India Bound M&A: A Checklist of Key Issues for General Counsel in Acquisitions Involving Indian Entities

Skills and Professional Development

Corporate, Securities, and Governance

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Key highlights:

- Companies planning an acquisition involving an Indian entity must consider several important India-specific aspects.
- Deal planning and implementation may be impacted by aspects such as India's foreign direct investment, anti-trust and tax regimes, and operational considerations.

India continues to be an increasingly attractive destination for foreign companies seeking to invest or to use India's large and diverse talent pool. In this context, general counsel of multinational corporations and groups based outside of India should consider certain issues when acquiring or investing in an Indian entity whether directly or as part of a global restructuring transaction or acquisition.

1. Indian exchange control considerations

Sectoral restrictions, capital instruments, and pricing guideline

India's foreign exchange regime (FDI Regime) allows foreign investment under automatic route (i.e., without government approval) in most of the sectors, except sensitive sectors such as defence, unregulated financial services, and other sectors.

The FDI Regime allows investments into ordinary shares and instruments that are mandatorily convertible into ordinary shares.

India's FDI regime allows foreign investment under automatic route in most sectors. Artwork by sdx15 / *Shutterstock.com*

Further, the broad underlying pricing principle for foreign investors (as opposed to an Indian resident) is to pay at least fair market value at the time of investment and not receive more than fair market value at the time of exit. However, transfer between two non-residents is outside the ambit of the pricing guidelines.

The FDI regime does not allow guaranteed returns — hence, structuring downside protection requires efforts.

Restricted investors

Under the FDI Regime, prior approval of the Indian Government is required in case of transactions where the acquirer or any direct or indirect beneficial shareholder of the acquirer is a person who is a resident or a citizen of a country which shares a land border with India (**Restricted Persons**). This restriction also applies to indirect restructurings in which any beneficial ownership is acquired by Restricted Persons.

Deferment of price payment

For secondary sale transactions between (Indian) residents and non-residents, only 25 percent of the amount of the total consideration can be deferred up to a maximum of 18 months from the date of the agreement. A similar cap and time restriction also applies to any indemnity payments under the acquisition agreements — however, in practice, acquisition agreements provide for a longer time as well as a higher cap for indemnity. Hence, at times, these considerations are structured based on commercial preferences and practical viability in the form of a parent guarantee, put options, offshore guarantees, a pledge, call options, an upfront price adjustment, or a stub purchase at a higher price in case of no claim.

Optionality

While put option clauses (granting a right to sell the stock at a future date) and call option clauses (granting a right to buy the stock at a future date) are allowed, there cannot be any guaranteed returns. The pricing at the time of exit needs to be in accordance with the pricing guidelines prescribed under the FDI Regime. Additionally, a minimum lock-in period (i.e., no transfer is permitted within a specific period from the date of acquisition) of one year or as prescribed for the specific sector also applies to instruments with an optionality clause.

Retention structure

In India, earn-out structures are common — shares are acquired upfront, and a portion of the consideration is withheld and is to be paid subject to achievement of pre-defined milestones. Alternatively, this is also implemented by way of a salary or bonus payout incentive structure, or by an acquisition in tranches. The most appropriate structure can be evaluated taking into account tax considerations as well as pricing restrictions set out under the FDI Regime.

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Swaps

While the FDI Regime allows primary share swap transactions subject to compliance with prescribed conditions, pure secondary share swap transactions are not permitted.

2. Anti-trust considerations

India’s anti-trust framework requires prior approval in case of mergers, amalgamations, and acquisitions of shares or voting rights, assets, or control. While the trigger for prior approval is linked to the amount of assets or turnover of the target group, there are *de minimis* threshold-related exemptions.

However, the Competition (Amendment) Act, 2023 seeks to introduce the “value of transaction” test which will lead to requiring prior approval from the regulatory authority if the deal value exceeds INR 2000 crores (approximately US$250,000,000). This was not the case earlier and hence would now need to be factored in going forward while considering deals involving Indian entities.

In India, there are no approval requirements like those recently introduced in the European Union that mandate approval based on the nature of the business of the target (such as for IT security or infrastructure), irrespective of its size.

