

WEBINAR ON

FAMILY SETTLEMENT & ALLIED ISSUES

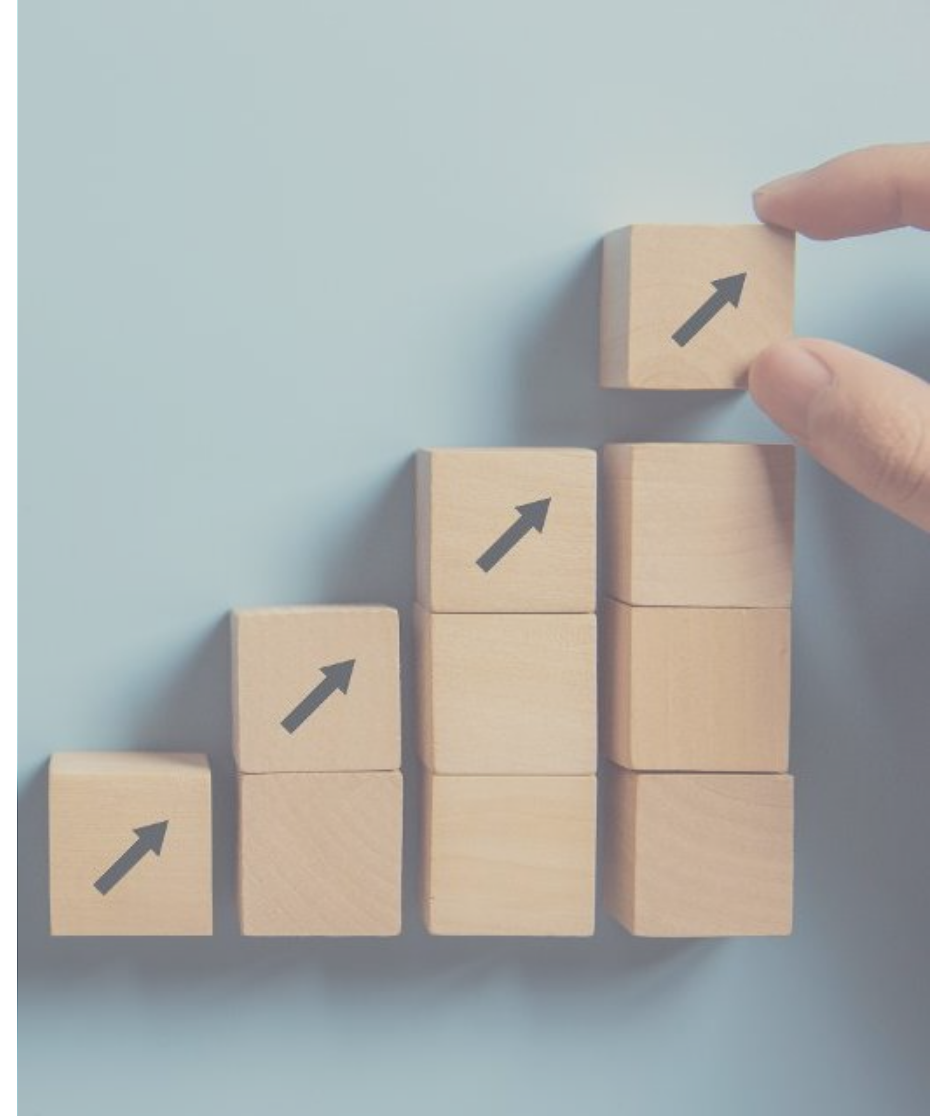


LANDSCAPE OF FAMILY BUSINESSES



Family

Oldest social institution in the history of mankind, that has survived through the ages.



Landscape of Family Businesses

- Over 70% of businesses in India are Family businesses
- Dominance of Family Businesses in nations like China, U.S.A. reflect upon its strategic advantages.⁽¹⁾
- About 35% of Fortune Global 500 companies are family-controlled.⁽²⁾
- India ranks third with family-owned businesses having a combined market capitalization of \$839 billion.⁽³⁾
- Family Business generated average annual returns of 13.9 per cent since 2006, more than double the 6 per cent reported by companies that were not.



(1)Credit Family Suisse 1000 Family Report

(2) *Astrachan, J.H. and Shanker, M.C. (2003), Family Businesses Contribution to the U.S. Economy: A Closer Look.*

