CASC BULLETIN

THE CHARTERED ACCOUNTANTS STUDY CIRCLE

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MEETINGS

Date	Speaker	Topic	Time
13 Sep 07	P.K. Ranganathan Certified Energy Auditor	Energy Accounting An Opportunity to Boost Profits	6.30.pm
27 Sep 07	CA S. Vinod	Recent Developments In Service Tax	6.30..pm

High Tea 6.00 pm (for both the meetings)

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ALL ABOUT MERGER & REVERSE MERGER

S. DHANAPAL

Merger

The provisions relating to merger and reverse merger are contained in sections 391 to 396 in Chapter V of Part VI of the Act though the sections do not specifically envisage anything about the terminology of merger and reverse merger. The provisions of the Act also deal with compromise or arrangement within or without amalgamation or merger. Compromise Or Arrangement can be done between a company and its creditors or any class of them and also between a company and its members or any class of them. Such a compromise or arrangement requires sanction of the court, which directs holding of meeting of creditors or members or class of creditors or members, as the case may be.

Following are the various types of mergers conventionally prevailing but are not categorized as such under the provisions of the Companies Act 1956

Veritical Merger - Merger of Companies that have actual or potential buyer-seller relationship

Horizotal Merger - Merger between two companies those who are competitors

Forward Merger - Merger of Target Company into the Acquirer Company

Conglomerate Merger - Merger between two companies both are in unrelated sectors

Reverse Merger - Merger of Acquirer Company into the Target Company

Demerger - Hiving off of an understanding into a separate Company

An attempt has been made through this article to throw some lights on the benefits and activities involved in an amalgamation / de-merger by Corporate Sector.

As envisaged above the laws related to mergers are codified in the Companies Act, 1956 which works in cyclic with various regulatory policies. The general law relating to mergers, amalgamations and reconstruction is embodied in sections 391 to 396 of the Companies Act, 1956 which jointly deal with the compromise and arrangement with creditors and members of a company needed for Merger. Section 391 gives the Court the power to sanction a compromise or arrangement between a company and its creditors/ members subject to certain conditions. Section 392 gives the power to the Court to oversee such compromises or arrangements with creditors and members. Section 393 provides for the disclosure of the information required to be provided to the creditors and members of the concerned company when they assenting to such an arrangement.

Section 394 envisages about the provisions for facilitating reconstruction and amalgamation of companies by making an appropriate application to the Court. Section 395 gives power and duty to acquire the shares of shareholders dissenting from the scheme or arrangement approved by the majority. And Section 396 deals with the power of the central government to provide for an amalgamation of companies in the national interest.

In any scheme of amalgamation, both the amalgamating company and the amalgamated company should comply with the requirements specified in sections 391 to 394 and submit details of all the formalities for consideration of the Court.

After the application is filed, the Court normally pass orders with regard to the dates of the hearing, and the provision of a copy of the application to the Registrar of Companies and the Regional Director in the Ministry of Corporate Affairs in accordance with section 394A and to the Official Liquidator for the report confirming that the affairs of the company have not been conducted in a manner prejudicial to the interest of the shareholders or the public. Before sanctioning the scheme of amalgamation, the Court has also to give notice of every application made to it under section 391 to 394 to the central government and the Court should take into consideration the representations, if any, made to it by the Central Government before passing any order granting or rejecting the scheme of amalgamation. Thus the central government is plays an important role in the matter of mergers.

Of course either at the time of hearing the petitions or afterwards in connection with the scheme of amalgamation, the Court would give the Objectors an opportunity to raise all the objections who may be shareholders or creditors or other stake holders.

Under Section 394, the Court has been specifically empowered to make specific provisions in its order sanctioning an amalgamation for the transfer to the amalgamated company of the whole or any parts of the properties, liabilities, etc of the amalgamated company. The rights and liabilities of the employees of the amalgamating company would stand transferred to the amalgamated company.

