Between the lines...

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I Government gives major push to foreign direct investment through radical changes in policy

In line with the Government's focus in respect of "ease of doing business" focus and the intent to further simplify the regulations governing foreign direct investment (**"FDI"**) in the country, the decision to liberalize FDI Policy was taken at a high-level meeting chaired by the Prime Minister on June 20, 2016.

Pursuant to the decision, Press Note No. 5 (2016 Series) (**"Press Note"**) was released on June 24, 2016, reviewing and amending the FDI Policy. Some salient points emerging from Press Note are briefly captured below.

- **Animal Husbandry**

FDI in animal husbandry (including breeding of dogs), pisciculture, aquaculture and apiculture sectors is now more liberalized by removal of certain conditionalities. It may be noted that FDI upto 100% under automatic route is permitted in such sectors.

- **Food Products manufactured/produced in India**

100% FDI permitted under Government approval route for trading, including through e-commerce, in food products manufactured or produced in India.

- **Defence**

FDI beyond 49% cap is now allowed under government approval route if investment will result in access to modern technology or for other reasons to be recorded. Requirement of state-of-art technology to permit FDI beyond 49%, as existed in the FDI Policy, is now removed. The Press Note also makes these changes applicable to manufacturing of small arms and ammunitions covered under the Arms Act, 1959.

- **Broadcasting**

FDI upto 100% is now allowed under automatic route in broadcasting carriage services, namely:

(a) Teleports;

(b) Direct to Home;

(c) Cable Networks;

(d) Mobile TV;

(e) Head end-in-the-Sky Broadcasting Services; and

(f) Cable Networks.

However, infusion of fresh foreign investment, beyond 49% in a company not seeking license/permission from sectoral Ministry which results in change in the ownership pattern or transfer of stake by existing investor to new foreign investor, would require Government approval.

- **Civil Aviation**

With respect to brownfield airport projects, 100% FDI is now permitted under automatic route.

With respect to scheduled air transport service/ domestic scheduled passenger airline and regional air transport service, FDI cap is now increased from 49% to 100%, with automatic route upto 49% and government route beyond 49% (for NRIs, 100% FDI will continue to be allowed under automatic route).

- **Private Security Agencies**

FDI cap for private security agencies is now increased from 49% to 74%, with FDI upto 49% under automatic route and from 49% upto 74% under the government route.

- **Trading**

There were certain sourcing norms or conditions applicable under FDI Policy for FDI in single brand product retail trading (**"SBRT"**), for example, in certain cases, sourcing of particular specified percentage of the value of goods purchased was required to be done from India, preferably from village and cottage industries, artisans and craftsmen. The Press Note alters this position by providing that such sourcing norms are not applicable upto three years from the commencement of business (i.e. opening of first store) for entities engaged in SBRT of products having state-of-art and cutting-edge technology and where local sourcing is not possible *[Note: The Press Release provided that the sourcing requirements have been relaxed up to 3 years and for entities having 'state-of-art and cutting edge' technology the sourcing norms have been relaxed for another 5 years. However, the Press Note is worded differently.]*

- **Pharmaceuticals**

Under FDI Policy, FDI in brownfield pharmaceuticals was permitted upto 100% under government route. Now, FDI in the sector is put under automatic route upto 74% while FDI beyond 74% remains under government route. It is pertinent to note that certain conditions are to be complied with for FDI in brownfield pharmaceuticals (under both automatic and government route) as laid down in the Press Note.

- **Branch office, liaison office or project office**

Branch office, liaison office or project office or any other place of business in India can be established without approval of Reserve Bank of India in cases where Foreign Investment Promotion Board approval or license/permission by the concerned Ministry or regulator has already been granted. However, this is applicable only if principal business of the applicant is defense, telecom, private security or information and broadcasting.

VA View

The Government has taken proactive steps and some bold decisions in liberalizing FDI norms in a number of sectors. It has dropped a stringent condition that accompanied FDI in defense sector. A condition which insisted on "state-of-art" technology has been replaced by "modern technology", which is a pragmatic move. The reform in brownfield pharma under automatic route up to 74% and FDI beyond 74% will aid merger and acquisitions opportunities and also raising capital in the sector. The liberalisation in airlines, allowing 100% foreign investment is far-reaching. The 100% automatic investment in brownfield airports improves the pricing for the project developers seeking to divest their holdings in brownfield airport projects. The liberalization of food retail and single-brand retail are likely to bring in more FDI to the country. In another move, tough local sourcing conditions have been diluted for companies having "state-of art" or "cutting edge" technology. The FDI liberalization shows the Government's appetite for continued reforms in respect of the FDI policy.

