AMARCHAND & MANGALDAS & SURESH A. SHROFF & CO.

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Insight

Analysis of Recent Developments in Indian Corporate Law

Foreword

It gives me great pleasure to present to you the thirty third issue of "*Insight*" covering the period from December 1, 2011 to March 1, 2012, the Firm's quarterly update of recent legal developments affecting the corporate world.

In this issue of "*Insight*", we have dealt with at the principle of 'piercing of the corporate veil' as espoused by the Supreme Court in the land mark *Vodafone* judgment. This issue also covers the other important changes in the last three months in relation to the foreign direct investment policy for single brand retail, the external commercial borrowings policy and the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Please do feel free to provide your feedback and suggestions to insight@amarchand.com.

Regards,

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Corporate Veil and the Vodafone Judgment

Back to Index Page

Introduction

In a recent land mark ruling of the Supreme Court in *Vodafone International Holdings B.V. v. Union of India & Anr. [Civil Appeal No. 733 of 2012 arising out of SLP (C) No. 26529 of 2010],* the Court set aside a Bombay High Court judgment directing Vodafone International Holdings to pay Rs.11,000 crores as income tax in a transaction that took place off-shore.

In May 2007, Vodafone International Holdings BV, a company incorporated in the Netherlands ("**Vodafone**"), acquired from Hong Kong based Hutchison Group, the entire share capital of CGP Investments (Holdings) Ltd. ("**CGP**"), a company incorporated in the Cayman Islands, which in turn controlled a 67% stake in Hutchison-Essar Ltd. ("**HEL**"), Hutchison's Indian mobile business. The sale price was USD 11.2 billion, and the Indian income tax authorities contended that capital gains were made by Vodafone in India and that Vodafone was therefore liable to pay tax thereon, amounting to approximately Rs.11,000 crores.

Vodafone, challenged the tax levied in the Bombay High Court, which ruled against it and in favour of the income tax authorities (the "**Revenue**"), holding that "*the essence of the transaction was a change in the controlling interest in HEL which constituted a source of income in India*". Vodafone appealed to the Supreme Court, which overturned the judgment of the Bombay High Court and ruled that Vodafone was not liable to pay income tax on the transaction. Please refer to our earlier special issue of "*Insight*" dated January 23, 2012 (Issue XXX) for a detailed analysis of the Supreme Court's judgment in the *Vodafone case*.

Other than in the context of tax planning and assessment, this decision of the Supreme Court has important implications in the context of the legal principle of the 'corporate veil', and when it may be lifted, particularly in the context of tax avoidance.

Corporate veil – what is it and when can it be pierced?

Indian law recognizes that upon incorporation, a company acquires a distinct legal identity, different from that of its shareholders, members or directors. This separate corporate existence enables the company to contract with its shareholders and third parties, to acquire and hold property in its own name, to sue and be sued in its own name, and shareholders of a company are not personally liable for the acts or liabilities of the company. It has perpetual succession, its life is not dependent on that of its shareholders and remains in existence, however often its members change, until it is dissolved.

The earliest legal case that recognized that a company is a separate legal entity, distinct from its members, is often traced back to *Salomon v Salomon [(1897) AC 22],* and a number of other decisions following it, have firmly established this principle.

In certain circumstances, courts may ignore the independent personality of the company, and 'lift' the corporate veil to go behind the corporate personality, to the individual members or to the economic entity constituted by a group of associated companies. This enables a court to lift the corporate veil of the company in order to determine the person(s) / entity(ies) responsible for controlling / carrying on the functions of the company. The principle was summarised by the Supreme Court in *Life Insurance Corporation of India v. Escorts Ltd [(1986) 1 SCC 264, 336].* when it stated:

> *"... the corporate veil may be lifted where a statute itself contemplates lifting the veil, or fraud or improper conduct is intended to be prevented, or a taxing statute or a beneficent statute is sought to be evaded or where associated companies are inextricably connected as to be, in reality, part of one concern. It is neither necessary nor desirable to enumerate the classes of cases where lifting the veil is permissible, since that must*

necessarily depend on the relevant statutory or other provisions, the object sought to be achieved, the impugned conduct, the involvement of the element of the public interest, the effect on parties who may be affected, etc.".

In this case, the corporate veil was proposed to be lifted to ascertain the real investing entities, when investments were made through a number of intermediary companies. Insofar as parent / subsidiary companies are concerned, the principle of the corporate veil demands that they also be treated as separate legal entities, unless they are in actuality and function as, a single economic entity. Hence, where the subsidiary, though having a distinct legal personality, does not in fact act autonomously and essentially carries out the instructions given to it by the parent, it is possible to say that the subsidiary and the parent are really one and the same. The Court has to examine whether the two companies are truly separate and independent, and among the factors it will consider are whether the persons conducting the business were "*guided by the same head and brain"* and whether the parent decided what the subsidiary should do [*Hackbridge-Hewittic & Easun Ltd. v. G.E.C. Distribution Transformers Ltd., [1992] 74 Comp Cas 543, 552-557, 563-571 (Mad)*]. Courts have also lifted the corporate veil if it is found that a subsidiary company has been constituted with the sole intention of concealing the true facts, to act as a façade and thereby perpetrate a fraud [*Delhi Development Authority v. Skipper Constructions Co. (P) Ltd., (1996) 4 SCC 622*], or to "*look at the realities of the situation and to know the real state of affairs*" [*Subhra Mukherjee v. Bharat Coking Coal, (2000) 3 SCC 312, 318*].

