NCFM

NSE's CERTIFICATION IN FINANCIAL MARKETS

Mergers and Acquisitions Module

NATIONAL STOCK EXCHANGE OF INDIA LIMITED

Test Details:

Sr. No.	Name of Module	Fees (Rs.)	Test Duration (in minutes)	No. of Questions	Maximum Marks	Pass Marks (%)	Certificate Validity
1	Financial Markets: A Beginners' Module *	1686	120	60	100	50	5
2	Mutual Funds : A Beginners' Module	1686	120	60	100	50	5
3	Currency Derivatives: A Beginner's Module	1686	120	60	100	50	5
4	Equity Derivatives: A Beginner's Module	1686	120	60	100	50	5
5	Interest Rate Derivatives: A Beginner's Module	1686	120	60	100	50	5
6	Commercial Banking in India: A Beginner's Module	1686	120	60	100	50	5
7	Securities Market (Basic) Module	1686	120	60	100	60	5
8	Capital Market (Dealers) Module *	1686	105	60	100	50	5
9	Derivatives Market (Dealers) Module *	1686	120	60	100	60	3
10	FIMMDA-NSE Debt Market (Basic) Module	1686	120	60	100	60	5
11	Investment Analysis and Portfolio Management Module	1686	120	60	100	60	5
12	Fundamental Analysis Module	1686	120	60	100	60	5
13	Financial Markets (Advanced) Module	1686	120	60	100	60	5
14	Securities Markets (Advanced) Module	1686	120	60	100	60	5
15	Mutual Funds (Advanced) Module	1686	120	60	100	60	5
16	Banking Sector Module	1686	120	60	100	60	5
17	Insurance Module	1686	120	60	100	60	5
18	Macroeconomics for Financial Markets Module	1686	120	60	100	60	5
19	NISM-Series-I: Currency Derivatives Certification Examination	1000	120	100	100	60	3
20	NISM-Series-II-A: Registrars to an Issue and Share Transfer Agents – Corporate Certification Examination	1000	120	100	100	50	3
21	NISM-Series-II-B: Registrars to an Issue and Share Transfer Agents – Mutual Fund Certification Examination	1000	120	100	100	50	3
22	NISM-Series-IV: Interest Rate Derivatives Certification Examination	1000	120	100	100	60	3
23	NISM-Series-V-A: Mutual Fund Distributors Certification Examination *	1000	120	100	100	50	3
24	NISM-Series-VI: Depository Operations Certification Examination	1000	120	100	100	60	3
25	NISM Series VII: Securities Operations and Risk Management Certification Examination	1000	120	100	100	50	3
26	Certified Personal Financial Advisor (CPFA) Examination	4495	120	80	100	60	3
27	NSDL–Depository Operations Module	1686	75	60	100	60 #	5
28	Commodities Market Module	2022	120	60	100	50	3
29	Surveillance in Stock Exchanges Module	1686	120	50	100	60	5
30	Corporate Governance Module	1686	90	100	100	60	5
31	Compliance Officers (Brokers) Module	1686	120	60	100	60	5
32	Compliance Officers (Corporates) Module	1686	120	60	100	60	5
33	Information Security Auditors Module (Part-1)	2528	120	90	100	60	2
	Information Security Auditors Module (Part-2)	2528	120	90	100	60	
34	Options Trading Strategies Module	1686	120	60	100	60	5
35	Options Trading (Advanced) Module	1686	120	35	100	60	5
36	FPSB India Exam 1 to 4**	2247 per exam	120	75	140	60	NA
37	Examination 5/Advanced Financial Planning **	5618	240	30	100	50	NA
38	Equity Research Module ##	1686	120	65	100	55	2
39	Issue Management Module ##	1686	120	80	100	55	2
40	Market Risk Module ##	1686	120	50	100	55	2
41	Financial Modeling Module ###	1123	150	50	75	50	NA

* Candidates have the option to take the tests in English, Gujarati or Hindi languages.

\# Candidates securing 80% or more marks in NSDL-Depository Operations Module ONLY will be certified as 'Trainers'.

** Following are the modules of Financial Planning Standards Board India (Certified Financial Planner Certification)

- FPSB India Exam 1 to 4 i.e. (i) Risk Analysis & Insurance Planning (ii) Retirement Planning & Employee Benefits (iii) Investment Planning and (iv) Tax Planning & Estate Planning
- Examination 5/Advanced Financial Planning

\## Modules of Finitiatives Learning India Pvt. Ltd. (FLIP)

\### Module of IMS Proschool

The curriculum for each of the modules (except Financial Planning Standards Board India, Finitiatives Learning India Pvt. Ltd. and IMS Proschool) is available on our website: www.nseindia.com > Education > Certifications.

Mergers and Acquisitions Module

Background

In a dynamic economy, business structures and company structures are in a state of constant flux. This leads to several forms of re-organisation. This workbook discusses the various forms of re-organisation and their implications in terms of legalities, valuation, accounting and taxation.

Learning Objectives

- To understand the various forms of re-organisation of companies and businesses and know what goes into a due diligence
- To know how re-organisations are executed under section 293 and Chapter V of the Companies Act 1956, and contrast the implications of alternate approaches and their limitations.
- To get insights on how buy-backs are to be executed under the SEBI regulations
- To appreciate the SEBI processes for substantial acquisition and take-over
- To understand how a company can de-list its shares from the exchange
- To gain insights on different approaches to valuation and their applicability
- To get oriented to how re-organisations are accounted in India, including the proposed Ind-AS framework for business combinations
- To know the tax implications of re-organisations

CONTENTS

Acronyms

BIFR	Board for Industrial & Financial Re-construction
BOT	Build Operate Transfer
DCF	Discounted Cash Flow
DPS	Dividend Per Share
EBIDTA	Earnings before Interest, Depreciation, Tax and Amortisation
EPS	Earnings Per Share
FCFE	Free Cash Flow to Equity
FCFF	Free Cash Flow to Firm
FDI	Foreign Direct Investment
NCLT	National Company Law Tribunal
NDA	Non-disclosure Agreement
P/E	Price to Earnings
RoC	Registrar of Companies
SEBI	Securities & Exchange Board of India
STT	Securities Transaction Tax
VAT	Value Added Tax
VRS	Voluntary Retirement Scheme
WACC	Weighted Average Cost of Capital

Distribution of weights of the Mergers and Acquisitions Module Curriculum

Chapter No.	Title	Weights (%)
1	Introduction to Mergers & Acquisitions	13
2	Scheme of Compromise, Arrangement or Re-construction	6
3	Buy-back of Securities	16
4	Substantial Acquisition of Shares & Takeovers	20
5	De-listing of Equity Shares	15
6	Valuation	12
7	Accounting for Mergers & Acquisitions	12
8	Taxation	6

Note: Candidates are advised to refer to NSE's website: www.nseindia.com, click on'Education' link and then go to 'Updates & Announcements' link, regarding revisions/updations in NCFM modules or launch of new modules, if any.

This book has been developed for NSE by Mr. Sundar Sankaran, Director, Finberry Academy Pvt. Ltd.

Chapter 1: Introduction to Mergers & Acquisitions

1.1 Background

In their quest for efficiency and competitiveness, business and companies keep re-organising themselves.

- When companies seek re-organisation pro-actively, to meet the demands of the customers or creditors or financial markets or governments, it is a case of voluntary re-organisation.
- Re-organisation can also be involuntary, when the customers or creditors or financial markets or the government force a company to re-organise.

In communist and socialist economic structures, governments are more inclined to support weak companies and businesses. Such support can allow a company or business to survive longer than would have been otherwise possible. Business re-organisation is therefore more common in capitalistic economic structures.

1.2 Types of Re-organisation

1.2.1 Internal Re-organisation

In an internal re-organisation, the affected parties are mostly within the organisation. For example, the company may choose to offer a voluntary retirement scheme (VRS) to its workers or change its organisation structure. These may or may not be linked to a decision to enter a new market, or exit from a market that is operating in or close down a factory.

Internal re-organisation is easier and quicker to execute.

1.2.2 External Re-organisation

This affects not only parties within the organisation, but also external stake-holders. The following are a few illustrations of external re-organisation:

- Capital Re-structuring

  The company may re-organise the capital by consolidating shares of different classes or splitting the shares into different classes. To the extent the rights of share-holders are affected, the company will need to take permission of the share-holders for the arrangement. This is covered by Section 391 of the Companies Act, 1956, discussed in the next Chapter. Sections 100 to 105 of the Companies Act, 1956 provide a framework for reduction of share capital outside the Section 391 requirements.

- Creditor Re-structuring

  The company may opt to re-work its obligations to creditors. The company will need to take permission of creditors whose rights are affected by the arrangement. This is covered by Section 391 of the Companies Act, 1956, discussed in the next Chapter.

- Merger& Amalgamation

  In a merger, two or more companies (amalgamating companies) choose to merge into a single company (amalgamated company). Thus, the amalgamated company acquires the amalgamating companies.This is covered by sections 391 – 394 of the Companies Act, 1956, discussed in the next chapter.

  - When merger is between two companies that are into the same products or services, it is called a horizontal merger.
  - In a vertical merger, the companies are in different points in the value chain. For example, a supplier and customer.
    - When the supplier acquires the customer, it is an example of forward integration.
    - When the customer acquires the supplier, it is an example of backward integration.
  - A conglomerate or diagonal merger is one where the merging companies are neither into the same products or services, nor in the same business. It may be part of the diversification strategy of the amalgamated company.

- Reverse Merger

  Normally, in a merger, a smaller or weaker company merges into a larger or healthier company. When the reverse happens viz a larger or healthier company merges into a smaller or weaker company, it is called a reverse merger.

  One reason for such a transaction is to let the weaker company continue to carry forward its losses to set off against future profits of the merged entity.

- De-merger / Hive-off / Spin Off

  This is the reverse of a merger. The company transfers one or more businesses into a separate company. The company doing the transfer is called 'demerged company'. The separate company into which the businesses are transferred is called 'resulting company'. The resulting company is either a subsidiary of the demerged company, or has an initial share-holding pattern that is a mirror image of the share-holding pattern of the demerged company.

  Such transactions are covered by Sections 391 to 394 of the Companies Act, 1956.

  Demergers are done for various reasons such as:

  - Family split. Control of the demerged company and resulting company are vested in different branches of the family.

- o Better focus – The demerged company and resulting company can take their own paths that are suitable for their underlying business.
- o Divestment of the resulting company, when that business is no longer of interest for the demerged company.
- o Dilution of stake in the resulting company, to help the demerged company to mobilise money, without dilution of stake in the demerged company.

- Slump Sale

  A slump sale is the sale of an entire undertaking, without values being assigned to individual assets or liabilities. In a slump sale, the net worth of the undertaking is taken to be the cost of acquisition and improvement.

  These are easier to implement. Since no high court approval is required, the transaction can be executed faster.

- Acquisition of Control

  Instead of merging the businesses or companies, promoters may choose to acquire control through a substantial acquisition, but keep the businesses distinct in different legal entities. The company can also choose to reduce the role of public share-holders through a buy-back, or go completely out of the public radar by de-listing the company. The legal framework for such transactions is discussed in Chapters 3, 4 and 5.

1.3 Stock Swap

The consideration for acquiring a business or company may be paid in various forms, such as cash, securities or by taking over the liabilities of the acquiree. When the share-holders in the acquiree company are given shares of the acquirer company as part of the acquisition, it is called a stock swap.

A benefit of stock swap is that the cash outflow for the acquirer company is minimized. Higher the value of the acquirer company's shares, the fewer the shares it needs to issue for the acquisition.

However, the share issue does cause dilution of promoter's stake in the acquirer company. Further, even earnings per share (EPS) of the acquirer company may be diluted, if the earnings of the acquiree company are not adequate.

1.4 Section 293 (1) (a) of the Companies Act, 1956

Section 293 limits the powers of the Board of a public company, or a private company which is a subsidiary of a public company. Under this section, the share-holders will have to approve certain decisions in a general meeting.

One such decision, covered in section 293 (1) (a) is to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company, or where the company owns more than one undertaking, of the whole or substantially the whole of any such undertaking.

Undertaking means the whole business. If only part of a business is sold, it would amount to sale of assets.

The resolution need not provide a valuation. It can however provide for limitations on how the proceeds from the sale will be used.

Thus, a company that wishes to re-organise itself by selling the whole or substantially the whole of one or more undertakings can easily do so, by passing the requisite share-holder resolution in general meeting. There is no need to approach the High Court / National Company Law Tribunal (NCLT).

However, once the undertakings are sold, the company's share capital may not be represented by available assets. If the company chooses to go for reduction of share capital, it will need share-holder approval through a special resolution, and also permission of the High Court / NCLT.

On account of the change in business, the company may choose to change its name. In that case, it will need share-holder approval through a special resolution and also permission of central government [power delegated to Registrar of Companies (RoC)].

Similarly, there may be a need to change the ownership of trade-marks, for which the Trade Marks Registry will need to be approached. Foreign Exchange Management Act, 1999 comes into play for international transactions. Some transactions may require permission of the competition commission. In some cases, change of objects clause or registered office may be required.

Several such incidental approvals and formalities come up. If a company re-organises itself under Chapter V of the Companies Act, 1956 (discussed in next Chapter), then the High Court / NCLT order under that chapter would be binding on various parties. The order would even prevail over SEBI Regulations. Besides, some of the income tax benefits associated with mergers and demergers (discussed in Chapter 8) are linked to Chapter V. Therefore, Chapter V is a popular form of re-organisation of companies.

1.5 Sick Companies

Re-structuring that involves sick companies (as transferor or transferee) are covered by Sick Industrial Companies (Special Provisions) Act, 1985 – not Companies Act, 1956. Therefore, the appropriate authority for such transactions would be the Board for Industrial and Financial Re-construction (BIFR).

1.6 Benefits of Re-organisation

Re-organisations are effected for various objectives, such as –

- Economies of scale
- Diversification
- Managing family split
- Enhancing market position
- Enhancing resource mobilization capability
- Access to newer markets / customers
- Access to newer technology
- Access to a wider product range
- Weakening or eliminating a competitor
- Tax benefits
- Encashment of value of brands or other intangible assets
- Reviving a weak or sick company

1.7 Re-organisation Costs

Several costs go into a re-organisation. Some of these are:

- SEBI Fees
- Fees of merchant bankers, valuation agencies, bankers to the issue, registrars, stock brokers and other intermediaries
- Value added Tax, octroi and any other such taxes levied by the central government, state government or municipal corporations
- Stamp duty (varies from state to state)
- Securities transaction tax
- Capital gains tax
- Other implications under income tax act, such as losing the tax-shield on accumulated losses or unabsorbed depreciation
- Costs associated with arranging meetings
- VRS and other re-structuring costs

At times, costs are more certain than the benefits. Some of the benefits may accrue after very long periods of time, or may accrue for a very short period of time.

It is important to do a cost-benefit analysis before embarking on a re-organisation.

1.8 Due Diligence

Prior to acquisition, the acquirer does a due diligence. The financial due diligence is normally conducted by an independent agency such as a consultant or chartered accountant. The legal due diligence is conducted by an attorney or solicitor firm. As part of the due diligence, the following are checked:

- Financial statements, especially focusing on qualifications by the auditors and notes to the accounts.
- Income tax returns, VAT / Central Excise / Sales Tax Returns, Service Tax Returns, Tax deducted at source (TDS) returns and position on various assessments by these authorities including demands, if any
- Bank accounts and discussions with the bankers
- Position on provident fund, super-annuation fund, gratuity fund, Employees' State Insurance Corporation and any other statutory dues and claims
- Balance confirmations with various parties
- Contracts and dealings with key buyers, sellers and other trade parties
- Contracts and dealings with lenders and investors
- Other material contracts, including with key personnel
- Labour disputes and wage settlements
- Memorandum of Association and Articles of Association of the company
- Resolutions passed by the board or share-holders
- Changes in share-holding structure of the company since inception
- Any disputes between any key share-holders and the company, and in the case of listed companies, the investor servicing track record and complaints pending
- Listing agreement and discussions with the stock exchange
- ROC filings including registration of charges
- Various licenses for the company to do business, such as the licenses under Shops & Establishments Act and Factories Act, including those that the company may not have acquired or those that may have expired
- Title deeds for the property owned by the company
- Brands, trade-marks, copyrights, technology and other intellectual property rights including digital assets
- Claims and pending litigation where the company is either a plaintiff or a defendant
- Powers of Attorney executed by or in favour of the company or its directors

At times, the due diligence is split into two stages – preliminary and final. The final due diligence is initiated only after discussions based on the preliminary indicate the possibility of a deal, or a term sheet for the deal is signed.

Before the due diligence process starts, a non-disclosure agreement (NDA) is signed between the parties concerned, including the due diligence agency.

Self-Assessment Questions

- VRS is an example of
  - Involuntary re-organisation
  - Voluntary re-organisation
  - External re-organisation
  - **Internal re-organisation**
- When merger is between two companies that are into the same products or services, it is called a ______________ merger.
  - **Horizontal**
  - Vertical
  - Diagonal
  - Reverse
- When a larger or healthier company merges into a smaller or weaker company, it is called a ______________ merger.
  - Horizontal
  - Vertical
  - Diagonal
  - **Reverse**
- In which of the following, values are not assigned to individual assets?
  - Merger
  - De-merger
  - Reverse merger
  - **Slump sale**
- Which of the following are benefits of Chapter V re-organisation?
  - High court permission not required
  - NCLT permission not required
  - **Binding on all**
  - Share-holder permission not required
- Appropriate authority for merger entailing sick company is
  - High court
  - NCLT
  - **BIFR**
  - CLB

Chapter 2: Scheme of Compromise, Arrangement or Re-construction

Chapter V of the Companies Act, 1956 covers such schemes.

2.1 Definitions

The following are applicable for sections 391 and 393.

2.1.1 Company

"Company" means any company liable to be wound up under the Companies Act, 1956.

2.1.2 Arrangement

"Arrangement" includes a re-organisation of the share capital of the company by the consolidation of shares of different classes, or by the division of shares into shares of different classes or by both those methods.

2.1.3 Unsecured Creditors

Unsecured creditors who may have filed suits or obtained decrees are deemed to be of the same class as other unsecured creditors.

2.1.4 Appointed Date and Effective Date

Appointed date is the date that is relevant for transfer of assets and liabilities. Fair value of assets and liabilities are determined as of the appointed date. It is normally the beginning of the financial year, though it can be any retrospective date.

Effective date is the date the certified court order is filed with RoC.

The transferee will recognise the merger on the effective date; but it will be as of the appointed date.

2.2 Power to compromise or make arrangements with creditors and members

Section 391 covers the following forms of compromise or arrangement:

- Between a company and its creditors or any class of them; or
- Between a company and its members or any class of them.

For any such compromise or arrangement, application can be made to the National Company Law Tribunal (NCLT) by the company, or any creditor or member of the company. Thus, it is not dependent on the Board of Directors of the company. Even a creditor or a member can apply. In the case of a company that is being wound up, the liquidator can apply to NCLT.

Although the NCLT is mentioned as the authority, vide the Companies (Second Amendment) Act, 2002, this has not yet been notified. Therefore, the power is being exercised by the

High Court, which was mentioned in the act before the 2002 amendment.

On receiving the application, the NCLT will order a meeting of the creditors or class of creditors or members or class of members, as the case may be. The meeting is to be called, held and conducted in such manner as the NCLT directs.

Every notice calling the meeting that is sent to a creditor or member has to be sent along with a statement setting forth the terms of the compromise or arrangement, and explaining its effect. In particular, any material interest of the directors, managing director or manager of the company, whether in that capacity or as member or creditor of the company or otherwise, and how the scheme will affect those interests is to be disclosed, if the effect is different from that on other persons.

In every notice calling the meeting that is given by advertisement, the aforesaid statement has to be included. Else, the advertisement has to include a notification of the place and manner in which creditors or members entitled to attend the meeting can obtain copies of the statement.

If rights of debenture-holders of the company are affected, then the statement has to disclose how the scheme will affect the trustees of any deed for securing the issue of the debentures.

A majority in number representing three-fourths in value of the creditors or class of creditors or members or class of members, as the case may be, present and voting in person (or by proxy, if allowed) at the meeting will have to agree to the scheme of compromise or arrangement.

The NCLT will need to be satisfied that the company or other applicant for the scheme has disclosed all material facts relating to the company, such as the latest financial position of the company, pendency of any investigation proceedings in relation to the company etc.

Thereafter, if the NCLT sanctions the scheme, it will be binding on the creditors or class of creditors or members or class of members, and also on the company. In the case of a company being wound up, it is binding on the liquidator and contributories of the company.

The NCLT order takes effect only when a certified copy is filed with the Registrar of Companies.

The order also needs to be attached to every copy of the memorandum of the company that is issued after the filing of the certified copy with the Registrar.

On receipt of the application for the scheme, NCLT has the power to stay the commencement or continuation of any suit or proceeding against the company, on such terms as it thinks fit, until the application is finally disposed of.

