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Highlights

i. Bombay HC decision on arbitration between two Indian parties

ii. Supreme Court on stamp duty on security trustee agreements

iii. Accounting standards to affect business combinations

iv. RBI harmonizes regulations for issuance of ESOPs and sweat equityOnline filing of FC-TRS forms

I. Bombay High Court decision on arbitration between two Indian parties

The Bombay High Court in the recent case of **Addhar Mercantile Private Limited v. Shree Jagdamba Agrico Exports Pvt. Ltd.,** has considered the issue as to whether two Indian parties choosing a foreign seat of arbitration and a foreign law governing the arbitration agreement may be construed to be contracting out of Indian law.

The parties had entered into an agreement whereby disputes between them were to be referred to arbitration and the arbitration clause included the following language: *"Arbitration in India or Singapore and English law to be apply."*

When dispute arose between the parties, Addhar filed an application under Section 11(6) of the Arbitration and Conciliation Act,1996 (the Arbitration Act) for appointment of an arbitrator as well as a petition under Section 9 of the Arbitration Act seeking interim reliefs. Shree Jagadamba opposed both the applications. Application under Section 11(6) of the Arbitration Act was opposed on the ground that the parties are governed by English Law and the seat of arbitration shall be at Singapore.

The Bombay High Court held that the intention of both parties was clear that the arbitration shall be either in India or in Singapore. It relied on the decision of the apex court in **TDM Infrastructure Pvt. Ltd. v. UE Development India Pvt. Ltd.,** where it was held that the intention of the legislature is clear that Indian parties should not be permitted to wriggle out of Indian law and this is a matter of Indian public policy. Hence, the Bombay High Court held that the arbitration has to be conducted in India and the arbitral tribunal will have to decide the disputes in accordance with the substantive law for the time being in force in India and since both the parties are Indian, they cannot derogate the Indian law.

Source: bombayhighcourt.nic.in

VA View

In our view, it is advisable that in an arbitration between two Indian parties, the seat of arbitration should be in India and the substantive law should be Indian law. Should Indian parties decide to choose a foreign seat of arbitration, issues may arise during the arbitration proceedings, which may pose practical challenges to the parties involved in the arbitration. We would welcome the final word on this issue from the apex court.

II. Structuring of transactions from stamp duty perspective

In the matter of **Chief Controlling Revenue Authority v. Coastal Gujarat Power Ltd.,** the Supreme Court decided upon the question of whether a single mortgage executed in favour of the security trustee for the benefit of several syndicated lenders would be treated as a single document or as multiple documents. The apex court held that a security trustee agreement ought to be construed separately for each syndicated lender and stamped as multiple documents.

The borrower, Coastal Gujarat Power Limited, required finance to set up a power project. Thirteen banks and financial institutions formed a consortium and executed a security trustee agreement appointing State Bank of India as the security trustee. The borrower executed a mortgage deed with the security trustee, and paid stamp duty of ₹ 421,000 on the document. The revenue authorities held that ₹ 5,462,000 ought to have been paid as stamp duty and, hence, demanded the balance amount of ₹ 5,041,000/- from the company.

Under Section 5 of the Gujarat Stamp Act, 1958 (the 'Act') any instrument comprising or relating to several distinct matters shall be chargeable with the aggregate amount of the duties with which separate instrument, each comprising or relating to one of such matters or distinct transactions, would have been chargeable under the Act.

The Gujarat High Court noted that stamp duty is payable on instruments and not on transactions. Therefore, merely because one single document was executed as against different sets of documents, such fact would not enable the State authorities to bring the transaction under the ambit of Section 5 of the Act.

The apex court however held that, by reading the trustee document, altogether 13 banks lent money to the mortgagor, and for the repayment of money, the borrower entered into separate loan agreements with 13 financial institutions. Had this borrower entered into a separate mortgage deed with these financial institutions in order to secure the loan there would have been a separate document for distinct transactions. On proper construction of this indenture of mortgage, the apex court regarded this as 13 distinct transactions which fall under Section 5 of the Act.

Source: http://judis.nic.in/supremecourt/imgs1.aspx?filename=42843

VA View

This decision will have a major impact on all transactions where a single document is executed for multiple transactions to save on stamp duty. This judgment is a departure from the established position that only the form of the instrument would be looked at for determination of stamp duty and not the nature of the transaction. This decision will lead the authorities to scrutinize the documentation structure thoroughly so as to ensure that proper stamp duty is paid on distinct transactions.

III. Accounting Standards to affect Business Combinations

The Accounting Standards issued by the Institute of Chartered Accountants of India, which are applicable from the next financial year, has brought in key changes in the accounting and recording of mergers and acquisitions.

