Thought Leadership Update

July 2014

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ACQUISORY

1 Editorial

Dear Readers,

Thank you for your feedback on our monthly thought leadership updates. It is our pleasure to know that the updates are useful to you. We would like to thank you for your feedback.

In this edition of the update, we have continued to capture updates from various regulatory authorities, latest updates from banking and finance. We continued to focus on PE investments in India, the potential growth of PE sector in India and the emerging need for due diligence. The pharmaceutical sector in India is fascinating and we have taken a closer look at the accounting landscape for the capitalisation of research and development cost, we have tried to provide a perspective on what is the intent of the standard setters and international practice in this area.

Recently, ICAI has issued draft Ind-AS 110, corresponding to the new/revised IFRS 10, issued by IASB. We have analysed the impact of IFRS 10 on real estate sector.

The recently enacted Companies Act, 2013 is a landmark legislation. In this edition we have focused on related party transactions requirement and its applicability. As we sign off for this month, we would like to remind you in case you have suggestions or inputs on topics we have covered, we would be delighted to hear from you. Happy reading !

Contact Us:

Harsh Vardhan Tyagi

Acquisory India Consulting Private Limited

Principal, Operations & Risk Consulting

Hand phone: +91 9967590865

harsh.tyagi@acquisory.com

2 Latest in Banking and Finance

Notifications/Circulars

RBI's liquidity coverage rule may adversely affect some banks: Moody's

- IDBI Bank, Oriental Bank of Commerce and Yes Bank are among banks that may be adversely affected because of the Reserve Bank of India's rule on Liquidity Coverage Ratio, the preparedness of a bank to meet redemption obligations for 30 days in a stressed-case scenario, said Moody's Investor Services. SBI, Axis Bank and HDFC Bank with a strong deposit franchise, are well prepared for such a scenario, it says.

- The Reserve Bank of India (RBI) issued the final Basel III framework on liquidity standards, including guidelines on the minimum LCR, liquidity risk monitoring tools and LCR disclosure standards. These guidelines are credit positive for Indian banks, Moody's said. These guidelines will encourage banks to improve asset-liability management because of the penalties associated with maturity mismatches, especially in short-term buckets. The requirement creates a credit-positive incentive for banks to focus on expanding retail deposits and reducing reliance on short-term wholesale funding.

- The main objective of these guidelines is to promote bank liquidity, Moody's said. The RBI will phase in the LCR with a minimum requirement of 60% starting January 1, 2015, rising 10 percentage points annually until it is 100% on January 1, 2019.

- LCR is designed to address short-term liquidity risk by ensuring that banks hold sufficient cash and other liquid assets to meet obligations in a 30-day market stress scenario. The RBI framework aligns broadly with the framework of the Basel Committee on Banking Supervision. At the same time, the central bank encouraged banks to adopt a ratio higher than the prescribed minimum to promote better liquidity risk management.

2 Latest in Banking and Finance

Notifications/Circulars

RBI reviewing regulatory framework for unregulated non-banking finance companies

- The Reserve Bank has recently said it is in the process of reviewing the regulatory framework for unregulated non-banking finance companies with a view to check financial frauds. In order to correct these and initiate actions against violations, we need to bring in suitable amendments to the statutory provisions. Reserve Bank is working with the government for such improvements in the law. RBI is working with government in making certain statutory amendments to tighten the regulation especially the definition of deposits.

India watching Iraq, economy prepared to deal with shocks: RBI's governor- Raghuram Rajan

- Reserve Bank of India Governor Raghuram Rajan said the country is watching the Iraq situation, but despite the uncertainty the domestic economy is better prepared to deal with any shocks on the external front.

Itz Cash scouting to raise Rs 120 crores to expand business

- Pre-paid card firm Itz Cash Card is scouting for additional funding as it looks to expand its business of providing plastic money for the under-banked.

- The Mumbai-based company is expected to start discussions to raise over $20 million (Rs 120 crore) in its next round of funding. Apart from private equity investors, it could also evaluate strategic investors for funding, according to sources familiar with the development. The company, which is majority owned by the Essel Group, has raised over Rs 100 crore in funding from Matrix Partners India, Lightspeed Venture Partners and Intel Capital over two rounds of funding, so far.

JPMorgan launches emerging markets opportunities fund

- JP Morgan Asset Management India today announced the launch of JPMorgan Emerging Markets Opportunities Equity Offshore Fund, an open ended fund of funds.

2 Latest in Banking and Finance

Articles

scheme that seeks to provide long term capital growth to its investors.

<u>Auto, home loans may get cheaper as call rates fall</u>

- The chances of loans for homes and automobiles turning cheaper have brightened with the rates on overnight borrowing falling below the rate at which the Reserve Bank of India lends to banks, indicating comfortable liquidity. If this trend persists owing to fund flows from overseas, banks may be able to slash rates even without waiting for the central bank to cut its policy rate.
- Overnight short-term rates have fallen sharply by about 70-90 basis points, or about 9-10%, in just three days after the Reserve Bank of India on June 18, 2014 infused Rs 10,000 crore through two-day term repo - a platform to lend short-term money to banks. A basis point is 0.01%
- "Banks will watch out for budget proposals on fiscal consolidations and may then take a call to cut loan spreads, even without any repo rate cut by the RBI".