2.3 NCLT's Power to Enforce Compromise or Arrangement

When NCLT sanctions a compromise or arrangement in respect of a company, it also has the power to supervise its implementation. At any stage, it can make orders or give directions, or make modifications to the scheme for its proper working.

If it is satisfied that he scheme cannot be worked satisfactorily, with or without modifications, NCLT can order winding up of the company. This order can be passed, either on its own motion or on the application of any person interested in the affairs of the company.

2.4 NCLT's Power for Facilitating Reconstruction or Amalgamation

This is covered by section 394. Where any person entitled to apply to NCLT, demonstrates to the NCLT:

- That the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the re-construction of any company or companies, or the amalgamation of any two or more companies; and
- That under the scheme, the whole or part of any part of the undertaking, property or liabilities of any company concerned in the scheme (the transferor company) is to be transferred to another company (the transferee company);

the NCLT may, while sanctioning the scheme or later, provide for 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;
- Provision to be made for any persons who, within such time and in such manner as the NCLT directs, dissent from the compromise or arrangement; and
- Other incidental, consequential and supplemental matters that are necessary to secure that the reconstruction or amalgamation is fully and effectively carried out.

In the case of amalgamation of a company that is being wound up, NCLT can sanction the scheme only after receiving a report from the registrar that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest.

Similarly, no order for dissolution of a transferor company can be made by the NCLT, unless a report is received from the Official Liquidator, on scrutiny of the books and papers of the company, that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest.

Within 30 days of the order, the company is bound to file it with the RoC.

2.5 Dissenting Share-holders

Section 395 covers situations where

- the scheme or contract involves transfer of shares or any class of shares in a transferor company to a transferee company; and
- the scheme is approved by holders of not less than nine-tenths in value of the shares whose transfer is involved (excluding shares already held on the date of the offer by the transferee company or its subsidiary or nominee) within four months of the offer made by the transferee company.

Where the two conditions are fulfilled, the transferee company can give notice to the dissenting share-holders to acquire their shares, within two months of the expiry of the four month period. The transferee company is entitled and bound to acquire the shares of these dissenting share-holders on the same terms as the shares of the approving share-holders are being transferred to the transferee company. A dissenting share-holder can however approach NCLT, within one month of the notice, requesting for an order against such acquisition.

One month after notice has been served on the dissenting share-holders, or if the share-holder has approached NCLT, then on disposal of the matter by the NCLT, the transferee company has to send a copy of the notice to the transferor company. Along with the notice, it has to:

- Send transfer deed, duly executed on behalf of the investor by any person appointed by the transferee company, and executed on its own behalf by the transferee company;
- Pay or transfer to the transferor company, the consideration payable to the investors for the shares that the transferee company is entitled to receive.

On receipt of the above, the transferor company has to register the transferee company as the holder of those shares. Within one month thereafter, it has to inform the investor about the registration of transfer and receipt of money.

The amounts received by the transferor company in this manner, are to be held in a separate account to be held in trust for the benefit of the concerned investors.

In case the transferee company or its subsidiaries or nominees already hold more than one-tenth in value of the shares of the same class as the shares whose transfer is involved, the above provision regarding acquisition of shares from dissenting share-holders is applicable only if-

- the transferee company offers the same terms to all holders of the shares of that class other than those held by the transferee or its subsidiaries or nominees; and
- the holders who approve the scheme or contract should not only represent nine-tenths in value of the shares whose transfer is involved, but also represent three-fourths in number of the holders of those shares.

Where after the transfer, the transferee company or its subsidiaries or nominees hold more than nine-tenths in value of the shares or shares of that class, of the transferor company-

- The transferee company has to give notice to other share-holders within one month; and
- Any such holder, within three months of the notice, can require the transferee company to acquire his shares.

In that case, the transferee company is entitled and bound to acquire those shares on the same terms as the shares of the approving share-holders, or on terms mutually agreed, or on terms set by the NCLT on application by the transferee company or the dissenting share-holder.

2.6 Amalgamation in National Interest by Central Government

Where the Central Government is satisfied that it is in public interest that two or more companies should amalgamate, it can by order notified in the Official Gazette, provide for their amalgamation into a single company. The company's constitution, property, power, rights, interests, authorities and privileges, liabilities, duties and obligations will be as specified in the order.

Every member or creditor, including debenture holder will have the same interest in or rights against the amalgamated company, as they had in or against the original amalgamating company. In case of a reduction in their interest or rights, they shall be entitled to compensation to be decided by such authority as may be mentioned in the order. The compensation will be paid by the amalgamated company.

Self-Assessment Questions

❖ Schemes of compromise and arrangement are covered by Chapter ________________ of the Companies Act, 1956

  ➢ II

  ➢ III

  ➢ IV

  ➢ **V**

- For the purposes of sections 391 and 393, “company” means ________
  - Company as defined in section 3 of the Companies Act, 1956
  - **A company that is liable to be wound up under the Companies Act, 1956**
  - A public limited company
  - A private limited company
- Fair value of assets and liabilities in a merger are determined as of the ________ date.
  - **Appointed**
  - Effective
  - Ex-merger date
  - Beginning of the financial year
- Section 391 covers the following forms of compromise or arrangement
  - Between a company and its creditors or any class of them
  - Between a company and its members or any class of them
  - **Both the above**
  - None of the above
- In the case of amalgamation of a company that is being wound up, NCLT can sanction the scheme only after receiving a report from the ________
  - **RoC**
  - Official liquidator
  - Both the above
  - None of the above
- The company is bound to file NCLT with the RoC within ________ days
  - 7
  - 15
  - **30**
  - 60

Chapter 3: Buy-back of Securities

3.1 Regulation and Definitions

A company can choose to buy-back securities earlier issued by it. The applicable regulation is Securities and Exchange Board of India (Buy Back of Securities) Regulations, 1998.

The regulations are applicable to buy-back of shares or other specified securities of a company listed on a stock exchange.

A company listed on a stock exchange cannot buy-back its shares or other specified securities so as to delist its shares or other specified securities from the stock exchange.

3.1.1 Associate

"Associate" includes a person:

- who directly or indirectly, by himself or in combination with relatives, exercise control over the company; or
- whose employee, officer or director is also a director, officer or employee of another company.

3.1.2 Control

"Control" includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or security-holders or voting agreements or in any other manner.

3.1.3 Small Share-holder

"Small shareholder" means a shareholder of a listed company, who holds shares or other specified securities whose market value, on the basis of closing price of shares or other specified securities, on the recognised stock exchange in which highest trading volume in respect of such security, as on record date is not more than two lakh rupees.

3.1.4 Tender Offer

"Tender Offer" means an offer by a company to buy-back its shares or other specified securities, through a letter of offer, from the holders of the shares or other specified securities of the company.

3.2 Permitted Methods of Buy-back

A company is permitted to buy-back its securities through any of the following methods:

- From the existing security-holders on a proportionate basis through the tender offer;
- From the open market through—

    - book-building process,
    - stock exchange;
- From odd-lot holders.

Proportionate basis means proportionate amongst share-holders who accept the tender offer.

A company cannot buy-back its shares or other specified securities from any person through negotiated deals, whether on or of the stock exchange, or through spot transactions or through any private arrangement.

No person or insider is permitted to deal in securities of the company on the basis of unpublished information relating to buy-back of shares or other specified securities of the company.

3.3 Provisions in the Companies Act, 1956

Section 77A of the Companies Act, 1956 authorises a company to purchase its own shares or other specified securities out of its free reserves or securities premium account or the proceeds of any shares or other specified securities. However, the prior issue cannot be of the same kind as the shares or securities being bought back.

The articles of the company will have to authorise the buy-back. Further, the buy-back needs to be authorised by a special resolution passed in general meeting of the company.

The requirement of buy-back authority being provided in the articles, and share-holders' special resolution is waived if the buy-back does not exceed 10 per cent of the paid up capital and free reserves of the company. However, board resolution will be required, and no other offer of buy-back without share-holders' special resolution should have been done in the preceding 365 days.

In any case, buy-back cannot exceed 25% of the total paid up capital and free reserves of the company. Further, buy-back of equity shares in a financial year is limited to 25% of total paid-up equity capital.

After the buy-back, the company's debt (secured and unsecured) cannot be more than twice its capital and free reserves.

The shares or securities proposed to be bought back have to be fully paid.

Buy-back of securities listed in a stock exchange is covered by the SEBI Regulations. Buy-back in other situations is covered by the Private Limited Company and Unlisted Public Limited Company (Buy-back of Securities) Rules, 1999.

While seeking permission of share-holders, the explanatory statement has to include the following information:

- Full and complete disclosure of all material facts;

- Necessity for buy-back;
- Class of security intended to be purchased under the buy-back;
- Amount to be invested under the buy-back; and
- Time-limit for completion of buy-back.

Buy-back has to be completed within 12 months from the date of passing the share-holders' resolution or board resolution.

After the resolution, but before the buy-back, a Declaration of Solvency has to be filed with the Registrar of Companies (and also SEBI, in the case of listed companies). The declaration has to state that the Board of Directors has made a full enquiry into the affairs of the company, based on which they have formed an opinion that the company is capable of meeting its liabilities and will not be rendered insolvent within one year from the date the declaration was adopted by the Board. The declaration has to be signed by at least two directors, of which one needs to be the managing director (if any).

The securities bought back will have to be extinguished and physically destroyed within 7 days of the last date of completion of buy-back.

Where buy-back of shares is out of free reserves, an amount equal to the nominal value of the shares bought back needs to be transferred to the Capital Redemption Reserve.

No issue of similar securities can be made for a period of 6 months from completion of buy-back. However, bonus issues and issues towards prior commitments, such as, conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares are permitted.

Besides the methods mentioned in the SEBI Regulations (Para B), the companies act also provides for purchase of securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Section 77B of the Companies Act, 1956, provides that a company cannot buy-back its shares or other securities-

- through any subsidiary company including its own subsidiary companies; or
- through any investment company or group of investment companies; or
- if a default is subsisting in repayment of deposit, or interest payable on a deposit, or redemption of debentures or preference shares, or payment of dividend to any share-holder, or repayment of any term loan or interest payable on term loan to any financial institution or bank.

A company is also not permitted to buy-back if it is in violation of section 159 (filing of annual returns), section 207 (payment of dividend within 30 days) or section 211 (preparation of financial statements).

Unlisted companies need to only comply with the Companies Act requirements. Listed companies have to comply with both the Companies Act requirements and the SEBI Regulations.

For example, one of the SEBI requirements is that copy of Share-holders' Resolution has to be filed with the stock exchanges where the shares or securities are listed, within 7 days. Board Resolution has to be similarly filed with the stock exchanges within 2 working days.

3.4 Buy-back through Tender Offer

As mentioned in Para B, this will be on proportionate basis. However, fifteen per cent of the number of securities which the company proposes to buy back or number of securities entitled as per their shareholding, whichever is higher, has to be reserved for small shareholders.

The explanatory statement sent to share-holders before the meeting has to mention the following:

- the maximum price at which the buy-back of shares or other specified securities shall be made and whether the Board of Directors of the company are being authorised at the general meeting to determine subsequently the specific price at which the buy-back may be made at the appropriate time
- if the promoter intends to offer their shares or other specified securities,
    - the quantum of shares or other specified securities proposed to be tendered, and
    - the details of their transactions and their holdings for the last six months prior to the passing of the special resolution for buy-back, including information of number of shares or other specified securities acquired, the price and the date of acquisition.

Within two working days from the date of the share-holders' resolution or Board resolution, the company has to make a public announcement in at least:

- One English national daily;
- One Hindi national daily; and
- One Regional language daily with wide circulation at the place where the registered office of the company is situated.

SEBI has specified the information that the public notice has to contain.

A copy of the public announcement, along with the soft copy, has also to be submitted to SEBI simultaneously through a merchant banker.

Within five working days of the public announcement, the company has to file with SEBI, a draft-letter of offer, along with soft copy. It has to contain specified disclosures, and needs to be submitted through a merchant banker who is not associated with the company.

SEBI is expected togive its comments on the draft letter of offer not later than seven working days of the receipt of the draft letter of offer. However, if SEBI has sought clarifications or additional information from the merchant banker to the buyback offer, the period of issuance of comments is extended to the seventh working day from the date of receipt of satisfactory reply to the clarification or additional information sought.

If SEBI specifies any changes, the merchant banker to the buyback offer, and the company have to carryout such changes in the letter of offer before it is dispatched to the shareholders.

The company making a buyback offer has to announce a record date for the purpose of determining the entitlement and the names of the security holders, who are eligible to participate in the proposed buyback offer.

The letter of offer along with the tender form has to be dispatched to the security holders who are eligible to participate in the buyback offer, not later than five working days from the receipt of SEBI comments.

The date of opening of the offer cannot be later than five working days from the date of dispatch of letter of offer.

The offer for buy back has to be kept open for a period of ten working days.

The shares proposed to be bought back have to be divided in to two categories:

(a) reserved category for small shareholders and

(b) the general category for other shareholders.

The entitlement of a shareholder in each category is to be calculated accordingly.

First, the shares or other specified securities tendered on the basis of entitlement have to be accepted. Thereafter, whatever is left to be bought back, if any, in one category should be first accepted, in proportion to those tendered in excess of their entitlement in the offer by security holders in that category. Thereafter, those from security holders who have tendered in excess of their entitlement in the other category can be accepted.

3.5 Escrow Account in Tender Offer

On or before the opening of the offer, the company has to deposit the following amount in an escrow, by way of security for performance of its obligations:

- If the consideration payable does not exceed Rs. 100 crores – 25 per cent of the consideration payable;
- If the consideration payable exceeds Rs. 100 crores – 25 per cent upto Rs. 100 crores and 10 per cent thereafter.

Escrow is permitted in the following forms:

- Cash deposited with a scheduled commercial bank, or
- Bank guarantee in favour of the merchant banker, or

- Deposit of acceptable securities with appropriate margin, with the merchant banker, or
- A combination of the above.

Where the escrow account consists of deposit with a scheduled commercial bank, the company, while opening the account, has to empower the merchant banker to instruct the bank to issue a banker's cheque or demand draft for the amount lying to the credit of the escrow account, as provided in the regulations.

Where the escrow account consists of bank guarantee, such bank guarantee has to be in favour of the merchant banker, valid until thirty days after the closure of the offer.

In case the escrow account consists of securities, the company has to empower the merchant banker to realise the value of such escrow account by sale or otherwise, and if there is any deficit on realisation of the value of the securities, the merchant banker is liable to make good any such deficit.

In case the escrow account consists of bank guarantee or approved securities, these cannot be returned by the merchant banker till completion of all obligations under the regulations.

Where the escrow account consists of bank guarantee or deposit of approved securities, the company has to deposit with the bank in cash a sum of at least one per cent of the total consideration payable, as and by way of security for fulfilment of the obligations.

On payment of consideration to all the security-holders who have accepted the offer, and after completion of all formalities of buy-back, the amount, guarantee and securities in the escrow, if any, can be released to the company.

In case of non-fulfilment of obligations under the regulations by the company, SEBI may, in the interest of the security-holders, forfeit the escrow account either in full or in part. The amount forfeited may be distributed pro rata amongst the security-holders who accepted the offer. Balance, if any, is to be utilised for investor protection.

3.6 Payment to Security-holders in Tender Offer

Immediately after the date of closure of the offer open, the company has to open a special account with a banker to an issue registered with SEBI. It has deposit in the account, such sum as would, together with ninety per cent of the amount lying in the escrow account, make-up the entire sum due and payable as consideration for buy-back. It can transfer money from the escrow account for this purpose.

The company has to complete the verifications of offers received and make payment of consideration to those security holders whose offer has been accepted, or return the shares or other specified securities to the security holders, within seven working days of the closure of the offer.

The company has extinguish and physically destroy the security certificates bought back, in the presence of a Registrar to the issue or the Merchant Banker and the Statutory Auditor, within fifteen days of the date of acceptance of the shares or other specified securities.

The companies act requirement of extinguishment within seven days of the last date of completion of buy-back too has to be complied with.

Compliance Certificate has to be given to SEBI, duly certified and verified by-

- The registrar and whenever there is no registrar by the merchant banker;
- Two directors of the company one of whom has to be a managing director where there is one;
- The statutory auditor of the company,

The certificate is to be furnished to SEBI on a monthly basis, by the seventh day of the month succeeding the month in which the securities certificates are extinguished and destroyed.

Within the same time-line, the details need to be provided to the stock exchanges where the securities are listed.

The provisions for Tender Offer are equally applicable to buy-back of odd-lots of shares or other specified securities.

3.7 Buy-back from Open Market

3.7.1 Through stock exchange

The special resolution or the Board resolution, as the case may be, has to specify the maximum price at which the buy-back shall be made.

The buy-back of shares or other specified securities cannot be made from the promoters or persons in control of the company.

The company has to appoint a merchant banker and make a public announcement with the specified details, including disclosures regarding details of the brokers and stock exchanges through which the buy-back of shares or other specified securities would be made.

The public announcement is to be made at least seven days prior to the commencement of buy-back. A copy of the public announcement has to be filed with SEBI within two days of the announcement.

The buy-back can be made only on stock exchanges having nationwide trading terminals.

The buy-back has to be made only through the order matching mechanism except 'all or none' order matching system. The identity of the company as a purchaser has to appear on the electronic screen when the order is placed.

The company and the merchant banker have to submit the information regarding the shares or other specified securities bought-back, to the stock exchange on a daily basis.

The said information has to be published in a national daily on a fortnightly basis, and every time when an additional five per cent of the buy-back has been completed. Publication is not required where there is no buy back during a particular period.

The requirement regarding extinguishment of certificates is similar to tender offer. Acceptances will have to be verified within 15 days of payout.

3.7.2 Through Book-building Process

The special resolution or the Board resolution, as the case may be, has to specify the maximum price at which the buy-back shall be made.

The company has to appoint a merchant banker for the buy-back. It has to make a public announcement with the specified details, including the detailed methodology of the book-building process, the manner of acceptance, the format of acceptance to be sent by the security-holders pursuant to the public announcement and the details of bidding centres.

The public announcement is to be made at least seven days prior to the commencement of buy-back. A copy of the public announcement has to be filed with SEBI within two days of the announcement.

The provisions regarding escrow arrangement for tender offer are also applicable here. However, the deposit in the escrow account is to be made before the date of the public announcement. Further, the amount to be deposited in the escrow account has to be determined with reference to the maximum price as specified in the public announcement.

The book-building process has to be made through an electronically linked transparent facility. The number of bidding centres cannot be less than thirty. There has to be at least one electronically linked computer terminal at all the bidding centres.

The offer for buy-back has to remain open to the security-holders for a period not less than fifteen days and not exceeding thirty days.

The merchant banker and the company have to determine the buy-back price based on the acceptances received. The final buy-back price, which will be the highest price accepted has to be paid to all holders whose shares or other specified securities have been accepted for buy-back.

The requirements for tender offer, pertaining to verification of acceptances, opening of special account, payment of consideration and extinguishment of securities are equally applicable for book-building.

3.8 General Obligations

3.8.1 Obligations of Company

The company has to ensure that:

- The letter of offer, the public announcement of the offer or any other advertisement, circular, brochure and publicity material contains true, factual and material information and does not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such documents;

- The company does not issue any shares or other specified securities including by way of bonus till the date of closure of the offer;
- The company pays the consideration only by way of cash;
- The company does not withdraw the offer to buy-back after the draft letter of offer is filed with SEBI or public announcement of the offer to buy-back is made;
- The promoter does not deal in the shares or other specified securities of the company in the stock exchange during the period the buyback offer is open.

No public announcement of buy-back can be made during the pendency of any scheme of amalgamation or compromise or arrangement pursuant to the provisions of the Companies Act.

The company has to nominate a compliance officer and investors service centre for compliance with the buy-back regulations and to redress the grievances of the investors.

Particulars of the security certificates extinguished and destroyed have to be furnished by the company to the stock exchanges where the shares or other specified securities of the company are listed within seven days of their extinguishment and destruction.

The company is not permitted to buy-back locked-in shares or other specified securities and non-transferable shares or other specified securities till the pendency of the lock-in or till the shares or other specified securities become transferable.

Within two days of the completion of buy-back, the company has to issue a public advertisement in a national daily, inter alia, disclosing:

(i) Number of shares or other specified securities bought;

(ii) Price at which the shares or other specified securities were bought;

(iii) Total amount invested in the buy-back;

(iv) Details of the security-holders from whom shares or other specified securities exceeding one per cent of total shares or other specified securities were bought back; and

(v) The consequent changes in the capital structure and the shareholding pattern after and before the buy-back.

3.8.2 Obligations of Merchant Banker

The merchant banker has to ensure that:

- The company is able to implement the offer;

- The provision relating to escrow account has been made;
- Firm arrangements for monies for payment to fulfil the obligations under the offer are in place;
- The public announcement of buy-back is made in terms of the regulations;
- The letter of offer has been filed in terms of the regulations;
- It files due diligence certificate with SEBI along with the draft letter of offer;
- The merchant banker has to ensure that the contents of the public announcement of offer as well as the letter of offer are true, fair and adequate and quoting the source wherever necessary;
- Section 77A and section 77B of the Companies Act, and any other laws or rules as may be applicable in this regard are complied with.

