Case studies on business restructuring

CTC Study Circle

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Key developments impacting/ triggering restructuring

1. Repatriation of profits
   – Scrapping of DDT and introduction of classical system of taxation in the hands of the shareholders
   – Introduction of buy-back tax on all types of buy-backs as well as on buy-back of listed shares
2. Depreciation on goodwill
3. Slump sale/ slump exchange related amendments
4. Concessional corporate tax rate (17%/ 25%) alongwith exemption from MAT
5. HNIs
   – Cess on super rich resulting in a maximum marginal tax rate of 42.74%
   – Estate duty/ inheritance tax
6. Capital gains
   – Deemed consideration on sale of shares for the transferor
   – Introduction of capital gains tax on sale of listed shares
7. Gift tax in the hands of all recipients on receipt of specified assets (including cash, immovable property, shares etc)
8. GAAR

Current trends/ themes

- M&A at an all-time high
- Overseas acquisitions/ investments
- De-leveraging, IPOs
- Mushrooming of startups and unicorns
- Externalisation
- Legal entity rationalization – mergers, demergers
- IBC – Preservation of losses, write-off of debt etc
- Shift of tax residency
- Family settlements/ succession planing

Listing – India/ overseas

Pre-IPO structuring

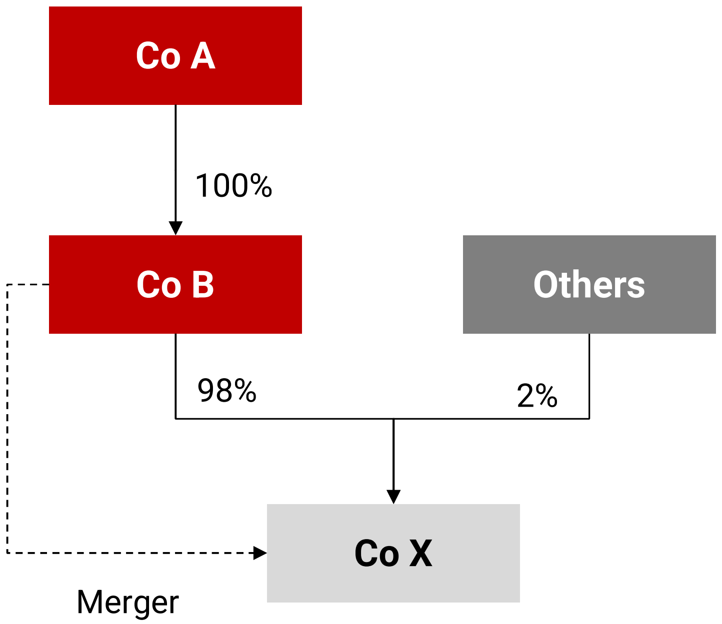
- Segregation of loss making business prior to IPO
- Legal entity rationalization and optimization of tax attributes within the group (e.g. merger of loss-making companies with profitable ones, removal of cross holdings etc)
- Carve out non-core activity/ assets e.g. real estate, treasury
- Consolidation of promoter shareholding and succession planning
- Increasing liquidity of shares by reducing per share price

Reduction in per share price

Objective – To reduce the per share price in order to increase liquidity post listing

- Possible options – Stock split, issue of bonus shares, rights issue, conversion of convertible instruments like debentures/ preference shares into equity shares
- Key tax issues
  - Short-term vs long-term capital gains
  - Treaty grandfathering in case of Mauritius/ Singapore shareholders
  - GAAR grandfathering

Listing of a delisted company – Tax issues



Sequence of events

- Co X incorporated in 1995
- Listed from 2000 to 2012; Delisted from all stock exchanges in 2012
- Merger of Co B into Co X in 2018; Co X issued its shares to Co A
- Listing of Co X in 2019
- Participation in OFS by Co A

Key considerations

- Can Co A avail taxation as per S.112A?
  - One of the conditions is that STT has been paid both on acquisition and transfer of such equity shares
  - STT was not paid on acquisition of Co X shares by Co A/ Co B
- Taxation of OFS in case S.112A is applicable?
- Any structuring possible to avail S.112A going forward?

Exits/ divestments

Tax issues on indemnity claim

Particulars	Indemnity Claim (Grossed up)	Indemnity Claim (normal)	Upfront sale price adjustment
Indemnity Loss	20.0	20.0	20.0
Sale consideration	100.0	100.0	80.0
Cost of shares	30.0	30.0	30.0
Capital Gains	**70.0**	**70.0**	**40.0**
LTCG Tax @ 28.5%	**(19.9)**	**(19.9)**	**(11.4)**
Post tax proceeds in hands of promoter	**51.1**	**51.1**	**38.6**
Payment of indemnity to company towards tax payment of prior period litigation	**20.0**	**20.0**	**NA Already adjusted**
Grossing up of tax paid by Company on indemnity receipt @ 25.17%	**26.7**	**NA**	**NA**
NET PROCEEDS POST TAX IN HANDS OF PROMOTER	**24.4**	**31.1**	**38.6**

SHA requires selling promoter to give indemnities on high-risk issues identified in course of diligence

Indemnity can be in nature of tax litigation of earlier period, liability under other commercial law and business-related risks.

While most indemnity loss (other than tax) shall be tax deductible in nature, In some cases, grossing up of indemnity amount is done to ensure the loss is fully recovered

Promoter shell out indemnity amount from post tax paid money and thereby there is significant tax leakage to that effect

- Use of convertible capital instrument (CCDs/CCPS) for indemnity losses by adjusting conversion factor can be explored
- For issues where indemnity claim has very high probability, **upfront consideration adjustment** can be most tax effective

Upside sharing between a PE and promoter

In case PE investors are able to exit at a valuation exceeding their benchmark, they typically share the upside with promoters

- Sansera Engineering DRHP – *If the amount realised by EEL and CEL is in excess of the investor benchmark rate as specified in the agreement, our Promoters are entitled to 30.00% of the excess amount realized by EEL and CEL at the time of their full cash exit, which may be paid in cash or such other method that achieves the same commercial effect*
- Options
  - Cash gift
  - Gift of shares
  - Convertible instruments – change of conversion ratio

Holding period in case of an immediate sale after receipt of gift by the promoters??

