# **Corpsec** Hotline

January 30, 2020

## JOURNEY FOR INDIAN PRIVATE EQUITY AND M&A FROM 2019 TO 2020: WHAT TO EXPECT?

The corporate sector in India experienced an eventful 2019, thanks to the plethora of legal, regulatory and policy changes announced and implemented by the Government, which have affected, both positively and negatively, the investment environment in India. While some of these developments were in the form of amendments to existing laws, some others saw the light in the form of innovative regulatory experiments. Largely, however, the focus has been on ease of doing business in India, opening avenues of receiving foreign investment in India and tightening the noose around corporate governance. In this write-up, we summarize some of the most significant developments, focusing on the impact such developments have had in 2019 and what we can expect in 2020.

### LIBERALIZATION OF THE FPI REGIME

In September 2019, the Securities and Exchange Board of India ("**SEBI**") notified the SEBI (Foreign Portfolio Investors) Regulations, 2019 ("**FPI Regulations 2019**"), which superceded the erstwhile SEBI (Foreign Portfolio Investors) Regulations, 2014. We summarize below some of the key changes brought in through this legislation and otherwise to the foreign portfolio investment regime. For our detailed analysis of the FPI Regulations 2019, refer to our hotline **here**.

***Registration and Categorization***

The FPI Regulations 2019 has done away with the 3 (three) categories of foreign portfolio investors ("**FPI**") and clubbed them into 2 (two) categories, which is now based on their existence in a Financial Action Task Force ("**FATF**") member country jurisdiction/s. Further, the FPI Regulations 2019 has finally clarified that while resident Indians, non-resident Indians and overseas citizens of India cannot apply for registration as an FPI, they can be stakeholders of an FPI applicant subject to fulfillment of certain conditions. Also, positively, the broad-based criteria, which many applicants were struggling to achieve and maintain, has been done away with.

***Off-shore derivative instruments***

The FPI Regulations 2019 has widened the definition of off-shore derivate instruments ("**ODIs**") to mean any instrument, by whatever name called, which is issued overseas by an FPI against securities held by it in India. The FPI Regulations 2019 instead permit issuance of ODIs by Category I FPIs and issuance of ODIs to only such persons who are eligible for registration as Category I FPIs. This in effect means that an unregulated entity which is eligible to seek registration as a Category I FPI is permitted to hold an ODI.

***Voluntary Retention Route***

In March 2019, the Reserve Bank of India ("**RBI**") announced the voluntary retention route ("**VRR**") for FPI debt subscriptions, which provides more flexibility in making investments in government securities and corporate bonds and the time period for such investment, by relaxing the concentration norms applicable in the general FPI route. To explain further, an investment made in corporate bonds under the VRR does not require a minimum of 2 (two) FPIs to hold the entire series of investment (unlike the FPI route where there is a 50% (fifty percent) diversification requirement). However, at least 75% (seventy five percent) of the money brought into the India under VRR is required to be retained in India for a period of 3 (three) years. Accordingly, a single FPI can now subscribe to an entire issue of corporate bonds irrespective of its tenure, so long as 75% (seventy five percent) of the amount is retained in India for a period of 3 (three) years.

While the flip flop around regulations pertaining to FPIs continue, the changes brought in through the FPI Regulations 2019 and VRR notification are a positive step and are likely to promote investor confidence.

### DEBT FUNDING IN INDIA

In January 2019, the external commercial borrowing ("**ECB**") framework in India underwent a complete overhaul, whereby the regulations were amended and superseded. The basket of eligible lenders has been expanded to include all residents of a FATF or International Organisation of Securities Commissions (IOSCO) compliant country, the basket of eligible borrowers has been expanded to include any entity that is capable of raising foreign direct investment and the end-use restrictions have been relaxed. Significantly, the sectors and industries which can raise ECB has widened. The erstwhile categories of ECB have been simplified and now, ECBs only consist of 2 (two) categories – foreign currency denominated and Indian Rupee denominated. The revisions to the regulatory framework for ECB by the RBI is in line with the liberalization tone set by the Government. Other than certain specific restrictions by reason of limited capital account convertibility in India, the ECB route has been substantially liberalized and is likely to increase the avenues for debt funding in India.

### AMENDMENTS TO THE INSOLVENCY AND BANKRUPTCY CODE

The Insolvency and Bankruptcy Code, 2016 ("**IBC**") and its impact on both corporate restructuring and corporate governance has been the talk of town for over 3 (three) years now. The ever-evolving IBC had far reaching

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developments in 2019, by way of amendments and evolving jurisprudence. Refer to our hotlines **here**, **here** and **here** on the developments in 2019 to the IBC regime.