Upon fulfilment of all obligations by the company under the regulations, the merchant banker has to inform the bank with whom the escrow or special amount has been deposited to release the balance amount to the company.

The merchant banker has to send a final report to SEBI in the form specified within 15 days from the date of closure of the buy-back offer.

Self-Assessment Questions

- Buyback of securities are governed by
  - Companies Act, 1956
  - Securities and Exchange Board of India (Buy Back of Securities) Regulations, 1998
  - **Both the above**
  - None of the above
- The cut-off for determining small share-holder under buy-back regulations is
  - **Market value Rs. 2 lakh**
  - Market value Rs. 1 lakh
  - Face value Rs. 1 lakh
  - Face value Rs. 50,000
- Buy-back is permitted from
  - Share premium account
  - Free reserves
  - Prior issue
  - **All the above**

- Share-holders' special resolution is not required if buy-back does not exceed
    - 25% of paid up capital and free reserves
    - **10% of paid up capital and free reserves**
    - 10% of paid up equity capital
    - 25% of paid up equity capital
- Buy-back has to be completed within ____________ from date of passing of resolution
    - 6 months
    - **1 year**
    - 2 years
    - None of the above
- The date of opening of the offer cannot be later than _________________ days from the date of dispatch of letter of offer.
    - 5
    - **5 working**
    - 7
    - 3 working

Chapter 4: Substantial Acquisition of Shares & Takeovers

4.1 Regulation and Definitions

One of the formats to acquire control over a company is by acquiring a substantial stake in the company. Such transactions are covered by the Securities and Exchange Board of India(Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

The regulations apply to direct and indirect acquisition of shares or votingrights in, or control over the target company.

4.1.1 Shares

"Shares" means shares in the equity share capital of a target companycarrying voting rights, and includes any security which entitles the holderthereof to exercise voting rights.

It also includes alldepository receipts carrying an entitlement to exercise voting rights in thetarget company.

4.1.2 Acquirer

Under the regulations, "acquirer" means any person who, directly or indirectly, acquires oragrees to acquire, whether by himself, or through, or with persons actingin concert with him, shares or voting rights in, or control over a target company.

Any such transaction of directly or indirectly, acquiring or agreeing toacquire shares or voting rights in, or control over, a target company is called an "acquisition".

4.1.3 Control

"Control" includes the right to appoint majority of the directors or tocontrol the management or policy decisions exercisable, by a person orpersons acting individually or in concert, directly or indirectly, includingby virtue of their shareholding or management rights or shareholdersagreements or voting agreements or in any other manner.

Since it is an inclusive definition, SEBI has the liberty to interpret several other scenarios of a similar nature to be situations where a person or group of persons have control.

However, a director or officer of a target company is not considered to be in control over such target company, merely by virtue of holding such position.

4.1.4 Target Company

"Target company" means a company and includes a body corporate orcorporation established under a Central legislation, State legislation orProvincial legislation, whose shares are listedon a stock exchange.

4.1.5 Persons Acting in Concert

"Persons acting in concert" means,—

(1) persons who, with a common objective or purpose of acquisitionof shares or voting rights in, or exercising control over a targetcompany, pursuant to an agreement or understanding, formal orinformal, directly or indirectly co-operate for acquisition of sharesor voting rights in, or exercise of control over the target company.

(2) Personsfalling within the following categories are deemed to bepersons acting in concert with other persons within the samecategory, unless the contrary is established—

(i) a company, its holding company, subsidiary company andany company under the same management or control;

(ii) a company, its directors, and any person entrusted with themanagement of the company;

(iii) directors of companies referred to in item (i) and (ii), and associates of such directors;

(iv) promoters and members of the promoter group;

(v) immediate relatives;

(vi) a mutual fund, its sponsor, trustees, trustee company, andasset management company;

(vii) a collective investment scheme and its collectiveinvestment management company, trustees and trusteecompany;

(viii) a venture capital fund and its sponsor, trustees, trusteecompany and asset management company;

(ix) a foreign institutional investor and its sub-accounts;

(x) a merchant banker and its client, who is an acquirer;

(xi) a portfolio manager and its client, who is an acquirer;

(xii) banks, financial advisors and stock brokers of the acquirer,or of any company which is a holding company orsubsidiary of the acquirer, and where the acquirer is anindividual, of the immediate relative of such individual.

Bank whose sole role is that of providing normalcommercial banking services or activities in relation to anopen offer under these regulations is exempted.

(xiii) an investment company or fund and any person who hasan interest in such investment company or fund as ashareholder or unit-holder having not less than 10 per centof the paid-up capital of the investment company or unitcapital of the fund, and any other investment company orfund in which such person or his associate holds not lessthan 10 per cent of the paid-up capital of that investmentcompany or unit capital of that fund.

Holding of units of SEBI-registered mutual funds is exempted.

4.1.6 Associate

"Associate" of aperson means—

(a) any immediate relative of such person;

(b) trusts of which such person or his immediate relativeis a trustee;

(c) partnership firm in which such person or hisimmediate relative is a partner; and

(d) members of Hindu undivided families of which suchperson is a coparcener.

4.1.7 Immediate Relative

"Immediate relative" means any spouse of a person, and includes parent,brother, sister or child of such person or of the spouse.

4.1.8 Offer Period

"Offer period" means the period between the date of entering into an agreement, formal or informal, to acquire shares, voting rights in, or control over a target company requiring a public announcement, or the date of the public announcement, as the case may be, and the date on which the payment of consideration to shareholders who have accepted the open offer is made, or the date on which open offer is withdrawn, as the case may be.

4.1.9 Tendering Period

"Tendering period" means the period within which shareholders may tender their shares in acceptance of an open offer to acquire shares.

4.2 Compulsory Open Offer

4.2.1 Substantial Acquisition of Shares or Voting Rights

A public announcement of an open offer for acquiring shares of the target company from other share-holders must be made in the following situations:

- If the acquirer (together with persons acting in concert), acquires any shares or voting rights in the target company, that take their voting rights in the target company to over 25% (including any shares or voting rights held before such acquisition).
- In a situation where more than 25% of the voting rights (but less than the maximum permissible non-public share-holding) are already held by the acquirer (together with persons acting in concert), if they acquire more than 5% of the voting rights in any financial year.
  - o The acquirers will need to keep their total share-holding within the maximum permissible non-public share-holding (which is the share-holding excluding the minimum public shareholding required under the Securities Contracts (Regulation) Rules, 1957).

    The rules have set the minimum public share-holding requirement for listed companiesat 25% in the case of private sector, and 10% for public sector enterprises. The target date for achieving this level is 2013.

Thus, for private sector, the maximum permissible non-public share-holding would be 75%; in the case of public sector enterprises it would be 90%.

- o The additional voting rights for the 5% criterion is to be calculated as follows:
  - ▪ Gross acquisitions alone is to be taken into account regardless of any intermittent fall in shareholding or voting rights whether owing to disposal of shares held or dilution of voting rights owing to fresh issue of shares by the target company.

    Suppose the acquirers had 27% stake in the beginning of the financial year. On account of conversion of some debentures, the stake fell to 26%. They are permitted 5% gross i.e. they will be able to take their stake to 31% (26% + 5%) – not 32% (27% plus 5%).
  - ▪ Where the target company has made an issue of new shares in any given financial year, the difference between the pre-allotment and the post-allotment percentage voting rights is regarded as the quantum of additional acquisition.

    Suppose the acquirers had 27% stake in the beginning of the financial year. The company made a rights issue. The acquirers took full benefit of their rights. Some other share-holders did not. On account of this, the acquirers' stake goes up to 29%. Their additional acquisition will be taken to be 2%.

- Unless covered in the general exemptions (discussed later in this Chapter) acquisition of shares by any person, such that the individual shareholding of such person acquiring shares exceeds the stipulated thresholds, also attracts the obligation to make an open offer for acquiring shares of the target company, irrespective of whether there is a change in the aggregate shareholding with persons acting in concert.

  Suppose the acquirers (including all persons acting in concert) had 47% stake in the beginning of the financial year. On account of transfers amongst them, one of the share-holders crosses the 25% limit or 5% limit mentioned above. The total share-holding of the persons acting in concert remains at 47%. Still, open offer will need to be made.

4.2.2 Acquisition of Control

Irrespective of acquisition or holding of shares or voting rights in a target company, no acquirer can acquire, directly or indirectly, control over such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations.

4.2.3 Indirect Acquisition

- Indirect acquisition means acquisition of shares or voting rights in, or control over, any company or other entity, that would enable the acquirers (together with persons acting in concert) to exercise or direct the exercise of 25% / 5% of voting rights in, or control over, the target company. Open offer is required even in the event of such indirect acquisition.

  Suppose W holds 20% stake in XYZ Ltd. W acquires control over ABC Ltd, which holds 6% stake in XYZ Ltd. Since the combined share-holding of W and ABC Ltd in XYZ Ltd now crosses 25%, open offer will be required.

  At times, such indirect acquisition can be quite remote. For example, in the previous case, ABC Ltd may not hold shares in XYZ Ltd. But it may control DEF Ltd, which in turn controls GHI Ltd, which in turn holds shares in XYZ Ltd. Open offer will be required even in such situations.

- The indirect acquisition is treated as a direct acquisition of the target company by the acquirer, in the following situations:
  - o the proportionate net asset value of the target company as a percentage of the consolidated net asset value of the entity or business being acquired is more than 80%; or
  - o the proportionate sales turnover of the target company as a percentage of the consolidated sales turnover of the entity or business being acquired is more than 80%; or
  - o the proportionate market capitalisation of the target company as a percentage of the enterprise value for the entity or business being acquired is more than 80%.

  The calculation vis-à-vis 80% is to be done on the basis of the most recent audited annual financial statements.

  The market capitalisation of the target company is to be taken into account on the basis of the volume-weighted average market price of such shares on the stock exchange for a period of sixty trading days

  preceding the earlier of-
  - o the date on which the primary acquisition is contracted; and
  - o the date on which the intention or the decision to make the primary acquisition is announced in the public domain.

  The calculation of volume-weighted average market price would be on the basis of shares traded on the stock exchange, where the maximum volume of trading in the shares of the target company is recorded during the period.

4.3 Voluntary Offer

An acquirer, who together with persons acting in concert with him, already holds twenty-five per cent or more but less than the maximum permissible non-public shareholding, is entitled to voluntarily make a public announcement of an open offer for acquiring shares. After completing the open offer, their share-holding cannot go above the maximum permissible non-public shareholding.

If an acquirer, or any person acting in concert with him, has acquired shares of the target company in the preceding fifty-two weeks without attracting the obligation to make a public announcement of an open offer, he is not eligible to make a voluntary public offer.

Further, during the open offer, the acquirer is not permitted to acquire shares of the target company through any other route.

During the six months after completion of the open offer, the acquirer can acquire shares of the target company only through another voluntary public offer. However, if any other person makes an open offer during the period, the acquirer is permitted to make a competing offer.

The restriction on acquiring new shares is not applicable to shares acquired through bonus issues or stock splits.

4.4 Offer Size

Compulsory public offer has to be for at least twenty six per cent of total shares of the target company, as of tenth working day from the closure of the tendering period.

- It has to take into account all potential increases in the number of outstanding shares during the offer period, contemplated as of the date of the public announcement.
- The offer size needs to be proportionately increased in case of an increase in total number of shares, after the public announcement, which is not contemplated on the date of the public announcement.

Voluntary public offer has to be for acquisition of at least such number of shares as would entitle the holder thereof to exercise an additional ten per cent of the total shares of the target company. Further, post-acquisition, the share-holding cannot cross the maximum permissible non-public share-holding limit.

If a competing offer is made, then the acquirer can increase the number of shares under the voluntary public offer within 15 working days from the public announcement of the competing offer.

If the public offer leads to the maximum permissible non-public shareholding limit being breached, the acquirer is required to bring down the non-public shareholding to the level specified.

An acquirer whose shareholding exceeds the maximum permissible non-public shareholding, pursuant to an open offer under these regulations, is not eligible to make a voluntary delisting offer under the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, unless a period of twelve months has elapsed from the date of the completion of the offer period.

The open offer has to be made to all shareholders of the target company, other than the following:

- The acquirer and persons acting in concert with him; and
- The parties to any underlying agreement including persons deemed to be acting in concert with such parties, for the sale of shares of the target company.

4.5 Offer Price

4.5.1 Direct acquisitions, or indirect acquisitions where any of the 80% criteria described in Para B are fulfilled

The offer price would be the highest of the following:

- The highest negotiated price per share of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer;
- The volume-weighted average price paid or payable for acquisitions, whether by the acquirer or by any person acting in concert with him, during the fifty-two weeks immediately preceding the date of the public announcement;
- The highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during the twenty-six weeks immediately preceding the date of the public announcement;
- The volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded;
- Where the shares are not frequently traded, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies; and
- The per share value computed as per Clause 3 below.

4.5.2 Indirect acquisitions where none of the 80% criteria described in Para B are fulfilled

The offer price would be the highest of the following:

- The highest negotiated price per share of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer;
- The volume-weighted average price paid or payable for acquisitions, whether by the acquirer or by any person acting in concert with him, during the fifty-two weeks immediately preceding the earlier of:
    - o the date on which the primary acquisition is contracted, and
    - o the date on which the intention or the decision to make the primary acquisition is announced in the public domain;
- The highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during the twenty-six weeks immediately preceding the earlier of:
    - o the date on which the primary acquisition is contracted, and
    - o the date on which the intention or the decision to make the primary acquisition is announced in the public domain;
- The highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, between the earlier of:
    - o the date on which the primary acquisition is contracted, and
    - o the date on which the intention or the decision to make the primary acquisition is announced in the public domain and the date of the public announcement of the open offer for shares of the target company;
- The volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the earlier of:
    - o the date on which the primary acquisition is contracted, and
    - o the date on which the intention or the decision to make the primary acquisition is announced in the public domain as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded; and
- The per share value computed as per Clause 3 below.

  If the offer price is incapable of being determined under any of these parameters, then subject to clause 3 discussed below, the offer price will be the fair price of shares of the target company, to be determined by the acquirer and the manager to the open offer, taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies.

4.5.3 Indirect acquisitions where none of the 80% criteria described in Para B are fulfilled, but 15% criteria is met

The scenario envisaged here is of an indirect acquisition, where:

- the proportionate net asset value of the target company as a percentage of the consolidated net asset value of the entity or business being acquired, is over 15%; or
- the proportionate sales turnover of the target company as a percentage of the consolidated sales turnover of the entity or business being acquired, is over 15%; or
- the proportionate market capitalization of the target company as a percentage of the enterprise value for the entity or business being acquired, is over 15%.

In such cases, the acquirer is required to compute and disclose, in the letter of offer, the per share value of the target company taken into account for the acquisition, along with a detailed description of the methodology adopted for such computation.

4.5.4 Other Factors

- In the case of points 1 and 2 above,
    - o Where the acquirer or any person acting in concert with him has any outstanding convertible instruments convertible into shares of the target company at a specific price, the price at which such instruments are to be converted into shares, is also to be considered as a parameter in the valuation.
    - o The price paid for shares of the target company has to include any price paid or agreed to be paid for the shares or voting rights in, or control over the target company, in any form whatsoever, whether stated in the agreement for acquisition of shares or in any incidental, contemporaneous or collateral agreement, whether termed as control premium or as non-compete fees or otherwise.
    - o The price parameters may be adjusted by the acquirer in consultation with the manager to the offer, for corporate actions such as issuances pursuant to rights issue, bonus issue, stock consolidations, stock splits, payment of dividend, de-mergers and reduction of capital, where the record date for effecting such corporate actions falls prior to three working days before the commencement of the tendering period.

      The dividend adjustment is to be made only where the dividend per share is more than fifty per cent higher than the average of the dividend per share paid during the three financial years preceding the date of the public announcement.
- Where the acquirer has acquired or agreed to acquire, whether by himself or through or with persons acting in concert with him, any shares or voting rights in the target company during the offer period, whether by subscription or purchase, at a price higher than the offer price, the offer price shall stand revised to the highest price paid or

payable for any such acquisition

No such acquisition is permitted after the third working day prior to the commencement of the tendering period and until the expiry of the tendering period.

- Where the acquirer or persons acting in concert with him acquires shares of the target company during the period of twenty-six weeks after the tendering period at a price higher than the offer price under these regulations, the acquirer and persons acting in concert have to pay the difference between the highest acquisition price and the offer price, to all the shareholders whose shares were accepted in the open offer, within sixty days from the date of such acquisition.

  This is not applicable to acquisitions under another open offer or pursuant to the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, or open market purchases made in the ordinary course on the stock exchanges, not being negotiated acquisition of shares of the target company whether by way of bulk deals, block deals or in any other form.

- Where the open offer is subject to a minimum level of acceptances, the acquirer can indicate a lesser price (which will need to be at least equal to the minimum mandated price under the regulations) at which he is prepared to acquire all the acceptances from investors, if these fall below the minimum level of acceptance.

  Suppose the minimum mandated price comes to Rs. 50 per share. Open offer is being made at Rs. 60 per share, subject to receiving investor acceptance for at least 20% of the share capital. The acquirer can indicate that at Rs. 50 (or a higher price), he is prepared to acquire all the acceptances received from investors, even if these amount to less than 20% of the share capital.

- In cases of indirect acquisition other than those where any of the 80% criteria specified in Para B are fulfilled, the offer price shall stand enhanced by an amount equal to a sum determined at the rate of ten per cent per annum for the period between the earlier of

  o the date on which the primary acquisition is contracted; or

  o the date on which the intention or the decision to make the primary acquisition is announced in the public domain,

  and the date of the detailed public statement, if such period is more than five working days.

- The offer price for partly paid up shares is to be computed as the difference between the offer price and the amount due towards calls-in-arrears including calls remaining unpaid with interest, if any, thereon.

  Suppose the offer price comes to Rs. 50. There are some partly paid shares where Rs. 4 is not yet called. The offer price for those shares will be Rs. 50 minus Rs. 4 i.e. Rs. 46.

Similar adjustment is to be made if the calls have been made but remain unpaid. In that case, interest on the arrears is also to be reduced from the offer price.

- The offer price for equity shares carrying differential voting rights is to be determined by the acquirer and the manager to the open offer with full disclosure of justification for the price so determined, being set out in the detailed public statement and the letter of offer.

  Such price cannot be lower than the amount determined by applying the percentage rate of premium, if any, that the offer price for the equity shares carrying full voting rights represents to the 60-day volume-weighted average market price of the shares carrying differential voting rights. This premium calculation is to be done only if the shares carrying full voting rights and the shares carrying differential voting rights, both are frequently traded shares.

  Suppose the 60-day volume-weighted average price for the shares carrying full voting rights is Rs. 50 and the offer price for those shares is Rs. 55 (i.e. 10% premium). If the 60-day volume-weighted average price for the shares carrying differential voting rights is R. 40, then the open offer price would be 10% higher i.e. Rs. 44.

- If any of the price parameters contained in this regulation are not available or denominated in Indian rupees, the conversion of such amount intoIndian rupees is to be effected at the exchange rate as prevailing on the datepreceding the date of public announcement. The acquirer has to set out thesource of such exchange rate in the public announcement, the detailed publicstatement and the letter of offer.
- If the shares are infrequently traded, as discussed in Clause 1 above, or the offer price is incapable of being determined, as discussed in Clause 2 above, SEBI may, at the expense of the acquirer, require valuation of the shares by anindependent merchant banker other than the manager to the open offer or anindependent chartered accountant in practice having a minimum experience of tenyears.

4.6 Mode of Payment

The offer price can be paid –

- In cash;
- By issue, exchange or transfer of listed shares in the equity share capital of the acquirer or of any person acting in concert;
- By issue, exchange or transfer of listed secured debt instruments issued by the acquirer or any person acting in concert with a rating not inferior to investment grade as rated by a credit rating agency registered with SEBI;
- By issue, exchange or transfer of convertible debt securities entitling the holder to

acquire listed shares in the equity share capital of the acquirer or of any person acting in concert; or

- A combination of the above.

  Where any shares have been acquired or agreed to be acquired by the acquirer and persons acting in concert with him during the fifty-two weeks immediately preceding the date of public announcement constitute more than ten per cent of the voting rights in the target company and has been paid for in cash, the open offer has to give an option to the shareholders to require payment of the offer price in cash. A shareholder who has not exercised an option in his acceptance shall be deemed to have opted for receiving the offer price in cash.

  In case of revision in offer price the mode of payment of consideration may be altered subject to the condition that the component of the offer price to be paid in cash prior to such revision is not reduced.

  The shares sought to be issued or exchanged or transferred, or the shares to be issued upon conversion of other securities, towards payment of the offer price, have to conform to the following requirements —

- Such class of shares are listed on a stock exchange and frequently traded at the time of the public announcement;
- Such class of shares have been listed for a period of at least two years preceding the date of the public announcement;
- The issuer of such class of shares has redressed at least ninety five per cent. of the complaints received from investors by the end of the calendar quarter immediately preceding the calendar month in which the public announcement is made;
- The issuer of such class of shares has been in material compliance with the listing agreement for a period of at least two years immediately preceding the date of the public announcement.

