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Research

# Mergers & Acquisitions

An India Legal, Regulatory  
and Tax Perspective

July 2023



Research

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## Contact

For any help or assistance please email us on [conciierge@nishithdesai.com](mailto:conciierge@nishithdesai.com) or visit us at [www.nishithdesai.com](http://www.nishithdesai.com).

## Acknowledgements

### **Prakhar Dua**

prakhar.dua@nishithdesai.com

### **Yogesh Nayak**

yogesh.nayak@nishithdesai.com

### **Harshita Srivastava**

harshita.srivastava@nishithdesai.com

### **Nishchal Joshipura**

nishchal.joshipura@nishithdesai.com

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# Introduction

## I. Overview of the M&A Market

While the merger and acquisition (“M&A”) activity in India was largely resilient during the period 2015-2019, India witnessed a surge with deal values in 2022 where strategic M&A deal volume and value reached all-time highs in India, while dealmaking dropped off in much of the rest of the world<sup>1</sup>. M&A in India was boosted by more than 20 large transactions and reached a record high of USD 107 billion — almost twice that of 2021<sup>2</sup>. One of the largest M&A was the merger of HDFC with HDFC Bank with the deal value pegged at USD 60 Billion which was the biggest in India’s corporate history and was higher than the total value of all deals — USD 52 Billion in 2021. 2022 witnessed some of the largest-ever transactions in the cement, aviation and banking sectors, which were driven by companies looking to either consolidate their positions or enter new segments. Although deal activity in 2022 has been lower than 2021, it has surpassed pre-pandemic levels.<sup>3</sup> The general M&A activity in India is near an all-time high with more companies are doing more deals than ever before.

Sectors such as banking and financial services, IT & ITES, fintech, energy and natural resources represented majority of the deals by volume and value followed by contribution from sectors such as e-commerce, manufacturing, education and aviation.<sup>4</sup> A few of the largest deals include merger of HDFC with HDFC Bank for USD 60 billion, acquisition by Adani Enterprises of Ambuja Cements and ACC Cements for USD 10.5 billion, L&T Infotech’s acquisition of Mindtree at USD 2.2 billion<sup>5</sup>.

## II. Conceptual Overview

In this section, we have briefly explained the different types of M&As that may be undertaken and an overview of certain laws that would be of significance to M&A in India.

### A. Mergers and Amalgamations

The term ‘merger’ is not defined under the Companies Act, 2013 (“CA 2013”) or under Income Tax Act, 1961 (“ITA”). As a concept, ‘merger’ is a combination of two or more entities into one;

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1 <https://www.bain.com/insights/india-m-and-a-report-2023/>.

2 PwC India report, titled ‘Deals in India: Annual Review 2022’.

3 PwC India report, titled ‘Deals in India: Annual Review 2022’.

4 <https://www.granthornton.in/insights/articles/annual-dealtracker-vol-2/> and <https://www.bain.com/insights/india-m-and-a-acquiring-to-transform/>.

5 PwC India report, titled ‘Deals in India: Annual Review 2022’.

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the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but organization of such entity into one business. The possible objectives of mergers are manifold — economies of scale, acquisition of technologies, access to varied sectors/ markets etc. Generally, in a merger, the merging entities would cease to exist and would merge into a single surviving entity.

The ITA does however define the analogous term ‘amalgamation’ as the merger of one or more companies with another company, or the merger of two or more companies to form one company. The ITA goes on to specify certain other conditions that must be satisfied for an ‘amalgamation’ to be eligible for benefits accruing from beneficial tax treatment (discussed in Part VI of this Paper).

Sections 230-234 of CA 2013 (the “**Merger Provisions**”) deal with the schemes of arrangement or compromise between a company, its shareholders and/or its creditors. These provisions are discussed in greater detail in Part II of this Paper. Commercially, mergers and amalgamations may be of several types, depending on the requirements of the merging entities. Although corporate laws may be indifferent to the different commercial forms of merger/amalgamation, the Competition Act, 2002 does pay special attention to the forms.

### I. Horizontal Mergers

Also referred to as a ‘horizontal integration’, this kind of merger takes place between entities engaged in competing businesses which are at the same stage of the industrial process. A horizontal merger takes a company a step closer towards monopoly by eliminating a competitor and establishing a stronger presence in the market. The other benefits of this form of merger are the advantages of economies of scale and economies of scope. These forms of merger are heavily scrutinized by the Competition Commission of India (“CCI”).

### II. Vertical Mergers

Vertical mergers refer to the combination of two entities at different stages of the industrial or production process. For example, the merger of a company engaged in construction business with a company engaged in production of brick or steel would lead to vertical integration. Companies stand to gain on account of lower transaction costs and synchronization of demand and supply. Moreover, vertical integration helps a company move towards greater independence and self-sufficiency.

### III. Congeneric Mergers

A congeneric merger is a type of merger where two companies are in the same or related industries or markets but do not offer the same products. In a congeneric merger, the companies may share similar distribution channels, providing synergies for the merger. The acquiring company and the target company may have overlapping technology or production systems, making for easy integration of the two entities. This type of merger is often resorted to by entities who intend to increase their market shares or expand their product lines.

## 1. Introduction

### IV. Conglomerate Mergers

A conglomerate merger is a merger between two entities in unrelated industries. The principal reason for a conglomerate merger is utilization of financial resources, enlargement of debt capacity, and increase in the value of outstanding shares by increased leverage and earnings per share, and by lowering the average cost of capital.<sup>6</sup> A merger with an unrelated business also helps the company to foray into diverse businesses without having to incur large start-up costs normally associated with a new business.

### V. Cash Merger

In a 'cash merger', also known as a 'cash-out merger', the shareholders of one entity receives cash instead of shares in the merged entity. This is effectively an exit for the cashed-out shareholders.

### VI. Triangular Merger

A triangular merger is often resorted to, for regulatory and tax reasons. As the name suggests, it is a tripartite arrangement in which the target merges with a subsidiary of the acquirer. Based on which entity is the survivor after such merger, a triangular merger may be forward (when the target merges into the subsidiary and the subsidiary survives), or reverse (when the subsidiary merges into the target and the target survives).

## B. Acquisitions

An 'acquisition' or 'takeover' is the purchase by one person, of controlling interest in the share capital or of all or substantially all of the assets and/or liabilities, of the target. A takeover may be friendly or hostile and may be structured either by way of agreement between the offeror and the majority shareholders or purchase of shares from the open market or by making an offer for acquisition of the target's shares to the entire body of shareholders.

Acquisitions may also be made by way of acquisition of shares of the target, or acquisition of assets and liabilities of the target. In the latter case, entire business of the target may be acquired on a going concern basis or certain assets and liabilities may be cherry picked and purchased by the acquirer. The transfer when a business is acquired on a going concern basis is referred to as a 'slump sale' under the ITA. Section 2(42C) of the ITA defines slump sale as a "transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales". The legal and tax considerations of slump sale vis a vis an asset sale is discussed in greater detail in Part VI of this Paper.

Another form of acquisition may be by way of demerger. A demerger is the opposite of a merger, involving the splitting up of one entity into two or more entities. An entity which has more than

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<sup>6</sup> Ibid, note 4, at p. 59

## 1. Introduction

one business, may decide to 'hive off' or 'spin off' one of its businesses into a new entity. The shareholders of the original entity would generally receive shares of the new entity.

In some cases, if one of the business units of a company is financially sick and the other business unit(s) is financially sound, the sick business units may be demerged from the company, thereby facilitating the restructuring or sale of the sick business, without affecting the assets of the healthy business unit(s). Conversely, a demerger may also be undertaken for moving a lucrative business into a separate entity. A demerger may be completed through a court process under the Merger Provisions or contractually by way of a business transfer agreement.

### C. Joint Ventures

A joint venture is the coming together of two or more businesses for a specific purpose, which may or may not be for a limited duration. The purpose of the joint venture may be an entry into a new business, or an entry into a new market (which requires specific skills, expertise or the investment by each of the joint venture parties). Parties can either set up a new company or use an existing entity, through which the proposed business will be conducted.

The parties typically enter into an agreement to set out the rights and obligations of each joint venture party and the broad framework for the management of the company, and such terms are then incorporated in the by-laws of the company for strengthening the enforceability.

# Mergers and Amalgamations: Key Corporate and Securities Laws Considerations

## I. Company Law

The Merger Provisions govern schemes of arrangements between a company, its shareholders and creditors. The Merger Provisions are in fact worded so widely that they provide for and regulate all kinds of corporate restructuring that a company can possibly undertake, such as mergers, amalgamations, demergers, spin-off/ hive off, and every other compromise, settlement, agreement or arrangement between a company and its members and/or its creditors.

### A. Procedure under the Merger Provisions

Since a merger essentially involves an arrangement between companies, those companies which intend to merge must make an application to the National Company Law Tribunal (“NCLT”) having jurisdiction over such company for (i) convening meetings of its respective shareholders and/or creditors; (ii) or seeking dispensation of such meetings basis the consents received in writing from the shareholders and creditors. Basis the NCLT order, either a meeting is convened or dispensed with. If the majority in number, representing 3/4th in value of the creditors or shareholders present and voting at such meeting (if the meeting is held) agree to the merger, then the merger, if sanctioned by the NCLT, is binding on all creditors and shareholders of the company. The Merger Provisions constitute a comprehensive code in themselves, and under these provisions, the NCLT has full power to sanction any alterations in the corporate structure of a company. For example, in ordinary circumstances a company must seek the approval of the NCLT for effecting a reduction of its share capital. However, if a reduction of share capital forms part of the corporate restructuring proposed by the company under the Merger Provisions, then the NCLT has the power to approve and sanction such reduction in share capital and companies will not be required to follow a separate process for reduction of share capital as stipulated under the CA 2013.

### B. Fast track Merger

The Fast Track merger covered under Section 233 of CA 2013 requires approval from shareholders, creditors, the Registrar of Companies, the Official Liquidator and the Regional Director. Under the fast track merger, scheme of merger shall be entered into between the following companies:

## 2. Mergers and Amalgamations: Key Corporate and Securities Laws Considerations

- i. two or more small companies (private companies having paid-up capital of less than INR 100 million and turnover of less than INR 1 billion per last audited financial statements); or
- ii. a holding company with its wholly owned subsidiary; or
- iii. such other class of companies as may be prescribed.

The scheme, after incorporating any suggestions made by the Registrar of Companies and the Official Liquidator, must be approved by shareholders holding at least 90% of the total number of shares, and creditors representing 9/10th in value, before it is presented to the Regional Director and the Official Liquidator for approval. Thereafter, if the Regional Director/ Official Liquidator has any objections, they should convey the same to the central government. The central government upon receipt of comments can either direct NCLT to take up the scheme under Section 232 (general process) or pass the final order confirming the scheme under the Fast Track process.

### C. Cross Border Mergers

Section 234 of the CA 2013 permits mergers between Indian and foreign companies with prior approval of the Reserve Bank of India (“**RBI**”). A foreign company means any company or body corporate incorporated outside India, whether having a place of business in India or not. The following conditions must be fulfilled for a cross border merger:

- i. The foreign company should be incorporated in a permitted jurisdiction which meets certain conditions.
- ii. The transferee company is to ensure that the valuation is done by a recognized professional body in its jurisdiction and is in accordance with internationally accepted principles of accounting and valuation.
- iii. The procedure prescribed under CA 2013 for undertaking mergers must be followed.

The RBI also issued the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 (“**Merger Regulations**”) on March 20, 2018 which provide that any transaction undertaken in relation to a cross-border merger in accordance with the FEMA Regulations shall be deemed to have been approved by the RBI.

## II. Securities Laws

### A. Takeover Code

The Securities and Exchange Board of India (the “**SEBI**”) is the nodal authority regulating entities that are listed or to be listed on stock exchanges in India. The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the “**Takeover Code**”) restricts and regulates the acquisition of shares, voting rights and control in listed companies. Acquisition of shares



## 2. Mergers and Amalgamations: Key Corporate and Securities Laws Considerations

or voting rights of a listed company, entitling the acquirer to exercise 25% or more of the voting rights in the target company or acquisition of control, obligates the acquirer to make an offer to the remaining shareholders of the target company. The offer must be to further acquire at least 26% of the voting capital of the company.<sup>1</sup> Regulation 3 read with Regulation 7 of the Takeover Code. Further, if the acquirer already holds 25% or more but less than 75% of the target company and acquires at least 5% shares or voting rights in the target company within a financial year, it shall be obligated to make an open offer. However, this obligation is subject to the exemptions provided under the Takeover Code. Exemptions from open offer requirement under the Takeover Code include inter alia acquisition pursuant to a scheme of arrangement approved by the NCLT. Further, SEBI has the power to grant exemption or relaxation from the requirements of the open offer under the Takeover Code in the interest of investors and the securities market. Such relaxations or exemptions can be sought by the acquirer by making an application to SEBI.

### B. Listing Regulations

The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“**Listing Regulations**”) provides for a comprehensive framework governing various types of listed securities. Under the Listing Regulations, SEBI has laid down conditions to be followed by a listed company while making an application before the NCLT, for approval of a schemes of merger/ amalgamation/ reconstruction. Certain key provisions under the Listing Regulations applicable in case of a scheme involving a listed company are as follows:

- **Filing of scheme with stock exchanges:** Any listed company undertaking or involved in a scheme of arrangement, must file the draft scheme with the relevant stock exchanges, prior to filing them with the NCLT (as per the process laid down under CA 2013), to seek a no-objection letter from the relevant stock exchanges.<sup>2</sup> In order to file the scheme of arrangement with the relevant stock exchanges, all listed entities would be required to submit valuation report, auditor’s certificate, no-objection certificates from lending scheduled commercial banks/financial institutions.<sup>3</sup>
- **Compliance with securities law:** The listed companies shall ensure that the scheme does not violate, limit or override any of the provisions of the applicable securities law or requirements of the stock exchanges.<sup>4</sup>

1 Regulation 3 read with Regulation 7 of the Takeover Code.

2 Regulation 37(1) of Listing Regulations.

3 SEBI Master Circular No. SEBI/HO/CFD/DIL1/CIR/P/2020/249 dated December 22, 2020; as amended by Circular No. SEBI/HO/CFD/DIL2/CIR/P/2021/0000000657 dated November 16, 2021, Circular No. SEBI/HO/CFD/DIL2/CIR/P/2021/0000000659 dated November 18, 2021; and Circular No. SEBI/HO/CFD/DIL2/CIR/P/2022/11 dated February 01, 2022.

4 Regulation 11 of the Listing Regulations.

## 2. Mergers and Amalgamations: Key Corporate and Securities Laws Considerations

- **Change in shareholding pattern:** The listed companies are required to file the pre and post arrangement shareholding pattern and the capital structure with the stock exchanges as per requirements of the listing authority or stock exchanges of the home country in which the securities are listed.<sup>5</sup>
- Corporate actions pursuant to merger: The listed company needs to disclose to the stock exchanges all information having a bearing on the performance/ operation of the listed entity and/or price sensitive information.<sup>6</sup>

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5 Regulation 69(2) of Listing Regulations; Part I, Para A, 2(e) of the SEBI Master Circular No. SEBI/HO/CFD/DIL1/CIR/P/2020/249 dated December 22, 2020.

6 Regulation 51(1) of Listing Regulations.

# Acquisitions: Key Corporate and Securities Laws Considerations

## I. Company Law

### Acquisition of Shares<sup>1</sup>

Acquisitions may be via acquisition of existing shares of the target, or by subscription to new shares issued by the target.

#### I. Transferability of Shares

Broadly speaking, an Indian company can be set up as a private company or as a public company. A restriction on transferability of shares is inherent to a private company, such restrictions are contained in its articles of association (the byelaws of the company) and are usually in the form of a pre-emptive right in favor of the other shareholders. With the introduction of CA 2013, although shares of a public company are freely transferable, share transfer restrictions for even public companies' shares have been granted statutory sanction.<sup>2</sup> The articles of association may prescribe certain procedures for transfer of shares that must be adhered to in order to effect a transfer of shares. It is therefore advisable for the acquirer of shares of a private company to ensure that the non-selling shareholders (if any) waive their rights of pre-emption and any other preferential rights that they may have under the articles of association. Any transfer of shares, whether of a private company or a public company, must comply with the procedure for transfer specified under its articles of association.

## II. Squeeze Out Provisions

### a. Section 236 of CA 2013

Section 236 of CA 2013, provides that, if a person or group of persons acquire 90% or Specific considerations when shares of an Indian company are acquired by a non-Indian acquirer is briefly addressed in our section on Exchange Control in Chapter V Public company can refuse registration of share transfers pursuant to Section 58(4) of the CA 2013 for a 'sufficient cause' more of the shares of a company by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, then such person(s) shall besides notifying the company of their intention to buy the remaining equity shares of the company, have

1 Specific considerations when shares of an Indian company are acquired by a non-Indian acquirer is briefly addressed in our section on Exchange Control in Chapter V.

2 Public company can refuse registration of share transfers pursuant to section 58(4) of the CA 2013 for a 'sufficient cause'.

