with other large operators that have been established in a given region for longer. But others will look to drive the next phase of their international growth via acquisitions. Choosing this route means taking on the risks associated with potentially complex M&A processes in order to access superior returns on investment.

As well as rapidly expanding their market share and gaining critical mass, acquisitions can help to diversify companies' product and client bases and help protect them against the effects of downturns in other regions. What's more, this is arguably an increasing trend among mid-market businesses: the landscape has changed in recent years and International M&A activity is no longer the preserve of the larger businesses. Armed with the right tools, mid-market companies are much better placed to build scale via acquisition than they have ever been.

The strategy to build scale and sophistication through M&A activity can also be critical in another area, which is readying the business for sale or to go public. While a clearly mapped-out exit horizon might not be a strong motivator for every business, for some it is a necessity. And a strategy based on international growth can be critical to achieving the scale necessary to attract potential acquirers or to fulfil listing requirements of public markets at home or abroad.

Armed with the right tools, mid-market companies are much better placed to build scale via acquisition than they have ever been.

Acquisitive strategies inevitably involve complex M&A processes. While these strategies can introduce a heightened element of risk, they can provide well-prepared and well-funded businesses with a quick and efficient means of gaining market share and expertise in a new territory.

In addition, the fact that acquisitions can also provide collateral benefits such as fresh intellectual property, new products and a new, ready-made client base, helps drive the top-line.

The acquisitive route also offers real potential for those building on their existing international expansion and moving into a new phase of development. They can also form an integral part of a well-planned exit strategy.

Siddhartha Nigam
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2 Overview of M&A environment in India

An overview: M&A in India

With the fiscal deficit, weak capital market, depreciating rupee levels and Euro crisis, the current macro-economic environment is challenging both at national and global level. The growth story of India continues on the back of domestic demand and consumption. India is projected to register a growth rate of over 7% in the current fiscal, which indicates that Indian companies are positive about their business prospects. Though high inflation, currency devaluation, corruption and governance related issues remain a concern, the long-term economic fundamentals of the country are intact.

On the flip side, the regulatory environment of India is undergoing significant changes. Whether it is International Financial Reporting Standards (IFRS), eXtensible Business Reporting Language (XBRL) or New Companies Bill, Indian companies could expect a massive phase of consolidation in the regulatory environment under which they operate. M&As are no exception.

Introduction of new guidelines by the Competition Commission of India (CCI) and Securities and Exchange Board of India (SEBI), for instance, could impact radical changes in the dynamics related with the M&A transactions. The budget proposals in 2012 on the retrospective amendment for the share transfer outside India (Vodafone issue) and the proposed GAAR Guidelines have clearly impacted the market sentiments and concerns.

While total M&A deal value was US$ 62 billion (971 deals) in 2010, it was US$ 54 billion (1026 deals) in 2011 and 1st 4 months of 2012 witnessed deal value of US$ 23 billion (396 deals).

In fact, 2012 has so far witnessed some large domestic mergers like Tech Mahindra with Satyam and Sesa Goa with Sterlite.
Amidst these structural changes, Indian M&A landscape is clearly witnessing some key trends in recent times, which are set out below.

Indian promoters are now willing to exit their businesses – change in attitude and attractive valuations are expected to trigger more M&A

A clear trend that is emerging now is the strategic shift in the behavioural pattern of Indian entrepreneurs, who are now more willing to sell a part or whole of their stake to exit their businesses to foreign players.

Attractive valuations from foreign players, given the significant growth opportunity in India, are prompting Indian entrepreneurs to evaluate exits. In my view, this is a significant shift in attitude and behaviour of Indian entrepreneurs who have the open mind to evaluate strategic buyers to exit their age-old businesses and this trend is expected to continue.

An overview: M&A in India

Case in point of successful exits by the Indian promoters includes Daiichi-Ranbaxy and Abbott- Piramal. British Petroleum's equity stake in Reliance Industries is one of the largest deals of 2011, which demonstrates the desire of Indian promoter group to bring in foreign technology and capital to enhance business capabilities.

In my view, the era of global collaborations and partnerships would become even more vital now than ever before.

Governance becoming an important driver for M&A deal closures

The Satyam saga and now the 2G telecom scam are now putting a strain on the corporate governance concerns of the Indian corporate world. In my view, while there are significant strategic interests of corporates from the US, Europe, Japan etc. in Indian companies and the Indian growth story, some of the ambiguous corporate governance practices do end up creating problems for the international corporate transactions.

Due diligence on transactions are getting more robust, with in-depth coverage limited not only to the financial, commercial, tax and legal aspects of a transaction, but also extending to promoter background checks on ethics and corporate governance practices. It is, therefore, imperative that Corporate India and entrepreneurs, who are looking to exit their business or planning to induct strategic players, focus towards enhancing their corporate governance practices.

Private Equity playing a key role in the Indian M&A landscape

Another trigger for M&A, which we are witnessing, is PE backed companies who are looking at M&A options to facilitate exits for the PE's. Moreover, large PE's are providing the necessary source of capital to finance M&A deals. The case in point is the I-Gate Patni deal which was part financed by Apax Partners.

Metals and minerals would continue to be important for India's national policy, especially the overseas coal assets for the power sector

The demand for power is increasing, but the lack of proper coal supply linkages is proving to be a major bottleneck in the production. In my view, we would see an increase in outbound deals by the Indian corporates looking at overseas coal and mineral assets. Deals that have concluded in 2011 in the power sector include GVK Power's acquisition of Hancock Coal in Australia for US$ 1.26 billion and GMR's acquisition of Indonesian coal assets for US$ 550 million.

M&A in certain sectors like telecom, aviation etc and capital inflows in certain sectors like retail need to be encouraged by enabling regulations for economic interests

A common public debate on FDI in retail has unfortunately been again put on the back burner by the Indian Government. In my view, India story has to mature and foreign capital is necessary not only to enhance the retail networks but also to build the back-end infrastructure.