  If SEBI is of the view that a company has not been materially compliant with the provisions of the listing agreement, the offer price is to be paid in cash only;

- The impact of auditors' qualifications, if any, on the audited accounts of the issuer of such shares for three immediately preceding financial years does not exceed five per cent. of the net profit or loss after tax of such issuer for the respective years; and
- SEBI has not issued any direction against the issuer of such shares not to access the capital market or to issue fresh shares.

Where the shareholders have been provided with options to accept payment in cash or by way of securities, or a combination thereof, the pricing for the open offer may be different for each option subject to compliance with minimum offer price requirements. The detailed public statement and the letter of offer have to contain justification for such differential pricing.

If the offer price consists of consideration to be paid by issuance of securities, which requires compliance with any applicable law, the acquirer has to ensure that such compliance is completed, not later than the commencement of the tendering period. If the requisite compliance is not made by such date, the acquirer has to pay the entire consideration in cash.

Where listed securities are offered as consideration, the value of such securities shall be higher of:

- The average of the weekly high and low of the closing prices of such securities quoted on the stock exchange during the six months preceding the relevant date;
- The average of the weekly high and low of the closing prices of such
- securities quoted on the stock exchange during the two weeks preceding the relevant date; and
- the volume-weighted average market price for a period of sixty trading days preceding the date of the public announcement, as traded on the stock exchange where the maximum volume of trading in the shares of the company whose securities are being offered as consideration, are recorded during the six-month period prior to relevant date.

The "relevant date" is the thirtieth day prior to the date on which the meeting of shareholders is held to consider the proposed issue of shares under subsection (1A) of Section 81 of the Companies Act, 1956.

The ratio of exchange of shares has to be duly certified by an independent merchant banker (other than the manager to the open offer), or an independent chartered accountant having a minimum experience of ten years.

4.7 General Exemptions

Compulsory offer is not applicable in the following cases:

- Acquisition pursuant to inter se transfer of shares amongst qualifyingpersons, being—
  - (i) Immediate relatives;
  - (ii) Persons named as promoters in the shareholding pattern filed bythe target company in terms of the listing agreement or theseregulations for not less than three years prior to the proposedacquisition;
  - (iii) A company, its subsidiaries, its holding company, other subsidiariesof such holding company, persons holding not less than fifty percent of the equity shares of such company, other companies inwhich such persons hold not less than fifty per cent

of the equityshares, and their subsidiaries subject to control over suchqualifying persons being exclusively held by the same persons;

(iv) Persons acting in concert for not less than three years prior to theproposed acquisition, and disclosed as such pursuant to filingsunder the listing agreement;

(v) Shareholders of a target company who have been persons acting inconcert for a period of not less than three years prior to theproposed acquisition and are disclosed as such pursuant to filingsunder the listing agreement, and any company in which the entireequity share capital is owned by such shareholders in the sameproportion as their holdings in the target company without anydifferential entitlement to exercise voting rights in such company.

The exemption under such situations is subject to the following conditions:

- o If the shares of the target company are frequently traded, the acquisition price per share shall not be higher by more than twenty-five per cent of the volume-weighted average market price for a period of sixty trading days preceding the date of issuance of notice for the proposed inter se transfer.

  If the shares of the target company are infrequently traded, the acquisition price shall not be higher by more than twenty-five per cent of the price the price mutually determined by the acquirer and the manager; and

- o The transferor and the transferee shall have complied with applicable disclosure requirements set out in the Regulations.

- Acquisition in the ordinary course of business by—

  (i) An underwriter registered with SEBI, by way of allotment pursuant to an underwriting agreement in terms of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

  (ii) A stock broker registered with SEBI, on behalf of his client in exercise of lien over the shares purchased on behalf of the client under the bye-laws of the stock exchange where such stock broker is a member;

  (iii) A merchant banker registered with SEBI or a nominated investor in the process of market making or subscription to the unsubscribed portion of issue in terms of Chapter XB of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

  (iv) Any person acquiring shares pursuant to a scheme of safety net in terms of regulation 44 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

  (v) A merchant banker registered with SEBI, acting as a stabilising agent or by the promoter or pre-issue shareholder in terms of regulation 45 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

(vi) By a registered market-maker of a stock exchange in respect of shares for which he is the market maker during the course of market making;

(vii) A Scheduled Commercial Bank, acting as an escrow agent; and

(viii) Invocation of pledge by Scheduled Commercial Banks or Public Financial Institutions as a pledgee.

- Acquisitions at subsequent stages, by an acquirer who has made a public announcement of an open offer for acquiring shares pursuant to an agreement of disinvestment, as contemplated in such agreement:

  The exemption is subject to the following —

  (i) Both the acquirer and the seller are the same at all the stages of acquisition; and

  (ii) Full disclosures of all the subsequent stages of acquisition, if any, have been made in the public announcement of the open offer and in the letter of offer.

- Acquisition pursuant to —

  (i) A scheme made under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) or any statutory modification or re-enactment thereto; or

  (ii) A scheme of arrangement involving the target company as a transferor company or as a transferee company, or reconstruction of the target company, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign; or

  (iii) A scheme of arrangement not directly involving the target company as a transferor company or as a transferee company, or reconstruction not involving the target company's undertaking, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign, subject to,

  o The component of cash and cash equivalents in the consideration paid being less than twenty-five per cent of the consideration paid under the scheme; and

  o Where after implementation of the scheme of arrangement, persons directly or indirectly holding at least thirty-three per cent of the voting rights in the combined entity are the same as the persons who held the entire voting rights before the implementation of the scheme.

- Acquisition pursuant to the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);
- Acquisition pursuant to the provisions of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;
- Acquisition by way of transmission, succession or inheritance;
- Acquisition of voting rights or preference shares carrying voting rights arising out of the operation of sub-section (2) of section 87 of the Companies Act, 1956 (1 of 1956).
- The acquisition of shares of a target company, not involving a change of control over such target company, pursuant to a scheme of corporate debt restructuring in terms of the Corporate Debt Restructuring Scheme notified by the Reserve Bank of India, or any modification or re-notification thereto, provided such scheme has been authorised by shareholders by way of a special resolution passed by postal ballot.
- An increase in voting rights in a target company of any shareholder beyond the limit (that attracts an obligation to make an open offer), pursuant to buy-back of shares is exempt from the obligation to make an open offer. However, the shareholder will have to reduce his shareholding below the limit within ninety days from the date on which the voting rights so increase.
- Other exemptions where the 5% / 25% limit specified in Clause B-1 are breached:
  - o Acquisition of shares by any shareholder of a target company, upto his entitlement, pursuant to a rights issue;
  - o Acquisition of shares by any shareholder of a target company, beyond his entitlement, pursuant to a rights issue, subject to fulfilment of the following conditions,—
    - (i) The acquirer has not renounced any of his entitlements in such rights issue; and
    - (ii) The price at which the rights issue is made is not higher than the ex-rights price of the shares of the target company, being the sum of,—
    - (A) the volume weighted average market price of the shares of the target company during a period of sixty trading days ending on the day prior to the date of determination of the rights issue price, multiplied by the number of shares outstanding prior to the rights issue, divided by the total number of shares outstanding after allotment under the rights issue.

      The volume weighted average market price is to be determined on the basis of trading on the stock exchange where the maximum volume of trading in the shares of such target company is recorded during such period; and
    - (B) the price at which the shares are offered in the rights issue, multiplied by the

number of shares so offered in the rights issue divided by the total number of shares outstanding after allotment under the rights issue

- o Increase in voting rights in a target company of any shareholder pursuant to buy-back of shares. This is subject to the following:
  - (i) Such shareholder has not voted in favour of the resolution authorising the buy-back of securities under section 77A of the Companies Act, 1956;
  - (ii) In the case of a shareholder resolution, voting is by way of postal ballot;
  - (iii) Where a resolution of shareholders is not required for the buyback, such shareholder, in his capacity as a director, or any

    other interested director has not voted in favour of the resolution of the board of directors of the target company authorising the buy-back of securities under section 77A of the Companies Act, 1956; and
  - (iv) The increase in voting rights does not result in an acquisition of control by such shareholder over the target company.

    If these conditions are not met, exemption will be available if the shareholder reduces his shareholding below the 25% / 5% level, within ninety days from the date on which the voting rights so increase;
- o Acquisition of shares in a target company by any person in exchange for shares of another target company tendered pursuant to an open offer for acquiring shares under these regulations;
- o Acquisition of shares in a target company from state-level financial institutions or their subsidiaries or companies promoted by them, by promoters of the target company pursuant to an agreement between such transferors and such promoter;
- o Acquisition of shares in a target company from a venture capital fund or a foreign venture capital investor registered with SEBI, by promoters of the target company pursuant to an agreement between such venture capital fund or foreign venture capital investor and such promoters.

In respect of inter se transfer of shares amongst qualifying persons, or acquisition by promoters from state-level financial institutions or their subsidiaries or companies promoted by them or venture capital fund or foreign venture capital investor discussed above, the acquirer has to intimate the stock exchanges where the sharesof the target company are listed, the details of the proposed acquisition, at least four working days prior to the proposed acquisition, andthe stock exchange hasto forthwith disseminate such information to the public.

In respect of any other acquisition made pursuant to exemption provided for in the regulation, the acquirer has to file a report with the stock exchanges where the sharesof the target company are listed, not later than fourworking days from the acquisition, and the stock exchange shall forthwithdisseminate such information to the public.

In respect of any acquisition of or increase in voting rights arising out of inter se transfer of shares amongst qualifying persons, or scheme of arrangement, or the operation of sub-section (2) of section 87 of the Companies Act, 1956, or scheme of corporate debt restructuring, or buyback, or rights, or acquisition by promoters from venture capital fund or foreign venture capital investor discussed above, a specified report is to be filed with SEBI within twenty-one working days of the date of acquisition.

In the case of convertible securities, discussed above, the date of the acquisition is the date of conversion of such securities.

4.8 Exemptions by SEBI

SEBI has the power to grant exemption from the obligation to make an open offer for acquiring shares under these regulations subject to such conditions as it deems fit to impose in the interests of investors in securities and the securities market.

SEBI may also grant a relaxation from strict compliance with any procedural requirement on being satisfied that:

- The target company is a company in respect of which the Central Government or State Government or any other regulatory authority has superseded the board of directors of the target company and has appointed new directors under any law for the time being in force, if,—
  - (i) Such board of directors has formulated a plan which provides for transparent, open, and competitive process for acquisition of shares or voting rights in, or control over the target company, to secure the smooth and continued operation of the target company in the interests of all stakeholders of the target company, and such plan does not further the interests of any particular acquirer;
  - (ii) The conditions and requirements of the competitive process are reasonable and fair;
  - (iii) The process adopted by the board of directors of the target company provides for details including the time when the open offer for acquiring shares would be made, completed and the manner in which the change in control would be effected; and
- The procedural requirements are likely to act as impediment to implementation of the plan of the target company and exemption from strict compliance with one or more of such provisions is in public interest, the interests of investors in securities and the securities market.

4.9 Manager to the Open Offer

The acquirer has to appoint a SEBI-registered merchant banker as manager to the open offer. The manager cannot be an associate of the acquirer.

The public announcement of the open offer for acquiring shares is to be made by the acquirer through such manager to the open offer.

4.10 Timing of Public Announcement / Public Statement

Public announcement has to be made on the date of agreeing to acquire shares or voting rights in, or control over the target company as follows:

- In the case of market purchases, it has to be made prior to placement of the purchase order with the stock broker to acquire the shares, that would take the entitlement to voting rights beyond the stipulated thresholds;
- In the case of an acquirer acquiring shares or voting rights in, or control over the target company upon converting convertible securities without a fixed date of conversion, or upon conversion of depository receipts for the underlying shares of the target company, public announcement has to be made on the same day as the date of exercise of the option to convert such securities into shares of the target company;
- If it is pursuant to an acquirer acquiring shares or voting rights in, or control over the target company upon conversion of convertible securities with a fixed date of conversion, it is to be made on the second working day preceding the scheduled date of conversion of such securities into shares of the target company;
- If it is pursuant to a disinvestment, public announcement is required to be made on the same day as the date of executing the agreement for acquisition of shares or voting rights in or control over the target company;
- In the case of indirect acquisition of shares or voting rights in, or control over the target company where none of the 80% criteria mentioned in Para B3 are met, public announcement may be made at any time within four working days from the earlier of
    - o The date on which the primary acquisition is contracted, and
    - o The date on which the intention or the decision to make the primary acquisition is announced in the public domain;
- In the case of indirect acquisition of shares or voting rights in, or control over the target company where any of the 80% criteria mentioned in Para B3 are met, public announcement is to be made on the earlier of
    - o The date on which the primary acquisition is contracted, and
    - o The date on which the intention or the decision to make the primary acquisition is announced in the public domain;

- If it is pursuant to an acquirer acquiring shares or voting rights in, or control over the target company, under preferential issue, public announcement has to be made on the date on which special resolution is passed for allotment of shares under sub-section (1A) of section 81 of the Companies Act, 1956;
- The public announcement pursuant to an increase in voting rights consequent to a buy-back not qualifying for exemption has to be made not later than the ninetieth day from the date of such increase in the voting rights beyond the relevant threshold;
- The public announcement pursuant to any acquisition of shares or voting rights in or control over the target company where the specific date on which title to such shares, voting rights or control is acquired is beyond the control of the acquirer, has to be made not later than two working days from the date of receipt of intimation of having acquired such title.
- Public announcement of voluntary offer has to be made on the same day as the date on which the acquirer takes the decision to announce an open offer for acquiring shares of the target company.

A detailed public statement has to be published by the acquirer through the manager to the open offer not later than five working days after the public announcement.

In the case of indirect acquisition of shares or voting rights in, or control over the target company where none of the 80% criteria mentioned in Para B3 are met, the detailed public statement pursuant to a public announcement has to be made not later than five working days of the completion of the primary acquisition of shares or voting rights in, or control over the company or entity holding shares or voting rights in, or control over the target company.

If the acquirer does not succeed in acquiring the ability to exercise or direct the exercise of voting rights in, or control over the target company, the acquirer is not required to make a detailed public statement of an open offer.

4.11 Dissemination of Public Announcement / Public Statement

- The public announcement is to be sent to all the stock exchanges on which the shares of the target company are listed, and the stock exchanges has to forthwith disseminate such information to the public.
- A copy of the public announcement has to be sent to SEBI and to the target company at its registered office within one working day of the date of the public announcement.
- The detailed public statement pursuant to the public announcement is to be published in all editions of
  - o Any one English national daily with wide circulation;

- o Any one Hindi national daily with wide circulation;
- o Any one regional language daily with wide circulation at the place where the registered office of the target company is situated; and
- o One regional language daily at the place of the stock exchange where the maximum volume of trading in the shares of the target company are recorded during the sixty trading days preceding the date of the public announcement.

- Simultaneously with publication of such detailed public statement in the newspapers, a copy of the same has to be sent to—
  - (i) SEBI through the manager to the open offer;
  - (ii) All the stock exchanges on which the shares of the target company are listed; the stock exchanges have to forthwith disseminate such information to the public;
  - (iii) The target company at its registered office, and the target company has to forthwith circulate it to the members of its board.

4.12 Contents of Public Notice / Public Statement

- The public notice has to include the following information:
  - o Name and identity of the acquirer and persons acting in concert with him;
  - o Name and identity of the sellers, if any;
  - o Nature of the proposed acquisition such as purchase of shares or allotment of shares, or any other means of acquisition of shares or voting rights in, or control over the target company;
  - o The consideration for the proposed acquisition that attracted the obligation to make an open offer for acquiring shares, and the price per share, if any;
  - o The offer price, and mode of payment of consideration; and
  - o Offer size, and conditions as to minimum level of acceptances, if any.
- The detailed public statement pursuant to the public announcement has to contain such information as may be specified in order to enable shareholders to make an informed decision with reference to the open offer.
- The public announcement of the open offer, the detailed public statement, and any other statement, advertisement, circular, brochure, publicity material or letter of offer issued in relation to the acquisition of shares under these regulations can not omit any relevant information, or contain any misleading information.

4.13 Letter of Offer

Within five working days from the date of the detailed public statement, the acquirer, through the manager to the open offer, has to file with SEBI, a draft of the letter of offer, containing such information as may be specified along with the prescribed fees.

The consideration payable under the open offer is to be calculated at the offer price, assuming full acceptance of the offer. If the offer is made with differential pricing, the consideration is to be calculated at the highest offer price, irrespective of manner of payment of the consideration.

The manager to the open offer has to provide soft copies of the public announcement, detailed public statement and the draft letter of offer to SEBI, which will upload them on the website.

SEBI has to give its comments on the draft letter of offer as expeditiously as possible, but not later than fifteen working days of the receipt of the draft letter of offer. In the event of no comments being issued by SEBI within such period, it shall be deemed that it does not have comments to offer.

If SEBI has sought clarifications or additional information from the manager to the open offer, the period for issuance of comments shall be extended to the fifth working day from the date of receipt of satisfactory reply to the clarification or additional information sought.

If SEBI specifies any changes, the manager to the open offer and the acquirer, have to carry out the changes in the letter of offer before it is dispatched to the shareholders.

In the case of competing offers, SEBI will provide its comments on the draft letter of offer in respect of each competing offer on the same day.

4.14 Escrow

At least two working days prior to the date of the detailed public statement of the open offer for acquiring shares, the acquirer has to create an escrow account towards security for performance of his obligations, and deposit in escrow account the aggregate amount as per the following scale:

Sl. No.	Consideration Payable for Open Offer	Escrow Amount
1	On the first Rs. 500 crore	25% of the consideration
2	On the balance consideration	Additional 10% of the balance consideration

Where an open offer is made conditional upon minimum level of acceptance, hundred per cent of the consideration payable in respect of minimum level of acceptance or fifty per cent of the consideration payable under the open offer, whichever is higher, is to be deposited in cash in the escrow account.

In the event of an upward revision of the offer price or of the offer size, the value of the escrow amount has to be computed on the revised consideration, and the additional amount is to be brought into the escrow account prior to effecting such revision.

The escrow may be in the form of:

- Cash deposited with any scheduled commercial bank; or
- Bank guarantee issued in favour of the manager to the open offer by any scheduled commercial bank; or
- Deposit of frequently traded and freely transferable equity shares or other freely transferable securities with appropriate margin.

The securities need to comply with the requirements mentioned in Para F.

If the escrow is created by way of a bank guarantee or by deposit of securities, the acquirer has to ensure that at least one per cent of the total consideration payable is deposited in cash with a scheduled commercial bank as a part of the escrow account.

The acquirer, while opening the escrow account with the scheduled commercial bank, empower the manager to the open offer to instruct the bank to issue a banker's cheque or demand draft or to make payment of the amounts lying to the credit of the escrow account, in accordance with requirements under these regulations.

Bank guarantee would be in favour of the manager to the open offer. It has to be kept valid throughout the offer period, and for an additional period of thirty days after completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer.

For the securities in the escrow, the acquirer has to empower the manager to the open offer to realise the value of the escrow account by

sale or otherwise, and in the event there is any shortfall in the amount required to be maintained in the escrow account, the manager to the open offer is liable to make good such shortfall.

The manager is not allowed to release the escrow account until the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, except for transfer of funds to the special escrow account mentioned in Para R.

If the acquirer does not fulfil its obligations, SEBI can direct the manager to forfeit the amount in the escrow, fully or partly.

The escrow deposited with the bank in cash can be released only as follows:

- In the event of withdrawal of the offer as certified by the manager, the entire amount can be released.
- Upto 90% can be transferred to the special escrow account mentioned in Para R.
- The balance of the escrow account after transfer of cash to the special escrow account, can be released to the acquirer on the expiry of thirty days from the completion of

payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, as certified by the manager to the open offer.

- The entire amount can be released to the acquirer upon the expiry of thirty days from the completion of payment of consideration to shareholders who have tendered their shares in acceptance of the open offer, upon certification by the manager to the open offer, where the open offer is for exchange of shares or other secured instruments.
- In the event of forfeiture for non-fulfilment of any of the obligations, the entire amount can be released to the manager. After deduction of expenses, if any, of registered market intermediaries associated with the open offer, the balance is to be distributed as follows:
    - o One-third of the escrow account to the target company
    - o One third of the escrow account to SEBI's Investor Protection and Education Fund
    - o One third of the escrow account to be distributed pro-rata among the shareholders who have accepted the open offer.