3. High-level tax considerations

Indirect acquisitions

In indirect acquisitions where majority of the operations of the target are in India (i.e., through an Indian entity), the valuation of the India business becomes critical. If such value is 50 percent or more of the target group’s value (along with certain financial thresholds), the gains on the transaction would be taxable in India and the acquirer would be required to withhold taxes. Depending on the outcome of the tax analysis and whether the “substantial value” test is fulfilled, acquirers typically seek to include certain protections in the acquisition document, such as indemnity protections requiring the seller to indemnify the acquirer against such tax-related payments and risk, and procedural requirements such as obtaining tax registrations in India, making tax filings in India, and providing valuation reports.

Direct acquisitions

If a non-resident purchases shares of an Indian company directly from another non-resident, Indian withholding tax will typically apply. The rate of withholding tax will be based on the capital gains tax rate payable by the seller, which depends on how long they held the shares. The seller typically provides a capital gains tax computation from an accountant.

If a non-resident purchases shares of an Indian company directly from another non-resident, Indian withholding tax will typically apply. Artwork by Ground Picture / *Shutterstock.com*

When purchasing shares of an Indian company from a resident, it is important to determine whether tax needs to be deducted at source. There are exemptions to this requirement, such as the consideration being below the threshold, or the acquirer not having a “Permanent Establishment” in India.

Several procedural requirements need to be complied with in this regard. For example, the seller and acquirer need to have a permanent account number (PAN), which is issued by Indian tax authorities to comply with various withholding and filing obligations. Obtaining a PAN typically takes two to three weeks and should be considered, especially in case of simultaneous sign and close deals, as the obligation to comply with various withholding and filing requirements within the prescribed time will kick in immediately upon closing of the transaction.

Transfer pricing

When acquiring group entities, it's important to ascertain the existing compliance with transfer pricing provisions, which require transactions between related parties to be conducted at arms' length prices and require compliance with certain other requirements. For large global mergers, transfer pricing implementation is typically a key aspect.

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No tax dues

Under India's income tax laws, transfer of specified assets (including shares of an Indian company) can be void if the seller has outstanding tax liabilities, unless a clearance (a No Objection Certificate or **NOC**) is obtained from tax authorities. However, obtaining a NOC can be a lengthy process and may not be commercially feasible. To address this, parties typically settle with contractual representations and warranties (with indemnity) and a certificate from a big four accounting firm confirming that there are no outstanding tax demands.

4. Key operational considerations

Requirements regarding directors and shareholders

In majority or 100 percent acquisitions involving Indian companies, certain day-to-day governance aspects need to be considered from an Indian perspective: the replacement of nominee shareholders (i.e., shareholders holding shares on behalf of another person, since Indian law requires a minimum number of shareholders for private and public companies) and the filing of certain forms (such as MGT-4 and MGT-5); the replacement of directors (where, at least, one director is to be a resident Indian director); and the update of statutory registers for changes in shareholders or directors and filing of beneficial ownership forms. It is also mandatory for directors to have an (Indian) Director Identification Number as well as a Digital Signature Certificate prior to appointment. Additionally, if the proposed director is a Restricted Person, prior security clearance for appointment is also required. While being procedural in nature, these items become relevant from a deal timeline perspective.

Mode of execution

While global practices have evolved to allow execution of documents through electronic signature platforms, the (Indian) Information Technology Act, 2000 allows only certified electronic signatures in the prescribed form for authentication of electronic records. Agreements executed using other electronic signature methods may thus be challenged on grounds of validity. Also, material contracts or transaction documents require pre-stamping in India, which should be taken into account when planning deal costs and timeline.

SBO

Akin to the "Ultimate Beneficial Owner" filings in United States, the (Indian) Companies Act, 2013 ("**CA 2013"**) requires disclosing "significant beneficial owners" (**SBOs**) of a company. Under CA 2013, the onus is both on the SBO and the company: (i) the relevant SBO must submit a declaration — SBOs include any person who, directly or through multiple layers, ultimately holds more than 10 percent of the company's shares, voting rights or distributable dividend or exercises "significant influence" or "control"; and (ii) the company must identify the SBOs. At the time of due diligence, it is critical to assess compliance with the existing reporting obligations of the target in this regard. Upon consummation of the transaction, it should also be analyzed whether the acquirer is required to make any SBO filings.

The aspects described above may impact the feasibility, structure, timeline, and implementation of the transaction. It is thus important to examine these considerations at a macro level while analyzing the investment to avoid last-minute roadblocks.

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