Between the lines...

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Highlights

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I. Warrants and partly paid shares as eligible FDI instrument

The Department of Industry Policy and Promotion (DIPP) released a press note (Press Note 9) on 15th September, 2015 making an amendment in the Consolidated FDI Policy, 2015 in relation to the issuance of partly paid equity shares and warrants by Indian companies to foreign investors.

With this amendment, an Indian company can issue warrants and partly-paid shares to non-residents so long as conditions specified by the Reserve Bank of India (RBI) are met. Prior to this, the Consolidated FDI policy had stipulated that these instruments can be issued to a non-resident only after approval through the government route.

The government's move comes more than a year after the RBI had notified that partly-paid shares and warrants issued by an Indian company would qualify as eligible instruments for FDI/ Foreign Portfolio Investment. The RBI had however, clarified that prior approval of the Foreign Investment Promotion Board (FIPB) would be necessitated irrespective of whether the investment was being made under the automatic route or the approval route.

This led to an ambiguity between the RBI guidelines and the FDI Policy. Accordingly, Press Note 9 has now amended the current FDI Policy to allow partly paid equity shares and warrants to be issued to foreign investors without government approval in those sectors where FDI is allowed under the automatic route.

The salient features of Press Note 9 are set out below:

(a) Partly paid equity shares and warrants (which include share warrants under the Companies Act, 2013) have now been included within the definition of 'Capital' under the FDI Policy.

(b) Preference shares and debentures must be fully paid up and must be mandatorily and fully convertible.

(c) A new paragraph 3.3.3 has been added to the FDI Policy which provides that Indian companies may issue warrants and partly paid equity shares to persons resident outside India subject to terms and conditions stipulated by the RBI in this regard.

Some of the key conditions for the issuance of partly paid equity shares and warrants as per the prevailing RBI guidelines are summarized below.

(i) The issuing Indian company and the non-resident investor needs to ensure that sectoral caps are not breached even after the equity shares get fully paid-up, or warrants get converted into fully paid equity shares.

(ii) In respect of companies whose activity falls within the government route under the FDI Policy, prior approval of the FIPB will be required for issuance of partly paid equity shares and warrants to eligible foreign investors.

(iii) Pricing:

Partly paid equity shares: Pricing has to be determined upfront and 25% of the total consideration amount (including share premium, if any), has to be received upfront. The balance consideration towards fully paid equity shares has to be received within a period of 12 months. The time period for receipt of the balance consideration within 12 months is not required to be complied with in case of a listed entity where the issue size exceeds INR 500 crores and the issuer complies with the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 regarding monitoring agency. Similarly, in case of an unlisted Indian company, the balance consideration amount can be received after 12 months where the issue size exceeds INR 500 crores (Indian Rupees five hundred crores). However, the investee company also has to appoint a monitoring agency on the same lines as required in case of a listed Indian company under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Warrants: Pricing and price/ conversion formula has to be determined upfront and 25% of the consideration amount has to be received upfront. The balance consideration towards fully paid up equity shares has to be received within a period of 18 months.

(iv) The reporting of issue or transfer of partly paid shares has to be made in form FC-GPR and form FC-TRS respectively, to the extent the equity shares are called up.

Source: http://dipp.nic.in/English/acts_rules/Press_Notes/pn9_2015.pdf

VA View

Till now the conflict between the Consolidated FDI Policy and the RBI Circular was creating confusion as regards whether warrants and partly paid shares could be issued to foreign investors only after approval through the government route. The amendment introduced by Press Note 9 aligns the Consolidated FDI Policy with the RBI Circular and will bring greater flexibility to Indian companies looking to raise funds from foreign investors.

II. Clarification on facility sharing agreements between group companies

The Department of Industrial Policy and Promotion (DIPP) after receiving certain references on the issue as to whether entering into facility share agreements through leasing/sub-leasing arrangements within group companies for the larger purposes of business activities would be construed to mean ‘real estate business’ within the provisions of Consolidated FDI Policy Circular of 2015 has clarified by a circular dated September 15, 2015that Facility sharing arrangements between group companies through leasing/sub-leasing arrangements for the larger interest in business will not be treated as 'real estate business' within the provisions of Consolidated FDI Policy Circular of 2015, provided such arrangements are at arm's length price in accordance with relevant provisions of Income Tax Act 1961, and annual lease rent earned by the lessor company does not exceed 5% of its total revenue.