***Amendments to the IBC***

The IBC underwent two sets of amendments in 2019 – in August and December. The key focus of these amendments was on ensuring timely admission and completion of the resolution process, primacy of financial creditors over operational creditors in the distribution of payments, the binding nature of the resolution plan on all the stakeholders and providing the committee of creditors ("**CoC**") with the power to modify the distribution of resolution proceeds based on commercial consideration. Pertinently, some of the key amendments are: (a) a resolution plan may contain provisions for restructuring of the corporate debtor, by way of merger, amalgamation or demerger; (b) the resolution plan shall be binding on the Central Government, State Government or any local authority to whom the corporate debtor owes a statutory debt; (c) the operational creditors will be paid at least the amount payable to them in the event of liquidation of the corporate debtor or the amount payable to them if realisations under the resolution plan were distributed in accordance with the priority in the liquidation waterfall, whichever is higher and dissenting financial creditors will be paid at least the amount payable to them under liquidation waterfall; and (d) continuing the production/ supply of certain goods and services in order to operate the corporate debtor as a going concern.

***Essar Ruling***

In November 2019, the Hon'ble Supreme Court in the case of *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta*[1] brought in much needed clarity in relation to some of the provisions of the IBC. One of the primary outcomes of the judgment is the upholding of the primacy of the commercial wisdom of the CoC, with a caveat that the CoC should focus on the *feasibility* and *viability* of the resolution plan, preserving the business as a going concern and maximizing the value of assets of the corporate debtor and balancing the interest of all the stakeholders. The Supreme Court also held that the courts have a limited power of judicial review in a resolution plan, so long as the CoC has considered the interest of all the stakeholders. It has also settled the dust that financial creditors and operational creditors can be treated differently under a resolution plan, since they are not placed in the same class of creditors. This judgment is crucial to reinforce the confidence that the IBC is a progressive legislation for the purpose of corporate restructuring.

The IBC has undergone a substantial number of amendments in 2019, the focus of which largely seems to be to provide clarity on the rights and duties of the CoC and the procedures to be followed for liquidation and restructuring. With the steady increase in the number of cases being referred under the IBC regime, the clarity in the procedural aspects, which has been the essence of the amendments in 2019, will go a long way in easing the process for companies.

## AMENDMENTS TO THE FDI REGIME

The Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 ("TISPRO") and Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018 have been superseded by Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("Non-Debt Rules"), Foreign Exchange Management (Debt Instrument) Regulations, 2019 and Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019. While the law around foreign investment has not been substantially modified by way of these amendments, there have been a few changes in nomenclature of instruments, power of the RBI and some seemingly unintended changes due to omission of certain provisions from the TISPRO. For example, while the term 'hybrid instruments' has been defined in the Non-Debt Rules to include optionally/ partially convertible debentures, preference shares, the term has not been used anywhere in the Non-Debt Rules.

The Non-Debt Rules also clearly demarcate between 'debt instruments' and 'non-debt instruments', which includes 'capital instruments' under the TISPRO and also certain other kinds of instruments in AIFs, REITs, INVITs, etc.

Further, certain sectoral caps and related changes were brought in through Press Note. 4 in 2019, which have been incorporated into the Non-Debt Rules. Pertinently, (a) the sectoral cap for single brand retail trading has been increased to 100% (one hundred percent) from 49% (forty nine percent); (b) it has been clarified that 'manufacturing activities' includes contract manufacturing; (c) 26% (twenty six percent) foreign direct investment has been permitted in 'Uploading/ streaming of news and current affairs through digital media' under the Government route; and (d) it has been clarified that e-commerce activities can only be undertaken by an Indian entity.

As far as foreign direct investment is concerned, while 2019 saw some important relaxations in key sectors, the confusion around the e-commerce sector continues.