(3) Credit Family Suisse 1000 Family Report



ADITYA BIRLA GROUP



Enriching Lives



Reliance



Prominent Family Businesses: India

- RELIANCE GROUP
- ADITYA BIRLA GROUP
- TATA Group
- GODREJ
- JINDAL GROUP
- TVS Group
- KIRLOSKAR GROUP

Prominent Family Businesses: Internationally

- WALMART
- DELL
- BMW
- BERKSHIRE HATHAWAY
- LG ELECTRONICS
- LVMH
- LOUIS DRYFUS COMPANY



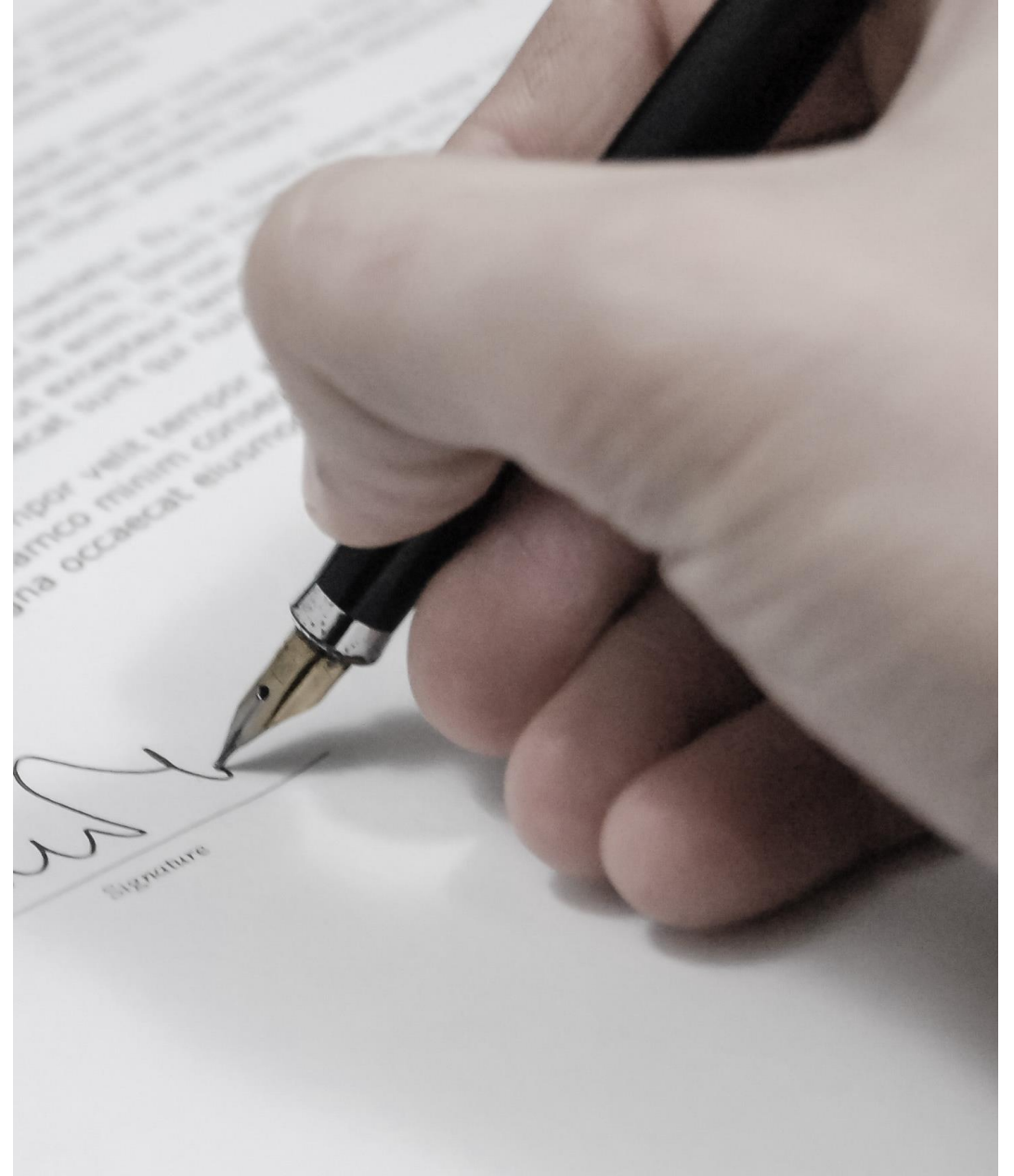
Survival Statistics

Family Businesses give high contribution to GDP
(around 70% of the Global GDP)

More than 30% of all family-owned businesses can
make transition into the second generation.

12% will still be viable into the third generation,

But **only 3%** of all family businesses operate at the
fourth-generation level and beyond.⁽¹⁾



Family Business: Strengths

- SHARED VALUES & VISION
- STABILITY
- COMMITMENT
- INNOVATION
- FLEXIBILITY
- LONG TERM OUTLOOK
- DECREASED COST



Family Business: Vulnerabilities

- INEQUALITIES OF POWER AND AUTHORITY
- CONFLICT OF EXPECTATION AND ROLES
- INCREASE OF SCEPTISIM WITH
GENERATIONAL SHIFT
- FAVOURITISM
- EGO CLASHES
- UNSTRUCTURED GOVERNANCE





Enriching Lives



murugappa



Raymond

Prominent Conflicts in Family Businesses

- Reliance Group
- Singhanian Group – Raymond
- Bajaj Group
- TVS Group
- Kirloskar Group
- Murugappa Group

Need for Family Settlement

- For Resolution of Conflicts
- For channelization of Conflicts into Valuable Asset
- For Protection of Family Peace, Legacy and Prosperity
- For advancing the continuity of Family Business
- For Better Governance



KEY CONSIDERATIONS





Key Considerations

- Subject Matter of the Conflict
- Objectives and Targets of the Settlement
- Wishlist and objectives of Parties
- Subjects (Assets, Properties, Entities, etc., [especially Intangible assets])
- The Business, its Structure and vision, values & interest of the Family
- Operational Interlinkages between the Parties
- Role of the Parties in the Business and their Ownership & Position in the Business



Key Considerations

- Pending Personal accounts of the Parties
- Flow of Information (both financial and non-financial) and its access with the Parties
- Interests of the New Generation
- Pending Litigations
- Regulatory Compliances, Approvals, Licenses, Quotas and Disclosures