Courts have the power to lift the corporate veil and disregard the independence of the corporate entity if it is used for tax evasion or to circumvent tax obligations [*Commissioner of Income Tax v. Sri Meenakshi Mills Ltd., AIR 1967 SC 819*], or to ascertain the residential status of the company for the purpose of tax incidence [*V.V.R.N.M. Subbayya Chettiar v. Commissioner of Income Tax, AIR 1951 SC 101; Narottam & Parekh Ltd v. Commissioner of Income Tax, AIR 1954 Bom 67*], or where the principle of corporate personality is too flagrantly opposed to justice, convenience or in the interest of revenue [*New Horizons Ltd. v. Union of India, (1995) 1 SCC 478*].

Ruling on corporate veil

In the *Vodafone case*, the Supreme Court dealt with the principle of the corporate veil and when it can be lifted, primarily in the context of taxation in India, at Paragraphs 66 to 68 of the judgment of the Chief Justice, and Paragraphs 43 to 46, 56 to 61 and 75 to 76, of Justice Radhakrishnan's judgment.

The Chief Justice first recognizes the principle of the corporate veil by noting that "*[t]he approach of both the corporate and tax laws, particularly in the matter of corporate taxation, generally is founded on the abovementioned separate entity principle, i.e., treat a company as a separate person. The Indian Income Tax Act, 1961, in the matter of corporate taxation, is founded on the principle of the independence of companies and other entities subject to income-tax*". On this basis, he further notes in the context of parent / subsidiary relationships, that it is generally accepted that the group parent company would give guidance to group subsidiaries, but that by itself would not justify lifting the corporate veil or imply that the subsidiaries are to be deemed residents of the State in which the parent company resides, and that "*a subsidiary and its parent are totally distinct tax payers*".

The Chief Justice then clarifies that it is only in a situation where the subsidiary is fully controlled or subordinate to the parent company, and / or the actual controlling parent company makes an indirect transfer through "*abuse of organization form/legal form and without reasonable business purpose*" which results in tax avoidance, that the separate legal entities may be ignored and the subsidiary's place of residence may be linked with that of its parent company, and tax imposed on the actual controlling parent company. "*Thus, whether a transaction is used principally as a colorable device for the distribution of earnings, profits and gains, is determined by a review of all the facts and*

circumstances surrounding the transaction. It is in the above cases that the principle of lifting the corporate veil or the doctrine of substance over form or the concept of beneficial ownership or the concept of alter ego arises."

While dealing with the aspect of tax liability in India and indirect transfers / holding company and subsidiary company relationships, the Chief Justice notes that it is common for foreign investors to invest in Indian companies indirectly, through an interposed foreign holding or operating company, such as Cayman Islands or Mauritius based company, for both tax and business purposes. The GAAR (General Anti Avoidance Rules), adopted by India and its judicial anti-avoidance rule, permit the Revenue to "*invoke the 'substance over form' principle or 'piercing the corporate veil*", if it is able to establish that the transaction in which the corporate entity is used is a "*sham or tax avoidant*". As an example, if the Revenue finds that in an investment transaction / acquisition, "*an entity which has no commercial/business substance has been interposed only to avoid tax*", then in such cases the Revenue would be entitled to ignore the separate legal identity or interposition of that entity, to look at the holding company as having directly made the investment / acquisition. The Chief Justice then lists out six factors that may be considered in order to determine whether the transaction is a sham and whether in a specific case, the corporate veil may be lifted, i.e. "*the concept of participation in investment; the duration of time during which the Holding Structure exists; the period of business operations in India; the generation of taxable revenues in India; the timing of the exit; the continuity of business on such exit.*"

Justice Radhakrishnan judgment also recognises the principle of the corporate veil and that a company / subsidiary company, is a separate entity which will be held to be so except in very limited circumstances. In the context of tax liability, he repeatedly observes that the veil can be lifted only if the Revenue establishes that the transaction / corporation has been "*effected to achieve a fraudulent or dishonest purpose, so as to defeat the law*", or where it is "*fraudulent, sham, circuitous or a device designed to defeat the interests of the shareholders, investors, parties to the contract and also tax evasion*". As such, merely because there is a holding / subsidiary relationship in which the holding company controls the subsidiary or that they are a single economic unit, would not justify a lifting of the corporate veil [*Adams v. Cape Industries Plc., (1991) All.ER. 929*], unless it is for the purposes of "*tax evasion*".

In the final analysis, the Supreme Court in *Vodafone*, decided against lifting the corporate veil as the tax authorities failed to establish, that the Vodafone transaction was a sham or tax evasion scheme. The Chief Justice noted, "*There is a conceptual difference between preordained transaction which is created for tax avoidance purposes, on the one hand, and a transaction which evidences investment to participate in India"* and that in order to ascertain into which bracket the transaction fell, one should take into account the six factors mentioned above. In this regard the Chief Justice observed that the Hutchison structure (i.e. the parent company in Hong Kong, the intermediate subsidiary in the Cayman Islands, and the final subsidiary in India etc.), had existed for a considerable length of time generating taxable revenues right from 1994, that the Share Purchase Agreement envisaged "*continuity*" of the telecom business, and that accordingly the Hutchison structure was not created or used as a sham or tax avoidance scheme. In the circumstances, where the court is satisfied that the transaction satisfies all the parameters of "*participation in investment*" the Court need not go into the questions such as de facto control vs. legal control, legal rights vs. practical rights, etc., and accordingly, there was no need to lift the corporate veil of the Hutchison or Vodafone entities.

