

## India's Cross-Border Merger Regulations, 2018: An Overview

### 1. Introduction

A cross-border merger is a merger, amalgamation or arrangement between an Indian and a foreign company. Such deals were a part of the Indian corporate landscape even when the old law, Companies Act, 1956 was in force. However, the scope was limited as only inbound mergers were allowed. The new law, Companies Act, 2013 (“**Act**”) has now made outbound mergers possible, but with a caveat. Pursuant to Section 234 of the Act, foreign companies from only certain jurisdictions<sup>1</sup> notified by the Indian government can be the “transferee company”. Subsequently, the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 (“**CAA Rules**”) were enacted to facilitate the sanctioning of both inbound and outbound mergers and other arrangements before the National Company Law Tribunal (“**NCLT**”). Thereafter, the Reserve Bank of India (“**RBI**”) also notified the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 (“**CMR**”) in order to address specific issues that may arise in such cross-border deals.

This newsletter aims to describe selective key provisions of CMR for inbound and outbound mergers in India.

### 2. Key Provisions

CMR defines an inbound merger as a merger between an Indian and a foreign company where the resultant company is an Indian company and which takes over the assets and liabilities of the merging companies. An outbound merger is a merger between an Indian and a foreign company where a foreign entity is the resultant company. All cross-border mergers pending as of March 20, 2018 shall be governed by these regulations. There is also a transition period of two years for such cross-border merger transactions to adhere with foreign exchange management law requirements. Some key provisions pertaining to both types of mergers are discussed below.

#### 2.1 Inbound merger

In an inbound merger, generally, the resultant entity can transfer or issue securities<sup>2</sup> to any person resident outside India provided the transfer takes place as per the entry routes, pricing guidelines, sectoral caps/investment limits and reporting requirements issued by RBI.<sup>3</sup> Most foreign investment in India is “automatic” i.e., where no prior investment approval is required; however, certain sectors do require permission and when the investment is beyond the scope of what is permitted automatically, it is essential to secure a government approval. The pricing varies where the investment is in listed or unlisted companies. For the former, it must be worked out

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<sup>1</sup> These include jurisdictions (a) whose securities regulator is a member of International Organization of Securities Commission, or (b) who have signed a bilateral MoU with Securities and Exchange Board of India, or (c) whose central bank is member of Bank of International Settlements, or (d) which have not been identified in the public statement of Financial Action Task Force (FATF) as jurisdictions (i) having deficiencies in anti-money laundering or combating terrorist financing, or (ii) which have not made sufficient progress to address the deficiencies, or (iii) failed to commit to an action plan with FATF to address them

<sup>2</sup> These can be equity shares, debentures, preference shares, share warrants issued by the Indian company

<sup>3</sup> These are covered under Foreign Exchange Management (Transfer or Issue of Security by a Person resident outside India) Regulations, 2017

according to Securities Exchange Board of India guidelines and for the latter, it must be as per internationally accepted valuation methods, which include discounted cash flow, net asset value, market price, profit earning capacity value and weighted average. If the foreign company is a joint venture or wholly-owned subsidiary of the Indian company, the transfer must conform to conditions prescribed under relevant RBI regulations.<sup>4</sup>

The Act mandates that every merger must be approved by NCLT which can take about six months, though some time for potential delays should be factored in. Upon receipt of the approval, every office of the foreign entity located outside India will be deemed to be a branch office of the resultant Indian company and such branches can be funded from India, within the prescribed thresholds.

If the offshore merging companies have taken any borrowings or issued guarantees, these will become liabilities of the resultant entity which have to be recorded in its books of accounts. In fact, they will have to be treated as external commercial borrowings (“ECBs”) and conform to RBI’s Master Direction on ECB within two years from the approval of the merger. ECBs are commercial loans taken by Indian entities from eligible foreign entities (who could be equity holders) which must adhere to certain parameters such as minimum maturity period (3-10 years, depending on the type of borrowing), permitted and non-permitted end-uses and other conditions. Further, all legal proceedings pending by or against the foreign company in any court, will continue by or against the resultant Indian company after the merger.

## 2.2 Outbound merger

A person resident in India can acquire or hold securities of the resultant foreign company in accordance with relevant RBI regulations. Once the merger is approved, the guarantees or borrowings of the Indian company become liabilities of the resultant foreign company who must, consequently, repay them in accordance with approved merger scheme. For instance, if the scheme allows purchase of shares of dissenting shareholders of the Indian company, it will also become liability of the resultant company. Further, all legal proceedings pending by or against the Indian company will continue by or against the resultant foreign company after the merger.

Indian offices of the transferor Indian company will be deemed to be a branch office of the resultant foreign company. Typically, a branch is registered in India as a place of business of a foreign entity. The eligibility criteria, registration process and compliances of a branch are covered under applicable RBI regulations.<sup>5</sup> Generally, a foreign entity will apply to an authorized bank to obtain approval letter to set up a branch office. However, under CMR this approval is deemed to be given provided the concerned branch conforms to all compliances prescribed by these regulations, which are not detailed here. The operations of a branch are narrower than a corporation and it cannot undertake anything outside the scope of the listed activities. These include:

- export/import of goods,

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<sup>4</sup> These conditions are mentioned under Regulation 6 of Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004

<sup>5</sup> This is Foreign Exchange Management (Establishment in India of a Branch Office or Liaison Office or a Project Office or any other place of business) Regulations, 2016

- provide professional consultancy services,
- do research work on resultant company's business activities,
- promote technical and financial collaboration with Indian companies,
- act as resultant company's representative,
- act as buying/selling agent of resultant company's goods in India,
- provide information technology and software development services,
- provide technical support for the goods supplied,
- represent a foreign airline/shipping company.

A branch can execute a lease for only 5 years. If the term is beyond that, RBI's approval is necessary.

### **2.3 Deemed approval**

Section 234 of the Act read with Rule 25A of the CAA Rules provide that every company proposing a cross-border merger must take prior approval from RBI before filing application for sanction to NCLT. CMR has now replaced the mandate with deemed approval. It means that any cross-border merger which adheres to the regulations will be deemed to be approved by RBI. The officer(s), which includes managing or whole-time director or company secretary, of the merging companies must submit a compliance certificate to NCLT to this effect. However, if a transaction does not conform to the CMR, RBI's approval will be necessary. This provision aims to expedite the merger process by reducing delays in sanction of the merger.

### **3. Conclusion**

CMR has consolidated and clarified the foreign exchange provisions concerning cross-border mergers in India. With its coming into force, the rules will allow Indian companies to merge their foreign businesses with their domestic companies while foreign companies could fold up the Indian company into a single entity. While it is early days, but the industry expects that such rules could potentially spur foreign bidders to consider buying Indian assets, particularly those involved in insolvency and bankruptcy proceedings. While this newsletter does not touch upon the tax aspects, yet it is clear that parties will have to carefully analyze the tax impact in all the relevant jurisdictions to ensure that the transaction is tax efficient and minimizes related risks, including possible creation of permanent establishment or PE for foreign resultant entities where having the Indian branch could be considered as having created as a PE. In addition, foreign entities considering outbound mergers must carefully assess ongoing reporting requirements, ability to undertake limited business activities etc. while contemplating their deals. Finally, while "deemed approval" should expedite the process to some extent, it must be noted that this approval is contingent upon compliance of all provisions covered under CMR by the parties.

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