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

a right to make an offer to buy out the minority shareholders at a price determined by a registered valuer, which shall be determined based on the fair value of shares of the company after taking into account valuation parameters including return on net worth, book value of shares, earning per share, price earning multiple vis-a-vis the industry average, and such other parameters as are customary for valuation of shares of such companies.<sup>3</sup>

#### b. Section 230 of CA 2013

Section 230 read with Rule 3 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 made effective from February 7, 2020, permits the shareholders of unlisted companies holding at least 75% of the securities (including depository receipts) with voting rights to make an offer for acquisition of any part of the remaining shares in such company, pursuant to an application of compromise or arrangement to be filed before the NCLT. Once NCLT approves such offer for acquisition, the minority shareholders would mandatorily be required to sell their shares to the acquiring shareholder. This method of squeeze-out is only available to unlisted companies and listed companies will be subject to the regulations prescribed by SEBI in this regard.

#### c. Scheme of capital reduction

Section 66 of the CA 2013 permits a company to reduce its share capital and prescribes the procedure to be followed for the same. The scheme of capital reduction under Section 66 of the CA 2013 must be approved by, (i) the shareholders of the company vide a special resolution; and (ii) by the NCLT by an order approving the reduction. When the company applies to the NCLT for its approval, the creditors of the company would be entitled to object to the scheme of capital reduction. The NCLT will approve the reduction only if the debt owed to the objecting creditors is safeguarded/provided for. In addition, the NCLT is also required to give notice of application of reduction of capital to the Central Government and SEBI (in case of a listed company) who will have a period of 3 (three) months to file any objections. Companies will have to mandatorily publish the NCLT order sanctioning the scheme of capital reduction. The framework for reduction of capital under Section 66 (and the erstwhile Section 100 under CA 1956) has been used by companies to provide exit to certain shareholders, as opposed to all shareholders on a proportionate basis. The courts have held that reduction of share capital need not necessarily be amongst all the shareholders of the company.<sup>4</sup>

#### d. New share issuance

Sections 42 and 62 of CA 2013 read with Rule 13 of the Companies (Share Capital and Debenture) Rules 2014 and Rule 14 of Companies (Prospectus and Allotment of Securities) Rules, 2014 prescribe the requirements for any new issuance of shares on a preferential basis (i.e. any

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3 Rule 27 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

4 Sandvik Asia Limited vs. Bharat Kumar Padamsi and Ors [2009]92SCL272(Bom); Elpro International Limited (2009 4 Comp LJ 406 (Bom)).

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

issuance that is not a rights or bonus issue to existing shareholders) by an unlisted company. Some of the important requirements under these provisions are described below:

- The company must engage a registered valuer to arrive at a fair market value of the shares proposed to be issued.<sup>5</sup>
- The issuance must be authorized by the articles of association of the company<sup>6</sup> and approved by a special resolution passed by shareholders in a general meeting,<sup>7</sup> authorizing the board of directors of the company to issue the shares.<sup>8</sup> A special resolution is one that is passed by at least 3/4th of the shareholders present and voting at a meeting of the shareholders. If shares are not issued within 12 months from date of passing of such special resolution, the resolution will lapse and a fresh resolution will be required for the issuance.<sup>9</sup>
- The explanatory statement to the notice for the general meeting should contain key disclosures pertaining to the object of the issue, pricing of shares including the relevant date for calculation of the price, shareholding pattern, change of control, if any, pre-issue and post-issue shareholding pattern of the company, whether the promoters/directors/key management persons propose to acquire shares as part of such issuance, etc.<sup>10</sup>
- Shares must be allotted within a period of 60 days of receipt of application money, failing which the money must be returned within a period of 15 days thereafter. Interest is payable @ 12% p.a. from the 60th day.<sup>11</sup>
- These requirements apply to equity shares, fully convertible debentures, partly convertible debentures or any other financial instrument convertible into equity.<sup>12</sup>

#### e. Issue of shares with differential voting rights<sup>13</sup>

The CA 2013 also allows for issuance of equity shares with differential voting rights as to dividend, voting or otherwise, provided that the company complies with the rules prescribed in this regard,<sup>14</sup> which require that:

- The articles of association of the company authorizes issue of shares with differential voting rights;
- The issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders;

<sup>5</sup> Section 62(1) (c) of CA 2013.

<sup>6</sup> Rule 13(2)(a) of the Companies (Share Capital and Debenture) Rules 2014.

<sup>7</sup> Rule 13(2)(b) of the Companies (Share Capital and Debenture) Rules 2014.

<sup>8</sup> Rule 13(1) of the Companies (Share Capital and Debenture) Rules 2014.

<sup>9</sup> Rule 13(2)(f) of the Companies (Share Capital and Debenture) Rules 2014.

<sup>10</sup> Rule 13(2)(d) of the Companies (Share Capital and Debenture) Rules 2014.

<sup>11</sup> Section 42(6) of CA 2013.

<sup>12</sup> Rule 13(1) of the Companies (Share Capital and Debenture) Rules.

<sup>13</sup> Section 43 of CA 2013.

<sup>14</sup> Rule 4 of the Companies (Share Capital and Debenture) Rules, 2014.

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

- The voting power in respect of the shares with differential rights shall not exceed 74% of the total voting power including voting power in respect of equity shares with differential rights issued at any point in time;
- The company shall not have defaulted in filing financial statements and annual returns for 3 financial years immediately preceding the financial year in which it has decided to issue shares with differential voting rights. Private companies may be exempt from these requirements if their memorandum and articles of association so provide.

#### **f. Limits on acquirer**

Section 186 of the CA 2013 provides for certain limits on inter-corporate loans and investments. An acquirer that is an Indian company might acquire by way of subscription, purchase or otherwise, the securities of any other body corporate up to (i) 60% of the acquirer's paid up share capital and free reserves and securities premium, or (ii) 100% of its free reserves and securities premium account, whichever is higher. However, the acquirer is permitted to acquire shares beyond such limits, if it is authorized by its shareholders vide a special resolution passed in a general meeting. These limits are not applicable in case of purchase of securities of a wholly owned subsidiary.

#### **g. Asset/ Business Purchase**

Besides share acquisition, the acquirer may also decide to acquire the business of the target which could typically entail acquisitions of all or specific assets and liabilities of the business for a pre-determined consideration. Therefore, depending upon the commercial objective and considerations, an acquirer may opt for (i) an asset purchase, whereby one company purchases all or part of the assets of the other company; or (ii) a slump sale, whereby one company acquires the 'business undertaking' of the other company on a going concern basis i.e., acquiring all assets and liabilities of such business.

Under CA 2013, the sale, lease or other disposition of the whole or substantially the whole of any undertaking of a company (other than a private company<sup>15</sup>) requires the approval of the shareholders through a special resolution.<sup>16</sup> The term "undertaking" means an undertaking in which the investment of the company exceeds 20% of its net worth as per the audited balance sheet of the preceding financial year, or an undertaking which generated 20% of the total income of the company during the previous financial year. Further this requirement applies if 20% or more of the undertaking referred to above is sought to be sold, leased or disposed of.

An important consideration for these options is the statutory costs involved i.e., stamp duty, tax implications etc. We have delved into this in brief in our chapter on 'Taxes and Duties'.

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<sup>15</sup> Private companies are exempted from this provision with effect from June 2015.

<sup>16</sup> Section 180 of CA 2013.

## II. Other Securities Laws

### A. Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (“ICDR Regulations”)

If the acquisition of an Indian listed company involves the issue of new equity shares or securities convertible into equity shares (“**Specified Securities**”) by the target (issuer) to the acquirer, the provisions of Chapter V (“**Preferential Issue Regulations**”) contained in ICDR Regulations will apply (in addition to company law requirements mentioned above). We have highlighted below some of the important provisions of the Preferential Issue Regulations.

#### I. Pricing of the Issue

The Preferential Issue Regulations set a floor price for an issuance. If the equity shares of the issuer have been listed on a recognized stock exchange for a period of 90 trading days or more as on the relevant date<sup>17</sup>, the floor price of the equity shares to be allotted pursuant to preferential issue shall be higher of the volume weighted average prices of the stock of the company either (a) 90 trading days; or, (b) 10 trading days preceding the relevant date.<sup>18</sup> If the equity shares of the issuer have been listed on a recognized stock exchange for a period of less than 90 trading days as on the relevant date, the floor price of the shares shall be higher of (a) the price at which the equity shares were issued via initial public offer, or value of price per share arrived under the scheme pursuant to which the equity shares of the issuer were listed; or (b) the average of the volume weighted average prices of the stock of the company during the period the stock has been listed prior to the relevant date; or (c) the average of 10 trading days volume weighted average prices of the related equity shares quoted on a recognized stock exchange during the two weeks preceding the relevant date.<sup>19</sup>

#### II. Lock-in

Securities issued to the acquirer (who is not a promoter of the target) are locked-in for a period of 6 months<sup>20</sup> from the date of trading approval.

The date of trading approval is the latest date when approval for trading is granted by all stock exchanges on which the securities of the company are listed. Further, if the acquirer holds any equity shares of the target prior to such preferential allotment, then such prior holding

17 ‘relevant date’ in case of (a) preferential issue of equity shares shall be 30 (thirty) days prior to the date on which the shareholders meeting is held to consider the proposed preferential issue (in case of a preferential issue pursuant to a resolution plan under Insolvency and Bankruptcy Code, 2016 or any resolution of stressed assets framework specified by RBI, the relevant date shall be the date of approval of the resolution plan or the corporate debt restructuring package); and, (b) in case of a preferential issue of convertible securities, either the relevant date referred in (a) or a date 30 (thirty) days prior to the date on which the holders of convertible securities become entitled to apply for equity shares.

18 Regulation 164(1) of ICDR Regulation.

19 Regulation 164(2) of ICDR Regulation.

20 Regulation 167 of the ICDR Regulation.

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

will be locked-in for a period of 90 trading days from the date of the trading approval<sup>21</sup>. If securities are allotted on a preferential basis to promoters/ promoter group,<sup>22</sup> they are locked-in for a period of 18 months from the date of trading approval, subject to a limit of 20% of the total capital of the company.<sup>23</sup>

The locked-in securities may be transferred amongst promoter/ promoter group or any person in control of the company, subject to the transferee being subject to the remaining period of the lock-in.<sup>24</sup>

### III. Exemption to Court Approved Merger

The Preferential Issue Regulations shall not apply in case a preferential allotment of shares is made pursuant to a scheme of arrangement approved by the NCLT under the Merger Provisions discussed above.<sup>25</sup>

## B. Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the “Takeover Code”)

If an acquisition is contemplated by way of issue of new shares, or the acquisition of existing shares or voting rights, of a listed company, to or by an acquirer, the provisions of the Takeover Code are applicable. The Takeover Code regulates both direct and indirect acquisitions of shares<sup>26</sup> or voting rights in, and control<sup>27</sup> over a target company.<sup>28</sup> The key objectives of the Takeover Code are to provide the shareholders of a listed company with adequate information about an impending change in control of the company or substantial acquisition by an acquirer and provide them with an exit option (albeit a limited one) in case they do not wish to retain their shareholding in the company.

21 Regulation 167(6) of the ICDR Regulation.

22 The terms ‘promoter’ and ‘promoter group’ are defined in great detail by the ICDR Regulations. Generally speaking, promoters would be the persons in over-all control of the company or who are named as promoters in the prospectus of the company. The term promoter group has an even wider connotation and would include immediate relatives of the promoter. If the promoter is a company, it would include, a subsidiary or holding company of that company, any company in which the promoter holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the promoter, etc.

23 Regulation 167 of the ICDR Regulation.

24 Regulation 168 of the ICDR Regulation.

25 Regulation 158 of the ICDR Regulation.

26 The term ‘shares’ means shares in the equity share capital of a target company carrying voting rights and includes any security which would entitle the holder thereof to exercise voting rights. The term also includes all depository receipts carrying an entitlement to exercise voting rights in the target company. Therefore, acquisition of depository receipts entitling the acquirer to exercise voting rights in the target company may trigger the open offer obligation.

27 The term ‘control’ includes the right to appoint the majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by the virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

28 A ‘Target Company’ has been defined as a company and includes a body corporate or corporation established by a Central Legislation, State Legislation or Provincial Legislation for the time being in force, whose shares are listed on a stock exchange.



### 3. Acquisitions: Key Corporate and Securities Laws Considerations

#### I. Mandatory offer

Under the Takeover Code, an acquirer is mandatorily required to make an offer to acquire shares from the other shareholders in order to provide an exit opportunity to them prior to consummating the acquisition, if the acquisition fulfils the conditions as set out in Regulations 3, 4 and 5 of the Takeover Code. Under the Takeover Code, the obligation to make a mandatory open offer by the acquirer<sup>29</sup> is triggered in the following events:

##### a. Initial trigger

If the acquisition of shares or voting rights in a target company entitles the acquirer along with the persons acting in concert (“PAC”) to exercise 25% or more of the voting rights in the target company.

##### b. Creeping Acquisition

If the acquirer already holds 25% or more and less than 75% of the shares or voting rights in the target, then any acquisition of additional shares or voting rights that entitles the acquirer along with PAC to exercise more than 5% of the voting rights in the target in any financial year.

It is important to note that the 5% limit is calculated on a gross basis i.e., aggregating all purchases and without factoring in any reduction in shareholding or voting rights during that year or dilutions of holding on account of fresh issuances by the target company. If an acquirer acquires shares along with other subscribers in a new issuance by the company, then the acquisition by the acquirer will be the difference between its shareholding pre and post such new issuance.

It should be noted that an acquirer (along with PAC) is not permitted to make a creeping acquisition beyond the statutory limit of nonpublic shareholding in a listed company i.e., 75%.<sup>30</sup>

##### c. Acquisition of ‘Control’

*If the acquirer acquires control over the target*

Regardless of the level of shareholding, acquisition of ‘control’ of a target company is not permitted, without complying with the mandatory offer obligation under the Takeover Code. What constitutes ‘control’ is most often a subjective test and is determined on a case-to-case basis. For the purpose of the Takeover Code, ‘control’ has been defined to include:

<sup>29</sup> See Annexure 2 for the meaning of persons acting in concert.

<sup>30</sup> Maximum permissible non-public shareholding is derived based on the minimum public shareholding requirement under the Securities Contracts (Regulations) Rules 1957 (“SCRR”). Rule 19A of SCRR requires all listed companies (other than public sector companies) to maintain public share- holding of at least 25% of share capital of the company. Thus, by deduction, the maximum number of shares which can be held by promoters i.e. Maximum permissible nonpublic shareholding) in a listed companies (other than public sector companies) is 75% of the share capital.

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

- Right to appoint majority of the directors;
- Right to control the management or policy decisions exercisable by a person or PAC, directly or indirectly, including by virtue of their shareholding or management rights or shareholder's agreements or voting agreements or in any other manner.
- Over time, the definition of 'control' has been subject to different assessments and has turned out to be, quite evidently, a grey area under the Takeover Code. The Supreme Court order in case of SEBI vs. Subhkam Ventures Private Limited<sup>31</sup> — which accepted an out-of-court settlement between the parties — left open the legal question as to whether negative control would amount to 'control' under the Takeover Code. In fact, the Supreme Court had ruled that SAT ruling in this case (against which SEBI had appealed before the Supreme Court) which ruled that 'negative control' would not amount to 'control' for the purpose of Takeover Code, should not be treated as precedent. With no clear jurisprudence on the subject-matter, each veto right would typically be reviewed from the commercial parameters underlying such right and its impact on the general management and policy decisions of the target company. SEBI, in light of Jet-Eti had transaction,<sup>32</sup> had indicated its plans to introduce new guidelines to define 'bright lines' to provide more clarity as regards 'change in control' in cases of mergers and acquisitions by issuing a discussion paper.<sup>33</sup> However, SEBI finally decided not to go ahead with the bright line test for determination of acquisition of 'control' and concluded that it needs to be determined on case-to-case basis.<sup>34</sup>

#### i. Indirect Acquisition of Shares or Voting Rights

For an indirect acquisition obligation to be triggered under the Takeover Code, the acquirer must, pursuant to such indirect acquisition be able to direct the exercise of such percentage of voting rights or control over the target company, as would otherwise attract the mandatory open offer obligations under the Takeover Code. This provision was included to prevent situations where transactions could be structured in a manner that would side-step the obligations under Takeover Code. Further, if:

- i. the proportionate net asset value of the target company as a percentage of the consolidated net asset value of the entity or business being acquired; or
- ii. the proportionate sales turnover of the target company as a percentage of the consolidated sales turnover of the entity or business being acquired; or
- iii. the proportionate market capitalisation of the target company as a percentage of the enterprise value for the entity or business being acquired; is in excess of 80%, on the basis of the most recent audited annual financial statements, then an indirect acquisition would be regarded as a direct acquisition under the Takeover Code for the purposes of the timing of the offer, pricing of the offer etc.

31 SAT Appeal No. 8 of 2009, Date of decision: January 15, 2010.

32 [http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-singleview/article/sebi-clears-jet-eti-had-deal.html?no\\_cache=1&cHash=fa0e9004624747f4ea1dad57cba60bad](http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-singleview/article/sebi-clears-jet-eti-had-deal.html?no_cache=1&cHash=fa0e9004624747f4ea1dad57cba60bad).

33 Discussion Paper on "Brightline Tests for Acquisition of 'Control' under SEBI Takeover Regulations" available at [https://www.sebi.gov.in/sebi\\_data/attachdocs/1457945258522.pdf](https://www.sebi.gov.in/sebi_data/attachdocs/1457945258522.pdf).

34 [https://www.business-standard.com/article/economy-policy/sebi-scarps-bright-line-control-test-proposal-117090801010\\_1.html](https://www.business-standard.com/article/economy-policy/sebi-scarps-bright-line-control-test-proposal-117090801010_1.html).