Financial Markets

Back to Index Page

The key developments in the financial and capital markets space during the period December 2011 to February 2012 are set forth below:

New Methods to Achieve Minimum Public Shareholding

The Securities and Exchange Board of India ("**SEBI**") has introduced two additional methods for listed companies to achieve minimum public shareholding levels of 25% or 10%, as applicable (as mandated by the Securities Contract (Regulations) Rules, 1957), being (i) the Institutional Placement Programme; and (ii) Offer for Sale through Stock Exchanges.

- Institutional Placement Programme: The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("**ICDR Regulations**") have been amended to include chapter VIII-A, which provides the regulatory framework for the Institutional Placement Programme.

- Offer for Sale through Stock Exchanges: Promoter and promoter group entities of listed companies have been permitted to undertake an offer for sale through stock exchanges to achieve minimum public shareholding subject to various conditions and requirements specified by SEBI.

Please refer to our earlier special issue "*Insight*" dated February 7, 2012 (Issue XXXI) for an overview of the above mentioned methods. Clause 40 A of the Equity Listing Agreement has also been amended to include the new methods.

Investor Grievance Redressal Mechanism at Stock Exchanges

In order to facilitate early redressal of investor grievances, SEBI has mandated stock exchanges including stock exchanges with nationwide terminals and functional stock exchanges with trading volumes to constitute an Investor Grievance Redressal Committee (IGRC) at every investor service centre. SEBI has also specified details of composition of IGRC.

Disclosure of Track Record of Public Issues Handled by Merchant Banks

SEBI has instructed that merchant banks to disclose track record of the stock performance of each public issue managed by them (in a format prescribed by SEBI) on their website and a reference to this disclosure is required to be included in all offer documents for public issues managed by them. The track record is required to be disclosed for a period of 3 financial years from the date of listing for each public issue managed by a merchant bank. This requirement is applicable for public issues listed on and from January 10, 2012. However, in respect of public issues managed during the past 3 years, the track record is required to be disclosed by March 31, 2012.

Prohibition on Payment of Incentives in Public Issue of Debt Securities

In respect of public issues of debt securities, SEBI has prohibited persons connected with the issue (including persons connected with the distribution of the issue) to offer any incentive, indirectly or indirectly, in any manner, whether in cash or kind or services or otherwise to any person for making an application for allotment of specified securities except for payment of fees or commission for services rendered in relation to the issue.

Amendments to the ICDR Regulations

SEBI has notified certain amendments to the ICDR Regulations. Key amendments are set forth below:

- *Warrants can be Issued Along with Public/Rights Issue*

  Companies undertaking public or rights issues can issue warrants with a maximum tenure of 12 months along with equity shares or other specified securities. Only one warrant will be permitted to be attached to one specified security. Disclosures about utilisation of funds proposed to be raised from conversion of warrants

will be required to be made by the issuer in the offer documents.

- *Amendments to list of Documents to be submitted by Merchant Banks at Various Stages in an Issue*

  (A) At the time of filing of Draft Offer Document

  (i) Merchant banks will now be required to submit a certificate to SEBI confirming that the Issue Agreement confirms with the format set forth in Schedule II of the ICDR Regulations.

  (ii) The requirement to separately submit a copy of inter-se allocation of responsibilities of each merchant bank with SEBI along with the draft offer document has been eliminated.

  (B) *Prior to Bid Opening*

  (i) The requirement to submit a copy of the syndicate agreement with SEBI prior to bid opening has been eliminated.

- *Reservation to Holders of Convertible Debt Securities in Rights/Bonus Issues*

  Listed companies that are proposing to make a rights or a bonus issue of equity shares were required to make a reservation for holders of outstanding fully or party convertible debt securities. The equity shares reserved for holders of such securities are required to be issued at the time of conversion on same terms on which the rights or bonus shares were issued. SEBI has now clarified that listed companies are required to make a reservation for only holders of compulsorily convertible debt securities at the time of undertaking a rights or a bonus issue of equity shares.

- *Amendments to certain Regulations on Preferential Issues*

  (A) Relevant Date for Calculation of Price

  SEBI has clarified that where the "relevant date" falls on a weekend or a holiday, the day preceding the weekend or the holiday will be reckoned as the "relevant date".

  (B) Pricing of Equity Shares

  The pricing formula for issuance of equity shares on a preferential basis was the higher of (i) average of the weekly high and low closing prices during the six months preceding the relevant date or (ii) average of the weekly high and low closing prices during the two week preceding the relevant date. SEBI has clarified that the six months period indicated above would now be 26 weeks preceding the relevant date. This is consistent with use of time period in "weeks" as a basis of calculation of price in SEBI regulations governing takeovers and delisting.

  (C) Waiver of Certain Requirements Relating to Preferential Allotment for Insurance Companies and Mutual Funds

  The Preferential Allotment Regulations does not permit allotment of securities on a preferential basis to any person who has sold any equity shares of the issuer during the six month preceding the relevant date. The Preferential Allotment Regulations also specifies that the pre-preferential holding of an allottee shall be locked-in from the relevant date up to a period of six months from the date of preferential allotment.

  SEBI has exempted mutuals fund registered with SEBI and insurance companies registered with IRDA from applicability of the

above mentioned regulations.

- *Disclosures in relation to Venture Capital Funds or Foreign Venture Capital Investors in Offer Documents*

  Where shares are contributed towards minimum promoters contribution by principal shareholders, who are 'venture capital funds' or 'foreign venture capital investors' registered with SEBI, specified disclosures are now required to be made in relation to these entities in the offer documents. These details will now include information in relation to sector focus, fund managers, details regarding the total number and nature of investors in the fund and details of companies controlled (directly or indirectly) by such funds.