KEY CHALLENGES



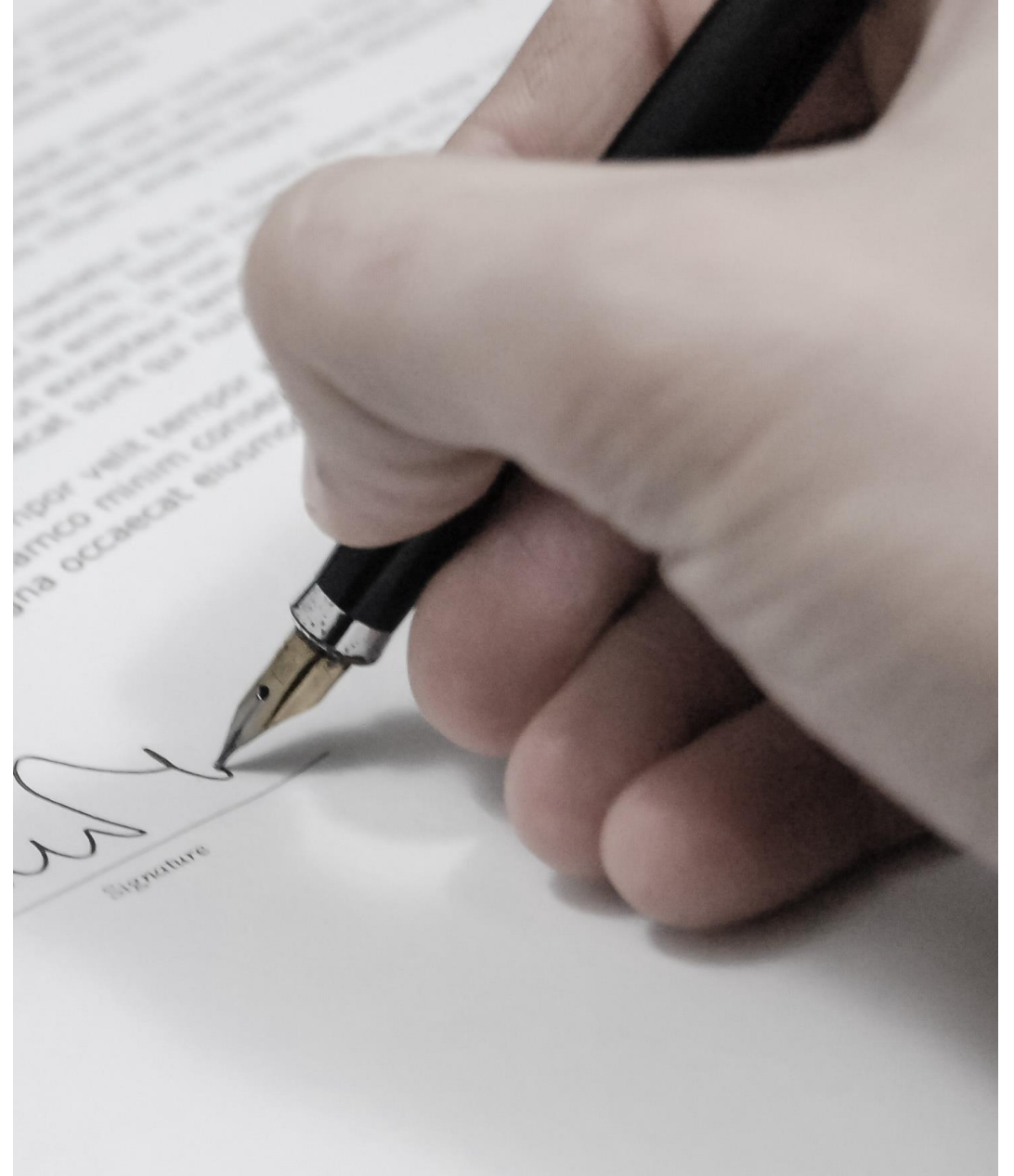
Key Challenges

- Lack of Trust between the Parties
- Deteriorating family decorum
- Clash of Authority – Especially among New Generation
- Bias in the relatives who supervise the settlement
- Conflicting Objectives of the Parties
[for e.g. Equitable Settlement Vs. Equal Settlement]
- Conflicting Wishlist of the Parties.
[For e.g. Claim on a common asset or entity by Parties]



Key Challenges

- Lack of Liquidity – Problems in monetary settlement
- Complicated group structure and operational and/or ownership interlocks
- Ongoing litigations
- Disagreements on financial data/information/ methodology of valuation
- Brand/ goodwill & their realignment– at the heart of Conflict



MANNER OF ACHIEVING FAMILY SETTLEMENT



Manner of achieving Family Settlement

Through..

MEDIATION

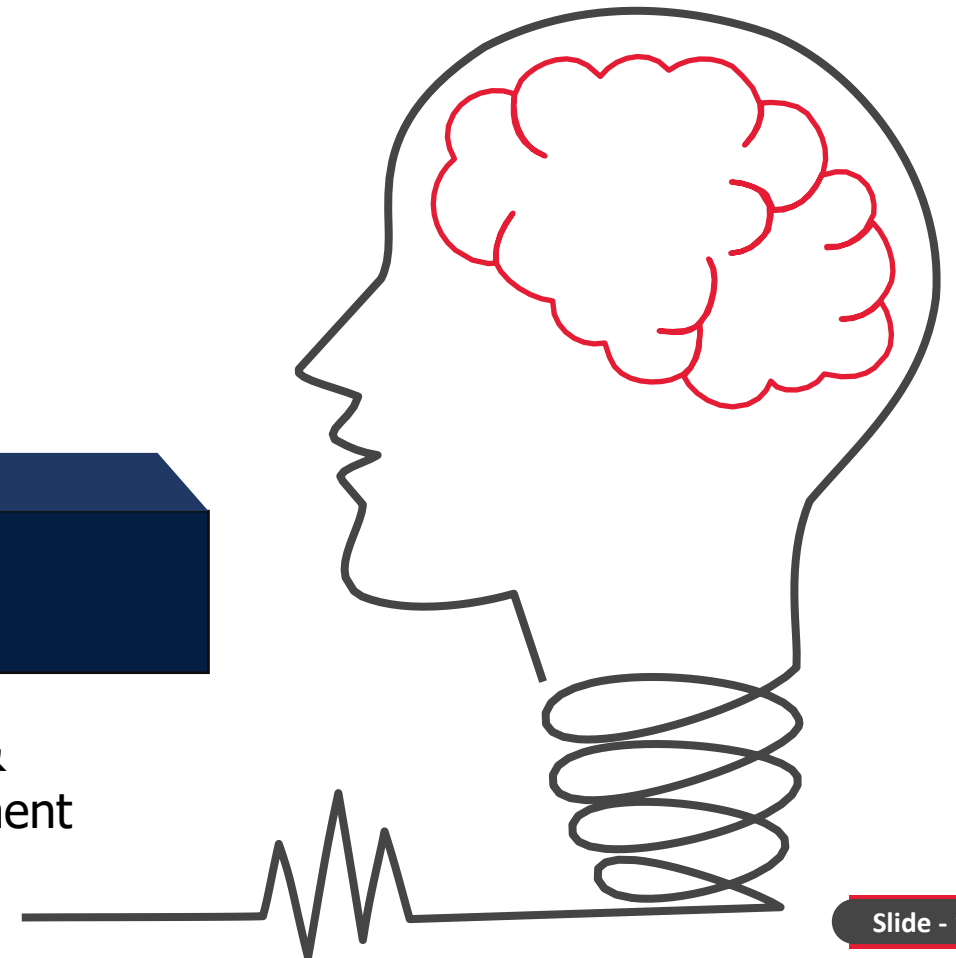
- Family Mediation
- Personal engagement with the help of Consultants
- Mediation Centers

COURT

- Declaratory Suits
- Partition Suits
- Execution Proceedings

NCLT

- Oppression & mismanagement Remedy



MODE OF DISTRIBUTION OF ASSETS



Mode of Distribution of Assets

1

**Valuation of
Bouquet &
Selection by
Parties**

2

Bidding Process

3

**Restructuring *viz.*
Merger/Demerger**

4

Slump Sale

STEPS TO ACHIEVE FAMILY SETTLEMENT



Steps to achieve Family Settlement

- Identifying Parties and Assets to the Settlement (esp., IPRs and brands)
- Identifying and aligning the interests & objectives of the Parties (esp., New Generation)
- Making a NO-WAR ZONE. Stalling all pending litigations/actions (later on withdrawing them)
- Creation of Robust Settlement Forum – Neutral Zone for updates and tracking the development
- Grouping of Assets into various categories/matrix/wish lists