Following are real advantages that normally available to the corporate sector by virtue of any Schemes of Amalgamation/ Merger as per the Section 391 to 394 of the Companies Act 1956:

- the operational costs will be considerably reduced and the management will be able to operate and run the amalgamated company as a single unit more effectively and economically resulting in better turnover and profits.
- with the enhanced capabilities and resources at its disposal, the amalgamated company will have greater flexibility to market and meet customer needs and will be able to compete more effectively.
- the facilities available with the companies could be pooled together and the amalgamated company will be better able to exploit the facilities available as

- one single unit for the benefit of the amalgamated company and such amalgamation will be conducive to better and more efficient and economic control and conduct of the companies.
- It would bring in greater economies in operation and will help in reducing expenditure considerably and a larger and growing company will mean enhanced financial and growth prospects for the people and organizations connected with the company and will be in public interest.
- It would result in better and optimum utilization of the assets of the companies by pooling their resources and reducing their overheads. An integration of activities would be economic and in the interests of all the companies concerned.
- The amalgamation when it materializes would result in centralised administration, economy of operations, integrated business approach, greater efficiency and investment in professional management.

ACTIVITY SCHEDULE FOR PLANNING MERGER

Sl. No.	Activity	Action to be taken for completion of activity
1.	Objects clauses to be examined	• Check the object clauses of the transferor and transferee company with regard to the power of amalgamation. • Check the object clause of the transferee company regarding power to carry on the business of the transferor company; if not, it is necessary to amend the Objects Clause. • Check if authorized capital of the transferee company is sufficient; if not it is to be amended.
2.	Preparation of Scheme of Amalgamation	The Scheme of amalgamation should be prepared by the Companies, which have arrived at a consensus to merger. There is no specific form prescribed for scheme of amalgamation but scheme should generally contain the following information: 1. Particulars about transferee and transferor Companies. 2. Appointed Date. 3. Main terms of transfer of assets from transferor to transferee with power to execute on behalf or for
	Preparation of Scheme of Amalgamation	transferee the deed/ documents being given to transferee. 4. Main terms of transfer liabilities from transferor to transferee covering any conditions attached to loans and other liabilities from bank/ financial institution etc. 5. Effective date when the scheme will come into effect. 6. Conditions as to carrying on the business activities by transferor between "appointed date" and "effective date". 7. Description of happenings and consequences of the scheme coming into effect on effective date. 8. Share Capital of Transferor Company specifying authorized capital, issued capital and subscribed and paid up capital. 9. Share Capital of Transferee Company covering above heads. 10. Description of proposed share exchange ratio, any conditions attached thereto, any fractional share certificates to be issued, Transferee Company's responsibility to obtain consent of concerned authorities for issue and allotment of shares. 11. Surrender of shares by shareholder of Transferor Company for exchange into new share certificates. 12. Conditions about payment of dividend, ranking of equity shares, pro rata dividend declaration and distribution. 13. Status of employees of the transferor companies from effective date and the status of the provident fund, gratuity fund, super annuity fund or any special scheme or funds created or existing for the benefit of the employees (if any). 14. Treatment on effective data of any debit balance of transferor company balance sheet (if any).

	Preparation of Scheme of Amalgamation	15. Miscellaneous provisions covering income-tax dues, contingencies, and other accounting entries deserving attention or treatment. 16. Commitment of transferor and transferee companies towards making applications/ petitions under sections 391 and 394 and other applicable provisions of the Companies Act, 1956 to the High Court. 17. Enhancement of borrowing limits of the transferee company upon the scheme coming into effect. 18. Transferor and transferee companies give assent to change in the scheme by the court or other authorities under law and exercising the powers on behalf of the companies by their respective Boards. 19. Description of powers of delegate of transferee to give effect to the scheme. 20. Qualification attached to the scheme which requires approval of different agencies, etc. 21. Description of revocation/ cancellation of the scheme in the absence of approvals qualified in clause 20 above not granted by concerned authorities. 22. The Transferor Company will be dissolved without winding up after amalgamation is affected. 23. Statement to bear costs, etc. in connection with the scheme by the transferee company.
3.	Board Meeting of both the transferor and transferee companies to be held	• Notice, Agenda of the board Meeting to be sent. • Board Meeting to be held. • Agenda for Board Meeting will include the following items: ✤ Effective date to be announced ✤ Approval of Scheme of Amalgamation ✤ Approval of Ratio ✤ Directors/ Officers to be empowered to make applications to appropriate High Courts and to take the necessary action.