- *Anchor Investors*

  The ICDR Regulations have been amended to specify the maximum number of anchor investors for allocation in an issue as per slabs indicated below:

  (a) A maximum of 2 anchor investors are permitted for allocation up to Rs. 10 crores;

  (b) A minimum of 2 and maximum of 15 investors are permitted for allocation above Rs. 10 crores up to Rs. 250 crores subject to a minimum allotment of Rs. 5 crores; and

  (c) A minimum of 5 and maximum of 25 investors are permitted for allocation above Rs. 250 crore, subject to minimum allotment of Rs. 5 crore per such investor.

Standardised Lot Size for 'Small and Medium Enterprises' (SME) Exchange/Platform

In relation to SMEs proposing to list their securities on the SME platform, SEBI has now prescribed the minimum lot size for the initial public offer (IPO) and for secondary trading depending on the price band of the securities offered. At the IPO stage the registrar to the issue shall (in consultation with the merchant banks, the issuer company and the stock exchanges) be responsible to finalise the basis of allotment in minimum lots and in multiples of minimum lot size as prescribed by SEBI and the secondary market trading lot size shall be the same, as the lot size at the application/allotment stage. The stock exchanges may review the lot size once in every 6 months wherever warranted, by giving an advance notice of at least one month to the market and shall ensure that the lot size shall be the same for the securities traded across the exchanges.

Toll Free Helpline Service for Investors

SEBI has launched a toll free helpline service number for investors. The service will be available to investors from all over India on all working days during normal working hours and will be in 14 languages. In the initial phase, the service will provide guidance pertaining to: status of companies, matters pertaining to other regulators that are not under SEBI purview, how and against whom to lodge a complaint, complaint status, information in relation to opening a demat/client account etc. as well as assistance in different procedures such as transfer and/ or transmission of shares, offering of securities etc.

Foreign Investment

Back to Index Page

There have been a number of key regulatory developments in the period from December 2011 to February 2012, in the foreign exchange control regime with respect to foreign direct investment ("**FDI**") and external commercial borrowings ("**ECBs**") i.e. foreign currency loans, as set forth below:

FDI Cap on Single Brand Retail Revised

On January 10, 2012, the Department for Industrial Policy and Promotion ("**DIPP**") issued a press note increasing the previously permissible FDI cap of 51% in single brand retail to 100% ("**Retail Press Note**"), under the approval route.

The existing FDI Policy, had provided for the following conditions:

(i) Products to be sold should be of a single brand only;

(ii) Products should be sold under the same brand internationally i.e. products should be sold under the same brand in one or more countries other than India;

(iii) Single brand product-retailing would cover only products which are branded during manufacturing; and,

(iv) The foreign investor should be the owner of the brand.

In addition to the abovementioned existing conditions, the Retail Press Note provides for an additional condition that mandatory sourcing of at least 30% of the value of products sold would have to be done from Indian small industries/ village and cottage industries, artisans and craftsmen, in relation to FDI proposals of beyond 51%.

As per the Retail Press Note, a 'small industry' is defined as industries which have a total investment of less than $1 million in plant and machinery. In case this valuation is exceeded at any point in time, the industry shall not classify as a 'small industry', and the compliance of this condition will be checked by self-certification by the company, the company's statutory auditors from duly certified accounts which the company will be required to maintain.

Additionally it may be noted that an application is to be made to the Secretariat of Industrial Assistance of the DIPP, specifically indicating the product/ product categories which are proposed to be sold under a 'single brand'. Any addition to the product/product categories to be sold under 'single brand' would require a fresh approval of the Government.

It may be noted that the revision of the FDI cap in single brand retail comes in the wake of the Government rolling back its decision to permit FDI in multi-brand retail. The local content sourcing condition may be a concern for some foreign investors especially for international luxury brands, for which the company may want to source their products internationally or from bigger manufacturers. The objective of permitting FDI in single brand retail is for attracting investments in production and marketing, improving the availability of such goods for the consumer, encouraging increased sourcing of goods from India, and enhancing competitiveness of Indian enterprises through access to global designs, technologies and management practice.

Changes to the ECB Policy

Between the period from December 2011 to February 2012, the Reserve Bank of India ("**RBI**") has made a number of modifications to the extant ECB policy by issuing certain circulars, which have provided for the following modifications / liberalizations:

(i) As per the existing ECB policy, the prior approval of the RBI is required for any request for cancellation of Loan Registration Number ("**LRN**") issued by the Department of Statistics and Information Management ("**DSIM**") of the RBI or change in permissible end-use for an existing ECB. In relation to the same, the RBI *vide* a circular issued on January 25, 2012 has made the following liberalizations:

(a) The designated Authorized Dealer ("**AD**") Category - I bank may directly approach DSIM for cancellation of LRN for ECBs availed, both under the automatic and approval routes, subject to (A) no draw down for the said LRN having taken place and (B) the monthly ECB-2 returns till date in respect of the LRN have been submitted to DSIM; and

(b) The designated AD Category-I bank may approve requests from ECB borrowers for change in end-use in respect of ECBs availed under the automatic route, subject to the following conditions: (A) the proposed end-use being permissible under the automatic route as per the extant ECB guidelines, (B) there being no change in the other terms and

conditions of the ECB, (C) the ECB being in compliance with the extant guidelines; and (D) the monthly ECB-2 returns till date in respect of the LRN have been submitted to DSIM. The AD Category – I bank shall continue to monitor the utilization of end-use proceeds and changes in the end-use should be promptly reported to DSIM, RBI in Form 83. However, it may be noted that any change in the end-use of ECBs availed under the approval route will continue to be referred to the Foreign Exchange Department, Central Office, RBI.