<u>State Bank of India among 24 public sector banks ineligible for Rs 50,000 crore EPFO investments</u>

- With non-performing assets on the rise, the country's largest bank — State Bank of India — along with 23 other government-owned banks, are no longer eligible for investments worth Rs. 50,000 crore made in bank deposits each year by the Employees' Provident Fund Organisation, the country's largest retirement fund.
- The Employees' Provident Fund Organisation (EPFO), which manages over Rs 6,00,000 crore of retirement savings entrusted to it mandatorily by 8.15 crore employees, can no longer invest in the bonds and deposit instruments of these banks as their bad loan levels have breached its internal threshold to define 'safe' investments.
- As many as 24 of the 29 public sector banks have net non-performing assets of over 2% of their net advances, disqualifying them from lucrative and predictable inflows from the PF department.

3 PE Investments in India

Article

- Private equity (PE) investments in the country have potential to touch $40 billion over the next 10 years. The PE industry is expected to contribute to the growth of the country's economy on a larger scale than earlier.

- "Over the next 10 years, deals, both in size and nature, will increasingly turn closer to those in some developed countries with a potential to reach $40 billion in 2025 in India.

- The total PE investments in the country stood at around $9 billion in FY14 and is likely to touch $10-12 billion in the current fiscal.

- We at Acquisory expect a more mature phase of investments in the country. While venture and growth opportunities will continue apace, the buyouts will be the biggest investment theme over the next few years.

- Consumer-centric businesses have been big themes for equity investors over the last few years. While this will continue, Indian consumerism is expected to embrace the rural markets as well over next five years, as growth reaches the interiors of the country.

- The diligence has become intensive with much focus on getting to know the sector well, which means speaking to other operators in the industry, point of view discussions and learning from previous experience of investors in the sector.

4 Accounting Landscape

Capitalisation of R&D Cost- Industry Focus- Pharmaceuticals

- Accounting requirements for capitalisation of in-house R&D cost as intangible asset are similar under Indian GAAP and IFRS. However, it appears from the financial statements of pharmaceutical entities that there exists diversity in practice in relation to criteria used for capitalisation of in-house R&D cost as intangible asset.

- Certain leading pharmaceutical entities consider final regulatory approval as substantial evidence at which point all the criteria for capitalisation of in-house R&D costs as intangible assets have been met, although obtaining approval in one country might not provide a sufficient basis for capitalising the development costs incurred to obtain new drug approvals in other countries.

- However, certain pharmaceutical entities indicate that the probable future economic benefits criterion is met even before the regulatory approval is received.

- The diversity in practice can be broadly categorised as follows:

1) *Capitalisation of development costs after the development of the product has been completed and all the necessary public registration and marketing approvals have been obtained.*

2) *Capitalisation of development costs even before regulatory approval is received, namely when a filing for approval had been made in a major market, and approval was considered highly probable.*

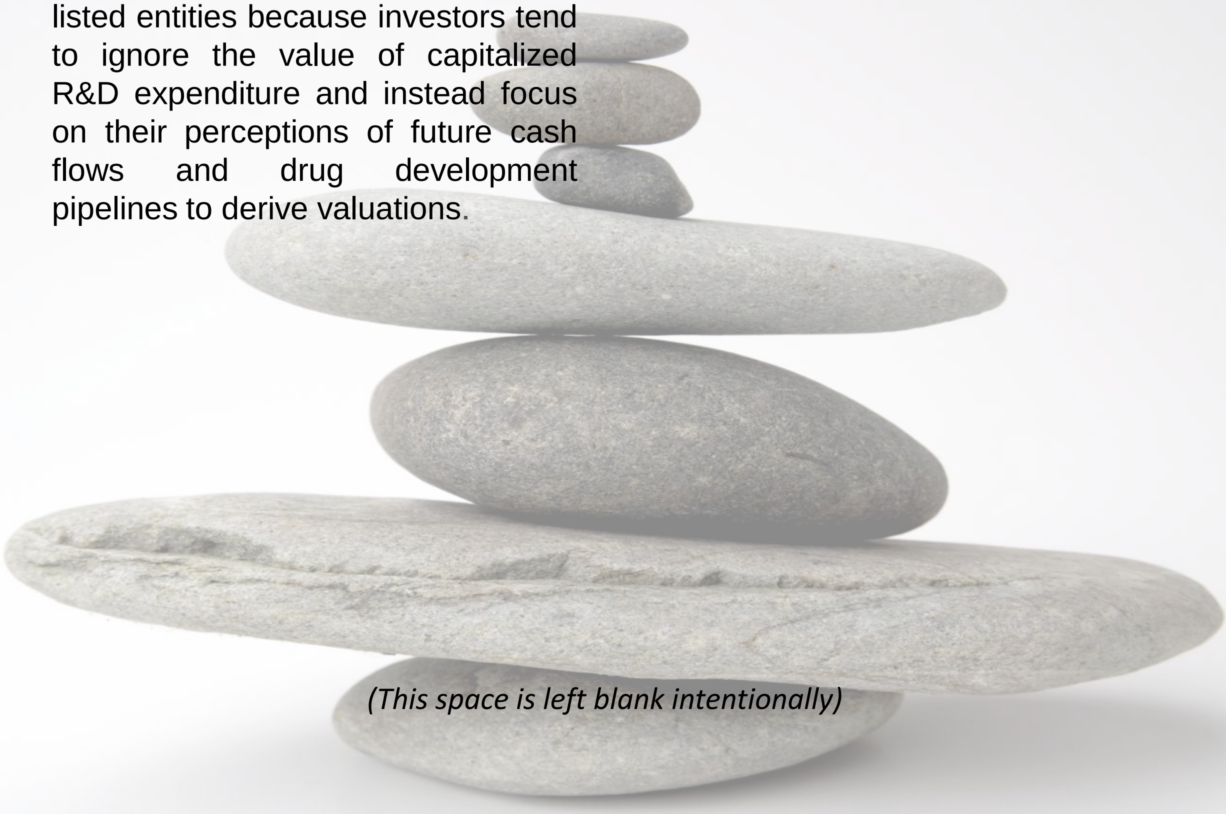
3) *Capitalisation of development costs even before filing for regulatory approval has been made in a major market. However, approval is considered highly probable.*