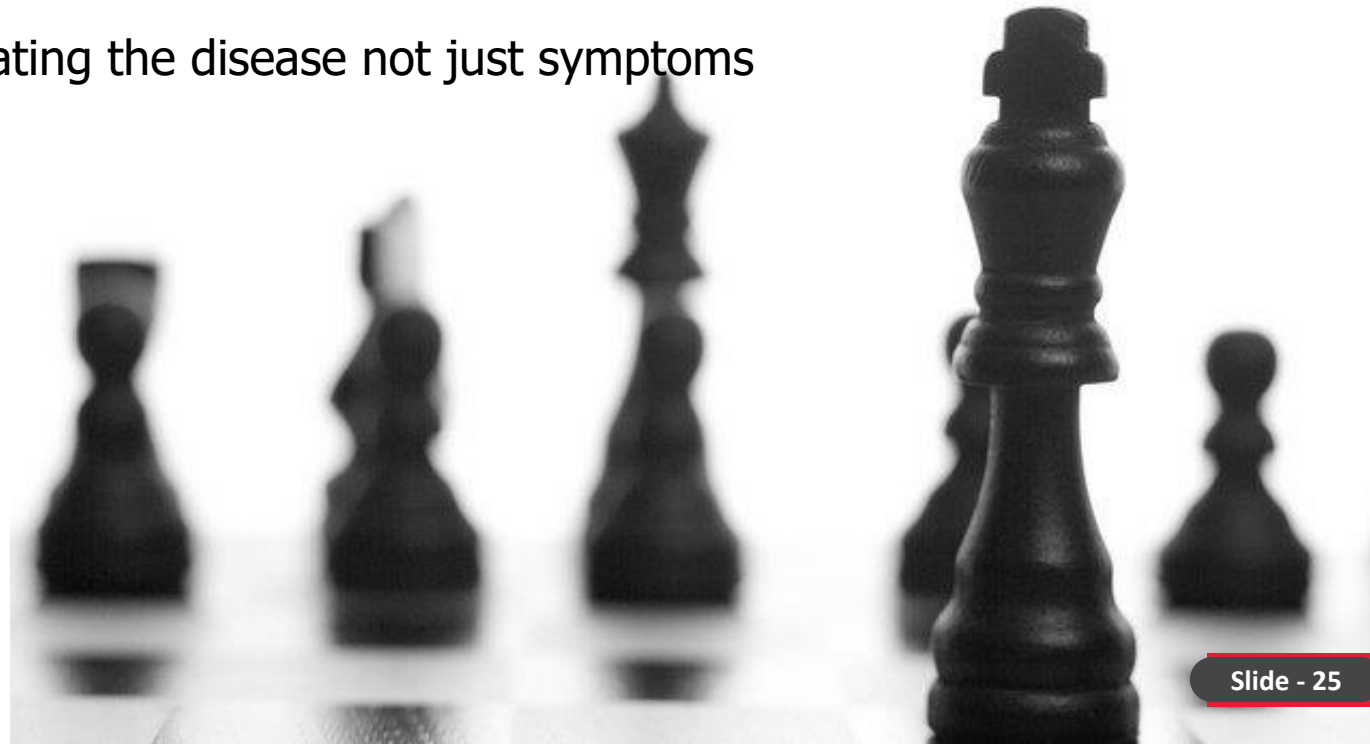
Steps to achieve Family Settlement

- Identifying Minor Issues that can be quickly resolved and tagging the most critical issues separately
- Achieving Agreement of the Parties on the Common Set of Financial Information
- Valuation and Restructuring and Tax Planning – **At the heart of Settlement**
- Formulate a shared settlement road map with clear milestones



Steps to achieve Family Settlement

- Settle easy issues first - It gives a good head start
- Creating 'Practical System' for orderly and transparent conduct of business and timely Exchange of Information between the Parties, in the interim period
- Robust Legal Advisory, Regulatory Assistance and Documentation
- Untangling the complicated interlinkages – Treating the disease not just symptoms



KEY POINTS TO COVER IN A SETTLEMENT AGREEMENT





Key Points for a Settlement Agreement

- Settlement Agreement must cover all relevant Beneficiaries/Parties, Assets and Accounts
- Clarity on cost distribution (duties/taxes/expenses/fees etc.).
- Provision for Settlement of Pending Accounts/inequalities
- Brand Protection -sustainable sharing/use of Brands
- Settlement of Legal Proceedings, if any.

Key Points for a Settlement Agreement

Following things need to be considered, **in case of continued joint control:**

- Division of Role & Responsibilities
- Decision making powers
- Sharing of MIS/Reporting
- Shareholding distribution in continuity with rights like anti-dilution etc.
- Directorships in Board.





Key Points for a Settlement Agreement

Following things need to be considered, **in case of exit:**

- Payment of consideration, taxes and other expenses
- Realignment of Employees and their dues
- Post-settlement arrangement between the Parties, if required

Key Points for a Settlement Agreement

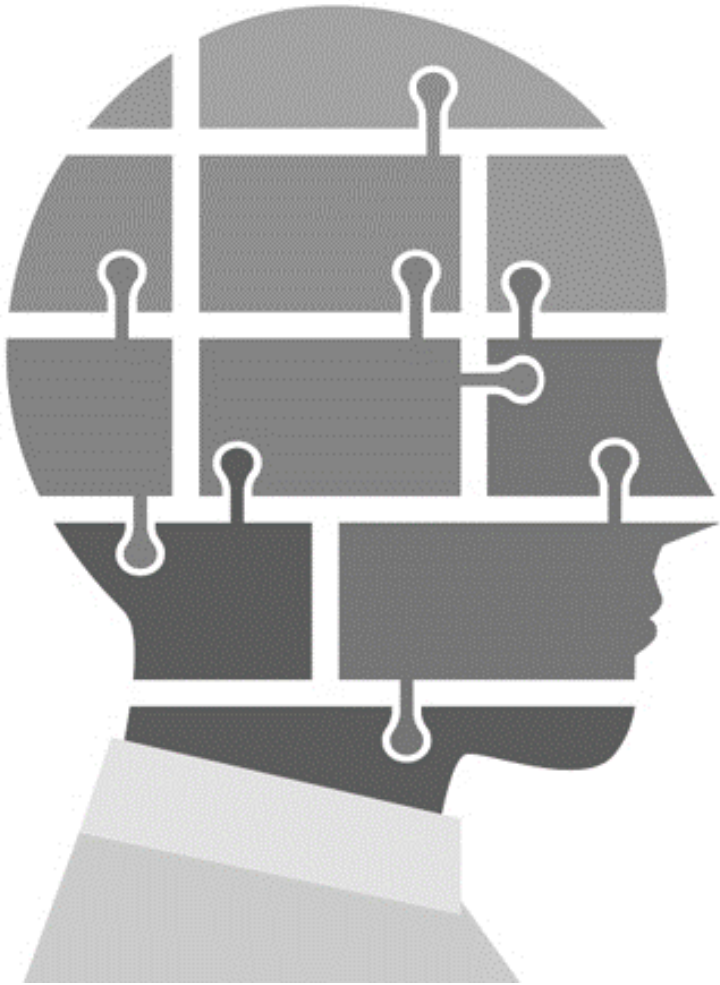
- Non-compete Clause
- Indemnity Clause
- Confidentiality Clause
- Application by Parties for Decree
- Clause for Breach of Agreement
- Dispute Resolution Clause – Arbitration
- Jurisdiction Clause