(ii) As per the existing ECB policy, the prior approval of the RBI was required for requests for reduction in the amount of ECB, changes in the drawdown schedule where the original average maturity period is not maintained and reduction in the all-in-cost of the ECB after obtaining the Loan Registration Number (LRN). The RBI has *vide* a circular issued on February 07, 2012, made the following liberalisations:

(a) The designated AD Category-I bank may approve requests from ECB borrowers for reduction in loan amount in respect of ECBs availed under the automatic route, subject to ensuring the following conditions: (A) the consent of the lender for reduction in loan amount has been obtained, (B) the average maturity period of the ECB is maintained, (C) the monthly ECB-2 returns have been filed with respect to the LRN to the DSIM and (D) the other terms of the ECB are unchanged;

(b) AD Category I banks had earlier been delegated the powers to approve changes / modifications in the drawdown / repayment schedule of the ECBs already availed, both under the approval and the automatic routes, subject to the condition that the average maturity period, as declared while obtaining the LRN, is maintained. Though any roll over or elongation of repayment on expiry of the average maturity period would still require the prior approval of the RBI, now the RBI has permitted AD Category I banks to approve requests from ECB borrowers for changes/ modifications in the drawdown schedule resulting in the original average maturity period undergoing change in respect of ECBs availed both under the automatic and approval routes, subject to ensuring the following conditions: (A) there are no changes/modifications in the repayment schedule of the ECB, (B) the average maturity period of the ECB is reduced as against the original average maturity period stated in the Form 83 at the time of obtaining the LRN, (C) such reduced average maturity period complies with the stipulated minimum average maturity period as per the extant ECB guidelines, (D) the change in all-in-cost is only due to the change in the average maturity period and (E) the ECB complies with the extant guidelines and (F) the monthly ECB-2 returns in respect of the LRN have been submitted to DSIM; and,

(c) Now the designated AD Category-I bank may approve requests from ECB borrowers for reduction in all-in-cost, in respect of ECBs availed both under the automatic and approval routes, subject to ensuring the following conditions: (A) the consent of the lender has been obtained and there are no other changes in the terms and conditions of the ECB and (B) the monthly ECB-2 returns in respect of the LRN have been submitted to DSIM.

(iii) On September 23, 2011, the RBI had enhanced the ECB limit for eligible borrowers under the automatic route to USD 750 million or equivalent per financial year per borrower for permissible end-uses under the automatic route. On January 05,

2012, the RBI has issued a circular which provides that consequent to the enhancement in limits, the revised average maturity guidelines under the automatic route are as follows:

(a) ECB up to USD 20 million or equivalent in a financial year with minimum average maturity of three years; and

(b) ECB above USD 20 million and up to USD 750 million or equivalent with minimum average maturity of five years.

(iv) On December 19, 2011, considering the specific needs of the micro finance sector, the RBI has reviewed the existing ECB policy in consultation with the Government of India and permitted Micro Finance Institutions ("**MFIs**") to raise ECB up to USD 10 million or equivalent during a financial year for permitted end-uses, under the automatic route. Subject to *inter alia*, the following detailed guidelines and safeguards:

(a) MFIs registered under the Societies Registration Act, 1860, Indian Trusts Act, 1880, conventional state-level cooperative acts, the national level multi-state cooperative legislation or under the new state-level mutually aided cooperative acts, non-banking financial companies ("**NBFC**") registered as 'Non Banking Financial Company-Micro Finance Institutions (NBFC-MFIs), government companies registered under Section 25 of the Companies Act, 1956 ("**Companies Act**"), are considered as eligible borrowers of ECB;

(b) Further, the MFIs registered as societies, trusts and co-operatives and engaged in micro finance should have a satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank authorized to deal in foreign exchange and would require a certificate of due diligence on 'fit and proper' status of the board/committee of management of the borrowing entity from the designated AD bank;

(c) Only permitted end use of the ECB proceeds are for lending to self-help groups or for micro-credit or for *bona fide* micro finance activity including capacity building;

(d) With a view to ensure minimization of systemic risk, the maximum amount of foreign currency borrowings of a borrower is capped at USD 10 million during a financial year. Non-Government Organisations (NGOs) engaged in micro finance activities can avail of ECB up to USD 10 million or equivalent per financial year under the automatic route as against the present limit of USD 5 million or equivalent per financial year, subject to the conditions specified by the RBI earlier;

(e) NBFC-MFIs will be permitted to avail of ECBs from multilateral institutions, such as IFC, ADB etc./ regional financial institutions/international banks / foreign equity holders and overseas organizations. Companies registered under Section 25 of the Companies Act and engaged in micro finance will be permitted to avail of ECBs from international banks, multilateral financial institutions, export credit agencies, foreign equity holders, overseas organizations and individuals. Other MFIs will be permitted to avail of ECBs from international banks, multilateral financial institutions, export credit agencies, overseas organizations and individuals; and,

(f) Certain documentary requirements and safeguards have also been specified by overseas organizations and individuals lenders.