An overview: M&A in India

Given the number of telecom players operating in India (in excess of 12) and the operating losses that some of the players are incurring, consolidation through M&A becomes imperative.

Telecom being such an important element of Indian infrastructure and communication industry, M&A provisions permitting consolidation does become critical. However, the recent Telecom Policy does not mention about the M&A provisions, which were much awaited by the sectors.

Another sector which possibly requires due consideration from the Indian Government and Regulators is aviation.

This is publicly known that the losses incurred by some of the key private airline operators in India (notwithstanding the National Carrier, Air India) and increasing losses are becoming difficult to sustain. In my view, serious consideration should be given to this industry to bring in foreign capital in national interest.

Given the significant M&A deals in pharma sector in the last 4 years, the Maira Committee was constituted to examine the FDI Policy in pharma, which currently allows 100% FDI with no cap.

The committee has recommended giving more teeth to the CCI in allowing M&A in the pharma sector and not changing the FDI limit. The Indian government has accepted the recommendations and this is clearly a positive step.

Recent amendments to the tax laws and implications for M&A

The Finance Minister, in the current budget, has not only taken us closer to the Direct Tax Code (DTC) regime by introducing General Anti Avoidance Rule (GAAR). The provisions of GAAR, as proposed, were anticipated to provide cascading effect on all transactions unless the government would have come out with the clarity in the guidelines and conditions. Now that the GAAR has been deferred by a year, it has brought an instant relief to the corporate world and the investor fraternity alike.

This welcome relief may be short-lived as the provisions of GAAR are very much part of the Income Tax Act and it is only the application of the same which has been deferred. It would now be applicable from financial year beginning April 01, 2013.

Effectively, we are only 10 months away from the applicability of the GAAR and therefore it is the need of the hour that all transactions entered today which may lead to any income being arising post April 01, 2013 should qualify the tests as laid down by GAAR.

Another major expected change in the current tax laws was the retrospective amendment of provisions to cover all direct and indirect transfer of shares/ assets of Indian companies under the Indian tax net and also introduce treaty overwrite provisions in case of such transactions (under GAAR). This amendment is a fallout of the Supreme Court verdict in the Vodafone case.

An overview: M&A in India

Introducing retrospective amendments to any major decision has always been the flavour of the government. The Sovereign state has the power to enact laws and it is implicit that they also have the powers to enact retrospective amendments. Leaving the constitutional validity of such retrospective amendments aside, these retrospective amendments are more damaging in terms of the lack of vision demonstrated to the international investor fraternity.

This amendment to tax the indirect transfer of shares of the Indian companies read with proposed anti-abuse provisions, as under GAAR, could make the exits of the PE's and other international companies taxable in India even if they are coming through the treaty countries providing for no tax incidence on such transfers.

The total tax demand raised by the tax department on various companies challenging such indirect transfers is approximately to the tune of Rs 34,000 crore. There was a public-interest litigation filed in the Delhi High Court against Kraft Foods for tax evasion relating to its US$ 19 billion takeover of Cadbury, which was entirely a case of sale of shares of a foreign company to another foreign company, with just a small portion of the deal connected to India.

According to the lawsuit, the brand's goodwill, franchise, market share, customer lists, relationship and the value of market, etc. are capital assets being transferred in India and therefore, Kraft is under the obligation to deduct the income tax, while making payment for the acquisition.

2012 Budget Proposals could lead to re-pricing of deals and impact deal sentiments

The 2012 Budget proposals on taxing share transfer outside India (Vodafone issue) and proposed GAAR (which has been subsequently withdrawn) has affected sentiments of investors as well as multinational companies. While there is a significant interest and momentum in inbound deals, the Vodafone issue could lead to re-pricing of transaction valuations and delay in deal closures.

New Competition Law (CCI Guidelines) could potentially delay M&A deal closures

The new Guidelines by CCI is a welcome step to bring in checks on competition. In my view, while the objective of the Guidelines is well taken, the key here would be the execution of the guidelines to enable smooth approval process of M&A transactions.

At the outset, the Regulations seem to consider size as the only measure of monopoly, implying a belief that only large monopolies are harmful. In my view, market share would prove a more comprehensive measure in scrutinising the existence of a potential monopoly.

An overview: M&A in India

While the regulations state that during the appreciable adverse effect analysis, the CCI will also look into other factors such as the relative market share, this still leaves out some loopholes. In the case of highly specialised small markets, two entities could combine to form a monopoly, and still remain outside the CCI scanner due to their small size.

Secondly, though the time limit for the CCI review has been reduced to 180 days, this could still be considered more of an optical reduction, since the outer time limit for passing judgment has been retained at 210 days. Further, both 180 and 210 days are in themselves relatively long periods vis-à-vis M&A, given the current volatile global environment.

Finally, it is crucial that the CCI be able to attract the requisite pool of talented manpower, including, and not limited to, economists, lawyers, bankers and corporate strategists, whose combined wisdom would be required to resolve issues involved in making complex decisions.

Else, under the provision to appeal against the CCI's decision, it is possible that the CCI's decision be overturned by Tribunals or Higher Courts, thereby, only staggering the M&A activity, and undermining the authority of the CCI.

New SEBI Takeover Code increasing the open offer trigger to 25% levels a welcome step, however, Indian promoters would need to be cautious

The New SEBI Takeover Code aims to enhance the threshold limit from 15% to 25%, and the open offer size, after the 25% trigger is hit, is enhanced from the current 20% to 26%.

In the case of Hotel Leela Ventures, where ITC currently holds 14.5% stake, under the new norms, ITC can hike its stake by another 10% and still stay away from making an open offer for additional 26%, as would be required now. More interesting would be the case of EIH Ltd - the hospitality company, which owns and operates the Oberoi chain of hotels - wherein Reliance and ITC are currently holding 14.5% stake each.