Upside to promoter from all shareholders

Objective – Upside to promoter before an IPO/ funding round

S.56(2)(x) applicability on issue of shares?

- CBDT flip flop on S.56(2)(x)
- No exception under Section 56(2)(x) and 56(2)(viib) to address genuine business situations (e.g., transactions between independent parties; real estate transactions etc.)
- Not applicable in case of a bonus issue
- Rights issue – Proportionate vs disproportionate

Whether S.56(2)(x) is triggered if a convertible instrument is issued at fair value on the date of investment but the fair value of underlying shares appreciates on the date of conversion

Promoter upside sharing agreements

- Co Act, 2013 prohibits allotment of ESOP/RSU to Promoters/ Directors owning > 10% in the Company
- On exercise of ESOP, difference between FMV and exercise price is taxable as salary income
- Post exercise, any realized appreciation is taxed as capital gains.

USE OF PARTLY PAID INSTRUMENT TO ACHIEVE THE OBJECTIVE

Particulars	Sweat equity	Partly Paid Instrument
FMV of Equity shares on date of allotment of incentive	150/share	150/share
FMV during exit event	**450/share**	**450/share**
Sweat Equity / Partly paid CCDs issued to be converted at FMV as on allotment (150/share)	75 Crs	75 Crs
Sell Price of Security on exit event	225 Crs	225 Crs
ESOP Taxation	Nil*	Nil
Long term capital gains	**150 Crs**	**150 Crs**

Step 1: Company would allot CCDs with Face value of INR 75 Crs (say 75000 CCDs of INR 1000 each) to promoters

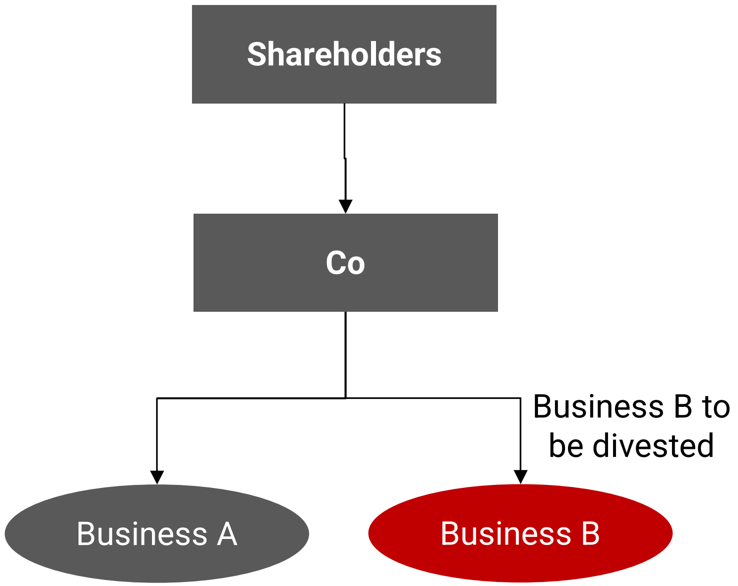
Step 2: Initial Call of INR 10 per CCDs to be made. i.e. Total initial call money of INR 7.5 lakhs

Step 3:
Case 1 - If FMV of Company increases on exit event:
a) Company would call for balance amount
b) Promoter would arrange bridge finance and fully subscribe the CCDs
c) Convert CCDs into equity at INR 150/share valuation
d) Sell immediately in market at INR 450/share
e) Repay the bridge finance from sale proceeds.

Case 2 - If FMV of Company decreases on exit event:
a) Company would call for balance amount
b) Promoter won’t pay and CCDs would be forfeited.

- Upside sharing achieved without locking promoter money upfront.
- Achieved same objective as ESOPs/ sweat equity being issued at current FMV

Divestment structuring



- Possible options
  - Slump sale of Business B to the buyer
  - Demerger of Business B followed by sale of shares
  - Slump sale of Business A to a New Co followed by sale of shares of existing Co
  - Demerger of Business A to a New Co followed by sale of shares of existing Co

