NCLT MERGER/ AMALGAMATION
Steps to think through and how to go about it?
A ‘Merger’ is a combination of two or more entities into one; this doesn’t include only the accumulation of assets and liabilities of the two or more entities, but organization of such entity into one business. Merger can occur in the following ways:

**Scenario 1:**

![Diagram of Scenario 1]

*In this scenario, the Company A would be merged with Company B and the Company A loses its legal existence and its shareholders become shareholders of the Company B.*

**Scenario 2:**

![Diagram of Scenario 2]

*In this scenario, the Company A and Company B would be merged and with new entity Company C. Therefore, the Company A and Company B will lose its legal existence and the assets, liabilities shall vest in Company C and its shareholders become shareholders of the Company C.*

The Companies Act 2013 (the Act) regulates the proposal relating to compromises, arrangements, reconstructions, mergers and amalgamations and powers to entertain these proposals are entrusted with the National Company Law Tribunal (the Tribunal). Under the Companies Act 1956 (the Erstwhile Act) the approval of jurisdictional High Court was necessary. The High Court had been highly burdened with loads of cases and there was a necessity to have a separate tribunal to deal with all corporate matters and thereby the Ministry of Corporate Affairs established the Tribunal and currently, all the proposals of corporate restructuring including mergers and closure of companies are empowered with the Tribunal.

Alternatively, the entities may choose to do restructuring without Tribunal route. It could be either Slump Sale or Asset transfer. However, the tax implication would be a concern. In case of slump sale or asset transfer tax benefits, carry forward of losses may not be available as compared to merger.
Before the process gets started, for the smooth completion of merger, the entities should ensure that: (i) the statutory records of the company are maintained appropriately; (ii) ensuring to comply with applicable laws (viz. Companies Act, Labour Laws and other sectoral regulations, basis the business of the company); (iii) No dues on statutory payments and all pending returns are filed; (iv) the valuation report in respect of shares, property and all assets, whether tangible or intangible, movable or immovable should be completed. Basis such valuation, the consideration for merger would be determined.

Merger Process

(i) Drafting of Scheme of Merger: The Scheme of Merger (the Scheme) plays a vital role throughout the merger process. Even the National Company Law Tribunal (the Tribunal) and other authorities rely upon the Scheme at the time of approving or at implementation stage. Therefore, the clauses in the Scheme shall become crucial while drafting. Few important clauses to be incorporated in the Scheme are: (i) the definition of Appointed Date and Effective Date (as explained below); (ii) Basis/ methodology of valuation; (iii) Disclosure of all material facts and implementation plan post-merger approval; (iv) Merger consideration, whether through issuance of equity shares or preference shares or both; (v) Transfer & vesting of Assets; (vi) Transfer of liabilities; (vii) Transfer of employees and ensuring their continuity.

(ii) Board of Directors Approval: The Board of Directors (the Board) of the transferor and transferee companies shall pass appropriate resolutions (a) approving the Scheme; (b) authorisation to make an application before the Tribunal; and (c) to appoint any Practising Professional (Chartered Accountant/Company Secretary/Advocate) to appear before the Tribunal.

(iii) Tribunal Consent on Meetings: Upon submission of application, the Tribunal shall fix the date of meetings of members and creditors. Accordingly, the transferor and transferee companies shall issue notices for the said meetings. It is pertinent to note that the date of each meeting should be proposed by both the companies while making an application to the Tribunal.

(iv) Notice of Meeting: Upon obtaining the consent from the Tribunal as mentioned above, the notice to be sent to (i) Jurisdictional Regional Director, the Income-Tax Authorities, the Reserve Bank of India (in case if the company has foreign direct investment), the Jurisdictional Registrar of Companies (the RoC), the Official Liquidator, the Service Tax Authorities and such other authorities which are likely to be affected by the Scheme.

In certain cases, where creditors are in huge, it may be complex to seek consent from 90% of total creditors, it is suggested reduce the list of creditors of the company. This would hasten the process of obtaining consents from the creditors.
(v) **Necessity of shareholders’ and creditors Meeting:** The shareholders and the creditors as the case may be of transferor and transferee company shall pass appropriate resolutions approving the Scheme. Voting at the meeting or meetings held in pursuance of the directions of the Tribunal on all resolutions shall take place by poll (*not by show of hands*).

(vi) **Dispensing the Creditors’ meeting requirement:** In case if the transferor company(ies) obtains the consent of more than 90% creditors in value to dispense the meeting requirement, then the Tribunal may exempt such company from convening creditors meeting.

(vii) **Filing of approved Scheme with the Tribunal:** The Company, shall present a petition to the Tribunal for sanction of the Scheme. On the basis of the application being made, the Tribunal shall fix the date of hearing and post hearing, the application will be approved and Tribunal shall issue Order approving the Scheme and such Order shall have to be filed with the jurisdictional RoC.

