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Between the lines...

March, 2015

Key Highlights...

- ✓ *Indian Accounting Standards notified*
- ✓ *Foreign investment norms in insurance companies*
- ✓ *Tribunal clarifies issue of location savings for transfer pricing adjustments*
- ✓ *Conditions imposed on FPIs on bond purchases*
- ✓ *New regulations for issuance of unsecured bonds*

I. New Indian Accounting Standards notified

The Ministry of Corporate Affairs has recently notified Indian Accounting Standards (Ind AS) that will put India's accounting standards at par with International Financial Reporting Standards (IFRS).

Ind AS norms, which are converged with global accounting standards, IFRS, can be followed by corporates on a voluntary basis from April 1, 2015.

The new norms would be mandatory from April 1, 2016 with the comparatives as on March 31, 2016 for companies having networth of Rs 500 crore or more and its holding, subsidiary, joint venture or associate companies.

The following companies shall be required to comply with Ind As for the accounting periods beginning on or after April 1, 2017, with the comparatives for the periods ending on March 31, 2017.

- ✓ companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than Rs. 500 crore.
- ✓ Other companies having a net worth of Rs 250 crores to Rs 500 crores.
- ✓ holding, subsidiary, joint venture or associate companies of companies described above

There is an exception in case of insurance companies, banking companies and NBFCs. Companies whose securities are listed or in the process of listing on SME exchanges shall not be required to apply new accounting standards.

Overseas subsidiary, associate, joint venture and other similar entities of an Indian company may prepare its standalone financial statements in accordance with the requirements of the specific jurisdiction, provided that such Indian company shall prepare its consolidated financial statements in accordance with Ind AS, either voluntarily or mandatorily.

Once a company starts following the Ind AS either voluntarily or mandatorily it shall be required to follow the Ind AS for all the subsequent financial statements even if any of the criteria specified in rules does not subsequently apply to it.

Source: http://www.mca.gov.in/Ministry/pdf/Notification_20022015.pdf

VA View

The new accounting standards notified by the Government which is benchmarked to international financial standards will alter the way their transactions get accounted in India. Moving to new financial reporting standards will make Indian corporate accounts comparable internationally, which could also lead to more foreign direct investments. The new standard for consolidated financial statements, which talks about the single control model, may change the way in which entities are included within a group. So, if a company has de facto control over another company irrespective of stake, it has to consolidate under new standards.

II. Foreign investment norms in insurance companies

Indian Insurance Companies (Foreign Investment) Rules, 2015 have been notified by the Government of India and has come into force with effect from 19th February, 2015.

The foreign equity investment cap in the sector has been hiked to 49 per cent and that includes foreign investment in the forms of FPI, FII, QFI, FVCI, NRI and DR.

The foreign equity investment cap of 49% shall also apply to Insurance Brokers, Third Party Administrators, Surveyors and Loss Assessors and other insurance intermediaries appointed under the IRDA Act, 1999.
It must be ensured that ownership and control shall remain at all times in the hands of resident Indian entities.

As per the rules, FDI up to 26% of the total paid-up equity of the Indian Insurance Company shall be allowed under the automatic route whereas FDI proposals which take the total foreign investment above 26% and up to the cap of 49% shall require FIPB approval.

Further, Foreign Portfolio Investment in an Indian Insurance Company shall be governed by the provisions contained in the relevant regulations under FEMA Regulations, 2000 and provisions of the Securities Exchange Board of India (Foreign Portfolio Investors) Regulations. Any increase of foreign investment of an Indian insurance company shall be in accordance with the pricing guidelines specified by Reserve Bank of India under the FEMA. Where an entity like a bank is allowed by IRDA to function as an insurance intermediary, the foreign equity investment caps applicable to that sector shall continue to apply provided that revenues of such entities from insurance business remain below 50% of total revenues in any financial year.

The Consolidated FDI Policy, 2014 has been amended to reflect the revised position in respect of the Insurance sector.

Source: dipp.nic.in/English/acts_rules/Press_Notes/pn3_2015.pdf

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The Government's intention to usher reforms in Insurance sector and hike cap of FDI to 49% is laudatory. The rules defines Indian control of an Indian insurer to mean control by resident Indian citizens or Indian companies, which are owned and controlled by resident Indian citizens. The rules also defines the term 'Indian ownership' of an Indian Insurance Company to mean more than 50 per cent of the equity capital in it is beneficially owned by resident Indian citizens or Indian companies, which are owned and controlled by resident Indian citizens.

III. *Tribunal clarifies issue of location savings for transfer pricing adjustments*

In the matter of Watson Pharma vs DCIT (ITAT Mumbai), the Tribunal held that where the operating margin earned by a taxpayer is at arm's length based on local market comparables and the taxpayer as well as its Associated Enterprises (AEs) operates in a perfectly competitive environment, no separate or additional allocation is required on account of location savings.

Watson Pharma, the tax payer, was engaged in providing Research and Development services to its AEs. The taxpayer used the transactional net margin method (TNMM) for testing of prices. The revenue department contended that the taxpayer should receive extra compensation due to the location savings that have arisen from the AE transferring the manufacturing activity from UK and other European countries to India, which is a lower cost jurisdiction.