Acquisitions/ JVs

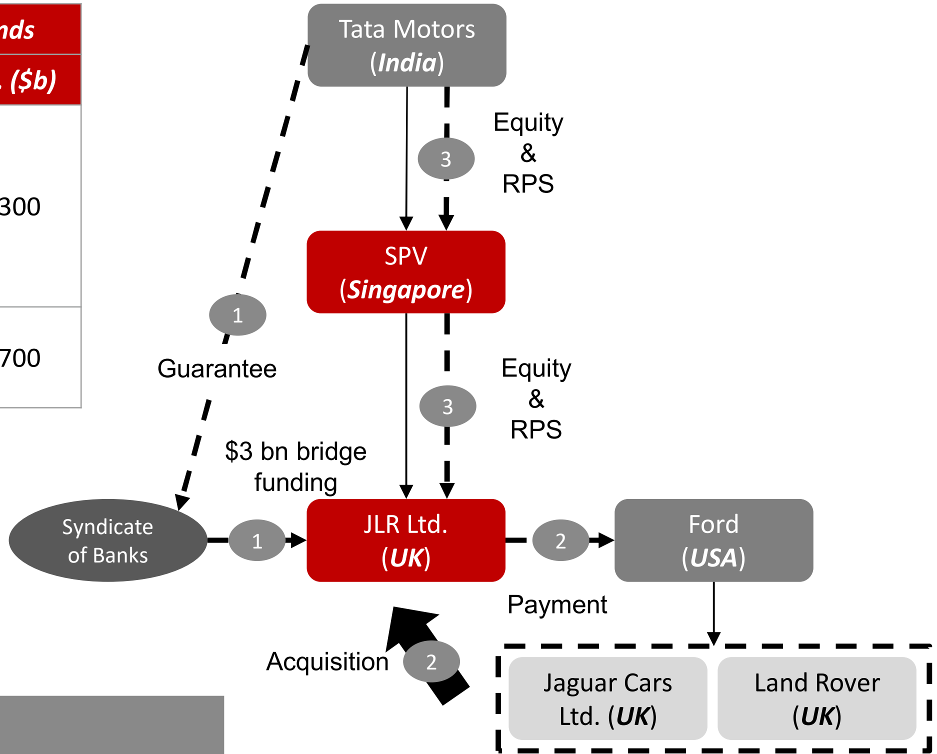
Funding for overseas acquisitions

- Funding through internal accruals – Debt versus equity infusion
  - Overall ETR impact to be assessed
  - If interest deduction is not available/ deferred in target country (either on account of thin capitalisation regulations or on account of entity specific considerations like tax losses or non-eligibility for fiscal consolidation etc), debt funding would result in an annual income pick-up in India without a corresponding deduction
  - Availability of underlying tax credit in India to optimize ETR
- If external debt is required
  - Debt servicing
  - Debt raised at an India level – Availability of interest deduction to Indian Co – S.36(1)(iii)/ S.57; alternatively, capitalization of interest?
  - Debt raised overseas with a guarantee from India

Tata – JLR acquisition

Sources of Funds		Application of Funds	
Particulars	Amt. ($b)	Particulars	Amt. ($b)
Secured NCD	~1.000	Purchase of Jaguar & Land Rover	~2.300
Equity Rights Issue	~0.600		
DVR Rights Issue	~0.400		
GDR Issue	~0.375		
FCCN Issue	~0.375	Expansion & WC	~0.700
Divestment	~0.250		

$3b Loan



Properties transferred

Intellectual Property Rights, 3 major manufacturing facilities, 2 advanced design and engineering centers in U.K., a worldwide network of 20 national sales companies

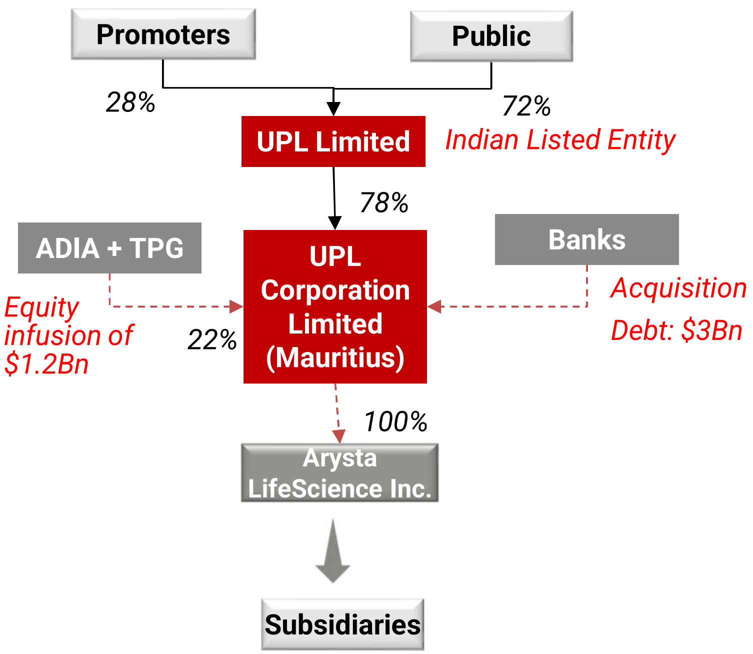
Mechanics

Step 1 Raising of a Bridge Loan from a Syndicate of Banks by JLR Ltd., which was guaranteed by Tata Motors India

Step 2 Purchase of entire JLR Business from Ford

Step 3 Pushdown of the funds raised in India to UK for repayment of Loan

UPL's Arysta acquisition



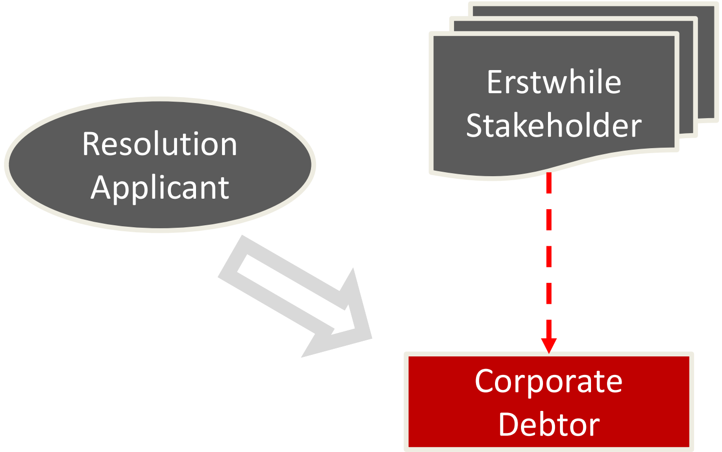
- **Acquisition** - UPL Limited acquired Arysta Lifescience Inc., US based company engaged in agricultural solutions business, in an all-cash consideration of ~$4.2Bn
- **Deal financing** – A mix of new equity and debt issuance by UPL Corporation to discharge cash consideration of ~$4.2Bn:
  - $1.2 billion equity issuance to ADIA (Abu Dhabi Investment Authority) and TPG Capital Asia (Global AIF)
  - $3.0 billion underwritten bank facility in place

