

## **INDIAN DEPOSITORY RECEIPTS**



[www.nishithdesai.com](http://www.nishithdesai.com)

[nda@nishithdesai.com](mailto:nda@nishithdesai.com)

**November 2009**

## INDIAN DEPOSITORY RECEIPTS

### **THE FIRM**

*We are a research based international law firm with offices in Mumbai, Bangalore, Silicon Valley and Singapore.*

*We specialize in strategic legal, regulatory and tax advice coupled with industry expertise in an integrated manner. We are known for handling select highly complex, innovative transactions or which require "critical surgery".*

*We acted as legal counsel to India's first NASDAQ listed Indian ADR issuance by Infosys Technologies followed by Wipro on NYSE besides Rediff, Sify, Siilverline, IMR Global, etc. We now represent a good mix of domestic and international offerings that has evolved from representing several Indian corporations in international offerings.*

*We have been engaged as counsel for several domestic Initial Public Offerings (IPOs), Qualified Institutional Placements (QIPs) and PIPE transactions. We were also involved in AIM and London Main Market Listing where for the first time an India focused real estate fund was proposing to get listed*

*Among the several firsts to our credit are the pioneering work done in the area of international taxation, advice for setting up the first India focused private equity fund, the first ever American Depository Receipt issuance by an Indian company, and the world's largest private equity investment in microfinance. Our key clients include marquee repeat Fortune 500 clientele, of which over 60 per cent are US corporations.*

*Financial Times – RSG Consulting ranked us the highest for 'Quality of the legal services rendered to our clients for the year 2009'. Pacific Business Press has rated us as Asian – Counsel Firm of the Year 2009 for Private Equity and Taxation in India. We are also part of the Asian Legal Business Watchlist as one of the 'Top 10 firms to watch in 2009' in Asia – Pacific.*

*Our research oriented approach has also led to the team members being recognized and felicitated for thought leadership. Consecutively for the fourth year in 2009, NDAites have won the global competition for dissertations at the International Bar Association. Nishith Desai, Founder of Nishith Desai Associates, has been named one of the 'Most In Demand Practitioners' by Chambers Asia 2009. He has also been ranked No. 28 in a global Top 50 "Gold List" by Tax Business, a UK-based journal for the international tax community.*

*Our trust-based, non-hierarchical, democratically managed organization that leverages research and knowledge to deliver premium services, high value, and a unique employer proposition has now been developed into a global case study and published by John Wiley & Sons, USA in a feature titled 'Management by Trust in a Democratic Enterprise: A Law Firm Shapes Organizational Behavior to Create Competitive Advantage' in the September 2009 issue of Global Business and Organizational Excellence (GBOE).*

## **FOREWORD**

A stable democratic government, a progressive economic and regulatory environment, and most importantly a sizable population of youth, afford a unique opportunity to India, the third largest economy in Asia, to lead the next global charge. Investment inflows into India in the first six months of 2009 stood at USD 10 billion signaling a trend the year will end higher vis-à-vis the inflows in 2008 which amounted to USD 16 billion.

With the integration of world economies and the emerging need for varied, de-risked, diverse sources of capital, the dependency on multiple external sources has assumed greater significance, especially in the wake of the present financial crisis. In their continued endeavors at making India an attractive investment destination as well as an avenue for raising capital, Indian regulators have made significant changes to the extant regulatory framework governing Indian Depository Receipts, thus providing a much needed fillip for fund raising from the Indian markets.

The Indian Depository Receipt has now re-emerged as one of the most potent instruments for foreign companies to tap capital from the large pool of Indian investors, even as it provides a new opportunity to Indian investors to participate in foreign equity.

The Capital Markets practice group at Nishith Desai Associates articulates through this research paper the economic advantages offered by Indian Depository Receipts to foreign companies and presents an analysis of the legal, regulatory and tax regime governing the issuance and subscription of Indian Depository Receipts.

Thank you.