4.15 Other Procedural Requirements

- While filing the draft letter of offer with SEBI, a copy of the draft letter of offer has to be sent to the target company at its registered office address and to all stock exchanges where the shares of the target company are listed.
- The letter of offer should be dispatched to the shareholders whose names appear on the register of members of the target company as of the identified date, not later than seven working days from the receipt of comments from SEBI. If no comments are received from SEBI, it is to be sent within seven working days of the expiry of the period within which SEBI is expected to offer its comments.
- There are situations where local laws or regulations of any jurisdiction outside India may expose the acquirer or the target company to material risk of civil, regulatory or criminal liabilities in the event the letter of offer in its final form were to be sent without material amendments or modifications into such jurisdiction. If the shareholders resident in such jurisdiction hold shares entitling them to less than five per cent of the voting rights of the target company, the acquirer may refrain from dispatch of the letter of offer into such jurisdiction.
- Every person holding shares, regardless of whether he held shares on the identified date or has not received the letter of offer, is entitled to tender his shares in acceptance of the open offer.
- Along with the despatch of letters of offer to investors, letters of offer have to be sent to

the custodian of shares underlying depository receipts, if any, of the target company.

- An acquirer may make upward revisions to the offer price, or the number of shares sought to be acquired under the open offer, at any time prior to the commencement of the last three working days before the commencement of the tendering period. In that case, the acquirer needs to:
  - Increase the amount kept in escrow
  - Make an announcement in respect of such revisions in all the newspapers in which the detailed public statement pursuant to the public announcement was made; and
  - Simultaneously inform SEBI, all the stock exchanges on which the shares of the target company are listed, and the target company at its registered office.
- During the offer period, the acquirer has to disclose every acquisition made by the acquirer or persons acting in concert with him of any shares of the target company, to each of the stock exchanges on which the shares of the target company are listed and to the target company at its registered office within twenty-four hours of such acquisition. The stock exchanges have to forthwith disseminate such information to the public.

  However, the acquirer and persons acting in concert with him are not permitted to acquire or sell any shares of the target company during the period between three working days prior to the commencement of the tendering period and until the expiry of the tendering period.
- One working day before the commencement of the tendering period, the acquirer has to issue an advertisement, announcing:
  - The schedule of activities for the open offer
  - The status of statutory and other approvals, if any, whether for the acquisition attracting the obligation to make an open offer, or for the open offer
  - Unfulfilled conditions, if any, and their status
  - The procedure for tendering acceptances and
  - Such other material detail as may be specified.

  The advertisement is to be published in all the newspapers in which the detailed public statement pursuant to the public announcement was made. It should also be sent to SEBI, all the stock exchanges on which the shares of the target company are listed, and the target company at its registered office.
- The tendering period is to start not later than twelve working days from date of receipt of comments from SEBI. It shall remain open for ten working days.

- Shareholders who have tendered shares in acceptance of the open offer are not entitled to withdraw such acceptance during the tendering period.
- Within ten working days from the last date of the tendering period, the acquirer has to complete all requirements under these regulations and other applicable law relating to the open offer including payment of consideration to the shareholders who have accepted the open offer.
- Where the acquirer is unable to make the payment to the shareholders who have accepted the open offer within the specified period owing to non-receipt of statutory approvals required by the acquirer, and SEBI is satisfied that such non-receipt was not attributable to any wilful default, failure or neglect on the part of the acquirer to diligently pursue such approvals, SEBI may grant extension of time for making payments. However, the acquirer will have to pay interest to the shareholders for the delay at such rate as may be specified.
- Where the statutory approval extends to some but not all shareholders, the acquirer has the option to make payment to such shareholders in respect of whom no statutory approvals are required in order to complete the open offer.
- The acquirer has to issue a post-offer advertisement within five working days after the offer period, giving details including aggregate number of shares tendered, accepted, and date of payment of consideration.

  The advertisement is to be issued in all the newspapers in which the detailed public statement pursuant to the public announcement was made. It has to be simultaneously sent to SEBI, all the stock exchanges on which the shares of the target company are listed, and the target company at its registered office.

4.16 Conditional Offer

- An acquirer may make an open offer conditional as to the minimum level of acceptance.
- Where the conditional open offer is pursuant to an agreement, such agreement has to contain a condition to the effect that in the event the

  desired level of acceptance of the open offer is not received, the acquirer shall not acquire any shares under the open offer, and the agreement attracting the obligation to make the open offer shall stand rescinded.
- In the case of a conditional open offer, the acquirer and persons acting in concert with him cannot acquire, during the offer period, any shares in the target company except under the open offer and any underlying agreement for the sale of shares of the target company pursuant to which the open offer is made.

4.17 Competing Offers

- When a public announcement of an open offer for acquiring shares of a target company is made, any person, other than the acquirer who has made such public announcement, is entitled to make a public announcement of an open offer (a competing offer) within fifteen working days of the date of the detailed public statement made by the acquirer who has made the first public announcement.
- No person shall be entitled to make a public announcement of an open offer for acquiring shares, or enter into any transaction that would attract the obligation to make a public announcement of an open offer for acquiring shares under these regulations, after this period of fifteen working days and until the expiry of the offer period for such open offer.
- The competing offer has to be for such number of shares which, when taken together with shares held by such acquirer (along with persons acting in concert with him), is at least equal to the holding of the acquirer who made the first public announcement, including the number of shares proposed to be acquired by him under the offer and any underlying agreement for the sale of shares of the target company pursuant to which the open offer is made.
- Under the regulations, the competing offer is not to be regarded as a voluntary public offer.
- Unless the open offer first made is conditional, no acquirer making a competing offer may be made conditional as to the minimum level of acceptances.
- The schedule of activities and the tendering period for all competing offers have to be carried out with identical timelines. The last date for tendering shares in acceptance of every competing offer shall stand revised to the last date for tendering shares in acceptance of the competing offer last made.
- Upon the public announcement of a competing offer, an acquirer who had made a preceding competing offer is entitled to revise the terms of his open offer, provided the revised terms are more favourable to the shareholders of the target company.

  The acquirers making the competing offers are entitled to make upward revisions of the offer price at any time up to three working days prior to the commencement of the tendering period.

4.18 Payment of Consideration

- For the amount of consideration payable in cash, the acquirer has to open a special escrow account with a banker to an issue registered with SEBI.

  The acquirer has to deposit adequate money in this account, which together with the moneys transferred from the escrow account mentioned in Para N, is adequate to make up the entire sum due and payable to the shareholders as consideration payable under the open offer.

The acquirer has to empower the manager to the offer to operate the special escrow account on behalf of the acquirer for the purposes under these regulations.

- The acquirer has to complete payment of consideration whether in the form of cash, or as the case may be, by issue, exchange or transfer of securities, to all shareholders who have tendered shares in acceptance of the open offer, within ten working days of the expiry of the tendering period.
- Unclaimed balances, if any, lying to the credit of the special escrow account, at the end of seven years from the date of deposit shall be transferred to SEBI's Investor Protection and Education Fund.

4.19 Completion of Acquisition

- The acquirer cannot complete the acquisition of shares or voting rights in, or control over, the target company, whether by way of subscription to shares or a purchase of shares attracting the obligation to make an open offer for acquiring shares, until the expiry of the offer period.

  However, the acquirer has the option of depositing cash of an amount equal to one hundred per cent of the consideration payable under the open offer assuming full acceptance of the open offer. In that case, the parties to an agreement may, after the expiry of twenty-one working days from the date of detailed public statement, act upon the agreement and the acquirer may complete the acquisition of shares or voting rights in, or control over the target company as contemplated.
- The acquirer has to complete the acquisitions contracted under any agreement attracting the obligation to make an open offer not later than twenty-six weeks from the expiry of the offer period.

  In the event of any extraordinary and supervening circumstances rendering it impossible to complete such acquisition within such period, SEBI may, for reasons to be published, grant an extension of time by such period as it may deem fit in the interests of investors in securities and the securities market.

4.20 Withdrawal of Open Offer

An open offer for acquiring shares, once made, cannot be withdrawn except under any of the following circumstances:

- Statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer under these regulations have been finally refused.

The requirement for such approval should have been specifically disclosed in the detailed public statement and the letter of offer;

- The acquirer, being a natural person, has died;
- Any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, and such agreement is rescinded. Such conditions should have been specifically disclosed in the detailed public statement and the letter of offer; or
- Such circumstances as in the opinion of SEBI, merit withdrawal.

In the event of withdrawal of the open offer, the acquirer shall, through the manager to the open offer, within two working days make an announcement in the same newspapers in which the public announcement of the open offer was published, providing the grounds and reasons for withdrawal of the open offer. Simultaneously, information has to be given in writing to SEBI, all the stock exchanges on which the shares of the target company are listed and the target company at its registered office. The stock exchanges have to forthwith disseminate the information to the public.

4.21 Other Obligations

4.21.1 Directors of Target Company

- During the offer period, no person representing the acquirer or any person acting in concert with him shall be appointed as director on the board of directors of the target company, whether as an additional director or in a casual vacancy.

  After an initial period of fifteen working days from the date of detailed public statement, appointment of persons representing the acquirer or persons acting in concert with him on the board of directors may be effected, if the acquirer deposits in cash in the escrow account, one hundred per cent of the consideration payable under the open offer.
- In the case of an open offer arising out a conditional agreement, no director representing the acquirer may be appointed to the board of directors of the target company during the offer period unless the acquirer has waived or attained such conditions and complies with the requirement of depositing cash in the escrow account.
- In the case of a conditional offer, the acquirer and persons acting in concert are not entitled to appoint any director representing them on the board of directors of the target company during the offer period, regardless of the size of the cash deposited in the escrow account.
- During the pendency of competing offers, regardless of the size of the cash deposited in the escrow account by any acquirer or person acting in concert with him, there can be no induction of any new director to the board of directors of the target company.

Only in the event of death or incapacitation of any director, the vacancy arising therefrom may be filled by any person subject to approval of such appointment by shareholders of the target company by way of a postal ballot.

- If the acquirer, or any person acting in concert, is already represented by a director on the board of the target company, such director cannot participate in any deliberations of the board of directors of the target company, or vote on any matter in relation to the open offer.

4.21.2 Acquirer

- Prior to making the public announcement of an open offer for acquiring shares, the acquirer should ensure that firm financial arrangements have been made for fulfilling the payment obligations under the open offer and ensure that the acquirer is able to implement the open offer, subject to any statutory approvals for the open offer that may be necessary.
- In the event the acquirer has not declared an intention in the detailed public statement and the letter of offer to alienate any material assets of the target company, or of any of its subsidiaries, whether by way of sale, lease, encumbrance or otherwise outside the ordinary course of business, the acquirer, where he has acquired control over the target company, is debarred from causing such alienation for a period of two years after the offer period.

  Such alienation can be done if a special resolution is passed by shareholders of the target company, by way of a postal ballot and the notice for such postal ballot inter alia contains reasons as to why such alienation is necessary.
- The acquirer has to ensure that the contents of the public announcement, the detailed public statement, the letter of offer and the post-offer advertisement are true, fair and adequate in all material aspects and not misleading in any material particular, and are based on reliable sources, and state the source wherever necessary.
- The acquirer and persons acting in concert with him shall not sell shares of the target company held by them, during the offer period.
- The acquirer and persons acting in concert with him shall be jointly and severally responsible for fulfilment of applicable obligations under these regulations.

4.21.3 Target Company

- Upon a public announcement of an open offer for acquiring shares of a target company being made, the board of directors of such target company have to ensure that during the offer period, the business of the target company is conducted in the ordinary course consistent with past practice.
- During the offer period, unless the approval of shareholders of the target company by

way of a special resolution by postal ballot is obtained, the board of directors of either the target company or any of its subsidiaries cannot-

- o Alienate any material assets whether by way of sale, lease, encumbrance or otherwise or enter into any agreement therefor outside the ordinary course of business;
- o Effect any material borrowings outside the ordinary course of business;
- o Issue or allot any authorised but unissued securities entitling the holder to voting rights.

  However, the target company and its subsidiaries are permitted to do the following:

  - ▪ Issue or allot shares upon conversion of convertible securities issued prior to the public announcement of the open offer, in accordance with pre-determined terms of such conversion;
  - ▪ Issue or allot shares pursuant to any public issue in respect of which the red herring prospectus has been filed with the Registrar of Companies prior to the public announcement of the open offer; or
  - ▪ Issue or allot shares pursuant to any rights issue in respect of which the record date has been announced prior to the public announcement of the open offer;
- o Implement any buy-back of shares or effect any other change to the capital structure of the target company;
- o Enter into, amend or terminate any material contracts to which the target company or any of its subsidiaries is a party, outside the ordinary course of business, whether such contract is with a related party, within the meaning of the term under applicable accounting principles, or with any other person; and
- o Accelerate any contingent vesting of a right of any person to whom the target company or any of its subsidiaries may have an obligation, whether such obligation is to acquire shares of the target company by way of employee stock options or otherwise.

- In any general meeting of a subsidiary of the target company in respect of the matters mentioned in the previous clause, the target company and its subsidiaries, if any, have to vote in a manner consistent with the special resolution passed by the shareholders of the target company.
- The target company is prohibited from fixing any record date for a corporate action on or after the third working day prior to the commencement of the tendering period and until the expiry of the tendering period.

- The target company has to furnish to the acquirer, within two working days from the identified date, a list of shareholders as per the register of members of the target company containing names, addresses, shareholding and folio number, in electronic form, wherever available, and a list of persons whose applications, if any, for registration of transfer of shares are pending with the target company.

  The acquirer has to reimburse reasonable costs payable by the target company to external agencies in order to furnish such information.

- Upon receipt of the detailed public statement, the board of directors of the target company has to constitute a committee of independent directors to provide reasoned recommendations on such open offer, and the target company has to publish such recommendations.

  The committee is entitled to seek external professional advice at the expense of the target company.

- The committee of independent directors has to provide its written reasoned recommendations on the open offer to the shareholders of the target company.

  Such recommendations have to be published at least two working days before the commencement of the tendering period, in the same newspapers where the public announcement of the open offer was published.

  Simultaneously, a copy of the same has to be sent to SEBI, all the stock exchanges on which the shares of the target company are listed, and to the manager to the open offer (and where there are competing offers, to the manager to the open offer for every competing offer).

  The stock exchanges have to forthwith disseminate such information to the public;

- The board of directors of the target company have to facilitate the acquirer in verification of shares tendered in acceptance of the open offer.

- The board of directors of the target company have to make available to all acquirers making competing offers, any information and co-operation provided to any acquirer who has made a competing offer.

- Upon fulfilment by the acquirer, of the conditions required under these regulations, the board of directors of the target company are required to register without any delay, the transfer of shares acquired by the acquirer in physical form, whether under the agreement or from open market purchases, or pursuant to the open offer.

4.21.4 Manager to the Offer

- Prior to public announcement being made, the manager to the open offer has to ensure that-

- o The acquirer is able to implement the open offer; and
- o Firm arrangements for funds through verifiable means have been made by the acquirer to meet the payment obligations under the open offer.

- The manager to the open offer has to ensure that the contents of the public announcement, the detailed public statement and the letter of offer and the post-offer advertisement are true, fair and adequate in all material aspects, not misleading in any material particular, are based on reliable sources, state the source wherever necessary, and are in compliance with the requirements under these regulations.
- The manager to the open offer has to furnish to SEBI, a due diligence certificate along with the draft letter of offer.
- The manager to the open offer has to ensure that market intermediaries engaged for the purposes of the open offer are registered with SEBI.
- The manager to the open offer has to exercise diligence, care and professional judgment to ensure compliance with these regulations.
- The manager to the open offer cannot deal on his own account in the shares of the target company during the offer period.
- The manager to the open offer has to file a report with SEBI, within fifteen working days from the expiry of the tendering period, confirming status of completion of various open offer requirements.

4.22 SEBI Power to Issue Directions

SEBI may, in the interest of investors in securities and the securities market, issue such directions as it deems fit, including-

- Directing divestment of shares acquired in violation of these regulations, whether through public auction or in the open market, or through an offer for sale under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, and directing the appointment of a merchant banker for such divestiture;
- Directing transfer of the shares, or any proceeds of a directed sale of shares acquired in violation of these regulations to SEBI's Investor Protection and Education Fund;
- Directing the target company or any depository not to give effect to any transfer of shares acquired in violation of these regulations;
- Directing the acquirer or any person acting in concert, or any nominee or proxy not to exercise any voting or other rights attached to shares acquired in violation of these regulations;

- Debarring any person who has violated these regulations from accessing the capital market or dealing in securities for such period as may be directed, having regard to the nature and gravity of the violation;
- Directing the acquirer to make an open offer for acquiring shares of the target company at such offer price as determined by SEBI in accordance with these regulations;
- Directing the acquirer not to cause, and the target company not to effect, any disposal of assets of the target company or any of its subsidiaries contrary to the contents of the letter of offer, where specified conditions are not met;
- Directing the acquirer who has failed to make an open offer or has delayed the making of an open offer, to make the open offer and to pay interest at such rate as considered appropriate by SEBI along with the offer price;
- Directing the acquirer who has failed to make payment of the open offer consideration to shareholders, not to make any open offer or enter into any transaction that would attract the obligation to make an open offer in respect of shares of any target company for such period as SEBI may deem fit;
- Directing the acquirer who has made an open offer but has delayed making payment of the open offer consideration to shareholders, to pay interest at such rate as considered appropriate by SEBI for the delayed period;
- Directing any person to cease and desist from exercising control acquired over any target company without complying with the requirements under these regulations;
- Directing divestiture of such number of shares as would result in the shareholding of an acquirer and persons acting in concert with him being limited to the maximum permissible non-public shareholding or below.

In any such proceedings, SEBI has to comply with principles of natural justice before issuing directions to any person.

SEBI may, for failure to carry out the requirements of these regulations by any intermediary registered with SEBI, initiate appropriate proceedings in accordance with applicable regulations.

Self-Assessment Questions

❖ Which of the following are an associate under the takeover regulations?

  ➢ Immediate relatives

  ➢ Trusts where person or immediate relative are a trustee

  ➢ Members of HUF where person is a co parcener

  ➢ **All the above**

- Period during which investors can give their shares in a take-over situation is called
    - **Tendering period**
    - Offer period
    - Public issue period
    - None of the above
- Which of the following can trigger a compulsory public offer?
    - Shareholding crossing 25%
    - More than 5% shareholding acquired in a financial year
    - **Either of the above**
    - None of the above
- Which of the following are permitted form/s of payment in a take over?
    - listed shares in the equity share capital of the acquirer or of any person acting in concert
    - listed secured debt instruments issued by the acquirer or any person acting in concert
    - convertible debt securities
    - **All the above**
- The acquirer can make a difference in pricing between cash payments and payments in the form of securities
    - **True**
    - False
- Detailed public statement is to be published within
    - 5 working days of board resolution
    - **5 working days of public announcement**
    - 5 working days of acquisition triggering the offer
    - None of the above
- The tendering period is to start not later than ten working days from date of receipt of comments from SEBI.
    - True
    - **False**

Chapter 5: De-listing of Equity Shares

5.1 Regulation and Definitions

Listed companies may choose to de-list their equity shares from some or all the stock-exchanges where they are listed. The applicable regulations are the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009.

These regulations do not apply to delisting made pursuant to a scheme sanctioned by the Board for Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985 or by the National Company Law Tribunal under section 424D of the Companies Act, 1956, if such scheme –

(a) Lays down any specific procedure to complete the delisting; or

(b) Provides an exit option to the existing public shareholders at a specified rate.

The words 'control', 'person acting in concert', 'promoter' and 'public shareholding' have the meanings respectively assigned to them under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 as amended from time to time.

5.2 Situations where de-listing is not permitted

De-listing is not permitted in the following situations:

- Pursuant to a buy-back of equity shares by the company; or
- Pursuant to a preferential allotment made by the company; or
- Unless a period of three years has elapsed since the listing of that class of equity shares on any recognised stock exchange; or
- If any instruments issued by the company, which are convertible into the same class of equity shares that are sought to be delisted, are outstanding.

The three-year requirement and bar on de-listing if convertible debentures remain outstanding are not applicable if the equity shares would remain listed on any recognised stock exchange which has nationwide trading terminals.

No company can apply for and no recognised stock exchange can permit delisting of convertible securities.

Promoters cannot directly or indirectly employ the funds of the company to finance an exit opportunity in the following situations:

- The company plans to delist its equity shares from all the recognised stock exchanges where they are listed, or from the only recognised stock exchange where they are listed; or
- After the proposed delisting, the equity shares would not remain listed on any recognised

stock exchange having nation-wide trading terminals

- The promoters of the company acquire delisted equity shares from the public shareholders.

No promoter or other person can –

(a) employ any device, scheme or artifice to defraud any shareholder or other person; or

(b) engage in any transaction or practice that operates as a fraud or deceit upon any shareholder or other person; or

(c) engage in any act or practice that is fraudulent, deceptive or manipulative;

in connection with any delisting sought or permitted or exit opportunity given or other acquisition of shares made under these regulations.

5.3 Voluntary De-listing

Any company is permitted delist its equity shares from all the recognised stock exchanges where they are listed or from the only recognised stock exchange where they are listed. All public shareholders holding equity shares of the class which are sought to be delisted have to be given an exit opportunity.

A company may delist its equity shares from one or more recognised stock exchanges where they are listed, and continue their listing on one or more other recognised stock exchanges, as follows:

- If after the proposed delisting from any one or more recognised stock exchanges, the equity shares would remain listed on any recognised stock exchange which has nationwide trading terminals, no exit opportunity needs to be given to the public shareholders;
- If after the proposed delisting, the equity shares would not remain listed on any recognised stock exchange having nationwide trading terminals, exit opportunity has to be given to all the public shareholders holding the equity shares sought to be delisted.

