ALMT Legal
ADVOCATES AND SOLICITORS

news flash

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RBI PERMITS ISSUE OF REDEEMABLE PREFERENCE SHARES & DEBENTURES

Introduction

The Reserve Bank of India ("**RBI**") has notified an amendment to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 ("**FEMA 20**") permitting an Indian company to issue **non-convertible redeemable preference shares or debentures** by way of a distribution of bonus to persons resident outside India under a court approved scheme of arrangement.

The amendment came into effect on 31 December 2013.

We are pleased to inform you that RBI found merit in the submissions made by ALMT Legal while representing one of its clients before the RBI and has issued this amendment to FEMA 20 as discussed below.

History of FEMA 20

Preference Shares & Debentures

With effect from 1 May 2007 only those preference shares that are fully and mandatorily convertible into equity are reckoned as eligible instruments that may be issued to a person resident outside India.

With effect from 8 June 2007 only those debentures that are fully and mandatorily convertible into equity are reckoned as eligible instruments that may be issued to a person resident outside India.

Foreign investments in any other types of preference shares or debentures (i.e. non-convertible, optionally convertible or partially convertible) after 1 May 2007 and 8 June 2007, as the case may be, are considered as debt requiring compliance with the External Commercial Borrowing (ECB) guidelines framed under the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000.

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Bonus Shares

Under the existing FEMA regulations an Indian company is generally permitted to issue bonus shares to its non-resident shareholders subject to the same conditions and restrictions regarding repatriation as are applicable to the original shares.

ALMT Legal Impact

ALMT Legal, in connection with one of its recent transactions, led by its Senior Partner, Hitesh Jain, and assisted by senior associate, Deblina Gooptu and associates, Nirmal Mahtani and Aditi Tralshawala made a representation to the RBI that a bonus issue by way of redeemable and non-convertible preference shares, should be allowed by an Indian company to its non-resident shareholders. In this regard, *inter-alia,* the following submissions were made to the RBI:

(i) Regulation 6A of FEMA 20 states that "*An Indian company may issue* ***bonus shares*** *to its non-resident shareholders, subject to the following conditions…"* and paragraph 3.5.1 of the FDI Policy states that "*FEMA provisions allow Indian companies to freely issue Rights /* ***Bonus shares*** *to existing non-resident shareholders, subject to adherence to sectoral cap, if any.*" The term 'bonus shares' is not defined in the FEMA regulations. Hence, the term 'bonus shares' should be widely interpreted to include redeemable non-convertible instruments.

(ii) The intention of Regulation 6A of FEMA 20 and paragraph 3.5.1 of the FDI Policy appears to be to include all types of shares, including redeemable non-convertible instruments, since a bonus issue is a means to reward the shareholders of a company, which can also be done by way of payment of dividend, which is not restricted under the foreign exchange laws of India.

Pursuant to the above representations, apart from granting specific approval to the client of ALMT Legal with respect to their bonus issue, the RBI has amended the provisions of FEMA 20, as detailed below.

The Amendment to FEMA 20

Regulation 7 of FEMA 20 has been amended to include therein sub-regulation (2), which provides that an Indian company can issue non-convertible redeemable preference shares or debentures out of its general reserves by way of distribution as bonus to the shareholders resident outside India, subject to the following conditions:

(i) the bonus issue is undertaken pursuant to a scheme of arrangement of the Indian company approved by a court in India, in accordance with the provisions of the Companies Act 1956 and the terms and conditions of such scheme have been complied with;

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(ii) the original acquisition of shares/ convertible debentures of the company by the non resident shareholders, entitling them to hold non-convertible redeemable preference shares or debentures is in accordance with FEMA 20;

(iii) a ‘no objection certificate’ has been obtained from the income tax authority of India by the Indian company/ transferee company/ new company; and

(iv) the company shall not engage in any activity or sector mentioned in Annex A to Schedule I of FEMA 20.

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