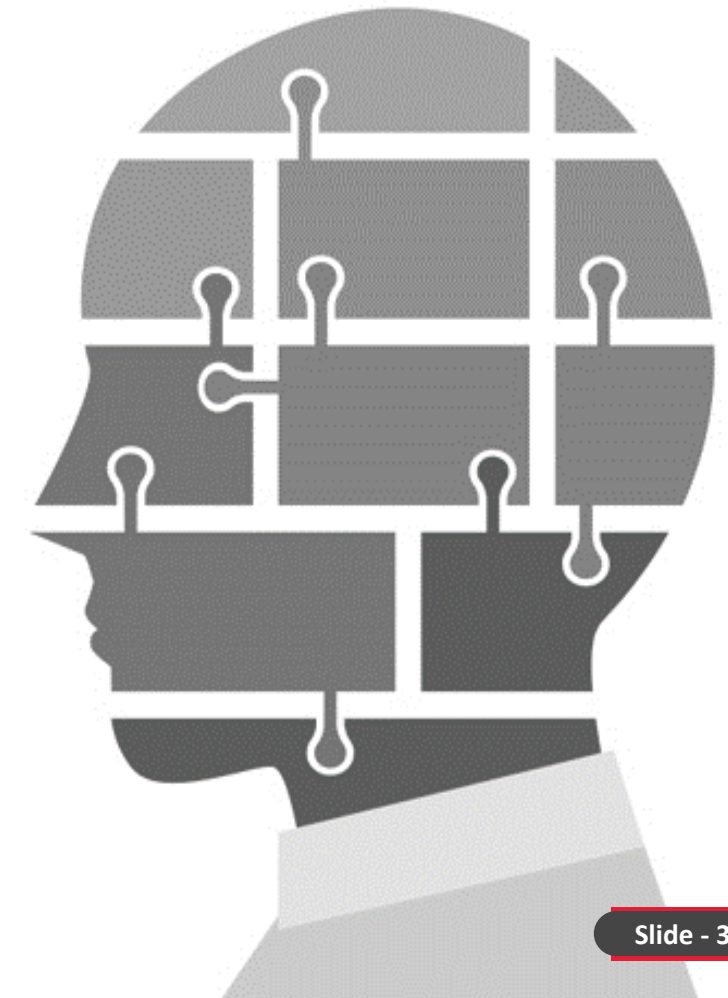
REGULATORY FRAMEWORK GOVERNING FAMILY SETTLEMENT



Regulatory Framework Governing Family Settlement



Regulatory Framework Governing Family Settlement



TAX ISSUES





Tax Issues

Transfer of properties or shares - In case of transferor

- Attraction of capital gains tax
- Applicability of section 50C or 50CA
- Transfer by non-relative/company

Transfer of properties or shares - In case of transferee

- Applicability of section 56
- Receipt by non-relative/company
- Attraction of stamp duty
- Transfer of shares of listed company-takeover code

Tax Issues

Transfer of interest in Partnership Firm/LLP

- Tax liability for outgoing partner or to the firm
- Payment of share in kind

In case of demerger, slump sale

- Approval of NCLT
- Carry forward of tax exemptions, business losses

Transfer by non-relative

- Transfer not less than book value/FMV
- Valuation of properties and shares as per Rule IIUA





Family Settlement through Court Decree

- Stamp duty exemption – state wise
- In case not regarded as transfer-No attraction of capital gains tax
- Transfer by non-relative – Whether may not be regarded as transfer?
- Transfer by company – To be treated as transfer
- Compensation received to settle inequalities between different groups of family, not taxable

Succession Planning in Advance

- Creating business entities of proportionate strength
- Transfer by way of will
- Holding immovable properties in LLP
- Creating private irrevocable Trust



Valuation aspects in Family Settlement



Valuation Considerations in Family Settlement

MACRO ASPECTS

- Understanding broad Terms of Proposed Family Settlement (Cash v. Swap deal)
- Identification of Specified “Businesses” and “Assets”
- Evaluation of Shareholding/Ownership of Parties of “Businesses” and “Assets” (Legally and as per mutual Understanding) – Individually / Jointly / HUF
- Businesses and Assets should be segregated as “Operating” and “Non Operating”
- Assets include “Tangibles” and “Intangibles” – whether in books or not
- Non Operating Assets can be Immovable Properties, Investments, excess Cash and Cash Equivalents
- Creating business entities of proportionate strength





Valuation Considerations in Family Settlement

VALUATION ASPECTS

- Valuation Date
- Valuation Mandate (Joint / Single)
- Scope and Limitation of Assignment
- Size of Stake to be valued (Controlling / Minority)
- Understanding regarding Use of Brand(s) (Individually / Jointly)
- Non Compete Considerations (Control / Synergy Premiums)
- Lock in conditions/Restrictions on Share Transfer etc.

Valuation Considerations in Family Settlement

DATA ANALYSIS AND NORMALISATION

- Acceptability of Data by all Parties (Last 3 year Financials and Projected Business Plan)
- Normalization of Financials /Earnings (Topline v. EBITDA v. PAT)
- Understanding Industry Trends (including Industry and Regulatory Changes)
- VALUATION OF OPERATING and NON OPERATING ASSETS
- Adjustments for Discounts and Premium





Valuation Considerations in Family Settlement

REGULATORY REQUIREMENTS OF VALUATION

- Fresh Issue of Shares (Registered Valuer- Companies Act) + (Merchant Banker-Income Tax) – Family (Individuals v. Companies)
- Right Issue (Renouncement ?)
- Transfer of Shares (Adjusted Net Asset Method) – 56(2(x) / 50 CA (Capital Gains)+ Rule 11 UA. Circle Rate for Immovable Properties
- Buyback of Shares (Valuation for price discovery)
- Slump Sale (Business Valuation)
- Scheme of Arrangement (Share Swap Ratio / Entitlement Ratio). SEBI Guidelines apply in case of Listed Company

Valuation Approaches & Methodologies

BUSINESSES VALUATION

- **Income Approach**
 - Discounted Cash Flow (DCF) Method
- **Market Approach (Multiples) - EV/EBITDA; PE; EV/Sales; P/BV etc.**
 - **Comparable Trading Multiples (CCM)**
 - **Comparable Transaction Multiples (CTM)**
 - **Price of Recent Investment (PORI)**

Note – Brand Valuation is Integral part of Business Valuation but sometimes is required separately for Purchase Price Allocation while allocating Business Valuation to Tangible and Intangible Assets. **“Royalty Relief method”** is applied in practice for Brand Valuations.

