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RBI RELEASES DRAFT REGULATIONS FOR CROSS BORDER MERGERS - PUBLIC COMMENTS INVITED BY 9 MAY 2017

5 May 2017

On 26 April 2017, the Reserve Bank of India (RBI) released the draft of Foreign Exchange Management (Cross Border Merger) Regulations, 2017 (Draft FEMA Regulations) ([available here](#)). Through these regulations, RBI intends to address the issues that may arise in cross border mergers. Accordingly, RBI has invited members of the public (including stakeholders and experts) to email their views and comments on the Draft FEMA Regulations to the RBI at cofidpolicy@rbi.org.in with the subject "Cross Border Mergers - Comments/Suggestions".

Background

On 13 April 2017, the Ministry of Corporate Affairs (MCA) had notified Section 234 of the Companies Act 2013 (Companies Act) and a new Rule 25A Companies (Compromises, Arrangements and Amalgamations) Rules 2016 (Companies Merger Rules) which provides for mergers and amalgamations between Indian companies and foreign companies. These provisions prescribe that the approval of RBI is mandatory for cross border mergers. For details, please refer to our previous newsflash dated [18 April 2017](#).

Accordingly, with an intention to establish a regulatory framework for regulating cross-border mergers, the RBI proposed the Draft FEMA Regulations seeking public comments on the same, latest by 9 May 2017.

Key provisions of the Draft FEMA Regulations

Deemed Approval of RBI

The Draft FEMA Regulations provide that cross border mergers undertaken in accordance with the Draft FEMA Regulations shall be deemed to be approved by the RBI. Thus, if all conditions set out in Draft FEMA Regulations are met, then no separate application is required to be made to the RBI for its approval.

Definition of Cross border merger

'Cross border merger' has been defined in the Draft FEMA Regulations to mean "any merger, demerger, amalgamation or arrangement between Indian company(ies) and foreign company(ies) in accordance with Companies (Compromises, Arrangements and Amalgamation) Rules, 2016 notified under the Companies Act, 2013;'

Accordingly, these Draft FEMA Regulations seem to cover cross border 'merger, demerger, amalgamation or arrangement'. However, Section 234 of the Companies Act and Rule 25A of the Companies Merger Rules which deals with cross border mergers, only refer to 'mergers and amalgamations' without any express mention of demergers or other forms of arrangement.

Since the Companies Act is the primary legislation which permits cross border mergers and amalgamations only, unless it is amended to include cross border demerger and arrangements, such demergers and arrangements would not be possible even if the final FEMA regulation on cross border merger mention so.

It is expected that this conflict may be rectified in the final regulations that are issued by the RBI basis the comments received by them on the Draft FEMA Regulations.

Provisions in relation to merger or amalgamation of foreign company with Indian company (Inbound Merger)

In case of Inbound Mergers, the Draft FEMA Regulations provide that:

1. *Issuance or transfer of security by merged Indian company to non-resident:*

Any issue or transfer of security by the merged Indian company to a person resident outside India should comply with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations 2000.

2. *Borrowing or impending borrowing from overseas sources obtained by the merging foreign company:*

Any borrowing or impending borrowing from overseas sources obtained by the merging foreign company, that becomes borrowing or impending borrowing of the Indian company, should comply with external commercial borrowing norms or trade credit norms or other foreign borrowing norms, as laid down under Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations 2000 or Foreign Exchange Management (Guarantee) Regulations 2000, as applicable.

3. *Assets outside India of merging foreign company:*

(a) The merged Indian company may acquire and hold any asset outside India which an Indian company is permitted under FEMA. Such assets can be transferred by the merged Indian company for undertaking a transaction permitted under FEMA.

(b) If FEMA provisions bar the merged Indian company from acquiring and holding any asset/security, then such Indian company would have to sell such asset/security within 180 days from the date of sanction of the scheme of cross border merger. The sale proceeds must be repatriated to India immediately through banking channels.

Provisions in relation to merger or amalgamation of Indian company with foreign company (Outbound Merger)

In case of Outbound Mergers, the Draft FEMA Regulations provide that:

1. *Residents permitted to acquire securities of merged foreign company:*

A person resident in India being a stakeholder in the merging Indian company may acquire or hold securities of the merged foreign company, in accordance with the

Foreign Exchange Management (Transfer or Issue of Foreign Security) Regulations 2000 or as per the provisions of the Liberalized Remittance Scheme.

