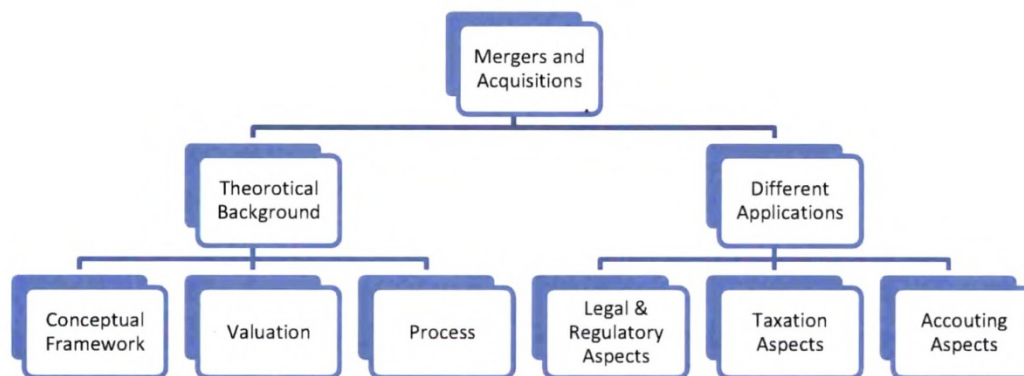


Mergers and acquisitions – Fundamental Conceptualization and Different Applications

The recent years witnessed a slew of acquisitions across diverse sectors of the economy in India. Unlike in the past, such activity was not limited to acquisitions within India or of Indian companies. Of all sectors, steel was the most dominant in terms of stake sales as deals valuing \$ 3.862 billion took place in Q1 of 2007-08 by the Indian companies in the global arena. Energy ranked second, with automotive and auto components close on its heels.²⁹ In the domestic segment, iron ore, aviation and steel were the most prolific in terms of mergers and acquisitions. The overall layout of the chapter can be presented as follows.

Figure 7: Chapter Layout



With Indian corporate houses showing sustained growth over the last decade, many have shown an interest in growing globally by choosing to acquire or merge with other companies outside India. One such example would be the acquisition of Britain's Corus by Tata an Indian conglomerate by way of a leveraged buy-out. The Tata also acquired Jaguar and Land Rover in a significant cross border transaction. Whereas both transactions involved the acquisition of assets in a foreign jurisdiction, both transactions were also governed by Indian domestic law.

Whether a merger or an acquisition is that of an Indian entity or it is an Indian entity acquiring a foreign entity, such a transaction would be governed by Indian domestic law. In the sections which follow, we touch up on different laws with a view to educate the reader of the broader areas of law which would be of significance. Mergers and acquisitions are methods by which distinct businesses may combine. Joint ventures are another way for two businesses to work together to achieve growth as partners in progress, though a joint venture is more of a contractual arrangement between two or more businesses.

2.1 Conceptual Framework

2.1.1 Mergers and Amalgamations

The term 'merger' is not defined under the Companies Act, 1956 (the '**Companies Act**'), the Income Tax Act, 1961 (the '**ITA**') or any other Indian law. Simply put, a merger is a combination of two or more distinct entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but to achieve several other benefits such as, economies of scale, acquisition of cutting edge technologies, obtaining access into sectors / markets with established players etc. Generally, in a merger, the merging entities would cease to be in existence and would merge into a single surviving entity.

Very often, the two expressions "merger" and "amalgamation" are used synonymously. But there is, in fact, a difference. Merger generally refers to a circumstance in which the assets and liabilities of a company (merging company) are vested in another company (the merged company). The merging entity loses its identity and its shareholders become shareholders of the merged company. On the other hand, an amalgamation is an arrangement, whereby the assets

and liabilities of two or more companies (amalgamating companies) become vested in another company (the amalgamated company). The amalgamating companies all lose their identity and emerge as the amalgamated company; though in certain transaction structures the amalgamated company may or may not be one of the original companies. The shareholders of the amalgamating companies become shareholders of the amalgamated company.

While the Companies Act does not define a merger or amalgamation, Sections 390 to 394 of the Companies Act deal with the analogous concept of schemes of arrangement or compromise between a company, its shareholders and/or its creditors. A merger of a company 'A' with another company 'B' would involve two schemes of arrangements - one between A and its shareholders and the other between B and its shareholders.

The ITA defines the analogous term 'amalgamation' as the merger of one or more companies with another company, or the merger of two or more companies to form one company. The ITA goes on to specify certain other conditions that must be satisfied for the merger to be an 'amalgamation'. Mergers may be of several types, depending on the requirements of the merging entities:

Horizontal Mergers. Also referred to as a 'horizontal integration', a kind of merger that takes place between entities engaged in competing businesses which are at the same stage of the industrial process.³⁰ A horizontal merger takes the company a step closer towards monopoly by eliminating a competitor and establishing a stronger presence in the market. Thus, the other benefits of this form of merger are the advantages of economies of scale and economies of scope.

Vertical Mergers. Vertical mergers refer to the combination of two entities at different stages of the industrial or production process. For example, the merger of a company engaged in the construction business with a company engaged in production of brick or steel would lead to vertical integration. Companies stand to gain on account of lower transaction costs and synchronization of demand and supply. Moreover, vertical integration helps a company move

towards greater independence and self-sufficiency. The downside of a vertical merger involves large investments in technology in order to compete effectively.

Congeneric Mergers These are mergers between entities engaged in the same general industry and somewhat interrelated, but having no common customer-supplier relationship. A company uses this type of merger in order to use the resulting ability to use the same sales and distribution channels to reach the customers of both businesses.³¹

Conglomerate Mergers. A conglomerate merger is a merger between two entities in unrelated industries. The principal reason for a conglomerate merger is utilization of financial resources, enlargement of debt capacity, and increase in the value of outstanding shares by increased leverage and earnings per share, and by lowering the average cost of capital.³² A merger with a diverse business also helps the company to foray into varied businesses without having to incur large start-up costs normally associated with a new business.

Cash Merger. In a typical merger, the merged entity combines the assets of the two companies and grants the shareholders of each original company shares in the new company based on the relative valuations of the two original companies. However, in the case of a 'cash merger', also known as a 'cash-out merger', the shareholders of one entity receive cash in place of shares in the merged entity. This is a common practice in cases where the shareholders of one of the merging entities do not want to be a part of the merged entity.