However, if an acquirer acquires at least 25% stake in a company, then he has to come out with a minimum open offer of 26%. This will result in making an acquirer ending up with "controlling" 51% stake in the target company.

Once the code takes effect, promoters will have to stay alert, as acquirers and PE players can acquire stakes up to 24.9% without triggering an open offer. Many Indian promoters run their companies with stakes in the range of 20-30%, and they may now need to strategically think of increasing their equity holdings.

For smaller investors, removal of non-compete fees is in line with the recommendation of the Takeover Committee. This recommendation is welcome and serves the purpose of protecting the interests of minority shareholders.

Integration for M&A important to achieve the desired results

As Indian companies continue to look for outbound deals to grow, integration planning and strategy would become vital for Indian corporates, as they elevate to managing larger assets post-acquisition.

The learning from the global M&A deals clearly indicate that poor integration planning and execution is one of the key reasons for the failure of deals and hence, adequate attention should be paid to bring in global practices for post-merger integration.

Summing up

Current times are clearly challenging (both from the economic and regulatory perspectives) which could lead to moderation in deal making, however, the long term outlook on M&A in India remains robust.

In my view, India's M&A environment would continue to grow stronger and bigger in years to come and our regulations and economic environment should facilitate closure of transactions.

As Western economies continue to show signs of weaknesses, Indian corporate should aim at seizing this time and opportunity to strengthen India's market position, while expanding their global footprint.

By Raja Lahiri
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(with inputs from Vaibhav Gupta)

2012-Top 5 M&A (Jan-Apr)					
Acquirer	**Target**	**Sector**	**US $ Mn**	**Deal Type**	**% Stake**
Sesa Goa Ltd (Sesa Sterlite - To be formed)	Sterlite Industries (India) Ltd, Vedanta Aluminium Ltd, The Madras Aluminium Company Ltd	Mining	12,763.80	Internal Restructuring	N.A.
Tech Mahindra Ltd	Satyam Computer Services Ltd.	IT & ITeS	1,400.00	Merger	N.A.
Piramal Healthcare Ltd	Vodafone Essar from ETHL Communications Holdings Ltd	Telecom	618.00	Increasing Stake to 11.00%	5.50%
Mitsui Sumitomo Insurance Company Ltd	Max New York Life Insurance Company Ltd.	Banking & Financial Services	530.00	Strategic Stake	26.00%
TV18 Broadcast Ltd	Eenadu Television Network	Media, Entertainment & Publishing	395.00	Strategic Stake	N.A.

2011-Top 5 M&A					
Acquirer	**Target**	**Sector**	**US $ Mn**	**Deal Type**	**% Stake**
Vedanta Plc	Cairn India	Oil & Gas	8,670.00	Increasing Stake to 38.5%	30.00%
British Petroleum	Reliance Industries	Oil & Gas	7,200.00	Strategic Stake	30.00%
Vodafone Group Plc	Vodafone Essar	Telecom	5,000.00	Increasing Stake	N.A.
Mundra Port SEZ Ltd	Abbot Point Port	Shipping & Ports	1,956.52	Acquisition	
Siemens AG	Siemens Ltd	Engineering	1,350.52	Increasing Stake to 75%	19.70%

2012-Top 5 M&A					
Acquirer	**Target**	**Sector**	**US $ Mn**	**Deal Type**	**% Stake**
Reliance Power Ltd	Reliance Natural Resources Ltd	Oil & Gas	11,000.00	Merger	N.A.
Bharti Airtel	Zain Africa BV	Telecom	10,700.00	Acquisition	
Abbott Labs	Piramal Healthcare Solutions - Domestic Formulations Business	Pharma, Healthcare & Biotech	3,720.00	Acquisition	
Hinduja Group	KBL European Private Bankers	Banking & Financial Services	1,863.00	Acquisition	
GTL Infrastructure	Aircel Ltd - 17,500 telecom towers	Telecom	1,787.23	Acquisition	

Source: Grant Thornton Dealtracker

3 Redefining the Takeover Code in India

Redefining the Takeover Code in India

After extensive public consultation and feedback, in July 2011 SEBI notified the takeover code last year. This article summarises the key features of the takeover code which is a key aspect for any corporate which is exploring an Acquisition of a listed company
SEBI has modified the existing takeover code based on feedback received to the draft takeover code and has also looked at bringing the regulation in line with international practices as also the experience and feedback on the earlier takeover code. Clearly, SEBI has attempted to balance the interests of all the stakeholders - promoter, acquirer and minority interests.

Increased threshold limits and open offer size

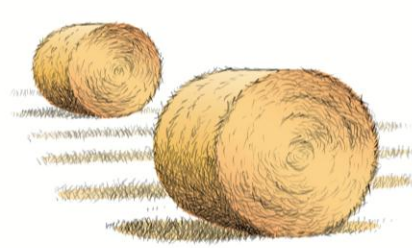
The most significant and welcome change has been the increase in threshold limit for open from 15% to 25%, bringing it more in the line with practices in the financial markets of countries like UK, Singapore, Hong Kong, the European Union and South Africa which are in the range of 30 to 35%.

The Indian companies act gives special rights to shareholders with over 25% stake through their ability to block key corporate decisions. Hence the logical limit for the takeover code is below 25% which has been notified. This will substantially assist Private Equity Players who are looking to invest as the threshold of 15% was becoming a constraint and this will also be a big benefit for smaller corporates who will now be able to raise more capital to feed their growth needs.

The mandatory open offer size has also been increased from 20 % to 26%. The SEBI panel on new takeover regulations had recommended an open offer for buying up to 100% in the target company, this has not been accepted due to intense opposition from industry and other market participants.