- *Debt-servicing by UPL Corporation Limited for Arysta acquisition? Can debt push-down be considered?*

Formation of JV

- Objective
  - 2 parties to form a JV with one party contributing cash and the other party contributing assets (such as land)
- Options
  - Form a new company and transfer land to the company
    - Capital gains tax on transfer of land to company could be significant depending on the stamp duty value
  - Form a new LLP/ partnership firm and transfer land as capital contribution
    - Section 45(3) – whether overrides Section 50C/ 43CA
    - Section 56(2)(x) – whether applicable in the hands of the LLP/ PF

Write-back of unsustainable debt of Corporate Debtor



Equity & Liabilities	INR Crs	Assets	INR Crs
Equity Share Capital	10.0	Fixed Assets	20.0
Reserves	(30.0)	Investments	5.0
Borrowings/ Loan	50.0	Trade Receivables	10.0
Other Creditors	15.0	Inventories	10.0
Total Liabilities	**45.0**	**Total Assets**	**45.0**

- B/f Losses of INR 30 Crs
- Bid Value – INR 10 Crs (to bank)
- **Write-back of debt INR 55 Crs**

Option 1 (routed through P&L)
Extinguishing unsustainable debts through P&L

- Ruchi Soya acquisition by Patanjali

Option 2 (routed through Balance Sheet)
- Converting unsustainable debts into Equity
- Undertaking Capital reduction to right size the CD

- Electrosteel acquisition by Vedanta Limited

Option 3 (No adjustment in books of CD)
- Purchase unsustainable debts from Financial Creditors
- Can convert Purchased debt to Equity → Facilitate tax neutral buy-back

- Essar Steel acquisition by Arcelor Mittal
- Monnet Ispat by Consortium of JSW and AION
- Alok Industries by JM Financial and Reliance

Taxability of write-back of loan

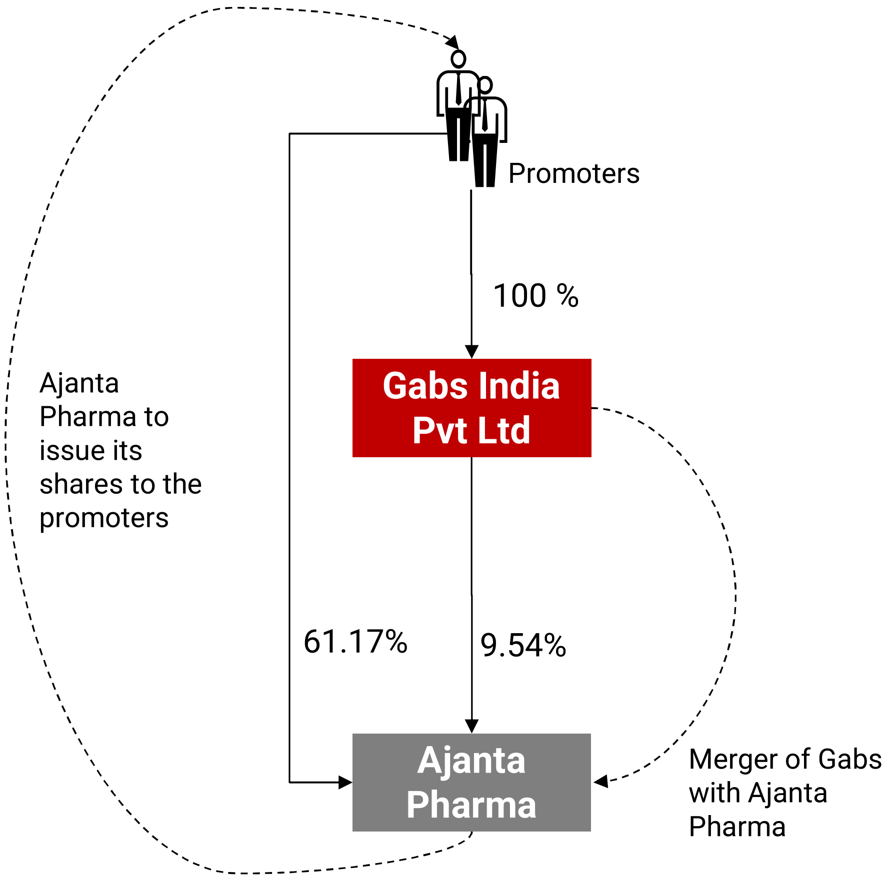
<table>
<tr><th>Provisions of the ITA</th><th>Remission of loan taken for acquiring capital assets</th><th colspan="2">Remission of loan used for working capital purposes</th></tr>
<tr><td>Section 28(iv) – Benefit or perquisite from business or profession</td><td colspan="3">×
(Mahindra & Mahindra[1])</td></tr>
<tr><td rowspan="2">Section 41(1) – Remission/ cessation of trading liability</td><td rowspan="2">×
(Mahindra & Mahindra[1])</td><td>Deduction claimed in any FY in form of interest, etc.</td><td>✓
(Rollatainers, Solid Containers, Logitronics[3])</td></tr>
<tr><td>No deduction claimed in any FY in the form of interest, etc.</td><td>×
(Compaq[3])</td></tr>
<tr><td>Section 56 – Receipt of any sum of money without consideration</td><td colspan="3">✓ (Mahindra & Mahindra[1]); however, in bonafide cases involving independent parties, arguable that there is no receipt without consideration</td></tr>
</table>

- Loan waivers are a standard feature of any resolution plan
- SC ruling in M&M provides relief in cases of term loan used for capex
- Taxability of write-back of working capital loan/ loan for business --> Possibility of litigation
- No specific relied under IBC - IBC only grants relief to past tax dues and not the ones arising on implementation of resolution plan