ASSET VALUATION

- **Asset Approach**
 - For Asset Heavy Companies;
 - Holding Companies;
 - Property, Plant & Equipment (PPE)
- **Replacement Cost Method** usually used for PPE

Implementation of Family Settlement in Corporate Form of Business



IMPLEMENTATION OF FAMILY SETTLEMENT IN CORPORATE FORM OF BUSINESS

- There are many business families whose major assets are in the form of Companies which cannot be distributed among the members as per the wish of the Family Members;
- Where there are many companies with cross holdings have created complicated group structure, making it tough to untangle them;
- The situation becomes more complex in case a listed company is involved;



Companies cannot be divided through a private agreement



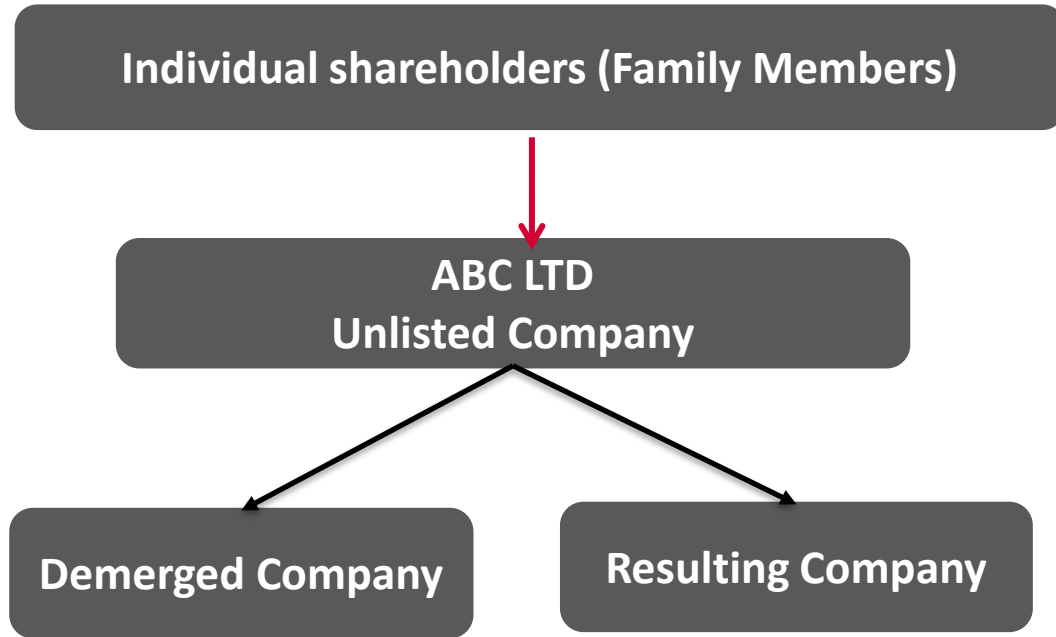
Companies cannot gift shares or assets to a shareholder



Company can transfer business only at fair value

CASE I

SHARES OF THE COMPANY (FAMILY BUSINESS) ARE HELD BY THE FAMILY MEMBERS DIRECTLY



Stage 1: The Demerged Undertaking of ABC Ltd will get Demerged into the Resulting Company. Post allotment of shares by the Resulting Company to the shareholders of ABC Ltd in the same proportion, a parallel entity will be created.

Stage 2: The family members would transfer shares by way of gift amongst each other to distribute the two businesses independently.



Share transfer pursuant to a gift from relative is exempt from tax under Section 56 (2) of the Income Tax Act, 1961.



In case, ABC Ltd is a listed Company, then it becomes complicated as Public shareholders also gets involved. In that case, the Resulting Company will have to apply for listing and thereby seek relaxation from Rule 19(2)(b) of the Securities Contracts Regulation Rules, 1957.



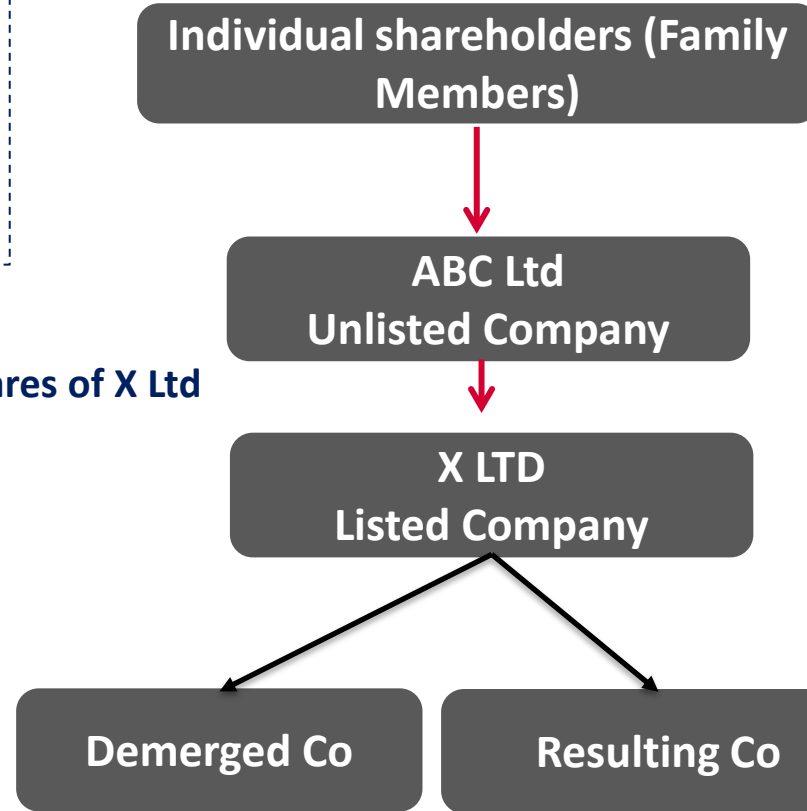
In case of Listed Co, post demerger Inter-se transfer of shares must be in compliance with Regulation 10(1)(a)(1) of SEBI (SAST) Regulation, 2011 to claim exemption from the obligation to make an open offer.

Case II

SHARES OF THE COMPANY (FAMILY BUSINESS) ARE NOT DIRECTLY HELD BY THE FAMILY MEMBERS, HOWEVER ARE HELD BY A COMPANY.

In such a case, it is not possible to transfer the shares by way of gift and thus, a complicated scheme has to be undertaken to achieve our target.

Holds 55% shares of X Ltd



Ultimate Shareholders

Stage 1: ABC Ltd will get collapsed after merger with X Ltd and the shareholders of ABC Ltd will get the same number of shares in X Ltd.

Stage 2: Demerger of the Demerged Undertaking of X Ltd into the Resulting Company. Resulting Company will issue shares to the shareholders of X Ltd, thereby creating a parallel entity. Also, the Resulting Company will have to apply for listing and thereby seek for relaxation from Rule 19(2)(b) of the Securities Contracts Regulation Rules, 1957.

Stage 3: The family members can transfer shares by way of gift amongst each other to handle the two businesses independently.



Share transfer pursuant to a gift from any relative is exempt from tax under Section 56 (2) of the Income Tax Act, 1961.



