PwC International Business Reorganisations Network – Monthly Legal Update

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Welcome

Welcome to the eighth edition of the PwC International Business Reorganisations (**IBR**) Network Monthly Legal Update for 2018.

The PwC IBR Network provides legal services to assist multinational organisations with their cross-border reorganisations. We focus on post-deal integration, pre-transaction separation and carve outs, single entity projects, and legal entity rationalisation and simplification as well as general business and corporate and commercial structuring.

Each month our global legal network brings you insights and updates on key legal issues multinational organisations.

We hope that you will find this publication helpful, and we look forward to hearing from you.

In this issue

In our August 2018 issue:

- PricewaterhouseCoopers Private Limited (India) provides an overview of the framework for cross-border mergers under Indian law; and
- PricewaterhouseCoopers Belastingadviseurs N.V. (Netherlands) reports on the Polbud case and its implications for cross-border conversions within the European Economic Area.

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PricewaterhouseCoopers Private Limited (India) – Cross-Border Mergers in India: A Paradigm Shift

At a glance

The Government of India has recently announced the regulatory framework in relation to cross-border mergers. Before this, Indian companies were not allowed to enter outbound mergers. Although, there was no specific bar on inbound mergers, however, in practice, implementation of inbound merger was a challenge due to the lack of a formal regulatory framework. Consequently, domestic companies were not able to enter inbound mergers frequently.

This paper provides a brief overview of the Government's enabling framework for cross-border mergers under its Indian Companies Act and Indian Exchange Control Regulations. In addition to this, a cross-border merger also needs to be analysed from the standpoint of tax, stamp duty and the licensing framework.

In detail

1. Overview

In 2017, the Ministry of Corporate Affairs (**MCA**) introduced enabling framework for inbound and outbound cross-border mergers under the Indian Companies Act.

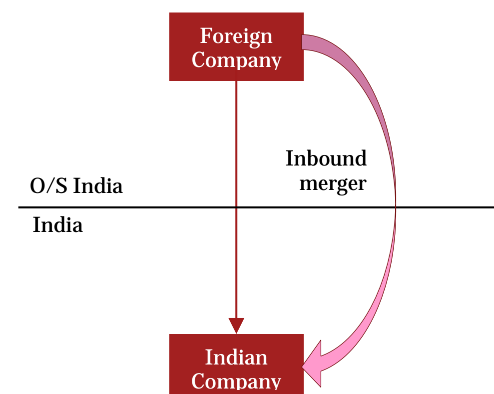
a Inbound mergers

A Foreign company[1], incorporated in any jurisdiction outside India, may merge with a company incorporated in India, subject to the approval of the National Company Law Tribunal in India (**NCLT**).

The NCLT is a quasi-judicial body established in India under the Indian Companies Act, which adjudicates issues faced by companies. The process of mergers typically takes around five to six months. Some key procedural requirements for merger include:

a obtaining the approval of the shareholders, the creditors and the NCLT; and

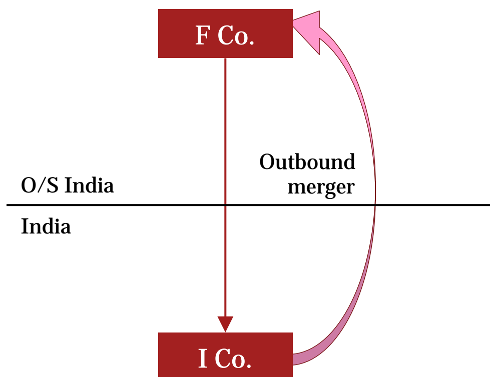
b filing of intimation to various statutory authorities, including the Income-tax Department, the Reserve Bank of India (**RBI**), the Securities and Exchange Board of India (**SEBI**) and sector-wise regulators.



[1] 'Foreign company' means any company or body corporate incorporated outside India, whether it has a place of business in India or not.

b Outbound mergers

A company, which is incorporated in India, can merge with a foreign company incorporated in certain specified jurisdictions, subject to the approval of the NCLT. These jurisdictions include Mauritius, the Netherlands, Singapore, the Cayman Islands, Abu Dhabi, DIFC (Dubai), the UAE, the United Kingdom and the United States.



2. RBI Guidelines

In both the situations illustrated above, there are important consideration from Indian Exchange Control Regulations perspective.

In this regard, the RBI notified following guidelines in 2018:

a Inbound mergers

a Issue of shares/securities by the resultant company2 in India, need to comply with India's Foreign Investment Policy.

b If the following assets and/or liabilities of a foreign company moves to the direct ownership of the resultant Indian company, it needs to comply with the prescribed Indian exchange control regulations relating to:

  i maintaining office or offices outside India;

  ii cross-border guarantees or borrowings;

  ii holding/disposing tangible or intangible assets;

  iii if an asset or security is not permissible to be held outside India, it will need to be disposed of within two years; and

  iv a bank account for merger transactions can be opened outside India for a period of up to two years to consummate the merger transaction.

b Outbound mergers

a Any person, who is resident in India, is allowed to acquire or hold shares/securities of the resultant company outside India only, in accordance with applicable Indian exchange control regulations.

b Indian company needs to comply with applicable Indian Exchange Control regulations if its following assets or liabilities move to the ownership of a foreign company:

  i maintaining office or offices outside India;

  ii cross-border guarantees or borrowings; and

  ii holding/disposing tangible or intangible assets.