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

#### Voluntary open offer

An acquirer who holds between 25% and 75% of the shareholding/ voting rights in a company is permitted to voluntarily make a public announcement of an open offer for acquiring additional shares of the company subject to their aggregate shareholding after completion of the open offer not exceeding 75%.<sup>35</sup> In case of a voluntary offer, the offer must be for at least 10% of the voting rights in the target company, but the acquisition should not result in a breach of the maximum non-public shareholding limit of 75%. As per SEBI's Takeover Code Frequently Asked Questions, any person holding less than 25% shareholding/voting rights can also make a voluntary open offer for acquiring additional shares. Any person who has been declared as a willful defaulter or is a fugitive economic offender cannot make an open offer or enter into any transaction that would attract obligations to make a public announcement of open offer.<sup>36</sup>

#### 2. Minimum Offer Size

##### i. Mandatory Offer<sup>37</sup>

Open offer for acquiring shares must be for at least 26% of the shares of the target company. It is also possible for the acquirer to provide that the offer to acquire shares is subject to a minimum level of acceptance.<sup>38</sup>

##### ii. Voluntary Open Offer<sup>39</sup>

In case of a voluntary open offer by an acquirer holding 25% or more of the shares/voting rights, the offer must be for at least 10% of the voting rights in the target company. While there is no maximum limit, the shareholding of the acquirer post acquisition should not exceed 75%. In case of a voluntary offer made by a shareholder holding less than 25% of shares or voting rights of the target company, the minimum offer size is 26% of the total shares of the company.

##### iii. Pricing of Offer

Regulation 8 of the Takeover Code sets out the parameters to determine offer price to be paid to the public shareholders, which is the same for a mandatory open offer as well as a voluntary open offer. There are certain additional parameters prescribed for determining the offer price when the open offer is made pursuant to an indirect acquisition. Please see Annexure 2 for the parameters as prescribed under Regulation 8 of the Takeover Code. It is important to note that an acquirer cannot reduce the offer price but an upward revision of offer price is permitted, subject to certain conditions.

##### iv. Competitive Bid/Revision of offer/bid

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<sup>35</sup> Regulation 6(1) of Takeover Code.

<sup>36</sup> Regulation 6A and 6B of Takeover Code.

<sup>37</sup> Regulation 7 (1) of Takeover Code.

<sup>38</sup> Regulation 19 of Takeover Code.

<sup>39</sup> Regulation 7 (2) of Takeover Code.

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

The Takeover Code also permits a person other than the acquirer (the first bidder) to make a competitive bid, by a public announcement, for the shares of the target company. This bid must be made within 15 (fifteen) working days from the date of the detailed public announcement of the first bidder. The competitive bid must be for at least the number of shares held or agreed to be acquired by the first bidder (along with PAC), plus the number of shares that the first bidder has bid for. Each bidder (whether a competitive bid is made or not) is permitted to revise his bid, provided such revised terms are more favourable to the shareholders of the target company.<sup>40</sup> The revision can be made up to 3 (three) working days prior to the commencement of the tendering period.

#### v. Take private mechanism

The SEBI (Delisting of Equity Shares) Regulations, 2021 (“**SEBI Delisting Regulations**”) prescribe the method and conditions for delisting of a company. The SEBI Delisting Regulations allow an acquirer in addition to the promoter of the company to initiate delisting of such company. Pursuant to Regulation 5A of the Takeover Code, an acquirer may delist the company pursuant to an open offer in accordance with the SEBI Delisting Regulations provided that the acquirer declares upfront his intention to delist. Prior to the inclusion of Regulation 5A, an open offer under the Takeover Regulations could not be clubbed with a delisting offer, making it burdensome for acquirers to delist the company in the future.

The Takeover Code provided for a 1 year cooling off period between the completion of an open offer under the Takeover Code and a delisting offer in situations where on account of the open offer the shareholding of the promoters exceeded the maximum permissible non-public shareholding of 75%.<sup>41</sup> This restriction is not affected by Clause 5A in that the acquirer will continue to be bound by this restriction if the acquirer’s intent to delist the company is not declared upfront at the time of making the detailed public statement.

### 3. Listing Regulations

On September 2, 2015, the Listing Regulations were notified and constitute the applicable law in this domain. The Listing Regulations provide a comprehensive framework governing various types of listed securities.

Regulation 30 of Listing Regulations deals with disclosure of material events by the listed entity whose equity and convertibles securities are listed. Such entity is required to make disclosure of events specified under Schedule III of the Listing Regulations. The Listing Regulations divide the events that need to be disclosed broadly in two categories. The events that have to be necessarily disclosed without applying any test of materiality are indicated in Para A of Schedule III of the Listing Regulation. Para B of Schedule III indicates the events that should be disclosed by the listed entity, if considered material.

<sup>40</sup> Regulation 20 of Takeover Code.

<sup>41</sup> Regulation 7(5) of the Takeover Code.

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

#### 4. SEBI (Prohibition of Insider Trading) Regulations, 2015 (“PIT Regulations”)

The PIT Regulations prohibit the following in case of a listed company (or a company that is proposed to be listed):

- i. an insider from communicating unpublished price sensitive information (“UPSI”);
- ii. any person from procuring UPSI from an insider; and,
- iii. an insider from trading in securities<sup>42</sup> when in possession of UPSI.

Therefore, the PIT prohibits the dissemination as well as the receipt of UPSI.

- i. Who is an insider?

**Insider:** Under the PIT Regulations, an ‘insider’ is a person who is (i) a connected person; or (ii) in possession of or having access to UPSI.<sup>43</sup>

**Connected Person:** A connected person is one who is directly or indirectly associated with the company (i) by reason of frequent communication with its officers; or (ii) by being in a contractual, fiduciary or employment relationship; or (iii) by holding any position including a professional or business relationship with the company whether temporary or permanent that allows such person, directly or indirectly, access to UPSI or is reasonably expected to allow such access.<sup>44</sup>

Therefore, any person who has any connection with the company that is expected to put him in possession of UPSI is considered to be a connected person. Persons who do not seemingly occupy any position in a company but are in regular touch with the company will also be covered. Certain categories of persons are all deemed to be connected, such as ‘immediate relatives’<sup>45</sup>, a holding, associate or subsidiary company, etc.

- ii. What is Unpublished Price Sensitive Information?<sup>46</sup>

UPSI means any information relating to a company or its securities, directly or indirectly, that is not generally available, and which upon becoming available is likely to materially affect the price of the securities. It includes: financial results; dividends; change in capital structure; mergers, demergers, acquisitions, de-listing, disposals and expansion of business and such other transactions; and changes in key managerial personnel. The term ‘generally available’<sup>47</sup> means information that is accessible to the public on a non-discriminatory basis

42 For the purpose of the PIT Regulations the term ‘securities’ does not include units of mutual funds.

43 Regulation 2(g) of the PIT Regulation.

44 Regulation 2(d) of the PIT Regulation.

45 Regulation 2(f) of the PIT Regulations, a spouse of a person, parent, sibling, and child of such person or of the spouse, any of whom is dependent financially on such person, or consults such person in taking decisions relating to trading in securities.

46 Regulation 2 (n) of the PIT Regulations.

47 Regulation 2(e) of the PIT Regulation.

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

#### iii. Defenses/Exceptions

The communication of UPSI by an insider and the procurement of UPSI by a person from an insider is permitted if such communication, procurement is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.<sup>48</sup> The following are valid defenses available to a person who trades in securities when in possession of UPSI:<sup>49</sup>

#### General

An off-market transaction or a block deal between persons who

- were in possession of the same UPSI (without being in breach of Regulation 3 and the UPSI was not obtained under Regulation 3(3)); and
- both counterparties made a conscious and informed trade decision.

The transaction was carried out pursuant to a statutory or a regulatory obligation to carry out a bona fide trade.

The transaction was undertaken pursuant to exercise of stock options in respect of which the exercise price was pre-determined in compliance of applicable regulations.

#### Specifically for non-individual insiders

- Individuals who executed the trade were different from individuals in possession of UPSI and were not in possession of such UPSI; or
- Chinese wall arrangements were in place and there was no leakage of information and the PIT Regulations were not violated; or
- Trades were made pursuant a trading plan.

Therefore, as long as the board is of the informed opinion that the transaction is in the best interest of the company, due diligence may be lawfully conducted. In case a particular transaction does not entail making an open offer to the public shareholders, the board of directors would be required to cause public disclosures of the UPSI prior to the proposed transaction to rule out any information asymmetry in the market. Additionally, a duty has been cast on the board of the company to cause the parties to execute confidentiality and non-disclosure agreements for the purpose of this provision. Therefore, introduction of Regulation 3(3) under the PIT Regulations has amply clarified that the communication or procurement of UPSI for the purpose of due diligence shall be permitted, subject to the conditions set out in the PIT Regulations.

#### iv. Trading plans<sup>50</sup>

A key change in the framework of PIT Regulations is the introduction of trading plans. Typically, 'insiders' who are liable to possess UPSI round the year are permitted

48 Regulation 3(1) of the PIT Regulation.

49 Regulation 4(1) of the PIT Regulation.

50 Regulation 5 of the PIT Regulation.

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

to formulate trading plans with appropriate safeguards. Every trading plan must cover a period of at least a year, must be reviewed and approved by the compliance officer of the company and then publicly disclosed. Trading cannot begin for a period of 6 months after the plan is publicly disclosed. Trading plans are a defense and do not provide absolute immunity from investigation under the PIT Regulations.

#### v. Due-Diligence Carve-Out

The PIT Regulations contain a specific carveout for communication and procurement of information (conduct of due-diligence) in connection with transactions involving mergers and acquisitions.<sup>51</sup> Therefore, based on whether or not a transaction entails making an open offer under Takeover Code, information may be communicated, provided, allowed access to or procured on the following conditions:

#### **Open Offer Obligation under Takeover Code**

Where the board of directors of the company is of the informed opinion that the proposed transaction is in the best interest of the listed company.

#### **No Open Offer Obligation under Takeover Code**

Where the board of directors of the listed company is of the informed opinion that the proposed transaction is in the best interest of the listed company. Information that constitutes UPSI is to be made generally available at least 2 trading days prior to the proposed transaction being effected in such form as the board of directors may determine to be adequate and fair to cover all relevant and material facts.

#### vi. Disclosures

A significant aspect of the insider trading norms is disclosure requirements for different categories of persons involved in the affairs of the company. It is important to bear in mind that going forward, every promoter, member of promoter group, designated persons, key managerial personnel and director of a company would be required to disclose to the company his holding of securities of the company as on date of appointment/date of notification of the PIT Regulations i.e., May 15, 2015. More importantly, every promoter, member of promoter group, designated persons or director would be required to make continual disclosures (within 2 trading days of such transaction) in case the traded value of securities over a calendar quarter exceeds the monetary threshold of INR 10 lakhs or such other value as may be specified. The company is also required to notify the stock exchanges in case such transactions by the promoter, employee or director exceeds this monetary threshold or in case of any incremental changes after such disclosure within 2 days of receipt of such information. These records will be required to be maintained by the company for at least 5 years.<sup>52</sup>

<sup>51</sup> Regulation 3(3) of the PIT Regulation.

<sup>52</sup> Regulation 7 (1) of the PIT Regulation.

### 3. Acquisitions: Key Corporate and Securities Laws Considerations

#### vii. Code of Conduct and Fair Disclosures

The board of every company is required to formulate and publish a code of practices and procedures to be followed for fair disclosure of UPSI in accordance with the principles set out in Schedule A to the PIT Regulations. Schedule A of the PIT Regulations sets out certain minimum standards such as equality of access to information, publication of policies such as those on dividend, inorganic growth pursuits, calls and meetings with analysts, publication of transcripts of such calls and meetings etc.<sup>53</sup> Additionally, the board of directors of every listed company and the board of directors or head(s) of the organisation of every intermediary shall ensure that the chief executive officer or managing director of every listed company and market intermediary shall formulate a code of conduct to regulate, monitor and report trading by designated persons and immediate relatives of designated persons.<sup>54</sup>

#### viii. Compliance officer

The PIT Regulations have enhanced the role of a compliance officer's role with respect to monitoring and regulating trading by employees and connected persons, in particular monitoring and approving trading plans. The PIT Regulations prescribe specific qualification criteria for a compliance officer who shall report to the board of directors of the company or the head of the organization, as the case may be.

#### ix. Pre-clearance of trades

A condition may be imposed on the insiders that they can deal in the securities of the company only after obtaining a prior approval in accordance with the procedure and policy prescribed by the company in that regard. In addition, it may also be prescribed that a preapproved trade will have to be undertaken within the stipulated time period, failing which the approval would lapse.

#### x. Notional trading windows

Usually, the trading windows are closed to eliminate any risk of insider trading and monitor compliant trading within a company. The trading window shall be closed when the compliance officer determines that a designated person or class of designated persons can reasonably be expected to have possession of unpublished price sensitive information. Trading restriction period shall be made applicable from the end of every quarter till 48 hours after the declaration of financial results.

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<sup>53</sup> Regulation 8 of the PIT Regulation.

<sup>54</sup> Regulation 9 of the PIT Regulation.



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**3. Acquisitions: Key Corporate and Securities Laws Considerations****xi. Chinese Walls**

To prevent the misuse of confidential information the organization/firm shall adopt a 'Chinese Wall' policy which separates those areas of the organization/firm which routinely have access to confidential information, from those areas which deal with sale/marketing/ investment advice or other departments providing support services. In order to monitor Chinese Wall procedures and trading in client securities based on UPSI, the organization/firm shall restrict trading in certain securities and designate such list as restricted/grey list. Securities of a listed company shall be put on the restricted/grey list if the organization/firm is handling any assignment for the listed company and is privy to UPSI.

# Competition Law

The Competition Act, 2002 (“**Competition Act**”) which replaced the Monopolies and Restrictive Trade Practices Act, 1969 primarily covers (i) anti-competitive agreements (Section 3), (ii) abuse of dominance (Section 4), and (iii) combinations (Section 5, 6, 20, 29, 30 and 31).

The Competition Commission of India (Procedure in regard to the Transaction of Business relating to Combinations) Regulations, 2011 (“**Combination Regulations**”) govern the manner in which the CCI will regulate combinations which have caused or are likely to cause an appreciable adverse effect on competition (“**AAEC**”) in India.

## I. Anti-Competitive Agreements

The Competition Act essentially contemplates 2 kinds of anti-competitive agreements — Horizontal Agreements i.e., agreements between entities engaged in similar trade of goods or provisions of services, and Vertical Agreements i.e., agreements between entities in different stages/levels of the chain of production, in respect of production, supply, distribution, storage, sale or price of goods or services. Anticompetitive agreements that cause or are likely to cause an AAEC within India are void under the provisions of the Competition Act.

A horizontal agreement that (i) determines purchase/sale prices, or (ii) limits or controls production supply, markets, technical development, investment or provision of services, or (iii) shares the market or source of production or provision of services, by allocation of geographical areas/type of goods or services or number of customers in the market, or (iv) results in bid rigging / collusive bidding, is presumed to have an AAEC. On the other hand, vertical agreements, such as tie-in arrangements,<sup>1</sup> exclusive supply or distribution agreements, etc., are examples where they can be considered to have an AAEC.

## II. Abuse of Dominant Position

An entity is considered to be in a dominant position if it is able to operate independently of competitive forces in India, or is able to affect its competitors or consumers or the relevant market in India in its favor. The Competition Act prohibits an entity from abusing its dominant position. Abuse of dominance would include imposing unfair or discriminatory conditions or prices in purchase/sale of goods or services and predatory pricing, limiting or restricting production/provision of goods/ services, technical or scientific development, indulging in practices resulting in denial of market access, etc.

<sup>1</sup> A tie-in arrangement would include any agreement where the purchaser of goods, (as a condition of such purchase) is made to purchase some other goods. A classic example of this on a global scale may be Microsoft’s bundling of its web browser Internet Explorer along with the Windows operating system, limiting Netscape’s web browser, Navigator, from having a significant presence in the market.

### III. Regulation of Combinations

In terms of Section 5 of the Competition Act, a ‘combination’ involves:

1. the acquisition of control, shares, voting rights or assets of an enterprise by a person;
2. acquisition of control of an enterprise where the acquirer already has direct or indirect control of another enterprise engaged in identical business; or
3. a merger or amalgamation between or amongst enterprises; that cross the financial thresholds set out in Section 5.

The financial thresholds for a combination are determined with reference to (i) the combined asset value and the turnover of the acquirer and the target in the event of an acquisition, and the combined asset value and the turnover of the combined resultant company, in the event of an amalgamation or merger, and (ii) the combined asset value and the turnover of the “group” to which the target/resultant company will belong pursuant to the proposed acquisition/merger.

Under Section 32 of the Competition Act, the CCI has been conferred with extra-territorial jurisdiction, meaning that any acquisition where assets/turnover are in India, and exceed specified limits, would be subject to the scrutiny of the CCI, even if the acquirer and target are located outside India.

