Highlights

- RBI clarifies rate of exchange for conversion of ECB to equity.
- Optionality provisions allowed on FDI instruments.
- Asset reconstruction companies allowed to convert debt into shares.
- CBEC issues clarification on levy of service tax on services by RWA to its members.
- Tesco Liaison Office wins tax relief in India.
- SC lays down guidelines on invoking writ jurisdiction in debt recovery matters.

Corporate Brief

➲ *RBI clarifies rate of exchange for conversion of ECB to equity.*

In terms of an earlier circular (A.P. DIR Series Circular No. 15 dated 01.10.2004) the Reserve Bank of India ('RBI') had allowed Indian companies to issue equity shares against External Commercial Borrowings ('ECB'). Indian companies are required to follow the pricing guidelines prescribed by RBI in this regard.

However, some references were received by RBI regarding how the rupee amount against which equity shares are to be issued shall be arrived at. Based on such references, RBI has issued a clarification on the rate of exchange to be applied to the amount in foreign currency borrowed or owed by the resident entity from/ to the non-resident entity. In its clarification, RBI has provided that where the liability sought to be converted by the company is denominated in foreign currency as in the case of ECB, import of capital goods, etc. the company is to apply the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion. The borrower company may also issue equity shares for a rupee amount less than that arrived at by a mutual agreement with the ECB lender.

RBI has further clarified that the principal of calculation of the Rupee equivalent for a liability denominated in foreign currency shall also apply where there is a conversion by an Indian company of its payables/ liability into equity shares or other securities to be issued to a non-resident.
[See A.P. (DIR Series) Circular No. 94, dated 16.01.2014]

➲ *Optionality provisions allowed on FDI instruments.*

Earlier only equity shares or preference shares/ debentures were eligible to be issued to persons resident outside India under the provisions of the Foreign Exchange Management (Transfer and Issue of Shares by a Person Resident Outside India) Regulations, 2000 ('Regulations'). RBI has now decided to allow optionality clauses in equity shares and compulsorily and mandatorily convertible preference shares/ debentures to be issued to a person resident outside India under the Foreign Direct Investment Scheme. Such optionality clause will provide for the buy-back of securities from the investor at the price prevailing/ value determined at the time of exercise of the optionality so as to enable the investor to exit without any assured return.

Furthermore, RBI has made the aforesaid allowance subject to certain conditions: (i) There is to be a minimum lock-in period as prescribed under the Regulations. Such lock-in is to be effective from the date of allotment of such shares or convertible debentures; (ii) After the lock-in period, the non-resident investor exercising such option shall be eligible to exit without any assured return; (iii) In case of a listed company, the non-resident investor shall be eligible to exit at the market price prevailing at the recognised stock exchanges; (iii) In case of an unlisted company, the non-resident investor shall be eligible to exit at a price not exceeding that arrived on the basis of Return on Equity as per the latest audited balance sheet; (iv) investments in Compulsorily Convertible Debentures, and Compulsorily Convertible Preference Shares of the investee company can be transferred at a price worked out as per any internationally accepted pricing methodology at the time of exit certified by a Chartered Accountant or a SEBI registered merchant banker.

The guiding principle being applied by RBI in such cases is that the non-resident investor should not be guaranteed any assured exit price at the time of making such investment, and exit should take place at the price prevailing at the time of exit.
[See A.P. (DIR Series) Circular No. 86 dated 09.01.2014]

➲ *Asset reconstruction companies allowed to convert debt into shares.*

RBI has allowed asset reconstruction companies ('ARCs') to convert a portion of their debt into shares of the borrower company as a measure of asset reconstruction provided that the shareholding of such ARCs does not exceed 26% of the post converted equity of the company under reconstruction. The ARCs are also required to obtain, for the purpose of enforcement of security interest, the consent of secured creditors holding not less than 60% of the amount outstanding to a borrower.

Additionally, ARCs are now permitted to acquire debt from other ARCs provided: (i) The acquisition is for the purpose of debt aggregation for the enforcement of security interest and as such the acquiring ARC's existing holdings at the time of acquisition are less than 60%, and the further acquisition from other ARCs shall add up to 60% or more of the total secured debt in the books of such acquiring ARCs; (ii) The transaction is settled on a cash basis; (iii) The selling ARC shall be required to utilise the proceeds so realised for the purpose of redemption of the underlying Security Receipts.