## E-COMMERCE POLICY

Keeping the spirit of complexity alive in the e-commerce sector, the Department for Promotion of Industry and Internal Trade ("**DPII**") released a draft National E-commerce Policy ("**E-commerce Policy**") for public consultation early in 2019. The E-commerce Policy recognizes commerce and data as the key proponents of India's growth and economic development. The E-commerce Policy defines 'e-commerce' broadly to include buying, selling, marketing or distribution of (i) goods, including digital products, and (ii) services; through an electronic network. The E-commerce Policy deals with issues in six broad themes: (i) data; (ii) infrastructure development; (iii) e-commerce marketplaces; (iv) regulatory issues; (v) stimulating the domestic digital economy; and (vi) export promotion through e-commerce. The E-commerce Policy focuses on the themes of consumer protection and promoting domestic businesses. For instance, one of the proposals set out in the E-commerce Policy is that all e-commerce sites/apps available for download in India must have a registered business entity in India as the importer on record or as the entity through which all sales in India are transacted. This may discourage foreign players from targeting Indian markets as this would result in additional compliance and cost for them and may also be a disadvantage to the Indian consumers, as it would restrict their access to products and services offered by the foreign players. Following through with the intent established with the proposed personal data protection bill, the E-commerce Policy classifies data as a sovereign resource. The E-commerce Policy reinforces the right of an individual over data pertaining to him/her and sets the tone for data localization by requiring that certain categories of data be stored within the country. The E-commerce Policy also justifies this by citing an increased spending in data infrastructure, which will create jobs in India. With the growing e-commerce sector in India, clarity regarding the applicable regulations to each of the stakeholders is crucial. Having said that, once the policy is finalized and changes made to the relevant laws, it will be interesting to

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analyse if the Government's focus is on ease of doing business or increased governance and accountability.

## TRACING THE 'SIGNIFICANT BENEFICIAL OWNERSHIP'

When the Ministry of Corporate Affairs ("**MCA**") notified the Companies (Significant Beneficial Owners) Rules in 2018, it raised more questions than provide answers, especially, regarding who a 'significant beneficial owner' is. In 2019, the MCA amended these rules with the aim to provide more clarity and to simplify the process of registration of a 'significant beneficial owner'. While the intent was to provide an objective test to determine the identity of the 'beneficial owner' based on the percentage holding of shares, voting rights and right to receive dividends, the subjectivity remains due to a number of aspects including on account of drafting ambiguities and over-arching provisions such as a criterion which mentions 'right to exercise, or actually exercises, significant influence or control, in any manner *other than through direct-holdings alone*'. While 'significant influence' has been defined to mean power to participate directly or indirectly in the financial and operating policy decisions, it is still not clear if the mere right to nominate directors on the board and affirmative voting rights will necessarily fall within the ambit of 'significant influence'. While the onus of identifying and reporting the 'significant beneficial owner' is on the reporting company, it is unlikely that the reporting company will have access to the relevant information and documents to make such identification. While the amendment rules provide more clarity on the previous set of rules, there are still many questions unanswered with respect to who constitutes a 'significant beneficial owner' and that is the reason for the frequent amendments and clarifications to these rules and extension to deadlines.

## MAJOR TAX REFORMS IN 2019

### *Reduction in tax rates*

The Taxation Laws (Amendment) Act, 2019 introduced a few relaxations on tax rates, two of the critical ones being, (a) reduction in corporate tax rates for domestic companies from 30% (thirty percent) to 22% (twenty two percent) and 25% (twenty five percent) to 15% (fifteen percent) (exclusive of applicable surcharge and cess) for new manufacturing companies set up and registered after October 1, 2019 subject to specified conditions; and (b) amendment of the threshold for applicability of Minimum Alternate Tax ("**MAT**") by reducing the trigger point from 18.5% (eighteen point five percent) of book profits to 15% (fifteen percent) of book profits and corresponding reduction in rate of MAT from 18.5% (eighteen point five percent) to 15% (fifteen percent). The reduction in rates for corporate tax is likely to result in distribution of higher profits to stakeholders thereby increasing consumption and increase in investment in the manufacturing sector and thereby, more manufacturing units being set up. Further, amendment regarding MAT is likely to boost foreign investments, particularly for investments into companies that enjoy several deductions / exemptions under the Income Tax Act, 1961.

### *Angel tax exemption*

In a much-needed move, the DPII revised the conditions to claim exemption from what is popularly referred to as 'angel tax' and streamlined the assessment process for start-ups to seek exemption from payment of 'angel tax'. While there were provisions for start-ups registered as such, to claim exemption from payment of this tax, the eligibility criteria for qualifying as a start-up were narrow and the process was cumbersome and in practice, few start-ups could avail of this exemption; thus, draining a substantial portion of their investment received towards payment of tax. The ambit of what entities shall be considered a 'start-up' has been expanded, by widening recognition afforded to start-ups from 7 (seven) years to 10 (ten) years (subject to turnover not exceeding INR 100 crore) and the consideration threshold has also increased from INR 10 crore to INR 25 crore. This move is a clear indication of the Government's intent to work with the industry to create a beneficial regulatory environment.

