TAX AUTHORITIES EYE GSK-HUL MERGER: COULD ATTRACT TAX ON LONG-TERM CAPITAL GAINS AND BRAND TRANSFER[1]

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GSK Consumer Healthcare India ("GSK India") is in the process of merging with Hindustan Unilever Ltd ("HUL") in the biggest deal in India's consumer packaged goods space. The proposed all-stock deal values GSK India at around I.N.R. 31,700 crore,[2] or close to U.S. $4.5 billion. Each shareholder of GSK India is likely to get 4.39 shares of HUL per share.

Given the size of the deal, the Indian income tax authorities have already begun dissecting its structure and mechanics to identify or assess any tax obligations resulting from the proposed merger.

STOCK ACQUISITION

While the merger may be "tax neutral" (subject to the fulfillment of prescribed conditions under the Income Tax Act, 1961), the shareholders of GSK India who will receive shares of HUL after the merger may be exposed to a 10% long-term capital gains tax upon a subsequent sale of the HUL shares received in the merger. This tax outcome must be taken into account.

This is, effectively, how mergers are taxed: exemption at the merger stage and subsequent taxation when shareholders subsequently sell the shares they receive.

BRAND TRANSFER

Apart from the stock, the deal also entails an offshore transfer of the Horlicks brand from GSK India's foreign shareholder, GSK PLC, to Unilever PLC, HUL's foreign shareholder.

The Indian tax treatment of the transfer of a brand between two foreign companies is a contentious tax issue in India, and the tax exposure likely will depend primarily on the situs of the brand and related aspects.

According to §9 of the Indian Income Tax Act, 1961, all income accruing or arising, directly or indirectly, through the transfer of a capital asset (*e.g.*, brands and trademarks) situated in India is deemed to accrue or arise (*i.e.*, to be earned) in India for tax purposes.

In the case of *CUB PTY Ltd. (formerly known as Foster's Australia Ltd) v. Union of India*, the ruling of the Delhi High Court supports the idea that if the owner of a

1 This article first appeared on Moneycontrol.com.

2 In India, the term crore is used as a shortcut reference to 10 million. Thus, I.N.R. 31,700 crore equals I.N.R. 317 billion.

brand is not located in India, its situs should be regarded as outside India. Thus, the transfer of the brand should not be taxable in India.

However, since most of the value for the Horlicks brand is derived from India, the Indian tax authorities may take a position that the value of the brand is primarily derived from India. If this position is raised and successfully maintained by the Indian tax authorities, all or most of the gain realized from the transfer would be taxable in India. As in all tax controversies, much depends on the facts of the case.

However, given the value of the deal will lead to the creation of goodwill in HUL's books, HUL may be able to mitigate its tax outcome in the subsequent years by amortizing that goodwill on a year-over-year basis. Having said this, "allowability of depreciation" (which is a tax-deductible expense) is often looked at differently by taxpayers and tax authorities. While there are judgments to support HUL's possible claim for depreciation deductions, the tax authorities likely would dispute the claim, if history holds true. Should HUL succeed in a claim for depreciation, it would be an added advantage for the company.

It is anticipated that royalties will be paid by HUL for the use of the brand. This will contribute to additional tax controversy. In principle, the royalty will be deductible, but the amount of the deduction is a factual issue, ripe for controversy. The amount of the deduction is capped by arm's length concepts. Here, views typically differ between that authorities and taxpayers. To some extent, it is mitigated, as the amount paid under the license agreement would be taxable in India and subject to withholding tax obligations for HUL.

CONCLUSION

India's M&A sector has been picking up swiftly this year, allowing shareholders to unlock value with billion-dollar deals like Flipkart-Walmart, and now GSK-HUL. Companies and shareholders are looking for more operational synergies and strategic acquisitions, and they are willing to pay big-ticket prices for them.

One hopes that the parties involved will carefully examine and evaluate the income tax aspects of these deals, as any exposure on the income tax front can impact the deal dynamics. The Indian tax authorities have already begun to scrutinize the HUL-GSK India deal, and only time will tell whether it will be smooth sailing on that front.