II. Companies (Acceptance of Deposits) Amendment Rules, 2016

The Ministry of Corporate Affairs (**"MCA"**) has issued the Companies (Acceptance of Deposits) Amendment Rules, 2016 on June 29, 2016 (**"Amendment Rules"**) which sets out various amendments to the Companies (Acceptance of Deposits) Rules, 2014.

MCA has by way of these Amendment Rules broadened the scope of exclusions to the exhaustive definition of the term 'deposits' under the Companies Act, 2013 (**"Act"**). Some of the significant amendments brought about by these Amendment Rules are as follows:

1. Exclusions from the scope of 'deposit'

- Any amount raised by compulsorily convertible debentures with tenure of 10 years as against the tenure of only 5 years earlier permitted.

- Any amount raised by issue of unsecured Non-convertible debentures not constituting a charge on the assets of the company and listed on a Stock Exchange.
- Certain additional amounts received in the course of business such as:
  - Consideration for providing future services in the form of a warranty or maintenance contract for a period as per common business practice or 5 years whichever is less;
  - Advance received in accordance with directions from Central or State Government and as allowed by any sectoral regulator;
  - Subscription towards publications.
- If any amount is received by or under:
  - Chit Funds (governed by Chit Fund Act, 1982);
  - Any collective investment scheme [governed by SEBI (Collective Investment Schemes) Regulations, 1999];
  - Company from (i) alternative investment funds; (ii) domestic venture capital funds and (iii) mutual funds.

2. Incentive to Start-ups:

Under the Amendment Rules, MCA has excluded any amount of ₹ 25 lakhs or more raised by a start-up company, by way of a convertible note which can be either convertible into equity shares or repayable within a period of five years in a single tranche, from a person.

The following terms have also been defined as under:

- Start-up companies are defined to mean those companies recognized as start-up companies under the notification issued by the Department of Industrial Policy Promotion, Ministry of Commerce and Industry.
- Convertible note is defined to mean an instrument evidencing receipt of money initially as a debt, repayable at the option of the holder or convertible into such number of equity shares of the start-up company upon occurrence of specified events and as per the other terms and conditions agreed to and indicated in the instrument.

3. Increasing the limit of outstanding deposits

The limit for outstanding deposits has been increased from 25% to 35% of the aggregate of paid-up share capital and free reserves for a public company. In case of private companies, a proviso has been introduced to allow private companies to accept from their members, monies not exceeding 100% of the aggregate of the paid up share capital, free reserves and securities premium account.

4. Additional Disclosure to be made in financial statement:

By way of a note, all companies will be required to disclose, the amounts received from a director and private companies shall additionally disclose the amounts received from relatives of directors.

VA View

The Amendment Rules offer an impetus to some 'extra' funding for start-ups without regulatory hassles. With the introduction of the above amendments, unsecured fund raising will be widely used to provide leverage to many companies. There would be some ease in doing business owing to exclusion of certain amounts received in the course of business. The Amendment Rules are an enabler for acceptance of sums from Domestic Venture Capitals Funds, Alternate Investment Funds, Collective Investment Schemes and Mutual Funds and this opens up new avenues of funding for companies.

The clarifications have liberalized the rules by opening avenues for unsecured fund raising, expanding the list of eligible investors and plugging certain gaps that existed in the deposit rules issued by the MCA.

III. Angel Tax

Section 56(2)(viib) of the Income Tax Act,1961 (**"the Act"**) introduced by Finance Act, 2012 with effect from April 1, 2013 provides that where a closely held company issues shares to a resident, for an amount received in excess of the fair market value of the shares, then the said excess portion will be regarded as income of the issuing company and charged to tax under the head 'Income from other sources'. However investments made by venture capital funds is exempted from the purview of this section.

By notification dated June 14, 2016, the Central Board of Direct Taxes (**'CBDT'**) have now extended the exemption to startups who receive consideration for issue of shares at a value higher than the face value of such shares.