#### A. Financial thresholds

The Competition Act prescribes financial thresholds linked with assets/turnover for the purposes of determining whether a particular transaction qualifies as a ‘combination’. A transaction that satisfies any of the following tests shall be treated as a ‘Combination’: An acquisition where the parties to the acquisition, i.e., the acquirer and the target, jointly have:

- Test 1 / India Asset Test and India Turnover Test — in India (i) assets higher than INR 2000 crore; or (ii) turnover higher than INR 6000 crore; or
- Test 2 / Global Asset Test and Global Turnover Test — Total assets in India or outside higher than USD 1 billion of which assets in India should be higher than INR 1000 crores; or (ii) total turnover in India or outside is higher than USD 3 billion of which turnover in India should be higher than INR 3000 crore; or

The acquirer group<sup>2</sup> has:

- Test 1 / India Asset Test and India Turnover Test — in India (i) assets higher than INR 8000 crores; or (ii) turnover higher than INR 24000 crores; or

2 A ‘group’ for the above purposes would mean two or more enterprises which, directly or indirectly, are in position to – i Exercise of not less than 50% or more of the voting rights in the other enterprise; or ii Appoint more than fifty per cent of the members of the board of directors in the other enterprise, or iii Control the management or affairs of the other enterprise.

## 4. Competition Law

- Test 2 / Global Asset Test and Global Turnover Test — (i) Total assets in India or outside higher than USD 4 billion of which assets in India are higher than INR 1000 crore; or (ii) total turnover in India or outside is higher than USD 12 billion of which turnover in India should be higher than INR 3000 crores.

### B. Deal Value Thresholds

Pursuant to an amendment<sup>3</sup> to the Competition Act a deal value threshold was newly introduced which requires, any transaction in connection with acquisition of any control, shares, voting rights or assets of an enterprise, merger or amalgamation, the deal value of which exceeds INR 2,000 crores and if such enterprise (i.e. the enterprise being acquired / taken control of / merged/ amalgamated) has 'substantial business operations in India', an approval from the CCI. It is expected that the CCI shall in due course issue regulations or clarifications to help determine the what would constitute 'substantial business operations in India'.

### C. Small Company Exemption

The Central Government has exempted certain enterprises from the provisions of Section 5 of the Act. Such enterprises are those that are party to any form of combination described under Section 5 of the Act — acquisitions and mergers / amalgamations alike — and, where the value of assets of the target entity or the merged entity is not more than INR 3.5 billion in India or turnover is not more than INR 10 billion. Further, the exemption also extends to specific situations where a portion of an enterprise or division or business is being acquired, taken control of, merged or amalgamated with another enterprise. In such cases, the value of assets and turnover of the said portion will be the relevant assets and turnover to be taken into account for the purposes of this exemption. This results in the entire enterprise value being disregarded in cases where it is the commercial intent for the acquirer to acquire only a portion of an enterprise. However, this exemption is only valid until March 28, 2027, unless further extended.<sup>4</sup>

### D. Pre-Filing Consultation

Any enterprise which proposes to enter into a combination may submit a request in writing to the CCI, for an informal and verbal consultation with the officials of the CCI about filing such proposed 'combination'. However, advice provided by the CCI during such pre-filing consultation is not binding on the CCI.

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<sup>3</sup> Competition (Amendment) Act, 2023 dated April 11, 2023.

<sup>4</sup> As amended by Notification No. S.O. 998(E) dated March 27, 2017.

## 4. Competition Law

### E. Mandatory Reporting before Consummation of the Combination

Section 6 makes void any combination which causes or is likely to cause an AAEC within India. Accordingly, Section 6 of the Competition Act requires every acquirer to notify the CCI of a combination. The CCI must form a prima facie opinion on whether a combination has caused or is likely to cause an AAEC within the relevant market in India, within 30 days of filing. The combination can be consummated only after the expiry of 150 days from the date on which notice is given to the CCI, or after the CCI has passed an order approving the combination.

### F. Multiple tranches

In order to ensure that all the combinations arising from small individual transactions which otherwise in isolation may not qualify the financial thresholds mentioned above but along with inter-connected or inter-dependent transactions may qualify the financial thresholds, are notified to CCI, the Combinations Regulations provide that in a situation where the ultimate intended effect of a business transaction is achieved by way of a series of steps or smaller individual transactions which are interconnected or inter-dependent on each other, one or more of which may amount to a combination, a single notice, covering all these transactions, may be filed by the parties to the combination.<sup>5</sup> Further, the Combinations Regulations were amended in 2014, wherein a provision was inserted which mandates companies to notify CCI if the substance of the transaction and any structure of the transaction(s), comprises a combination, and that has the effect of avoiding notice in respect of the whole or a part of the combination shall be disregarded.

### G. Green Channel

In furtherance of the Government of India's ease of doing business initiatives, the CCI introduced certain important amendments to its Combination Regulations on August 13, 2019 ("**2019 Amendment Regulations**") which came into effect from August 15, 2019.

The 2019 Amendment Regulations provide for a green channel route whereby parties that meet the criteria described below need not wait for the approval of the CCI to consummate a notifiable transaction ("**Green Channel**"). Once the acknowledgment of the form filed under this Green Channel route has been received by the parties, the transaction will be deemed approved and parties will be able to consummate the transaction immediately.

To avail of the benefit of the Green Channel route, the qualifying criteria is that the parties to the combination, their group entities and each of their, direct or indirect investee entities (even an investment of a single share in a company shall make such company an investee entity) should not: (i) produce/provide similar or identical or substitutable product or service or; (ii) engage in any activity relating to production, supply, distribution, storage, sale and service or

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<sup>5</sup> Regulation 9(4).

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trade in product or service which are at different stage or level of production chain or; (iii) engage in any activity relating to production, supply distribution, storage, sale and service or trade in product or service which are complementary to each other. This analysis will also have to be undertaken while considering all plausible alternative market definitions.

The acquirer would also be required to make a positive declaration confirming that the combination falls under the Green Channel (meaning there are no overlaps at any level as discussed above). If it is found that either such declaration or any other statement made by the acquirer in the form is incorrect then the form and deemed approval of the CCI shall both be considered void ab initio. The parties will however have an opportunity to be heard before the CCI renders the approval void ab initio.

### H. Exceptions to Filing

Schedule I to the Combination Regulations specifies certain categories of transactions which are ordinarily not likely to have an AAEC and therefore would not normally require to be notified to the CCI which inter alia include:

- Acquisitions of shares or voting rights as an investment or in the ordinary course of business as long as the total shares or voting rights held by the acquirer directly or indirectly is less than 25% of the total shares or voting rights of the company, and as long as control is not acquired.
- Acquisition of not more than 5% shares or voting rights in any financial year (on a gross basis) by an acquirer or its group, if (a) the acquirer or its group already hold 25% or more of the shares or voting rights of the acquired enterprise but do not hold 50% or more shares of voting rights of the acquired enterprise either prior to or after such acquisition and (b) joint or sole control is not acquired.
- Acquisition by an acquirer who already holds 50% or more shares or voting rights except in cases where the transaction results in a transfer from joint control to sole control.
- An acquisition of assets unrelated to the business of the acquirer, or acquired solely as an investment or in the ordinary course of business, other than an acquisition of a substantial business operation.
- Acquisitions of stock-in-trade, raw materials, stores and spares, trade receivables and other similar current assets (in the ordinary course of business).
- Acquisitions of shares or voting rights pursuant to a bonus or rights issues, or buyback shares, not leading to acquisition of control.
- Acquisition of shares or voting rights or assets within the same group, except where the acquired enterprise is jointly controlled by enterprises that are not part of the same group.
- Merger or amalgamation: (i) of holding and subsidiary company and/ or (ii) of companies which are majority held by the same group. However, the merger or amalgamation must not lead to the transfer of joint control to sole control. A share subscription, financing facility or any acquisition by a public financial institution, foreign institutional investor, bank or venture capital fund (“VCF”) pursuant to any loan or investment agreement, would not

#### 4. Competition Law

qualify as a combination that will be regulated by the CCI, and such transactions are exempt from the Combination related provisions under the Competition Act. However, such public financial institution, FII, bank or VCF is required to notify the CCI of the details of the acquisition within 7 days of completion of the acquisition.

- Impact on transactions involving listed companies: In combination involving listed companies, a primary transaction may trigger notification with CCI and subsequent open offer obligation under the Takeover Code. In cases where clearance from the CCI is not received within the statutory time period required to complete the open offer as prescribed under the Takeover Code, then as per the Takeover Code, SEBI may direct the acquirer to pay interest to shareholders for the delay beyond the maximum period within which the tendering shareholders are required to be paid.

# Exchange Control

## I. Foreign Direct Investment

India's story with respect to exchange control is one of a gradual, deliberate and carefully monitored advance towards full capital account convertibility. Though significant controls have been removed and foreign companies can freely acquire Indian companies across most sectors, these are subject to strict pricing and reporting requirements imposed by the Central Government and the RBI.

Investments in, and acquisitions (complete and partial) of, Indian companies by non-resident entities and individuals, are governed by the terms of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (“**Non-Debt Instruments Rules**”), issued in supersession of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (the “**FI Regulations**”) and the press notes issued by the Department of Industrial Policy and Promotion, Government of India.

The Ministry of Finance, on October 15, 2019 notified Sections 139, 143 and 144 of the Finance Act, 2015 which had proposed amendments to certain sections of the Foreign Exchange Management Act, 1999 (“**FEMA**”), being Section 6 (Capital Account Transactions), Section 46 (Power of Central Government to make rules) and Section 47 (Power of RBI to make regulations) respectively. These amendments resulted in a shift of power from the RBI to the Central Government and a bifurcation of instruments into debt instruments and non-debt instruments. The Central Government (in consultation with the RBI) was entrusted with powers to frame rules on non-debt instruments while the RBI (in consultation with the Central Government) is entrusted with the power to draft regulations for debt instruments.

As a result, the Central Government notified the Non-Debt Instruments Rules superseding the erstwhile FI Regulations, and Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018. RBI also notified the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 that provides for reporting requirements in relation to any investment made under the Non-Debt Instruments Rules.

The Non-Debt Instrument Rules were also modified as on December 5, 2019 (“**Amendment to Non-Debt Instruments Rules**”) to incorporate the provisions of the Press Note 4 of 2019 (detailed below) announced by the Department for Promotion of Industry and Internal Trade (“**DPPIIT**”). Other than the changes set forth herein, certain sector specific changes (such as in contract manufacturing, digital media, e-commerce, single brand retail trading conditions) that were not included in the Non-Debt Instrument Rules, have now been reflected by the Amendment to the Non-Debt Instruments Rules.



## 5. Exchange Control

The Non-Debt Instruments Rules segregate foreign investments into various types: person resident outside India, foreign portfolio investor (FPI), non-resident Indian (NRI) or an Overseas Citizen of India (OCI), other nonresident investors and foreign venture capital investments (FVCI).

### A. Key changes in definition in the Non-Debt Instruments Rules

- **“Non-Debt Instruments”** has been defined as: (i) all investments in equity instruments in incorporated entities: public, private, listed and unlisted; (ii) capital participation in LLP; (iii) all instruments of investment recognized in the FDI Policy notified from time to time; (iv) investments in units of AIFs, REITs and InvITs; (v) investment in units of mutual funds of Exchange-Trade Fund which invest more than 50% in equity; (vi) junior-most layer (i.e. equity tranche) of securitization structure; (vii) acquisition, sale or dealing directly in immovable property; (viii) contribution to trusts; and (ix) depository receipts issued against equity instruments. It must be noted that FI Regulations did not allow for foreign direct investment in trusts except VCF and investment vehicles. The Non-Debt Instruments Rules specifically include contribution to trusts in the definition of non-debt instruments.
- **“Debt Instruments”** has been defined to mean all instruments other than non-debt instruments as defined above.
- **“Equity Instruments”** replaces the defined term ‘capital instruments’ in FI Regulations. Equity Instruments means equity shares, convertible debentures, preference shares and share warrants issued.
- **“Hybrid Securities”** has been introduced in the Non-Debt Instruments Rules to mean hybrid instruments such as optionally or partially convertible preference shares or debentures and such other instruments as specified by the Central Government from time to time, issued to a person resident outside India by an Indian company or a trust. However, the term ‘Hybrid Security’ has not been used anywhere in the Non-Debt Instruments Rules.
- The definition of **‘Foreign Investment’**, includes an explanation that in the event any declaration is made by a person as per the provisions of the CA, 2013, stating that the beneficial interest in the securities is being held by a person resident outside India, then even though the investment is made by a resident Indian citizen, the same shall be counted as foreign investment.
- The definition of **‘Sectoral Cap’** has been amended under the Amendment to the Non-Debt Instruments Rules to omit “debt” meaning the composite sectoral cap under the Non-Debt Instruments Rules will now include only (i) foreign investment on a repatriable basis by persons resident outside India in equity of a company or capital of an LLP; and (ii) indirect foreign investment.

### B. Foreign Direct Investment (FDI)

FDI means investment through equity instruments by a person resident outside India in an unlisted Indian company; or in 10% or more of the post-issue paid-up equity capital on a fully diluted basis of a listed Indian company. In case an existing investment by a person resident outside

## 5. Exchange Control

India in equity instruments of a listed company falls to a level below 10%, of the post-issue paid-up capital on a fully diluted basis, the investment shall continue to be treated as FDI.

Schedule I of the Non-Debt Instruments Rules contains the Foreign Direct Investment Scheme (“**FDI Scheme**”) and sets out the conditions for FDI in India. Sectors in which FDI is prohibited include lottery business, gambling and betting including casinos, chit funds, Nidhi company, trading in transferable development rights and real estate business or construction of farm houses, manufacturing of cigars or tobacco, sectors not open to private sectors such as atomic energy, railway operations, foreign technology collaborations such as franchise, trademark, brand name, management contract is also prohibited for lottery business and gambling and betting activities. Entry routes and sectoral caps are prescribed for sectors specifically permitted under the FDI Scheme. In sectors or activities not listed under the FDI Scheme or prohibited, foreign investment is permitted up to 100% through the automatic route, subject to applicable laws and specified conditionalities.

**Automatic Route and Government approval Route:** Automatic route means the entry route where investment by a person resident outside India does not require the prior approval of the RBI or the Central Government. Government route, on the other hand, requires prior government approval and foreign investment received under this route is subject to conditions stipulated by the government in its approval.

Earlier, the determination of automatic route or approval route was made based on the sector in which the investee company operates. However, pursuant to Press Note 3 published on April 17, 2020,<sup>1</sup> the Government of India has prescribed mandatory government approval route for all investments made by any entity of a country that shares land border with India, i.e., Bangladesh, China, Pakistan, Nepal, Myanmar, Bhutan and Afghanistan. Further, this requirement shall also be applicable in case where any beneficial owner of an investment into India is situated in or is a citizen of any such countries. Accordingly, all investments from neighbouring countries, regardless of the sector in which the investee company operates, would require prior government approval.

The onus of compliance with sectoral or statutory caps on foreign investment and attendant conditions, if any, is on the company receiving foreign investment. A foreign investor can acquire equity shares, compulsorily convertible preference shares, share warrants or convertible debentures<sup>2</sup> in an Indian company up to the investment (or sectoral) caps for each sector provided in the FDI Scheme. Subsequent to the abolition of the Foreign Investment Promotion Board (“**FIPB**”), which provided prior approval as required for certain sectors, the Government of India, vide an Office Memorandum dated June 5, 2017, has entrusted the work of granting government approval for foreign investments to the concerned administrative ministries/departments of the Government and for certain specific situations, to the DIPP, now renamed as DPIIT.

1 Press Note 3 (2020 Series) Available at [https://dipp.gov.in/sites/default/files/pn3\\_2020.pdf](https://dipp.gov.in/sites/default/files/pn3_2020.pdf).

2 A foreign investor may also subscribe to preference shares. However, in order to fall under the automatic route, the preference shares / debentures must be compulsorily convertible into equity, failing which the investment will be treated as a debt and the External Commercial Borrowings (ECB) policy will be applicable.

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**Issuance by Indian company:** An Indian company may issue equity instruments to a person resident outside India subject to entry routes, sectoral caps and attendant conditionalities prescribed in the FDI Scheme.

**Issuance by listed Indian company:** A person resident outside India may purchase equity instruments of a listed Indian company on a stock exchange in India, provided that the person making the investment has already acquired control of such company in accordance with SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 and continues to hold such control and the amount of consideration may be paid as per the mode prescribed by RBI or out of the dividend payable by the Indian investee company; provided further that such dividend is credited to a specially designated non-interest bearing rupee account for acquisition of shares on the recognized stock exchange.

**Issuance against pre-incorporation expenses:** A wholly owned subsidiary set up in India by a non-resident entity, operating in a sector where 100% foreign investment is allowed under the automatic route and there are no FDI linked performance conditions, may issue equity instruments to the said non-resident entity against pre-incorporation or pre-operative expenses incurred by the non-resident entity up to a limit of 5% of its authorized capital or USD 500,000 whichever is less.

Issuances by Indian company for other consideration: An Indian company may issue, equity instruments to a person resident outside India, if the Indian investee company is engaged in an automatic sector, against —

- a. swap of equity instruments; or
- b. import of capital goods or machinery or equipment (excluding second-hand machinery); or
- c. pre-operative or pre-incorporation expenses (including payments of rent etc.)

In case of swap of equity instruments, valuation involved in the swap arrangement is required to be made by a merchant banker registered with SEBI or an investment banker outside India registered with the appropriate authority in the host country.

An Indian company may issue equity shares against any funds payable by it to a person resident outside India, the remittance of which is permitted under the FEMA, the Non-Debt Instrument Rules and corresponding rules.