This approach if accepted would have provided complete exit option to other shareholders of the company, but resulted in significantly costlier acquisitions where the acquirer would have had to be additionally cautious, thereby resulting in delayed consummation of deals or possibly lesser deal activity. This provision would have been especially more difficult for Indian acquirers, as Indian banks do not provide financial assistance for acquisitions. Setting the offer size at 26% will make the open offer process an affordable one for strategic acquirers and also create a level playing field between Indian acquirers and their foreign counterparts.

In case of voluntary open offers, for acquirers already holding 25% or more voting rights in the target company, the minimum offer size has been reduced from 20% to 10% ,subject to a maximum shareholding of 75% in the target company, to promote fair and transparent consolidation of holdings.



Redefining the Takeover Code in India

Level playing field for promoters and minority investors

SEBI has removed non-compete fees or control premium, in line with the takeover committee recommendations of upholding the basic objective of the takeover code which is to provide equitable treatment to all shareholders. Now, any amount paid to the promoters, in form of non-compete fee, control premium etc, would have to be added in the offer price. With these rules coming into force, both promoters and public shareholders of a listed company would get the same price for their shares being purchased by an acquirer.

Other aspects of the Takeover Code

In sectors where the Government has capped FDI to 26% or 49%, such as airlines, the takeover code would prove contradictory as a foreign acquirer may end up holding as much as 51 per cent if the open offer issue is fully subscribed. While the finance ministry and the industry had demanded that SEBI amend the Takeover Code to allow foreign airlines to acquire up to 26% in Indian carriers, SEBI has said that in these cases the acquirer is advised to first acquire shares from the public through an open offer and then tap promoters to buy additional stakes.

The new regulations have also made it mandatory for the board of the target company to issue a recommendation on the offer being made by the acquirer and such a recommendation, to accept or reject the offer, would have to be made public at least two days before the commencement of the offer. The public shareholders would thus be aware of the recommendations of the board of target company and would assist them in their decision making.

This is again in line with international practice and puts additional responsibility on the Board to consider if the takeover offer is in the interest of the company or not.

In the pricing of the shares of the target companies, the committee has recommended the highest of the following four prices - the negotiated price, volume weighted average price over the last 52 weeks prior to the public announcement, the highest price payable or paid in the last 26 weeks before the public announcement, or the volume weighted average price of 60 trading days prior to the public announcement.; which they feel is more representative of the valuation of the company rather than the previously used benchmark of the higher of 2 week/26-week average prior to the announcement.

Redefining the Takeover Code in India

The takeover code also specifies that companies cannot breach the maximum promoter shareholding limit of 75%. In case it happens, the acquirer has to reduce its shareholding to a maximum of 75%.

While the Committee had recommended automatic delisting of the target company if the acquirer's shareholding exceeds the 90 per cent delisting threshold through the open offer, and the intention to delist has been declared upfront., SEBI has rejected this proposal much to the displeasure of acquirers who plan on 'going private' in India.

The earlier ambiguity in the definition of what constitutes control, was clarified by the committee, taking the view that both the 'ability', and the 'right' to appoint directors and therefore control policy decisions, were been considered. The proposed change has not been accepted by the SEBI Code and the previous definition of 'control' would continue where there are some gaps which we presume will get clarified later.

Certain other provisions related to the annual limit on creeping acquisitions and the definition of persons acting in concert (PAC) is under review after these issues were highlighted by industry.

Conclusion

Overall, the new takeover code provides further clarity to deal makers and tries to balance the interests of acquirers, investors and more importantly the minority shareholders. Having said that, we believe that the new takeover code could pave the way for a transparent environment for mergers and acquisitions, and larger deals in the Indian M&A space.

We also believe that there should be an active market for control through hostile transactions to improve shareholder value and make managements and promoters more responsible. The takeover code is a good step towards achieving this but more legislation is required in this area.

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Piyush Patnaik
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4 Impact of the Companies Bill

Impact of the Companies Bill on India's M&A horizon

M&As are a vital commercial tool required for the growth of corporate business whether by way of internal restructurings or for the purpose of acquisitions / divestments. The procedures for M&A under the present Companies Act, 1956 ('Co Act') are governed by the provisions of Section 391 to 394 which detail the manner in which arrangements and compromises between Company and their shareholders and creditors are given effect to.

The existing Companies Act, 1956 was enacted by the Indian Legislature over half-a-century ago. In the ensuing years, much has changed in the nature of businesses and the manner in which they are conducted both domestically and internationally. The resultant growth and expansion of the Indian economy has led to the development of a complex, diverse and dynamic business environment. Hence there is a requirement to develop a legislation that is compact, amenable to clear interpretation, and able to adequately respond to the needs of the ever evolving economic activities and business models of India Inc. – all the while nurturing a positive environment conducive to investment and growth.

Like its past avatars (The Companies Bill 2009 and Companies Bill 2008), the Companies Bill 2011 (the 'Bill') was enacted keeping in view the globalisation of the Indian corporates. An illustration of this ethos is the proposal in The Bill permitting both inbound and outbound cross border mergers between Indian Companies and foreign companies whereas the Co Act permits only inbound mergers (foreign company merging into an Indian company) and not the other way round.

The Companies Bill 2011 provides for Compromises, Arrangements and Amalgamations which are likely to have an impact on restructuring transactions. While some of the proposals are intended to make it easier for companies to implement the scheme, others impose checks and balances to prevent possible abuse of these provisions by companies.

The Bill was presented before the Lok Sabha on 14 December 2011 by the Ministry of Corporate Affairs, after which, due to criticism from opposition parties, it was referred back to the Standing Committee to suggest further changes. The parliamentary Standing Committee on Finance is still discussing the Bill with various authorities and it is quite uncertain when it will be tabled before the Parliament.

Impact of the Companies Bill on India's M&A horizon

Some of the key amendments that are proposed in the Bill are analysed below:

Provision for cross border mergers

One of the key provisions in the Bill permits Indian companies to merge into companies located in specific foreign jurisdictions (to be notified) and vice versa.

