Key Provisions of Merger, Demerger & Restructuring

9th February 2019

Soniya Sankhesara
### Presentation Contents

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<td>Restructuring</td>
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Modes of M&A Restructuring

- Merger / Amalgamation
- Demerger
- Acquisition
- Internal Restructuring
  - Business Purchase
  - Share Purchase
  - Buyback
  - Capital Reduction
  - Slump Sale / Itemized Sale
M&A - Key Drivers

While the above drivers are illustrative, corporate houses undertake M&A / Structuring for various reasons:

- Consolidation of businesses OR Un-locking of value
- Streamlining of operations and Saving of admin costs by reducing legal entities
- Explore any fiscal benefits that may be possible
- Inorganic growth and Enhancing the footprints
Key challenges in M&A / Restructuring

- Tax issues incl. GAAR / Complex Accounting
- Stakeholders approval
- Valuation mismatch
- Multiple Regulatory approvals CCI, SEBI etc
- Post M&A integration of business and people
- Stamp duty cost and overall time frame
In the recent times, most of the above have undergone a change resulting into increased time frame for understanding and decision making.
Merger
Merger - Typical Ways

Merger of Company A with Company B

- Consideration in the form of shares of Company B
- Shareholders of Company A merge with Shareholders of Company B
- No shares to be issued by Hold Co

Merger of Companies A & B with Company C

- Consideration in the form of shares of Company C
- Shareholders of Company A merge with Shareholders of Company B, which then merge with Shareholders of Company C

Merger of Sub Co with Hold Co

- 100% of Sub Co merges with 100% of Hold Co
- Merger of Sub Co with Hold Co

Merger of Hold Co with Sub Co

- Consideration in the form of shares of Sub Co
- Shareholders of Hold Co merge with Shareholders of Sub Co

All the property and liabilities of the amalgamating company to be transferred to the Amalgamated Company.

Balance Sheet of Hold Co

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital</td>
<td>100</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>50</td>
</tr>
<tr>
<td>Investment in WOS</td>
<td>100</td>
</tr>
<tr>
<td>Other Assets</td>
<td>50</td>
</tr>
</tbody>
</table>

Whether all the property of Hold Co transferred to WOS??
• Shareholders holding **not less than 3/4th 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.
### Merger - Tax consideration

<table>
<thead>
<tr>
<th>In the hands of</th>
<th>Taxability / Treatment</th>
<th>Section</th>
<th>Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amalgamating company</td>
<td>No capital gains tax on transfer of assets</td>
<td>47(vi)</td>
<td>Amalgamated company should be an Indian company</td>
</tr>
<tr>
<td>Shareholders of Amalgamating Company</td>
<td>No capital gains tax on transfer of shares</td>
<td>47(vii)</td>
<td>1. Consideration to be <strong>in form of shares in amalgamated company</strong> (except where the amalgamated company itself is a shareholder)  &lt;br&gt; 2. Amalgamated company should be an Indian company</td>
</tr>
<tr>
<td>Cost of acquisition of shares received on amalgamation by the shareholders</td>
<td>= Cost of acquisition of shares held by the shareholders in the amalgamating company</td>
<td>49(2)</td>
<td>Transfer as referred u/s. 47(vii)</td>
</tr>
<tr>
<td>Period of holding of shares received on amalgamation by the shareholders</td>
<td>Includes period of holding of shares held by the shareholders in the amalgamating company</td>
<td>Expln. (i)(c) to 2(42A)</td>
<td>Transfer as referred u/s. 47(vii)</td>
</tr>
</tbody>
</table>