[1] CIT vs Mahindra and Mahindra ([2018] 404 ITR 1 (SC))
[2] Rollatainers vs CIT [2011] 15 taxmann.com 111 (Delhi HC); Solid Containers (308 ITR 417)
[3] CIT vs Compaq Electric Ltd [2011] 16 taxmann.com 385 (Karnataka HC); SLP dismissed by SC

Legal entity rationalisation

Ajanta Pharma case



Rationale

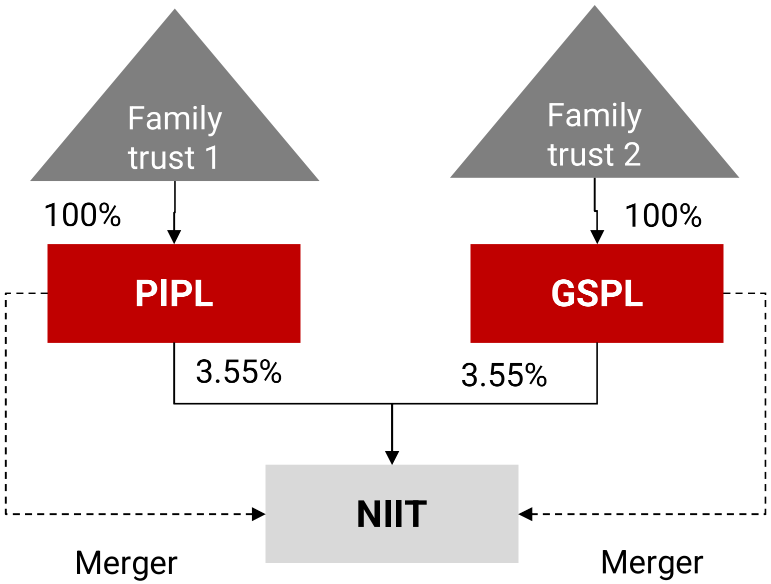
- Simplify the group structure and reduce the shareholding tiers such that the promoters hold the shares directly

NCLT's order

- GIPL and promoters were avoiding tax liability (capital gains on sale of shares + DDT)
- The scheme was not in public interest and hence, was rejected

First scheme to be rejected by invoking GAAR

NIIT case



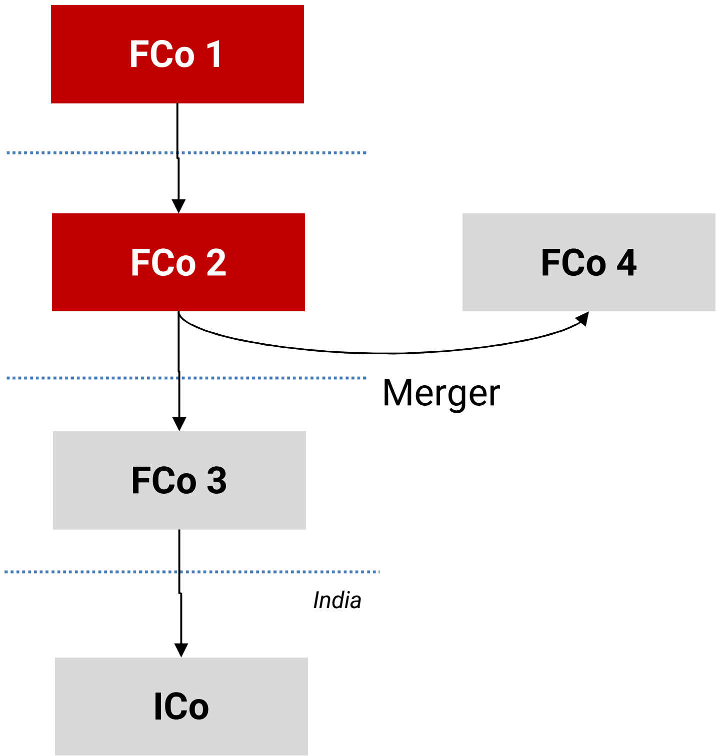
Rationale

- Reduction of shareholding tiers
- Bringing shares directly under the trusts for succession planning
- Appointed Date : 31 March 2017

NCLT's order

- NCLT cannot sit over the views of shareholders / board, unless their views are against framework of law and public policy
- Onus is on income-tax authorities to establish that the scheme is a vehicle to evade tax – authorities failed to demonstrate the same. Tax efficient and beneficial way of structuring a transaction possible and is not tax evasion

Merger of two foreign companies – Indirect transfer of Indian Co

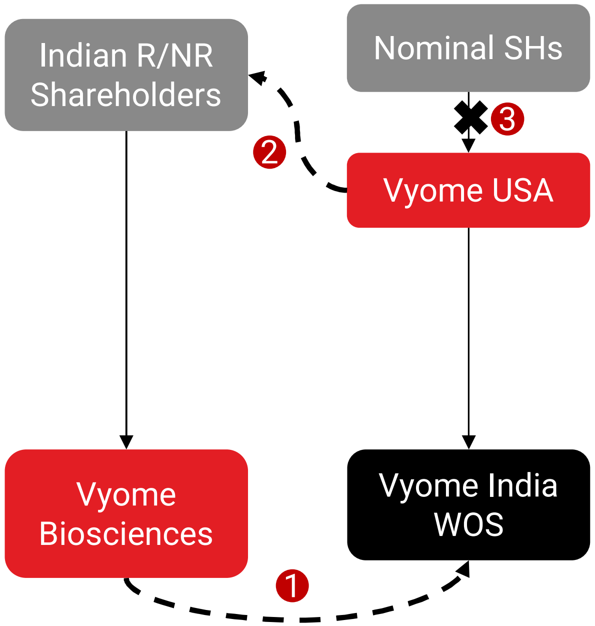


Post merger, FCo4 to hold FCo3

- Assume:
  - FCo2 is merged with FCo4, FCo1 becomes shareholder.
  - Transaction is tax neutral in FCo 2's country
- Question
  - Does FCo1 / FCo2 trigger tax in India if ICo is significant value driver for FCo2
- Tax implications
  - FCo1 is considered to have transferred shares of FCo2 which is deemed to be an asset in India. **FCo1 is not protected in S. 47(via)/ S.47(viab)**
  - FCo2 effects a transfer of an asset deemed to be in India. Transfer is exempt under S. 47(viab)

