Grant Thornton
An instinct for growth™

RBI notifies foreign exchange regulations for cross-border mergers

The Companies Act, 2013 (‘Companies Act’) was amended in April 2017 permitting cross-border mergers i.e. inbound merger (cross-border merger of a foreign company into an Indian company) and outbound merger (cross-border merger of an Indian company into a foreign company). As per the provision, a prior approval of the Reserve Bank of India (‘RBI’) is required for a cross-border merger. In this regard, the RBI has notified the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 (‘FEMA Regulation’) on 20 March, 2018. These regulations govern cross-border mergers and provide an extensive guidance in this regard.

Summary

FEMA Regulation, 2018 is progressive in nature where deemed approval is provided in cases, where the cross-border merger is undertaken as per the existing regulation under automatic route. The regulations provide sufficient checks and balances with onus on management for all compliances. Further, where the regulations do not permit the merged company (under both inbound and outbound scenario) to acquire, hold or transfer an asset, such asset needs to be sold by the merged company within a period of two years from sanction of the merger scheme.

The key highlights of the regulations are as under:

Cross-border merger defined

Cross-border merger has been widely defined to mean any merger, amalgamation and any other arrangement between an Indian and a foreign company in accordance with the rules notified under the Companies Act.

Inbound merger

In the case of an inbound merger, where the merged ("resultant") company is an Indian company:

- **Issue of securities:** The merged company may issue or transfer any security, to a person resident outside India in accordance with the requirements for foreign investment as laid down in Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017.
- **Acquisition of assets:** An office outside India of the foreign company shall be deemed to be the branch/office outside India of the merged company. The merged company may undertake any transaction as permitted to a branch/office under the Foreign Exchange Management (Foreign Currency Account by a person resident in India) Regulations, 2015.
- **Continuation of borrowings:** Merged company has been permitted to continue guarantees or outstanding borrowings of the foreign merging company from overseas sources in the books of merged company, subject to compliance within a period of two years to the External Commercial Borrowing (ECB)/ Trade Credit norms or other foreign borrowing norms, as laid down under Foreign Exchange Management Regulations. No remittance for repayment of such liability shall be made from India within such period of two years. End use conditions shall not apply on such ECB.
- **Compulsory sale of assets not permitted to be acquired:** Merged company permitted to acquire, transfer or hold any asset outside India subject to FEMA regulations. If the regulations do not permit, such asset is to be sold by the merged company within a period of two years from date of sanction of merger scheme. Merged Indian company is also allowed to operate foreign bank account for this purpose.

Outbound Merger

In the case of an outbound merger where the merged company is a Foreign company:

- **Issue of Securities:** Person residing in India may acquire/hold securities of merged foreign company subject to FEMA outbound investment regulations. In case of Individuals, the fair value of the acquisition of foreign security is limited to the limit prescribed under LRS Scheme.

- **Acquisition of assets:** An office in India of the merging Indian company shall be deemed to be the branch/office in India of the merged foreign company. The merged foreign company may undertake any transaction as permitted to a branch/office under the Foreign Exchange Management (establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016.
- **Repayment of borrowings:** Repayment of guarantees or outstanding borrowings of the Indian company should be as per the merger scheme sanctioned by NCLT. NOC from Indian lenders would be required.
- **Compulsory sale of assets not permitted to be acquired:** Merged foreign company would be permitted to acquire, transfer or hold any asset in India subject to FEMA regulations. If the regulations do not permit, such asset needs to be sold by the merged foreign company within a period of two years from sanction of the merger scheme.

Other provisions

- **Valuation:** Valuation for inbound and outbound mergers is required to be undertaken as per internationally accepted pricing methodology for valuation of shares at an arm's length. This needs to be certified by a Chartered Accountant (CA), public accountant or authorised merchant banker.
- **Consideration:** Any compensation paid by Merged Company to the holder of security of the merging Indian or foreign company, as the case may be, can be paid, in accordance with the scheme sanctioned by the NCLT.
- **Reporting obligation:** Reporting obligations are vested with the respective merged Indian and foreign companies, as the case may be, in specified formats (yet to be prescribed by RBI).
- **Deemed approval:** Deemed prior approval for any transaction on account of a cross-border merger undertaken in accordance with the Regulations.

- **Other Approval:** Any prior approval required for cross-border merger from any other regulator needs to be completed as per the respective regulation;
- **Certification:** Certificate from the Managing Director/Whole Time Director and Company Secretary (if available), ensuring compliance to these Regulations needs to be furnished along with the application made to the NCLT.

Our comments

With the RBI notification in place, cross-border mergers are now a reality. Deemed approval status to cross-border mergers (undertaken in accordance with the regulations) would facilitate curtailing a material process time for completion of the merger process and is a welcome move. The regulation has removed reference to demerger transactions, which formed part of the draft notification. This brings in consistency with the provisions of the Companies Act. Outbound merger makes its mark for the first time in the history of Indian legislation. However, the issue of specific tax neutrality of such mergers remain a concern.

© 2018 Grant Thornton India LLP. All rights reserved.