National Stock Exchange is recognised by SEBI for this purpose, as a stock exchange having nationwide trading terminals.

5.3.1 Procedure where no exit opportunity is provided

The proposed delisting has to be approved by a resolution of the board of directors of the company in its meeting;

The company has to issue a public notice of the proposed delisting in at least one English national daily with wide circulation, one Hindi national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchanges are located;

The public notice needs to mention the names of the recognised stock exchanges from which the equity shares of the company are intended to be delisted, the reasons for such delisting, and the fact of continuation of listing of equity shares on recognised stock exchange having nationwide trading terminals.

The company has to make an application to the concerned recognised stock exchange for delisting its equity shares.

The recognised stock exchange has to dispose of the application within a period not exceeding thirty working days from the date of receipt of the application complete in all respects.

The fact of delisting is to be disclosed in the first annual report of the company, prepared after the delisting.

5.3.2 Procedure where exit opportunity is required to be given

Besides approval of the Board, prior approval of shareholders of the company by special resolution is required. This has to be passed through postal ballot, after disclosure of all material facts in the explanatory statement sent to the shareholders in relation to such resolution.

The special resolution can be acted upon, if and only if the votes cast by public shareholders in favour of the proposal amount to at least two times the number of votes cast by public shareholders against it.

'Public shareholders' means the holders of equity shares, other than the following:

(a) promoters;

(b) holders of depository receipts issued overseas against equity shares held with a custodian and such custodian.

Application is to be made to the concerned recognised stock exchange for in-principle approval of the proposed delisting.

Within one year of passing the special resolution, the final application has to made to the concerned recognised stock exchange.

An application seeking in-principle approval for delisting has to be disposed of by the recognised stock exchange within a period not exceeding thirty working days from the date of receipt of such application complete in all respects.

The recognised stock exchange cannot unfairly withhold the application, but may require the company to satisfy it as to –

(a) compliance with requirement of share-holders' resolution;

(b) the resolution of investor grievances by the company;

(c) payment of listing fees to that recognised stock exchange;

(d) the compliance with any condition of the listing agreement with that recognised stock exchange having a material bearing on the interests of its equity shareholders;

(e) any litigation or action pending against the company pertaining to its activities in the securities market or any other matter having a material bearing on the interests of its equity shareholders;

(f) any other relevant matter as the recognised stock exchange may deem fit to verify.

A final application for delisting has to be accompanied with such proof of having given the exit opportunity, as the recognised stock exchange may require.

5.4 Exit Opportunity

Upon receipt of in-principle approval for delisting from the recognised stock exchange, the company has to make a public announcement in at least one English national daily with wide circulation, one Hindi national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchange is located.

The public announcement needs to contain all material information including the following information:

1. The floor price and the offer price and how they were arrived at
2. The dates of opening and closing of the offer
3. The name of the exchange from which the equity shares are sought to be delisted
4. The manner in which the offer can be accepted by the shareholders
5. Disclosure regarding the minimum acceptance condition for success of the offer
6. The names of the merchant banker and other intermediaries together with the helpline number for the shareholders
7. The specified date
8. The object of the proposed delisting
9. The proposed time table from opening of the offer till the payment of consideration or return of equity shares
10. Details of the escrow account and the amount deposited therein
11. Listing details and stock market data:
    (a) High, low and average market prices of the equity shares of the company during the preceding three years;
    (b) Monthly high and low prices for the six months preceding the date of the public announcement; and,

(c) The volume of equity shares traded in each month during the six months preceding the date of public announcement

12. Present capital structure and shareholding pattern
13. The likely post-delisting shareholding pattern
14. The aggregate shareholding of the promoter together with persons acting in concert and of the directors of the promoter where the promoter is a company and of persons who are in control of the company
15. A statement, certified to be true by the board of directors of the company, disclosing material deviation, if any, in utilisation of proceeds of issues of securities made during the five years immediately preceding the date of public announcement, from the stated object of the issue
16. A statement by the board of directors of the company confirming that all material information which is required to be disclosed under the provisions of continuous listing requirement have been disclosed to the stock exchanges
17. Name of compliance officer of the company
18. It should be signed and dated by the promoter. Where the promoter is a company, the public announcement has to be dated and signed on behalf of the board of directors of the company by its manager or secretary, if any, and by not less than two directors of the company, one of whom has to be a managing director where there is one.

The public announcement cannot contain any false or misleading statement. It has to specify a date, being a day not later than thirty working days from the date of the public announcement, which will be the 'specified date' for determining the names of shareholders to whom the letter of offer is to be sent.

Before making the public announcement, the promoter has to appoint a merchant banker registered with SEBI and such other intermediaries as are considered necessary.

The promoter and the merchant banker are responsible to ensure compliance with the provisions regarding exit opportunity.

Promoter cannot appoint any person as a merchant banker if such a person is an associate of the promoter.

5.5 Escrow

Before making the public announcement, the promoter has to open an escrow account and deposit therein the total estimated amount of consideration calculated on the basis of floor price and number of equity shares outstanding with public shareholders.

On determination of final price and making of public announcement accepting the final price, the promoter has to forthwith deposit in the escrow account such additional sum as may be sufficient to make up the entire sum due and payable as consideration in respect of equity shares outstanding with public shareholders.

The escrow account can consist of either cash deposited with a scheduled commercial bank, or a bank guarantee in favour of the merchant banker, or a combination of both.

Where the escrow account consists of deposit with a scheduled commercial bank, the promoter, while opening the account, has to empower the merchant banker to instruct the bank to issue banker's cheques or demand drafts for the amount lying to the credit of the escrow account, for the purposes mentioned in these regulations.

The amount in such deposit, if any, remaining after full payment of consideration for equity shares tendered in the offer and those tendered within one year from de-listing, has to be released to the promoter.

Where the escrow account consists of a bank guarantee, such bank guarantee has to be valid till payments are made in respect of all shares tendered within one year from de-listing.

5.6 Letter of Offer

The promoter has to despatch the letter of offer to the public shareholders of equity shares, not later than forty five working days from the date of the public announcement, so as to reach them at least five working days before the opening of the bidding period.

The letter of offer has to be sent to all public shareholders holding equity shares of the class sought to be delisted whose names appear on the register of the company or depository as on the date specified in the public announcement.

The letter of offer has to contain all the disclosures made in the public announcement and such other disclosures as may be necessary for the shareholders to take an informed decision.

The letter of offer is to be accompanied with a bidding form for use of public shareholders and a form to be used by them for tendering shares.

5.7 Bidding Period

The date of opening of the offer cannot be later than fifty-five working days from the date of the public announcement.

The offer has to remain open for a minimum period of three working days and a maximum period of five working days, during which the public shareholders may tender their bids.

5.8 Share-holder Rights in Book-building Process

All public shareholders of the equity shares which are sought to be delisted are entitled to participate in the book building process, as follows:

1. The book building process is to be made through an electronically linked transparent facility and the promoter has to enter into an agreement with a stock exchange for the purpose.
2. The public announcement and letter of offer are to be filed without delay with the stock exchange mentioned above, and such stock exchange has to forthwith post the same in its website.
3. The minimum number of bidding centres is prescribed as follows:
   (a) The four metropolitan centres situated at Mumbai, Delhi, Kolkata and Chennai;
   (b) Such cities in the region in which the registered office of the company is situated, as are specified by the stock exchange mentioned above.
4. There has to be at least one electronically linked computer terminal at all bidding centres.
5. The shareholders may withdraw or revise their bids upwards not later than one day before the closure of the bidding period. Downward revision of bids is not permitted.
6. The promoter has to appoint 'trading members' at the bidding centres, whom the public shareholders may approach for placing bids on the on-line electronic system.
7. The shareholders holding dematerialised shares desirous of availing the exit opportunity can deposit the equity shares in respect of which bids are made, with the special depositories account opened by the merchant banker for the purpose prior to placement of orders. Alternately, they can mark a pledge for the same to the merchant banker in favour of the said account.
8. The merchant banker has to ensure that the equity shares in the said special depositories account are not transferred to the account of the promoter unless the bids in respect thereof are accepted and payments made.
9. The holders of physical equity shares may send their bidding form together with the share certificate and transfer deed to the trading member appointed for the purpose, who has to, immediately after entering their bids on the system, send them to the company or the share transfer agent for confirming their genuineness.

   The company or the share transfer agent has to deliver the certificates which are found to be genuine to the merchant banker, who shall not make it over to promoter unless the bids in respect thereof are accepted and payment made. The bids in respect of the certificates which are found to be not genuine have to be deleted from the system.
10. The verification of physical certificates has to be completed in time for making the public announcement of closure of offer.

11. The bids placed in the system need to have an audit trail which includes stock broker identification details, time stamp and unique order number.
12. The final offer price is to be determined as the price at which the maximum number of equity shares is tendered by the public shareholders. If the final price is accepted, then, the promoter has to accept all shares tendered where the corresponding bids placed are at the final price or at a price which is lesser than the final price. The promoter may, if he deems fit, fix a higher final price.

A promoter or a person acting in concert with any of the promoters cannot make a bid in the offer and the merchant banker has to take necessary steps to ensure compliance.

Any holder of depository receipts issued on the basis of underlying shares held by a custodian and any such custodian too are not entitled to participate in the offer.

Any holder of depository receipts can participate in the book building process if the holder exchanges such depository receipts with shares of the class that are proposed to be delisted.

5.9 Floor Price

The floor price has to be disclosed in the Letter of Offer and Public Announcement. It cannot be less than –

- Where the equity shares are frequently traded in all the recognised stock exchanges where they are listed, the average of the weekly high and low of the closing prices of the equity shares of the company during the twenty six weeks or two weeks preceding the date on which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered, whichever is higher, as quoted on the recognised stock exchange where the equity shares of the company are most frequently traded;
- Where the equity shares of the company are infrequently traded in all the recognised stock exchanges where they are listed, the floor price has to be determined by the promoter and the merchant banker, taking into account:
  - o The highest price paid by the promoter for acquisitions, if any, of equity shares of the class sought to be delisted, including by way of allotment in a public or rights issue or preferential allotment, during the twenty six weeks period prior to the date on which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered and after that date upto the date of the public announcement; and,
  - o Other parameters including return on net worth, book value of the shares of the company, earning per share, price earning multiple vis-à-vis the industry average.

- Where the equity shares are frequently traded in some recognised stock exchanges and infrequently traded in some other recognised stock exchanges where they are listed, the highest of the prices arrived at in accordance with the above two methods.

Equity shares are to be deemed to be infrequently traded, if on the recognised stock exchange, the annualised trading turnover in such shares during the preceding six calendar months prior to month in which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered, is less than five per cent. (by number of equity shares) of the total listed equity shares of that class.

5.10 Promoter's Right to Reject Offer Price

The promoter is not bound to accept the equity shares at the offer price determined by the book building process. Where the promoter decides not to accept the offer price so determined –

- The promoter cannot acquire any equity shares tendered pursuant to the offer and the equity shares deposited or pledged by a shareholder have to be returned or released to him within ten working days of closure of the bidding period;
- The company cannot make the final application to the exchange for delisting of the equity shares;
- The promoter can close the escrow account; and,
- In a case where the public shareholding at the opening of the bidding period was less than the minimum level of public shareholding required under the listing agreement, the promoter has to ensure that the public shareholding is brought up to such minimum level within a period of six months from the date of closure of the bidding, through any of the following methods:
    - o Issue of new shares by the company in compliance with the provisions of the Companies Act, 1956 and the Guidelines or Regulations of SEBI relating to issue of securities and disclosures;
    - o The promoter making an offer for sale of his holdings in compliance with the provisions of the Companies Act, 1956 and the Guidelines or Regulations of SEBI relating to issue of securities and disclosures; or
    - o The promoter making sale of his holdings through the secondary market in a transparent manner.

5.11 Successful Voluntary Offer

A voluntary offer is deemed to be successful if post-offer, the shareholding of the promoter (along with the persons acting in concert) taken together with the shares accepted through eligible bids at the final price, reaches the higher of –

(a) ninety per cent of the total issued shares of that class excluding the shares which are held by a custodian and against which depository receipts have been issued overseas; or

(b) the aggregate percentage of pre-offer promoter shareholding (along with persons acting in concert with him) and fifty per cent of the offer size.

5.12 Payment of Consideration / Return of Equity Shares

Immediately on ascertaining success of the offer, the promoter has to open a special account with a banker to an issue registered with SEBI, and transfer thereto, the entire amount due and payable as consideration in respect of equity shares tendered in the offer, from the escrow account.

All shareholders whose equity shares are verified to be genuine have to be paid the final price stated in the public announcement within ten working days from the closure of the offer.

The equity shares deposited or pledged by shareholders have to be returned or released to them, within ten working days from the closure of the offer, in cases where the bids pertaining thereto have not been accepted.

5.13 Share-holders' Rights Post-Offer

Where, pursuant to acceptance of equity shares tendered in terms of these regulations, the equity shares are delisted, any remaining public shareholder holding such equity shares can tender his shares to the promoter upto a period of at least one year from the date of delisting. In that case, the promoter has to accept the shares tendered at the same final price at which the earlier acceptance of shares was made. Payment would be made out of the escrow account.

5.14 Failure of Offer

Where the offer fails-

- The promoter cannot acquire any equity shares tendered pursuant to the offer and the equity shares deposited or pledged by a shareholder have to be returned or released to him within ten working days of closure of the bidding period;
- The company cannot make the final application to the exchange for delisting of the equity shares; and
- The promoter can close the escrow account.

5.15 Post-Closure Announcement

Within eight working days of closure of the offer, the promoter and the merchant banker have to make a public announcement in the same newspapers in which the original public announcement of offer was made, regarding-

(i) the success of the offer along with the final price accepted by the acquirer; or

(ii) the failure of the offer; or

(iii) rejection of the final price by the promoters.

5.16 Compulsory De-listing

A recognised stock exchange may, by order, delist any equity shares of a company on any ground prescribed in the rules made under section 21A of the Securities Contracts (Regulation) Act, 1956. These grounds are:

(a) the company has incurred losses during the preceding three consecutive years and it has negative net worth;

(b) trading in the securities of the company has remained suspended for a period of more than six months;

(c) the securities of the company have remained infrequently traded during the preceding three years;

(d) the company or any of its promoters or any of its director has been convicted for failure to comply with any of the provisions of the Act or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 (22 of 1996) or rules, regulations, agreements made thereunder, as the case may, be and awarded a penalty of not less than rupees one crore or imprisonment of not less than three years;

(e) the addresses of the company or any of its promoter or any of its directors, are not known or false addresses have been furnished or the company has changed its registered office in contravention of the provisions of the Companies Act, 1956 (1 of 1956); or

(f) shareholding of the company held by the public has come below the minimum level applicable to the company as per the listing agreement under the Act and the company has failed to raise public holding to the required level within the time specified by the recognized stock exchange

The decision regarding compulsory delisting has to be taken by a panel to be constituted by the recognised stock exchange consisting of –

(a) two directors of the recognised stock exchange (one of whom will be a public representative);

(b) one representative of the investors;

(c) one representative of the Ministry of Corporate Affairs or Registrar of Companies; and

(d) the Executive Director or Secretary of the recognised stock exchange.

Before passing the de-listing order, the recognised stock exchange has to give notice of the proposed delisting, in one English national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchange is located.

Time period of not less than fifteen working days from the notice has to be given, within which representations may be made to the recognised stock exchange by any person who may be aggrieved by the proposed delisting.

The notice is also to be displayed on the stock exchange's trading systems and website.

Where the recognised stock exchange passes an order for compulsory de-listing, it has to –

- Forthwith publish a notice of the fact of such delisting, in one English national daily with wide circulation and one regional language newspaper of the region where the concerned recognised stock exchange is located. The notice has to contain the name and address of the company, the fair value of the delisted equity shares determined by an independent valuer appointed by the stock exchange, and the names and addresses of the promoters of the company who would be liable; and
- Inform all other stock exchanges where the equity shares of the company are listed, about such delisting and the surrounding circumstances.

  'Valuer' means a chartered accountant within the meaning of clause (b) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949), who has undergone peer review as specified by the Institute of Chartered Accountants of India constituted under that Act, or a merchant banker appointed to determine the value of the delisted equity shares.

Where a company has been compulsorily delisted, the company, its whole time directors, its promoters and the companies which are promoted by any of them cannot, directly or indirectly, access the securities market or seek listing for any equity shares for a period of ten years from the date of such delisting.

5.17 Share-holders' Rights in Compulsory De-listing

The promoter of the company is bound to acquire the delisted equity shares from the public shareholders by paying them the value determined by the valuer. However, the shareholders can choose to retain their shares.

5.18 Provisions for Small Companies

An easier de-listing process is available for small companies as follows:

- Where a company has paid up capital upto one crore rupees and its equity shares were not traded in any recognised stock exchange in the one year immediately preceding the date of decision, the equity shares may be delisted from all the recognised stock exchanges where they are listed, without following the procedure.

- Where a company has three hundred or fewer public shareholders and where the paid up value of the shares held by such public shareholders in such company is not more than one crore rupees, its equity shares may be delisted from all the recognised stock exchanges where they are listed, without following the procedure.

In the above cases, Board Resolution and Special Resolution will be required, as in the case of voluntary de-listing with exit opportunity. Further, the following steps are required:

- The promoter has to appoint a merchant banker and decide an exit price in consultation with him;
- The exit price offered to the public shareholders shall not be less than the price arrived at in consultation with the merchant banker;
- The promoter writes individually to all public shareholders in the company informing them of his intention to get the equity shares delisted, indicating the exit price together with the justification therefor and seeking their consent for the proposal for delisting;
- At least ninety per cent of such public shareholders have to give their positive consent in writing to the proposal for delisting, and consent either to sell their equity shares at the price offered by the promoter or to remain holders of the equity shares even if they are delisted;
- The promoter completes the process of inviting the positive consent and finalisation of the proposal for delisting of equity shares within seventy five working days of the first individual communication made to them;
- The promoter makes payment of consideration in cash within fifteen working days from the date of expiry of the seventy five working days mentioned above.

The individual communication made to the public shareholders has to contain justification for the offer price and specifically mention that consent for the proposal would include consent to dispense with the exit price discovery through book building method.

Based on compliance with the above, the concerned stock exchange can de-list the shares.

5.19 Listing of de-listed shares

No application for listing can be made in respect of any equity shares,

(a) which have been voluntarily delisted, for a period of five years from the delisting;

(b) which have been compulsorily delisted, for a period of ten years from the delisting.

However, an application for listing of delisted equity shares may be made at any time, where a recommendation in this regard has been made by the Board for Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985.

Self-Assessment Questions

- SEBI's de-listing regulations do not apply to scheme sanctioned by-
  - Board for Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985
  - the National Company Law Tribunal under section 424D of the Companies Act, 1956
  - **Either of the above**
  - None of the above
- Which of the following are allowed to be de-listed from all stock exchanges
  - **Equity**
  - Convertible securities
  - Both the above
  - None of the above
- While de-listing, if the equity shares would remain listed on any recognised stock exchange which has nationwide trading terminals, no exit opportunity needs to be given to the public shareholders
  - **True**
  - False
- Share-holders' resolution is required for all forms of de-listing.
  - True
  - **False**
- 'Public shareholders' means the holders of equity shares, other than the following:
  - Promoters
  - Holders of depository receipts issued overseas
  - **Both the above**
  - None of the above
- The date of opening of the offer pursuant to proposed de-listing, cannot be later than ______________ working days from the date of the public announcement.
  - 15
  - 30
  - 45
  - **55**

Chapter 6: Valuation

6.1 Background

Chapter V of the Companies Act, 1956 does not insist on a valuation report. However, there are situations where SEBI guidelines call for a professional valuation by a merchant banker or valuation agency. These were discussed in Chapters 3, 4 and 5.

In the case of structure products, SEBI insists on valuation by a SEBI-approved credit rating agency.

Reserve Bank of India insists on fair valuation by a Category 1 Merchant Banker or Chartered Accountant, as per discounted cash flow (DCF) method, for foreign direct investment (FDI) in unlisted companies.

Even when it is not required by law, appointment of a valuer is a standard market practice for most transactions that are in the nature of mergers, demergers or acquisitions.

6.2 Valuation Methods

Before a valuation, there has to be clarity on what is being valued viz. business or the shares.

For example, if Company A proposes to acquire a business of Company B for cash, then it needs a valuation of the business proposed to be acquired. Valuation of Company B or its shares is not relevant.

However, if Company A proposes to acquire Company B through a stock swap, then the value of the shares of Company B, based on valuation of its businesses, becomes a factor.

Various methods are available for valuation. These are discussed in Chapters 4 and 5 of the Workbook, Financial Markets (Advanced) authored by Mr. Sundar Sankaran.

Broadly, the valuation methods can be grouped as follows:

6.2.1 Market-based Methods

- Capitalised Earnings Value / Price – Earnings Multiple

  The valuation here is based on the following relationship:

  EPS X P/E Ratio = Price per share

  Earnings per Share (EPS) is projected for the company being valued.