**Discharge of consideration by way of mix of equity and debenture or cash**
<table>
<thead>
<tr>
<th>In the hands of</th>
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<th>Section</th>
<th>Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Assets for Amalgamated Company: - Stock - Capital Assets - Depreciable Assets</td>
<td>= Cost of acquisition of the stock / capital assets to the amalgamating company = WDV of depreciable assets held by amalgamating company</td>
<td>- 43C - Expln. 7 to 43(1) - 49(1) - Expl. 2 to 43(6)(c)</td>
<td>Amalgamated company should be an Indian company</td>
</tr>
<tr>
<td>Period of holding of capital assets received by Amalgamated company pursuant to amalgamation</td>
<td>Includes period for which capital assets were held by the amalgamating company</td>
<td>Expln. (i)(b) to 2(42A) r.w.s. 49(1) and 47(vi)</td>
<td>Impact of Merger on carry forward of business losses and unabsorbed losses –Section 72A</td>
</tr>
</tbody>
</table>
• Shares in I Co transferred from F Co.1 to F Co.2 pursuant to merger of F Co.1 with F Co.2
• Transfer exempt u/s 47(via) if following conditions are satisfied:
  - 25% shareholders of Transferor company continue as shareholders of Transferee company
  - Such transfer does not attract tax in the F Co.1 country
• No implication under Sec. 56(2)(x) to F Co 2 since transfer exempt under 47(via) and 47(viab)
• ICo entitled to carry forward and set off earlier years tax losses against the current year income since
  - the change in shareholding is on account of merger of two foreign companies; and
  - 51% of shareholders of amalgamating co. becomes shareholder of amalgamated Co. [Proviso 2 to section 79]
Case Study 1 - Whether 2(1B) compliant?

- Condition of at least 75% shareholder becoming shareholder in Co B is not fulfilled
- Is merger compliant of Section 2(1B)?
Tax implications in India on transfer of shares of ICo to CoB?

Conditions u/s 47(via):
1. At-least 25% shareholders of Co A continue to be shareholders of Co B
2. Exempt in foreign country

Whether the merger would be tax neutral if Co A holds Debenture, Bonds (i.e. other than shares) or immovable / movable properties??
Demerger
Demerger - Modus operandi

**Non-Mirror shareholding Demerger**

- Shareholders
- Demerged Co
- Resulting Co
  - Unit A
  - Unit B

**Mirror shareholding demerger** – *this is typically carried out by the listed company and pursuant to demerger the resulting company will also get listed*

- Shareholders
- Demerged Co
  - Cancellation of Demerged Co’s shareholding in Resulting Co
  - Resulting Co
  - 100%
  - Unit A
  - Unit B
Demerger - Meaning

Meaning [Section 2(19AA)]
- Transfer of one or more undertakings from the Demerged company to the Resulting company

Conditions
- Transfer of all properties and liabilities at *book values*
- Discharge of consideration by issue of shares on proportionate basis (except where Resulting company is the Hold Co)
- Allotment of shares to shareholders holding not less than 3/4th in value of the shares in the Demerged company
- Transfer to be on a going concern basis
Section 2(19AA) - Demerger

......
......
......

(iv) the resulting company issues its shares to the shareholders of the demerged company on a **proportionate basis**;

(v) the shareholders holding **not less than three-fourths in value of the shares** in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger,

Whether shares to be issued on a proportionate basis [clause (iv)] to each class and kind of shares?

Whether condition prescribed in clause (v) is to be fulfilled for each class and kind or on an overall basis?
“Undertaking” shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

What is an Undertaking?

An undertaking refers to a business activity engaged with a view to earn profits.

In General parlance:

- Undertaking refers to a division or a part of a business enterprise carrying on operations independently.
- Means an “enterprise”, “venture” or engagement.

Demerged Co has only 1 undertaking – can that be demerged?

