CASC BULLETIN

The Chartered Accountants Study Circle

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MEETINGS

Date	Time	Speaker	Topic
11.02.10	06.15 PM	CA CHINNSAMY GANESAN	IFRS FOR SMES
25.02.10	06.15 PM	CA V.S. GANESAN	ISSUES ARISING OUT OF SEC. 195 OF IT ACT, 1961

High Tea 6.00 pm (for the meetings)

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ALL ABOUT MERGER AND DEMERGER

S DHANAPAL

This is a Two Article. The first part appears in this issue. The Second part will appear in next issue.

The provisions relating to merger and amalgamation are contained in sections 391 to 396A in Chapter V of Part VI of the Act. Any proposal of amalgamation or merger begins with the process of due diligence, as the proposal for merger without due diligence is like entering a tunnel with darkness growing with each step. The due diligence process makes the journey see the light at the end of the tunnel - the light of wisdom to amalgamate or not.

The Act and the relevant rules pertaining to amalgamation are to be followed scrupulously. The provisions of the Act also deal with compromise or arrangement within or without amalgamation or merger. Presently, the High Court enjoys powers of sanctioning amalgamation matters under section 394 of the Act though it is a matter of time when this power will be exercised by National Company Law Tribunal. Amalgamation means merger of one or more companies with another company or the merger of two or more companies to form one company.

The terms merger and amalgamation have not been defined in the Companies Act, 1956 (hereinafter referred to as the Act). The terms merger and amalgamation are synonyms and the term 'amalgamation', as per Concise Oxford Dictionary, Tenth Edition, means, 'to combine or unite to form one organization or structure'

According to Income Tax Act amalgamation means:

"amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that -

(i) 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;

(ii) 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;

(iii) 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,

Procedure to be followed while approving the scheme of amalgamation:

The procedure to be followed while getting the scheme of amalgamation approved will depend upon sections 391 to 394A. Though, section 391 deals with the issue of compromise or arrangement which is different from the issue of amalgamation as deal with under section 394, as section 394 too refers to the procedure under section 391 etc., all the section are to be seen together while understanding the procedure of getting the scheme of amalgamation approved. Again, it is true that while the procedure to be followed in case of amalgamation of two companies is wider than the scheme of compromise or arrangement though there exist substantial overlapping. The procedure to be followed while getting the scheme of amalgamation and the important points, are as follows:

(1) Any company, creditors of the company, class of them, members or the class of members can file an application under section 391 seeking sanction of any scheme of compromise or arrangement. However, by its very nature it can be understood that the scheme of amalgamation is normally presented by the company. While filing an application either under section 391 or section 394, the applicant is supposed to disclose all material particulars in accordance with the provisions of the Act.

(2) Upon satisfying that the scheme is prima facie workable and fair, the Court/ Tribunal order for the meeting of the members, class of members, creditors or the class of creditors. Rather, passing an order calling for meeting, if the requirements of holding meetings with class of shareholders or the members, are specifically dealt with in the order calling meeting, then, there won't be any subsequent litigation. The scope of conduct of meeting with such class of members or the shareholders is wider in case of amalgamation than where a scheme of compromise or arrangement is sought for under section 391.

(3) The scheme must get approved by the majority of the stake holders viz., the members, class of members, creditors or such class of creditors. The scope of conduct of meeting with the members, class of members, creditors or such class of creditors will be restrictive some what in an application seeking compromise or arrangement.

(4) There should be due notice disclosing all material particulars and annexing the copy of the scheme as the case may be while calling the meeting.

(5) In a case where amalgamation of two companies is sought for, before approving

the scheme of amalgamation, a report is to be received form the registrar of companies that the approval of scheme will not prejudice the interests of the shareholders.

(6) The Central Government is also required to file its report in an application seeking approval of compromise, arrangement or the amalgamation as the case may be under section 394A.

(7) After complying with all the require ments, if the scheme is approved, then, the certified copy of the order is to be filed with the concerned authorities.

CHECKLIST/STEPS FOR AMALGAMATION/MERGER

S. No.	STEPS
1)	Calling Board meeting to take in-principle approval of Board and to appoint consultants.
2)	Draft of Scheme of Amalgamation
3)	Securing Approval of Board of Draft of Scheme of Amalgamation
4)	Intimation to Bankers, Financial Institutions and other secured creditors and obtain their consent
5)	Application to be filed to the Court for direction to convene the Extraordinary General Meeting of Shareholders, Creditors or to obtain dispensation in case of Holding-Subsidiary Amalgamation.
6)	Draft notice, form of proxy and get it approved by the Registrar of the Court or companies, if meetings not dispensed with
7)	Dispatch of notices for holding the meeting to pass the resolution along with the explanatory statement as required under section 393(1)(a) of the Companies Act, 1956 if meetings not dispensed with
8)	Publication of advertisement in English & Local Language newspapers, as approved by the Court, regarding holding of the Meetings of Shareholders and Creditors.
9)	Filing of Report in the form of affidavit by the Chairpersons of the meetings with the Court.
10)	Holding of General Meeting to approve Merger or Amalgamation with requisite majority
11)	Passing of Resolution approving the Scheme of Amalgamation subject to High Court confirmation by both companies
12)	Filing of Resolutions with the registrar of companies within 30 days in Form No. 23.

13)	Filing of the petition with High Court for approval of the scheme within 7 days of filing of chairman's reports of meetings
14)	Notice to the official liquidator of the Transferor Company from Registrar of Companies of Transferor and Transferee company (ies) and inspection by official liquidator of records of transferor company.
15)	Publication of advertisement as approved by the Court notifying the date of hearing fixed by the High Court regarding consideration of petition.
16)	Official Liquidator and Regional Director to submit reports to High Court.
17)	Hearing by the Court and prior to passing order allowing the scheme, to hear objections. Court may approve, with or without conditions.
18)	Filing of certified copy of Court's Order with the Registrar of Companies within 30 days in form No. 21.

