UPDATES

Corporate – Legal Milestones in 2019 anda Look Ahead

28 February 2020

This update covers:

Some key amendments to the exchange control regulations, Companies Act, 2013, and the Indian Stamp Act, 1899 were introduced in the second half of 2019. This update summarises some of these developments along with our expectations for the year 2020.

a. The Year that Was

This year witnessed changes to the foreign investment policy aimed at streamlining regulations, liberalising existing sectoral restrictions and bringing clarity on existing conditionalities in certain sectors. Additionally, steps were taken to decriminalise offences under the Companies Act, 2013 and to bring parity on stamp duty payable on transfer of shares, irrespective of the form in which such shares are held.

• Changes to the Foreign Direct Investment Regime

Pursuant to an amendment to the Foreign Exchange Management Act, 1999, the Government of India was vested with the power to regulate capital account transactions involving 'non-debt instruments' (such power was previously with the Reserve Bank of India). Consequently, the Government of India notified the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules), which consolidate various regulations applicable to 'non-debt instruments'.

The NDI Rules supersede the Foreign Exchange Management (Transfer and Issue of Security by a Person Resident outside India) Regulations, 2017, which previously regulated foreign direct investments and foreign portfolio investments. While there are no major changes vis-à-vis the previous regime, the NDI Rules streamline various regulations, based on the class of investor and the mode of investment.

Another important development last year was the shift in policy direction by the Government of India to liberalise FDI in the insurance intermediaries sector, which was restricted to 49% under the automatic route. The changes proposed will allow FDI up to 100% under the automatic route in insurance intermediaries, subject to compliance with prescribed conditions including those notified by the Insurance Regulatory and

Development Authority of India (IRDAI) (pursuant to the notification of the Indian Insurance Companies (Foreign Investment) Amendment Rules, 2019). These conditions include:

- ensuring either the chairman, CEO, Principal Officer or the Managing Director of the insurance intermediary is a resident Indian citizen;
- applying to the IRDAI prior to repatriation of dividend;
- bringing in the latest technological, managerial, and other skills;
- making disclosures in prescribed formats in connection with payments made to promoter/group/subsidiary/associated entities;
- prohibiting payments (other than dividend) to related parties beyond 10% of the total expenses of the insurance intermediary in a financial year; and
- ensuring that majority of the members on the board of directors and key management persons are resident Indian citizens.

While the government's intent to liberalise this sector is clear, formal notification of this shift in policy is still awaited.

Additionally, over the past year, there have been changes in the Foreign Direct Investment (FDI) regulations for certain sectors, which have been summarised below:

a. Single brand retail trading (SBRT)

   i. Local sourcing rules, applicable to SBRT entities having FDI in excess of 51%, require that at least 30% of their total procurement should be from India. These rules have been liberalised to permit such SBRT entities to include goods procured from India, by themselves or through their group entities for the purpose of exports or their global operations, towards the satisfaction of the 30% local sourcing requirement.

      Local sourcing rules continue to require an assessment of compliance as an average of five years in the first instance (beginning 1 April of the year of commencement of business) and on an annual basis thereafter.

   ii. SBRT entities have been permitted to engage in e-commerce activities without setting up a physical retail store (a prerequisite previously), provided such a physical store is set up within 2 years of commencement of online sales.

b. Digital Media

   Previously, the FDI regime did not have any specific provision dealing with 'digital news' activities. However, in 2019, an FDI cap of 26% under the government approval route was imposed on '*uploading or streaming of news and current affairs through digital media*'.

   This has led to a degree of ambiguity regarding the precise scope of this provision as several digital news websites previously operated with higher foreign investment limits.

c. Contract manufacturing

   Previously, there was some ambiguity in the FDI regime relating to contract manufacturing activities. The scope of manufacturing activities, which is under the automatic route for FDI of up to 100%, has now been expanded to specifically include contract manufacturing activities.

- ## Changes to the Companies Act, 2013

1 Significant Beneficial Ownership Rules

In 2018, the Ministry of Corporate Affairs had issued rules relating to '*significant beneficial owners*' of Indian companies, i.e. the Companies (Significant Beneficial Owners) Rules, 2018 (SBO Rules) with the intention to bring greater transparency in corporate structures. These rules had been kept in abeyance on account of ambiguity in the scope of their applicability.

In 2019, following amendments to the SBO Rules, more objective criteria for the purposes of identification of 'significant beneficial owners' were introduced. Existing 'significant beneficial owners' and corresponding investee companies are required to complete reporting requirements by 31 March 2020. Further, the onus of identifying 'significant beneficial owners' has been put on the investee companies.

2 Decriminalisation of certain compoundable offences

To provide a balance between corporate governance requirements and ease of doing business in India, the Companies (Amendment) Act, 2019 has re-categorised 16 out of 81 compoundable offences (i.e. offences punishable with fine only, or fine or imprisonment, or both) as civil offences (therefore, no imprisonment). Such civil offences are adjudicated upon by officers that are empowered to impose penalties and issue directions to rectify offences.

- ## Changes in Stamp Duty Laws

The Finance Act, 2019 brought in changes to the Indian Stamp Act, 1899 with the intent to streamline the administration and levy of stamp duty. One of the key amendments introduced was in relation to the stamp duty payable on the transfer of securities. The stamp duty payable on transfer of securities will now be at par, irrespective of whether the securities are held in physical or dematerialised form (previously, transfer of securities in dematerialised form were exempt from payment of stamp duty). The stamp duty rates now payable on transfer of securities (other than debentures, whether physical or dematerialised) are:

1. 0.015% of the consideration, if the transfer is on a delivery basis; and
2. 0.003% of the consideration if it is on a non-delivery basis;

Further, stamp duty payable on the issuance of securities (other than debentures) was reduced to 0.005% of the market value.

These changes will come into effect from 1 April 2020.

b. Looking Ahead

While the intent of liberalising the FDI regime in the insurance intermediaries sector is a welcome move, stakeholders are optimistic that the statutory changes will be formally notified soon. Further, it remains to be seen if the Government of India will also liberalise FDI in insurance companies. To this effect, the IRDAI has sought the views of stakeholders in connection with liberalising investments in insurance companies to permit FDI up to 74%. On a separate note, further clarity is expected on the scope of activities covered within the ambit of 'digital news media' and how regulations for this sector will affect corporate structures of entities that have already received FDI in excess of 26%.

Additionally, the Government of India has also constituted a committee to consider the re-categorisation of the remaining compoundable and non-compoundable offences featuring in the Companies Act, 2013 as civil offences (an announcement to this effect has also recently been made in the Union Budget).

For a round-up of some of the key legal developments across sectors in 2019 and a brief insight on what to expect in 2020, please read our sector-wise updates, which can be accessed at: https://trilegal.com/knowledge-repository/page/2/?title=milestone