  However, if a foreign company is not permitted to hold such assets or liabilities, these need to be disposed of or paid within the prescribed timeframe of upto two years.

c Special Non-Resident Rupee Account can be opened by a foreign company, in accordance with applicable Indian Exchange Control regulations, for a maximum period of up to two years, to consummate the merger transactions.

[2] ' A 'resultant company' is an Indian or foreign company that takes over the assets and liabilities of the companies involved in a cross-border merger.

Prior approval is required from the RBI if any of the conditions given above are not met. Approval depends on the facts of a case on a case-to-case basis.

3. Other considerations

Additional approval-related requirement: Prior approval from the sectoral regulator/ licensing authority(ies) or additional compliances may be required in India for certain regulated sectors such as Telecom, Broadcasting, Financial Services etc.

Cross-border demergers: While it was possible for a foreign company to transfer its undertaking or business to an Indian company under erstwhile corporate laws, the new provisions only refer to "mergers and amalgamations" without explicitly mentioning demergers. Consequently, there is lack of clarity on the possibility of a foreign company demerging its business undertaking with an Indian company, or vice versa.

Stamp duty: Both inbound and outbound mergers are subject to stamp duty related implications in India. Stamp duty rates depend on various factors such as the state in which the registered office of the Indian company is situated, the nature of assets (fixed assets or current assets) and the location of its fixed assets.

Taxation-related issues faced in outbound mergers: The tax-neutral treatment accorded by the Indian Income Tax Act (**IT Act**) is limited to capital gains arising for inbound mergers. And since the current Tax regime does not extend this benefit to outbound mergers, taxpayers opting for such mergers may not be able to enjoy tax-neutral treatment. Therefore, in order to avail tax-neutral treatment, it is advisable that they ensure that their inbound mergers are compliant with the conditions of the IT Act. It is also important to fully understand the tax-related impact on companies and their shareholders in the case of outbound mergers.

4. How we can help

We can provide end to end support to our clients in such cross-border merger process, including:

a conceptualisation of structure;

b setting-out road map/ step plan for implementation;

c help in NCLT approval process;

d help in post-merger filings and other licensing compliances; and

e help in obtaining RBI approval / clarification in case of any deviations

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PricewaterhouseCoopers Belastingadviseurs N.V. (Netherlands) – European Court of Justice 25 October 2017, case C-106/16 (Polbud)

At a glance

On 25 October 2017, the European Court of Justice issued its judgement in the Polbud case, which centred on the transfer of the registered office of Polbud – Wykonawstwo sp.z o.o. to Luxembourg and its continued existence as a company incorporated under Luxembourg law.

The most important aspect of this judgment is that the European Court of Justice leaves no doubt that companies are not required to conduct any economic activities in the host member state in order to be able to cross-border convert within the European Economic Area unless the laws of such host state explicitly require this to qualify as a domestic legal entity.

In detail

1. Polbud case

The general meeting of shareholders of Polbud – Wykonawstwo sp.z o.o. (**Polbud**), a company with limited liability established in Poland, decided by a resolution of 30 September 2011 to transfer the registered office of the company to Luxembourg.

On 28 May 2013, the general counsel of Consoil Geotechnik Sàrl, whose registered office is in Luxembourg, adopted a resolution, which implemented the resolution of 30 September 2011 and transferred the registered office of Polbud to Luxembourg in order to apply Luxembourg law to it without the loss of its legal personality. Consequently, Polbud's registered office transferred to Luxembourg and its name became 'Consoil Geotechnik'.

On 24 June 2013, Polbud lodged an application at the registry court in Poland for deregistration from the Polish commercial register. The registry requested Polbud to provide several documents related to liquidation of the company, which Polbud refused since it was not in the process of being wound up.

After several legal procedures, the Supreme Court of Poland referred the following questions to the European Court of Justice (**European Court**):

a Do Articles 49 and 54 of the Treaty on the Functioning of the European Union (**TFEU**) preclude the application, by the member state in which a company was initially incorporated, of provisions of national law which makes removal from the trade register conditional on that company being wound up after liquidation has been carried out, if that company has been reincorporated in another member state pursuant to a shareholders' decision to continue the legal personality acquired in the state of initial incorporation?

If the answer to that question is negative:

b Can Articles 49 and 54 TFEU be interpreted as meaning that the requirement under national law that a process of liquidation of a company be carried out, which precedes the winding up of the company by removal from the commercial register, is a measure which is appropriate, necessary and proportionate to a public interest deserving of protection that consists in the safe guarding of the interests of creditors, shareholders and employees of the migrant company?

c Should Article 49 and Article 54 TFEU be interpreted as meaning that restrictions on freedom of establishment cover a situation in which – for the purpose of its conversion to a company of another member state – a company transfers its registered office to that of another member state without changing its main head office, which remains in the state of initial incorporation?