(v) Under the extant ECB policy, "eligible borrowers" have been permitted to avail of ECBs designated in INR from foreign equity holders under the automatic/ approval route, as the case may be. NGOs engaged in microfinance activities have been permitted to avail of ECBs designated in INR, under the automatic route, from overseas organisations and individuals as per the extant ECB guidelines. In order to facilitate the same, on December 29, 2011 the RBI has decided to allow non-residents to hedge their currency risk in respect of ECBs denominated in INR, with AD Category I banks in India, subject to *inter alia,* the following conditions:

(a) the following products are permitted: Forward foreign exchange contracts with rupee as one of the currencies, foreign currency-INR options and foreign currency-INR swaps;

(b) the foreign equity holder / overseas organisation or individual approaches the AD bank in India with a request for forward cover in respect of underlying transaction for which he needs to furnish appropriate documentation, on a pre-deal basis to enable the AD bank in India to satisfy itself that there is an underlying ECB transaction, and details of his overseas banker, address, etc;

(c) Undertakings from the customer stating that the same underlying exposure has not been hedged with any other AD Category- I bank/s in India and that if the underlying exposure is cancelled, the customer will cancel the hedge contract immediately, has to be taken;

(d) the amount and tenor of the hedge should not exceed that of the underlying transaction and should be in consonance with the extant regulations regarding tenor of payment / realization of the proceeds;

(e) on due date, settlement is to be done through the correspondent bank's Vostro or the AD bank's Nostro accounts and AD banks in India may release funds to the beneficiaries only after sighting funds in Nostro / Vostro accounts;

(f) the contracts, once cancelled, cannot be rebooked;

(g) the contracts may, however, be rolled over on or before maturity subject to maturity of the underlying exposure; and

(h) on cancellation of the contracts, gains may be passed on to the customer subject to the customer providing a declaration that he is not going to rebook the contract or that the contract has been cancelled on account of cancellation of the underlying exposure.

(vi) As per the existing ECB regulations, Infrastructure Finance Companies ("**IFCs**") are currently permitted to borrow up to 50% of their net owned fund for on-lending in the infrastructure sector under the automatic route. ECBs beyond this threshold require an approval from the RBI. On January 25, 2012, RBI has issued a circular, introducing the requirement of IFCs to submit a certification from the AD banks of their leverage ratio when seeking an approval for ECBs under the approval route i.e. for on-lending in the infrastructure sector in excess of 50% of their net owned fund.

(vii) As per the existing ECB regulations, availing of ECB is permissible for the infrastructure sector, which is defined to include (i) power, (ii) telecommunication, (iii) railways, (iv) road including bridges, (v) sea port and airport, (vi) industrial parks, (vii) urban infrastructure (water supply, sanitation and sewage projects), (viii) mining, refining and exploration and (ix) cold storage or cold room facility, including for farm level pre-cooling, for preservation or storage of agricultural and allied produce, marine products

and meat. Developers of SEZ were also allowed to provide such infrastructure facilities within the SEZ. On February 29, 2012, in view of the infrastructural needs of the country, the RBI issued a circular modifying the policy by permitting availing of ECBs for the proposed National Manufacturing Investment Zones (NMIZ) under the approval route.

The RBI has been fairly dynamic in making the requisite amendments to the ECB policy to simplify procedures and make the required liberalization, to ease the burden of Indian companies seeking to raise foreign currency loans under a tough economic climate.

FDI Policy Modification in relation to Equity Shares issued by Conversion of Import of Capital Goods

Under the existing regulatory framework as liberalized *vide* a circular issued by the RBI on June 30, 2011 ("**June 30 Circular**"), providing that equity shares/ preference shares are permitted to be issued pursuant to conversion of or in lieu of payment for:

(i) import of capital goods / machineries / equipments (including second-hand machineries), subject to certain specified conditions which included a condition that all such conversions of import payables for capital goods into FDI should be completed within 180 days from the date of shipment of goods; and

(ii) pre-operative / pre-incorporation expenses (including payments of rent, etc.), subject to certain specified conditions which included a condition that the capitalization should be completed within the 180 days time period permitted for retention of share application money under the extant FDI policy,

both under the government route of the FDI policy i.e. with the prior approval of the Government / the Foreign Investment Promotion Board ("**FIPB**").

On December 09, 2011, the RBI issued a circular amending the abovementioned conditions, by providing that:

(i) in case of conversions of import payables for capital goods into FDI, all applications shall be completed in all respects, for conversions of import payables for capital goods into FDI within 180 days from the date of shipment of goods; and

(ii) in case of pre-operative / pre-incorporation expenses (including payments of rent, etc.), the applications, complete in all respects, for capitalization being made within 180 days from the date of incorporation of the company.

The modifications make the stipulated time limits exclude the time period for obtaining the relevant approvals from governmental and regulatory authorities, which is not in the control of the applicant company.

Compounding of contraventions under the Foreign Exchange Act, 1999

On January 20, 2012, RBI updated the master circular on compounding on compounding of contraventions ("**Compounding Master Circular**") under the Foreign Exchange Management Act, 1999 ("**FEMA**"), to incorporate the modifications introduced by the RBI circular dated December 13, 2011. The modifications consist of, *inter alia*:

(i) delegation of powers to the regional offices of the RBI to compound contravention of FEMA in respect of delays in reporting inward remittance, filing of form FC-GPR after allotment of shares, and in issue of shares beyond 180 days in terms of Schedule 1 to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 to facilitate operational convenience and improve customer service;

(ii) allowing for applicants to furnish along with their applications for compounding of a contravention under FEMA, details relating to FDI, ECBs, overseas direct investment and

branch office/ liaison office (as per the form prescribed by the Compounding Master Circular) along with an undertaking that they are not under investigation of any agency such as the Directorate of Enforcement, Central Bureau of Investigation etc., and a copy of the Memorandum of Association and latest audited balance sheet.