Triangular Merger. A triangular merger is often resorted to for regulatory and tax reasons. As the name suggests, it is a tripartite arrangement in which the target merges with a subsidiary of the acquirer. Depending on which entity is the survivor after such merger, a triangular merger may be forward (when the target merges into the subsidiary and the subsidiary survives), or reverse (when the subsidiary merges into the target and the target survives).

2.1.2 Acquisitions

An acquisition or takeover is the purchase by one company of controlling interest in the share capital, or all or substantially all of the assets and/or liabilities, of another company. A takeover may be friendly or hostile, depending on the offer or company's approach, and may be effected through agreements between the offer or and the majority shareholders, purchase of shares from the open market, or by making an offer for acquisition of the offeree's shares to the entire body of shareholders.

Friendly takeover. Also commonly referred to as 'negotiated takeover', a friendly takeover involves an acquisition of the target company through negotiations between the existing promoters and prospective investors. This kind of takeover is resorted to further some common objectives of both the parties.

Hostile Takeover. A hostile takeover can happen by way of any of the following actions: if the board rejects the offer, but the bidder continues to pursue it or the bidder makes the offer without informing the board beforehand.

Leveraged Buyouts. These are a form of takeovers where the acquisition is funded by borrowed money. Often the assets of the target company are used as collateral for the loan. This is a common structure when acquirers wish to make large acquisitions without having to commit too much capital, and hope to make the acquired business service the debt so raised.

Bailout Takeovers. Another form of takeover is a 'bail out takeover' in which a profit making company acquires a sick company. This kind of takeover is usually pursuant to a scheme of reconstruction/rehabilitation with the approval of lender banks/financial institutions. One of the primary motives for a profit making company to acquire a sick/loss making company would be to set off of the losses of the sick company against the profits of the acquirer, thereby reducing the tax payable by the acquirer. This would be true in the case of a merger between such companies as well.

Acquisitions may be by way of acquisition of shares of the target, or acquisition of assets and liabilities of the target. In the latter case it is usual for the business of the target to be acquired by the acquirer on a going concern basis, i.e. without attributing specific values to each asset / liability, but by arriving at a valuation for the business as a whole (in the context of the ITA, such an acquisition is referred to as a 'slump sale'. An acquirer may also acquire a target by other contractual means without the acquisition of shares, such as agreements providing the acquirer with voting rights or board rights. It is also possible for an acquirer to acquire a greater degree of control in the target than what would be associated with the acquirer's stake in the target, e.g., the acquirer may hold 26% of the shares of the target but may enjoy disproportionate voting rights, management rights or veto rights in the target.

2.1.3 Joint Ventures

A joint venture is the coming together of two or more businesses for a specific purpose, which may or may not be for a limited duration. The purpose of the joint venture may be for the entry of the joint venture parties into a new business, or the entry into a new market, which requires the specific skills, expertise, or the investment of each of the joint venture parties. The execution of a joint venture agreement setting out the rights and obligations of each of the parties is usually a norm for most joint ventures. The joint venture parties may also incorporate a new company which will engage in the proposed business. In such a case, the byelaws of the joint venture company would incorporate the agreement between the joint venture parties.

2.1.4 Demergers

A demerger is the opposite of a merger, involving the splitting up of one entity into two or more entities. An entity which has more than one business, may decide to 'hive off' or 'spin off' one of its businesses into a new entity. The shareholders of the original entity would generally receive shares of the new entity. If one of the businesses of a company is financially sick and the other business is financially sound, the sick business may be demerged from the company. This facilitates the restructuring or sale of the sick business, without affecting the assets of the healthy business. Conversely, a demerger may also be undertaken for situating a lucrative business in a

separate entity. A demerger, may be completed through a court process under the Merger Provisions, but could also be structured in a manner to avoid attracting the Merger Provisions.

Corporate restructuring is partial dismantling or otherwise re-organizing a company for the purpose of making it more efficient and therefore more profitable. The process of corporate restructuring often occurs after buy-out, corporate mergers and acquisitions, demergers, bankruptcies etc.

A restructuring wave is sweeping the corporate world. Takeovers, mergers and acquisition activities continue to accelerate. From banking to oil exploration, telecommunication to power generation, petrochemicals to aviation, companies are coming together as never before.

2.1.5 The concept of value

In the most general sense, the terms mergers and acquisitions refer to the exchange of ownership control of a business enterprise. Company A and Company B may merge and form a new composite company; Company A may purchase or acquire Company B, or vice versa. In either situation, it is imperative that both companies should be valued either formally or informally.

There are several perspectives of value as follows:

Book Value

The book value of a company is obtained from the balance sheet by taking the adjusted historical cost of the company's assets and subtracting the liabilities. Tangible book value is calculated in the same way as finding regular book value; intangible assets are possibly excluded in the calculation. The book value does not provide a true indication of a company's value, nor does it take into account the cash flow that can be generated by the company's assets.

Liquidation value

Liquidation value is another benchmark of the company's value. It is measure of the per share value that would be derived if the firm's assets were liquidated and all liabilities and preferred stock were paid. Liquidation value may be a more realistic measure than book value. If accurately computed, it may be a more accurate indicator of the true value of the firm's assets.

On the other side, the liquidation value does not measure the earning power of the firm's assets. These assets may have different values depending on the user. If the firm is using its assets very efficiently, the company's value may be well in excess of the liquidation value.³³

Fair market value

Fair market value is the price at which the property would change hands between a willing buyer and a willing seller when the seller is not under any compulsion to buy and the buyer is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts. A determination of fair market value will depend upon the circumstance in each case. No formula can be devised that is applicable to the multitude of different valuation issues arising in estate and gift tax cases. A sound valuation will be based on all relevant facts, but the elements of common sense, informed judgment and reasonableness must enter into the process of weighing those facts and determining their aggregate significance.³⁴