The first of these relates to Ind AS-36, in respect of the method to be used for accounting the goodwill of the target company. According to the extant accounting standards, the goodwill is amortized over a period of five years. Under the new accounting standards, the goodwill will undergo an impairment test in each year. For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the target company are assigned to those units or groups of units.

Thus goodwill will be tested for impairment at each level of allocation and this will reflect the way an entity manages its operations, with which the goodwill would naturally be associated. A cash-generating unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that the unit may be impaired, by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. If the recoverable amount of the unit exceeds the carrying amount of the unit, the unit and the good will allocated to that unit shall be regarded as not impaired. If the carrying amount of the unit exceeds the recoverable amount of the unit, the entity shall recognize the impairment loss. This method of measuring goodwill, as against the previous method of standard amortization, can affect the overall value of the company.

Under the extant accounting standards, control is assessed based on ownership of more than 50% of the voting power or control of the composition of the Board of Directors. However, under Ind AS-110, a new definition of control has been introduced as per which an investor controls an investee if it has all the following: (a) power over the investee (b) exposure, or rights, to variable returns from its involvement with the investee, and (c) the ability to use its power over the investee to affect the amount of the investor's returns. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, when exercised or converted, to give the entity voting power or reduce another party's votingpower over the financial and operating policies of another entity (potential voting rights).The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other parties, are to be considered when assessing whether an entity has the power to govern the financial and operating policies of another entity.

Further, under Ind AS-27, redeemable preference shares shall be classified and presented under'liabilities' as 'long term borrowings' and the disclosure requirements in this regard applicable to such borrowings shall be applicable mutatis mutandis to redeemable preference shares. Thus, companies that have outstanding preference share capital will now be required to capitalize such dividend costs as borrowing costs, which will affect the leverage ratio of these companies.

VA View

The new accounting standards, called IndAS, would need companies to make changes in the way they account for revenue and tax and the merger and acquisition deals will have to be structured taking into account the accounting standards which would be applicable from April 1, 2015.

IV. RBI harmonizes regulations for issuance of ESOPs and sweat equity

The Reserve Bank of India vide Notification No. FEMA.344/2015 RB dated June 11, 2015 made certain amendments in the RBI regulations with reference to the provisions governing the issue of options/sweat equity shares by listed and unlisted companies under the Companies Act, 2013, SEBI Guidelines and FEMA, 1999.

Prior to the amendment, an Indian company could issue shares under an ESOP scheme to its employees or employees of its joint venture or wholly owned overseas subsidiary/subsidiaries who are resident outside India, directly or through a trust, provided the scheme had been drawn in accordance with the Companies Actor SEBI Regulations as the case may be. In addition to this, the face value of the shares allotted under the scheme to non-resident employees could not exceed 5% of the paid up capital of the issuer.

Now, an Indian company may issue "employees' stock option" and/or "sweat equity shares" to its employees/ directors or employees/directors of its holding company or joint venture or wholly owned overseas subsidiary/ subsidiaries who are resident outside India, provided that:

a. The scheme has been drawn either in terms of regulations issued under the Securities Exchange Board of India Act, 1992 or the Companies (Share Capital and Debentures) Rules, 2014 notified by the Central Government under the Companies Act 2013, as the case may be.

b. The "employee's stock option"/ sweat equity shares issued to non-resident employees/directors under the applicable rules/regulations are in compliance with the sectoral cap applicable to the said company.

c. Issue of "employee's stock option"/ sweat equity shares in a company where foreign investment is under the approval route or where an employee/director is a citizen of Bangladesh/Pakistan shall require prior approval of the Foreign Investment Promotion Board (FIPB) of Government of India.

Source: https://rbi.org.in/Scripts/BS_FemaNotifications.aspx?Id=9915

V. Online filing of FCTRS returns

With a view to promoting the ease of reporting of transactions under foreign direct investment, the Reserve Bank of India (RBI), under the aegis of the e-Biz project of the Government of India has enabled online filing of the Foreign Currency Transfer of Shares (FCTRS) returns for reporting transfer of shares, convertible debentures, partly paid shares and warrants from a person resident in India to a person resident outside India or vice versa.

The design of the reporting platform enables the customer to login into the eBiz portal, download the reporting form (FCTRS), complete and then upload the same onto the portal using their digitally signed certificates. The Authorised Dealer Banks (ADs) will be required to download the completed forms, verify the contents from the available documents and if necessary, call for additional information from the customer and then upload the same for RBI to process and allot the Unique Identification Number (UIN). The FCTRS services of RBI will be made operational on the e-Biz platform from August 24, 2015.

It may be noted that for the present, the online reporting on the e-Biz platform is an additional facility to the Indian residents to undertake their FCTRS reporting and the manual system of reporting as prescribed in terms of A.P. (DIR Series) Circular No.6 dated July 18, 2014 would continue till further notice.

Source: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9993&Mode=0

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