## C. Foreign Portfolio Investors

Foreign portfolio investors registered with the SEBI as per the SEBI (Foreign Portfolio Investment) Regulations, 2019 are permitted to invest in equity instruments of an Indian company listed or to be listed on a recognized stock exchange in India subject to the conditions set forth under Schedule II of the Non-Debt Instruments Rules:

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- a. Total holding by each FPI or an investor group, is less than 10% of the total paid-up equity capital on a fully diluted basis or less than 10% of the paid-up value of each series of debentures or preference shares or share warrants issued by Indian company (individual limits), and the total holdings of all FPIs put together, is not exceeding 24% of paid-up equity capital on a fully diluted basis or paid-up value of each series of debentures or preference shares or share warrants (aggregate limit); provided this aggregate limit may be increased by the Indian company up to the sectoral cap/statutory ceiling, with approval of its board of directors and general body through a resolution and a special resolution, respectively. Once the aggregate limit has been increased to a higher threshold, the Indian company cannot reduce the same to a lower threshold; provided further that the aggregate limit with respect to an Indian company in a sector where FDI is prohibited shall be 24%.
- b. An FPI may purchase equity instruments of an Indian company through public offer or private placement, subject to individual and aggregate limited specified.
- c. An FPI may purchase units of domestic mutual funds or Category III Alternative Investment Fund or offshore fund for which no objection is issued in accordance with SEBI (Mutual Fund) Regulations, 1996, which in turn invest more than 50% in equity instruments on repatriation basis subject to the terms and conditions specified by the SEBI and the RBI.
- d. An FPI may purchase units of REITs and InVITs on repatriation basis subject to terms specified by SEBI.

### D. Non-resident Indian (“NRI”) or Overseas Citizen of India (“OCI”) on repatriation basis

An NRI or OCI may purchase or sell equity instruments of a listed company on repatriation basis, on a recognized stock exchange in India through a branch designated by an Authorised Dealer for the purpose; and the total holding by any individual NRI or OCI shall not exceed 5% of the total paid-up equity capital on a fully diluted basis or shall not exceed 5% of the paid-up value of each series of debentures or preference shares or share warrants issued by Indian company; and the total holdings of all NRIs and OCIs put together shall not exceed 10% of the total paid-up equity capital on a fully diluted basis or shall not exceed 10% of the paid-up value of each series of debentures or preference shares or share warrants; provided that this 10% limit may be raised to 24% if a special resolution to that effect is passed by the general body of the Indian company.

An NRI or OCI may without limit purchase or sell units of domestic mutual funds which invest more than 50% in equity.

### E. NRI or OCI on non-repatriation basis

An NRI or OCI, including a company, a trust and a partnership firm incorporated outside India and owned and controlled by NRIs or OCIs, may purchase or contribute towards the following, on a non-repatriation basis, and such investment is deemed to be domestic investment made at par with the investment by residents:

## 5. Exchange Control

- a. Equity instrument issued by a company without any limit either on the stock exchange or outside it; and/or
- b. Units issued by an investment vehicle without any limit, either on the stock exchange or outside it; and/or
- c. Capital of a limited liability partnership without any limit; and/or
- d. Convertible notes issued by a startup entity.

An NRI or OCI, including a company, a trust and a partnership firm incorporated outside India and owned and controlled by NRIs or OCIs are not permitted to make any investment in equity instruments or units of a Nidhi company or a company engaged in agricultural or plantation activities or real estate business or construction of farm houses or dealing in transfer of development rights.

## F. Investment by other non-resident investors

Long term investors like sovereign wealth funds (“SWFs”), multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks may purchase securities subject to terms specified by the RBI and the SEBI.

## G. Investment in a Limited Liability Partnership (“LLP”)

A person resident outside India or an entity incorporated outside India, not being an FPI or an FVCI, may contribute to the capital of an LLP operating in sectors or activities where foreign investment up to 100% is permitted under automatic route and there are no FDI linked performance conditions.

## H. Foreign venture capital investors (“FVCI”)

An FVCI registered with the SEBI can invest in:

- a. Securities issued by an Indian company in the following sectors, and whose securities are not listed on a recognized stock exchange at the time of issue of securities:
  - i. Biotechnology;
  - ii. IT related to hardware and software development;
  - iii. Nanotechnology;
  - iv. Seed research and development;
  - v. Research and development of new chemical entities in pharmaceutical sector;
  - vi. Dairy industry

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- vii. Poultry industry;
  - viii. Production of bio-fuels;
  - ix. Hotel-cum-convention centers with seating capacity of more than 3000;
  - x. Infrastructure sector.
- b. Units of a VCF or a category I Alternative Investment Fund (“**Cat-I AIF**”) or units or a scheme or of a fund set up by a VCF or Cat-I AIF.
  - c. Equity or equity linked instrument or debt instrument issued by an Indian ‘start-up’ irrespective of the sector in which the start-up is engaged. The definition of ‘start-up’ is as per the DPIIT’s notification;<sup>3</sup> provided that if the investment is in equity instruments, then sectoral caps, entry routes and attendant conditions apply.

An FVCI may purchase securities or instruments either from issuer of securities/instruments or from any person holding these securities or instruments. FVCI may invest in securities on a recognized stock exchange subject to the provisions of Securities and Exchange Board of India (FVCI) Regulations, 2000.

The FVCI may acquire, by purchase or otherwise, from or transfer by sale or otherwise, to any person resident in or outside India, any security or instrument it is allowed to invest in, at a price that is mutually acceptable to the buyer and the seller/issuer. The FVCI may also receive proceeds of liquidation of VCF or of Cat-I AIF or of schemes or funds set up by the VCFs or Cat-I AIFs.

### I. Investment by a person resident outside India in an investment vehicle

A person resident outside India (other than a citizen of Pakistan or Bangladesh) or an entity incorporated outside India (other than an entity incorporated in Pakistan or Bangladesh) may invest in units of investment vehicle.<sup>4</sup> Investment vehicle may issue its units to a person resident outside India against swap of equity instruments of a special purpose vehicle proposed to be acquired by such investment vehicle.

Investment made by an investment vehicle into an Indian entity is considered as indirect foreign investment for the investee Indian entity if the Sponsor or Manager or Investment Manager

<sup>3</sup> While the definition of ‘startup’ under the rules still refer to notification dated February 16, 2016 issued by DPIIT, Notification G.S.R. 127(E), February 19, 2019 provides the latest definition of startup as below (which needs to be aligned under the rules); An entity shall be considered as a Startup: i. Up to a period of ten years from the date of incorporation/ registration, if it is incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India. ii. Turnover of the entity for any of the financial years since incorporation/ registration has not exceeded one hundred crore rupees. iii. Entity is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation. Provided that an entity formed by splitting up or reconstruction of an existing business shall not be considered a ‘Startup’.

<sup>4</sup> Investment Vehicle means an entity registered and regulated under the regulations framed by the SEBI or any other authority designated for that purpose and shall include, namely: (i) Real Estate Investment Trusts (REITs) governed by the Securities and Exchange Board of India (REITs) Regulations, 2014; (ii) Infrastructure Investment Trusts (InvITs) governed by the Securities and Exchange Board of India (InvITs) Regulations, 2014 (iii) Alternative Investment Funds (AIFs) governed by the Securities and Exchange Board of India (AIFs) Regulations, 2012;

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(a) is not owned and not controlled by resident Indian citizens; or (b) is owned or controlled by person's resident outside India.

### J. Issue of Convertible Notes by an Indian startup company

A person resident outside India (other than an individual who is a citizen of Pakistan or Bangladesh or an entity which is registered or incorporated in Pakistan or Bangladesh) may purchase convertible notes issued by an Indian startup company for an amount of INR 25 lakhs or more in a single tranche. Such issuance is required to comply with the entry route, sectoral caps, pricing guidelines and other conditions for foreign investment. Similarly, transfers of a convertible note between a person resident outside India and a person resident in or outside India is also permitted subject to compliance with entry route, sectoral caps, pricing guidelines and other conditions as prescribed. An NRI or an OCI may acquire convertible notes on non-repatriation basis subject to certain conditions of the Non-Debt Instruments Rules.

### K. Acquisition of rights shares/ bonus shares

A person resident outside India may subscribe to shares issued on a rights basis/bonus issuance by an Indian company provided that the offer of shares is in compliance with the provisions of CA 2013, and does not result in breach of sectoral caps applicable to the company, and the price at which the shares are offered to the person resident outside India is not less than the price offered to the resident shareholders. These conditions are also applicable in case a person resident outside India makes investment in equity instruments (other than share warrants) issued by an Indian company as a rights issue that are renounced to a person to whom it was offered.

### L. Issue of Shares under merger/ amalgamation / demerger

A transferee company may issue shares to the shareholders of a transferor company under a scheme of merger or amalgamation approved by an Indian court, provided that the sectoral caps mentioned above are not exceeded.

### M. Issue of partly-paid up shares and share warrants

Currently, only equity shares, compulsorily convertible preference shares and compulsorily convertible debentures and share warrants are permitted under the FDI route as equity instruments.

Partly paid shares can be issued to person resident outside India if (i) pricing of partly paid shares is determined up front and at least 25% of the total consideration amount (including share premium) is paid up front; and (ii) the remaining amount is invested within a period of 12 months of issuance. As regards the issuance of share warrants, the following conditions must be complied with: (i) pricing and conversion formula / price is required to be determined up front and 25% of the

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total consideration is required to be paid up front; and (ii) the remaining amount is required to be brought in within a period of 18 months. Further, the price at the time of conversion should not be less than the fair value of the shares as calculated at the time of issuance of such warrants.

It must also be noted that only companies in which investment can be made under the automatic route can issue partly paid shares or share warrants. For companies under the approval route, prior approval concerned administrative ministries/departments of the Government will be required to issue partly paid shares or share warrants.

### N. ESOP and sweat equity shares

Indian company may issue 'employees' stock option' and/or 'sweat equity shares' to its employees or directors or employees or directors of its holding company or joint venture or wholly owned overseas subsidiary or subsidiaries who are resident outside India; provided that (i) the scheme has been drawn in terms of the regulations under SEBI or the Companies (Share Capital and Debentures) Rules, 2014; (ii) such employee stock options or sweat equity shares are in compliance with the sectoral cap applicable to the said company; (iii) issue of employee stock option or sweat equity shares in a company that requires prior government approval should procure such approval prior to issuance.

### O. Pricing under the automatic route

Acquisition of shares of an Indian company by a person resident outside India under the automatic route may only be made in accordance with the pricing requirements provided in the Non-Debt Instruments Rules. The price of shares issued to non-residents cannot be less than:

- a. the price worked out in accordance with the SEBI guidelines in case of a listed Indian company or in case of a company going through a delisting process as per the SEBI (Delisting of Equity Shares) Regulations, 2021;
- b. the fair value of shares determined as per any internationally accepted pricing methodology for valuation of shares on arm's length basis duly certified by a chartered accountant or a merchant banker registered with SEBI, in case of a practicing cost accountant, in case of an unlisted Indian company.



## 5. Exchange Control

### P. Investment in Depository Receipts

Any security or unit in which a person resident outside India is allowed to invest under the Non-Debt Instruments Rules are eligible instruments for issue of depository receipts<sup>5</sup> in terms of Depository Receipts Scheme, 2014 (“**DR Scheme**”).

Companies incorporated outside India may issue Indian Depository Receipts<sup>6</sup> (IDRs) through a domestic depository, to persons resident in India and outside India subject to such issue being in compliance with the Companies (Registration of Foreign Companies) Rules, 2014 and the ICDR Regulations, be denominated in Indian rupee only and the proceeds of issue of IDRs be immediately repatriated outside India by companies issuing such IDRs. Any issue of IDRs by financial or banking companies having presence in India, either through a branch or subsidiary, requires prior approval of the sectoral regulator.

## II. Indirect Foreign Investment;

Foreign investment may be direct or indirect. Generally speaking (and subject to certain exceptions) if:

- a. an Indian investing company is (i) not “owned”<sup>7</sup> and “controlled”<sup>8</sup> by resident Indian citizens; or (ii) is owned or controlled by persons resident outside India; or
- b. an investment vehicle whose sponsor or manager or investment manager (i) is not owned and not controlled by resident Indian citizens; or (ii) is owned or controlled by person resident outside India; then the entire investment by the investing company into the subject downstream Indian investee company would be considered as indirect foreign investment.

Indian entity that has received indirect foreign investment is required to comply with entry route, sectoral caps, pricing guidelines and other conditions as applicable for foreign investment. Further, it has been clarified that an investment made by an Indian entity which is owned and controlled by NRI(s), on a non-repatriation basis, shall not be considered for calculation of indirect foreign investment.<sup>9</sup>

5 Depository receipt means a foreign currency denominated instrument, whether listed on an international exchange or not, issued by a foreign depository in a permissible jurisdiction on the back of eligible securities issued or transferred to that foreign depository and deposited with a domestic custodian and includes ‘global depository receipt’ as defined in the Companies Act, 2013 (18 of 2013);

6 Indian Depository Receipts means any instrument in the form of a depository receipt created by a domestic depository in India and authorised by a company incorporated outside India making an issue of such depository receipts;

7 A company is considered to be owned by resident Indian citizens, if the Indian company where ownership is vested in resident Indian citizens and / or Indian companies, which are ultimately owned and controlled by resident Indian citizens.

8 A company is considered to be controlled by resident Indian citizens, if the Indian company where control is vested in resident Indian citizens and / or Indian companies, which are ultimately owned and controlled by resident Indian citizens; “control” means the right to appoint majority of directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreement or voting agreement.

9 Notification S.O. 3206(E), dated August 06, 2021 issued by Department of Economic Affairs, Ministry of Finance.

### III. Transfer of equity instruments of an Indian company by or to a person resident outside India

The Non-Debt Instruments Rules have detailed the provisions in relation to transfer of equity instruments of an Indian company by or to a person resident outside India. A person resident outside India, holding equity instruments of an Indian company, or units or a person resident in India, may transfer such equity instruments or units so held by him in compliance with the conditions specified:

- a. Transfer by non-resident (not NRI / OCI / erstwhile overseas body corporate) to non-resident: a person resident outside India, not an NRI or an OCI or an erstwhile overseas corporate body, may transfer by way of sale or gift the equity instruments of an Indian company or units held by him to any person outside India; this may also include transfer of equity instruments of an Indian company pursuant to liquidation, merger, de-merger, amalgamation of entities or companies incorporated or registered outside India.

Where the equity instruments are held by person resident outside India on a non-repatriable basis, the transfer by way of sale where the transferee intends to hold the equity instruments on a repatriable basis, is required to comply with the entry routes, sectoral caps or investment limits, pricing guidelines, documentation and reporting requirements for such transfers, as prescribed from time to time.

- b. Transfer by sale or gift or sale on stock exchange: Person resident outside India, holding equity instruments of an Indian company or units may transfer the same to person resident in India by way of sale or gift or may sell the same on a recognized stock exchange in India in the manner specified by SEBI; provided that such transfer is required to comply with entry routes, sectoral caps or investment limits, pricing guidelines, documentation and reporting requirements for such transfers, as prescribed from time to time.
- c. Transfer by sale: A person resident in India holding equity instruments of an Indian company or units, may transfer the same to a person resident outside India by way of sale, subject to sectoral caps, investment limits, pricing guidelines or other conditions as applicable for investment by person resident outside India.
- d. Gift by Resident to Non-resident on non-repatriation basis: A person resident in India holding equity instruments or units of an Indian company on a non-repatriation basis may transfer the same to a person resident outside India by way of gift with the prior approval of the RBI and subject to the following conditions:
  - i. the donee is eligible to hold such security under the Non-Debt Instruments Rules;
  - ii. gift does not exceed 5% of the paid-up capital of the Indian company or each series of debentures or each mutual fund scheme;
  - iii. the applicable sectoral cap in Indian company is not breached;
  - iv. the donor and donee are 'relatives' as defined under Section 2(77) of Companies Act, 2013;

## 5. Exchange Control

- v. value of the security to be transferred by donor together with any security transferred to any person residing outside India as gift during the financial year does not exceed the rupee equivalent of USD 50,000.
- e. Transfer of equity instruments with optionality clause: Person residing outside India holding equity instruments of an Indian company containing an optionality clause and exercising the option or right, may exit without any assured return, subject to pricing guidelines and a minimum lock-in period of 1 year or as prescribed, whichever is higher.
- f. Deferred consideration: Transfer of equity instruments between a person resident in India and a person outside India structured as a deferred payment is permitted in the following manner: an amount not exceeding 25% of the total consideration may be paid by the buyer (i) on a deferred basis, within a period not exceeding 18 months from the date of the transfer agreement; or (ii) may be settled through an escrow arrangement between the buyer and seller for a period not exceeding 18 months from the date of the transfer agreement; or (iii) may be indemnified by the seller for a period not exceeding 18 months from the date of payment of the full consideration, if the total consideration has been paid by the buyer to the seller. Provided that the total consideration finally paid is required to comply with the applicable pricing guidelines.
- g. Transfer by pledge: Transfer of equity instruments or an Indian company or units of an investment vehicle by way of pledge is subject to: (i) any person being promoter of a company that has raised ECB in compliance with the Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations, 2000, may pledge the shares of the borrowing company or of its associate resident companies subject to certain conditions; (ii) any person resident outside India holding equity instruments in an Indian company or units of an investment vehicle may pledge the equity instruments or units in favour of a bank in India/nonbanking financial company to secure credit facilities for bona fide purposes or in favour of an overseas bank to secure credit facilities extended to such person who is the promoter of the Indian company or overseas group company of such Indian company.

In case of invocation of pledge, transfer of equity instruments is required to comply with sectoral caps, pricing guidelines and other conditions at the time of creation of pledge.