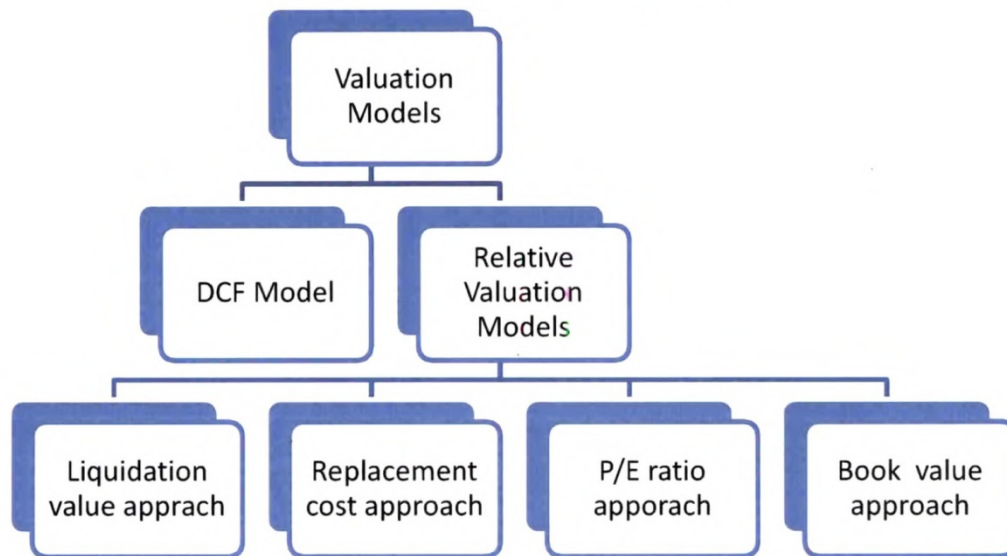
Economic value

The economic value is the value of the expected earnings from using the item discounted at an appropriate rate to give a present-day value. The problem is not in defining the measure but in actually estimating future earnings, as this implies knowledge of what is going to happen.³⁵

2.1.6 Valuation approaches

In the most general sense, the terms mergers and acquisitions refer to the exchange of ownership control of a business enterprise. Company A and Company B may merge and form a new composite company; Company A may purchase or acquire Company B, or vice versa. In either situation, it is imperative that both companies should be valued either formally or informally.³⁶

Figure 8: Valuation Approaches



Discounted cash flow method³⁷(DCF)

The theory for any financial investment evaluation is the capital budgeting approach that includes four concepts:

Free cash flow: The investor has put money into projects because he expects it to generate cash throughout the lifetime of his investment. We define these as cash flow to the investors. In the following analysis, the cash flow is defined as

‘free cash flow’. Free cash flow is a company’s true operating cash flow.

Free cash flow is generally not affected by the company’s financial structure. Free cash flow is defined to ensure consistency between the cash flow and the discount rate used to value the company. Appendix 3 explains the calculation of free cash flow.

Time value of money: One unit of currency is worth more today than it is tomorrow, since there is a cost of capital. This refers to opportunity cost. The sooner they are received, the less they are worth.

Cost of capital

If the cash flow is not risk free, a risk premium will be concerned in the investment. The expected return on an asset should be positively related to its risk. The relationship between expected return on an individual security and Beta of the security could be described as capital-asset-price model (CAPM)

$$R = R_f + [E(R_m) - R_f] * (\text{beta})$$

Where,

R represents expected return on a security

R_f represents risk free rate

$E(R_m) - R_f$ represents the difference between expected return on market and risk free rate

Beta represents the Beta of the security.

The CAPM is used to estimate the cost of equity in this thesis.

Weighted average cost of capital:

The average cost of capital is a weighting of its cost of equity and its cost of debt

$$WACC = K_b * (1 - T) * (B/V) + K_s (S/V)$$

Where,

K_b = the pretax market expected yield to maturity on debt

K_s = the market-determined opportunity cost of equity capital

T = the tax rate

B = the value of debt S = the value of equity V = the value of assets

While making a decision in mergers and acquisitions, this thesis has used the discounted cash flow (DCF) method. Assuming that the value of a company is equal to the sum of the present

value of the various cash flow streams. The ultimate goal is to translate expectations about the company into financial performance and translate financial performance into values.

Relative approaches

Besides the DCF approach, there are five commonly used relative approaches. They are

1. Liquidation value
2. Replacement cost
3. Price-to-earning ratio
4. Market to book ratio
5. Book value

The liquidation-value approach sets the continuing value equal to an estimate of the proceeds from the sales of the assets. Liquidation value is often far different from the value of the company as a going concern. In a growing, profitable industry, a company's liquidation value is probably far below the going-concern value. In a dying industry, liquidation value may exceed going-concern value.

The replacement-cost approach sets the continuing value equal to the expected cost to replace the company's assets. This approach has a number of drawbacks. The most important ones are the following:

- Only tangible assets are replaceable. The company's 'organizational capital' can be valued only on the basis of the cash flow the company generates. The replacement cost of the company's tangible assets may greatly understate the value of the company.
- Not all the company's assets will ever be replaced. Consider a machine used only by this particular industry. The replacement cost of the asset may be so high that it is not economic to replace it. Yet, as long as it generates a positive cash flow, the asset is valuable to the ongoing business of the company. Here, the replacement cost may exceed the value of the business as an ongoing entity.

The price-to-earnings (P/E) ratio approach assumes that the company will be worth some multiple of its future earnings in the continuing period. Of course, this will be true; the difficulty arises in trying to estimate an appropriate P/E ratio.

Suppose the current industry average P/E ratio is chosen. However, prospects at the end of the forecast period are likely to be very different from today's P/E ratio. Therefore, the drawbacks of price-to-earning(P/E) ratio are as follows:

- It is too affected by transitory events
- It hardly reflects future trends and historical fluctuation.
- It does not include enough financial information such as different leverages used by firms in the same industry.
- It hardly reflects risk differences even when restricted to the same industry's comparison.

The market-to-book ratio approach assumes that the company will be worth some multiple of its book value, often the same as its current multiple or the multiples of comparable companies. This approach is conceptually similar to the P/E approach and therefore faces the same problems. In addition to the complexity of deriving an appropriate multiple, the book value itself is distorted by inflation and the arbitrariness of some accounting assumptions.