Source: http://dipp.nic.in/English/acts_rules/fdi_clarifications/clarification_FDI%20policy_15092015.pdf

III. MAT provisions not to apply to FIIs/FPIs

The provision pertaining to minimum alternate tax or MAT under section 115JB of the Income Tax Act, 1961 ('the Act') provides that in case the tax payable on the total income of a company in respect of any previous year, computed under the Act, is less than 18.5% of its book profit, such book profit shall be deemed to be the total income of such company.

A controversy, however, had arisen on the applicability of MAT on Foreign Institutional Investors ('FIIs') due to inconsistent rulings of the Authority for Advance Rulings ('AAR') on the issue. Based on the rulings in favor of the revenue which held that MAT was applicable to foreign companies even though they had no permanent establishment in India, the income tax department started issuing notices and finalized assessments while raising MAT demand on various FIIs on capital gains made by them.

In order to rationalize the MAT provisions, an amendment was made vide Finance Act of 2015 under section 115JB of the Act excluding the income of foreign companies earned in relation to capital gains arising on transactions in securities, interest, royalty or fees for technical services, etc. from the chargeability of MAT. However, the amendment was intended to only apply prospectively from April 1, 2015, i.e. assessment year 2016-17 and therefore there was no clarity on whether MAT provisions apply to FIIs for the preceding years.

The aforesaid controversy prompted the Government to constitute a committee to examine the matter relating to levy of MAT on FIIs for the period prior to 01.04.2015 and give its recommendation on the said issue. Thus, a high level committee was set up under the chairmanship of Justice (Retd.) A.P. Shah, popularly known as the A P Shah Committee to investigate the applicability of MAT on FIIs. In its report, the Committee recommended that MAT cannot be applied to FIIs and foreign companies not having a permanent establishment in India or a place of business in India and recommended that an amendment be made to Section 115JB of Act or that the CBDT issue a circular clarifying the complete inapplicability of the MAT to FIIs/ FPIs.

The Report states that Section 115JB of the Act is not applicable to FIIs/ FPIs because the term "Company" means only companies covered by the Companies Act. Foreign companies are not required to prepare profit and loss account under the Companies Act. They are also not required to present the profit and loss account before an annual general meeting, as has been provided for under the MAT provisions of the Act.. If the applicability of MAT is extended to FIIs, it would require them to prepare their global accounts and lay them before an annual general meeting. Furthermore, under the SEBI (Foreign Portfolio Investor) Regulations, 2014, FIIs are not mandated to maintain books of accounts as provided under the Companies Act.

The Committee has also noted that "place of business" means a permanent and specific location in that country from where a company habitually and regularly carries on its business. Since, FIIs do not have any physical presence in India, Section 115JB does not apply to FIIs.

The Government has accepted the recommendation and accordingly issued an instruction stating that necessary amendments would be brought into the Act to clarify the inapplicability of MAT provisions to FIIs/ FPIs not having a place of business/permanent establishment in India for the period prior to April, 2015. The CBDT has also directed the field officers to keep the pending assessment proceedings in case of FIIs/ FPIs in abeyance and to not pursue recovery of outstanding demands.

The CBDT on September 24, 2015 has further issued a press release clarifying that with effect from April 1, 2001, the provisions of section 115JB of the Act shall not be applicable to a foreign company, if :

a) the foreign company is a resident of a country having DTAA with India and such foreign company does not have a permanent establishment within the definition of the term in the relevant DTAA, or

b) the foreign company is a resident of a country which does not have a DTAA with India and such foreign company is not required to seek registration under Section 592 of the Companies Act, 1956 or Section 380 of the Companies Act, 2013.

An appropriate amendment to the Act in this regard will also be carried out.