- The accounting standard require capitalisation if certain criteria are met. Internationally, most companies do not capitalise such expenditure till regulatory approvals are received resulting in low levels of such assets being recognized.

- In India, there is considerably more diversity in practice on capitalization of development costs which causes a lack of comparability in reported financial information. While it is true

Capitalisation of R&D Cost- Industry Focus- Pharmaceuticals

that the specifics of each drug development can be unique; the benefits of increased profits due to earlier capitalisation is often lost by listed entities because investors tend to ignore the value of capitalized R&D expenditure and instead focus on their perceptions of future cash flows and drug development pipelines to derive valuations.



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4 Accounting Landscape

IFRS 10- impact on real estate industry

- The Institute of Chartered Accountants of India (ICAI) recently issued draft Ind-AS 110 corresponding to the new/ revised IFRS 10, Consolidated Financial Statements issued by the International Accounting Standards Board (IASB). The Ind-AS is similar to IFRS 10 with the exception that the Ind-AS does not contain provision relating to exemption from preparation of consolidated financial statements. This has been left to be governed by the Companies Act, 2013 and the SEBI regulations.

- The new standard on consolidation significantly increases the responsibility on the reporting entities to make and disclose the judgement for consolidation of entities.

This article briefly discusses the new requirements brought about by IFRS 10 and its impact on the real estate industry (excluding real estate funds).

A brief take on IFRS 10

- IFRS 10 was issued by the IASB in May 2011 together with amended IAS 27 Separate Financial Statements and IFRS 12 Disclosure of Interests in Other Entities. These standards are effective for annual periods beginning on or after January 01, 2013 and must be applied retrospectively, subject to certain transition rules.

- IFRS 10 introduces a new definition of control that will determine which entities are to be consolidated. Previously, IFRS had two consolidation models – one for special purpose entities (SIC 12) and another for all other investees (IAS 27). With the advent of IFRS 10, there will only be a single control model where the investor would consolidate an investee only when it has power, exposure to variability in returns and a linkage between the two.

IFRS 10- impact on real estate industry

- This new definition of control may significantly impact the composition of financial statements. One of the highly impacted industries is most likely the real estate industry which has complex group structures, special purpose vehicles created for individual projects, significant related party transactions and complex contractual arrangements.

- The application of IFRS 10 could mean that the real estate companies may have to re-evaluate all their investments which may result in consolidation which were hitherto not consolidated under the consolidation standards and deconsolidation of certain investments which do not fall under the new definition of control.

Determination of control

- IFRS 10 uses a single control model and places an emphasis on the following three elements to determine if the investor controls the investee:

  − Power over the Investee
  − exposure, or rights, to variable returns
  − the ability to use its power over the investee to affect the amount of the investor's returns

Captive power generators

- The real estate industry is under continuous innovation to improve profitability. Vertical integration is one of the strategies adopted by major players to cut costs and consolidate their position in the market. Say, a company has developed a property and wants to ensure continuous power supply to the property; the company could contract with an existing power generator for purchase of power. The local regulation may require the company to hold a certain percentage of equity in the generator to qualify the power generator as a captive power generator. It is also not uncommon that the company finances the expansion of the power generator to meet the power needs of the property being developed by the company.

IFRS 10- impact on real estate industry

- Such arrangements call for a detailed review of the relationship the company has with the power generator to evaluate whether the company controls the power generator.

Investment properties as silos

- An investor should evaluate whether independently leased out properties of an entity that may be collateralised with a debt can be considered as a silo. Say a company owns several properties that have been leased out to various companies. The company has financed the construction of the property with various loans with recourse only to the respective property developed with the borrowed funds. The lessee will need to evaluate whether the leased property can be considered as a silo within the company for further evaluation under IFRS 10 for consolidation. The situation becomes more complex when the lessee has provided a residual value guarantee or has a fixed purchase price option.

Should the lessee conclude that the silo needs to be consolidated based on the principles laid out in IFRS 10, other challenges related to consolidation will emerge. Ascertaining the relevant financial balances of the silo (carving out) will be the first practical issue the lessee will have to deal with among others.