- h. Transfer by FPI: An FPI may transfer by way of sale or gift, the equity instruments of an Indian company or units held by him to any person resident outside India; this would also include transfer of equity instruments of an Indian company pursuant to liquidation, merger, de-merger, amalgamation of entities or companies incorporated or registered outside India.
- i. Pricing guidelines: Price of equity instruments of an Indian company, when such instruments are being i) transferred from a resident in India to a person resident outside India, cannot be less than:
  - i. The price worked out in accordance with the SEBI guidelines in case of a listed Indian company;
  - ii. The price at which a preferential allotment of shares can be made under the SEBI guidelines, in case of a listed company or in case or in case of a company going through a delisting process as per the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;

## 5. Exchange Control

- iii. Valuation of equity instruments done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a Merchant Banker registered with SEBI or a practicing Cost Accountant, in case of an unlisted Indian company.

On the other hand, the price of equity instruments of an Indian company, when such instruments are being transferred by a person resident outside India to a person resident in India, cannot exceed:

- i. Price worked out in accordance with the SEBI guidelines in case of a listed Indian company;
- ii. The price at which a preferential allotment of shares can be made under the SEBI guidelines, in case of a listed company or in case of a company going through a delisting process as per the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;
- iii. Valuation of equity instruments done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a Merchant Banker registered with SEBI or a practicing Cost Accountant, in case of an unlisted Indian company.

The guiding principle being that the person resident outside India is not guaranteed any assured exit price at the time of making such investment or agreement and is required to exit at the price prevailing at the time of exit.

Further, in case of convertible equity instruments, the price or conversion formula of the instrument should be determined upfront at the time of issue of the instrument. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instrument.<sup>10</sup>

## IV. Overseas Investment

An Indian company that intends to acquire or invest in a foreign company outside India must comply with the Foreign Exchange Management (Overseas Investment) Rules, 2022 (“**OI Rules**”), Foreign Exchange Management (Overseas Investment) Regulations, 2022 (“**OI Regulations**”) and Foreign Exchange Management (Overseas Investment) Directions, 2022 (“**OI Directions**”) (collectively referred to as the “**OI Laws**”).

The OI Laws, released by the Government of India and the RBI, overhauled, *inter alia*, the erstwhile Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004, and can be seen as an extension of the process of liberalization initiated by the Government of India in the 1990s. The OI Laws contain detailed provisions governing investments made by an Indian company in a foreign company by grant of ‘general permission’ to make an ‘overseas direct investment (“**ODI**”)’ or an ‘overseas portfolio investment (“**OPI**”)’ in bona fide business

<sup>10</sup> Notification S.O. 4355(E), dated December 05, 2019 issued by Department of Economic Affairs, Ministry of Finance.

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activities, subject to compliance with the applicable rules and regulations. While the term ODI has been defined as ‘investment by way of acquisition of unlisted equity capital<sup>11</sup> of a foreign entity<sup>12</sup>, or subscription as a part of the memorandum of association of a foreign entity, or investment in 10%, or more of the paid-up equity capital of a listed foreign entity or investment with control where investment is less than 10% of the paid-up equity capital of a listed foreign entity’, the term OPI means ‘investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC, provided that OPI by a person resident in India in the equity capital of a listed entity, even after its delisting shall continue to be treated as OPI until any further investment is made in the entity’.

The Indian party may choose to fund the ODI out of balances held in Exchange Earner’s Foreign Currency (EEFC) account, by drawing funds from an authorized dealer subject to certain limits, or using the proceeds of an ADR/GDR issue, swap of shares, capitalization of exports, or using the proceeds of external commercial borrowings (ECBs)..

It has been clarified that the OI Laws shall not apply to acquisition or transfer of any investment outside India made (a) out of Resident Foreign Currency Account; or (b) out of foreign currency resources held outside India by a person who is employed in India for a specific duration irrespective of length thereof or for a specific job or assignment, duration of which does not exceed three years; or (c) foreign currency acquired when the person resident in India was resident outside India or has inherited from a person who was resident outside India.

### A. ODI in a Foreign Entity

An Indian company is permitted to invest in all the foreign entities taken together at the time of undertaking ODI up to 400% of its net worth as on the date of the last audited balance sheet<sup>13</sup> or as directed by the RBI, in consultation with the Government of India from time to time, without seeking the prior approval of the RBI.

An Indian company making ODI in a foreign entity is required to route all its transactions relating to such investment through the AD bank designated by it. However, different AD banks may be designated, if required, for different foreign entities.

ODI cannot be made if the foreign entity is engaged in real estate activity; gambling in any form or dealing with financial products linked to the Indian rupee without specific approval of the RBI. The term ‘real estate activity’ means ‘buying and selling of real estate or trading in Transferable Development Rights but does not include the development of townships, construction of residential or commercial premises, roads or bridges for selling or leasing.

11 “equity capital” means equity shares or perpetual capital or instruments that are irredeemable or contribution to non-debt capital of a foreign entity in the nature of fully and compulsorily convertible instruments.

12 “foreign entity” means an entity formed or registered or incorporated outside India, including International Financial Services Centre that has limited liability, provided that the restriction of limited liability shall not apply to an entity with core activity in a strategic sector.

13 “last audited balance sheet” means audited balance sheet as on date not exceeding eighteen months preceding the date of the transaction.

## 5. Exchange Control

Any financial commitment in a foreign entity exceeding USD 1 billion (or its equivalent) in a financial year will require the prior approval of the RBI even when the total financial commitment of the Indian entity is within the eligible limit under the automatic route (i.e., 400% net worth as per the last audited balance sheet).

ODI by an Indian entity engaged in financial or non-financial services activity into a foreign entity engaged in financial services activities is subject to special requirements.

### B. Investment by way of capitalization due to the Indian company

The OI Laws provide for ODI by way of capitalization, within the time period, if any, specified for realization under FEMA, of any amount due towards the Indian entity from the foreign entity, the remittance of which is permitted under FEMA or does not require prior approval of the Government of India or the RBI.

The financial commitment limit of 400% of the net worth does not include capitalization of retained earnings.

In case where the proceeds are overdue beyond the period specified for realization/repatriation, before permitting such capitalization, AD bank may grant necessary extension making the requisite application post proper due diligence.

### C. Transfer of shares

An Indian company may transfer equity capital of a foreign entity by way of a sale — either to a person resident in India who is eligible to make such investments under the OI Rules or, to a person resident outside India.

If the transfer is on account of merger, amalgamation, demerger or on account of buy-back of foreign securities, such transfer shall have the approval of the competent authority as per the applicable laws in India or the laws of the host country, as the case maybe.

In the event where the disinvestment by the Indian company pertains to ODI — (i) the transferor, in case of full divestment (other than by way of liquidation), shall not have any outstanding dues to be received from the foreign entity; (ii) the transferor, in case of any divestment must have stayed invested for at least one year from the date of making the ODI.

The abovementioned conditions are not applicable in case of transfer by way of merger, demerger between two or more foreign entities that are wholly owned, directly or indirectly, by the Indian company, or where there is no change or dilution in aggregate equity holding of the Indian company in the merged, demerged or amalgamated entity.

Further, unlike the erstwhile regime, disinvestment involving write-off is now permitted under the automatic route.

## 5. Exchange Control

Furthermore, the OI Laws have, *inter alia*, dispensed with the requirement of approval for (a) investment / divestment by persons resident in India under investigation by any investigative agency / regulatory body; and (b) write-off on account of disinvestment.

The equity capital of the foreign entity may also be pledged by the Indian company as security, to avail of fund/non-fund-based credit facilities for itself or for the foreign entity.

### D. Guarantee by Indian party

The Indian entity may issue corporate, personal or bank guarantee, subject to certain conditions, to or on behalf of the foreign entity or any of its step-down subsidiary in which the Indian entity has acquired control through the foreign entity.

In case of a guarantee extended by a group company, it is counted towards the utilization of its financial commitment limit independently and in case of a resident individual promoter, the same is counted towards the financial commitment limit of the Indian entity; provided that where the commitment is extended by a group company, any fund-based exposure to or from the Indian entity is deducted from the net worth of such group company for computing its financial commitment limit.

Further, no guarantee is permitted to be open-ended, and the guarantee invoked shall not be a part of the non-fund-based commitment but be considered as lending.

Where a guarantee has been extended jointly and severally by two or more Indian entities, 100% of the amount of such guarantee is reckoned towards the individual limits of each of such Indian entities.

In case of performance guarantee, 50% of the amount of guarantee is reckoned towards the financial commitment limit.

### E. Investment by Individuals

The Liberalized Remittance Scheme (“LRS”)<sup>14</sup> was introduced on February 4, 2004, as a liberalization measure to facilitate foreign remittance by Indian resident individuals for permitted current or capital account transactions or a combination of both.

An individual may draw from an authorized person, foreign exchange not exceeding USD 250,000 per financial year (April to March)<sup>15</sup> or such amount as decided by RBI from time to time for permitted capital account transactions.

An Indian resident individual may make ODI by way of investment in equity capital or OPI, subject to the overall ceiling under the LRS.

<sup>14</sup> A.P. (DIR Series) Circular No. 64 dated February 4, 2004 (as amended from time to time).

<sup>15</sup> Also see Para A1 of Master Direction – LRS (No. 7/2015-16) – Updated as on August 24, 2022.

## 5. Exchange Control

An Indian resident individual may make ODI in an operating foreign entity not engaged in financial services activity and which does not have subsidiary<sup>16</sup> or step down subsidiary where the Indian resident individual has control in the foreign entity; provided that ODI can be made by an Indian resident individual with control in a foreign entity engaged in a financial or a non-financial services activity, regardless of having a subsidiary or a step down subsidiary, by way of (i) inheritance; (ii) acquisition of sweat equity shares; (iii) acquisition of minimum qualification shares issued for holding a management post in the foreign entity; and (iv) acquisition of shares or interest under ESOP or Employee Benefits Scheme:

*Provided* that the OI Directions permits the Indian resident individuals to make OPI in the units of any investment fund overseas, duly regulated by the regulator for the financial sector in the host jurisdiction, within the overall limit for LRS.

Further, acquisition of less than 10% of the equity capital, whether listed or unlisted, of a foreign entity without control by way of (i) acquisition of sweat equity shares; (ii) acquisition of minimum qualification shares issued for holding a management post in the foreign entity; and (iii) acquisition of shares or interest under ESOP or Employee Benefits Scheme, shall be treated as an OPI.

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<sup>16</sup> 'Subsidiary' or step-down subsidiary' of a foreign entity means an entity in which the foreign entity has control.



# Taxes and Duties

## I. Income Tax Act, 1961

Under the ITA, residents are taxable on worldwide income, while non-residents are taxable only on India-source income i.e., only and to the extent that such income accrues or arises, or is deemed to accrue or arise in India or is received or deemed to be received in India.<sup>1</sup>

The ITA contains specific provisions which govern the classification and computation of income. There are 5 heads of income under which income is chargeable to tax under the ITA, one of them being “Capital Gains”.<sup>2</sup>

Section 45 of the ITA levies tax on capital gains arising on the transfer of a capital asset. Section 2(47) of the ITA defines the term ‘transfer’ in relation to a capital asset<sup>3</sup> to include:

- i. sale, exchange or relinquishment of the asset; or
- ii. extinguishment of any rights therein; or
- iii. compulsory acquisition thereof under any law; or
- iv. in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or
- v. maturity or redemption of a zero-coupon bond; or
- vi. any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882; or
- vii. any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever), which has the effect of transferring, or enabling the enjoyment of, any immovable property.

Income chargeable to tax as capital gains is computed by deducting the following from the value of the consideration received — (a) expenditure incurred wholly and exclusively with respect to such transfer, and (b) cost of acquisition of the capital asset and any cost of improvement of the capital asset.

1 Section 4 read with section 5 of the ITA.

2 Section 14 of the ITA.

3 Section 2 (14) defines ‘capital asset’ as property of any kind held by an assessee whether or not connected with his business or profession, but excludes (a) stock in trade, consumable stores or raw materials held for the purposes of his business or profession, (b) personal effects, i.e., movable property held for personal use, and (c) certain agricultural land.

## 6. Taxes and Duties

Further, under Section 9(1)(i) of the ITA, capital gains arising to a non-resident is considered taxable in India if they are earned directly or indirectly through the transfer of a capital asset situated in India.

The ITA contains several provisions that deal with the taxation of different categories of M&A. The ways in which M&A transactions can be undertaken are:

Amalgamation (i.e., a merger which satisfies the conditions mentioned below)<sup>4</sup> or merger;

- Demerger or spin-off;
- Share Sale;
- Slump Sale; and
- Asset Sale

If a merger or any other kind of restructuring results in a transfer of a capital asset (as referred above) for a resident or a capital asset that is situated in India for a non-resident, it may lead to a taxable event.<sup>5</sup>

### A. Amalgamation

The ITA defines an ‘amalgamation’ as the merger of one or more companies with another company, or the merger of two or more companies to form one company. The ITA also requires that the following conditions must be met by virtue of the merger, for such merger to qualify as an ‘amalgamation’ under the ITA:

- all the property of the amalgamating company(ies) becomes the property of the amalgamated company;
- all the liabilities of the amalgamating company(ies) become the liabilities of the amalgamated company; and
- shareholders holding not less than 75% of the value of the shares of the amalgamating company become shareholders of the amalgamated company. There is a specific carve out from the satisfaction of this condition in case of amalgamation of a subsidiary into its parent, as it is impossible for the condition to be satisfied in such cases.

Section 47 of the ITA sets out certain transfers that are exempt from the provisions of Section 45 (the charging provision for tax on capital gains) and such transfers are exempt from tax on capital gains. The relevant exemptions are provided below:

<sup>4</sup> Section 2(1B) of the ITA.

<sup>5</sup> Capital gains characterization under the ITA also depends on accounting treatment of the transferred asset as ‘capital asset’, frequency of sale, period of holding etc. In case the asset is held as a trading asset and is transferred as part of business, income arising may also be categorized as ‘business income’ under the ITA.

## 6. Taxes and Duties

- for an amalgamating company (transferor)

Section 47(vi): The transfer of a capital asset in a scheme of amalgamation by the amalgamating company to the amalgamated company is exempt from tax on capital gains, provided the amalgamated company is an Indian company.<sup>6</sup> Please note that for this exemption to be applicable to a merger, it is essential that the merger falls within the definition of ‘amalgamation’ provided above. Special exemptions have also been included in case of amalgamations involving banking companies.<sup>7</sup>

- for a foreign amalgamating company (transferor) in connection with transfer of shares in an Indian company

Section 47(via): When a foreign holding company transfers its shareholding in an Indian company to another foreign company as a result of a scheme of amalgamation, such a transfer of the capital asset i.e. shares in the Indian company, would be exempt from tax on capital gains in India for the foreign amalgamating company, if it satisfies the following conditions:

- i. at least 25% of the shareholders of the amalgamating foreign company continue to be the shareholders of the amalgamated foreign company, and
- ii. such transfer does not attract capital gains tax in the country where the amalgamating company is incorporated.

It may be noted that while the definition of ‘amalgamation’ under Section 2(rB) of the ITA requires that 75% (in terms of value of shares) of the shareholders of the amalgamating company should become the shareholders in the amalgamated company, this section specifies 25% of the number of shareholders as the corresponding figure. The above provisions also indicate that an Indian company may not amalgamate into a foreign company without attracting capital gains tax liability in India.

- for the shareholders of the amalgamating company

Section 47(vii): Transfer by the shareholders of an amalgamating company, in a scheme of amalgamation, of shares of the amalgamating company (the capital asset) as consideration for the allotment of shares of the amalgamated company, is exempt from tax on capital gains, provided that the amalgamated company is an Indian company.<sup>8</sup> The exemption from tax on capital gains would only be to the extent that the transfer is for the consideration for shares of the amal-

6 This section only requires that the amalgamated (or the surviving) company must be an Indian company. The amalgamating company may be an Indian company or a foreign company. In this connection it is useful to note that the meaning of the term ‘company’ under the Companies Act differs considerably from the meaning under the ITA. Under the Companies Act, ‘company’ would generally refer to an Indian company (unless specifically provided otherwise). Under the ITA, the term ‘company’ has a much broader meaning and inter alia includes an Indian company and a foreign body corporate (i.e., including a foreign company).

7 Sections 47(viaa), 47(vica), 47(vicb) of the ITA.

8 In this scenario, the shareholders get shares of the amalgamated company in exchange for their shareholding in the amalgamating company, and the amalgamating company is dissolved. It should be noted that the term transfer is used here in the context of the definition of this term under the ITA, which includes the extinguishment of any right in a capital asset. So if the rights of the shareholders in the shares of the amalgamating company are extinguished, it would amount to a transfer (which is exempt from capital gains tax if the conditions specified are complied with).

## 6. Taxes and Duties

gated company. If any consideration other than shares of the amalgamated company, such as cash or bonds, was paid to the shareholders of the amalgamating company, it may be considered liable to tax on capital gains.<sup>9</sup> If any of the conditions specified above are not satisfied (including the conditions specified in the definition of ‘amalgamation’), the transfer of capital assets in a merger would be subject to tax on capital gains.

