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The legislative regime of M&A Transactions: An Overview

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Any segment of transactional law consists of multiple facets. Any transaction pertaining to the field of Mergers & Acquisitions involves the intervention of various sector-specific as well as general legislations. The primary legislative regime of the aforesaid transaction can be traced in the Companies Act, 2013. However, any transaction pertaining to M&A doesn't stand exhaustive of the aforesaid act but involves the interference of various legislations that create a comprehensive legal structure for such transactions. The Article intends to put light on the imminent features of the essential legal provisions that have an impact on an M&A transaction.

Keywords: *Indian economy, transactional laws, mergers & acquisitions, companies act.*

INTRODUCTION

The Indian economy is on the verge of exiting pandemic influences and creating a new paradigm that aligns with the pre-pandemic era. There is no dispute in the fact that the initial months of the pandemic had impacted the corporate sector in an adverse manner. However, as the economy adjusted to the new normal, there was gradual normalcy in the transactional market. M&A transactions have witnessed significant growth in the last two quarters, which can be claimed as a recovery from the pandemic influences. Supplemented with the Ease of Doing Business policies incorporated by the Government of India, M&A transactions have witnessed

a steep growth with settlements of deals worth \$82.3 billion only in the second quarter of 2022.¹ The financial markets witnessed the merger of INOX with PVR becoming one of the most extensive transactional deals of 2022². Further, the acquisition of Housing Development Financing Corporation by HDFC Bank made its place in the financial highlights of H1 of 2022³. The Indian start-up universe had left no stone unturned to excel in this domain as well with acquisitions of Ed-tech start-ups Aakash Institute by BYJUs developing the picture. The current financial year witnesses M&A deals making headlines in the financial markets. In light of the aforesaid fact, through the course of the article, endeavours have been made by the author to analyse the legislative regime in course of an M&A transaction.

MERGERS v/s ACQUISITION

Although the two terms have been used as conjoint twins, it shall be necessary to embark on a demarcation between them as the two concepts aren't identical in nature. A Merger transaction involves the consolidation of two existing entities to form a unified entity. On the other hand, an Acquisition transaction involves taking over the shares and voting rights of one company of the other, which may result in a holding-subsidiary or associate company relationship. While mergers can be defined to mean the unification of two players into a single entity, acquisitions are situations where one player buys out the other to combine the bought entity with itself.

MERGERS AND ACQUISITIONS UNDER COMPANIES ACT 2013

Companies Act 2013 persists to be the primary legislation governing the corporates in India. Chapter XV of the Companies Act 2013 pertains to Compromises and Arrangements, which

¹ 'India saw Record \$82.3 Billion Merger And Acquisition Deals In Q2 Of 2022 Even As Global M&A Volume Slumps: Report' (*Swarajaya*, 28 June 2022) <<https://swarajyamag.com/business/india-saw-record-823-billion-merger-and-acquisition-deals-in-q2-of-2022-even-as-global-ma-volume-slumps-report>> accessed 15 July 2022

² 'PVR, Inox get SEBI nod for merger to create India's largest multiplex chain' (*Business Standard*, 22 June 2022) <https://www.business-standard.com/article/companies/pvr-inox-get-sebi-nod-for-merger-to-create-india-s-largest-multiplex-chain-122062101288_1.html#:~:text=The%20two%20companies%20had%20announced,every%2010%20shares%20of%20Inox> accessed 15 July 2022

³ Gopika Gopakummar, 'HDFC to merge with HDFC Bank' (*Mint*, 4 April 2022) <<https://www.livemint.com/companies/news/hdfc-to-merge-with-hdfc-bank-11649046971022.html>> accessed 15 July 2022

shall be construed as restructuring deals including buy-outs, private acquisitions influenced outside the purview of the Takeover Code, public acquisitions affected through SEBI (SAST) Regulations 2011, etc. The Act provides for the primary mechanism which is the pre-requisite for affecting an acquisition or amalgamation deal. In terms of the provisions entailed in the act, every arrangement that intends to execute a merger or amalgamation, or acquisition of two or more entities shall be subjected to preliminary approval by NCLT. In pursuance of its preliminary approval, NCLT shall be responsible for ordering a meeting of the members who shall be validating such approval through a special resolution through Postal Ballot or in the General Meeting⁴. In respect of companies that fulfill the criteria of e-voting laid in the act, such resolution may alternatively be convened through e-voting.⁵

Any resolution passed by a company on this behalf shall be subjected to final approval by NCLT, in absence of which, the such scheme shall not be enforced. The Act mentions that the term 'compromise or arrangements' shall be inclusive of takeover offers. However, such inclusion shall be limited to takeovers of unlisted companies⁶. For acquisitions or takeovers of the listed company, perusal of SEBI Regulations shall be made.