Whether investment undertaking can be demerged?
Liabilities relatable to the undertaking:

Liabilities include –

a. the liabilities which arise out of the activities or operations of the undertaking;

b. the specific loans or borrowings (including debentures) raised, incurred and utilized solely for the activities or operations of the undertaking; and

c. so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Common borrowings – whether proportion of aggregate liabilities to be considered for transfer or individually?
“**Demerged company**” means the company whose undertaking is transferred to a resulting company pursuant to demerger *[section 2(19AA)]*

• “**Resulting company**” means **one or more companies (including a wholly owned subsidiary thereof)** to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger *[section 2(41A)]*

Whether wholly owned subsidiary includes step down wholly owned subsidiary also?
Case Study 3 - Resulting Company

Question:

*Whether demerger as per section 2(19AA)?*

“Resulting company” means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and

the resulting company in consideration of such transfer of undertaking, issue shares to the shareholders of the demerged company.
Demerger - A Case Study

The undertakings were transferred to Sintex Infra and Sintex Auto but shares were issued by the holding company i.e. Sintex plastic technology under section 2(41A) of the IT Act.
## Demerger - Tax Consideration

<table>
<thead>
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<th>Conditions / Remarks</th>
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<tr>
<td>Demerged Company</td>
<td>No capital gains tax on transfer of assets</td>
<td>47(vib)</td>
<td>Resulting company should be an Indian company</td>
</tr>
<tr>
<td>Shareholders of Demerged Company</td>
<td>No capital gains tax on receipt of shares from the resulting company</td>
<td>47(vid)</td>
<td></td>
</tr>
<tr>
<td>Cost of Assets for Resulting Company:</td>
<td>= WDV of depreciable asset to be the same as WDV in the hands of the Demerged Company</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>= No specific provision for cost of Capital Asset acquired</td>
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<tr>
<td></td>
<td>- Expln 7A to 43(1)</td>
<td></td>
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<td></td>
<td>- Expln 2B to 43(6)(c)</td>
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<td></td>
<td>- 49(1)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of acquisition of shares received on demerger by the shareholders</td>
<td>= Cost of acquisition of shares in demerged company be split on the basis of net book value of the assets transferred bearing to the Net worth of the Demerged Company immediately before such demerger</td>
<td>49(2C)</td>
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## Demerger - Tax Consideration

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<tr>
<td>Period of holding of shares received on demerger by the shareholders</td>
<td>Includes period of holding of shares held in the demerged company</td>
<td>Explanation 1(i)(g) to Section 2(42A)</td>
<td></td>
</tr>
<tr>
<td>Period of holding of capital assets</td>
<td>Includes period of holding of capital assets held in the demerged company</td>
<td>Expln 1(i)(b) to 2(42A) r.w.s. 49(1) and 47(vib)</td>
<td></td>
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</tbody>
</table>
Demerger - Tax Consideration

Cost split up in the hands of shareholders

• “Cost of acquisition of shares of resulting company” [Section 49(2C)]
  \[ \text{Cost of acquisition of shares in demerged Company} \times \frac{\text{Net book Value of the assets transferred in the demerger}}{\text{Net worth of the demerged company before the demerger}} \]

• “Cost of acquisition of the original shares held by the shareholders in the demerged company” [Section 49(2D)]
  \[ \text{Cost of acquisition of shares in demerged company} - \text{Cost of acquisition of shares of resulting company arrived at under section 49(2C)} \]

• “Net worth” is defined as the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger

Whether the definition of Net worth is to be interpreted strictly to include only ‘General Reserve’?

How does the above formula work in case where a negative net-worth undertaking is transferred?
MAT Credit, Goodwill and Section 56 – Merger/Demerger

**MAT Credit**
- MAT payable on book profits in the absence of Nil / lower tax profits
- Credit for MAT allowable to the assessee company who has paid such taxes
- Amalgamating company ceases to exist after amalgamation
- No specific provision in the IT Act for carry forward of MAT credit in case of amalgamation or demerger. However, Mumbai ITAT* and Ahmedabad ITAT** have endorsed a favorable view in case of amalgamation and demerger (proportionate basis) respectively

* SKOL Breweries Ltd vs ACIT [2008] 28 ITATINDIA 998 (Mum)  
** Adani Gas Ltd. v. ACIT (ITA Nos. 2241 & 2516/Ahd/2011)