Involvement of strategic operating partners

- It is not uncommon for companies with different competencies to partner together for development and maintenance of properties (e.g., a partner for construction of the properties and another for the marketing and on-going maintenance of the property). In such arrangements, there may be more than one activity of the company that significantly affects the partners' returns. When there are multiple activities that affect significantly the returns of the partners, and these activities are directed by different partners, it is important to determine which of the activities most significantly affect the partners' return. It is likely that one activity may be directed by the voting

IFRS 10- impact on real estate industry

rights which are held by a partner while the other activity may be directed through a contract by different partners.

- Significant judgement is involved in ascertaining which among the multiple activities is the relevant activity. The partner that has power over that relevant activity would then consolidate the company. This situation and determination differs from a scenario of joint control, which is defined as the contractually agreed sharing of control and requires unanimous consent of the parties sharing control for decisions about the relevant activities.

Agency in structured entities

- To comply with local state regulations on ceiling on land holdings, real estate companies may hold land in other entities (special purpose vehicles (SPV)), whose shareholder could be relatives of the sponsors/promoters or employees of the company. Such SPVs carry on real estate operations. The current consolidation framework in India does not cover such arrangements for consolidation as the real estate company has no share holding. Hence, such SPVs do not get consolidated.

- Under IFRS 10, the real estate company will need to evaluate whether the shareholders of the SPV are acting as agents of the real estate company despite there being no direct ownership of equity. A similar challenging situation arises where two real estate companies controlled by different family members/relatives have significant inter-company transactions.

Other situations meriting careful consideration

Following are certain other aspects that require careful consideration:

- The terms of a joint development arrangement with contractual rights given to the land owner and developer.

- Evaluation of long term arrangements with suppliers.

IFRS 10- impact on real estate industry

In conclusion

- While the Ind-AS 110 is still in draft, the application of its principles could have far reaching impacts on the real estate industry. The increasing complexity in group structures and transactions result in management judgement playing a significant role in drawing conclusions under Ind-AS 110 or IFRS 10. This application of judgement for concluding whether an entity needs to be consolidated or not will also need to be disclosed in the financial statements regardless of what the final conclusion on consolidation is. Many entities may even consider modifying arrangements that currently exist if they lead to unintended or unwanted consolidation related conclusions.

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5 Indian Auditing Updates

Related Party Transactions

- One of the most major concern for Corporates after the enactment of Companies Act, 2013 is regarding to entering into related party transactions. The New Law requires strict disclosure and compliance and much onus in the Act as well as in Corporate Governance Norms notified by SEBI has been laid on the Audit Committee and the Board to see that related party transactions are transparent.

- As per Companies Act, 1956 there were 22 parties included in definition of relatives which have been now trimmed down to only 8 as per Companies Act 2013.

<u>Transactions Covered under Section 188 of Companies Act, 2013</u>

- *Sale, Purchase or Supply of any goods or materials;*
- *Selling or otherwise disposing of, or buying, property of any kind;*
- *Leasing of property of any kind;*
- *Availing or rendering of any services;*
- *Appointment of any agents for purchase or sale of goods, materials, services or property;*
- *Such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and*
- *Underwriting the subscription of any securities or derivatives thereof, of the Company.*

<u>Transactions excluded</u>

- Transaction of Loan is excluded, however the same is covered under Section 185 i.e. Loan to Directors.

- **All arm's length transaction *(and not arm's*** *length price) entered in the ordinary course of* business. Arm's length means i.e. A transaction between two related parties that is conducted on terms as if they were unrelated, so that there is no question of a conflict of interest.

Related Party Transactions

Approvals Required

- As per Section 177 (4) (iv) every company which is require to form Audit Committee has to take prior approval for all related party transaction (whether on Arm's length or not) either entered or modified from the Audit Committee. The Audit Committee shall consist:

  - *of minimum three directors out of which Independent Director should form a majority; and*

  - and Independent Director shall be chairman of Audit Committee.

  (Audit Committee will also require to certify and approve whether the transaction is on arm's length and in the ordinary course of business).

- Prior consent of the Board by passing a resolution at the meeting of the Board. **Meeting through Video conferencing is allowed.**

- Prior approval of Company by special resolution (members interested or if it is a related party then it shall not vote on special resolution) is required if.

  - *a company having a paid-up share capital of ten crore rupees or more shall not enter into a contract or arrangement with any related party;*

  (or)

  - *a company shall not enter into transaction or transactions, where the transaction or transactions to be entered into:*

  * sale, purchase or supply of any goods or materials directly or through appointment of agents **exceeding twenty five percent of the annual turnover;**

  * selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents and availing or rendering any services directly or through appointment of agents **exceeding ten percent of net worth.**

Related Party Transactions

* leasing of property of any kind exceeding ten percent of the net worth or exceeding ten percent of turnover.

The condition should have been satisfying both (a) and (b) and not **'or' which has been given** in the rules. This means that every company big or small will come under the purview of the provisions and will require to pass special resolution for each related party transaction exceeding the limits.

- It is also worth to note that the member who is a related party or party interested shall not vote on special resolution. This is absolutely contradictory to Section 2(93) and Section 47 dealing with voting rights which says that every member shall have right to vote on every resolution placed before the Company. The minority will become majority in this case and may raise a serious issue going forward in closely held companies.

Amended Clause 49 of Corporate Governance relating to related party transactions

- As per SEBI related party transaction means a transaction for transfer of resources, services or obligations between a company and a related party, regardless whether a price is charged.