Mergers & demergers

Demerger – Issue of shares by parent



Mechanics

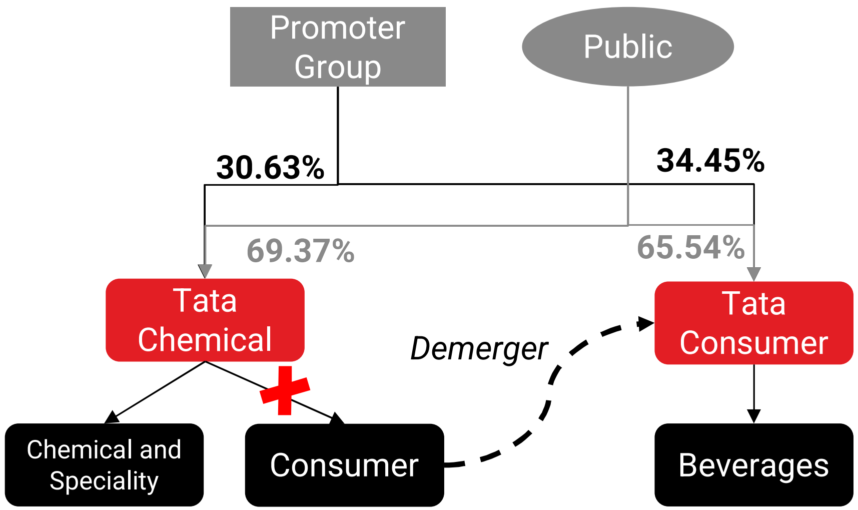
- Vyome Biosciences demerged its business undertaking to Vyome India
- Vyome USA, 100% shareholder of Vyome India, issued its shares to the shareholders of Vyome Biosciences

Possible objectives

Externalization, better valuation and overseas fund raising

Does this transaction qualify as a demerger as per the Income-tax Act?

Demerger – Value unlocking



- Overall Market-cap increased by ₹ 25,000 Crs – VALUE UNLOCKED

Tata Chemicals	31-01-2018	31-03-2019	25-07-2020
P/E Ratio	16.95	7.79	1.1
MCap (In Crs)		15,000	7,683.45
MPS	718.45	588	307.00

Tata Consumer	31-01-2018	31-03-2019	25-07-2020
P/E Ratio	42.92	29.52	81.93
MCap (In Crs)		12,871	37,668.43
MPS	290.60	208	404.25

As on March 2019	Tata Consumer	Tata Chemical
Book Networth (Crs)	8,359.37	11,796.21
% of Netwoth Transferred	0.66%	

What should be the cost of acquisition?

The ratio of apportionment of cost of acquisition of the original TCL shares pursuant to Sections 49(2C) and 49(2D) of the Income Tax Act, 1961 is as under:

Name of the Company	% of total Cost of Acquisition of the Equity Shares
Tata Chemicals Limited	99.34%
Tata Consumer Products Limited	0.66%
Total	**100%**

Accordingly, the cost of acquisition of equity shares allotted in TCPL should be 0.66% of the total cost of acquisition of the equity shares held in TCL prior to the demerger.

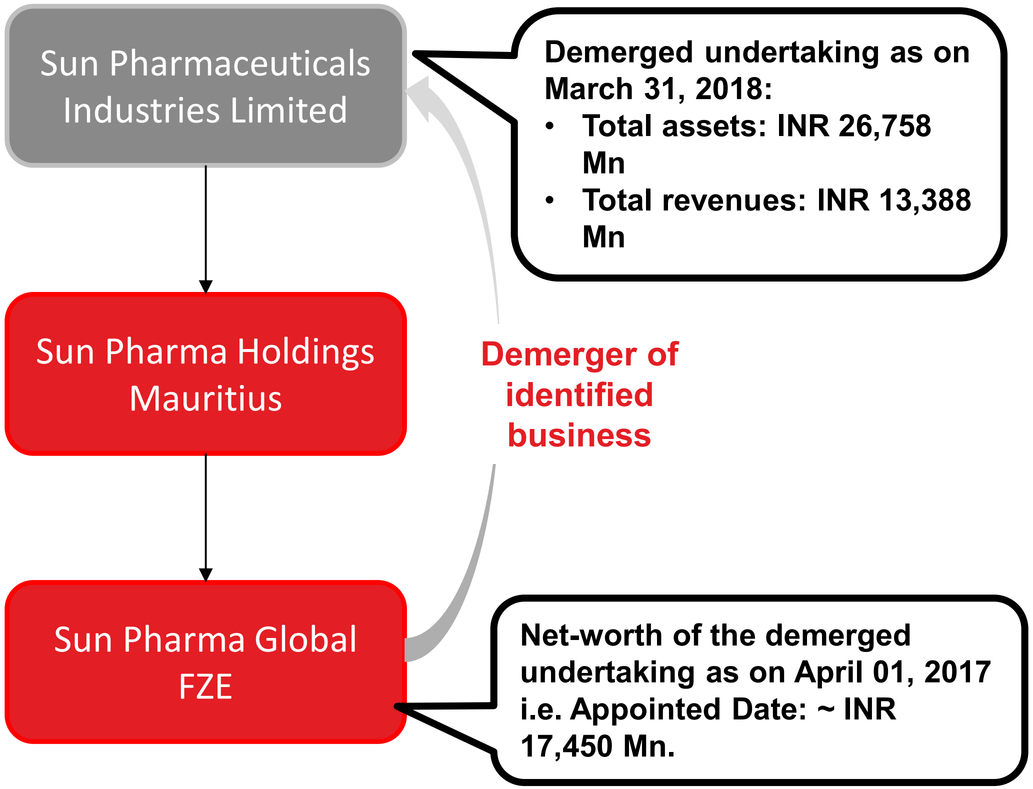
The communication is merely for the general guidance of the shareholders, and should not be considered as a substitute for any independent opinion that the shareholders may obtain. Determination of cost of acquisition is otherwise an involved exercise requiring application of Section 55(2)(ac) read with Section 112A of the Income Tax Act, 1961. Shareholders are advised to take necessary professional advice in the matter, as may be needed. The concerned regulatory, statutory or judicial authority, including any assessing officer / appropriate appellate authority, could take a different view. The Company takes no express or implied liability in relation to this guidance.

