

## Between the lines...

August, 2014

### Key Highlights...

- ✓ Clarification to the scope of “related parties” under new Companies Act, 2013.
- ✓ Partly paid equity shares and warrants issued by an Indian company, which are now eligible instruments for the purpose of FDI and FPI by FIIs.
- ✓ Switch over to the NIC 2008 from the NIC 1987 version in RBI reporting.
- ✓ Restoration of limit of Financial Commitment by Indian Party to 400% of the net worth under ODIs.
- ✓ Increase in LRS limit to USD 1,25,000/-.

### I. Removing Difficulties in respect of Related Party Transactions

#### Independent Directors

Rule 3 of Companies (Specification of definition details) Rules, 2014 has been amended and it now excludes independent directors of holding companies and their relatives from the definition of related parties.

#### Voting Pattern

The second change that has been brought up is in the way related parties can vote in a meeting. Only those related parties who are related in the context of a contract being discussed in the said meeting and for which special resolution under section 188(1) of the Companies Act, 2013 (“2013 Act”) is being passed cannot vote, but other related parties (i.e. who are related to the company, but not specifically to the contract for which vote is

taken) can vote.

#### Mergers, Amalgamations and Schemes of Arrangements

It has been clarified that the various restrictions imposed by Section 188 of the 2013 Act will not affect mergers, amalgamations, compromises and schemes of arrangements.

#### Requirement of Fresh Approval

There is no requirement of fresh approval for related party contracts which were entered into by the company prior to the commencement of the Act with due compliance of the provisions under the previous Companies Act, 1956 until the expiry of the original term of such contracts. However, if the terms of the earlier contracts are modified, approvals according to the 2013 Act would be necessary.

Source: MCA general circular no. 30/2014 dated July 17, 2014 and Companies (Specification of definitions details) Amendment Rules, 2014 (notification dated July 17, 2014)

#### VA View

The combined effect of these clarifications should be viewed as a toning down of the restrictive provisions of Section 188 of the 2013 Act.

As per Rule 15(2) of the *Companies (Meetings of Board and its Powers) Rules, 2014*, if a related party contract (which is not on arms-length basis and in excess of the specified limits) is entered between the foreign holding company and its Indian wholly owned subsidiary (WOS), the special resolution shall be required to be passed by the holding company for the purpose of entering into the transactions between WOS and its holding company. However getting the special resolution passed by the foreign holding company may be quite a task in case of large MNCs with diversified shareholding.

The recent clarifications should have exempted the transactions between the foreign holding company and Indian WOS as in such a case shareholder interest is not affected.

## ***II. Issue of Partly-paid Shares and Warrants by Indian Company to Foreign Investors***

As per the existing regulations, only equity shares and compulsorily and mandatorily convertible preference shares/debentures were recognized as Foreign Direct Investment (FDI) compliant instruments. Further, equity shares or compulsorily and mandatorily convertible preference shares/debentures containing an optionality clause but without any option/ right to exit at an assured price have also been recognized as FDI compliant instruments. Recently by the Circular dated July 14, 2014, Reserve Bank of India (RBI) has revised the said policy to the effect that partly paid shares and warrants issued by Indian companies in accordance with the Act and SEBI guidelines will henceforth be eligible for FDI and foreign portfolio investment (FPI) by Foreign Institutional Investors (FIIs)/Registered Foreign Portfolio Investors (RFPIs) subject to compliance with FDI and FPI schemes and conditions as prescribed in the said circular including but not limited to:

### ***For Partly-paid shares***

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- The pricing of the partly paid equity shares would be determined upfront and 25 per cent of the total consideration amount (including share premium, if any), would also be received upfront.
- The balance consideration would be received within a period of 12 months.
- The time period for receipt of the balance consideration within 12 months shall not be insisted upon where the issue size exceeds Rs. 500 crores and the issuer complies with SEBI Regulations regarding monitoring agency.
- In case of an unlisted Indian company, the balance consideration can be received after 12 months where the issue size exceeds Rs. 500 crores. However, the investee company shall appoint a monitoring agency on the same lines as required in case of a listed Indian company.

### ***For Warrants***

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- The pricing of the warrants and price/ conversion formula shall be determined upfront and 25% of the consideration amount shall also be received upfront.
- The balance consideration shall be received within a period of 18 months.
- The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such warrants. Thus, company shall be free to receive consideration more than the pre-agreed price.