The book-value approach assumes that the continuing value equals the book value of the company. Often, the implicit assumption of this approach is that the company will earn a return on capital (measured in terms of book values) exactly equal to its cost of capital. Therefore, the book value should represent the discounted expected future cash flow. Unfortunately, book values are affected by inflation and the choice of accounting rules. Therefore, they do not provide reliable information for these assumptions.³⁸

McKinsey has tested how well free cash flow explained the market value of 35 US companies. Correlation between market value and free cash flow value is very high. ($R^2 = 0.94$)³⁹ Therefore, in this study it was decided to use the discounted cash flow approach in the following evaluation.

2.1.7 Valuation process

Business valuation is partly art and partly science. The term 'judgment' may be regarded as an 'art'; while the term 'systematic' may be related to 'science'. There are many dimensions of the science in business valuation that are listed as follows:

- General accounting principles and the financial data of the business
- Facts associated with the historical growth of the business
- Extrapolation of financial data into future time periods
- Calculation of various valuation ratios and statistical formulae

There are many dimensions of the art in business valuation which are:

- Understanding the economically efficient life of productive assets
- Understanding the economically relevant industry in which the business is valued
- Understanding the appropriateness of one valuation method
- Understanding the limitations of financial information from comparable businesses
- Understanding the economic environment

A business valuation is often dependent on valuator's knowledge, both accounting concepts and economic concepts. Accounting is a systematic way of documenting the business's financial activities, while economics is a systematic way of understanding the market environment in which the business's financial activities take place. Accounting methods are relatively more static in nature than economic methods; there are more systematic practices and principles that guide the application of accounting methods. There is rarely a situation where all aspects of a valuation are accounting related or all aspects are economics related.⁴⁰

³⁹

⁴⁰

Different Applications of Business

In this part of the chapter, the review of different applications which directly affects the mergers and acquisitions are discussed. Mergers and acquisitions are affected by many factors. There are major three aspects discussed here. They are as follows:

2.2 Legal & Regulatory aspects of Mergers and Amalgamation

The regulatory Framework of Mergers and amalgamations covers

1. The Companies Act, 1956
2. The Competitions Act, 2002
3. FEMA, 1999
4. SEBI Takeover Code, 1994
5. Income Tax Act, 1961
6. Mandatory Permission of Court
7. Stamp Duty Act
8. The Indian Stamp Act, 1899

2.2.1. The Companies Act, 1956

Sections 390 to 394 (the “**Merger Provisions**”) of the Companies Act govern a merger of two or more companies under Indian law. The Merger Provisions are in fact worded so widely, that they would provide for and regulate all kinds of corporate restructuring that a company may possibly undertake; such as mergers, amalgamations, demergers, spin-off/hive off, and every other compromise, settlement, agreement or arrangement between a company and its members and/or its creditors.

Procedure under the Merger Provision.

Since a merger essentially involves an arrangement between the merging companies and their respective shareholders, each of the companies proposing to merge with the other(s) must make an application to the Company Court⁴¹ (the 'Court') having jurisdiction over such company for calling meetings of its respective shareholders and/or creditors. The Court may then order a meeting of the creditors/shareholders of the company. If the majority in number representing $\frac{3}{4}$ th in value of the creditors/shareholders present and voting at such meeting agrees to the merger, then the merger, if sanctioned by the Court, is binding on all creditors/shareholders of the company. The Court will not approve a merger or any other corporate restructuring, unless it is satisfied that all material facts have been disclosed by the company. The order of the Court approving a merger does not take effect until a certified copy of the same is filed by the company with the Registrar of Companies.

The Merger Provisions constitute a comprehensive code in themselves, and under these provisions Courts have full power to sanction any alterations in the corporate structure of a company that may be necessary to affect the corporate restructuring that is proposed. For example, in ordinary circumstances a company must seek the approval of the Court for effecting a reduction of its share capital. However, if a reduction of share capital forms part of the corporate restructuring proposed by the company under the Merger Provisions, then the Court has the power to approve and sanction such reduction in share capital and separate proceedings for reduction of share capital would not be necessary.

Applicability of Merger Provisions to foreign companies.

Section 394 vests the Court with certain powers to facilitate the reconstruction or amalgamation of companies, i.e. in cases where an application is made for sanctioning an arrangement that is:

- for the reconstruction of any company or companies or the amalgamation of any two or more companies; and
- under the scheme the whole or part of the undertaking, property or liabilities of any company concerned in the scheme (referred to as the 'transferor company') is to be transferred to another company (referred to as the transferee company').

Section 394 (4) (b) makes it clear that:

- a 'transferor company' would mean any body corporate⁴², whether or not a company registered under The Companies Act (i.e. an Indian company), implying that a foreign company could also be a transferor, and
- a 'transferee company' would only mean an Indian company.

Therefore, the Merger Provisions recognize and permit a merger/reconstruction where a foreign company merges into an Indian company. But the reverse is not permitted, and an Indian company cannot merge into a foreign company.

Amalgamation can be effected in any one of the following ways:

- (i) Transfer of undertaking by order of the High Court⁴³
- (ii) Purchase of shares of one company by another company⁴⁴
- (iii) Amalgamation of companies in national interest⁴⁵
- (iv) Amalgamation of companies in liquidation⁴⁶
- (v) Amalgamation for revival and rehabilitation⁴⁷

Merger or Amalgamation under section 391 – 394 of The Indian companies Act, 1956

Merger or amalgamation under a scheme of arrangements as provided under sections 391 – 394 of the Act is the most convenient and most common method of obtaining a complete merger or amalgamation between the companies. There is active involvement of the court and amalgamation is complete only after the court sanctions it under section 394 (2) and takes effect when such order of court is filed with the registrar of companies. In fact, The Companies Act, 1956 serve as a complete code in themselves in respect of provisions and procedures relating to sponsoring of the scheme, the approval thereof by the creditors and the members, and the sanction thereof by the court.⁴⁸ The companies are required to obtain the following approvals in respect of the scheme of amalgamation:

- i. Approval of Board of directors
- ii. Approval of stock Exchanges
- iii. Approval of Shareholders/Creditors
- iv. Approval of Financial Institutions
- v. Approval of High Court
- vi. Approval of Reserve Bank of India
- vii. Combination under the Competition Act, 2002

2.2.2 The Competition Act, 2002

Following provisions of the Competition Act, 2002 deals with mergers of the company:-

1. Competition Act, 2002⁴⁹ deals with “Combinations” which defines combination by reference to assets and turnover
 - a. Within India
 - b. Within India and outside India.