Yours faithfully,

Nishith Desai

## TABLE OF CONTENTS

<b>INDIAN DEPOSITORY RECEIPTS</b> .....	5
1. INTRODUCTION .....	5
1.1. Raising Capital – New Avenues .....	7
2. DEPOSITORY RECEIPTS .....	7
3. INDIAN DEPOSITORY RECEIPTS.....	7
3.1. Who can capitalize on IDRs?.....	8
3.2. BENEFITS OF IDRs .....	10
3.2.1. Benefits to the Issuing Company .....	10
3.2.2. Benefits to Investors.....	11
4. INDIAN DEPOSITORY RECEIPTS - THE LEGAL FRAMEWORK .....	12
4.1. Chronological evolution of IDR provisions .....	12
4.2. Eligible Companies .....	14
4.3. Eligible Investors .....	16
4.4. Minimum subscription amount .....	19
5. IDR MECHANISM - THE PROCESS .....	19
5.1. Procedure prior to issue of IDRs.....	19
5.1.1. Conditions of an IDR Issue.....	20
5.1.2. Regulatory Approvals .....	21
5.1.3. Other procedural requirements.....	22
5.1.4. Regulatory Costs .....	22
5.1.5. In-Principle Listing Permission.....	23
5.1.6. Appointment of Intermediaries .....	23
5.1.7. Matters to be Specified in the Prospectus.....	25
5.1.8. Disclosure Requirements under ICDR Regulations .....	25
5.1.9. IDR Issue Price.....	25
5.1.10. Registration of Documents .....	25
5.1.11. Provisions as to establishment of place of business of India.....	26
5.2. POST- IDR ISSUES .....	26
5.2.1. Listing of IDRs.....	26
5.2.2. Repatriation of IDR proceeds.....	27

5.2.3.	Distribution of Dividends Attached to IDRs .....	27
5.2.4.	Transfer of IDRs .....	27
5.2.5.	Redemption of IDRs for equity shares in the Issuing Company.....	28
5.2.6.	Period of redemption of IDRs.....	29
5.2.7.	Continuous Disclosure Requirements .....	29
5.2.8.	Penalty for Contravention.....	30
6.	TAXATION OF INDIAN DEPOSITORY RECEIPTS.....	30
6.1.	Distribution of Dividends Attached to IDRs.....	31
6.2.	Transfer of IDRs.....	32
6.3.	Redemption of IDRs for equity shares in the Issuing Company .....	34
6.4.	Transfer of equity shares in the Issuing Company.....	34
7.	CONCLUSION.....	35

**INDIAN DEPOSITORY RECEIPTS**  
 AN ENTRY TICKET FOR RAISING CAPITAL IN INDIA

**1. Introduction**

The New Economic Order, or “NEO” introduced by Dr. Manmohan Singh as Finance Minister in 1991<sup>1</sup>, initiated the liberalization and deregulation process of the Indian economy. Today, the Indian economy is one of the most fundamentally sound and progressive economies; a fact that is manifested by the continued and sustained GDP growth in the region of 7-8 per cent per annum. Even in the current global recessionary environment, the Indian economy has been resilient as it continues on its high growth path.

While global stock markets are facing harsh challenges of a continuing recession, the Sensex —the leading index of Bombay Stock Exchange--recorded a jump of more than 2000 points on a single day of trading on May 18, 2009, relenting only after trading was suspended for the day. This is not just an isolated incident but part of an upward trend. The Sensex has risen by close to 70 per cent since the beginning of the year 2009 (January 1, 2009 to September 30, 2009)<sup>2</sup>. This bull-run is largely attributable to overall improvement in market sentiment, better macro-economic indicators and the presence of a stable and pro-development Central Government elected into power in May 2009. If a ‘bull-run’ is a harbinger of the strength and stability of an economy, then there is little doubt that the Indian economy is a robust economy. This, coupled with a strong consumption-led domestic demand, makes India a highly attractive investment destination – both from a strategic perspective, as well on an opportunistic note.