In case of Listed Co, post demerger Inter-se transfer of shares must be in compliance with Regulation 10(1)(a)(1) of SEBI (SAST) Regulation, 2011 to claim exemption from the obligation to make an open offer.

Case III

A MORE COMPLICATED STRUCTURE



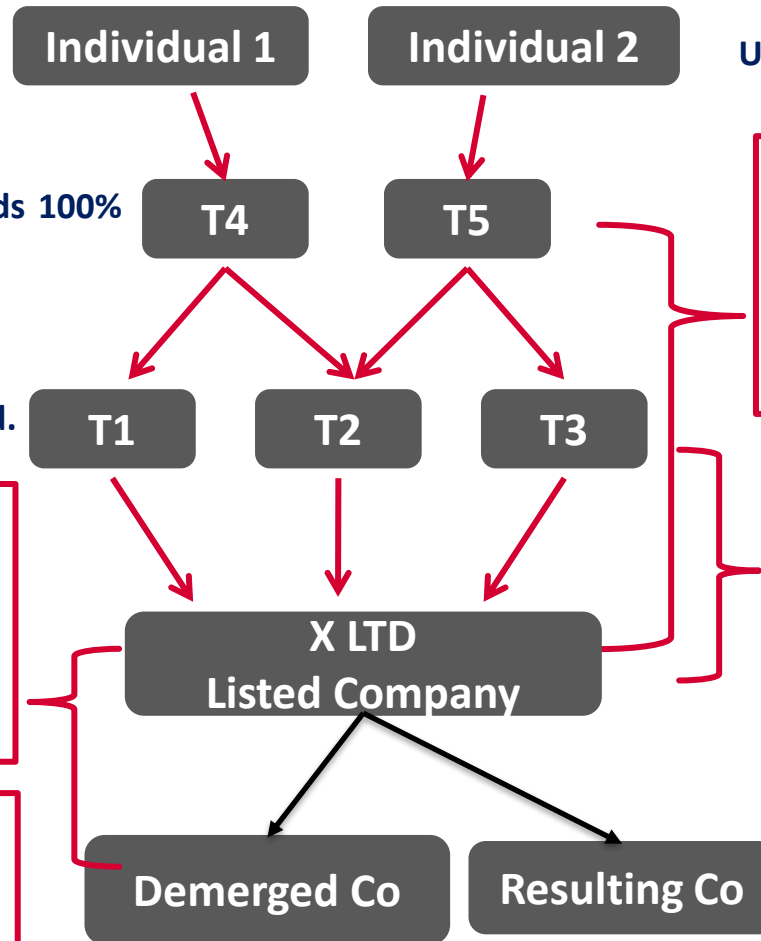
Ultimate Shareholders

T4 and T5 collectively holds 100% shares in T1, T2 and T3

T1, T2 & T3 are the promoter companies of X Ltd.

Stage 3: Demerger of the Demerged Undertaking of X Ltd. Post-Demerger, the Resulting Company will have to apply for listing and thereby seek for relaxation from Rule 19(2)(b) of the Securities Contracts Regulation Rules, 1957.

Stage 4: The family members can transfer shares by way of gift amongst each other to handle the two businesses independently.



Stage 2: Subsequently, T4 & T5 will be Merged with X Ltd and the shareholding of T4 & T5 in X Ltd will be cancelled. In consideration, X Ltd will issue and allot the same number of shares to the Ultimate shareholders.

Stage 1: T1, T2 and T3 will be Merged with X Ltd and the present shareholding of T1, T2 & T3 in X Ltd will be cancelled. In consideration, X Ltd will issue and allot the same number of shares to the shareholders of T1, T2 & T3 i.e. T4 and T5.



Share transfer pursuant to a gift from any relative is exempt from tax under Section 56 (2) of the Income Tax Act, 1961.



Acquisition of shares pursuant to Inter-se transfer of shares amongst the Immediate relatives under Regulation 10(1)(a)(1) of SEBI (SAST) Regulation, 2011 shall be exempted from the obligation to make an open offer. (In case of Listed Company)



CRITICALS ISSUES RELATING TO MERGER & DEMERGER STRUCTURES



INCOME TAX

- **Demerger** must fulfill definition under Section 2 (19AA) of ITA.
- **Merger** should comply the conditions of '**Amalgamation**' as defined under Section 2(1B) of ITA.
- **Section 47** of the ITA specifically exempts from capital gain tax in the hands of companies and its shareholders;
- **Section 72A** of the ITA provides for carry forward of accumulated losses and the unabsorbed depreciation
- **Section 56 (2)** of the ITA exempts tax on transfer of shares by way of gift from relative. The definition of **Relative** mentioned in the ITA has to be complied with.





OTHER CRITICAL ISSUES



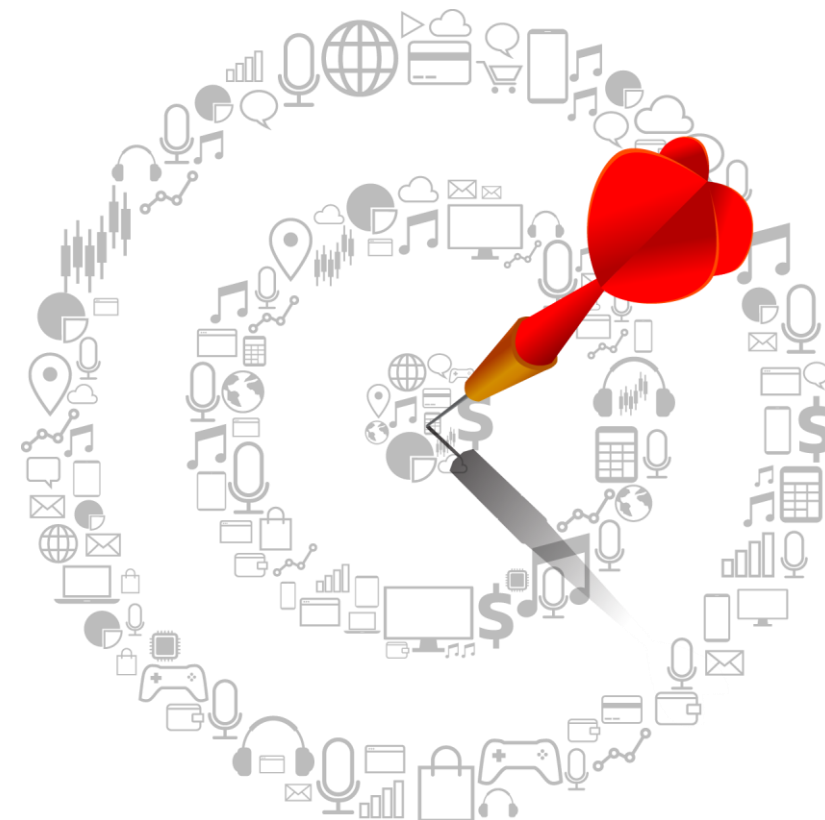
- **Approval of Lender:** very critical to convenience the business logic of merger/demerger;
- **Companies Act:** Compliance of section 230-232/233 the Companies Act, 2013.
- **Valuation and Fairness of the scheme:** needs to ensured especially in case outside shareholders are there
- **Stamp Duty:** The location of the units being transferred and registered office of the company will have stamp duty implications
- **GST:** Merger/Demerger is GST Neutral only if it is of entire business “Undertaking”
- **Listing Requirement:** (1) Ensure the fairness of scheme for public shareholders; (2) In case of Demerger of Listed Co, listing of Resulting Co. will be with exemption from SEBI u/r 19(2)(b) of SCRR. (3) Post Demerger inter se swap of shares should be in compliance with SEBI (SAST) Regulations, 2011 to claim exemption from Open Offer
- **FEMA:** In case any of the member is non-resident
- **RBI & Other Regulators** if involved