## INCREASED GOVERNANCE – 'NEW INFORMANTS'

In September 2019, SEBI brought in some key changes to the insider trading regime by introducing the concept of informant policy. The aim of these amendments is to increase the reporting of violation of insider trading norms, by encouraging and incentivizing people to come forward and report such incidents. The policy protects the identity of the informant, while putting the responsibility of providing relevant information on the informant. The policy also proposes a monetary reward and penalty concept for informants to incentivize and penalize behavior. These amendments try to balance the interest of all stakeholders, while enabling SEBI to detect early, the instances of insider trading and aiding it to gather evidence for the same. While restrictive to some extent, such developments showcase India's growing focus on good governance.

## SEBI – LISTING OF 'START-UPS'

In 2015, SEBI had introduced the concept of an 'institutional trading platform' ("**ITP**") which facilitated listing of start-ups engaged in certain sectors. However, the ITP failed to take off successfully due to the stringent norms and conditions required to be fulfilled for listing. In 2019, SEBI amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 to introduce provisions on the lines of the erstwhile ITP, with the focus being on increased accessibility. ITP, now re-christened as the 'Innovators Growth Platform' ("**IGP**") has broadened the definition of 'eligible investors' who can hold shares in the company proposed to be listed (which previously only included qualified institutional buyers) and has done away with the cap on post-issue shareholding, thereby making it more promoter-friendly. Whether the IGP manages to provide a boost to the start-up eco-system by providing access to public funds, remains to be seen.

## REGULATORY SANDBOXES

The sector regulators in India seem to be veering towards the concept of 'innovative sandboxes' in order to test new technological products before their launch in the market. The SEBI, RBI and Insurance Regulatory and Development Authority each have come out with their framework for innovative sandboxes. The primary feature of an innovative sandbox is the live testing of new products or services in a controlled regulatory environment, for which regulators may or may not permit certain regulatory relaxations for the duration of the testing. While the idea is a welcome move and is likely to benefit all the stakeholders (regulators, promoters and consumers), only time will tell if this step has the desired market impact.

## CLARIFICATION AND CONFUSION ON 'BASIC WAGES'

The Hon'ble Supreme Court of India in the matter of *West Bengal v. Vivekananda Vidyamandir & Others*[2] upheld and yet again clarified what constitutes 'basic wages' for the purposes of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952. The Supreme Court reiterated that allowances *which are made universally, ordinarily and necessarily to all employees across the board or to all employees in a particular category/grade* will fall within the ambit of 'basic wages'. Only the allowances which have been specifically excluded from the definition of ‘basic wages’, for instance, house rent allowances or which have a nexus or linkage to extra output and/or variable amount which is not paid across the board to all employees, can be excluded from the definition of ‘basic wages’ for the purpose of calculating provident fund contributions. While this judgment reinforced the interpretation of ‘basic wages’, the judgment has also left companies seeking more clarity on implementation of the same, as any retrospective application will result in an administrative and legal nightmare for companies, along with a significant financial impact.

### LOOKING FORWARD TO 2020...

The year 2020 will be the testing ground for the legal and regulatory changes implemented by the Government in 2019. With the liberalization of the FPI and ECB regimes, the stage appears to be set for a growth in the foreign debt market in India. Further, the opening up of more sectors for foreign direct investment and the exemption on angel tax is likely to give a much-needed push to the equity investment market in India as well. The impact of other regulatory developments like the E-commerce Policy and regulatory sandboxes can be gauged once they are fully implemented in 2020.

Looking forward, from a regulatory perspective, one can expect 2020 to be yet another year that will witness a significant number of changes in existing laws and new laws being enacted to regulate certain unregulated sectors. For instance, an increase in the sectoral cap for foreign direct investment in the insurance sector is expected.

From the perspective of RBI, one can expect some form of legislation for regulation of payment gateways and payment aggregators and for resolution of stressed assets. Further, the amendments to the intermediary guidelines (which deal with directions for entities that store or transmit data on behalf of other persons) have been under discussion for a substantial time and are expected to be notified in early 2020. These amendments are likely to increase the liabilities and responsibilities of the intermediaries with respect to content published on the platforms.

One of the major regulatory reforms that is being awaited in 2020 is the unification of several labour laws - the Code on Wages, 2019 has been approved by both Houses of Parliament and has also received Presidential assent. It will come into effect once the date of its enforcement is notified in the official gazette.

It will be interesting to see whether the regulatory changes proposed to be implemented in 2020 drives India Inc towards achieving the aspirational USD 5 trillion economy goal.

– Saumya Ramakrishnan, Parag Srivastava, Karan Kalra & Nishchal Joshipura
You can direct your queries or comments to the authors

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[1] Civil Appeal No. 8766-67 of 2019
[2] Civil Appeal No 6221 of 2011

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