2. *Borrowings or impending borrowings of merging Indian company:*

The foreign resultant company would be liable to repay outstanding borrowings or impending borrowings of the merging Indian company, in terms of the scheme of cross border merger as approved by the National Company Law Tribunal.

3. *Assets in India of merging Indian company:*

- (a) The merged foreign company may acquire and hold assets in India which a foreign company is permitted under FEMA. Such assets can be transferred by the foreign company subsequent to the scheme, by undertaking a transaction permissible under FEMA.
- (b) If FEMA provisions bar the merged foreign company from acquiring and holding any asset/security, then such foreign company would have to sell such asset/security within 180 days from the date of sanction of the scheme of cross border merger. The sale proceeds must be repatriated outside India immediately through banking channels.

Jurisdiction of Foreign Company specified for both Inbound and Outbound Mergers

The Draft FEMA Regulations provide that the foreign company should be incorporated in a jurisdiction specified in Annexure B to Companies (Compromises, Arrangements and Amalgamation) Rules 2016.

Accordingly, unlike the Companies Merger Rules where the jurisdiction of foreign companies is only prescribed for Outbound mergers, the Draft FEMA Regulations prescribe this requirement for both Inbound and Outbound mergers.

Valuation

In terms of the Draft FEMA Regulations, *"The valuation of the Indian company and the foreign company for the purpose of cross border merger shall be done as per internationally accepted pricing methodology for valuation of shares on arm's length basis which should be duly certified by a Chartered Accountant/public accountant/merchant banker authorized to do so in either jurisdiction."*

While the Companies Merger Rules were silent on the valuation requirements for Inbound Mergers, the Draft FEMA Regulations prescribe this requirement for both Inbound and Outbound mergers.

Reporting of Transactions

The Draft FEMA Regulations provide that:

- 1. all the transactions arising due to cross border merger are required to be reported to the RBI in the same manner in which it is otherwise required to be reported under FEMA.
- 2. the Indian company and the foreign company involved in the cross-border merger would be required to furnish reports as may be prescribed by the RBI.

(Accordingly, it is expected that the RBI would come out with the specified formats for such reports in the final regulations.)

Khaitan comment

We had mentioned in our previous newsflash on cross border mergers that the foreign exchange control norms, amongst others, need to be aligned to enable cross border mergers. The initiative of the RBI to issue the Draft FEMA Regulations and to invite comments from public (stakeholders and experts in this field) on Draft FEMA Regulations is definitely a step in the right direction.

The Draft FEMA Regulations provide for deemed approval of the RBI in case all criterions of Draft FEMA Regulations are met. Inclusion of this deeming approval provisions in the Draft FEMA Regulations is a welcome move, since this relaxes the mandatory requirement (set out under Companies Act) of seeking prior approval of RBI for all cross border mergers. However, corresponding amendments may follow to the Companies Act in this regard.

While the Draft FEMA Regulations seek to address some concerns from exchange control laws standpoint, certain concerns remain unanswered. By way of an example, for outbound mergers, it is also not clear as to (i) whether the offices and establishments of the merging Indian company would be treated under FEMA as branch office/liaison office/project office of the foreign company; (ii) whether the current or other bank accounts of merging Indian company would be required to be re-designated because post-merger these will become the bank accounts of the foreign company.

Further, some of the present provisions of the Draft FEMA Regulations seem to be challenging from a practical standpoint, for example:

- In case of both Inbound Mergers and Outbound Mergers, if FEMA bars the merged company from acquiring or holding any asset/ security received pursuant to the scheme, the merged company is obligated to sell such asset/ security within 180 days from the sanction of the scheme. Failure to do so may lead to imposition of penalties. In such situations, parties would have to bear additional stamp duty and tax implications on account of sale of such assets/ securities, in addition to the taxes and duties already paid on the court order approving the scheme.
- In case of Inbound Mergers, the borrowings from overseas sources obtained by the merging foreign company will have to conform to the Indian external commercial borrowing norms or trade credit norms or other foreign borrowing norms. Practically, in case the borrowings do not comply with these norms, reconciling such borrowings with the aforementioned norms may be difficult. As a result, the foreign company may be constrained to repay such loans before proceeding with the merger, which may have adverse implications on its cash flows or business.

Accordingly, it is important that all concerned stakeholders actively send out their comprehensive comments to the RBI by 9 May 2017 so that all the loopholes in the present Draft FEMA Regulations could be plugged-in.

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