- The scope of Related Party has been extended to cover two more aspects vis-à-vis any person who has control or joint control or significant control over the Company **OR is a KMP of the company** or its parent company, apart from the ten parties mentioned under Section 2 (76).

- Similarly, the scope of an entity for being considered as a related party has also been enhanced to cover the following entities apart from those covered under Section 2(76) of the Act.

- The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others) or

5 Indian Auditing Updates

Related Party Transactions

- One entity is an associate or joint venture of the other entity (or an associate or joint venture of member of a group of which the other entity is a member) or

- Both entities are joint ventures of the same third party; or

- One entity is a joint venture of a third entity and the other entity is an associate of the third entity; or

- The entity is a post-employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, sponsoring employers are also related to the company; or

- The entity is controlled or jointly controlled by a person identified under Section 2(76) or has control or joint control or significant influence over the Company or is a KMP or the company or of a parent of the Company.

- A person having control or joint control or significant control over the Company has significant influence over the entity (or of a parent of the entity).

Material Related Party Transaction

- All listed Companies, where the total of transaction to be entered into along with the transactions already entered with related parties during a financial year **exceeds 5 percent of** annual turnover or **20 percent of net worth as** per last audited balance sheet **(higher of the two) it will be considered as a material related** party transaction which will be required to be approved by the members of the Company excluding those who are related via a special resolution. Further, the norms require that Audit Committee shall approve all related party transactions which is in line with Section 177 (4) (iv).

- Additional disclosure requirements instilled in the norms include that every company shall **disclose a policy on related part transactions on its** website and Annual Report and details of related party dealings shall be disclosed on quarterly basis along with compliance report on Corporate Governance.

IASB publishes Exposure Draft Investment Entities–Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)

- The proposed amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* are designed to clarify three issues about the application of the requirement for investment entities to measure subsidiaries at fair value instead of consolidating them. The proposed amendments:

(a) confirm that the exemption from presenting consolidated financial statements continues to apply to subsidiaries of an investment entity that are themselves parent entities;

(b) clarify when an investment entity parent should consolidate a subsidiary that provides investment-related services instead of measuring that subsidiary at fair value; and

(c) simplify the application of the equity method for an entity that is not itself an investment entity but that has an interest in an associate that is an investment entity.

The proposals are open for public comment till September 15, 2014.

IFRS 15: Revenue from contracts with customers

- IASB and FASB have issue converged Standard on revenue recognition. The Standard will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally.

- The core principle of the new Standard is for companies to recognise revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services.

- The new Standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements.

Update on the Disclosure Initiative

The ***Disclosure Initiative*** is a portfolio of projects designed to improve the quality of information provided in financial reports.

- ***Amendments to IAS 1***

The proposed amendments are intended to clarify, instead of significantly change, existing IAS 1 requirements. Although the proposed amendments are relatively modest, it is expected they will help to address some perceived barriers to exercising judgement in areas such as the application of materiality and determining the order of the notes to the financial statements. *The Exposure Draft is open for comment until 23 July 2014*

Amendments to IAS 7

- In another short-term project, the IASB is considering proposals to amend IAS 7 to require the disclosure of changes in liabilities classified in financing activities.

Target improvement in disclosure of accounting policies

- A meaningful review of the disclosure requirements in individual Standards involves assessing the related recognition and measurement requirements. The project team is analysing and categorising the disclosure requirements in all Standards to identify ways to simplify the disclosure requirements without reducing the usefulness of the information available to users of the financial statements.

Materiality

- IASB is currently reviewing how materiality is defined, interpreted and applied in different jurisdictions and for different purposes related to financial reporting—securities law,

6 IFRS Updates

auditing standards and local GAAP.

- The review includes an assessment of the academic literature and court judgements. National and regional standard-setters are also providing with information from their jurisdictions.

- The project team will discuss the research with the IASB in September 2014 and ultimately publish the results of research as a paper setting out our assessment of the core issues influencing how materiality is perceived and applied. We expect this analysis to raise awareness of the main issues and help us identify possible actions that the IASB could take.

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Notifications/Circulars

Income-tax (Second Amendment) Rules, 2014 – Amendment in Rule 6AAH

- Section 35CCD was inserted by the Finance Act, 2012 to provide a deduction of 150% to a company which in respect of the expenditure incurred on the skill development project notified by the Board in accordance with the guidelines as may be prescribed. The Guidelines for approval of skill development project and conditions subject to which a skill development project is to be notified under Section 35CCD are given in Rule 6AAF and Rule 6AAG respectively. Further, Rule 6AAH provides for the meaning of expressions used in Rule 6AAF and Rule 6AAG.