Receipt of Advance Payments for Export of Goods and Services

In terms of the existing Foreign Exchange Management (Export of Goods and Services) Regulations, 2000, the prior approval of the RBI is required for is required to be obtained by an exporter for receipt of advance where the export agreement provides for shipment of goods extending beyond the period of one year from the date of receipt of advance payment

On February 21, 2012 the RBI has issued a circular, which has permitted AD Category- I banks to allow exporters to receive advance payment for export of goods which would take more than one year to manufacture and ship and where the 'export agreement' provides for shipment of goods extending beyond the period of one year from the date of receipt of advance payment subject to the following conditions:

(i) the Know Your Client (KYC) and due diligence exercise has been done by the AD Category – I bank for the overseas buyer;

(ii) compliance with the Anti Money Laundering standards has been ensured;

(iii) the AD Category-I bank should ensure that export advance received by the exporter should be utilized to execute export and not for any other purpose i.e., the transaction is a *bona-fide* transaction;

(iv) progress payment, if any, should be received directly from the overseas buyer strictly in terms of the contract;

(v) the rate of interest, if any, payable on the advance payment shall not exceed London Inter-Bank Offered Rate (LIBOR) + 100 basis points;

(vi) there should be no instance of refund exceeding 10% of the advance payment received in the last three years;

(vii) the documents covering the shipment should be routed through the same authorised dealer bank; and

(viii) in the event of the exporter's inability to make the shipment, partly or fully, no remittance towards refund of unutilized portion of advance payment or towards payment of interest should be made without the prior approval of the RBI.

Clarification in relation to transfer of assets of Branch and Liaison Offices

The RBI *vide* a circular dated December 30, 2009 ("**2009 Circular**") had introduced certain amendments in the Foreign Exchange Management (Establishment in India of branch or office or other place of business) Regulations, 2000, in terms of which powers in relation to the following were delegated to AD Category –I banks:

(i) submission of annual activity certificate by branch offices or liaison offices;

(ii) extension of the validity period of liaison offices; and,

(iii) closure of branch offices or liaison offices of foreign entities in India.

On March 1, 2012, RBI has *vide* a circular, clarified the scope of the powers delegated to the AD Category –I banks under the 2009 Circular. As per the clarification issued in the present circular, the transfer of assets of liaison office / branch office to subsidiaries or other liaison offices / branch offices or any other entity is permitted only with the specific approval of the central office of the Foreign Exchange Department of RBI and is, therefore, beyond the scope of delegated powers of the AD Category I banks.

RBI Permits FII Investment In "To Be Listed" Debt Securities

On March 1, 2012, the RBI issued a circular permitting foreign institutional investors ("**FII**") or sub accounts of FIIs ("**Sub Accounts**") registered with the SEBI to invest in primary issues of non-convertible debentures ("**NCDs**") and bonds ("**FII Circular**"). The FII Circular stipulates that the NCDs and bonds issued to FIIs should be committed to be listed within 15 days of the investment being made. In case such instruments are not listed within the specified timeframe of 15 days, then the FIIs or Sub Accounts shall be required to dispose these NCDs or bonds through sale to a third party or the issuer. Additionally, the FII Circular stipulates that the terms of offer to FIIs or Sub Accounts should contain a clause that the issuer of such debt securities shall immediately redeem or buyback the said securities from the FIIs/ Sub Accounts in such an eventuality.

Prior to the FII Circular issued by the RBI, SEBI *vide* Circular No. CIR/IMD/FIIC/18/ 2010 dated November 26, 2010 had permitted FII's and Sub Accounts to invest in 'to be listed' debt securities. The FII Circular confirms the understanding set out in the previous SEBI circular by incorporating these in the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.

Company Law

Back to Index Page

Amendment to preferential allotment rules of unlisted companies

The Ministry of Corporate Affairs ("**MCA**") on December 14, 2011 *vide* the Unlisted Public Companies (Preferential Allotment) Amendment Rules, 2011 ("**2011 Amendment Rules**") has notified the following amendments to the existing Unlisted Public Companies (Preferential Allotment) Rules, 2003 ("**2003 Rules**"):

(i) *Definition of 'preferential allotment'*: The 2011 Amendment Rules have amended the definition of 'preferential allotment' to mean allotment of shares and hybrid instruments convertible into shares on preferential basis pursuant to Section 81(1A) of the Companies Act. The definition of 'preferential allotment' set out under the 2003 Rules included issue of shares to promoter and relatives in public issue or otherwise, which has now been removed post amendment;

(ii) *Special Resolution*: In terms of the 2011 Amendment Rules, a special resolution shall have to be passed for issue of shares or hybrid instruments convertible into shares at a general meeting for authorizing the Board of Directors to make such allotment. The special resolution should also mention the details of the proposed allottees. Additionally, the preferential issue is also required to be authorized under the articles of association of the company;

(iii) *Nature of 'offer'*: The 2011 Amendment Rules provide that an offer for preferential allotment has to made in compliance with Section 81 (1A) read with Section 67(3) of the Companies Act and cannot be made to more than 49 persons. Any offer in contravention of the aforementioned provisions of the Companies Act shall be treated as a 'public offer' for which the provisions set out in the Securities Contracts Regulation Act, 1956, the Securities and Exchange Board of India Act, 1992 and the rules issued there-under, shall have to be complied with. Furthermore, the company shall not make any fresh offer or invitation unless the previous allotment has been completed in terms of Section 60B (9) of the Companies Act. This amendment appears to have been made in light of the SAT Order dated October 18, 2011 in the matter of *Sahara India Real Estate Corporation Limited and others v. SEBI* ("Sahara Order") wherein SAT held that optionally fully convertible debentures were 'hybrid instruments' and that allotment of such debentures to more than 49 persons 'on private placement' basis would be considered a public issue.