Most pertinently, the AAR in 2012, in Castleton Investment Limited: [2012] 348 ITR 537 had held that section 115JB of the Act was applicable to foreign companies. It was the effect of this very ruling that the income tax department started raising MAT demands on various FIIs. The company challenged the correctness of the AAR ruling before Supreme Court through a Special Leave Petition. Very recently, the Supreme Court was prompted to dismiss the said petition after the Government agreed to abide by its own circular of exempting foreign companies from paying MAT if they didn't have a permanent place of business in India.

Source: http://finmin.nic.in/reports/ReportonApplicabilityofMinimumAlternateTax%20onFIIsFPIs.pdf

VA View

This clarification will end the confusion over the applicability of MAT on foreign companies that invest in India through the foreign direct investment or venture capital route, without creating a presence here.

As in the words of Justice A. P. Shah, "the government has avoided huge litigation with 68 notices and the right signal has gone to the investors." the Government's approach in conclusively resolving the MAT issue is a step in the right direction which would instill confidence in foreign investors by providing predictability and tax certainty to them.

IV. Further relaxation of deposit rules for private companies

The Ministry of Corporate Affairs has come out with a notification on 15th September, 2015 making an amendment to Companies (Acceptance of Deposits) Second Amendment Rules, 2015. Earlier, deposits from directors in case of all types of companies, public or private, were exempted under the Companies (Acceptance of Deposits) Rules, 2014 ("Deposit Rules").

The new amendment states that –

> *"any amount received from a Person who, at the time of the receipt of the amount, was a director of the company or a* ***relative of the director of the private company:***
>
> *Provided that the director of the company or relative of the director of the private company, as the case may be, from whom money is received, furnishes to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and the company shall disclose the details of money so accepted in the Board's report.*

Henceforth, the amount received from the relatives of directors has been excluded from the purview of definition of 'deposits'.

The MCA vide an exemption Notification dated June 5, 2015 had exempted private company from accepting any amount from its members, subject to a condition that such amount shall not exceed **100% of the net worth.**

Source: http://www.mca.gov.in/Ministry/pdf/Amendement_Rules_15092015.pdf

VA View

With the new amendments, the current position with respect to acceptance of deposits is summarised as under:

(i) Amount accepted from Shareholders of a Public Company is not exempted and have to comply fully with the Deposit Rules.

(ii) Amount accepted from Directors of a Public Company is exempted under Rule 2(1)(c)(viii) of the Deposit Rules.

(iii) Amount accepted from Relatives of directors of a Public Company is not exempted and have to comply fully with the Deposit Rules.

(iv) Amount accepted from Shareholders of a Private Company is exempted to the extent of 100% of the net worth.

(v) Amount accepted from Directors of a Private Company is exempted under Rule 2(1)(c)(viii) of the Deposit Rules.

(v) Amount accepted from Relatives of directors of a Private Company is exempted.

However, along with this relaxation, an added compliance requirement has been mandated by the Ministry of Corporate Affairs that the company should disclose the details of the money so accepted in its Board's Report.

VI. SEBI issues fresh regulations on listing and disclosures

SEBI has notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. While a time period of ninety days has been given for implementing the Regulations, two specific provisions of the regulations are applicable with immediate effect:

(i) passing of ordinary resolution instead of special resolution in case of all material related party transactions subject to related parties abstaining from voting on such resolutions, in line with the provisions of the Companies Act, 2013, and

(ii) re-classification of promoters as public shareholders under various circumstances.

The Listing Regulation consolidates the provisions of existing listing agreements for different segments of the capital market, namely, Equity including convertibles issued by entities listed on the Main Board of the Stock Exchanges, Small and Medium Enterprises listed on SME Exchange and Institutional Trading Platform, Non- Convertible Debentures, Non-Convertible Redeemable Preference Shares, Indian Depository Receipts, Securitized Debt Instruments and units issued by Mutual Fund Schemes.

The Listing Regulations have been sub-divided into two parts namely,(a) substantive provisions incorporated in the main body of Regulations; (b) procedural requirements in the form of Schedules to the Regulations.

Source:http://www.sebi.gov.in/sebiweb/home/detail/31894/yes/PR-SEBI-Listing-Obligations-and-Disclosure-Requirements-Regulations-2015-Listing-Regulations

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