MERGERS OF HOLDING AND SUBSIDIARY COMPANIES

When a company acquires more than half of the share capital of another company, or if a company is vested with controlling the composition of the Board of directors of another company, such companies are said to have a holding-subsidary relationship⁷. Further, a small company may be defined as a private company whose share capital doesn't exceed INR 2 crores and whose turnover doesn't exceed INR 20 crores.⁸ In the events when such companies intend to divulge their identities to one, the Companies Act provides a distinctive mechanism for the same. The Act forgoes the requirement of approval by NCLT if such scheme of arrangement has been subjected to approval by shareholders representing 90% of the shares of the company.

⁴ Companies Act, 2013, s 230

⁵ Companies Act, 2013, s 108

⁶ Companies Act, 2013, s 233

⁷ Companies Act, 2013, s 2(46) read with s (87)

⁸ Companies Act, 2013 read with Companies (Specifications of Definitions & Details) Rules, 2014, s (85)

Further, such a scheme shall also be approved by creditors representing 9/10th of the total lending of the company. Such schemes shall be filed before the Registrar and Official Liquidator for inviting objections, and such objections shall be duly incorporated.⁹

ACQUISITIONS UNDER SEBI TAKEOVER CODE 2011

SEBI (Substantial Acquisition of Shares and Takeover) Regulations 2011, alternatively referred to as the Takeover Code, lays down the disclosure as well as procedural requirements associated with an acquisition transaction. The purpose of the act may be identified as regulating hostile takeovers, structuring friendly takeovers, and enforcing a mechanism that discloses the identity of controlling shareholders in any entity.

Whenever an acquiring entity, pursuant to any transaction, acquires up to 25% of the voting rights of a concerned target company, such acquirer shall necessarily affect a public announcement to further acquire shares of the concerned company.¹⁰ However, it shall be necessary to emphasize that such further acquisition shall adhere to the regulations pertaining to maximum permissible shareholding¹¹. In events, where the subsequent acquisition of shares violates the provisions relating to maximum permissible shareholding, such target company shall be compulsorily delisted in accordance with SEBI (Delisting of Shares) Regulations 2008¹². However, if a target company intends to continue as a listed entity, such entity, within a period of twelve months from the date of such acquisition, reduces the public shareholding in accordance with Securities Contract Regulations (Rules).

In addition to the above, the features of the Act are that it mandates any person whose shares have reached the level of 5% of the shareholding of the concerned entity shall serve a notice to the Stock Exchange as well as the concerned target company. Further, if such a person having a

⁹ Companies Act, 2013, s 233

¹⁰ SEBI (SAST) Regulations, 2011, Regulation 3(1)

¹¹ SEBI (SAST) Regulations, 2011, Regulation 3(2)

¹² Securities Contract (Regulation) Rules, 1957, r 21

stake of 5%, acquires or redeems more than 2% of the shares or voting rights of the concerned target company must affect the disclosures in the same manner.¹³

APPROVALS UNDER COMPETITION ACT 2002

In the fall of the H1 of 2022, the financial markets witnessed headlines that highlighted CCI's approval of the acquisition of Air Asia by Air India, resulting in the former becoming a wholly owned subsidiary of the latter.¹⁴ Overlapping with the same period, NCLAT upheld the order of CCI discarding the acquisition of Future Group by Amazon on account of failure to disclose certain essential information.¹⁵ The powers conferred on CCI to sanction certain acquisitions are derived from Competition Act 2002 which stands as the legislative regime that regulates agreements & transactions which cause or are likely to cause '*adverse appreciable effect on competition in India*'.

The objective of the aforesaid legislation is to regulate the abuse of competitive powers on part of market players in order to ensure that the economy functions in a 'fair competitive state'. In lieu of the aforesaid objective, the Competition Commission of India has been entrusted with the responsibility of sanctioning 'combinations' which fall within the ambit of criteria specified in the act.¹⁶ The general rule outlays that any combination which causes or is likely to cause an adverse appreciable effect on competition in India' shall be deemed to be void.¹⁷ In respect of the aforesaid general rule, any acquiring entity shall be required to serve a notice with appropriate disclosures before CCI prior to executing a merger or acquisition which satisfies the definition of combination.