For example, an Indian company with turnover of Rs. 3000 crores cannot acquire another Indian company without prior notification and approval of the Competition Commission. On the other hand, a foreign company with turnover outside India of more than USD 1.5

billion (or in excess of Rs. 4500 crores) may acquire a company in India with sales just short of Rs. 1500 crores without any notification to (or approval of) the Competition Commission being required.

2. The Competition Act, 2002⁵⁰ states that, no person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void. All types of intra-group combinations, mergers, demergers, reorganizations and other similar transactions should be specifically exempted from the notification procedure and appropriate clauses should be incorporated.⁵¹ These transactions do not have any competitive impact on the market for assessment under the Competition Act, Section 6.

2.2.3 Foreign Exchange Management Act,1999

The foreign exchange laws relating to issuance and allotment of shares to foreign entities are contained in The Foreign Exchange Management (Transfer or Issue of Security by a person residing out of India)⁵² These regulations provide general guidelines on issuance of shares or securities by an Indian entity to a person residing outside India or recording in its books any transfer of security from or to such person. RBI has issued detailed guidelines on foreign investment in India vide "Foreign Direct Investment Scheme" contained in Schedule 1 of said regulation.

2.2.4 SEBI Takeover Code 1994

SEBI Takeover Regulations permit consolidation of shares or voting rights beyond 15% up to 55%, provided the acquirer does not acquire more than 5% of shares or voting rights of the target company in any financial year.⁵³ However, acquisition of shares or voting rights beyond 26% would apparently attract the notification procedure under the Act. It should be clarified that

notification to CCI will not be required for consolidation of shares or voting rights permitted under the SEBI Takeover Regulations. Similarly the acquirer who has already acquired control of a company (say a listed company), after adhering to all requirements of SEBI Takeover Regulations and also the Act, should be exempted from the Act for further acquisition of shares or voting rights in the same company.

2.2.5 The Indian Income Tax Act (ITA), 1961

Merger has not been defined under the ITA but has been covered under the term 'amalgamation' as defined in section 2(1B) of the Act. To encourage restructuring, merger and demerger has been given a special treatment in the Income-tax Act since the beginning. The Finance Act, 1999 clarified many issues relating to Business Reorganizations thereby facilitating and making business restructuring tax neutral. As per Finance Minister this has been done to accelerate internal liberalization. The Indian Income Tax Act, 1961 contains certain provisions which are indeed compulsory for the participants of mergers and acquisitions to follow. This includes meaning and definitions of related terms and other provisions which fix on tax liability of taxability in the hands of Transferee Company⁵⁴

The transfer of shares by the shareholders of the transferor company in lieu of shares of the transferee company on merger is not regarded as transfer and hence gains arising from the same are not chargeable to tax in the hands of the shareholders of the transferee company.⁵⁵ In case of merger, cost of acquisition of shares of the transferee company, which were acquired in pursuant to merger will be the cost incurred for acquiring the shares of the transferor company.⁵⁶

2.2.6 Mandatory permission by the courts

Any scheme for mergers has to be sanctioned by the courts of the country. The company act provides that the high court of the respective states where the transferor and the transferee

companies have their respective registered offices have the necessary jurisdiction to direct the winding up or regulate the merger of the companies registered in or outside India.

The high courts can also supervise any arrangements or modifications in the arrangements after having sanctioned the scheme of mergers.⁵⁷ Thereafter the courts would issue the necessary sanctions for the scheme of mergers after dealing with the application for the merger if they are convinced that the impending merger is “fair and reasonable”.

The courts also have a certain limit to their powers to exercise their jurisdiction which have essentially evolved from their own rulings. For example, the courts will not allow the merger to come through the intervention of the courts, if the same can be effected through some other provisions of the Companies Act; further, the courts cannot allow for the merger to proceed if there was something that the parties themselves could not agree to; also, if the merger, if allowed, would be in contravention of certain conditions laid down by the law, such a merger also cannot be permitted. The courts have no special jurisdiction with regard to the issuance of writs to entertain an appeal over a matter that is otherwise “final, conclusive and binding.”⁵⁸

2.2.7 Stamp duty

Stamp Act varies from state to State. As per Bombay Stamp Act, conveyance includes an order in respect of amalgamation; by which property is transferred to or vested in any other person. As per this Act, rate of stamp duty is 10 per cent.

2.2.8 Legal Procedure For Bringing About Merger Of Companies:

The legal process is as follows.

1. Examination of object clauses: The MOA of both the companies should be examined to check the power to amalgamate is available. Further, the object clause of the merging company should permit it to carry on the business of the merged company. If such clauses do not exist, necessary approvals of the share holders, board of directors, and company law board are required.
2. Intimation to stock exchanges: The stock exchanges where merging and merged companies are listed should be informed about the merger proposal. From time to time, copies of all notices, resolutions, and orders should be mailed to the concerned stock exchanges.
3. Approval of the draft merger proposal by the respective boards: The draft merger proposal should be approved by the respective BOD's. The board of each company should pass a resolution authorizing its directors/executives to pursue the matter further.
4. Application to high courts: Once the drafts of merger proposal is approved by the respective boards, each company should make an application to the high court of the state where its registered office is situated so that it can convene the meetings of share holders and creditors for passing the merger proposal.
5. Dispatch of notice to share holders and creditors: In order to convene the meetings of share holders and creditors, a notice and an explanatory statement of the meeting, as approved by the high court, should be dispatched by each company to its shareholders and creditors so that they get 21 days advance intimation. The notice of the meetings should also be published in two news papers.

6. **Holding of meetings of share holders and creditors:** A meeting of share holders should be held by each company for passing the scheme of mergers at least 75% of shareholders who vote either in person or by proxy must approve the scheme of merger. Same applies to creditors also.
7. **Petition to High Court for confirmation and passing of HC orders:** Once the mergers scheme is passed by the share holders and creditors, the companies involved in the merger should present a petition to the HC for confirming the scheme of merger. A notice about the same has to be published in 2 newspapers.
8. **Filing the order with the registrar:** Certified true copies of the high court order must be filed with the registrar of companies within the time limit specified by the court.
9. **Transfer of assets and liabilities:** After the final orders have been passed by both the HC's, all the assets and liabilities of the merged company will have to be transferred to the merging company.
10. **Issue of shares and debentures:** The merging company, after fulfilling the provisions of the law, should issue shares and debentures of the merging company. The new shares and debentures so issued will then be listed on the stock exchange.