2. The judgment of the European Court

2.1 The third question

The European Court starts by answering the third question raised by the Supreme Court of Poland.

According to the European Court, a company must satisfy the conditions on conversion provided by the legislation of that the host member state in order for a company to convert itself into the laws of that host member state. Particularly important is the test adopted by the latter state to determine the connection of a company to its national order (ECJ judgment of 27 September 1988, *Daily Mail and General Trust*, 81/87, EU:C:1988:456, paragraphs 19 – 21).

With respect to freedom of establishment the European Court indicates that this does not only extend to a situation in which a company formed in accordance with the legislation of a member state where it has its registered office wants to set up a branch in another member state in which branch its main or entire business is to be conducted (ECJ judgment of 9 March 1999, *Centros*, C-212/97, EU:C:1999:126, paragraph 17). Freedom of establishment also extends to a situation in which a company formed in accordance with the legislation of a member state wants to convert itself into a company under the laws of another member state, even though that company conducts is main or entire business in the first member state.

With regard to the test to determine the connection of a company to its national order, the European Court makes clear that based on the current EU law, each member state has the power to define such connecting factor required for a company to be regarded as incorporated in accordance with its national legislation. The event that a company governed by the laws of a member state converts itself into a company under the laws of another member state cannot provide justification for the first member state preventing or deterring the company concerned from undertaking a cross-border conversion by means of imposing conditions that are more restrictive than those that apply to the conversion of a company within that member state itself (ECJ judgments of 27 September 1988*, Daily Mail and General Trust*, 81/87, EU:C:1988:456, paragraphs 19 – 21; of 16 December 2008, Cartesio, C-210/06, EU:C:2008:723, paragraphs 109 – 112; and of 12 July 2012, VALE, C-378/10, EU:C:2012:440, paragraph 32).

In light of the foregoing, the European Court rules that the freedom of establishment laid down in articles 49 and 54 TFEU is applicable to the transfer of the registered office of a company formed in accordance with the laws of a member state to the territory of another member state for purposes of its conversion into a company governed by the laws of another member state, even when there is no change in the location of the real head office of that company.

2.2 The first and second question

Whether there is a restriction of freedom of establishment

Although Polish law in principle allows a company to transfer its registered office to a member state other than the Republic of Poland without the loss of its legal personality, a company incorporated under Polish law that wishes to implement such transfer is only able to de-register from the Polish commercial register if it has been liquidated.

According to the European Court, national legislation impedes, if not prevents, the cross-border conversion of a company if it requires the liquidation of a company in the aforementioned circumstances and therefore constitutes a restriction on freedom of establishment (ECJ judgment of 16 December 2008, *Cartesio*, C-210/06, EU:C:2008:723, paragraphs 112 and 113).

Whether the restriction on freedom of establishment is justified

A restriction on freedom of establishment is only permissible (i) if it is justified by overriding reasons in the public interest, and (ii) if it is appropriate for ensuring the achievement of the objective in question and not go beyond what is necessary to achieve that objective (ECJ judgment of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraph 42).

The Supreme Court of Poland considers that the restrictions on freedom is justified in the Polbud case by the objective of protecting the interest of creditors, minority shareholders and employees of the transferred company.

The European Court recalls that overriding reasons in the public interest include the protection of interests of creditors, minority shareholders and workers (ECJ judgments of 13 December 2005, *SEVIC Systems*, C-411/03, EU:C:2005:762, paragraph 28 and of 21 December 2016, AGET *Iraklis*, C-201/15, EU:C:2016:972 paragraph 73). However, the European Court judges that mandatory liquidation goes beyond what is necessary to achieve the objective of protecting the interests of creditors, minority shareholders and employees.

Another justification for the restriction of freedom by requiring mandatory liquidation, argued by the Polish government, is the objective of preventing abusive practices. According to the European Court, the fact that either the registered office or real head office of a company was established in accordance with the legislation of a member state for the purpose of enjoying the benefit of a more favourable legislation does not, in itself, constitute abuse. Moreover, the mere fact that a company transfers its registered office from one member state to another cannot be the basis for the general presumption of fraud and cannot justify a restriction on the freedom of establishment. As the general obligation to liquidate a company amounts to a general presumption of the existence of abuse, such general obligation is disproportionate. Consequently, the European Court holds that articles 49 and 54 TFEU preclude legislation of a member state which provides that conversion of a company incorporated under the laws of a member state into a company incorporated under the laws of another member state requires implementation of a liquidation procedure.

3. Consequences

This judgement of the European Court clarifies that freedom of establishment in the sense of articles 49 and 54 TFEU is applicable to the cross-border transfer of the registered office of a company within the European Economic Area, for the purpose of a cross-border conversion, in accordance with the conditions imposed by the legislation of the recipient member state. Even in the situation where there is no change in the location of the real head office.

Additionally, the European Court makes clear that national legislation which negatively impacts the cross-border conversion of a company by requiring the implementation of a liquidation procedure in order to complete the cross-border conversion goes beyond the objective of protecting the rights of creditors, minority shareholders and employees and is disproportionate as a measure to prevent or to penalise fraud.

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