¹³ SEBI (SAST) Regulations, 2011, Regulation 30

¹⁴ 'Air India's acquisition of Air India Asia gets a CCI nod' (*The Hindu*, 14 June 2022) <<https://www.thehindu.com/business/air-indias-acquisition-of-airasia-india-gets-cci-nod/article65527597.ece>> accessed 15 July 2022

¹⁵ Shruti Mahajan, 'NCLAT upholds CCI ruling to suspend approval for Amazon future deal' (*Money Control*, 13 June 2022) <<https://www.moneycontrol.com/news/trends/legal-trends/nclat-upholds-cci-ruling-to-suspend-approval-for-amazon-future-group-firm-investment-deal-8677071.html>> accessed 15 July 2022

¹⁶ Competition Act, 2002, s 6(1)

¹⁷ Competition Act, 2002, s 6(2)

The primary objective of the legislation is to ensure a fair competitive environment with freedom of trade and condemnation of practices that infringe the spirit of fair competition by enforcing a regulatory regime. CCI, in terms of powers vested in it through the act, may initiate inquiry against existing combinations, practices resulting in 'AAECI', order division of dominant enterprise that abuses its' position, order compensation to be awarded to the affected parties, and may impose penalties.¹⁸

FOREIGN EXCHANGE MANAGEMENT ACT

In respect of a transaction that involves association with a company incorporated outside India, provisions laid in respect of Cross-Border Mergers shall be duly examined. A Cross Border Merger may be classified into two categories:

- **Inbound Merger:** A transaction wherein the company incorporated outside India merges with the Indian company and the resultant entity is an Indian company.
- **Outbound Mergers:** A transaction wherein an Indian company merges with a company incorporated outside India and the resulting entity is a foreign entity.

The Companies Act recognises a distinctive mechanism in respect of cross-border mergers. The provisions of the Act dealing with cross-border mergers have recognised the Central government's authority to notify rules in consultation with RBI. In exercise of the aforesaid authority, provisions were notified that reserved the requirement of RBI approval in respect of cross-border mergers.¹⁹ However, with a conjoint reading of FEM (Cross Border Merger) Regulations 2018, it shall be concluded that such foreign exchange provisions have assumed a deemed RBI approval in respect of Cross Border Mergers.²⁰ Further, the aforesaid regulations direct us to FEM (Transfer or Issue of security to a Person Resident Outside India) Regulations 2017 which deals with Inbound Mergers FEM (Transfer or Issue of Security) Regulations 2004 introduces us to Outbound Mergers. If the transaction in question satisfies the criteria enumerated in the regulations, then the presumption of general permission prevails. However,

¹⁸ Competition Act, 2002

¹⁹ Companies Act, 2013, s 234

²⁰ FEM (Cross Border Mergers) Rules, 2018, r 9

in cases where the concerned company fails to qualify the listed criteria, an application may be pursued by them to obtain special permission from RBI.

INCOME TAX ACT 1961

The provisions of the Income Tax Act identify the merging entity as the amalgamating company and the company in which such entity is proposed to be merged as an amalgamated entity.²¹ A transfer of a capital asset within the ambit of the Income Tax Act shall be subjected to Capital Gain Tax. The relevant provisions outline that any transfer in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company, shall not be regarded within the meaning of the term 'transfer'.²² Further, under IT Act, any transfer by a shareholder in a scheme of amalgamation, of a capital asset, being shares held in the amalgamating company shall not be regarded within the meaning of the term 'transfer' if the transfer is made in consideration of the allotments to him of any shares in the amalgamated company and the amalgamated company is an Indian company.²³ Therefore, no capital gain tax shall accrue in respect of the aforesaid transaction. However, no such relaxation has been provided in respect of an outbound merger, and therefore, Capital Gain Tax shall be levied on the transferor company. In respect of the transfer of shares, gains from the transfer of capital assets located anywhere in the globe that is earned by a resident firm are taxed in India. Only gains from the transfer of a capital asset located in India should be taxed in the case of non-residents.

CONCLUSION

In addition to the above provisions, a company entering into an M&A transaction shall observe due compliance with the Stamp Act, Contract Act 1872, Goods and Services Tax laws, SEBI (LODR) Regulations 2009, SEBI (Delisting) Regulations 2018, Securities Contract (Regulation) Act 1956 and SEBI Act as well. Further, in respect of entities involving sectoral regulation, sector-specific acts including the Insurance Act, 1938, Banking Regulation Act, 1949, etc. shall be duly

²¹ Income Tax Act, 1961, s 2(1B)

²² Income Tax Act, 1961, s 2(47)

²³ Income Tax Act, 1961, s 47

observed. Through this Article, the Author intends to shed light on the major legislations that govern an M&A transaction. It shall be necessary to mention that through the last few years, M&A has developed as a distinctive branch of transactional law. Despite a decline of 8.7% in the global M&A market, India has been witnessing a steep rise in its' transactional markets. The aforesaid increment shall be accredited to favourable corporate policies coupled with extensive growth in the start-up forum. The legislations discussed above provide a favourable, effective and efficient mechanism of corporate governance as well as ease of doing business for a corporate organisation, thereby, preparing a conducive environment for the financial growth of the economy.