2.3 Taxation Aspects of Mergers

2.3.1 Income Tax Act, 1961

The ITA contemplates and recognizes the following types of mergers and acquisitions activities:

- Amalgamation (i.e. a merger which satisfies the conditions mentioned below⁵⁹)
- Slump sale/asset sale;
- Transfer of shares; and
- Demerger or spin-off.

The ITA defines an 'amalgamation' as the merger of one or more companies with another company, or the merger of two or more companies to form one company. The ITA also requires that the following conditions must be met by virtue of the merger, for such merger to qualify as an 'amalgamation' under the ITA:

- all the property of the amalgamating company(ies) becomes the property of the amalgamated company;
- all the liabilities of the amalgamating company(ies) become the liabilities of the amalgamated company; and
- shareholders holding not less than 75% of the value of the shares of the amalgamating company become shareholders of the amalgamated company.

2.3.2 Tax on Capital Gains.

Section 45 of the ITA levies tax on capital gains arising on the transfer of a capital asset⁶⁰.

Section 2(47) of the ITA defines the term 'transfer' in relation to a capital asset to include:

- (i) The sale, exchange or relinquishment of the asset; or
- (ii) The extinguishment of any rights therein; or

- (iii) The compulsory acquisition thereof under any law; or
- (iv) In a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or
- (v) Any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882; or
- (vi) Any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever), which has the effect of transferring, or enabling the enjoyment of, any immovable property.

If a merger or any other kind of restructuring results in a transfer of a capital asset (as defined above), it would lead to a taxable event.

2.3.3 Capital gains tax implications for mergers

Section 47 of the ITA sets out certain transfers that are exempt from the provisions of Section 45 (the charging provision for tax on capital gains) and such transfers are exempt from tax on capital gains. The relevant exemptions are provided below.

1. For an amalgamated company (transferor)

The transfer of a capital asset in a scheme of amalgamation by the amalgamating company to the amalgamated company is exempt from tax on capital gains, provided the amalgamated company is an Indian company³⁴. Please note that for this exemption to be applicable to a merger, it is essential that the merger falls within the definition of 'amalgamation' provided above.

2. for a foreign amalgamating company (transferor) in connection with transfer of shares in an Indian company

When a foreign holding company transfers its shareholding in an Indian company to another foreign company as a result of a scheme of amalgamation, such a transfer of the capital asset *i.e.* shares in the Indian company, would be exempt from tax on capital gains in India for the foreign amalgamating company, if it satisfies the following conditions: (a) At least 25% of the shareholders of the amalgamating foreign company continue to be the shareholders of the amalgamated foreign company, and (b) such transfer does not attract capital gains tax in the country where the amalgamating company is incorporated.⁶¹ It may be noted that while the definition of 'amalgamation' requires that 75% (in terms of value of shares) of the shareholders of the amalgamating company should become the shareholders in the amalgamated company, this section specifies 25% of the number of shareholders as the corresponding figure. The above provisions also indicate that an Indian company may not amalgamate into a foreign company without attracting capital gains tax liability in India, as and when permitted by the Companies Act.⁶²

3. Shareholders of the amalgamating company

Transfer by the shareholders of amalgamating company, in a scheme of amalgamation, of shares of the amalgamating company (the capital asset) as consideration for the allotment of shares of the amalgamated company, is exempt from tax on capital gains, provided that the amalgamated company is an Indian company⁶³. The exemption from tax on capital gains would only be to the extent that the transfer is for the consideration for shares of the amalgamated company. If any cash consideration was paid to the shareholders of the amalgamating company, it would be liable to tax on capital gains. If any of the conditions specified above are not satisfied (including the conditions specified in the definition of 'amalgamation'), the transfer of capital assets in a merger would be subject to tax on capital

gains.⁶⁴ If any of the conditions specified above are not satisfied (including the conditions specified in the definition of 'amalgamation'), the transfer of capital assets in a merger would be subject to tax on capital gains.

Computation of capital gains tax Income chargeable to tax as capital gains is computed by deducting the following from the value of the consideration received – (a) expenditure incurred wholly and exclusively with such transfer, and (b) cost of acquisition of the capital asset and any cost of improvement of the capital asset. The cost of acquisition for a shareholder, of shares of the amalgamated company, is deemed to be the cost of acquisition of the shares of the amalgamating company.⁶⁵

Long term and short term capital gains If a capital asset is held by an assessee for not more than 3 years immediately prior to the transfer, such capital asset would be a short term capital asset. If the capital asset is held for more than 3 years, then it is a long term capital asset. Any other capital asset would be a short term capital asset. However, in case of shares of a company/ security listed on a stock exchange, it would be a short term capital asset if it is held by the assessee for a period not exceeding 1 year. This distinction is important as the rate of capital gains tax on transfer of short term capital assets and long term capital assets differs.

Long-term capital gains realized on the transfer of listed shares of Indian companies on the floor of a recognized stock exchange in India are exempt from taxation in India, provided such transaction is subject to securities transaction tax ("STT") as further discussed below. Long-term capital gains arising on transfer of listed shares of Indian companies off the recognized stock exchange in India will be chargeable to tax at a rate of 10.558 per cent (including surcharge and education cess but without indexation benefits). Long-term capital gains with respect to shares of an unlisted company are subject to Indian tax at a rate of 21.115 percent (including surcharge and education cess but with indexation benefits).⁶⁶

Short-term capital gains realized on the transfer of listed shares of Indian companies on the floor of a recognized stock exchange in India are subject to tax at a rate of 15.836 percent (including surcharge and education cess), provided such transaction is subject to STT. Short-term capital gains on the transfer of an Indian security that is listed but not subject to STT, or is unlisted are subject to tax at a rate of 42.23 percent (including surcharge and education cess).⁶⁷

2.3.4 Capital gains tax implications for demergers

The term 'demerger' in relation to companies is defined by Section 2(19AA) of the ITA to mean the transfer, pursuant to a scheme of arrangement under the Merger Provisions by a demerged company of its one or more undertakings, to any resulting company, in such a manner that:

- All the *property* of the undertaking⁶⁸, being transferred by the demerged company, immediately before the demerger becomes the property of the resulting company by virtue of the demerger;
- All the *liabilities*⁶⁹ relating 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;
- The property & the liabilities of the undertaking/undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

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- The *resulting company issues*, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;
- The *shareholders holding not less than 3/4ths 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(ies) 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;
- The transfer of the undertaking is on a going concern basis;
- The demerger is in accordance with the conditions, if any, notified under subsection (5) of section 72A by the Central Government in this behalf.