The investors who finance small companies during their initial years of operations are popularly known as angel investors or seed investors. To sustain the initial expenses of startups private investors provide seed funding at more favourable terms than most formal sources of capital. The angel investment is made in the venture based on its preliminary valuation and potential of growth in future. The term angel tax has been coined from this concept of angel investments.

The notification issued by CBDT has altered the position with an aim to encourage entrepreneurship initiatives as part of the Startup India Action Plan. Nonetheless, not all the startups are qualified for the aforesaid exemption. The notification categorically states that only startups which fulfill the conditions specified by the Department of Industrial Policy and Promotion (**"DIPP"**) as per a circular dated February 17, 2016 are eligible for the angel tax exemption. The circular defines startup and lays down the qualifications for an entity to be treated as a startup. It is pertinent to note that the DIPP circular states that any startup that wishes to avail the tax exemption would have to obtain certificate of an eligible business from Inter- Ministerial Board of Certification constituted for this purpose which is a major backlash for startups. Also, there is no grandfathering provision for the retrospective investments and they will continue to be under income tax scrutiny.

VA View

While it is a welcome move and is widely appreciated in the market, the new regime comes with its own baggage. Since benefit under the policy is so interwoven with obtaining a certificate from the bureaucracy, it is difficult to say any tangible advantage would come for startups. Further, there will be practical difficulty in getting such certification as proof of innovation is the underlying criteria. However, the policy can only be considered as a good sign with regards to the way the government is thinking about the future of startups in our country. Having said that, it would be interesting to see how this policy plays a role in promotion of the ultimate objective of inculcating and encouraging entrepreneurship culture in India.

III. Non-residents not to be subjected to higher tax for not obtaining PAN

The Finance Act, 2016 amended section 206AA of the Income Tax Act (**"the Act"**) with effect from June 1, 2016 to reduce the higher rate of taxation in case of non-residents, not being a company or a foreign company who do not have a Permanent Account Number ("PAN") subject to such conditions as may be prescribed. Prior to the amendment, section 206AA provided that any person who is entitled to receive any income which is chargeable to tax in India shall furnish PAN to the person responsible for deducting such tax, failing which tax shall be deducted at a minimum rate of 20%.

To give effect to this amendment, the Central Board of Direct Taxes (**"CBDT"**) by a notification dated June 24, 2016 has inserted a new Rule 37BC providing for the prescribed details to be submitted by a non-resident payee for relaxation from deduction of tax at higher rate when PAN is not available. The new Rule provides that a non-resident deductee shall not be subject to higher tax under section 206AA in respect of payments for interest, royalty, fees for technical services, and transfer of capital assets, where the deductee furnishes 'specified details/documents' which include:

a) Name, e-mail ID, contact number

b) Address of the non-resident payee in the country of residence

c) Tax Residency Certificate ('TRC')

d) Tax Identification Number ('TIN') in the country of residence

Accordingly, Form 27Q has been amended to provide that the aforesaid details shall be furnished by the deductor in cases where the PAN of the person receiving income is not available.

VA View

This amendment will simplify and ease the flow of transactions and remove administrative hassles and cost burden for both the payer and payee as they will no longer be required to obtain a PAN solely to avoid a higher rate of tax deduction. With this provision, the government has also achieved the secondary objective of gathering more data and information on potential tax evasions.

V. Managerial Personnel Remuneration Rules amended

The Ministry of Corporate Affairs (**"MCA"**) has amended Companies (Appointment & Remuneration of Managerial Personnel) Rules 2014 to provide:

- Form MR 1, not required to be filed for appointment of CEO, CS and CFO.
- Details of only top 10 employees now to be given having remuneration exceeding ₹ 10.2 million instead of all employees exceeding ₹ 6.0 million earlier in Board Report
- Limit for part of the year increased from ₹ 500,000 to ₹ 850,000 per month
- Several other disclosures in Board Report for Listed Companies omitted.

VI. Relaxation in Rules for rotation of Statutory auditors

The Ministry of Corporate Affairs (**"MCA"**) has issued a removal of difficulty order to provide relief in case of rotation of auditors. The order has clarified that the three year transitional period has not to be reckoned from the date of commencement of this Act, i.e., April 1, 2014 but from the date the date of the first annual general meeting of the company held after April 1, 2014.

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