4.	Press Release	• The news may be released to the press for information of members and others.
5.	Financial Institutions/ Banks/ Trustees to Debenture holders, if any, to be formally advised and their consent sought.	• Financial institutions/ trustees to Debenture holders, if any, to be formally advised and their consent sought.
6.	Application to the High Court	• An application to the High Courts concerned of both the transferor and transferee companies will have to be made under Companies (Court) Rules, 1959, for summons for direction to convene the meeting in Form No.33 of the Companies (Court) Rules, 1956. • Affidavit in support of summons will be in form 34 of the Companies (Court) Rules, 1959. • Appointing chairman of the meeting. • Fix quorum of the meeting.An order by judge is summons convening meeting of the member of the transferor and transferee companies to approve the scheme and for approval. These will be in form No.35 of Companies (Court) Rules, 1959. • In case of a merger of a potentially sick company with a healthy company, the possibility of reducing the share capital of the sick company to the extent of losses to be considered and procedure for reduction to be undertaken (if applicable). This would have an effect on the EPS of the merged company. • If there are any calls in arrears of transferor Company, the High Court direction to be sought specifically (if any).
7.	Notices of Extra Ordinary General Meeting.	• Notices and Statements under section 393 of the Act will have to be printed. It will be in Form 36 of Companies (Court) Rules, 1959. • Take approval of draft of notice from Registrar of HIGH COURT period involved 5 days.

	Notices of Extra Ordinary General Meeting.	• Proxy Forms in Form No.37 will have to be sent along with the notice. • Hall for the meetings to be finalized. • Notices will be in Form No 36 and will be sent to individual members in the name of the chairman of the meeting concerned, as required by Rule 73. • Notice should be accompanied by ❖ The statement ❖ A Copy of the Scheme. ❖ Form of Proxy. • The Notice will be advertised in the newspapers in such manner as the court may direct not less than 21 clear days before the meeting. The advertisement will be in Form No 38.
8.	Meetings of Members	• The Meetings will be held as scheduled. The management will answer the queries of the members, permitted by the chair. • Decision of the meeting will be ascertained by poll only (Rule 77). • Approval is required of a majority in number of persons present and voting representing three-fourths in value of the members. • Chairman of each meeting will within the time fixed by the Judge (or within 7 days of the meeting) submit a report in Form No 39.
9.	Petition to Court	• Where the scheme is approved by members, the companies will within 7 days of filing of the report by the Chairman present a petition to the Court for confirmation of the scheme. The Petition will be in Form No 40. • Filing of copy of petition with annexures with ROC through Form No 61 (eform). A copy of the petition will be served on the Regional Director and others as directed by the Court.

10.	Directions on the petition	• The Court will fix a date for the hearing of the petition. • The Court will also direct official liquidator to scrutinize the books of the transferor company and submit a report thereon in terms of section 394 of the Act.
11.	Notice of the Hearing	• Notice of the hearing will be advertised in the same papers as the court may direct not less than 10 days before the date fixed for the hearing.
12.	Official Liquidator's Report	• The Official liquidator upon directions of the Court will be required to inspect the books of the Transferor Company and report that the affairs of the Company have not been conducted in a manner prejudicial to the interest of its members or to public interest. • The official liquidator may nominate a chartered accountant from his panel to conduct the inspection and report to him. He may direct that inspection should cover 3 - 5 years. The fees payable will also be fixed. The official liquidator's representative will visit the company's office and particulars required will be furnished to him. • On the basis of the reports of the representative, the official liquidator will submit his report to the court. • Thereupon the court will order dissolution from the date specified in the order.
13.	Hearing and Order	• Any person interested including creditors and employees may appear before the court and make submission. • The order of the Court may include such directions with regard to any matter and such modification in the scheme as the judge may think fit to make for the proper working of the Scheme. • The order may direct that a certified copy of the same should be filed with the Registrar of Companies within 30 days from the date of the order or such other time as may be fixed by the court.

