A YEAR ON, THE RESERVE BANK OF INDIA NOTIFIES REGULATIONS ON CROSS BORDER MERGERS

The Companies Act, 1956 permitted inbound mergers, i.e., merger of a foreign company into an Indian company. Even then, there were no foreign exchange regulations on inbound mergers. A key change that was introduced by the Companies Act, 2013 (the "**Companies Act**") was to enable outbound mergers as well, i.e., merger of an Indian company with a foreign company, subject to approval of the Reserve Bank of India (the "**RBI**").

On April 13, 2017, the Indian government made effective the provisions of the Companies Act enabling cross border mergers. Soon thereafter, the RBI released draft regulations on cross border mergers covering foreign exchange regulatory issues. Finally, on March 20, 2018, the RBI has notified regulations governing cross border mergers (the "**RBI Regulations**").

This update sets out our analysis and critique of the RBI Regulations.

Definition of cross border mergers

The term "cross border merger" has been defined to include any merger, amalgamation or arrangement involving an Indian company and a foreign company in accordance with the Companies (Compromises, Arrangement and Amalgamation) Rules, 2016 (the "**Companies Rules**"). As Section 234 of the Companies Act refers only to mergers and amalgamations, it is unclear whether a reference to "arrangements" in the RBI Regulations enables arrangements beyond the scope of mergers and amalgamations between an Indian company and a foreign company, such as demergers or reorganization of an Indian company under the Companies Act. For this reason, the reference to "arrangements" in the RBI Regulations creates ambiguity.

Deemed approval of the RBI

The RBI Regulations set out several conditions for inbound mergers and outbound mergers. Only if a merger can comply with all of the conditions set out in the RBI Regulations, no approval of the RBI will be required. The compliance of the conditions has to be self-certified by the managing director, whole-time director or company secretary of the foreign company as well as the Indian company involved in such merger and the certificate has to be filed with the National Company Law Tribunal ("**NCLT**") along with the merger scheme.

Conditions for inbound mergers

In case of an inbound merger, the resultant company will be an Indian company which will own the assets and liabilities of the foreign company upon the merger being effective. The key conditions to be complied with for an inbound merger are as follows:

- Issue of shares by the resultant Indian company to non-resident shareholders of the foreign company will be required to be in compliance with India's foreign exchange regulations on foreign investments, including, the entry routes, sectoral caps/conditions and reporting requirements.

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- Any overseas office of the foreign company will be deemed to be a branch office outside India of the resultant Indian company, and such branch office will be required to comply with India's foreign exchange regulations on overseas branch offices.

- All guarantees or outstanding borrowings of the foreign company from an overseas lender which are acquired by the resultant Indian company will be required to comply with India's foreign exchange regulations on guarantees and external commercial borrowings within two (2) years from the merger being effective, except that, end use restrictions under the foreign exchange regulations governing external commercial borrowing will not have to be complied with. Also, the resultant Indian company will not be permitted to remit any monies in respect of such guarantees or outstanding borrowings for two (2) years. Given this condition, the resultant Indian company will have to re-negotiate existing credit facilities with overseas lenders to enable compliance with India's foreign exchange regulations on external commercial borrowings which set out extensive requirements on all-in-cost ceiling, maturity period, and security arrangements. Further, although compliance of regulations is required to be made by the resulting Indian company within two (2) years from the merger being effective, there is an immediate prohibition on payments under existing borrowings or guarantees by the resultant Indian company which is unreal and lacks reasoning. Also, ensuring compliance with these requirements for existing credit facilities is likely to be a cumbersome and challenging task. Further, India's foreign exchange regulations on guarantees only permit certain types of guarantees to be issued by an Indian company, as a result of which most of such guarantees will likely have to be cancelled.

- The resultant Indian company will be permitted to hold assets of the foreign company to the extent permitted under India's foreign exchange regulations. However, if a particular asset cannot be held by the resultant Indian company in compliance with India's foreign exchange regulations, then the Indian company is required to dispose-off such assets within a period of two (2) years from the merger being effective and repatriate the sale proceeds to India.

Conditions for outbound mergers

In case of an outbound merger, the resultant company will be a foreign company which will own the assets and liabilities of the Indian company upon the merger being effective. The key conditions to be complied with for an outbound merger are as follows:

- Issue of shares by the resultant foreign company to Indian residents will be required to be in compliance with India's foreign exchange regulations on overseas investments by Indian residents. Further, the value of the shares issued by the resultant foreign company to Indian resident individuals cannot exceed the permitted limits under the liberalized remittance scheme (currently, US$250,000 per financial year).

- Any office in India of the resultant foreign company will be deemed to be a branch office in India of the resultant foreign company and such branch office will be required to comply with India's foreign exchange regulations on establishment of branch offices in India by persons resident outside India. Accordingly, the branch office can only undertake activities permitted by such regulations.

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- All guarantees or outstanding borrowings of the Indian company which are acquired by the resultant foreign company will have to be repaid as per the merger scheme sanctioned by the NCLT. However, if a particular liability is payable by the Indian company to an Indian lender in Indian Rupees, the resultant foreign company cannot acquire such liability unless permitted under the Foreign Exchange Management Act, 1999. We see an issue here in the sense that Indian lenders are put on a higher pedestal than overseas lenders, as the resultant foreign company is required to repay all borrowings of the Indian company in case of an outbound merger, whereas for an inbound merger, the RBI Regulations do not require immediate payment of such liabilities, but in fact prohibit even ongoing committed payments to be made to overseas lenders under existing lending arrangements. This discriminatory and non-level playing field needs to be addressed.

- The resultant foreign company will be permitted to hold assets of the Indian company only to the extent permitted under India's foreign exchange regulations. However, if a particular asset cannot be held by the resultant foreign company in compliance with relevant regulations then the resultant foreign company will have a period of two (2) years from the merger being effective to dispose-off such assets and repatriate the sale proceeds outside India as per the merger scheme sanctioned by the NCLT.

Our comments

Besides the issues emphasized above, in our view, on an overall basis, the Companies Act and the RBI Regulations permitting cross border mergers is a positive step and thereby allowing deal makers to explore more innovative structures including non-cash structures for consummating cross border transactions. Also, the RBI's decision to permit cross border mergers without the RBI's approval on the abovementioned conditions being met is commendable and will reduce significant time on deal closures.

Having said that, India's income tax statute does not extend capital gains tax exemptions for outbound mergers as it does for inbound mergers. In our view, this aspect needs to be addressed soon. Also, the Companies Act has an overarching statement that all procedural requirements applicable to a domestic merger will be required for a cross border merger, which may pose significant issues. For instance, in a domestic merger, the domestic merging companies need to get clearance from Indian tax authorities and company law authorities. If we strictly apply this principle to an inbound merger, a foreign company will be required to obtain clearances from their relevant tax authorities and company law authorities overseas. The difficulty will arise if such overseas authorities do not customarily issue such clearances.

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