The acquisition of debt from other ARCs should not result in extension of the date of redemption of the Security Receipts issued by the acquiring ARCs for the assets acquired from banks/ other financial institutions; nor shall it extend the period of realisation of assets beyond 8 years from the date of acquisition of the asset by the acquiring ARCs from the banks/ financial institutions concerned.
[See DNBS (PD) CC. No. 35 / SCRC / 26.03.001/ 2013-2014 dated 23.01.2014]

Taxation Brief

➲ *CBEC issues clarification on levy of service tax on services by RWA to its members.*

Under the negative list approach towards applicability of service tax, service by a Resident Welfare Association (RWA) to its own members by way of reimbursement of charges or share of contribution up to INR 5000/- per month per member for sourcing of goods or services from a third person for the common use of its members is exempted from service tax. Upon receipt of certain queries from stakeholders, the Ministry of Finance ('Ministry') has issued a clarification paper on certain aspects of the levy of service tax on services provided by RWAs to its own members.

In terms of the clarification issued, if the per month per member contribution of any or some members of a RWA exceeds INR 5000/-, the entire contribution of such members whose per month contribution exceeds INR 5000/- would be ineligible for the exemption from service tax. Service tax would then be leviable on the aggregate amount of monthly contribution of such members.

The Ministry has also clarified that the taxable service of aggregate value not exceeding INR 10 lakh in any financial year that is exempt from service tax does not include the value of services which are exempt from service tax. Also, where the utility charges are collected by the RWA from its members and paid to the agencies without charging any consideration or commission, the RWA is acting as a pure agent and as such is excluded from the levy of service tax. Additionally, the clarification provides that RWAs are allowed to avail cenvat credit and use the same for payment of service tax, in accordance with the Cenvat Rules.
[See Circular No. 175/01/2014-ST dated 10.01.2014]

➲ *Tesco Liaison Office wins tax relief in India.*

The Bangalore Income Tax Appellate Tribunal ('ITAT') has held in the case of *M/s. Tesco International Sourcing Limited vs. Dy. Director of Income Tax (International Taxation)* that the activities of the Liaison Office ("LO") established by Tesco, Hong Kong, in India is in the nature of acting as a communication channel between Tesco, Hong Kong and certain apparel vendors. Consequently, the ITAT has held that no profits can be attributable to the activities undertaken by the LO.

The LO was established in India in 2001 for coordinating between Tesco, Hong Kong and certain apparels vendors in India. It was submitted that the activities of the LO were (i) identification of the vendors in India, (ii) communication of the design and specification requirements of Tesco, Hong Kong to the vendors, (iii) receiving prototypes from vendors, (iv) quality check of the products before production, and (v) tracking the production and delivery of the products, including forecasting and scheduling of the product orders. The Assessing Officer passed draft assessment order arriving at a taxable income of the LO for the Assessment Years 2003-04 to 2007-08, which were taxable in India.

It was contended by the LO that its activities are covered under the exemption provided in Clause (b) Explanation 1 of Section 9(1)(i) of the Income Tax Act, 1961, and that no income can be deemed to accrue or arise in India. In its order dated 10.01.2014 the ITAT has held that the LO is only enabling the vendors to purchase goods of a particular specification that is required by Tesco, Hong Kong, and since the whole object of the transaction is to purchase goods for the purpose of exports, the LO is not earning any income in India.
[See ITA Nos. 1323 to 1327 of 2011]

Litigation Brief

➲ *SC lays down guidelines on invoking writ jurisdiction in debt recovery matters.*

In the case of *T.P. Vishnu Kumar vs. Canara Bank*, , the Supreme Court of India has observed that the High Courts can only interfere with the Orders/Interim Orders passed by The Debt Recovery Tribunals (DRT) in the matter of recovery of dues. The Supreme Court has laid down guidelines to appeal such Orders where there is a statutory violation resulting in prejudice to a party and such proceedings or action is wholly arbitrary, unreasonable and unfair.

When a specific remedy is available to an aggrieved party, the High Courts in exercise of their writ jurisdiction under Article 226 of The Constitution of India are not justified in interfering with the Orders of the DRT to examine the correctness of the rejection of applications. Section 20 of the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, lays down the provisions of appeal to the Appellate Tribunals. Section 18 deals with bar of jurisdiction and Section 17 confers the power of civil courts on DRT to deal with applications from banks and financial institutions for recovery of debts. The Supreme Court has also observed that if the correctness of any interim order passed by a Tribunal is tested in a Writ Court, it will only defeat the object and purpose of establishing such Tribunals. Therefore, an aggrieved party should not request the Hon'ble High Court to invoke its writ jurisdiction when there already exists a proper mechanism of the DRT to deal in such matters.
[See (2013) 10 SCC 652]

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