### ***Other Conditions***

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- The onus of compliance of all the conditions under FEMA as regards entry route, sectoral caps and all other conditions under FDI guidelines shall be on the Investee company in case of issue of partly paid shares /warrants as well as upon resident transferor or transferee in accordance with extant guidelines in case of transfer of partly-paid shares/warrants.

- The company and the non-resident investor while issuing and acquiring respectively the partly paid shares or warrants shall ensure that the sectoral caps are not breached even after the shares get fully paid-up or warrants get converted into fully paid equity shares.
- The Indian company whose activity/ sector fall under government route would require prior approval of the Foreign Investment Promotion Board (FIPB), Government of India for issue of partly-paid shares/ warrants.
- Non-Resident Indians (NRIs) shall also be eligible to invest on non-repatriation basis in partly-paid shares and warrants issued by Indian companies in accordance with the provisions of the Companies Act/ SEBI guidelines / Income tax provisions, as applicable.

*Source: A.P.(DIR Series) Circular No.3 dated July 14, 2014*

#### **VA View**

As for warrants and partly-paid shares, the liberalization should be expected to increase inflow of capital into India and increase fund raising options for Indian companies. Further, the Indian company can get a price higher than the fair value worked out at the time of issuance of the warrants but is insulated from the price being lowered at the time of conversion.

### **III. Foreign Direct Investment – Reporting under FDI Scheme**

In terms of FEMA regulations as amended from time to time, Indian companies are required to report the details of the issue of shares, convertible debentures, partly paid shares and warrants in form FC-GPR and transfer of shares, convertible debentures, partly paid shares and warrants by way of sale from a person resident in India to a person resident outside India or vice versa, are required to be reported by the transferor/transferee resident in India to the AD Bank in form FCTRS. For the aforesaid purpose, Indian companies were until now required to report the NIC Codes in the FCGPR and FCTRS forms as per the NIC 2008 version.

RBI by circular dated July 18, 2014 has now in terms of Press Note 4 (2014 Series) dated June 26, 2014 issued by the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India, decided to switch over to the National Industrial Classification 2008 (NIC 2008) from the NIC 1987 version, for the purpose of classification of activities under the industrial classification system in the Forms FC-GPR and FC-TRS.

It has also been decided to introduce a uniform State and District code list for reporting of details of FDI by Indian companies in Form FCGPR. The list can be accessed on the RBI website.

*Source: A.P. (DIR Series) Circular No. 6 dated July 18, 2014*

### **IV. Financial Commitment (FC) by Indian Party under Overseas Direct Investments (ODI) – Restoration of Limit**

RBI by Circular dated July 3, 2014 decided to restore the limit of Overseas Direct Investments (ODI)/ Financial Commitment (FC) to be undertaken by an Indian Party under the automatic route to the limit prevailing, as per the extant FEMA provisions, prior to August 14, 2013 i.e. 400 per cent of the net worth of the Indian Party under the Automatic Route.

It has, however, been decided that any financial commitment exceeding USD 1 (one) billion (or its equivalent) in a financial year would require prior approval of the Reserve Bank even when the total FC of the Indian

Party is within the eligible limit under the automatic route (i.e., within 400% of the net worth as per the last audited balance sheet).

*Source: A.P. (DIR Series) Circular No.1 dated July 3, 2014*

## **V. Titbits...**

- ✓ Ministry of Finance has proposed raising the Foreign Direct Investment (FDI) cap from 26 per cent to 49 per cent through the FIPB route in Insurance Sector.
- ✓ Under the Finance Bill, 2014, Dividend Distribution Tax ('DDT') is proposed to be applied to the amount of dividend distributed to shareholders by grossing up the said amount. The said amendment will have the effect of raising the DDT from 16.995% at present to 19.98%. The new rate will be applicable to all dividends proposed on or after 01.10.2014.

*Source: Union Budget, 2014*

- ✓ AD Category -I banks have been allowed to remit up to USD 125,000 per financial year, under the Liberalized Remittance Scheme, for any permitted current or capital account transaction or a combination of both. The Scheme can now be used by resident individuals for acquisition of immovable property outside India.

*Source: A.P. (DIR Series) Circular No.5 dated July 17, 201*



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