**Goodwill**
- Excess consideration paid over the value of the net assets taken over from the Transferor Company may be considered as Goodwill arising on amalgamation
- Further, goodwill is an intangible asset u/s 32(1)(b) of the Act and depreciation on goodwill should be allowable under this section - CIT vs Smifs Securities Limited [TS-639-SC-2012]

**Section 56**
- No implications on receipt of properties in the hands of the Transferee Company/Resulting Company pursuant to amalgamation or demerger - Clause (IX) to the proviso of Section 56(2)(x)
Cross Border Merger
Cross Border Merger

Inbound Mergers are mergers wherein a foreign company merges with an Indian company.

Consideration in the form of shares of Indian Co.

Outbound Mergers are mergers wherein an Indian company merges with a foreign company.

Consideration in the form of shares of Foreign Co.
Challenges in Cross Border Merger (still some path to cross....)

Inbound Merger

- Treatment of accumulated losses of foreign company
- Indian amalgamated co to comply with FEMA Cross border merger regulations
- Round tripping issue

Outbound Merger

- Income-tax exemption not available
- Issue of shares to resident only up to LRS
- Permanent Establishment risk
Case Studies on Merger and Demerger
Case study 4

Merger of A Co (Unlisted) into B Co (Listed Co) and Mr. X issued listed shares of B Co

1 April 2006

A Co (Unlisted)  

15 April 2018  

Merger  

B Co (Listed)  

Shares issued on merger

What will be the cost of acquisition of B Co.’s shares in the hands of Mr. X?
Demerger of A Co (Unlisted) into B Co (Listed Co)

1 April 2006

Mr. X

Shares issued on demerger

A Co
(Unlisted)

Demerger
15 April 2018

B Co
(Listed)

How the cost of acquisition of shares of B Co. in the hands of Mr. X would be computed?
Merger of A Co (Listed) into B Co (Unlisted) and B Co getting listed pursuant to merger

1 April 2006

Merger 15 April 2018

Sale of B Co – 1 May 2018

Shares issued on merger

A Co (Listed)  

Mr. X

B Co (Unlisted)  

Mr. Y

What will be the cost of acquisition of A Co.’s shares in the hands of Mr. X?
Demerger of A Co (Listed) into B Co (Unlisted) and subsequent listing of B Co

How the cost of acquisition of shares of A Co. in the hands of Mr. X would be computed?
Merger of A Co (Listed) into B Co (Listed)

Mr. X

Sale of B Co – 1 May 2018

Mr. Y

Shares issued on merger

1 April 2006

A Co (Listed)

Merger 15 April 2018

B Co (Listed)

What will be the cost of acquisition of A Co.’s shares in the hands of Mr. X?
A Co. and B Co are related parties;
The consideration paid by the B Co. is more than the fair value of net assets of A co.
B Co. recorded the difference between the consideration and the fair value of net assets of A co. as “Goodwill”

Whether B co. can claim tax depreciation on the Goodwill arising pursuant to merger?
Overseas Demerger

Conditions u/s 47(vic)

1. Shareholders holding at least $\frac{3}{4}$th in value of Demerged Co become shareholders of Resulting Co.

2. Exempt in foreign country

Whether the Demerger would be tax neutral if Demerged Co. holds Debenture, Bonds (i.e. other than shares) or immovable / movable properties ??
Buy-back of Shares
### Taxability provisions

**[Section 115QA]**

- From 1 June 2013, Buyback tax provisions were introduced on unlisted companies and exemption was provided to its shareholders, as buy-back tax was to be paid by the company.
- Currently, buy-back of shares is taxable @ 23.296% (incl. of Surcharge & Cess) on the difference between buy-back consideration and amount which was received by the company for issue of such shares.
- Buy-back provisions are not applicable to listed companies so gains on buy-back, if any, are taxable in hands of shareholder of the listed company.