For Tata Chemicals Limited

Particulars	Tata Consumer	Tata Chemical
Price on 31 Jan 18 / share	₹ 290.60	₹ 718.45
Actual Cost / share		₹ 200.00

Cost of Acquisition of shares allotted by Tata Consumer Ltd. should be 1.32 per share (200*0.66%) or 4.74 per share (718*0.66%)?

Sun Pharma – Demerger of the business from Sun Pharma Global FZE
Restructuring # 1



Demerger rationale

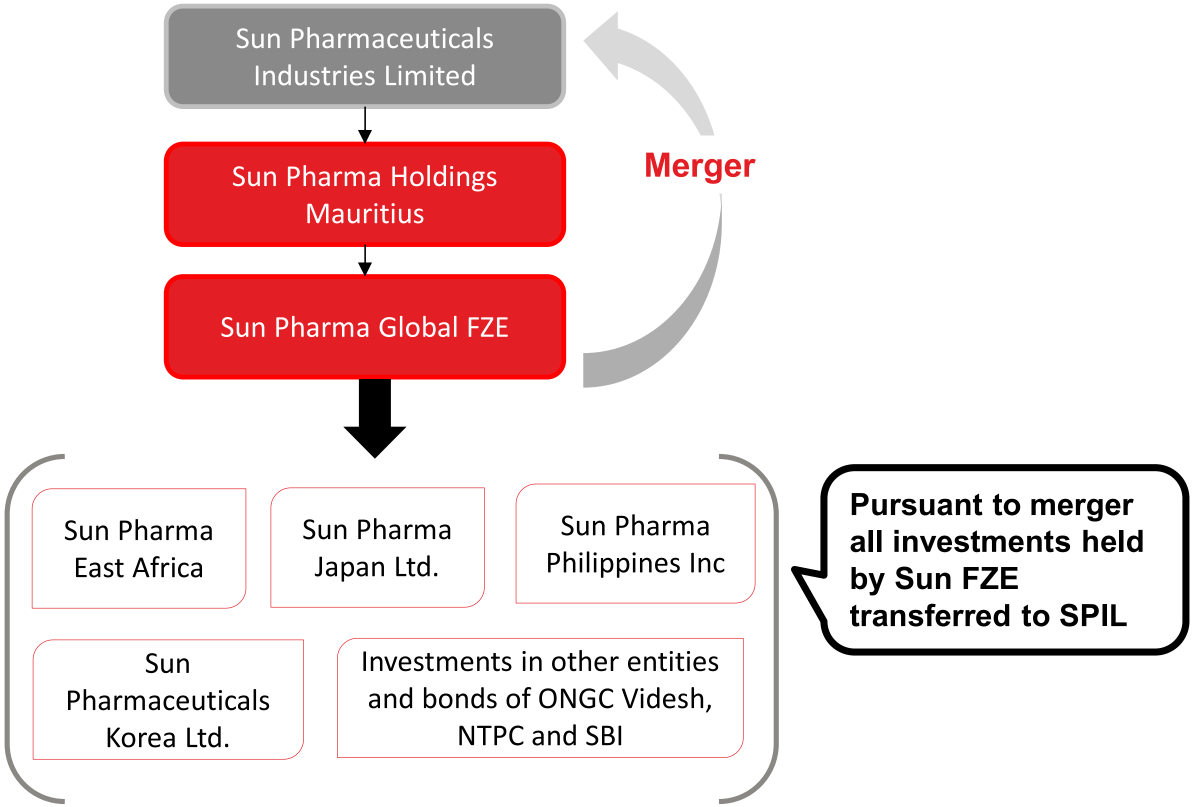
- Integrating and consolidating the business activities in relation to Generic Products
- Strengthening of business, synergistic benefits and economies of scale

Key considerations

- No consideration was discharged due to operational of law (as subsidiary cannot hold shares in holding company)

    - Whether demerger is tax neutral?

Sun Pharma – Merger of Sun Pharma Global FZE
Restructuring # 2



Merger rationale

- Merger will integrate the business and provide impetus to operations
- Combined bigger portfolio of products and direct access to markets
- Cost optimisation and reduction in multiplicity of legal and regulatory compliances

Key considerations

- No consideration will be discharged due to operational of law (as subsidiary cannot hold shares in holding company)
  - Whether merger is tax neutral
  - Whether S.56 implications will arise as investments received without consideration

Optimization of tax losses

Company A

Accumulated tax losses in 'Trading'/ 'Distribution' business

Company B

Profit making

Analysis of various options for utilization of tax losses of 'Trading'/ 'Distribution' business of Company A

Option I – Merger of Company A into Company B

- Losses of Company A may not be transitioned as 'Trading' / 'Distribution' business may not qualify to be an industrial undertaking