CROSS HOLDING OF SHARES IN CASE OF AMALGAMATION

It is common practice, situation arises, that the companies subject to amalgamation hold shares in the capital of each other company. This is termed as the cross holdings

Three situations of cross holdings are possible

- The Transferor and Transferee Company both holds shares of each other company
- The Transferor Company holds shares in the share capital of Transferee Company
- The Transferee Company holds shares in the share capital of Transferor Company

TRANSFEROR COMPANY HOLDING SHARES OF TRANSFEREE COMPANY:

- The transferor company might be holding shares of the transferee Company under investments.
- Transfer of shares of Transferee Company as held by the transferor company to the transferee company is in violation of section 77 and 77A of the Act.
- However, the court's power under section 391 is not in any way affected as section 77A is merely an enabling provision
- Similarly, the conditions for a buy back under section 77A cannot be applied to a scheme under section 100 to 104 and section 391. The two provisions operate in independent fields.

TRANSFEREE COMPANY HOLDING SHARES OF TRANSFEROR COMPANY:

Cancellation of shares:

In case of amalgamation of hundred percent subsidiary with holding company, the equity shares of transferor company, if any held by the transferee company on record date shall be cancelled and shall be deemed to have been cancelled without any further act or deed and no shares of the transferee company are required to be issued in lieu thereof.

Even non-fixation of consideration was held to be not a material factor in sanctioning the scheme as approved by the shareholders

Effect on non cancellation of shares:

In case the transferee company itself holding the shares of the transferor company and not treating them cancelled, the net result would be allotment of shares of transferee Company to the transferee company in lieu of its holding in the transferor company. This would be gross violation of the Companies Act. In order to avoid this situation, Companies are resorting for creation of TRUST to hold such shares for certain time and dispose them off in the market at appropriate time.

CREATION OF TRUST

Under the scheme of Amalgamation provisions to be made for creation of an independent trust and the trust shall hold the shares for the time being and sell them in open market at appropriate time. The provisions can be drafted as follows:

In case Transferor Company Holding shares of Transferee Company:

"The Transferor Company shall create/ has created a trust and transfer/transferred the shares of the Transferee Company held by the Transferor Company as on the appointed date/record date and the said trust will be holding the same for the benefit of Transferor Company or its successor or its assigns. The said trust may sell such share in open market at appropriate time as decided by Trustee (s) pursuant to Trust deed and deposit the monies realised with the Transferor Company, its successors or its assigns."

In case Transferee Company Holding shares of Transferor Company:

"The Transferee Company shall create/ has created a trust and transfer/transferred the shares of the Transferor Company held by the Transferee Company as on the appointed date/record date and the said trust will be holding the same for the benefit of Transferee Company or its successor or its assigns. The said trust may sell such share in open market at appropriate time as decided by Trustee (s) pursuant to Trust deed and deposit the monies realised with the Transferee Company, its successors or its assigns."

Accounting of Trust Shares

As per the Accounting Standard No.14, issued by the Institute of Chartered Accountants of India, no clear guidelines is available for treatment of shares held in trust.

In case of merger of ICICI Ltd with ICICI Bank Ltd, the shares of ICICI bank Ltd held by the ICICI Ltd before amalgamation were transferred to a Board of Trustee. Such shares was shown under the head 'Other assets' in the Balance Sheet of ICICI bank Ltd

Taxation on the proceeds of Trust shares

The shares held by the Trust are the investments of either the Transferor Company or that of the Transferee Company in shares of other Company. On sale of shares the Trustee transfers the proceeds of Trust shares to Transferee Company, being treated as income in the hand of Transferee Company. In the light of the said discussion the following two issues arises:

- Ascertainment of net gain
- Decision on the head of Income

Ascertainment of net gain

To ascertain the net gain, the cost of acquisition is of important.

Since the trust is holding the shares of Transferee Company for its own benefit, the face value of shares is relevant.Hence, the question is whether the cost of original investment to be treated as the cost of acquisition or the face value of shares or which ever is less.

Decision on the head of Income

In case of sale of shares is considered as sale proceeds of investment the gain shall be subject to capital gain tax and be nominal. In case this is considered as business income the incidence of tax shall be at higher rate.

No Consideration and no Taxation

In the case of Saraswati Industrial Syndicate Ltd. v. CIT [1990] 186 ITR 278, 283-84/53 Taxman 92, the Supreme Court agreed with the Tribunal's view that the amalgamating company ceased to exist in the eye of law. Respectfully following the view expressed by the Supreme Court, it is clear that amalgamation of the wholly-owned subsidiary foreign company with its parent company does not result in transfer for consideration and, therefore, does not give rise to any capital gains. The liability to capital gains tax (if any) can only be on the transferor company (subsidiary), which in the instant case has lost its identity and ceased to exist. In the light of the foregoing discussion, it is ruled that no capital gains chargeable under section 45 arose to APH on its amalgamation with the applicant in respect of the shares of APL.

Thus the amalgamation of a wholly-owned subsidiary company with its parent company does not result in a transfer for consideration and, therefore, does not give rise to any capital gains

Though, in the task of sanctioning the scheme of amalgamation, the court has wide powers the net effect of such trusts on the interest of general investors and on the share market wherein anomalies exist. There are no specific guidelines, rules or provisions in the Act regarding treatment of cross holdings among the companies under amalgamation. In practice the treatment and/or accounting of cross holdings differ from company to company depending upon the provisions made in the scheme of amalgamation and approved by the court. (to be concluded)

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