	Hearing and Order	• The order will be in form 41 with such variations as may be necessary. • The order may include order for dissolution of the transferor company if the Official Liquidator has submitted the report. • The Court may make any provision for any person who dissents from the scheme. • The order will not have any effect till a certified copy is filed with the Registrar.
14.	Filing/ Annexing	• Within 30 days of the making of the order, a certified copy thereof will be filed with the Registrar of Companies through Form 21. • In computing the period of 30 days the time taken in obtaining certified copy has to be excluded. • A copy of the Court's order will be annexed to every copy of the memorandum and articles of association of the transferee company.
15.	Effective Date	• As soon as the scheme has become effective, particulars could be intimated through press and to government authorities, banks, creditors, customers and others. Certified copy of the Court order will be given wherever necessary.

As envisaged above, the court enjoys vast powers in relation to grant of sanction for amalgamation of companies and can make provisions in the order, in respect of all or any of the following matters: -

- the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company;
- the allotment or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which, under the compromise or arrangement are to be allotted or appropriated by that company to or for any person;
- the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;
- the dissolution without winding up, of any transferor company;
- the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company;
- the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;
- such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

REVERSE MERGER

(Profit making Company merging with Loss making Company)

Unabsorbed losses and depreciation of amalgamating company are available to the amalgamated company to carry forward and to set off in the profit of the Company after AMALGAMATION

As per Section 72A of the Income Tax Act, 1961, the accumulated loss and unabsorbed depreciation of the amalgamating company shall be allowed in the assessment of the amalgamated company provided the following conditions are satisfied:

The amalgamating company should own an industrial undertaking.

The amalgamating company should have been engaged in the business for atleast three years during which the accumulated loss has occurred or the unabsorbed depreciation has accumulated and it has held continuously as on the date of the amalgamation at least three-fourths of the book value of the assets held by it two years prior to the amalgamation.

The amalgamated company should hold continuously for a minimum period of five years from the date of amalgamation at least three-fourths in the book value of fixed assets of the amalgamating company.

Amalgamated company continues the business of the amalgamating company for a minimum period of five years.

Amalgamated company to comply any other conditions as may be prescribed. In this connection Rule No. 9C in terms of Income - tax (Thirty - third Amendment Rules), 1999, is reproduced hereunder:

Notification No. S.O. 1239(E), dated 15th December, 1999.

[(2000) 24 ITR 11 (St)]

In exercise of the powers conferred by Section 295, read with clause (iii) of sub - Section (2) of Section 72A of the Income - tax Act, 1961 (43 of 1961, the Central Government hereby makes the following rules further to amend the Income - tax Rules, 1962, namely:-

(1) These rules may be called the Income - tax (Thirty - third Amendment) Rules, 1999.

(2) They shall come into force on the date of their publication in the Official Gazette.

In the Income - tax Rules, 1962, after rule 9B, the following shall be inserted, namely:-

S. 9C. Conditions for carrying forward or set - off of accumulated loss and unabsorbed depreciation allowance in case of amalgamation.- The conditions referred to in clause (iii) of Sub - Section (2) of section72A shall be the following, namely:-

the amalgamated company, owing an industrial undertaking of the amalgamating company by way of amalgamation, shall achieve the level of production of at least fifty percent of the installed capacity of the said undertakings before the end of four years from the date of amalgamation and continue to maintain the said minimum level of production till the end of five years from the date of amalgamation:

Provided that the Central Government, on an application made by the amalgamated company, may relax the condition of achieving the level of production or the period during which the same is to be achieved or both in suitable cases having regard to the genuine efforts made by the amalgamated company to attain the prescribed level of production and the circumstances preventing such efforts from achieving the same;

The amalgamated company shall furnish to the Assessing Officer a certificate in Form No. 62, duly verified by an accountant, with reference to the books of account and other documents showing particulars of production, along with the return of income for the assessment year relevant to the previous year during which the prescribed level of production is achieved and for subsequent assessment years relevant to the previous years falling within five years from the date of amalgamation.

As per Section 2(1B) of the Income Tax Act, 1961 "Amalgamation", in relation to companies, means the merger of one or more companies with another company (the company or companies which so merger being referred to as the amalgamating company or companies and the company with which they merger or which is formed as a result of the merger, as the amalgamated company) in such a manner that -

- all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation:
- all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,
- otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by other company or as a result of the distribution of such property to the other company after the winding up of the first - mentioned company.