Option II – Merger of Company B into Company A

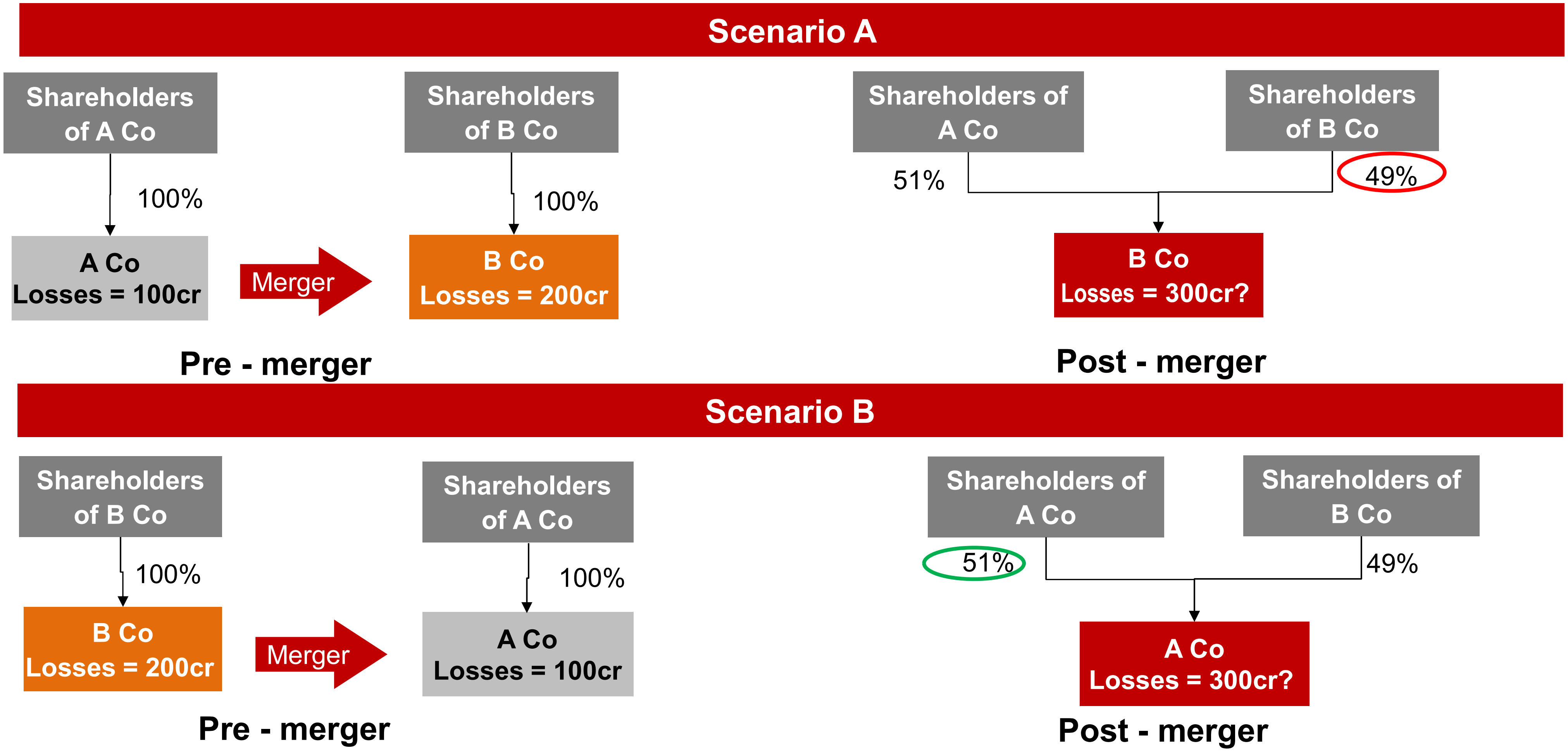
- Commercial rationale to be justified
- Carry forward and set off of losses may be affected if there is significant change (more than 49%) in shareholding of Company A
- Stamp duty costs

Option III – Demerger of Company A's 'Trading' / 'Distribution' business into Company B

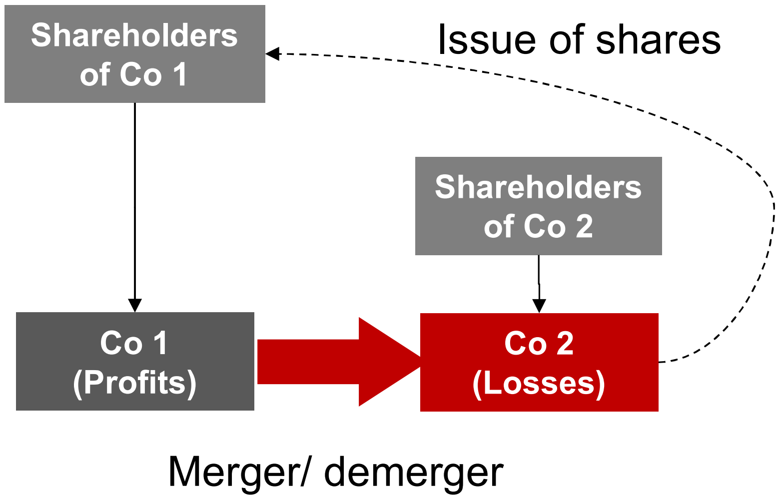
- No requirement that the demerged business should be an industrial undertaking
- No requirement to continue loss making business of Company A

Accelerated utilization of tax losses within the group vs stamp duty costs

Preservation of tax losses – Case # 1



Preservation of tax losses – Case # 2



- Nominal issue of shares
- Issue of preference shares

Concluding thoughts

Concluding thoughts

- Structuring to be backed by commercial rationale and the same should be documented adequately in order to mitigate GAAR exposure
- Rely on specific exemptions provided in the Act
- Timelines for implementation
- Transaction costs to be considered

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