  In the case of unlisted companies, Price to Earnings Ratio (P/E Ratio) of the peer group is considered. Peer group would be other listed companies from the same sector of a similar size.

  Where more than one such company exists in the peer group, then a weighted average is used. Suitable adjustments are made to the ratio to reflect specific areas where the company is different from the peer group.

If the company's EPS is projected to be Rs. 6, and peer group P/E Ratio is 12 times, then the shares of the company will be valued at Rs. 6 X 12 i.e. Rs. 72 per share.

If the company has issued 10 crore shares, then the valuation of the company would be Rs. 72 X 10 crore i.e. Rs. 720 crore.

- EBIDTA Multiple

  Earnings are affected by factors such as:

  - o Financing mix of debt and equity
  - o Accounting policies regarding depreciation and amortisation
  - o Tax planning

  These factors are not so closely linked to the actual operations of the company. An alternate approach to valuation uses Earnings before Interest, Depreciation, Tax and Amortisation (EBIDTA). It is based on the following relationship:

  EBIDTA X EBIDTA Multiple = Valuation

  EBIDTA is projected for the company being valued. As with P/E Ratio, EBIDTA multiple for the peer group can be used, when the company is not listed.

  If the company's EBIDTA is projected at Rs. 50 crore, and the peer group EBIDTA multiple is 20 times, then the company will be valued at Rs. 50 crore X 20 i.e. Rs. 1,000 crore.

- Enterprise Value

  This is calculated as the market value of equity and debt of the company, less cash/ bank and the value of investments in the company's portfolio.

  If a company's shares are valued at Rs. 50 per share, and it has issued 10 crore shares, then the market value of the company's shares (also referred to as 'market capitalisation') would be Rs. 50 X 10 crore i.e. Rs. 500 crore.

  Suppose the market value of the debt that the company has taken is Rs. 10 crore, and the company has an investment portfolio worth Rs. 5 crore. The company also has Rs. 2 crore in the form of bank / cash.

  Enterprise Value can be calculated as Rs. 500 cr. + Rs. 10 cr. – Rs. 5 cr. – Rs. 2 cr. i.e. Rs. 503 cr.

- Price to Book Value

  The valuation is based on the following relationship:

  Book Value per share X Price to Book Value Ratio = Price per share

  The book value per share of the company is considered. Price to Book Value Ratio of the peer group is used for unlisted companies.

  If the book value per share of the company is Rs. 22, and Price to Book Value ratio of the peer group is 1.5, then each share of the company is valued at Rs. 22 X 1.5 i.e. Rs. 33.

- Sales Multiple

  This method links valuation to the sales turnover of the company. The relationship used is as follows:

  Sales Turnover X Sales Multiple = Valuation

  Suppose the sales turnover of a company is Rs. 150 crore.

  The peer group sales turnover is Rs. 600 crore, and peer group market capitalisation is Rs. 1,800 crore. The peer group sales multiple is thus Rs. 1,800 crore ÷ Rs. 600 crore i.e. 3 times.

  Accordingly, the company will be valued at Rs. 150 crore X 3 i.e. Rs. 450 crore.

6.2.2 DCF-based Methods

The market-based models are based on EPS, sales multiple etc. at a point of time. Discounted Cash Flow (DCF) methods use the projected cash flows of the company over a period of time. By discounting those cash flows to the present value, due weightage is given to the timing of those cash flows.

Annual cash flows are taken for an initial period (say, 3 years), at the end of which the cash flows are expected to have a stable growth rate.

The discounted value based on cash flows in the initial period, is called 'initial value'.

The discounted value based on cash flows in the stable growth period, is called 'terminal value'. It is calculated by dividing the Year 4 cash flow by (discount rate – stable growth rate).

The total valuation of the company is equal to initial value + terminal value.

Acquirers are cautious about paying too much terminal value, since it relates to a period further into the future. This is particularly in the case of industries where technology or buyer behavior changes rapidly.

There are two facets to free cash flows:

- Free Cash flow to Firm

  "Free Cash Flow to the Firm" (FCFF) is the operational cash flow that is available for servicing debt and equity investors. It is calculated as follows:

  FCFF = PAT + Depreciation & Amortisation + Interest (1 – Tax Rate) – Normal Working Capital Investment – Normal Fixed Capital Investment

  The projected free cash flows to firm for each year is discounted at the Weighted Average Cost of Capital (WACC).

- Free Cash Flow to Equity

  From the Free Cash Flow to the Firm, if the payments towards debt servicing are reduced, the balance belongs to equity investors. This is called "Free Cash Flow to

Equity" (FCFE). This has to be discounted at the Cost of Equity to arrive at the Value of Equity of the firm.

FCFE = FCFF – Interest (1-tax rate) – Loan Repayment

Suppose a company's projections are as shown in Table 6.1.

Table 6.1

Projections of Company XYZ

				Rs. Crore
			Projected Cash Flow	
		Year 1	*Year 2*	*Year 3*
1	Profit after Tax	100	150	250
2	Depreciation & Amortisation	20	18	16
3	Interest	15	13	10
4	Debt Repayment	20	22	25
5	Normal Working Capital Investment	8	10	15
6	Normal Fixed Capital Investment	15	20	25

Let us assume the following:

- The company will grow at a steady rate of 7% p.a. for the period after the initial period of 3 years.
- Weighted average cost of capital 10%
- Cost of equity 12%
- Tax rate 33.66%

The discount factor for arriving at present value can be calculated as shown in Table 6.2. For each additional year, it is calculated using the formula 1 ÷ (1 + r), 'r' being the discount rate.

The calculation of FCFF and FCFE are shown in Table 6.3.

The valuation for the initial period is shown in Table 6.4.

The terminal value is shown in Table 6.5. The Year 4 free cash flows are calculated by applying the stable growth rate to the Year 3 free cash flows.

Table 6.2

Discount Factor

Discount Factor					
		Year 1	*Year 2*	*Year 3*	*Year 4*
Weighted Average Cost of Capital					
	10%	0.909091	0.826446	0.751315	0.683013
Cost of Equity					
	12%	0.892857	0.797194	0.71178	0.635518

Table 6.3

FCFF & FCFE

	Free Cash Flows			
		Year 1	*Year 2*	*Year 3*
	FCFF			
1	Profit after Tax	100.00	150.00	250.00
2	Depreciation & Amortisation	20.00	18.00	16.00
3	Interest * (1 - Tax Rate)	9.95	8.62	6.63
5	Normal Working Capital Investment	8.00	10.00	15.00
6	Normal Fixed Capital Investment	15.00	20.00	25.00
7	**FCFF = 1+2+3-5-6**	**106.95**	**146.62**	**232.63**
4	Debt Repayment	20.00	22.00	25.00
8	**FCFE = 7-3-4**	**77.00**	**116.00**	**201.00**

Table 6.4

Valuation for Initial period

	Valuation for Initial Period			
		Year 1	*Year 2*	*Year 3*
1	FCFF	106.95	146.62	232.63
2	Discount Factor	0.909091	0.826446	0.751315
3	Present Value = 1 X 2	97.23	121.18	174.78
4	Free Cash Flow Valuation of Firm			
	(for initial period) - Total of 3 values	**393.19**		
5	FCFE	77.00	116.00	201.00
6	Discount Factor	0.892857	0.797194	0.71178
7	Present Value = 5 X 6	68.75	92.47	143.07
8	Free Cash Flow Valuation of Equity			
	(for initial period) - Total of 3 values	**304.29**		

Table 6.5

Terminal Value

B57 — f_x Terminal Value

	A	B	C	D	E	F
56						
57			**Terminal Value**			
58						
59		1	FCFF in Year 3			232.63
60		2	Stable growth rate			7%
61		3	FCFF in Year 4 [1 X (1+2)]			248.92
62		4	Weighted Average Cost of Capital			10%
63		5	Discount Rate - Stable Growth Rate (4 - 2)			3%
64		6	Terminal Value of FCFF (3÷5)			8,297.28
65			(as of end of Year 4)			
66						
67		7	Discount Factor for Year 4			0.683013
68						
69		8	**Terminal Value of FCFF (6 X 7)**			**5,667.15**
70			(as of today)			
71						
72		9	FCFE in Year 3			201.00
73		10	Stable growth rate			7%
74		11	FCFE in Year 4 [9 X (9+10)]			215.07
75		12	Cost of Equity			12%
76		13	Discount Rate - Stable Growth Rate (12 - 10)			5%
77		14	Terminal Value of FCFF (11÷13)			4,301.40
78			(as of end of Year 4)			
79						
80		15	Discount Factor for Year 4			0.635518
81						
82		16	**Terminal Value of FCFE (14 X 15)**			**2,733.62**
83			(as of today)			

The final valuation is shown in Table 6.6.

Table 6.6

Final Valuation

B85 — f_x Final Valuation

	A	B	C	D	E	F	G
84							
85		**Final Valuation**					
86					*Initial Value*	*Terminal Value*	***Total Value***
87							
88		Based on FCFF			393.19	5,667.15	**6,060.34**
89							
90		Based on FCFE			304.29	2,733.62	**3,037.91**

6.2.3 *Asset-based Methods*

Under this method, the balance sheet values are re-stated to their current realisable value. In the case of mines, the present value of the estimated mineral resources lying below the ground would be used. The true net worth of the company is assessed as the value of assets minus the value of liabilities (excluding share capital and reserves).

Choice of appropriate method is an art. Irrespective of method adopted the valuation need to be adjusted to reflect the realities of the situation. Some of these adjustments are as follows:

- Unutilised assets

  If the company has surplus land, then the market value of that surplus land is added to the valuation. Similarly, if the company owns land whose value is significantly above the value reflected in the books, then the differential value is added to the valuation.

  If the acquirer is not interested in such land, then that may be demerged into a separate company, which the acquirer does not acquire.

- Investments

  An acquirer taking over a business may not be interested in the treasury investments that are held in the acquiree company. In such a case, the valuation is arrived at, after excluding the post-tax income arising of the treasury investments.

- Build Operate Transfer (BOT) Projects

  Some infrastructure projects are awarded on the basis that the party builds the asset, then operates it for a specified period (say, 30 years) and then transfers it back to the government. The transfer value is fixed upfront.

  In such cases, the terminal value is calculated based on the value fixed in the agreement, rather than the values calculated based on FCFF or FCFE.

- Control premium

  An acquirer may be prepared to pay more if the acquisition will lead to obtaining control over the company. This is a control premium.

  Earlier, transactions were structured in a form where the control premium or other payments would be paid to the promoters as a non-compete fee or under some other name; the company's share-holders did not get the benefit of such payments. As discussed in Chapter 4, Para E, SEBI has now mandated that even such valuation needs to be paid to the company or its share-holders.

Valuation Reports tend to provide the value based on more than one method, so that the acquirer has a range of values.

The final value at which the transactions are concluded would also depend on the negotiation strength of the respective parties.

Self-Assessment Questions

- For FDI in unlisted companies, RBI insists on valuation based on
  - P/E Ratio
  - P/BV Ratio
  - **DCF**
  - Enterprise Value
- Chapter V of the Companies Act, 1956 does not insist on a valuation report.
  - **True**
  - False
- Sales multiple is an example of
  - **Market-based method**
  - DCF method
  - Asset-based method
  - None of the above
- Which of the following is true?
  - FCFF is discounted at cost of equity
  - FCFE = FCFF – Interest payments
  - **FCFE + Post-tax Debt servicing = FCFF**
  - Weighted average cost of capital is not a factor in free cash flow valuation
- Asset-based method of valuation is commonly used for valuing mines.
  - **True**
  - False
- Non-compete fee paid to promoters does not affect the pay-off for other share-holders.
  - True
  - **False**

Chapter 7: Accounting for Mergers & Acquisitions

7.1 Regulatory Framework

The following standards are relevant in accounting for mergers and acquisitions.

- AS 14: Accounting for Amalgamations
- AS 10: Accounting for Fixed Assets
- AS 26: Intangible Assets
- ASI 11: Accounting for Taxes on Income in case of an Amalgamation
- Ind AS 103: Business Combinations

7.2 AS 14: Accounting for Amalgamations

This standard, issued by the Council of the Institute of Chartered Accountants of India, came into effect in respect of accounting periods commencing on or after 1.4.1995. It is mandatory in nature.

It deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves. Share acquisitions are not covered by this standard. As discussed in Chapter 1,

- In an amalgamation, one or more companies cease to exist.
- In a share acquisition, the acquired company is not dissolved. It continues to be in existence. Only the share-holding / control of the acquired company changes hands.

7.2.1 Definitions

- "Amalgamation" means an amalgamation pursuant to the provisions of the Companies Act, 1956 or any other statute which may be applicable to companies.
- "Transferor company" means the company which is amalgamated into another company.
- "Transferee company" means the company into which a transferor company is amalgamated.
- "Reserve" means the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability.
- "Amalgamation in the nature of merger" is an amalgamation which satisfies all the following conditions.
  (i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

- "Amalgamation in the nature of purchase" is an amalgamation which does not satisfy any one or more of the conditions specified for an amalgamation in the nature of a merger.
- "Consideration" for the amalgamation means the aggregate of the shares and other securities issued and the payment made in the form of cash or other assets by the transferee company to the shareholders of the transferor company.
- "Fair value" is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.
- "Pooling of interests" is a method of accounting for amalgamations, the object of which is to account for the amalgamation as if the separate businesses of the amalgamating companies were intended to be continued by the transferee company. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

7.2.2 Types of Amalgamations

Those amalgamations where there is a genuine pooling, not merely of the assets and liabilities of the amalgamating companies, but also of the shareholders' interests and of the businesses of these companies, are amalgamations which are in the nature of 'merger'. The five conditions listed in the definitions para are meant to assess this.

The accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamating companies. This is the 'pooling of interests' method of accounting.

In the second category are those amalgamations which are in effect a mode by which one company acquires another company and, as a consequence, the shareholders of the company which is acquired normally do not continue to have a proportionate share in the equity of the combined company, or the business of the company which is acquired is not intended to be continued. Such amalgamations are amalgamations in the nature of 'purchase'. They are accounting through the 'purchase' method of accounting.

7.2.3 Pooling of Interests Method of Accounting

Under the pooling of interests method, the assets, liabilities and reserves of the transferor company are recorded by the transferee company at their existing carrying amounts.

However, if, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies has to be adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies are reported in accordance with Accounting Standard (AS) 5: 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

7.2.4 Purchase Method of Accounting

Under the purchase method, the transferee company accounts for the amalgamation either by incorporating the assets and liabilities at their existing carrying amounts or by allocating the consideration to individual identifiable assets and liabilities of the transferor company on the basis of their fair values at the date of amalgamation.

The identifiable assets and liabilities may include assets and liabilities not recorded in the financial statements of the transferor company.

Where assets and liabilities are restated on the basis of their fair values, the determination of fair values may be influenced by the intentions of the transferee company. For example, the transferee company may have a specialised use for an asset, which is not available to other potential buyers.

The transferee company may intend to effect changes in the activities of the transferor company which necessitate the creation of specific provisions for the expected costs, e.g. planned employee termination and plant relocation costs.

7.2.5 Consideration

The consideration for the amalgamation may consist of securities, cash or other assets. In determining the value of the consideration, an assessment is made of the fair value of its elements.

When the consideration includes securities, the value fixed by the statutory authorities may be taken to be the fair value. In case of other assets, the fair value may be determined by reference to the market value of the assets given up. Where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective net book values.

Adjustments may have to be made to the consideration in the light of one or more future events.

- When the additional payment is probable and can reasonably be estimated at the date of amalgamation, it is included in the calculation of the consideration.
- In all other cases, the adjustment is recognised as soon as the amount is determinable. In that case, Accounting Standard (AS) 4: 'Contingencies and Events Occurring after the Balance Sheet Date', would be applicable.

7.2.6 Reserves

If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved and they appear in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company.

Therefore, reserves which are available for distribution as dividend before the amalgamation would also be available for distribution as dividend after the amalgamation.

The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company is adjusted in reserves in the financial statements of the transferee company.

If the amalgamation is an 'amalgamation in the nature of purchase', the identity of the reserves, other than the statutory reserves (e.g. Investment Allowance Reserve), is not preserved. The amount of the consideration is deducted from the value of the net assets of the transferor company acquired by the transferee company.

- If the result of the computation is negative (i.e. consideration is more than net assets), the difference is debited to goodwill arising on amalgamation.
- If the result of the computation is positive, the difference is credited to Capital Reserve.

The statutory reserves are retained in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company, so long as their identity is required to be maintained to comply with the relevant statute.

The statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Account') which is disclosed as a part of 'miscellaneous expenditure' or other similar category in the balance sheet.

When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.

7.2.7 Goodwill

Goodwill arising on amalgamation represents a payment made in anticipation of future income and it is appropriate to treat it as an asset to be amortised to income on a systematic basis over its useful life.

Due to the nature of goodwill, it is frequently difficult to estimate its useful life with reasonable certainty. Such estimation is, therefore, made on a prudent basis. It is considered appropriate to amortise goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

In estimating the useful life of goodwill arising on amalgamation, some of the factors to consider are as follows:

- the foreseeable life of the business or industry;
- the effects of product obsolescence, changes in demand and other economic factors;
- the service life expectancies of key individuals or groups of employees;
- expected actions by competitors or potential competitors; and
- legal, regulatory or contractual provisions affecting the useful life.

7.2.8 Profit & Loss a/c Balance

In the case of an 'amalgamation in the nature of merger', the balance of the Profit and Loss Account appearing in the financial statements of the transferor company is aggregated with the corresponding balance appearing in the financial statements of the transferee company. Alternatively, it is transferred to the General Reserve, if any.

In the case of an 'amalgamation in the nature of purchase', the balance of the Profit and Loss Account appearing in the financial statements of thetransferor company, whether debit or credit, loses its identity.

7.2.9 Disclosures

The following disclosures are considered appropriate in the first financial statements following the amalgamation:

(a) names and general nature of business of the amalgamating companies;

(b) effective date of amalgamation for accounting purposes;

(c) the method of accounting used to reflect the amalgamation; and

(d) particulars of the scheme sanctioned under a statute.

Further, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation, in the case of pooling of interests:

(a) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;

(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.

Under the purchase method, the following additional disclosures are considered appropriate in the first financial statements following the amalgamation:

(a) consideration for the amalgamation and a description of the consideration paid or contingently payable; and

(b) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortisation of any goodwill arising on amalgamation.

7.2.10 Amalgamation after Balance Sheet Date

When an amalgamation is effected after the balance sheet date but before the issuance of the financial statements of either party to the amalgamation, disclosure is made in accordance with AS 4: 'Contingencies and Events Occurring After the Balance Sheet Date', but the amalgamation is not incorporated in the financial statements.

7.3 AS 10: Accounting for Fixed Assets

This is a mandatory standard. It does not deal with the specialised aspects of accounting for fixed assets that arise under a comprehensive system reflecting the effects of changing prices, but applies to financial statements prepared on historical cost basis.

It does not deal with accounting for the following items to which special considerations apply:

(i) forests, plantations and similar regenerative natural resources;

(ii) wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources;

(iii) expenditure on real estate development; and

(iv) livestock.

It also does not deal with the treatment of government grants and subsidies, and assets under leasing rights.

When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. It may be appropriate to consider also the fair market value of the asset acquired, if this is more clearly evident.

An alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, is to record the asset acquired at the net book value of the asset given up; in each case an adjustment is made for any balancing receipt or payment of cash or other consideration.

When a fixed asset is acquired in exchange for shares or other securities in the enterprise, it is usually recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident.

Goodwill, in general, is recorded in the books only when some consideration in money or money's worth has been paid for it.

Whenever a business is acquired for a price (payable either in cash or in shares or otherwise) which is in excess of the value of the net assets of the business taken over, the excess is termed as 'goodwill'.

Goodwill arises from business connections, trade name or reputation of an enterprise or from other intangible benefits enjoyed by an enterprise.

7.4 AS 26: Intangible Assets

AS 26 came into effect in respect of expenditure incurred on intangible items during accounting periods commencing on or after 1-4-2003 and is mandatory in nature.

The standard applies to accounting for intangible assets, except:

(a) intangible assets that are covered by another Accounting Standard;

(b) financial assets;

(c) mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources; and

(d) intangible assets arising in insurance enterprises from contracts with policy holders.

A financial asset is any asset that is:

(a) cash;

(b) a contractual right to receive cash or another financial asset from another enterprise;

(c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or

(d) an ownership interest in another enterprise.

The standard does not apply to:

(a) intangible assets held by an enterprise for sale in the ordinary course of business (AS 2: Valuation of Inventories, and AS 7: Accounting for Construction Contracts are applicable);

(b) deferred tax assets (AS 22: Accounting for Taxes on Income, is applicable);

(c) leases (AS 19: Leases, is applicable); and

(d) goodwill arising on an amalgamation (AS 14: Accounting for Amalgamations, is applicable) and goodwill arising on consolidation (AS 21: Consolidated Financial Statements, is applicable).

This standard should not be applied to expenditure in respect of termination benefits also.