(iv) *Application Money*: The 2011 Amendment Rules stipulate that (A)

the subscription money should be paid only through a cheque or a demand draft but not cash, (B) if the preferential allotment is not completed within 60 days from the receipt of application money then such money should be refunded within 15 days, failing which the company shall have to repay it with an interest of 12% per annum and (C) the application money shall be kept in a separate bank account and shall not be utilized for purposes other than adjustment against allotment of securities and repayment of monies in case on non-allotment; and,

(v) *No Marketing*: Any unlisted company offering securities through preferential allotment shall not release any public advertisements or utilize any media marketing, distribution channels or agents to inform the public at large about the offer.

Earlier, the MCA *vide* its circular dated May 24, 2011 had invited comments on the Draft Unlisted Public Companies (Preferential Allotment and Private Placement) Rules, 2011 ("**Draft Rules**"). Certain changes proposed in the Draft Rules, including the requirement for obtaining government approval in case of preferential issues exceeding Rs. 5 crores have not been included in the 2011 Amendment Rules.

The 2011 Amendment Rules, which comes in the wake of the Sahara Order, reinforce the need for transparency in the preferential allotment mechanism followed by unlisted companies. The changes introduced in the said rules would need to be borne in mind by private equity players and other foreign investors proposing to invest in unlisted public companies.

Clarification on using video conferencing and e-voting facilities in meetings of listed companies

On December 27, 2011, the MCA *vide* General Circular no. 72/2011 ("**December Circular**") notified that the requirement of holding shareholders or directors meetings through video conferencing shall continue to be optional for listed companies even after financial year 2011-12. The December Circular has been issued as a clarification to a previous MCA General Circular no. 35/2011 dated June 6, 2011 ("**June Circular**") wherein video conferencing facility for holding shareholders meetings in a listed company was made a mandatory requirement after financial year ending March 31, 2012.

Furthermore, the December Circular has widened the ambit of 'agencies' that can provide e-voting facilities in general meetings. Earlier, the June Circular notified only National Security Depository Limited and Central Securities Depository Services (India) Limited as agencies for providing and supervising electronic platforms for e-voting in general meetings of listed companies. The December Circular now extends this facility to agencies that have obtained the requisite certificate from Standardization Testing and Quality Certification Directorate, Department of Information Technology, Ministry of Communication and Information Technology, Government of India.

The December Circular is a part of the "green initiative" and amongst a number of circulars issued by the MCA in the past year simplifying and modernizing compliance procedures, *inter alia*, permitting issue of notices / documents in the electronic mode, permitting electronic voting platforms, etc.

The December Circular has been issued in light that videoconferencing and e-voting facilities are in variance to the provisions of the Companies Act (under Section 174 and 287 the Companies Act, directors / shareholders are required to be physically present at board / general meetings to constitute quorum) and the proposed Companies Bill, 2011. The December Circular unlike its predecessor does not set out a time frame in which the requirements for using videoconferencing and e-voting facilities shall be made mandatory for listed companies, thereby providing additional time to such companies for setting up video conferencing and e-voting mechanisms for conducting shareholders and general meetings, respectively. The use of

videoconferencing and e-voting facilities for conducting meetings, however, is a welcome initiative on the part of MCA and shall be especially beneficial from the perspective of foreign investors and shareholders in Indian companies, as it will facilitate and streamline interaction between members and directors who are located across geographies which will ultimately translate into better corporate governance.

From the Bench

Back to Index Page

Calcutta High Court rules on applicability of stamp duty to a scheme of amalgamation / demerger in West Bengal

From the Bench

Calcutta High Court rules on applicability of stamp duty to a scheme of amalgamation / demerger in West Bengal

In the Matter of Emami Biotech Ltd. [C.P. No. 627 of 2011], a Single Company Judge of the Calcutta High Court ruled on the issue of whether the transfer of property effected through an order of a court on a scheme of amalgamation/ demerger would be chargeable with stamp duty in the State of West Bengal. The Single Company Judge of the Calcutta High Court held that court orders would be treated as an "instrument" under the Indian Stamp Act, 1899 as applicable to the state of West Bengal ("**Stamp Act**"), and be chargeable with stamp duty under the charging section in the Stamp Act.

The Single Judge in *Emami* distinguished an earlier contrary decision on the issue of a two judge bench of the Calcutta High Court as not having considered the Supreme Court decision in *Hindustan Lever* v. *State of Maharashtra* [(2004) 9 SCC 438] in the context of the Bombay Stamp Act (applicable to Maharashtra), wherein the Supreme Court had observed that the transfer of any property upon the sanction of a scheme of amalgamation or demerger was akin to a sale. The observation in *Hindustan Lever* has been followed and applied by the Delhi High Court, Allahabad High Court and Madras High Court.

This decision is useful in bringing the Calcutta High Court in line with the Supreme Court's observations in Hindustan Lever and with other decisions in the country following Hindustan Lever. Until this decision is stayed or reversed in Appeal, stamp duty is payable on all court orders in the State of West Bengal effecting any transfer of property pursuant to a scheme of amalgamation or demerger.

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The views expressed in this Newsletter do not necessarily constitute the final opinion of Amarchand Mangaldas on the issues reported herein and should you have any queries in relation to any of the issues reported herein or on other areas of law, please feel free to contact us at the following co-ordinates:

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