ITA defines the term “demerged company” to mean a company, whose undertaking is transferred, pursuant to a demerger, to a resulting company⁷⁰. ITA defines a “resulting company” to mean one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company⁷¹.

The ITA contains certain tax beneficial provisions in the case of a demerger. If the demerger fulfills the conditions listed above, the transfer of assets by the demerged company to a resulting company, which must be an Indian company, is exempted from capital gains tax under the ITA⁷².

Further, when a demerger of a foreign company occurs, whereby both the demerged and resulting companies are foreign, but the assets demerged include or consist of shares in an Indian company, the transfer of these shares is exempt from capital gains tax in the hands of the demerged company under Section 47(vic) of the IT Act, if the following conditions are satisfied:

- The 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
- Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

Since such a demerger would not occur in India and hence the provisions of the Companies Act would not be applicable, the requirement of the application of the Merger Provisions to such a demerger, is not required to be satisfied.

2.4 Accounting Aspects of Amalgamations

“Accounting Standard-14 ‘Accounting for Amalgamations’ lays down the accounting and disclosure requirements in respect of amalgamations of companies and the treatment of any resultant goodwill or reserves.

Exception:

This standard does not deal with cases of acquisitions which arise when there is a purchase by one company (acquiring company) of the whole or part of the shares, or the whole or part of the assets, of the another company (acquired company) in consideration by payment in cash or by issue of shares or other securities in the acquiring company or partly in one form and partly in the other. The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

2.4.1 Types of Amalgamation:

Accounting Standard (AS) – 14 recognizes two types of amalgamation:

- (a) Amalgamation in the nature of merger.
- (b) Amalgamation in the nature of purchase.

An amalgamation should be considered to be an amalgamation in the nature of merger when all the following conditions are satisfied:

- (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 receivables 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 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 except to ensure uniformity of accounting policies.

An amalgamation should be considered to be an amalgamation in the nature of purchase, when any one or more of the conditions specified above is not satisfied. These amalgamations are in effect a mode by which one company acquires another company and hence, the equity shareholders of the combining entities do not continue to have a proportionate share in the equity of the combined entity or the business of the acquired company is not intended to be continued after amalgamation.

Sanction of composite scheme of arrangement in nature of purchase of shares and demerger of hotel business of demerged company to resulting company and consequent reconstruction of the share capital of demerged company under section 391, read with sections 394, 78 and 100 consisting of reduction of paid-up share capital as well as utilization of share premium account – meetings of equity share holders of both companies and unsecured creditors of demerged company had been dispensed with in view of their written consent- Regional Director stated that as per scheme, capital profit on demerger would be transferred to general reserve in the books of resulting company which was not in consonance with generally accepted accounting principles as also AS-14 which provide that any profit arising out of the capital transaction, like merger or demerger, or to be treated as capital profit and, hence, would be transferred to capital reserve and not to general reserve⁷³.

Whether observation Regional Director was not in consonance with accounting principle in general and Accounting Standard – 14 in particular, AS-14 is applicable only in case of amalgamation and not in case of demerger, as envisaged in instant scheme- Held, Yes

2.4.2 Methods of Accounting for Amalgamation:

There are two methods of accounting for Amalgamations:

- i. The pooling interest method
- ii. The purchase method.

The pooling of interest method is used in case of amalgamation in the nature of merger. The purchase method is used in accounting for amalgamations in the nature of purchase.

i. The Pooling of Interest method:

Since merger is a combination of two or more separate business, there is no reason to restate carrying amounts of assets and liabilities. Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

In preparing the transferee company's financial statements, the assets, liabilities and reserves (whether capital or revenue or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the date of amalgamation. The balance of the Profit and Loss account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to the General reserve, if any.

If, at the time of amalgamation, the transferor and the transferee company have conflicting accounting policies, a uniform set of accounting policies should be adopted following the amalgamation. The effects of the financial statements of any changes in the accounting policies should be reported in accordance with AS-5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

The difference between the amount recorded as share capital (plus any additional consideration in form of cash or other assets) and as the amount of share capital of the transferor company should be adjusted in the reserves. It has been clarified that the difference between the issued share capital of the transferee company and the share capital of the transferor company should be treated as capital reserve. The reason given is that this difference is akin to share premium. Furthermore, reserve created on amalgamation is not available for the purpose of the distribution to shareholders as dividend and / or bonus share. It means that if consideration exceeds the share capital of the Transferor Company (or companies), the unadjusted amount is the capital loss and adjustment must be made, first of all in capital reserve and in case capital reserves are insufficient, in the revenue reserves. However, if capital reserves and revenue reserves are insufficient the unadjusted difference may be adjusted against revenue reserves by making addition thereto by appropriation from Profit and Loss account. There should not be direct debit to the Profit and Loss account. If there is insufficient balance in Profit and Loss account also, the difference should be reflected on the asset side of the balance sheet in a separate heading.

ii. The Purchase Method:

In preparing the transferee company's financial statements, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or, alternatively, the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation. The reserves (whether capital or revenue or

arising on revaluation) of the transferor company, other than the statutory reserves, should not be included in the financial statements of the transferee company except as in case of statutory reserve.

Any excess of the amount of the consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognised in the transferee company's financial statements as goodwill arising on amalgamation. If the amount of consideration is lower than the value of the net assets acquired, the difference should be treated as capital reserve.

The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life. The amortisation period should not exceed five years unless somewhat longer period can be justified.

The reserves of the transferor company, other than statutory reserves should not be included in the financial statements of the transferee company. The statutory reserves refer to those reserves which are required to be maintained for legal compliance. The statute under which a statutory reserve is created may require the identity of such reserve to be maintained for a specific period.

Where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with such statutory reserves of the transferor company should be recorded in the financial statements of the transferee company by crediting the relevant statutory reserve account. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Account') which should be disclosed as a part of "miscellaneous expenditure" or other similar category in the balance sheet. When the statutory reserve is no longer required to be maintained, both the reserves and the aforesaid account should be reversed.