<b>CUMULATIVE CHANGE IN MOVEMENT OF GLOBAL INDICES<sup>3</sup></b>					
<i>Index</i>	<i>Cumulative change over end-2003 level in per cent</i>				
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>BSE Sensex, India</b>	<b>13.1</b>	<b>61.0</b>	<b>136.1</b>	<b>247.4</b>	<b>65.2</b>
Hang Seng Index, Hong Kong	13.2	18.3	58.8	121.2	1.1
Jakarta Composite Index, Indonesia	44.5	68.1	161.0	296.8	35.5
Nikkie 225, Japan	7.6	50.9	61.3	43.4	-22.9
Kospi Index, South Korea	10.5	69.7	76.8	133.9	25.6
Kuala Lumpur Comp Index, Malasiya	14.2	13.4	38.0	82.0	-3.3
TSEC Weighted Index, Taiwan	4.2	11.2	32.8	44.4	-25.2
SSE Composite Index, China	-15.4	-22.4	78.7	251.5	43.7

Further, a comparative performance between the Asian stock exchanges in the recent past reflects that, Indian stock exchanges have provided reasonably better turnover during the financial turmoil.

<sup>1</sup> Dr. Manmohan Singh, the present Hon'ble Prime Minister of India was Union Finance Minister in 1991

<sup>2</sup> <http://www.bseindia.com/histdata/hindices2.asp>

<sup>3</sup> Indian Economic Survey 2008-2009

<b>COMPARATIVE MARKET CAPITALIZATION (IN USD MILLIONS)<sup>4</sup></b>			
	2006	2007	2008
<b>India</b>	<b>818,879</b>	<b>1,819,101</b>	<b>845,478</b>
<b>China</b>	2,426,326	6,226,305	2,793,613
<b>Japan</b>	4,726,269	4,453,475	3,220,485
<b>Singapore</b>	276,329	353,489	180,021
<b>Hong Kong</b>	895,249	1,162,566	468,595
	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>India</b>	<b>94.4</b>	<b>83.4</b>	<b>85.2</b>
<b>China</b>	102.8	183.1	121.3
<b>Japan</b>	132.8	136.9	152.9
<b>Singapore</b>	41.6	118.6	101.5
<b>Hong Kong</b>	50.9	89.3	76.2

The Bombay Stock Exchange (“BSE”) and the National Stock Exchange (“NSE”) are the two leading stock exchanges in India. Currently, 4,946 companies and 7,792 securities are listed on the BSE<sup>5</sup> and 1,434 companies and 1,376 securities are listed on the NSE<sup>6</sup>. In respect of the primary Indian markets, although the number of Initial Public Offers (“IPOs”) declined sharply in the year 2008, the mean IPO size increased from INR 3,390 million in the year 2007 to INR 4,970 million in the year 2008. In the current year, we have already witnessed Adani Power Limited’s public offering of INR 310 million and NHPC Limited’s INR 600 million offering. The debt market for new issues in the year 2008 was virtually at a standstill. In 2009, however, a strong revival is expected with instances of large companies adopting debt for raising capital– Tata Capital’s successful INR 50 million bond issue and Axis Bank’s proposed INR 30,000 million bond issue.

<b>RESOURCE MOBILIZATION THROUGH PRIMARY MARKET<sup>7</sup></b>					
		<i>(in INR million, except for Number of IPOs)</i>			
	<b>Mode</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
1.	Debt	660	3,890	5,940	0
2.	Equity	303,250	326,270	587,220	494,850
	<i>Of which, IPOs</i>	<i>99,180</i>	<i>247,790</i>	<i>339,120</i>	<i>183,930</i>
	<i>Number of IPOs</i>	<i>55</i>	<i>75</i>	<i>100</i>	<i>37</i>
	<i>Mean IPO size</i>	<i>1,800</i>	<i>3,300</i>	<i>3,390</i>	<i>4,970</i>
3.	Private placement	838,120	1,174,070	11,848,550	1,750,610
4.	Euro issues (ADR/GDR)	97,880	113,010	331,360	62,710
	<b>Total (1 to 4)</b>	<b>1,239,910</b>	<b>1,617,690</b>	<b>2,773,070</b>	<b>2,308,770</b>