While the Bill seeks uncharted territories by including such mergers, it remains to be seen whether the RBI will permit such cross border mergers under the automatic route. If not, it is likely that the step taken in the Bill will be negated to a large extent.

Small companies merger/ short form merger

Under the Bill, the protracted procedures required for an M&A have been dispensed with for M&A between two small companies or between a holding company and a wholly owned subsidiary company by allowing them to proceed further without the approval of Court /NCLT subject to certain conditions.

The limits for 'Small Company' have been relaxed to include a company with a share capital of Rs 50 lakh or a turnover of Rs 2 crore which under the Companies Bill 2009 was Rs 5 crore and Rs 20 crore respectively.

Reverse mergers

The Bill has plugged an existing loophole that allows a 'backdoor' listing of companies. A merger of a listed transferor company with an unlisted transferee may not automatically result in listing of the resulting entity unless it goes through the process of a public offering.

The proposed bill offers an option to the transferee company to continue as an unlisted company by buying out shareholders of the listed transferor company who may decide to opt out of the unlisted transferee company by paying them in cash. However, the proposal of opting out of listing the transferor has been done away with in the case of a demerger.

Dispensation of meeting of creditors and shareholders

Currently, to convene a shareholder's or a creditor's meeting for approval of a restructuring scheme is a time and cost consuming process. The dispensation of meeting of creditors/shareholders is presently at the discretion of the jurisdictional High Court. In order to simplify this process, the Bill has permitted companies to dispense with the meetings if the consent of 90% of the value of the shareholders and the creditors, by way of an affidavit has been obtained.

The existing requirement to obtain an approval from a majority in number of shareholders or creditors has also been done away with.

Impact of the Companies Bill on India's M&A horizon

Protection of minority interest

The Bill permits any shareholder, creditor or other "interested person" to object to a scheme of arrangement, however subject to an onerous requirement that only persons holding at least 10% of the shares of the Company or at least 5% of the total debt outstanding in the Company are eligible to raise an objection. This provision is likely to substantially erode the power of minority shareholders and creditors in case of restructuring schemes. However, the Bill seeks to protect the interest of minority by introducing the concept of exit opportunities to dissenting shareholder in case of any restructuring, which may be insufficient protection.

Valuation & accounting requirements

An unlisted company will have to procure a certificate from the Company's Statutory Auditor stating that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with applicable accounting standards. Under the existing provisions there is no such requirement either for listed or unlisted companies.

It is important to note that SEBI has directed that this auditor's certificate is required to be filed with the respective stock exchanges on which the shares of the company are listed (if at all). The purpose of this requirement is to ensure that the Court does not consider Schemes involving 'dubious' financial re-engineering since schemes of arrangement tend to have overriding impact on matters of accounting and valuation.

The Bill also specifically provides that the report of an expert valuer has to be disclosed to the shareholders. This is significant because a substantial amount of litigation on schemes of arrangement relate to matters of valuation, and consequently the share exchange ratio. There is currently no requirement to obtain an expert valuation, although it has now become a matter of practice for companies to obtain at least one, if not two, valuation reports as a part of the restructuring process.

Introduction of National Company Law Tribunal (NCLT)

Under the Companies Act, schemes of arrangement are to be approved by the High Court that has jurisdiction over the companies involved. While this ensures an oversight of the scheme and its fairness, there have been concerns regarding possible delays. For example, the average time taken for a scheme to be implemented from start to finish is no less than 6 months, and in several cases, the schemes have taken a couple of years to be approved by the High Court.

To that extent, the proposal to move the jurisdiction of the High Court in such matters to the NCLT is welcome since it will be a specialized body dealing only with cases under company and related laws thereby introducing elements of timeliness and efficiency. Although the setting up of the NCLT has been on the anvil for a long time, with the passing of the Bill, the process may get expedited.

Impact of the Companies Bill on India's M&A horizon

Abolition of trust shares

When there are mergers between companies that have cross-holdings of shares (e.g. between a parent and a subsidiary), the shares that one company holds in the other will typically be cancelled, and to that extent, no shares will be issued under the scheme.

However, in the last few years, a practice has developed where shares were in fact issued under the scheme by the transferee company to a trust, to be held for its own benefit. The trust could further sell those shares and pay over proceeds to the beneficiary, being the company. This resulted in the dual advantage to the Company to indirectly hold such shares in order to provide access to liquidity should the company require it in future, while still allowing the promoters to retain a controlling stake over the company. The Bill effectively negates this practice, and requires any cross-held shares to be compulsorily cancelled.

Notice to regulatory authorities

Certain other reforms have been proposed by the Bill one of which is that notice of the scheme must be additionally provided to various regulatory authorities such as the Income Tax Department, SEBI, Reserve Bank of India (RBI), Competition Commission of India (CCI) which is not presently required. On account of this, the procedure for obtaining approval of the various specified regulatory authorities is likely to become cumbersome and time consuming.

Conclusion

As is evident from the above discussion, the Bill is progressive and looks to align the law with current commercial realities. However, it also proposes to subject mergers and amalgamations to certain cumbersome regulatory approvals which may not necessarily be required.

The fate of the Bill is unclear since it will depend on when it is tabled before the Standing Committee and the progress of deliberations thereafter. The Bill if passed with a few modifications will certainly promote growth of the Indian economy.

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(with inputs from Preeti Arora)

5 GAAR and M&A

GAAR: an overview

In the words of John Maynard Keynes, a well-known British Economist, "The avoidance of taxes is the only intellectual pursuit that carries any reward."

Internationally, tax avoidance has been recognised as an area of concern and several countries have expressed concern over tax evasion and avoidance. This is also evident from the fact that most of the nations have legislated or are legislating doctrine of General Anti-Avoidance Regulations (GAAR) in their tax code or strengthening their existing code.