- for the shareholders/interest holders of a foreign amalgamating company in relation to indirect transfer tax

Section 47(viab) of the ITA provides that any transfer by the shareholders, in a scheme of amalgamation, of shares/interests of a foreign amalgamating company (the capital asset) that derive their value ‘substantially’ from Indian assets<sup>10</sup> (indirect transfer), is exempt from tax on capital gains, if it satisfies the following conditions:

- i. at least 25% of the shareholders of the amalgamating foreign company continue to be the shareholders of the amalgamated foreign company, and
- ii. such transfer does not attract capital gains tax in the country where the amalgamating company is incorporated.

Section 49(1)(iii)(e) of the ITA provides that the cost of acquisition of assets transferred by way of a scheme of amalgamation that are covered by the exemptions under Section 47 mentioned above would be deemed to be the cost of acquisition of the assets in the hands of the amalgamating company. Similarly, Section 49(2) provides that the cost of acquisition for a shareholder, of shares of the amalgamated company, is deemed to be the cost of acquisition of the shares of the amalgamating company.

## B. Demerger

The term ‘demerger’ in relation to companies is defined in Section 2(19AA) of the ITA to mean the transfer, pursuant to a scheme of arrangement under the Merger Provisions by a demerged company of its one or more undertakings, to any resulting company, in such a manner that:

- All the property of the undertaking,<sup>11</sup> being transferred by the demerged company, immediately before the demerger becomes the property of the resulting company by virtue of the demerger;

<sup>9</sup> The Gujarat High Court, in CIT v. Gautam Sarabhai Trust, [1988] 173 ITR 216 (Guj) had held that a shareholder receiving any other property other than shares by virtue of a merger would not qualify for the exemption under Section 47(vii).

<sup>10</sup> Explanation 6 to Section 9(1)(i) of the ITA clarifies that the term ‘substantial’ would mean the foreign shares/interest would need to have a minimum value of INR 10 Crore and have to derive at least 50% of their value from Indian assets.

<sup>11</sup> The term ‘undertaking’ would include any part of an undertaking, any unit or division of an undertaking or a business activity as whole, but does not include individual assets or liabilities which do not constitute a business activity.

## 6. Taxes and Duties

- All the liabilities<sup>12</sup> relating to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- The property & the liabilities of the undertaking/undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger. In other words, the resulting company should record property and the liabilities of the undertaking at the value appearing in the books of accounts (book value) of the demerged company. This condition is impossible to be met by resulting companies that follow Indian accounting standards, since they are required to record the property and liabilities of the undertaking at fair value. In order to facilitate tax neutral demerges involving companies following Indian accounting standards, Finance Act, 2019 (No.2) amended Section 2(19AA) of the ITA to provide that the requirement of recording property and liabilities of the undertakings received by the resulting company at book value shall not be applicable in a case where the property and liabilities of the undertakings received by the resulting company are recorded at fair value, due to the application of Indian accounting standards;
- The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;
- The shareholders holding not less than 3/4ths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or its subsidiary) become shareholders of the resulting company (ies) by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;
- The transfer of the undertaking is on a going concern basis;
- The demerger is in accordance with the conditions, if any, notified under subsection (5) of section 72A by the Central Government in this behalf.

Section 2(19AAA) of the ITA defines the term “demerged company” to mean a company, whose undertaking is transferred, pursuant to a demerger, to a resulting company. Section 2(41A) defines a “resulting company” to mean one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company.

The ITA contains certain tax beneficial provisions in the case of a demerger. If the demerger fulfills the conditions listed above, the transfer of assets by the demerged company to a resulting company, which must be an Indian company, is exempted from capital gains tax under Section 47(vib) of the ITA.

Further, in case of a demerger of a foreign company, whereby both the demerged and resulting companies are foreign, but the assets demerged include or consist of shares in an Indian company,

12 The term ‘liabilities’ would include liabilities and specific loans/borrowings incurred or raised for the specific business activity of the undertaking. In case of a multipurpose loan, such value of the loan will be included, that bears the same proportion as the value of the demerged assets to the total assets of the company.

## 6. Taxes and Duties

the transfer of these shares is exempt from capital gains tax in the hands of the demerged company under Section 47(vic) of the ITA, if the following conditions are satisfied:

- The shareholders holding at least 3/4ths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
- Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

However, since both the demerged and the resulting companies in the aforesaid example are based outside India, hence the provisions of the CA 2013 (as the case may be) would not be applicable.

As in the case of a merger, a specific exemption provision covers demergers in an 'indirect transfer' situation i.e., Section 47(vicc) of the ITA, whereby any transfer of a foreign company's shares, that derive their value 'substantially' from Indian assets (indirect transfer), as part of a demerger would be exempt from capital gains tax in the hands of the demerged company if the following conditions are satisfied:

- The shareholders holding at least 3/4ths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
- Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

## C. Share Sale<sup>13</sup>

The tax rate of capital gains depends mainly on whether the gains are short term or long term. Short term capital gains (“STCG”) arise upon the transfer of capital assets held by a taxpayer for a period of 36 months or less before the date of transfer (12 months or less in the case of securities listed on a recognized stock exchange in India, and 24 months in the case of unlisted shares of an Indian company). Long term capital gains (“LTCG”) arise upon the transfer of a capital asset held for a period of more than 36 months (12 months in the case of listed securities and 24 months in the case of unlisted shares of an Indian company).

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13 All tax rates mentioned in this chapter are exclusive of applicable surcharge and cess.

## 6. Taxes and Duties

The table below sets out the rates at which capital gains are taxable under the ITA for different forms of share sales:<sup>14</sup>

Category	Short-Term Capital Gains	Long-Term Capital Gains	
		Resident shareholder	Non-resident shareholder or foreign company
Sale of listed equity shares on the floor of the recognized stock exchange (Securities Transaction Tax (“STT”) paid)	15% <sup>15</sup>	10% <sup>16</sup> without indexation or foreign exchange fluctuation benefit	10% without foreign exchange fluctuation benefit <sup>17</sup>
Sale of other listed securities	Rate of tax generally applicable to taxpayer <ul style="list-style-type: none"> <li>■ For Individuals, as per prescribed slab rates</li> <li>■ For Domestic Companies, 15% to 30% as applicable</li> <li>■ For Foreign Companies, 40%</li> </ul>	20% with indexation benefit; or 10% without indexation benefit, whichever is more beneficial <sup>18</sup>  20% with indexation benefit <sup>20</sup>	10% without indexation and foreign exchange fluctuation benefit <sup>19</sup>  10% without indexation and foreign exchange fluctuation benefit <sup>21</sup>
Sale of unlisted securities			

<sup>14</sup> Surcharge, and, a health and education cess at 4% on the aggregate amount of tax and surcharge applies. Rates of surcharge are:

Taxable income	Foreign Companies	Domestic companies	Individuals
Up to INR 5 million	Nil	Nil	Nil
Above INR 5 million up to INR 10 million	Nil	Nil	10%
Above INR 10 million up to INR 20 million	2%	7%	15%
Above INR 20 million to INR 50 million	2%	7%	25%
Above 50 million to INR 100 million	2%	7%	37%
Above INR 100 million	5%	12%	37%

<sup>15</sup> Section 111A of the ITA.

<sup>16</sup> Section 112A of the ITA. LTCG arising from transfer of listed equity shares in a company on or after April 1, 2018 and where such transfers are liable to STT on acquisition and transfer, are taxable at 10%, where such capital gains exceed INR 0.1 million. Taxpayers have been granted the benefit of step up of COA based on fair value of listed equity shares as on January 31, 2018. Further, CBDT has notified certain transactions of acquisition of equity shares (like initial public offer, offer for sale, merger, shares allotted to qualified institutional buyers, bonus issue etc.) on which the condition of payment of STT shall not apply and accordingly, LTCG on transfer of such equity shares shall be taxable at 10%.

<sup>17</sup> Ibid.

<sup>18</sup> Section 112 of the ITA.

<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

## 6. Taxes and Duties

All transactions entered into on a recognized stock exchange in India will be subject to STT, which is levied on the transaction value. In the case of sale of equity shares on a delivery basis, STT is generally levied at the rate of 0.1% on the value of the transaction on both the buyer and seller of the equity shares<sup>22</sup>.

Further, India has entered into tax treaties with several jurisdictions that allow for allocation of taxation rights in a cross-border transactions. In case where a non-resident is resident of a jurisdiction with a beneficial tax treaty with India (such as Mauritius or Singapore), subject to fulfilment of other requirements, they may claim benefits under the tax treaty to neutralize capital gains tax exposure in India.

Moreover, in case unlisted shares of a company are transferred at less than the fair market value (“FMV”) then the FMV shall be deemed to be the full value consideration for the purposes of computing capital gains tax in the hands of the transferor.<sup>23</sup> Further, in case of transfer of shares at less than FMV, even the transferee may be subject to tax on the difference between the FMV and the consideration paid under the head ‘income from other sources’.<sup>24</sup> Lastly, in this regard, it shall be noted that under section 56(2)(viiB) of the ITA, if a private company issues shares to a resident at a premium (above the face value), then the difference between the consideration received for such shares and their FMV should be taxable in the hands of the issuing company, commonly referred as Angel Tax.

Further, the Finance Act, 2023 has enlarged the scope of the Angel Tax to cover investments received by non-residents as well.

However, this provision is not applicable to consideration for issuance of shares received: (i) by a venture capital undertaking from a venture capital company or a VCF; or (ii) by a specified fund<sup>25</sup>; or (iii) by a company from a class or classes of persons as may be notified by the Government in this behalf. Importantly, ‘eligible start-ups’, (i.e., start-ups that qualify the prescribed conditions and are recognized as ‘eligible start-ups’ by Government) are exempt from section 56(2)(viiB).

### D. Slump Sale

A slump sale is defined under the ITA as transfer of one or more undertaking(s) by any means for a lump sum consideration, without assigning values to the individual assets and liabilities of the undertaking.<sup>26</sup> ‘Undertaking’ has been defined to include an undertaking, or a unit or a division of an undertaking or business activity taken as a whole. However, undertaking

22 Section 98 of the Finance Act (No. 2), 2004.

23 Section 50CA of the Income Tax Act, 1961.

24 Section 56(2)(x) of the Income Tax Act, 1961.

25 As defined under clause (aa) in explanation to Section 56(2)(viiB) of the ITA.

26 Section 2(42C) of the ITA.



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does not mean a combination of individual assets which would not constitute a business activity in itself.<sup>27</sup>

For the purpose of computing capital gains, the cost of acquisition would be the ‘net worth’ of the undertaking on the date of the transfer.<sup>28</sup> The ‘net worth’ of the undertaking shall be determined by calculating the difference between the aggregate value of total assets and aggregate value of total liabilities as per the books of accounts of the seller.

Further, for the purpose of such calculation, the aggregate value of total assets shall be,

- in the case of depreciable assets, the written down value of the block of assets determined in accordance with the ITA;
- in the case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD, nil; and
- in the case of other assets, the book value of such assets.

If the undertaking, which is being sold under slump sale was held by the transferor Indian company for more than 36 months, the capital gains realized on such sale would be taxed as LTCG, i.e., at the rate of 20% (exclusive of surcharge and education cess). If, however, the undertaking was held for 36 months or less by the transferor Indian company, the capital gains realized would be taxed as STCG, i.e., at the rate of 30% (exclusive of surcharge and education cess). Prior to the Finance Act, 2021, there was no stipulation regarding the determination of the full value of consideration for computing capital gains in case of slump sales. However, the Finance Act 2021 brought about an amendment in this regard which provides that the full value of consideration shall be deemed to be the fair market value (“FMV”) of the undertaking to be determined as per prescribed rules. On the heels of an amendment made by the Finance Act, 2021, Central Board of Direct Taxes (“CBDT”) has released valuation rules for computing capital gains arising from a slump sale.

A slump sale is useful in situations when it would not be feasible to go through the process of amalgamation or demerger under the Merger Provisions. Further, it is also a useful restructuring tool in case of transactions such as externalizations as an undertaking may be transferred by an Indian company at ‘net worth’ to another Indian company in a tax neutral manner. Time taken for a slump sale is substantially less than the time taken for merger.

It would also be useful to note that prior to amendment by Finance Act, 2021, the definition of ‘slump sale’ under the ITA uses the term ‘sale’<sup>29</sup> specifically, and excluded any other type of transfer as defined under the ITA. Therefore, the transfer of an undertaking in consideration for issue of securities of the transferee or any other property other than cash was considered to be tax neutral in India.<sup>30</sup> The Finance Act, 2021 replaces the word ‘sale’, and instead defines

<sup>27</sup> Explanation 1 to Section 2 (19AA).

<sup>28</sup> Section 50B of the ITA.

<sup>29</sup> The term ‘sale’ is defined as a transfer of property in consideration for cash under the Sale of Goods Act, 1930.

<sup>30</sup> Upheld by the Bombay High Court in CIT v. Bharat Bijlee Limited, [2014] 364 ITR 581 (Bombay).

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the term to include the transfer of an undertaking “by any means”. The term ‘transfer’ has been defined broadly under the ITA to include specifically an ‘exchange’, ‘relinquishment’ and ‘extinguishment’.

### E. Asset Sale (itemized sale)

In an asset sale, the acquirer only purchases the assets of the seller. This does not amount to the transfer of the business as a going concern and specific values are attributed to each of the assets. The capital gains tax payable by the seller will depend on the period that the seller has held each of the assets that are transferred. This method of acquisition is usually used where the acquirer does not want to acquire the liabilities of the seller and more so if the acquirer believes that the seller has not disclosed certain liabilities or there is a distinct possibility that unforeseen liabilities could arise in the future. The ITA provides separate computation provisions for asset sale, depending upon whether the asset is depreciable or non – depreciable.

- **Non – depreciable assets:**

If the assets which are being sold were held by the transferor Indian company for more than 36 months, the capital gains realized on such sale would be taxed as LTCG, i.e., at the rate of 20% (exclusive of surcharge and education cess). If, however, the assets were held for 36 months or less by the transferor Indian company, the capital gains realized would be taxed as STCG, i.e., at the rate of 30% (exclusive of surcharge and education cess).

- **Depreciable assets:**

Capital gains is determined based on whether the block of assets (“**Block**”)<sup>31</sup> exists post transfer or not.

#### a. Capital gains when the Block continues to exist post transfer

Capital gains from the transfer would be deemed to be STCG and should be taxable in hands of transferor at the applicable tax rate, irrespective of the period of holding of such asset. The capital gains will be determined as the difference, if any, between (1) the sale consideration from the transfer of the concerned assets, together with the transfer of any other asset within that Block in the same financial year, and (2) the aggregate of:

- i. Expenditure incurred in connection with such transfers;
- ii. Written Down Value (“**WDV**”) of the Block at the beginning of the financial year; and
- iii. Actual cost of any asset acquired during that year and forming part of that Block.<sup>32</sup>

<sup>31</sup> ‘Block of assets’ is defined in Section 2(11) of the ITA as a group of assets falling within a class of assets in respect of which the same percentage of depreciation is prescribed. Such block of assets may comprise of (a) tangible assets such as buildings, machinery, plant or furniture; (b) intangible assets such as know-how, patents, copyrights etc.

<sup>32</sup> Section 50(1) of the ITA.

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### b. Capital gains when the Block ceases to exist post transfer

Where all assets from a Block are transferred such that the Block ceases to exist, capital gain from such transfer should be deemed to be STCG and should be taxable in hands of transferor at the applicable tax rate, irrespective of the period of holding of such asset.

The capital gain from such transfer should be determined as the difference, if any, between (1) the sale consideration from the transfer of the concerned assets, together with the transfer of any other asset within that Block in the same financial year, and (2) the aggregate of:

- i. WDV of the Block at the beginning of the year; and
- ii. Actual cost of any asset acquired during that year and forming part of that Block.<sup>33</sup>

Applicable surcharge on Indian companies would be 7% if income is between INR 1-10 crores and 12% if income exceeds INR 10 crores. Further, 4% cess on the quantum of income-tax and surcharge is applicable to all taxpayers.

Please note that any cross-border transaction between related parties that is liable to tax under the ITA would also be subject to ‘transfer pricing’ requirements under Indian law, mandating the transaction to be undertaken at an ‘arm’s length price’ and other documentation requirements.

## F. Other Considerations

### I. Indirect Transfer

Gains earned by a resident company from the transfer of capital assets situated anywhere in the world are taxable in India. In the case of non-residents, only those gains arising out of the transfer of a capital asset situated in India should be taxable.<sup>34</sup>

The source rule pertaining to a ‘capital asset situated in India’ was examined by the Supreme Court of India in Vodafone International Holdings B.V. v. Union of India,<sup>35</sup> which dealt with the transfer of shares of a non-resident company between two non-residents. The Supreme Court held that a share is legally situated at the place of incorporation/ registration of the company or where the shares may be effectively dealt with. Therefore, while the shares of an Indian company would be considered as situated in India, the shares of a company incorporated outside India would ordinarily be viewed as situated outside India. However, subsequent to the above-mentioned Vodafone judgment, the Government of India introduced indirect transfer tax rules through introduction of Explanation 5 to Section 9(1)(i) of the ITA (“**Indirect Transfer**”). This insertion clarified that the transfer of shares of a foreign company which derives its value substantially from assets located in India shall be subject to capital gains tax in India.

<sup>33</sup> Section 50(2) of the ITA.

<sup>34</sup> Section 9 of the Income Tax Act, 1961. Further, India also introduced a rule to tax non-residents on the transfer of foreign securities the value of which are substantially (directly or indirectly) derived from assets situated in India (Indirect Transfer Tax).

<sup>35</sup> (2012) 341 ITR 1(SC).