<sup>4</sup> National Stock Exchange Global Stock Market Factbook 2009

<sup>5</sup> [http://www.bsindia.com/about/st\\_key/list\\_cap\\_raised.asp](http://www.bsindia.com/about/st_key/list_cap_raised.asp)

<sup>6</sup> [http://www.nse-india.com/content/equities/eq\\_businessgrowth.htm](http://www.nse-india.com/content/equities/eq_businessgrowth.htm)

<sup>7</sup> Indian Economic Survey 2008-2009

## 1.1. RAISING CAPITAL – NEW AVENUES

Indian companies have reached out to the global equity markets in the past by issuing American Depository Receipts (“**ADRs**”) / Global Depository Receipts (“**GDRs**”). It now appears that the time is ripe for a role reversal. For overseas companies seeking to raise capital from the Indian stock markets, the Indian Depository Receipt (“**IDR**”) mechanism offers a way to do so.

IDR is not a new concept. It was introduced almost nine years ago on December 13, 2000 via Section 605A of the Companies Act, 1956 (“**Act**”) and detailed guidelines governing IDRs were first released on February 23, 2004 via the Companies (Issue of Indian Depository Receipts) Rules, 2004 (“**IDR Rules**”). In this research paper, we have detailed the mechanism of how funds may be raised by foreign companies in India by issuing IDRs.

The paper goes on to elaborate the regulatory framework, the advantages and challenges this new instrument presents to the issuer as well as the Indian retail investor (who was once disallowed from investing in foreign companies) who can now acquire an economic interest in a foreign company. IDRs are proposed to be listed on the Indian stock exchanges and will derive their value from the equity shares of the foreign company listed on their home jurisdiction stock exchange.

## 2. DEPOSITORY RECEIPTS

A company can raise capital from overseas markets through listing instruments on an overseas stock exchange with its domestic securities as underlying. This preferred instrument for raising capital is referred as depository receipt (“**Depository Receipt**”). A Depository Receipt is a negotiable (transferable) financial instrument listed and traded publicly on a local stock exchange representing underlying shares of a foreign listed company. It enables investors to hold shares in foreign companies. The most common types of Depository Receipts issued in the global capital markets today are the ADR and GDR.

A Depository Receipt contains features of equity shares and carries rights, which are similar to rights attached to equity shares. The Depository Receipt holder, thus, enjoys the right to appropriate disclosures by the foreign company issuing Depository Receipts; the right to corporate benefits/ dividends attached to the Depository Receipts; and the right to vote under certain circumstances.

## 3. INDIAN DEPOSITORY RECEIPTS

In the Indian context, a Depository Receipt is referred to as an Indian Depository Receipt. IDRs are transferable securities listed on Indian stock exchanges in the form of depository receipts. Conceptually, the IDRs shall be issued by the Issuing Company, i.e., a foreign corporation desirous of raising capital in the Indian markets through an Indian depository participant. The last mile issuance of actual instrument is done by an Indian depository participant. The Indian depository participant will issue depository receipts against the underlying equity shares of the foreign corporation.



According to the IDR Rules,

an **IDR**<sup>8</sup> is defined as:

*“...any instrument in the form of a depository receipt created by a domestic depository in India representing the underlying equity shares of the Issuing Company.”*

an **Issuing Company**<sup>9</sup> is defined as:

*“...a company incorporated outside India, making an issue of IDRs through a domestic depository”*

The introduction of IDR has created a new route for foreign companies to advantageously tap into Indian sources of capital at better valuations and cheaper administrative costs.