CASE STUDY – FAMILY SETTLEMENT



Objective

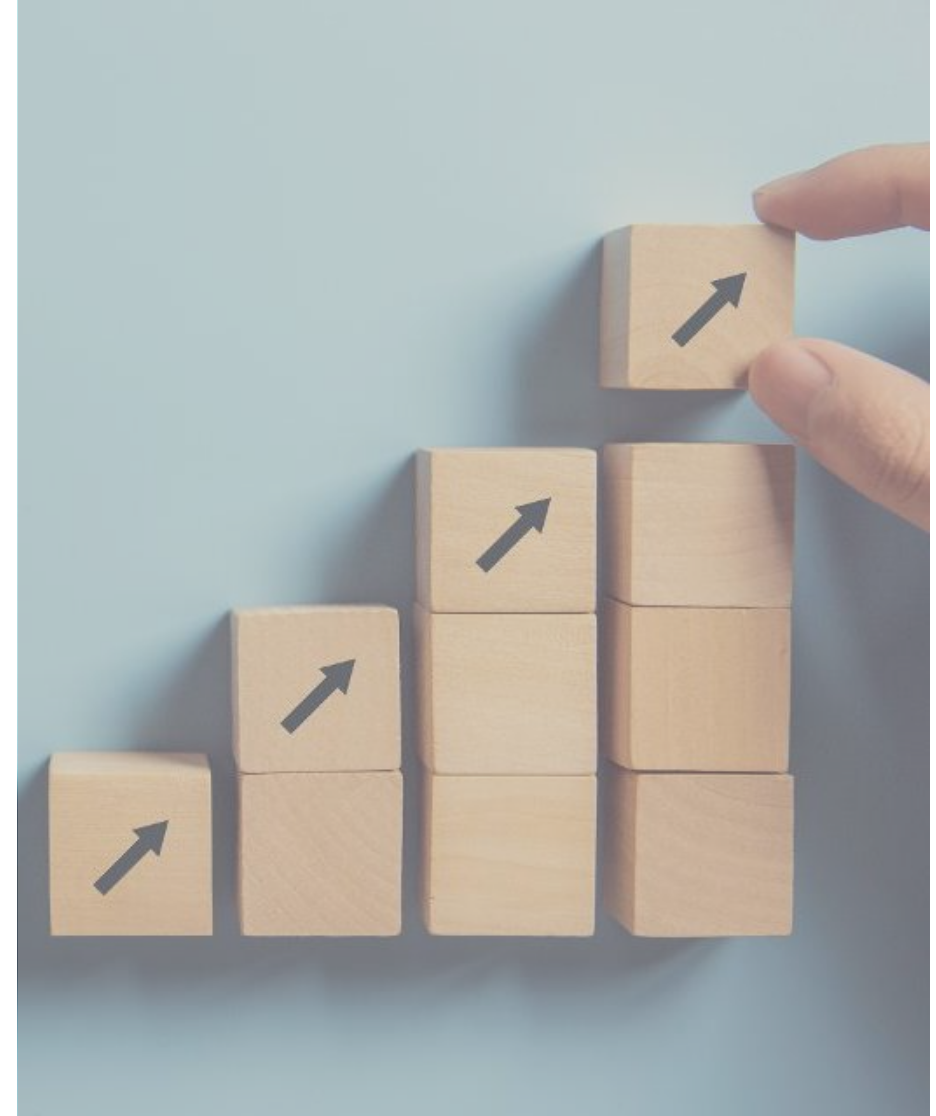
**To achieve an amicable family settlement
by division of business (of around INR 400
Cr) and assets among Family of 4 Brothers**



Business majorly consisted of:

- Partnership Firms
- Companies
- Immovable Properties
- Brands

[All these were interlinked]



Key Considerations Involved

- Major business was being carried in partnership firms under various divisions
- Family was divided into two separate groups.
- Different Groups handled different business divisions, which were clearly identifiable.
- Groups were involved in different portfolio of activity one was predominantly in marketing and another was into production/finance etc.



Key Challenges Faced

- Lack of trust among parties with respect to operations handled by each other
- Disharmony in family leading to constant heated arguments
- Younger family members Vs. Elders
- Disturbance in business operations by one set of family
- Disagreement on a common set of Financials
- Minor issues (having no material bearing on the settlement) were at the top of the list of Parties
- Evaluation of Brands, their Usage & Migration



How Settlement was achieved?

- All business units, product brands, properties involved were clearly identified
- Parties Wishlist and Issues were discussed & analysed
- Truce was declared to stop blame game.
- Unnecessary issues were weeded out and issues which could be quickly resolved were resolved quickly
- For distribution of business and assets amongst family, it is necessary to get the same valued. But non-acceptance of financial data by each other resulted into absence of common data set



How Settlement was achieved?

- No valuation was possible and independent valuations resulted into varied outcomes.
- Following options were advised
 - ❖ Option 1: Bidding on Asset Blocks
 - ❖ Option 2: Building of Asset Bouquets by one group & selection by the other
- Parties opted for Option 2, above
- Bouquets were prepared by one set of family and selection was made by the other
- Memorandum of Family Settlement was executed



Steps undertaken for Culmination

- Formation of Control Council to decide on various matters related to implementation of family settlement up to the Separation Date
- Identification of timelines for settlements
- Restrictions on undertaking major capital expenditure and introducing code of conduct for the interim period



Steps undertaken for Culmination

- Business Entities were realigned in following manner:
 - ❖ Inter family gift of shares
 - ❖ Renouncement of Partnership Interest
 - ❖ Relinquishment of ownership in entities holding immovable properties
 - ❖ Pending Accounts/Inequalities amongst parties were settled by inter-business payments and/or exchanges