### Other provisions

- In case of corporate shareholders, MAT may be applicable.
- No deemed dividend implications on buyback [*Clause (iv) to section 2(22)*].
- Following issues are still unresolved:
  - No provisions of allowability of any expenses incurred during the buy back of shares by the Company have been introduced.
  - Benefit on account of indexation which the shareholders can opt for in case of normal scenario of sale of shares instead of buy-back.
# Buy-back of Shares

<table>
<thead>
<tr>
<th>Taxability in the hands of</th>
<th>Listed Shares</th>
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<th></th>
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<th>Unlisted Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Equity Shares</td>
<td>Preference Shares</td>
<td>Equity Shares</td>
<td>Preference Shares</td>
<td>Equity Shares</td>
<td>Preference Shares</td>
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</tr>
<tr>
<td><strong>Company</strong></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liability of Buyback Tax</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td><strong>Shareholders</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Held more than 12 months (listed shares) / 24 months (unlisted shares) *</td>
<td>10% (gains exceeding INR 1 lakh)</td>
<td>20% (with indexation) 10% (without indexation)</td>
<td></td>
<td></td>
<td></td>
<td>Exempt u/s 10(34A)</td>
<td></td>
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<tr>
<td>Held upto 12 months (listed shares) / 24 months (unlisted shares) *</td>
<td>15%</td>
<td></td>
<td>As per slab rates</td>
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* Plus applicable surcharge and cess
Capital Reduction
Capital Reduction of Shares

Tax implications in the hands of the company

- Distribution to shareholders by a Company on the reduction of its capital is deemed as dividend to the extent to which the Company possesses accumulated profits, whether capitalized or not.
- Deemed dividend u/s 2(22)(d) is subject to Dividend Distribution Tax u/s 115-O of the IT Act.

Tax implications in the hands of the shareholders

- Reduction of share capital by a company and pro-rata distribution of cash / assets to the shareholders amount to transfer and therefore, taxable as capital gains.
- For determining the amount liable to capital gain tax, full value of consideration is reduced by the amount, which has been reckoned as dividend.

Other provisions

- Capital loss on account of capital reduction in the hands of the shareholders not involving payment of any consideration cannot be allowed under the provisions of IT Act. *[Bennett Coleman & Co. Ltd. v. The Addl. CIT (ITA No 3013/MUM/2007)]*
- As there is no receipt of shares by the company, Section 56(2)(x) – Not Applicable.
Impact of Explanation 2A of section 2(22)

In case of an amalgamated company, the accumulated profits, whether capitalized or not, or loss, as the case may be, shall be increased by the accumulated profits, whether capitalized or not, of the amalgamating company on the date of amalgamation.

Particulars | INR
---|---
Accumulated Profit of A Co | 420
Accumulated Profit of B Co | 80
Total | 500

What if the merger had happened in 2017? Can accumulated profits of A Co. be considered at the time of capital reduction?
Facts of the case:
- Company A, an Indian unlisted company, undertakes buy back of its own shares
- Company A to buy back 20 lakh shares at Rs. 100/share. Fair market value of the same is Rs. 120/share
- Company A to pay cash as a consideration to the shareholders whose shares are being bought back

Will there be any tax implication u/s. 56(2)(x) of the IT Act in the hands of Company A?
Facts of the case:
Company A, an Indian company, undertakes capital reduction against accumulated losses of the company and no cash is paid on capital reduction to the shareholders.

What will be the taxability of loss on capital reduction in the hands of the shareholders?
Whether Section 50CA applies in any of the below scenarios?