## 6. Taxes and Duties

As per Explanation 6 to section 9(1)(i) of the ITA,<sup>36</sup> a foreign company is considered to derive its value substantially from assets located in India if the value of such assets (“**Indirect Transfer Test**”):

- i. exceeds INR 100 million; and
- ii. represents at least 50% of the value of all the assets owned by the company or the entity, as the case may be.

Additionally, Explanation 6 also provides that the value of the assets for the purposes of the Indirect Transfer Test shall be the fair market value (“**FMV**”) of the assets determined as per any internationally accepted valuation methodologies without reduction of liabilities.

Further, as per clause (d) of Explanation 6, value of the assets for the purposes of determining whether the Indirect Transfer Test is satisfied should be computed as on a specified date (“**Specified Date**”). Specified date has been defined in the ITA to mean

- a. date on which the accounting period of the foreign company / entity ends preceding the date of transfer of a share or an interest; or
- b. date of transfer, if the book value of the assets of the foreign company/ entity on the date of transfer exceed the book value of the assets as on the date referred in (a) above by 15%

In addition to the above, Explanation 7 to Section 9(1)(i), provides for an exemption from the indirect transfer provisions to small shareholders, who together with associated enterprises hold a de minimis shareholding (less than 5%).

The demands raised by the Indian Government under the indirect transfer tax provisions spurred investment treaty arbitration cases against India — among which are Vodafone International Holdings BV v. The Republic of India (“**Vodafone arbitration**”) and Cairn Energy Plc and CUHL v the Republic of India (“**Cairn arbitration**”). The arbitral tribunals have ruled in favour of the foreign investors against India in the Vodafone and Cairn arbitrations.

In this backdrop, the Indirect Transfer provisions were amended by the Taxation Laws (Amendment) Act, 2021 (“**2021 Act**”) to remove the retrospective application of such Indirect Transfer provisions. The 2021 Act makes following changes in the Indirect Transfer provisions:

- **An embargo on future tax demands:** The 2021 Act provides that the Indirect Transfer provisions would not apply to income accruing or arising as a result of an Indirect Transfer undertaken prior to May 28, 2012. The 2021 Act has added a proviso to Explanation 5 to section 9 (1) (i) of the ITA for non-application of Indirect Transfer provisions on (i) assessments or reassessments initiated under specified sections, (ii) orders passed enhancing a tax assessment or reducing a refund and (iii) orders passed deeming a person to be an assessee-in-default for not withholding taxes in respect of indirect transfers prior to May 28, 2012.
- **Nullification of tax demands raised:** The 2021 Act also provides that demands raised for indirect transfers of Indian assets made prior to May 28, 2012 shall be nullified, subject

<sup>36</sup> Explanation 6 to section 9(1)(i) was introduced through Finance Act, 2015

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to fulfilment of the following conditions<sup>37</sup> by the person in whose case such demand has been raised:

- withdrawal or an undertaking for withdrawal of appeal filed before an appellate forum or a writ petition filed before a High Court or the Supreme Court of India;
- withdrawal or an undertaking for withdrawal of any proceedings for arbitration, conciliation or mediation initiated by such person such as under a bilateral investment treaty; and
- furnishing of an undertaking waiving their rights to seek or pursue any remedy or any claim in relation to such income whether in India or outside India.

**Refund of amounts paid:** The 2021 Act also provides that the Government shall refund the taxes paid in cases where the application of Indirect Transfer provisions is being withdrawn due to fulfilment of the conditions mentioned above. However, no interest, cost or damage shall be paid by the Government on such refund of taxes.

The 2021 Act saw moves towards settlement of quite a few cases including the Indian tax authorities withdrawing their petition before the SC over taxability in the Sanofi case<sup>38</sup> and reports regarding the Indian Government settled the long-running tax disputes arising from the Indirect Transfer provisions with Vodafone Group<sup>39</sup> and Cairn Energy<sup>40</sup>.

## II. Tax on Business Income — Carry Forward of Losses

Section 72A of the ITA provides that in case of amalgamation of a company owning an industrial undertaking<sup>41</sup> with another company, the accumulated loss and the unabsorbed depreciation of the amalgamating company is deemed to be the loss / allowance for depreciation, of the amalgamated company. The amalgamated company would then be entitled to carry forward such loss and depreciation and set off such amounts against its future profits. However, the following conditions must be satisfied for availing the above entitlement:

### a. The amalgamated company:

- i. Holds 3/4ths of the book value of the fixed assets which it acquired from the amalgamating company continuously for a period of 5 years from the date of amalgamation;
- ii. Continues to carry on the business of the amalgamating company for a minimum period of 5 years from the date of amalgamation. This would imply that if the amalgamating

<sup>37</sup> On August 28, 2021, the Government has notified the draft rules for public consultation to specify the conditions to be fulfilled and the process to be followed to give effect to the amendment made by the 2021 Act.

<sup>38</sup> SLP(C) No. 19856-58 of 2013.

<sup>39</sup> <https://economictimes.indiatimes.com/news/economy/policy/vodafone-files-for-retro-tax-settlement-with-india/articleshow/88061385.cms>.

<sup>40</sup> <https://www.livemint.com/companies/retrospective-tax-india-refunds-rs-7-900-cr-to-cairn-to-settle-dispute-11645706981790.html>.

<sup>41</sup> Industrial undertaking means an undertaking engaged in manufacture or processing of good, manufacture of computer software, generation/distribution of electricity/ power, telecommunications services etc. This does not cover undertakings in the software service sector and certain other service sectors.

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company were engaged in more than one business prior to amalgamation, the amalgamated company would be required to carry on all of those businesses; and

- iii. Fulfills such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

### **b. The amalgamating company:**

- i. has been engaged in the business, in which the loss occurred or depreciation remained unabsorbed, for 3 or more years; and
- ii. has held continuously, on the date of amalgamation, at least 3/4ths of the book value of the fixed assets held by it 2 years prior to the date of amalgamation.

Section 72A(4) of the ITA provides a similar benefit for demergers. However, in the case of a demerger, the company does not need to satisfy any conditions similar to those applicable to mergers. In the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall:

- a. where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;
- b. where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

In a case where these conditions are not met, carry-forward and set-off of losses will not be allowed to the amalgamated or the resulting company (as the case maybe). Section 79 of the ITA provides that in order for a company to claim carry-forward and set-off of losses for a particular assessment year, 51% of the voting power of the company must be beneficially held during that assessment year by the same shareholders who held such voting right on the last day of the year or years in which the loss was incurred. However, this provision shall not be applicable in a case where there is a change in shareholding of an Indian company, that is a subsidiary of a foreign company, as a result of amalgamation or demerger of a foreign company, subject to the condition that 51% shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.<sup>42</sup> Further, domestic transfer pricing rules have also been introduced under the ITA by which expenses may be disallowed in case of transactions between related parties.

<sup>42</sup> Special exemptions are also provided in case of death of a shareholder, gift of shares to relatives.

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### III. Transfers declared void under Section 281

Where there are assessment proceedings or tax litigations under the ITA pending on any person, including a company, any charge created on or transfer envisaged of any assets of such person shall be considered void as per section 281 of the ITA —

- i. if it is not made for adequate consideration and there is a notice of the pendency of such proceeding or with a notice of such tax or other sum payable by such person; or
- ii. if it is not made with the previous permission of the assessing officer.

A certificate under section 281 is key in a merger or acquisition situation in a case where the transferor has pending assessment proceedings or tax litigation under the ITA at any level.

### IV. Assessment post succession of business

Section 170 of the ITA provides the manner of taxation (i.e., who is assessable) in cases of succession of a business (or profession) to a person who succeeds and carries on the business (from its predecessor). It envisages separate assessments on both, the predecessor and the successor (for which they both separately compute their taxes, apply deductions, and pay taxes as per their applicable rates). The issue regarding the validity of assessment / re-assessment proceedings initiated on predecessor entities during the pendency of reorganization proceedings before the adjudicating authorities have been subject to litigation in the past. In order to clarify this issue, the Finance Act, 2022, amended Section 170 of the ITA (with effect from April 1, 2022) to provide that where assessment / re-assessment proceedings are initiated on predecessor entity during the pendency of reorganization proceedings, such proceedings shall be deemed to have been made on the successor entity. The amendment to Section 170 of the ITA should put an end to further litigation on this issue going forward. The amendment also appears to be in line with the spirit of the definition of ‘demergers’ in Section 2(19AA), and ‘amalgamation’ in Section 2(1B) which envisage all assets and liabilities of the demerging/amalgamating entity (predecessor) to stand transferred to the resulting entity (successor).

## II. Goods and Services Tax

From July 1, 2017, the Goods and Services Tax (“GST”) regime has come into force, which replaced the erstwhile indirect tax regime. Under the GST regime, Central GST and State GST is levied on all intra-state supplies of goods and/ or services, and Integrated GST is levied on imports and all supplies of goods and/or services undertaken in the course of inter-state trade or commerce. The slab rates for the levy of GST on the supply of goods/services are fixed at 5%, 12%, 18% or 28%.

In an asset purchase depending on the type of asset being sold, the rate of GST will vary. Since a ‘business’ per se does not qualify as ‘goods’ or ‘services’ under the GST Act, no GST is levied on slump sale transactions. Further, since ‘shares’ are covered under the definition of ‘securities’ and ‘securities’ are specifically excluded from the ambit of ‘goods’ under the GST law, there

## 6. Taxes and Duties

would be no GST incidence upon transfer of shares, including in case of amalgamations and demergers.

### III. Stamp Duty

Stamp duty is a duty payable on certain specified instruments/documents. Broadly speaking, when there is a conveyance or transfer of any movable or immovable property, the instrument or document effecting the transfer is liable to payment of stamp duty.

#### A. Stamp duty on court order for mergers/demergers

Since the order of the Court merging two or more companies, or approving a demerger, has the effect of transferring property to the surviving /resulting company, the order of the NCLT may be required to be stamped. The stamp laws of most states require the stamping of such orders. The amount of the stamp duty payable would depend on the state specific stamp law.

#### B. Stamp duty on share transfer

With effect from July 1, 2020, share transfers of unlisted securities both in physical and dematerialized form are subject to stamp duty at 0.015% of the purchase consideration. Stamp duty in the case of listed securities varies from 0.015% to 0.003% depending on whether they are traded on a cash on delivery basis or cash on non-delivery basis.

#### C. Stamp duty on shareholder agreements/joint venture agreements

Stamp duty will be payable as per the state specific stamp law.

#### D. Stamp duty on share purchase agreements

Stamp duty may be payable on an agreement that records the purchase of shares/debentures of a company. This stamp duty is payable in addition to the stamp duty on the share transfers mentioned above.



### E. Transaction costs for asset purchase vs. slump sale vs. share purchase

Transaction related costs are generally higher in the case of an asset purchase as compared to a share purchase or slump sale. This is primarily because in a share purchase or slump sale, there would usually be no incidence of GST, which may be levied on different aspects of an asset purchase. Further, the rate of stamp duty is also usually higher in an asset purchase and slump sale, and it is dependent on the nature of the assets being transferred. While for tax purposes, no values are assigned to the individual assets of the undertaking being transferred (in a slump sale), it is necessary to assign values to assets for the purpose of determining the stamp duty payable.

The stamp duty on a transfer of shares is currently 0.015% of the consideration payable for the shares, which rate is usually far less than the stamp duty rates applicable for transfer of movable/immovable assets which may vary from 3% to 5% from state to state.

## Conclusion

As Dale Carnegie<sup>1</sup> said “Flaming enthusiasm, backed by horse sense and persistence, is the quality that most frequently makes for success”. A quote that holds good for M&A in India, and a credo to which Indian companies seem to subscribe given their successes to date in completing acquisitions. There is little to stop Indian companies that desire to be global names for playing the merger and acquisition game globally. With a plethora of financing options, this aspiration has become a reality for many corporate houses, who can now boast of having the best in the industry under their wings. Indian companies have often surpassed their foreign counterparts in corporate restructuring both within and beyond the national frontiers. Mergers and acquisitions are powerful indicators of a robust and growing economy. The legal framework for such corporate restructuring must be easy and facilitative and not restrictive and mired in bureaucratic and regulatory hurdles. The biggest obstacle in the way of completing a merger or an amalgamation remains the often long drawn out court procedure required for the sanction of a scheme of arrangement.

The recommendations of the JJ Irani Report are of particular significance in this regard. The Report has recommended that legal recognition to ‘contractual merger’ (i.e., mergers without the intervention of the court) can go a long way in eliminating the obstructions to mergers in India. The report also recommended that the right to object to a scheme of merger/acquisition should only be available to persons holding a substantial stake in the company.

As George Bernard Shaw<sup>2</sup> is reputed to have said “we are made wise not by the recollection of our past, but by the responsibility for our future”, and the future of India is bright indeed.

### Team M&A

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1 November 24, 1888 – November 1, 1955.

2 106. July 26, 1856 – November 2, 1950, Nobel Prize for Literature 1925.





## About NDA

At Nishith Desai Associates, we have earned the reputation of being Asia's most Innovative Law Firm — and the go-to specialists for companies around the world, looking to conduct businesses in India and for Indian companies considering business expansion abroad. In fact, we have conceptualized and created a state-of-the-art Blue Sky Thinking and Research Campus, Imaginarium Aligunjan, an international institution dedicated to designing a premeditated future with an embedded strategic foresight capability.

We are a research and strategy driven international firm with offices in Mumbai, Palo Alto (Silicon Valley), Bengaluru, Singapore, New Delhi, Munich, and New York. Our team comprises of specialists who provide strategic advice on legal, regulatory, and tax related matters in an integrated manner basis key insights carefully culled from the allied industries.

As an active participant in shaping India's regulatory environment, we at NDA, have the expertise and more importantly — the VISION — to navigate its complexities. Our ongoing endeavors in conducting and facilitating original research in emerging areas of law has helped us develop unparalleled proficiency to anticipate legal obstacles, mitigate potential risks and identify new opportunities for our clients on a global scale. Simply put, for conglomerates looking to conduct business in the subcontinent, NDA takes the uncertainty out of new frontiers.

As a firm of doyens, we pride ourselves in working with select clients within select verticals on complex matters. Our forte lies in providing innovative and strategic advice in futuristic areas of law such as those relating to Blockchain and virtual currencies, Internet of Things (IOT), Aviation, Artificial Intelligence, Privatization of Outer Space, Drones, Robotics, Virtual Reality, Ed-Tech, Med-Tech and Medical Devices and Nanotechnology with our key clientele comprising of marquee Fortune 500 corporations.

The firm has been consistently ranked as one of the Most Innovative Law Firms, across the globe. In fact, NDA has been the proud recipient of the Financial Times–RSG award 4 times in a row, (2014-2017) as the Most Innovative Indian Law Firm.

We are a trust based, non-hierarchical, democratic organization that leverages research and knowledge to deliver extraordinary value to our clients. Datum, our unique employer proposition has been developed into a global case study, aptly titled 'Management by Trust in a Democratic Enterprise,' published by John Wiley & Sons, USA.

## Research@NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our "Hotlines". These Hotlines provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our NDA Labs dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction. We regularly write extensive research papers and disseminate them through our website. Our ThinkTank discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

As we continue to grow through our research-based approach, we now have established an exclusive four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. Imaginarium AliGunjan is a platform for creative thinking; an apolitical ecosystem that connects multi-disciplinary threads of ideas, innovation and imagination. Designed to inspire 'blue sky' thinking, research, exploration and synthesis, reflections and communication, it aims to bring in wholeness — that leads to answers to the biggest challenges of our time and beyond. It seeks to be a bridge that connects the futuristic advancements of diverse disciplines. It offers a space, both virtually and literally, for integration and synthesis of knowhow and innovation from various streams and serves as a dais to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research publications. Please feel free to contact us at [research@nishithdesai.com](mailto:research@nishithdesai.com).

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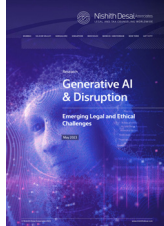
Extensive knowledge gained through our original research is a source of our expertise.



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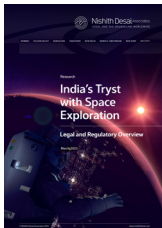
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**Nishith Desai** Associates  
LEGAL AND TAX COUNSELING WORLDWIDE

**MUMBAI**

93 B, Mittal Court, Nariman Point  
Mumbai 400 021, India  
Tel +91 22 6669 5000

**SILICON VALLEY**

220 S California Ave., Suite 201  
Palo Alto, California 94306, USA  
Tel +1 650 325 7100

**BENGALURU**

Prestige Loka, G01, 7/1 Brunton Rd  
Bengaluru 560 025, India  
Tel +91 80 6693 5000

**SINGAPORE**

Level 24, CapitaGreen  
138 Market St  
Singapore 048 946  
Tel +65 6550 9855

**MUMBAI BKC**

3, North Avenue, Maker Maxity  
Bandra–Kurla Complex  
Mumbai 400 051, India  
Tel +91 22 6159 5000

**NEW DELHI**

13-H, Hansalaya Building, 15  
Barakhamba Road, Connaught Place  
New Delhi 110 001, India  
Tel +91 11 4906 5000

**MUNICH / AMSTERDAM**

Maximilianstraße 13  
80539 Munich, Germany  
Tel +49 89 203 006 268

**NEW YORK**

1185 6th Avenue, Suite 326  
New York, NY 10036, USA  
Tel +1 212 464 7050

**GIFT CITY**

408, 4th Floor, Pragya Towers  
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