Tax payers across the world arrange their business/ affairs in a way that gives them maximum tax advantage. On one hand, tax authorities look through these transactions carrying reduction in tax liability with jaundiced eye while taxpayers label those as genuine 'tax planning'. This difference in approach and outlook becomes the subject matter of debate and turns to protracted litigation.

The tax payers have time and again expressed their desire to introduce reforms that would act as deterrent to the use of sophisticated weapons of the tax authorities. More so, in environment of moderate rates of tax, it is necessary that the correct base be subject to tax in the face of aggressive tax planning and use of opaque low tax jurisdictions for residence as well as for sourcing capital.

Introduction of GAAR in India

Currently India has specific anti-avoidance provisions engraved both in the domestic tax laws and in some of the tax treaties through the 'limitation of benefits' clause. GAAR provisions were proposed under the Union Budget 2012 announced on 16th March. The Direct Taxes Code Bill 2010 (DTC), one of the two most significant contemporary tax reforms being pursued by the Indian policymakers, proposed to implement the GAAR for the first time in domestic legislation.

Given the postponement of DTC, GAAR as part of tax reforms was introduced through this budget. As per the budget proposals, GAAR provisions were to come into effect from 1st April, 2012. However in the Finance Bill, 2012 passed by the Lok Sabha, the Finance Minister has deferred its applicability by a year to 1st April, 2013. The Finance Minister clarified that the GAAR applicability has been deferred by a year to provide more time to both taxpayers and the tax administration to address all GAAR-related issues.

Nonetheless, we all know, that GAAR has made debut in India and it is reality now even though effective after a year. GAAR is introduced to counter aggressive tax avoidance schemes, while ensuring that it is used only in appropriate cases, by enabling a review by a GAAR panel (known as Approving Panel).

GAAR: an overview

Scope of provisions

GAAR as envisaged in the Union Budget 2012 is a broad set of provisions which seek to tax an "impermissible avoidance arrangement' which may be a step, a part or whole of an arrangement herein referred to as 'transaction'.

The main premise of invoking GAAR is that any transaction or step in a transaction which has one of its main purposes i.e. the obtaining of a tax benefit, should be disregarded, or dealt with in such a manner so as to protect the right of the revenue to taxes. In addition to obtaining the tax benefit, the transaction should:

- create rights and obligations which are not normally created between persons dealing at arm's length; or
- result directly or indirectly in the misuse of the provisions of the Act; or
- lack commercial substance either wholly or in part; or
- be entered into in such a manner which would not normally be employed for bonafide purposes.

In other words, once the 'tax benefit' test is satisfied, the arrangement needs to satisfy at least one of the above four additional tests.

Some of important terms used are as explained below.

"Tax benefit" means:

- a reduction, avoidance or deferral of, or an increase in a refund of tax under the Income Tax Act ("ITA" or "the Act").
- a reduction, avoidance or deferral of, or an increase in a refund of tax for a Tax Treaty.
- a reduction in tax bases including increase in loss.

Lack of commercial substance

An arrangement will be deemed to lack commercial substance if:

1. the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or
2. it involves or includes:
   - round trip financing; (the ordinary meaning of the word 'round-tripping' is 'a journey to place and back again)
   - an accommodating party;
   - elements that have effect of offsetting or cancelling each other; or
   - a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of fund which is the subject matter of such transaction; or
3. it involves the location of an asset or of a transaction or of the place of residence of any party which would not have been so located for any substantial commercial purpose other than obtaining tax benefit for a party.

GAAR: an overview

Consequences if GAAR triggered:

Once treated as an impermissible avoidance arrangement, look through is permitted by:

- disregarding or combining any step of the arrangement
- ignoring the arrangement for the purpose of taxation law
- disregarding or combining any party to the arrangement
- reallocating expenses and income between the parties to the arrangement
- relocating place of residence of a party, or location of a transaction or situs of an asset to a place other than provided in the arrangement
- considering or looking through the arrangement by disregarding any corporate structure
- re-characterising equity into debt, capital into revenue etc.

If a transaction is regarded as an avoidance transaction, it could be disregarded, combined with any other step in the transaction or re-characterised, or the parties to the transaction could be disregarded as separate persons and treated as one.

The provisions are drafted in a manner to permit the application of principles relating to lifting corporate veil, substance over form test, economic substance test, and thin capitalisation rules such as re-characterisation of debt into equity or vice versa.

However, the Finance Bill provides that the administrative guidelines shall be issued to regulate conditions and to supplement the effective implementation of GAAR.

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Impact of GAAR on India's M&A horizon

Taxpayers, domestic and foreign, will witness a paradigm shift in empowerment and approach of tax authorities in India towards taxation of transactions, structures and arrangements. GAAR provisions may impact cross border deals, investments into India by foreign institutional investors and PE funds, domestic transactions, even within two units of one conglomerate, as well as day to day business transactions.

These provisions are substantially overriding in nature and would impact all restructuring and acquisitions. GAAR provisions expressly clarify that the holding period of a structure or arrangement and the fact that it provides a legitimate exit route for investors is not relevant for the purpose of determining commercial substance.

GAAR is one of the proposals which is facing maximum criticism from within or outside India. The question arises while similar provisions also exist in other countries, why there should be so much hue and cry about Indian GAAR proposals? Possible answer may be that the issue is not that India should have GAAR or not, but the issue is more around possibility of its misuse and ineffective implementation.

Looking at the present time consuming dispute resolution system in India, wide powers of Indian tax officials and more so their unpredictable assessment of a case, worry of the international community (especially considering wide scope of GAAR and lack of proper guidelines to avoid any misuse of these provisions) is completely understandable.

Some of the emerging concerns, which are becoming boost dampener for M&A market, are mentioned below.