- In exercise of the powers conferred by Section 295 read with Section 35CCD of the Income-tax Act, 1961, the Central Government has widened the meaning of "Training Institute"; to include within its scope, a training institute -

  (a) affiliated to, or approved by, or empanelled by, the National Skill Development Agency;

  (b) affiliated to, or approved by, or empanelled by, the Central Government and certified by the National Council for Vocational Training as having training standards equivalent to training institutes affiliated to the National Council for Vocational Training; or

  (c) affiliated to, or approved by or empanelled by, the State Government and certified by the National Council for Vocational Training or a State Council for Vocational Training as having training standards equivalent to training institutes affiliated to the National Council for Vocational Training or, as the case may be, the State Council for Vocational Training

Income-tax (Third Amendment) Rules, 2014 – Amendment in Rule 6AAE and substitution of Rule 6AAD

- Section 35CCC was inserted by the Finance Act, 2012 to provide a deduction of 150% to an assessee in respect of any expenditure incurred on agricultural extension project notified by the Board in this behalf in accordance with the guidelines as may be prescribed. Rule 6AAD provides for Guidelines for approval-

Notifications/Circulars

of agricultural extension project under Section 35CCC. In exercise of the powers conferred by Section 295 read with section 35CCC of the Income-tax Act, 1961, the Central Board of Direct Taxes has substituted the Rule 6AAD with new Rule 6AAD. The new Rule 6AAD authorises the Member (IT), Central Board of Direct Taxes to directly receive and process the application made by the assessee in this regard. Earlier the process of making application and issuing notification was routed to CBDT through CIT or DIT, as the case may be, having jurisdiction over the case. The processing time has thus been effectively reduced.

- Consequential amendments have been made in Rule 6AAE which provides for the conditions subject to which an agricultural extension project is to be notified under Section 35CCC.

Amendment in Notification No. 61/2013 dated 8-8-2013

- Section 10(15)(iv)(h) exempts any interest payable by any public sector company in respect of bonds or debentures and subject to such conditions as may be notified by the Central Government. In exercise of the powers conferred by section 10(15) (iv)(h) of the Income-tax Act, 1961, the Central Government had through Notification 61/2013 dated August 08, 2013 authorised specified entities, namely, Cochin Shipyard Ltd., Airport Authority of India Ltd, IIFCL, RECL etc to issue during the financial year 2013-14 tax-free, secured, redeemable, non convertible bonds, aggregating to specified amounts. The said notification also laid down conditions to be fulfilled namely eligibility, tenure of bonds, PAN, Rate of interest, issue expense & brokerage, public issue, private placement, repayment of bonds and selection of merchant bankers. The Board has through this notification, amended Notification No. 61/2013 dated August 08, 2013, by including IFCI Limited in the list of authorised specified entities. Further, the allocated amount of bonds, which Indian Railway Finance Corporation

7 Direct Taxes Updates

Notifications/Circulars

Limited (IRFC) was authorised to issue, has been decreased .

Agreement for avoidance of double taxation and prevention of fiscal evasion with Sri Lanka

- In exercise of the powers conferred by Section 90 of the Income-tax Act, 1961, the Central Government has, through this notification, notified that the provisions of the agreement between the Government of the Republic of India and the Government of the Democratic Socialist Republic of Sri Lanka for the avoidance of taxation and prevention of fiscal evasion with respect to taxes on income shall be given effect to in the Union of India with effect from the 1st April, 2014.

Clarification on interpretation of provisions of Section 10(2A)

- Section 10(2A) provides that share in the total income of the firm shall not form a part of total income of a partner. A firm is assessed as such and is liable to pay tax on its total income.

A partner is not liable to tax once again on his share in the said total income. Various references were received by the Board seeking clarification as to what will be the amount exempt in the hands of the partners of a partnership firm in cases where the firm has claimed exemption/deduction under Chapter III or VI A of the Act.

Notifications/Circulars

Chief Commissioner of Central Excise empowered (Under Rule 12CCC of CER & Rule 12AAA of CCR)

- Rule 12CCC of Central Excise Rules 2002 (CER) & Rule 12AAA of CENVAT Credit Rules, 2004 (CCR) Provides for imposition of restrictions including suspension of registration in case of manufacturer, first/ second stage dealers or an exporter against duty evasion, default in duty payment or false utilisation of CENVAT Credit. Now, the Chief Commissioner of Central Excise has been empowered in the place of officer authorised by the board for imposition of restrictions and/or withdrawal of facilities.

- Chief Commissioner is required to provide an opportunity of being heard to assessee before issuing order against proposal to impose restriction. The pending proposals before authorised officer of CBEC/DGCEI will be transferred to Chief Commissioner of Central Excise.

Rupee Drawing Arrangement

- Increase in trade related remittance limit- The limit of trade transactions has been increased from the existing Rs. 2,00,000/- (Rupees Two Lakh only) per transaction to Rs. 5,00,000/- (Rupees Five Lakh only) per transaction, with immediate effect in respect of the Permitted Transactions under the Rupee Drawing Arrangements (RDAs).

Remittance Scheme

- Vide August, 2013 circular, Reserve Bank of India (RBI) had reduced the limit under Liberalised Remittance Scheme from USD 2,00,000 to USD 75,000 to contain the fall of rupee. Since forming of new Government at the centre and stabilising of rupee, has prompt RBI to increase the limit from USD 75,000 to USD 1,25,000 with immediate effect- June 03, 2014.

- Liberalised Remittance Scheme is an effective way of remitting funds abroad by resident individuals for any permitted capital or current account transactions.

9 Capital Markets Updates

Notifications/Articles

Direct to Account Facility

- In order to facilitate receipt of foreign inward remittances directly into bank accounts of the beneficiaries, RBI has decided to allow foreign inward remittances received under Rupee Drawing Arrangement (RDA) to be transferred to the KYC compliant beneficiary bank accounts through electronic mode, such as, NEFT, IMPS, etc.