(viii) **Winding-Up without Dissolution:** Upon the order being passed and scheme becoming effective, the transferor company shall wound-up and it need not follow a separate lengthier process of dissolution/ winding up.

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**Post- Merger Implementation**

Though it is presumed that upon receiving the Order from the Tribunal, the merger is said to be completed, it is imperative to note that, post-merger implementation plays a vital role where the merged entity shall have to comply with the instructions provided by the Tribunal in its Order on implementation, manage culture clashes between the employees of two entities and the smooth integration of human resource is of utmost importance.

**Companies Act 2013**

**Issuance & Allotment of shares:** As per the approved Scheme, the transferee company shall allot the shares to the shareholders of the transferor company as per the agreed swap ratio determined on the basis of the valuation report. Additionally, such allotment to be reported to the Reserve Bank of India (in case if the company has foreign direct investment).

**Income Tax Act, 1961**

(i) Under the IT Act, capital gains tax may not be applicable by virtue of Section 47 of the Act. Section 47 (vi) clearly states that Section 45 (capital gains) shall not be applicable in the case of a transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company subject to the conditions as specified under section 47.

(ii) Accumulated losses and unabsorbed depreciation of transferor company may be carry forwarded to transferee company in case of amalgamation or demerger.
**Labour Laws**

(i) The services of all the employees of the transferor company should be transferred to the Transferee company on the terms and conditions not less beneficial to such employees than those subsisting with reference to the transferor company. The position, rank, and designation of the employees would be decided by the transferee company.

(ii) The services of such employees should not be treated as broken or interrupted for the purposes of bonus, provident fund, gratuity, superannuation or other statutory purposes and for all purposes will be reckoned from the date of their respective appointments with the respective transferor company, as the case maybe.

(iii) PF accounts of all the employees will have to be transferred.

**Accounting Treatments**

(i) The assets and liabilities of the transferor company would be completely transferred to the transferee company as on Appointed Date as provided in the Scheme.

(ii) The assets of the transferor company would be bought by the transferee company and the difference between the sale consideration and the difference between the assets and liabilities (including contingent liabilities) of the transferor company shall have to be accounted as goodwill or capital reserve into the books of the transferee company.

**Foreign Exchange Management Act**

In cases where, the transferee company’s business is under automatic route, then there is no requirement of obtaining prior approval of RBI. In such cases, the transferee company, upon allotting shares to the shareholders of transferor company pursuant to the Scheme, file the necessary forms as prescribed.

**Miscellaneous**

**Surrender/Amendment of all Registrations:** All registration pertaining to the transferor company to be surrendered to the applicable authorities. Pursuant to the Scheme, in case if name of the transferee company is amended, then the transferee company shall make a separate application to each authority for amending the existing registrations.
(a) **Appointed Date versus Effective Date:**

**Appointed Date:**

i. Date on which assets and liabilities of the transferor company vest in and stand transferred to the transferee company;

ii. Accounts on the appointed date form the basis for valuation of shares and determination of share exchange ratio;

iii. Appointed date is relevant for the purpose of assessment of income of the transferor and transferee companies;

**Effective Date:**

i. Date on which Scheme is complete & effective i.e. certified copy of the Tribunal order is filed with the RoC or last of the approvals is obtained

ii. From the effective date amalgamation becomes effective and transferor company stands dissolved.

(b) **Nature of Business Operations (after Appointed Date):** From the Appointed Date and till the Effective Date, there are no explicit restrictions or condition on the transferor company with respect to conducting business of the company. However, it is expected to carry the business in good faith and with prior mutual consultation of the transferee company. The transferor company should carry on their respective business activities with reasonable diligence, business prudence and should not take any business decisions without prior mutual consultation of the transferee company. Alternatively, it is suggested that the companies may consider executing a Memorandum of Understanding (the MoU) or even a shareholders’ agreement, which could be effective between Appointed Date and Effective Date. The MoU could contain the ways and means of taking decisions in ordinary course of business, list of transactions which would require the approval of the transferee, appointment and removal of key managerial personnel, banking transactions etc.

(c) **Status of the Company (after Appointed Date):** It would carry on its regular business as provided above, until the Effective Date. Post Effective Date, the transferor company shall be wound up without dissolution and it shall lose its legal existence.

(d) **Difference in Swap Ratio/Exchange Ratio:**

Swap ratio refers to the ratio in which the shareholders of the transferor company would get shares in the transferee company. This shall form part of the total consideration for a merger. Therefore, this would be considered key pointer for any merger/amalgamation. This being a commercial decision, there could be scenarios where each investor/shareholder may get less or more shares than their actual entitlement. This could be considered as difference in consideration for each shareholder or as a difference in swap ratio. Difference in swap ratio could be any of these scenarios: (i) Difference between Equity and Preference...
(ii) Difference between Equity Shareholders; (iii) Difference between Preference Shareholders; (iv) Difference between Founders/Promoters and other Shareholders (irrespective of nature of shares they hold).