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

An asset is a resource:

(a) controlled by an enterprise as a result of past events; and

(b) from which future economic benefits are expected to flow to the enterprise.

Enterprises frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes or systems, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles).

Not all these items will meet the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing to the enterprise. If an item does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in an amalgamation in the nature of purchase, it forms part of the goodwill recognised at the date of the amalgamation.

To be identifiable, it is necessary that the intangible asset is clearly distinguished from goodwill. Goodwill arising on an amalgamation in the nature of purchase represents a payment made by the acquirer in anticipation of future economic benefits. The future economic benefits may result from synergy between the identifiable assets acquired or from assets which, individually, do not qualify for recognition in the financial statements but for which the acquirer is prepared to make a payment in the amalgamation.

An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits.

The capacity of an enterprise to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law.

In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an enterprise may be able to control the future economic benefits in some other way.

If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.

An intangible asset acquired in an amalgamation in the nature of purchase is accounted for in accordance with Accounting Standard (AS) 14: Accounting for Amalgamations.

Where in preparing the financial statements of the transferee company, the consideration is allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation, the following should be evaluated:

- Judgement is required to determine whether the cost (i.e. fair value) of an intangible asset acquired in an amalgamation can be measured with sufficient reliability for the purpose of separate recognition.

  Quoted market prices in an active market provide the most reliable measurement of fair value. The appropriate market price is usually the current bid price. If current bid prices are unavailable, the price of the most recent similar transaction may provide a basis from which to estimate fair value, provided that there has not been a significant change in economic circumstances between the transaction date and the date at which the asset's fair value is estimated.
- If no active market exists for an asset, its cost reflects the amount that the enterprise would have paid, at the date of the acquisition, for the asset in an arm's length transaction between knowledgeable and willing parties, based on the best information available. In determining this amount, an enterprise considers the outcome of recent transactions for similar assets.
- Certain enterprises that are regularly involved in the purchase and sale of unique intangible assets have developed techniques for estimating their fair values indirectly. These techniques may be used for initial measurement of an intangible asset acquired in an amalgamation in the nature of purchase, if their objective is to estimate fair value as defined in this Statement and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, where appropriate, applying multiples reflecting current market transactions to certain indicators driving the profitability of the asset (such as revenue, market shares, operating profit, etc.) or discounting estimated future net cash flows from the asset.
- A transferee can recognise an intangible asset that meets the recognition criteria, even if that intangible asset had not been recognised in the financial statements of the transferor. If the cost (i.e. fair value) of an intangible asset acquired as part of an amalgamation in the nature of purchase cannot be measured reliably, that asset is not recognised as a separate intangible asset but is included in goodwill.

- Unless there is an active market for an intangible asset acquired in an amalgamation in the nature of purchase, the cost initially recognised for the intangible asset is restricted to an amount that does not create or increase any capital reserve arising at the date of the amalgamation.

An intangible asset may be acquired in exchange or part exchange for another asset. In such a case, the cost of the asset acquired is determined in accordance with the principles laid down in this regard in AS 10: Accounting for Fixed Assets.

The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

Many factors need to be considered in determining the useful life of an intangible asset including:

(a) the expected usage of the asset by the enterprise and whether the asset could be efficiently managed by another management team;

(b) typical product life cycles for the asset and public information on estimates of useful lives of similar types of assets that are used in a similar way;

(c) technical, technological or other types of obsolescence;

(d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) expected actions by competitors or potential competitors;

(f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the company's ability and intent to reach such a level;

(g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

(h) whether the useful life of the asset is dependent on the useful life of other assets of the enterprise.

Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life will be short.

If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless:

(a) the legal rights are renewable; and

(b) renewal is virtually certain.

7.5 ASI 11: Accounting for Taxes on Income in case of an Amalgamation

- Where the amalgamation is in the nature of purchase and the consideration for the amalgamation is allocated to individual identifiable assets/ liabilities on the basis of their fair values at the date of amalgamation as permitted in AS 14, the deferred tax assets should be recognised by the transferee enterprise at the time of amalgamation itself considering these as identifiable assets, so long as it fulfils the requirements of prudence. This will automatically affect the amount of the goodwill/capital reserve arising on amalgamation.

  If the prudential conditions are not satisfied at the time of the amalgamation, but are satisfied by the first annual balance sheet date following the amalgamation, the deferred tax assets are to be recognised. The corresponding adjustment should be made to the goodwill/capital reserve arising on the amalgamation.

  If, however, the conditions for recognition of deferred tax assets are not satisfied even by the first annual balance sheet date following the amalgamation, the corresponding effect of any subsequent recognition of the deferred tax asset on the satisfaction of the conditions should be given in the statement of profit and loss of the year in which the conditions are satisfied and not in the goodwill/capital reserve.

- Where the amalgamation is in the nature of purchase and the transferee enterprise incorporates the assets/liabilities of the transferor enterprise at their existing carrying amounts as permitted in AS 14, the deferred tax assets should not be recognised at the time of amalgamation.

  However, if, by the first annual balance sheet date subsequent to amalgamation, the unrecognised deferred tax assets are recognised the corresponding adjustment should be made to goodwill/capital reserve arising on the amalgamation.

  In a case where the conditions for recognition of deferred tax assets as per AS 22 are not satisfied by the first annual balance sheet date following the amalgamation, the corresponding effect of any subsequent recognition of the deferred tax asset on the satisfaction of the conditions should be given in the statement of profit and loss of the year in which the conditions are satisfied and not in the goodwill/capital reserve.

- Where the amalgamation is in the nature of merger, the deferred tax assets should not be recognised at the time of amalgamation.

  However, if, by the first annual balance sheet date subsequent to the amalgamation, the unrecognised deferred tax assets are recognised the corresponding adjustment should be made to the revenue reserves.

  In a case where the conditions for recognition of deferred tax assets as per AS 22 are not satisfied by the first annual balance sheet date following the amalgamation, the corresponding effect of any subsequent recognition of the deferred tax asset on the satisfaction of the conditions should be given in the statement of profit and loss of the year in which the conditions are satisfied and not in the revenue reserves.

7.6 Ind AS 103: Business Combinations

The Ministry of Commerce has notified this standard, as part of the efforts towards convergence with the International Financial Reporting Standards, issued by International Accounting Standards Board (IASB). However, no applicability date has been set.

This Indian Accounting Standard does not apply to:

(a) the formation of a joint venture

(b) the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer has to identify and recognise the individual identifiable assets acquired or liability assumed.

An entity has to determine whether a transaction or other event is a business combination, by applying the definition in this Indian Accounting Standard, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity is to account for the transaction or other event as an asset acquisition.

An acquirer might obtain control of an acquiree in a variety of ways, for example:

(a) by transferring cash, cash equivalents or other assets (including net assets that constitute a business);

(b) by incurring liabilities;

(c) by issuing equity interests;

(d) by providing more than one type of consideration; or

(e) without transferring consideration, including by contract alone.

A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:

(a) one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;

(b) one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;

(c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or

(d) a group of former owners of one of the combining entities obtains control of the combined entity.

Business combinations are to be accounted by applying the acquisition method. This entails:

(a) identifying the acquirer;

(b) determining the acquisition date, which is the date on which control is acquired over the acquiree;

(c) recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire, at their acquisition date fair values; and

(d) recognising and measuring goodwill or a gain from a bargain purchase.

Goodwill is to be measured as the excess of (a) over (b) below:

(a) The aggregate of:

 (i) the consideration transferred, measured in accordance with this Indian Accounting Standard, which generally requires acquisition-date fair value;

 (ii) the amount of any non-controlling interest in the acquiree measured in accordance with this Indian Accounting Standard; and

 (iii) in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

(b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Indian Accounting Standard.

In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the amount in (b) above, exceeds the aggregate of the amounts specified in (a) above. The excess needs to be re-validated by reviewing the various elements.

- If clear evidence exists, of the underlying reasons for classifying the business combination as a bargain purchase, then the acquirer has to recognise the excessin other comprehensive income on the acquisition date. This is to be accumulated in equity, as capital reserve. The gain is attributed to the acquirer.
- If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, the acquirer, after reassessment and review, has to recognise the excess directly in equity as capital reserve.

Self-Assessment Questions

❖ AS 14 deals with accounting for

 ➢ **Amalgamations**

 ➢ Acquisitions

 ➢ Both the above

 ➢ None of the above

- Which of the following conditions need to be met for an amalgamation in the nature of a merger
  - Assets and liabilities of transferor become assets and liabilities of transferee
  - Shareholders holding not less than 90% of the face value of the equity shares of the transferor company become share-holders of transferee company
  - Cash payment is restricted to fractional shares
  - **All the above**
- Pooling of interests is used in the case of
  - **Amalgamation in the nature of merger**
  - Amalgamation in the nature of purchase
  - Both the above
  - None of the above
- If the amalgamation is an 'amalgamation in the nature of merger', the identity of the reserves is preserved
  - **True**
  - False
- It is considered appropriate to amortise goodwill over a period not exceeding ________________ years unless a somewhat longer period can be justified.
  - 3
  - **5**
  - 7
  - 10
- AS 26 does not apply to
  - Financial assets
  - Mineral rights
  - Intangible assets arising in insurance enterprises from contracts with policy holders
  - **All the above**

Chapter 8: Taxation

8.1 Definitions

The following are relevant definitions from the Income Tax Act, 1961.

8.1.1 Amalgamation

"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 nine-tenths 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 the 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;

8.1.2 Demerger

"Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertakings to any resulting company in such a manner that –

(i) All the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;

(ii) All the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

(iii) The property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

(iv) The resulting company issues, in consideration of the demerger, 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, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) The transfer of the undertaking is on a going concern basis;

(vii) The demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf (covered in Para N).

Explanation 1 : For the purposes of this clause, "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.

Explanation 2 : For the purposes of this clause, the liabilities referred to in sub-clause (ii), shall 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 utilised solely for the activities or operations of the undertaking; and

(c) In cases, other than those referred to in clause (a) or clause (b), 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.

8.2 Capital Asset – Long Term or Short Term

When a capital asset is transferred, capital gains tax would be applicable. The taxation depends on whether the asset transferred is a short-term capital asset or a long term capital asset.

If the asset is held for more than 36 months, it would qualify as a long term capital asset. Else, it would be a short term capital asset.

Instead of 36 months, holding of over 12 months would qualify as long term capital asset for the following assets:

- Equity or preference shares in a company;
- Securities (debentures, government securities etc.) that are listed in a recognised stock exchange in India;
- Units of UTI;
- Units of mutual funds registered with SEBI;
- Zero coupon bonds.

8.3 Transactions not treated as a transfer

The following are not treated as a transfer for the purposes of capital gains tax:

- Distribution of assets in kind by a company to its share-holders on its liquidation
- Transfer of a capital asset by a company to its wholly-owned Indian subsidiary company
- Transfer of a capital asset by a wholly-owned subsidiary company to its Indian holding company
- Transfer of a capital asset in a scheme of amalgamation, by the amalgamating company to the amalgamated company, if the latter is an Indian company
- Transfer of shares in an Indian company, held by a foreign company, to another foreign company, in pursuance of a scheme of amalgamation between the two foreign companies, if at least 25% of the share-holders of the amalgamating foreign company continue to be share-holders of the amalgamated foreign company, and the transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated
- Any transfer in a scheme of amalgamation of a banking company with a banking institution
- Any transfer in a demerger of a capital asset by the demerged company to resulting company, if the latter is an Indian company
- Any transfer of shares held in an Indian company a demerged foreign company to the resulting foreign company, if the following conditions are satisfied:
    - o Shareholders holding at least three-fourths in value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and
    - o The transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated.
- Any transfer or issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company, if the transfer or issue is made in consideration of demerger of the undertaking

- Any transfer by a shareholder, in a scheme of amalgamation, of shares held by him in the amalgamating company, if the transfer is made in consideration of the allotment to him of any shares in the amalgamated company, if the amalgamated company is an Indian company, except where the shareholder itself is the amalgamated company

8.4 Capital Gains Tax

The calculations are detailed in Chapter 11 of Mutual Funds (Advanced) Module authored by Mr. Sundar Sankaran.

The gain on transfer of a short term capital asset is a short-term capital gain. It is added to the income of the assessee and taxed at the applicable rate.

The gain on transfer of a long term capital asset is a long-term capital gain. It is taxed as follows:

- The maximum tax that is payable on such gain is 10% plus surcharge plus education cesses.
- The investor can opt for indexation. In that case, sales realization minus indexed cost of acquisition becomes the base on which capital gains tax is to be levied. The applicable rate would be 20% plus surcharge plus education cesses.

The assessee pays long term capital gains tax at the lower of the two values calculated above.

The benefit of indexation is not available to the transferor in the case of the following long term capital assets:

- Bonds or debentures, other than capital indexed bonds issued by the Government
- Depreciable assets, other than an asset used by a power generating unit eligible for depreciation on straight line basis
- Undertaking / division transferred by way of slump sale
- Global Depository Receipts (GDR), Units or other securities purchased in foreign currency, in specified situations.

If the capital asset is equity shares in a company or units of equity-oriented mutual fund schemes, and if securities transaction tax is charged at the time of transfer, then the capital gains tax is as follows:

- Long term capital gains – Exempt
- Short term capital gains – 15% plus surcharge plus education cesses

On buyback of shares / securities by a company, the investor has to bear capital gains tax as in the case of normal sale of those shares / securities.

8.5 Securities Transaction Tax (STT)

It is applicable to equity and equity oriented mutual fund schemes as follows:

Delivery-based purchase of equity shares or units of equity oriented funds in a recognized stock exchange	0.10% of value of shares or units bought
Delivery-based sale of equity shares or units of equity oriented funds in a recognized stock exchange	0.10% of value of shares or units sold
Non-delivery-based sale of equity shares or units of equity oriented funds in a recognized stock exchange	0.025% of value of shares or units sold
Sale of Derivatives (Futures) in a recognized stock exchange	0.017% of trade value
Sale of Derivatives (Options) in a recognized stock exchange	0.017% of the sum of strike price and premium
If the option is exercised, the purchaser would need to pay	0.125% of value of shares bought

STT is also applicable on the sale of unlisted equity shares under an offer for sale to the public, including in an initial public offer, from July 1, 2012. It is to be collected by the lead merchant banker.

8.6 Block Deals

These are deals placed through a separate trading window in the exchange, for a minimum quantity of 5,00,000 shares or minimum value of Rs.5 crore. Transactions in the nature of large mergers and acquisitions are effected through this window.

Block deal transactions are permitted in the stock exchange only at a price which is 1% more or below the market price or previous day's closing price. Therefore, if the negotiated price in the case of a transaction is beyond the price limit, it cannot be executed as a block deal in the stock exchange.

The only option to execute the deal would be through an off-market transaction.

In off-market transactions, STT is not levied. Therefore, the benefit of concessional taxation in equity shares and equity mutual fund schemes, at nil rate for long term and 15% for short term will not be available for such trades. Such transactions will therefore be chargeable at 10% (without indexation) or 20% (with indexation) in the case of long term capital asset. Short term capital gains arising out of such off-market transactions will be added to the income of the assessee.

8.7 Slump Sale

A slump sale is the sale of an entire undertaking, without values being assigned to individual assets or liabilities. In a slump sale, the net worth of the undertaking is taken to be the cost of acquisition and improvement.

Net worth for the purpose of slump sale is the value of assets of the undertaking minus value of liabilities of the undertaking. The asset value will have to exclude the impact of any revaluation. In the case of depreciable assets, the asset value would be the written down value of the block of assets as per the income tax calculations.

Any profits or gains arising from a slump sale is chargeable to tax as long term capital gains of the previous year in which the transfer took place. However, if any capital asset being one or more undertakings owned or held by the assess for up to 36 months is transferred under the slump sale, then the capital gain would be deemed to be short-term capital gain.

8.8 Sale Consideration – Special Cases

In the case of transfer of land or building, if the sale consideration declared in the conveyance deed is lesser than the valuation as per the stamp duty stipulation of the state government, then the valuation as per stamp duty stipulation will be taken to be the sale consideration.

If the consideration received or accruing as a result of the transfer cannot be ascertained or determined, then the fair market value of the asset on the date of transfer will be taken to be the sale consideration.

8.9 Notional Cost – Special Cases

In the following cases, instead of actual cost, notional cost of acquisition is adopted:

- When an asset is transferred by a parent company to its 100% subsidiary (or vice versa), if the transferee company is an Indian company, then actual cost for the transferee company would be the same as it would have been for the transferor company, if it had continued to hold the asset for the purpose of its business.
- When an asset is transferred under a scheme of amalgamation to an Indian company, actual cost for the amalgamated company would be the same as it would have been for the amalgamating company, if it had continued to hold the asset for the purpose of its business.
- When an asset is transferred to an Indian company in case of a demerger, actual cost for the resulting company would be the same as it would have been for the demerged company, if it had continued to hold the asset for the purpose of its business.

8.10 Depreciation on Transferred Assets

While calculating taxable profits, depreciation charged in the books of accounts (which would have been in line with the provisions of the Companies Act, 1956) is added back to the book profits. Thereafter, depreciation allowed under the income tax act is subtracted, as part of the adjustments to determine taxable profit.

In the normal course, depreciation is charged at the applicable rates on the actual cost of the asset. However, in the cases mentioned in the previous paragraph, depreciation is charged on the notional cost of the asset.

8.11 Telecom License Transfer

Telecom license fees are allowed to be amortised over the license period, subject to conditions.

Where under a scheme of amalgamation / demerger, telecom license is transferred by the amalgamating / demerged company to the amalgamated / resulting company, amortisation will not be allowed for the amalgamating / demerged company. It will be available for the amalgamated / resulting company.

8.12 Preliminary Expenses

After amalgamation/demerger, benefit of amortisation of preliminary expensesis not allowed for the amalgamating/demerged company. It will be available for the amalgamated/resulting company.

8.13 Amalgamation / Demerger Expenses

If an Indian company incurs any expenditure towards amalgamation or demerger, it is allowed as a deduction in five successive years in five equal instalments.

8.14 Carry forward and Set off of Loss and Depreciation

Depreciation and business loss, in the normal course, can be carried forward only by the person who has incurred the loss. However, amalgamation and demerger transactions are among the exceptions to this principle.

8.14.1 Amalgamation

The accumulated loss and unabsorbed depreciation of the amalgamating company is deemed to be the loss or depreciation of the amalgamated company, for the previous year in which the amalgamation is effected, if the following conditions are fulfilled:

- There has been an amalgamation of
    - o A company owning an industrial undertaking or a ship or a hotel with another company; or

- o A banking company with a specified bank; or
- o A public sector airlines with another public sector airlines;

- The amalgamating company has been engaged in the business in which the accumulated loss occurred or depreciation remained unabsorbed, for at least three years;
- The amalgamating company has 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;
- The amalgamated company continues to hold at least three-fourths of the book value of fixed assets of the amalgamating company which it has acquired as a result of amalgamation for five years from the effective date of amalgamation;
- The amalgamated company continues the business of the amalgamating company for a period of at least five years; and
- The amalgamated company fulfils such other conditions as may be prescribed to ensure revival of the business of the amalgamating company, or to ensure that the amalgamation is for genuine business purpose.

If any of these conditions is not fulfilled, then that part of brought forward loss or unabsorbed depreciation that has been set off by the amalgamated company is to be treated as the income of the amalgamated company for the year in which the failure to fulfil the condition occurs.

'Specified bank' means the State Bank of India (SBI) or a subsidiary bank of SBI or a nationalised bank.

8.14.2 Demerger

The accumulated loss and unabsorbed depreciation of the demerged company is allowed to be carried forward and set off by the resulting company. The central government can set conditions to ensure that the demerger is for genuine business purposes.

If the loss/depreciation directly relates to the undertakings being demerged, then that loss/ depreciation can be carried forward in the hands of the resulting company.

If it cannot be so related to the undertakings being demerged, then it will be apportioned between the demerged company and the resulting company in the ratio of the assets retained by the demerged company and the assets transferred to the resulting company.

Self-Assessment Questions

- Which of the following are conditions that an amalgamation has to fulfil, as per the Income Tax Act?
  - Assets of amalgamating company become assets of amalgamated company
  - Liabilities of amalgamating company become liabilities of amalgamated company
  - Shareholders holding not less than nine-tenths in value of the shares in the amalgamating company or companies become shareholders of the amalgamated company
  - **All the above**
- To qualify as a long term capital asset, government securities listed in a recognised stock exchange need to be held for
  - **12 months**
  - 24 months
  - 36 months
  - 60 months
- Benefit of indexation is not available for-
  - Capital indexed bonds issued by the government
  - **Depreciable assets**
  - Both the above
  - None of the above
- If STT is paid, short term capital gains in equity shares is taxed at –
  - Marginal rate of taxation
  - Nil rate of taxation
  - **15%**
  - 10%
- When unlisted shares are sold through an offer for sale, STT is applicable
  - **True**
  - False
- Block deal transactions are permitted in the stock exchange only at a price which is _% more or below the market price or previous day's closing price.
  - **1**
  - 2
  - 3
  - 5