- The procedure to be followed for the purpose can be referred in the said circular available on RBI website.

External Commercial Borrowings (ECB) for Civil Aviation Sector

- RBI had *vide A.P. (DIR Series) Circular No. 113* dated April 24, 2012 allowed ECB to be raised by airline companies for working capital as a permissible end-use, under the approval route, subject to the conditions stipulated in the said Circular. The scheme was extended till December 31, 2013 *vide* A.P. (DIR Series) Circular No. 116 dated June 25, 2013. On a review RBI has decided that this scheme of raising ECB for working capital for Civil Aviation Sector will continue till March 31, 2015. All other conditions stipulated in aforesaid Circular dated April 24, 2012 shall remain unchanged.

Foreign investment in India in Government Securities

- The present limit for investment in Government Securities by SEBI registered FIIs, QFIs, long term investors and FPIs registered in accordance with SEBI guidelines stands at USD 30 billion. On a review, to encourage longer term flow, RBI has now decided that foreign investment by all eligible investors i.e. RFPIs (including existing FIIs and QFIs) and Long term investors registered with SEBI– WFs, Multilateral Agencies, Pension/ Insurance/Endowment Funds and foreign Central Banks, shall henceforth be permitted only in Government dated securities having residual maturity of 1 year and above.

- Existing investment in T-bills and Government dated securities of less

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than 1 year residual maturity shall be allowed to taper off on maturity/ sale and no fresh investment in T-bills and Government dated securities of less than 1 year residual maturity is allowed.

SEBI may ease norms for bonus shares sale during IPO

- As part of its efforts to revive primary markets, SEBI may relax restrictions on sale of bonus shares held by promoters or other investors during an IPO of a company, even if these shares have been held for less than a year. As per the existing regulations, shares that have been held for a period of less than a year are not eligible to be offered for sale in an IPO.

- This restriction applies to all classes of shares, including bonus shares or equity granted to existing shareholders on the basis of their prevailing stake. According to senior officials, the SEBI board will consider this reform measure in the primary markets this week, which has finalised after taking into account suggestions made by the regulator's Primary Market Advisory Committee and representations from market participants.

Offshore listing regime: How to raise funds and monetize investments

- Government's recent initiative to allow unlisted companies to list on offshore markets through the depository receipt (DR) mechanism without the requirement of simultaneous listing in India is likely to be a major shot in the arm for many sectors, and also offer exits to private equity players looking to monetize their investments.

- Government has only recently prescribed that SEBI shall not mandate any disclosures, unless the company lists in India. Once the air around disclosures to SEBI has been cleared, we can expect offshore listing of DRs to grow on the back of the reasons set out below:

(a) *offshore listing will offer the opportunity to a slew of young Indian companies to tap the overseas markets.*

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(b) offshore listing would allow Indian entrepreneurs the platform to tap investors that have a much better understanding of the value proposition of the business.

(c) foreign investors will find it more amenable to invest in DR's denominated in foreign currency as against INR, which has depreciated by more than 50% since 2007.

(d) proceeds of the DR can be structured to retire existing debt or private equity.

(e) from a tax perspective, investors can finally breathe easy. There will be no tax on the sale of DRs on the stock exchange.

(f) listing of DRs is likely to be much cheaper than listing of shares on foreign exchanges and sometimes the compliance costs of ADR / GDR may be lower than the compliance costs of domestic listing.

SEBI planning to provide fresh avenues for start ups through crowd-funding norms

- The Securities and Exchange Board of India (SEBI) is planning to provide fresh avenues for start-ups and small and medium enterprises (SMEs) to raise early-stage funding through Internet-based platforms. The regulator on Tuesday proposed new guidelines for crowd funding in an attempt to provide a more efficient and cost-effective fund-raising platform than public issue or private placement offering.

- Crowd-funding is solicitation of funds from multiple investors through an online platform or social networking site for a specific project, business venture or social cause. It can be classified into four categories, including donation crowd-funding, reward crowd-funding, peer-to-peer lending and equity crowd-funding.

- Apart from equity-based crowd-funding, other forms of crowd-funding will not come under Sebi's purview as they do not generally involve issuance of securities for financial returns. Under the security-based crowd-funding, Sebi is

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exploring three routes such as equity, debt and fund-based crowd-funding.

- SEBI has proposed to allow only accredited investors to participate in crowd-funding. It has defined accredited investors as qualified institutional buyers, companies with a minimum net worth of Rs. 20 crore, HNIs with a minimum net worth of Rs. 2 crore or more and eligible retail investors.

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Company Law Board (Qualifications, Experience And Other Condition Of Service Of Members) (Amendment) Rules, 2014 - Amendment In Rule 8

- MCA vide Notification No. GSR 197(E) [F.NO.A- 12018/1/2011 AD.IV], dated March 20, 2014 has notified that in exercise of the powers conferred by Section 10E (2A), read Section 642 of Companies Act, 1956 [Corresponding to section 465 read with section 469 of the Companies Act, 2013] the Central Government has made amendments in Company Law Board (Qualifications, Experience and other Conditions of Service of Members) Rules, 1993 the rules would be called the Company Law Board (Qualifications, Experience and other Conditions of Service of Members) (Amendment) Rules, 2014. In rule 8 of 1993 Rules, a proviso shall be inserted giving powers to Central Government to give extension in service of Chairman, Vice Chairman and Members.