COMPANY WISE COMPLIANCE

A. Amalgamating (Transferor) company

It must be an industrial undertaking - that it carried on the business of manufacture or processing of Goods; or the manufacture of computer software; the business of generation or distribution of electricity or any other from of power; or the business of providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services; or mining; or the construction of ships, aircrafts or rail systems;

It should have been engaged in the business in which accumulated loss occurred for three or more years before amalgamation;

It should have held continuously as on the date of the amalgamation at least three - fourths of the book value of fixed assets held by it two years prior to the date of amalgamation;

B. Amalgamated company

It holds continuously for a minimum period of five years from the date of amalgamation at least three - fourths of the book value of fixed assets of the amalgamating company acquired in scheme of amalgamation;

It continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation; and

It shall achieve the level of production of at least fifty percent of the installed capacity of the said undertaking before the end of four years from the date of amalgamation and continue to maintain the said minimum level of production till the end of five years from the date of amalgamation;

It shall furnish to the Assessing Officer a certificate in prescribed form, duly verified by an accountant, with reference to the books of account and other documents showing particulars of production, along with the return of income for the assessment year relevant to the previous year during which the prescribed level of production is achieved and for subsequent assessment years relevant to the previous years falling within five years from the date of amalgamation;

It fulfils the above conditions to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

The requirement of proving that the purpose of amalgamation was to revive the business of amalgamating company, shows that this provision is more appropriate in case of rehabilitation of sick industries.

IN NUTSHELL

<u>Features of reverse mergers under Section 72A of the Income Tax Act, 1961</u>

Amalgamation should be between the companies and none of them should be a firm of partners or sole - proprietor. In other words, partnership firm or sole - proprietary concerns cannot get the benefit of tax relief under Section 72A.

The companies entering into amalgamation should be engaged in either industrial activity or shipping business. In other words, the tax relief under Section 72A would not be made available to companies engaged in trading activities or services.

After amalgamation the "sick" or "financially unviable company" shall survive and the other income generating company shall extinct. In other words, essential condition to be fulfilled is that the acquiring company will be able to revive or rehabilitate having consumed the healthy company.

One of the merger company should be financially unviable and nave accumulated losses to qualify for the merger and other merger partner should be profit earning so that tax relief to maximum extent could be had. In other words the company which is financially unviable should be technically sound and feasible, commercially and economically viable but financially weak because of financial stringency or lack of financial resources or its liabilities have exceeded its assets and is on the brink of insolvency. The second requisite qualification associated with financial unviability is the accumulation of losses for past few years.

The merger should result into the following benefits to the amalgamated (acquired / target) company i.e. (a) carry forward of accumulated business losses of the amalgamating company; (b) carry forward of unabsorbed depreciation of the amalgamating company and (c) accumulated loss would be allowed to be carried forward and set of for eight subsequent years.

Accumulated loss should arise from "profits and gains from business or profession" and not be loss under the head "capital gains" or "speculation". For qualifying carry forward loss, the provisions of Section 72 should have not been contravened. Similarly for carry forward of unabsorbed depreciation the conditions of Section 32 should not have been violated.

Specified authority has to be satisfied of the eligibility of the company for the relief under Section 72 of the Income - tax Act, 1961. It is only on the recommendation of the specified authority that Central Government may allow the relief.

The company should make an application to the "specified authority" for requisite recommendation of the case to the Central Government for granting or allowing the relief.

Procedure for merger or amalgamation to be followed in such cases is the same as in any other cases. Specified Authority makes recommendation after taking into consideration the Court's direction on scheme of amalgamation.

Amalgamation should be in the public interest i.e. it should not be against public policy, should not defeat the basic tenets of law, and must safeguard the interest of employees, consumers, customers, creditors and shareholders apart from the promoters of the company through the revival of the company.

Conclusion

The underlying principle behind mergers and amalgamations is that companies merge and become a single entity to achieve greater advantage. In simple terminology, mergers are considered as an important tool by companies for purpose of expanding their operation and increasing their profits and for the benefit of the amalgamated company and such amalgamation will be conducive to better and more efficient and economic control and conduct of the companies.