1. Very wide scope: The scope of Indian GAAR is very wide as it seeks to cover within its ambit nearly all the arrangements which have an element of 'tax benefit' accruing to the taxpayer. In other words, the principle condition along with the four additional tests could have the effect of bringing each and every transaction resulting in a lower tax liability for the taxpayer under the purview of GAAR.

Further, while a transaction as a whole may be a bonafide one, however, the tax authorities can invoke GAAR provisions if any of the steps on a standalone basis are undertaken to obtain a tax benefit. Consequently, even genuine business transactions might fall on the wrong side of GAAR. In fact, it seems that while taking all commercial decisions and determining the manner of their implementation, the tax implications of these provisions would play a pivotal role. However, principally speaking, it should be the other way round i.e. if a transaction as a whole is justifiable; the question of invoking GAAR should not arise.

2. GAAR vs. Treaty provisions: It has been proposed that the GAAR provisions would apply to a taxpayer irrespective of the fact that the treaty provisions are more beneficial. It may be noted that a unilateral enactment of a new domestic tax law which is contrary to an existing treaty, without an amendment in treaty could possibly be regarded as violation of international law and is generally known as 'treaty override'.

Impact of GAAR on India's M&A horizon

It may be relevant to note that according to the rules of legislative interpretation, specific legislation overrides general legislation. Therefore, an argument may be taken that change of a domestic law generally, which could be the case with GAAR, may not affect the treaty. However, in the absence of an anti-avoidance provision under the treaty, the reaction of India's treaty partner countries needs to be observed.

It may be noted while the limited treaty override provisions are theoretically in line with substance over form rule or economic substance rule (as envisaged under the OECD commentary and global practice for anti-avoidance measures), it is unclear as to how such interplay between the tax treaty provisions and the domestic override provisions would be balanced by the tax administration. For instance, if a particular transaction is eligible for tax treaty relief (especially where the tax treaty already has a limitation of benefit clause), could the domestic anti-avoidance rules still be invoked by the revenue to pierce the corporate veil and deny tax treaty relief?

3. Wide powers of tax authorities: Tax authorities are given powers to invoke GAAR by using any one of the criterion which are vast as well as ambiguous.

Thus there is a need to lay down more objective criteria and specific administrative guidelines for invoking GAAR and determining the tax consequences in cases where GAAR is invoked and to establish a reasonable level of accountability for the tax authorities.

4. Constitution of the Panel: At the assessment of stage, need of triggering of GAAR provisions is felt, the matter will be referred to an Approving Panel. The approving panel shall be set up by the Board and would comprise of 3 members. It may be ideal if certain industry experts are nominated for the Approving Panel who can bring in their expert knowledge/ experience which can help in understanding true business or commercial purpose of a transaction.

This may help in achieving the long term objective of the tax authorities of bringing the actual tax evaders under the tax net. In the Finance Bill 2012 passed by the Lok Sabha it is announced that to induct an independent member in the GAAR approving panel is a step in this direction.

5. GAAR vs. SAAR: There are varied international precedents when it comes to the interaction between general and special anti-abuse provisions, with some jurisdictions ruling out applicability of general anti avoidance measures in cases where more specific anti-abuse provisions have been applied such as Germany. The approach of OECD countries is different, with common law countries espousing a view that the existence of special anti-avoidance measures cannot preclude overarching general anti-avoidance rules.

Impact of GAAR on India's M&A horizon

6. Approach to AAR: In the recent announcement to the Finance Bill 2012 passed by the Lok Sabha it is mentioned that all taxpayers, resident as well as non-resident, to approach the Authority for Advance Ruling to know whether an arrangement to be undertaken was permissible under GAAR. This move should take care of some of the emerging concerns relating to uncertainty as it provides opportunity for a more comprehensive consideration of proposed transaction well in advance.

However, in the Indian context an overlap between general and specific anti-avoidance rules would inevitably lead to expensive and needless litigation in the absence of clear and transient administrative guidelines.

7. Onus of proof: As per the initial budget proposals, the onerous burden of proving that the transaction was not entered into for the purposes of obtaining a tax benefit lies on the taxpayer. This move caused anxiety and uncertainty among the tax payers. However in the Finance Bill, 2012 passed by the Lok Sabha, the Finance Minister mentioned that the onus of proving tax avoidance will be on tax authorities and not on the taxpayer. This is in line with International practices. So in a way, one concern is taken care of.

Conclusion

For a foreign investor, a country's tax regime is a very significant factor if not a decisive one. Today businesses are looking at inorganic growth to achieve better economies of scale, synergy and competency in the form of business reorganisation.

Therefore the tax policies of the government need to be critically framed as to achieve the purpose of tax reform and also being positive to business environment of the country.

Worldwide, GAAR has been criticised and supported equally by international tax experts. The rule of law requires law to be certain and predictable, such that law abiding citizens are aware of what is permitted and what is prohibited. While the concept of GAAR may as such be against this principle, to some extent, GAAR is important, since it is not humanly possible to make laws for each and every tax avoidance tool used by a creative taxpayer.

The success of GAAR lies in its judicious, selective and sensible implementation. In the Indian context, considering the aggression of tax administration in some cases, the introduction of GAAR may be worrisome to a tax payer unless implemented in the balanced manner with adequate safeguards for protecting the taxpayer. Tax payers would keenly await draft subordinate legislation, which law makers expect would be open for public debate.

The intent of the Indian lawmakers to legislate GAAR is progressive in so far as tax policy decisions are directed. However, an important question is whether, in the current context, the introduction of GAAR is well timed, or still a premature effort towards alignment with internationally accepted principles of anti-avoidance.

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6 Considering Transfer Pricing

Transfer pricing considerations in M&A transactions

In the complex global business environment, size dominates. Every multinational enterprise (MNE) on the staircase of expansion resorts to any one of the various tools of M&A as it widens the scope of their businesses and brings efficiency improvements through synergies and scale. The above can also be a result of decisions of rationalisation, centralisation or de-centralisation of operations between group entities (manufacturing sites and/or processes, research and development activities, sales, services), with the primary focus on availing the economies of scale and widespread geographies.