Difference in such ratio or such allocation among the shareholders may be considered as detrimental to the interest of shareholders. There are no explicit restrictions under the Act or the IT Act and no precedents on having different swap ratios as mentioned above. However, having the different swap ratio between equity shareholders may draw the attention of the Tribunal and Income Tax Department (ITD) questioning on fairness of consideration. The authority may object considering that the different ratio between the equity holders would be unfair and unjust to the shareholders, in which case the rationale behind the commercial decision would have to be justified with reasoning before the Tribunal.

Further, it is also pertinent to note that, in past the Courts have ruled that if the swap ratio is as per the valuation report and if such ratio is accepted by the Board of Directors in their meeting and by the majority shareholders (more than 90% in value) (suggested to have 100% approval), then Court/Tribunal/Registrar of Companies/Regional Director/ITD may not object on swap ratio/exchange ratio.

(e) Payment of Stamp Duty: Previously, stamp duty was payable in a scheme of merger/demerger and/or amalgamation, on the Order of the High Court approving the scheme, if such payment was specified in the schedule to the respective State’s Stamp Act. After the introduction of the Act, the reference to the order of the High Court has been replaced with the Order of the Tribunal. Thus, if required under the Stamp Act of the States in which the companies forming part of this scheme is located, the stamp duty will have to be paid on the approval of the Tribunal. Further, in case if the companies to the merger are located in more than one state, then the stamp duty shall be payable in each of those states. The Bombay High Court order in the case of The Chief Controlling Revenue Authority and Anr. vs. M/s Reliance Industries Limited Mumbai and Anr. AIR 2016 Bom 108, ruled that when the companies involved in a scheme of merger are located in more than one state, then the approval of the Tribunal in both states is required, therefore the stamp duty also will have to be paid on both instruments, i.e. on both Tribunal orders.

(f) Challenges/Deal Breakers in case of Merger:

(i) The timelines will depend on any material compliance irregularities under the Foreign Exchange Management Act, 1999 (FEMA), the Companies Act, 2013, Income Tax Laws (including pending assessments). Further, if there are any objections to the proposed scheme of merger from any stakeholders (e.g. creditors, customers or employees) the Tribunal would insist in providing sufficient time to present their case. This would also consequently extend timelines.

(ii) The meetings of creditors are to be convened as per the directions of the Tribunal. However, in such case creditors written consents can be provided to the Tribunal along with an application seeking exemption from holding creditor meetings. Basis the application, the exemption may be granted. However, in case where there are a large number of creditors, timeline get extended in obtaining creditor consents. Further, some creditors could also use this opportunity to try and force a settlement in respect of any outstanding payment disputes or even approach the Tribunal to file objections. It is advisable to have no objection from all the creditors prior to making an application to the Tribunal.
(iii) The transferor and transferee companies will have to ensure that employees being transferred are provided no lesser benefits than what they enjoy prior to the Merger (including continuity of service). The employees have an opportunity to file objections before the Tribunal against the proposed scheme.

(iv) **Post-merger transitioning** will need to be managed. This will include transfer or assignment of contracts (including lease), transferor of employees, notifying banks, amending or obtaining registrations etc.

(v) **Minority Shareholders’ Interests:** Keeping interests of minority shareholders would become crucial in any merger. Therefore, the Scheme should not be prejudicial to the interests of the minority shareholders and if the Tribunal believes that the Scheme is prejudicial to the interests of the minority shareholders, this may be rejected. The Courts/Tribunal at their discretion may seek the opinion from the practicing professionals on the fairness of the Scheme. Therefore, it is always suggested to obtain the written consent from all the shareholders on the merger Scheme and while making an application these consents could be enclosed to the application to be made before the Tribunal.

(vi) **Authority to Amalgamate/Merger:** The Memorandum of Association (the MoA) of the company must provide for the power to amalgamate the company with the other company. However, there are 2 views expressed by the Courts in this regard. It was held that the powers for amalgamation is an inherent power for the company and is not an object to be specified particularly. Thus, any company can go for amalgamation even if there are no specific clauses in the MoA. However, it is pertinent to note that if the MoA specifically prohibits the company from any amalgamation or merger the company cannot proceed with the same unless the same is amended to provide such right. Contradictory to this, the Courts have also held that if the object clause does not specify for amalgamating power, the act of going for compromise or arrangement becomes ultra vires and it cannot be carried on through a Scheme. Therefore, the authority always insists on expressed clause for amalgamation in the object clause in its MoA.

**Conclusion**

Considering the nuances associated with Mergers and its strategies, it becomes imperative to be vigilant as there is little scope for trial and error and most importantly, errors are difficult to be reversed. The risks associated are not merely financial ones. A failed merger can disrupt work processes, weaken stakeholders’ confidence and can have a significant influence on the brand. Post-merger integration, or the lack of thereof, is one of the main reasons behind these failures. There are various reasons why deals are unsuccessful in creating value post-merger.
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