Clarification with regard to resolution passed u/s 293 of Companies Act, 1956 prior to 12-09-2013

- Ministry of Corporate Affairs vide General Circular No. 4/2014 o [NO.1/32/2013-CL.V (PT.FILE)], dated March 25, 2014 has clarified that resolution passed under section 293 of the Companies Act, 1956 prior to September 12, 2013 with reference to borrowings (subject to the limits prescribed) and/or creation of security on assets of the company will be regarded as sufficient compliance of the requirements of Section 180 of the Companies Act, 2013 for a period of one year from the date of notification of Section 180 of the 2013 Act.

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SEBI has revised Alternative Investment Funds (AIFs) regulations

- Securities and Exchange Board of India (SEBI), has revised Alternative Investment Funds (AIFs) regulations and prescribed strict disclosure norms which requires AIFs to disclose disciplinary history of the fund, its sponsors, manager, partners, promoters and associates in the placement memorandum.

- AIFs is also required to disclose pending and past cases of litigation, civil and criminal cases. Any administrative actions such as warning and deficiency letters.

- All existing AIFs who has not made the disclosure has to file this with Investors within 30 days of the circular as addendum to placement memorandum. A copy of same shall also be filed with SEBI 7 days before sending it to Investors.

- Other than above many other changes has been made by SEBI in AIFs regulations regarding to filing of compliance test reports, changes in placement memorandum which can be referred from the SEBI Circular.

Clarification on CSR

- Ministry of Corporate Affairs (MCA) has come out with a clarification dated June 18, 2014 on Section 135 of Companies Act, 2013 and Schedule VII thereto dealing with Corporate Social Responsibility (CSR). The clarification impresses upon Companies to carry out CSR activities in more liberal fashion by reducing the rigidities so as to ensure that the mandatory contribution made is with essence of the subject.

Some of the major points clarified by MCA are highlighted below for quick reference

- Expenses incurred by the Company towards fulfilment of any Act/Statute and Regulations will not be considered as contribution made towards CSR activities.

- Salaries paid to CSR staff/volunteers appointed by the Company for handling CSR activities will constitute as CSR contributions..

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- **Any financial year** referred under Section 135 (1) implies **any one of the three preceding financial year.** It means if any Company which has networth or turnover or net profit as specified in Section 135 in any of the three preceding years, has to comply with CSR norms.

- Singular events such as sponsoring events, holding marathons, charitable contribution etc. will not be considered as a CSR expenditure.

- Any contribution made by the Foreign holding company in any CSR activity in India through its subsidiary will form part of CSR contribution by such Indian Company.

SEBI has issued norms for public issue of debt securities (applicable to both NBFC's and non NBFC's issuers)

- The minimum offer size has to be Rs. 100 crores out of which minimum 75% shall be subscribed. In case if the Company is unable to get the minimum subscription then it has to refund the money within 12 days from the closure of the issue. In case of any delay the refund has to be made along with interest at 15% per annum for the delay period. The important point to note here is that Companies Act, 2013 do not specify any minimum subscription requirements for public issue of equity and debt and it has to be specified by entity under its offer document.

- The entities has to make disclosures in the offer document about details of money utilised from previous issues of the issuer as well as of group companies.

- The entities coming out with public issue has to specify the objects of the issue including the percentage earmarked for each objects of the issue. Further the amount earmarked for General Corporate Purpose shall not exceed 25% of the amount raised by the issuer in the proposed issue.

- The new norms will be applicable for the draft offer document for issuance of debt securities filed with the stock exchange on or after July 16, 2014.

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<u>MCA clarification on Independent Directors (IDs)</u>

- Ministry of Corporate Affairs (**'MCA'**) has come up with clarifications on pecuniary relationships, appointment, tenure & remuneration payable to Independent Directors (**'ID'**) vide its recent general circular No. 14/2014 dated June 09, 2014.

- Considering the provisions of Section 188 MCA clarified that any transaction done by ID with the Company or its holding /subsidiary/associate companies in ordinary course of business and at arm's length will not be considered as having **'pecuniary relationship'.**

- Further in consultation with SEBI, MCA clarified that any fee received by ID under sub-section (5) of section 197, reimbursement of expenses for attending Board and other meetings and profit related commission approved by the members, in accordance with the provisions of the Act shall also not be considered as ID having pecuniary relationship with Company or its holding/subsidiary/associate companies.

- MCA clarified that any previous appointment of ID shall not be considered and they would be appointed as a fresh under the provisions of the Act. So the appointment of all ID whether existing or new one has to be in compliance with provisions of Section 149 and Schedule IV of the Act *(However the differences still prevail between revised Clause 49 of Listing Agreement and provisions of the Act regarding to the tenure limit of ID already serving the Board of existing companies).*

- Further MCA has cleared the possibility on appointment of ID for less than 5 years. In accordance with provisions of Section 149 (11) it has been clarified that, no person can hold office of ID for more than two consecutive terms'. Such a person shall have to demit office after two consecutive terms even if the total number of years of his appointment in such consecutive terms is less than 10 years.

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