2.4.3 Consideration for Amalgamation:

The consideration for 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. In determining the value of the consideration, assessment is made of the fair value of its various elements.

The consideration for the amalgamation should include any non-cash element at fair value. The fair value may be determined by a number of methods. For example, in case of issue of 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, and where the market value of the assets given up cannot be reliably assessed, such assets may be valued at their respective book values.

While the scheme of amalgamation provides for an adjustment to the consideration contingent on one or more future events, the amount of the additional payment should be included in the consideration if payment is probable and a reasonable estimate of the amount can be made. In all other cases, the adjustment should be recognised as soon as the amount is determinable.

2.4.4 Treatment of Reserves in Amalgamation:

If the amalgamation is an 'amalgamation in the nature of merger'

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. Thus, for example, the General Reserve of the transferor company becomes the General Reserve of the transferee company, the Capital Reserves of the transferor company becomes the Capital Reserve of the transferee company and the Revaluation Reserve of the transferor company becomes the Revaluation Reserve of the transferee company. As a result of preserving the identity, 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 form of cash and other assets) and the amount of share capital of the transferor company is adjusted in reserves in the financial statements of Transferee Company.

If the amalgamation is an 'amalgamation in the nature of purchase'

If the amalgamation is in 'amalgamation in the nature of purchase', the identity of reserves, other than statutory reserves is not preserved, dealt with in certain circumstances mentioned below.

Certain reserves may have been created by the transferor company pursuant to the requirements of, or to avail of the benefits under, the Income Tax act 1961; for example, Development Allowance reserves, or Investment Allowance Reserve. The Act requires that the identity of the reserves should be preserved for a specified period. Likewise, certain other reserves may have been created in the financial statements of the transferor company in terms of the requirements of other statutes. Though, normally, in an amalgamation, in the nature of purchase, the identity of the reserves is not preserved, but an exception is made in respect of reserves of the aforesaid nature (referred to hereinafter as 'statutory reserves') and such reserves retain their identity 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. This exception is made only in those amalgamations where the requirements of the relevant statute for recording the statutory reserves in books of the transferee company are complied with. In such cases 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.

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, the difference is debited to goodwill arising on amalgamation and dealt with in the manner stated below as treatment of goodwill on amalgamation. If the result of the computation is positive, the difference is credited to Capital Reserve.

2.4.5 Goodwill on Amalgamation:

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 amortized to income on systematic basis over its

useful life. Due to the nature of goodwill, it is difficult to estimate its useful life, but estimation is done on a prudent basis. Accordingly, it should be appropriate to amortize goodwill over a period not exceeding five years unless a somewhat longer period can be justified.

The following factors are to be taken into account in estimating the useful life of goodwill:

- (i) The forceable life of the business or industry;
- (ii) The effects of product obsolescence, changes in demand and other economic factors;
- (iii) The service life expectancies of key individuals or groups of employees;
- (iv) Expected actions by competitors or potential competitors; and
- (v) Legal, regulatory or contractual provisions affecting the useful life.

Balance of Profit and Loss Account:

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 the transferor company, whether debit or credit, loses its identity.

Treatment of Reserves Specified in a Scheme of Amalgamation

The scheme of amalgamation sanctioned under the provisions of the Companies Act, 1956 or any other statute may prescribe the treatment to be given to the reserves of the transferor company after its amalgamation. Where the treatment is so prescribed, the same is followed. In some cases, the scheme of amalgamation sanctioned under a statute may prescribe a different treatment to be given to the reserves of the transferor company after amalgamation as compared to the requirements of this Standard that would have been followed had no treatment been prescribed by the scheme.

In such cases, the following disclosures are made in the first financial statements following the amalgamation:

- (a) A description of the accounting treatment given to the reserves and the reasons for following the treatment different from that prescribed in this Standard.
- (b) Deviations in the accounting treatment given to the reserves as prescribed by the scheme of amalgamation sanctioned under the statute as compared to the requirements of this standard that would have been followed had no treatment been prescribed by the scheme.
- (c) The financial effect, if any, arising due to such deviation.

2.4.6 Disclosure Requirement:

- (a) For amalgamations of every type of the following disclosures should be made in the first financial statements following the amalgamations:
 - (i) names and general nature of business of the amalgamating companies;
 - (ii) effective date of amalgamation for accounting purposes;
 - (iii) the method of accounting used to reflect the amalgamation; and
 - (iv) particulars of the scheme sanctioned under a statute.
- (b) In case of amalgamations accounted for under the pooling of interests method, the following additional disclosures are required to be made in the first financial statements following the amalgamation:
 - (i) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;
 - (ii) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.
- (c) In case of amalgamations accounted for under the purchase method the following additional disclosures are required to be made in the first financial statements following the amalgamations:
 - (i) consideration for the amalgamation and a description of the consideration paid or contingently payable, and

- (ii) the amount of any difference between the consideration and the value of net identifiable assets required, and the treatment thereof including the period of amortization of any goodwill arising on amalgamation.

2.4.7 Amalgamation after the Balance Sheet Date:

While amalgamation is effected after the balance sheet date but before the issuance of the financial statement of either party to the amalgamation, disclosures should be made as per the provisions of Accounting Standard 4, 'Contingencies and Events Occurring after the Balance Sheet Date', but the amalgamation should not be incorporated in that financial statements. In certain circumstances, the amalgamation may also provide additional information affecting the financial statements themselves, for instance, by allowing the going concern assumption to be maintained.

Requirement under listing agreement with respect to accounting treatment for amalgamations:

While filling for approval, any draft Scheme of amalgamation/merger/reconstruction, etc. with the stock exchange under the listing agreement, the company is also required to file an auditors' certificate to the effect that the accounting treatment contained in the scheme is in compliance with all the Accounting Standards specified by the Central Government.⁷⁴ However, in case of companies where the respective sectoral regulatory authorities have prescribed norms for accounting treatment of items in the financial statements contained in the scheme, the requirements of the regulatory authorities shall prevail.

For this purpose, mere disclosure of deviations in the accounting treatments shall not be deemed as compliance.

⁷⁴ section 211(3C) of the Companies Act, 1956.