The Mumbai ITAT however held that both the tax payer and the AE, operated in a perfectly competitive market and the taxpayer did not have exclusive access to any such factor that could result in location specific advantages. As a result, no super profits arose in the entire supply chain. Thus, there is no basis in saying that that taxpayer had advantage over competitors due to the location of its AEs.

Source: Watson Pharma Pvt. Ltd. v. DCIT [TS-3-ITAT-2015(Mumbai)-TP]

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The Tribunal has provided the much-needed clarity in this aspect and this ruling stipulates that where local market comparables are available, specific adjustment for location saving is not required. The Tribunal's ruling is welcome as the government looks to put in place a non-adversarial tax regime and restore the country's appeal as a destination for foreign investors.

IV. *Conditions imposed on FPIs on bond purchases*

The Reserve Bank of India and the Securities and Exchange Board of India has imposed conditions on the purchase of bonds by Foreign Portfolio Investors (FPI).

FPIs shall be permitted to invest in government securities, the coupons received on their existing investments in government securities. These investments shall be kept outside the applicable limit (currently USD 30 billion) for investments by FPIs in government securities.

FPIs are restricted from investing in Government securities having a minimum residual maturity of less than 3 years. This restriction was not applicable on corporate bonds. However, the RBI has now mandated that FPIs would henceforth be permitted to invest in corporate bonds only with a minimum residual maturity of 3 years. FPIs cannot also invest in corporate bonds with maturity exceeding 3 years but having optionality clauses exercisable within 3 years.

This requirement is only for new investments by FPIs. Existing bonds held by FPIs can be redeemed prior to 3 years.

Furthermore, FPIs shall not invest in liquid and money market mutual fund schemes. There will, however, be no lock-in period and FPIs shall be free to sell the securities (including those that are presently held with less than 3 years residual maturity) to domestic investors.

Source: http://www.sebi.gov.in/sebiweb/home/list/1/7/0/0/Circulars

VA View

The above conditions have been imposed to push foreign investors to invest in longer-term bonds, in comparison to short term investments which entail volatility to the currency.

V. New regulations for Private Placement of NCDs (maturity more than 1 year) by NBFCs

The Reserve Bank of India has amended the guidelines for private placement of non-convertible bonds (NCD) with maturity more than 1 year. The issues shall be governed by the following instructions:

- ✓ The minimum subscription per investor shall be Rs. 20,000;
- ✓ The issuance of private placement of NCDs shall be in two separate categories, those with a maximum subscription of less than Rs. 1 crore and those with a minimum subscription of Rs. 1 crore and above per investor;
- ✓ There shall be a limit of 200 subscribers for every financial year, for issuance of NCDs with a maximum subscription of less than Rs. 1 crore, and such subscription shall be fully secured;
- ✓ There shall be no limit on the number of subscribers in respect of issuances with a minimum subscription of Rs. 1 crore and above; the option to create security in favour of subscribers will be with the issuers. Such unsecured debentures shall not be treated as public deposits as defined in NBFCs Acceptance of Public Deposits (Reserve Bank) Directions, 1998.
- ✓ An NBFC (excluding Core Investment Companies) shall issue debentures only for deployment of funds on its own balance sheet and not to facilitate resource requests of group entities / parent company / associates.
- ✓ An NBFC shall not extend loans against the security of its own debentures (issued either by way of private placement or public issue).
- ✓ Tax exempt bonds offered by NBFCs are exempted from the applicability of the circular.

Source: http://www.rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=9574

VI. Tidbits

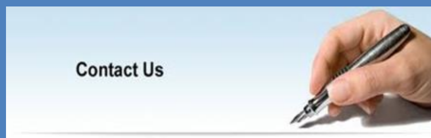
1. The Ministry of Corporate Affairs has clarified that provisions of Section 186 of the Companies Act, 2013 pertaining restrictions on loans and investments by a company shall not apply to banks, insurance companies and housing finance companies making acquisition of securities in the ordinary course of its business. Therefore these financial institutions are exempt from seeking approval of their shareholders or acquiring securities.

   Source: http://www.mca.gov.in/Ministry/pdf/ROD_1st_2015.pdf

2. Under SARFAESI Act, 2002, “substantial change in management” means the change in the management by way of transfer of shares or amalgamation or transfer of the business of the company. The Reserve Bank of India has decided that every Securitization Company/Reconstruction Company (SC/RC) is required to obtain prior approval of the Reserve Bank for any substantial change in its management. henceforth only the following changes in the share holding pattern of the SC/RC will require Reserve Bank’s prior approval:
   - ✓ any transfer of shares by which the transferee becomes a sponsor
   - ✓ any transfer of shares by which the transferor ceases to be a sponsor
   - ✓ an aggregate transfer of ten percent or more of the total paid up share capital of the SC/RC by a sponsor during the period of five years commencing from the date of certificate of registration.

A transfer shall be deemed to be a transfer of more than ten percent of the total paid up share capital of the SC/RC, if the aggregate of all the transfer of shares made by the sponsor prior to that transfer, and including that transfer, is 10% or more of the total paid up share capital of the SC/RC.

Source: http://www.rbi.org.in/scripts/BS_CircularIndexDisplay.aspx



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