- Consideration paid on capital reduction is INR 150
- Consideration paid on capital reduction is INR 40
- Capital reduction is done at par value
- Capital reduction is done at NIL value
Key regulatory provisions governing mergers and demergers
Listed Entities to comply with **Regulation 11, 37 and 94** of LODR for every Scheme of Arrangement proposed u/s 230 to 234 and Section 66 of CA 2013

SEBI Circular dated March 10, 2017 *(as amended)* provides conditions and compliances by Listed Entities while undertaking Scheme of Arrangement

WOS Merger/Demerger from WOS to parent – No SEBI/SE approval – Only intimation to SE

Filing of Scheme of Arrangement by Listed Entities with NCLT only post receipt of observation letter or No objection letter (“Letter”) from SEs

  - Such Letter to be placed before Tribunal
  - Validity of Letter is 6 months from date of its issue
  - Submission of prescribed documents with SEs post sanction of Scheme
• Amalgamation / Demerger is regulated under section 230 to 234 of the Companies Act, 2013
• Approval of NCLT, MCA, RD, OL and other applicable authorities will be required
• One of the most important documents in the process is the Scheme of Amalgamation / Arrangement
• Apart from others, following clauses in the scheme requires specific attention:
  - Vesting of Assets and Liabilities
  - Consideration
  - Appointed date and Effective date
  - Accounting treatment
  - Conditionality
Company law

Finalizing the scheme of amalgamation / arrangement and other relevant documents

Board meetings & Audit committee meetings (as applicable) of all the companies

Filing of the scheme with the Stock Exchanges (in case of listed companies) and other regulators (as may be applicable)

Obtaining No-Objection Certificate from the Stock Exchanges and approvals from other regulators (as may be applicable)

Filing applications with NCLT

Hearing of the applications by the NCLT and NCLT shall give directions to convene the meeting of shareholders and creditors and to issue notices to regulatory authorities
Company law

Shareholders and creditors meeting and issuing notices to regulatory authorities

Filing petition

Admission of petition

Obtaining regulatory approval like RD, RoC, OL, etc. (as may be applicable)

Final hearing at NCLT

Filing Order with ROC
Stamp Duty implications on Merger / Amalgamation and Demerger

- Duty is payable in the States—
  - where order approving the scheme is passed; and
  - where the properties of transferor company are located

- Specific entry in the Schedule levying duty on NCLT order sanctioning amalgamation - Maharashtra, Gujarat, Rajasthan, Haryana Karnataka, Andhra Pradesh

- Article 25 (da) of Schedule 1 to Maharashtra Stamp Act, 1958 as below:
  - 10% of the market value of shares issued or consideration paid. However, the duty shall not exceed higher of:
    - 5% of the Market value of the property located within the state of Maharashtra or
    - 0.7% of the Market value of the shares issued
    - However, there is an overall cap of Rs. 25 crores in Maharashtra

- No specific entry in case of states other than the above
  - Depending on the state, possibility of mitigation of stamp duty could be explored through appropriate transfer mechanism
Competition Laws

Process Chart

M&A Deal

Analysis of Combination, Threshold limits, group etc.

Threshold limits breached

Yes

Whether exemption available?

No

Threshold limits not breached

Yes

File notice with CCI

Proceed with Deal Closure

Target based exemption:
Assets < 350 crs OR
Turnover < 1,000 crs
[S.O.988(E) dtd 27.3.17]

Short Form I

To call for more details

Long Form II

Approval of CCI

Deal Reject

Approval of CCI

Yes

No

Yes

No
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Expansion</th>
</tr>
</thead>
<tbody>
<tr>
<td>CA 2013</td>
<td>Companies Act, 2013</td>
</tr>
<tr>
<td>CCI</td>
<td>Competition Commission of India</td>
</tr>
<tr>
<td>DDT</td>
<td>Dividend Distribution Tax</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investments</td>
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<tr>
<td>GST</td>
<td>Goods &amp; Service Tax</td>
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<tr>
<td>Hold Co</td>
<td>Holding Company</td>
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<tr>
<td>I-GAAP</td>
<td>Indian General Accepted Accounting Principles</td>
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<tr>
<td>Ind AS</td>
<td>Indian Accounting Standards</td>
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Thank You