Any M&A that takes place, leads to a restructuring of an existing business of the concerned MNEs or may lead to an internal as well as external reallocation of functions, assets (both tangible and intangible), and risks within the MNE group. M&As are typically accompanied by reallocation of profits among the members of the MNE group, immediately as well as after the restructuring over a few years. This gives potential avenues for erosion of tax base in a cross border situation. M&A deals are swarmed with Transfer Pricing (TP) implications, not only in the bringing together of potentially inconsistent TP systems, but also in the integration objectives and financing needs of the acquirers.

How transfer pricing comes into picture and its impact

Pursuant to a merger or acquisition scheme, the MNEs might face a plethora of additional decisive issues related to TP implications which might also attract the attention of the tax authorities.

Some of the probable examples of areas for disputes are:

Debt push-down

In case the acquirer intends to allocate debt, financing fees, and other acquisition costs to an acquired entity, the cash flows generated by the entity as a result of its transfer pricing policy should be carefully scrutinized so as to ensure that the entity is able to meet its allocated debt obligations.

The potential problem here is whether the prevailing TP regime will allow payment of interest by entities if the profits of affiliates are reduced by revisions of TP policies post M&A. Affiliates that are profitable at the operating level, but record losses after substantial interest expense, could attract unwelcome tax authority attention and increase the group's overall TP risk profile.

Supply chain structures

TP issues may also arise due to shift in profits as a result of change in supply chain structures resulting in change in profit centers pursuant to a scheme of M&A.

Transfer pricing considerations in M&A transactions

Situations arising out of an M&A deal which might raise the eyebrows of the tax authorities in India also include:

Payment of royalty, payment of marketing expense, movement of intangibles to a centralised entity in the MNE group and the difficulty of distinction between legal and economic ownership of intangibles, payment of management cross charges, payment of procurement fee, etc.

Other areas of potential TP exposure include:

- risk of additional local country examinations to challenge the reduced profit levels
- potential exit charges when a tax authority claims valuable functions were removed from its tax base
- the inability of the company's accounting systems to provide the data needed to implement and test the new arrangements
- the deductibility of new inter-company charges

The transfer pricing tools to navigate TP audit risks associated with M&A

There are various ways to manage these risks.

a) TP risk management should begin during due diligence with an appropriately diligent search for possible TP exposures for the new business.

b) an early transfer pricing analysis right at the time of initiation of the change can allow the new business to integrate transfer pricing into its business plans by anticipating difficulties in the near future and preparing itself accordingly. Early and robust documentation of transfer pricing policy is the foundation of an effective risk free M&A deal.

c) a comparison and evaluation of the profits of the Indian taxpayer before and after the deal surely act as a strong audit defense in case of any M&A transaction. Thus, the security checks on account of TP should be on both pre- and post-transaction, as both are extremely important facets of the analysis under consideration.

Some of the best practices towards the same are set out below.

Best practices	Stage of restructuring where they are required
Bilateral or unilateral Advanced Pricing Arrangements, in case feasible	Pre-Restructuring
Water-tight inter-company agreements to the extent possible	At the time of restructuring, Post- Restructuring
Consistent TP policies to assure local tax authorities that the exercise is not designed solely for availing tax benefits between tax differential jurisdictions.	At the time of restructuring, Post- Restructuring
Consideration of local laws of jurisdictions where the entities undergoing the merger or acquisition are located	Pre-Restructuring, At the time of restructuring, Post-Restructuring
Revenue Authorities expect the tax payers to maintain robust and timely TP documentation	Pre-Restructuring, At the time of restructuring, Post-Restructuring

Transfer pricing considerations in M&A transactions

The last two help in substantiating the facts flowing out of the new business structure and can be corroborated by documents capturing internal analysis and financial effects of the whole act of M&A (e.g. reports, discussions, calculations, forecasts/budgets, costs benefits analysis) , feasibility studies and comparability analysis of other viable options at disposal.

The Indian experience with TP authorities

The Indian Transfer Pricing Regulations came into force in 2001 with the transfer pricing audits effectively beginning from 2003. Till date, seven rounds of transfer pricing audit have completed resulting in total adjustment to income of approximately USD 20 billion.

Considering that Indian Revenue Authorities have started getting extremely aggressive on transfer pricing issues already mentioned above and have explicitly included Business Restructuring transactions under the TP regulations (TPR), through the Finance Bill of 2012, it is imperative that tax payers maintain a robust documentation vis-à-vis their business restructurings by way of M&As to clearly bring out roles, responsibilities of the newly formed entity (both pre and post the restructuring) as well as describe the functions, assets and risk of the concerned entities clearly.

This would assist the tax payer to defend the appropriateness of its new business model and mitigate against potential transfer pricing adjustments.

Since now it is explicitly required under the Indian TPR to test whether transactions between the two entities (which obtain the status of associated enterprises under the Indian TP regime of the Indian Income Tax Act) involving movement of the functions, assets and risks are at an arm's length price. TP policies are required to be carefully formulated and documented keeping in mind the following important aspects:

- the restructuring transactions under the M&A and the functions, assets and risks before and after the M&A;
- the business reasons for and the expected benefits from the M&A, including the role of synergies;
- the options realistically available to the parties.

Recommendations

Looking at the current scenario of transfer pricing disputes in India in terms of the number of cases and quantum involved, it would also be prudent to conduct an exhaustive TP analysis and put in place a strong transfer pricing policy required to be maintained. The above should be supported by legal agreements that have been entered between the concerned entities to substantiate the terms of arrangement to mitigate risk of potential disregard of the restructuring payment made or not made by the tax payer.

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