#### **ATTENTION DRAWING IDR FEATURES**

- Relaxation in the minimum paid-up capital and free reserves requirements from USD 100 million to USD 50 million
- Issuing Company to have a track record of distributable profits as against declaring of dividends
- Non-Residents (FIIs/ NRIs) permitted to invest in IDRs
- Domestic mutual funds permitted to invest in IDRs
- Anchor Investors permitted to upto 30 per cent of overall QIB allocation limit
- Simplified listing agreement for IOSCO member countries for listing IDRs on stock exchanges
- Overseas Custodian Banks need not have a place of business in India
- Proposal to provide for procedures for Rights issue of IDRs

### **3.1. Who can capitalize on IDRs?**

Foreign companies can list IDRs on Indian stock exchanges and offer their securities to investors at large against a private placement of their own securities to access the large pool of Indian investors. Considering the characteristics of IDRs, foreign companies with the following objectives may seek to issue IDRs:

- Companies seeking to benefit from the buoyant market conditions in India.
- Companies that perceive India as a potential market.
- Companies that perceive India as a potential source of raw materials, manufactured products, or other such goods.
- Companies seeking to gain a foothold in sectors in which India has a global leadership position, such as business processes outsourcing, pharmaceuticals and information technology.
- Companies listed on overseas stock exchanges seeking a simultaneous listing in another overseas jurisdiction.

<sup>8</sup> Rule 3(i)(c) of IDR Rules

<sup>9</sup> Rule 3 (1)(d) of IDR Rules

IDRs also provide a unique opportunity for Indian investors to invest in foreign companies. The current exchange control regulations, outlined below, provide limited routes for Indian investors to invest in securities of foreign companies.

- i. Liberalized Remittance Scheme: Under the Liberalized Remittance Scheme (“**LRS**”) of RBI (“**Reserve Bank of India**”), resident individuals are permitted to remit a maximum of USD 200,000 per financial year for any permitted capital and current account transactions or a combination of both, including the purchase of immoveable property or shares or any other asset outside India without prior approval of the RBI.
- ii. Funds paid out of a Resident Foreign Currency Account: Indian resident individuals can also acquire foreign securities, through funds paid out of a resident foreign currency account (“**RFC Account**”). An Indian resident individual can maintain an RFC Account out of foreign exchange:
  - a. received as pension or any other superannuation or other monetary benefits from his employer outside India; or
  - b. realized on conversion of the assets acquired when such person was resident outside India; or
  - c. inherited from a person who was resident outside India; or
  - d. received or acquired as a gift or inheritance from a person resident outside India.
- iii. Overseas Direct Investments: Indian entities are permitted to make overseas direct investments by making investments in securities of companies in overseas jurisdictions per the provisions of the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 (“**ODI Regulations**”). Under Regulation 6B of the ODI Regulations, an Indian company whose securities are listed in Indian stock exchanges is permitted to invest up to 50 per cent of its networth as of the date of the last audited balance sheet in (i) shares; and (ii) bonds / fixed income securities, rated not below investment grade by accredited/registered credit rating agencies, issued by listed overseas companies.

The Regulation 7 of the ODI Regulations further imposes certain additional requirements on a person seeking to make investment in an entity engaged in the financial services sector should fulfill the following additional conditions:

- The Indian entity should be registered with the appropriate regulatory authority in India for conducting the financial sector activities;
- The Indian entity should have earned net profit during the preceding three (3) financial years from the financial services activities;
- The Indian entity should have obtained approval for investment in financial sector activities abroad from regulatory authorities concerned in India and abroad; and
- The Indian entity should have fulfilled the prudential norms relating to capital adequacy as prescribed by the regulatory authority concerned in India.

IDRs offer Indian residents (individuals and corporate entities alike) a method to freely invest in foreign companies, which derive their value from the underlying equity share of the Issuing Company; and can be

converted into underlying shares of the Issuing Company at any time at the instance of the IDR holder after the initial one (1) year lock-in on IDRs from the date of its issuance.

### **3.2. BENEFITS OF IDRs**

The new route to enter Indian markets by listing IDRs on Indian stock exchanges and providing exposure to Indian investors of foreign securities is not only beneficial for the Issuing Company, but also for the investors.

#### **3.2.1. Benefits to the Issuing Company**

- *Provides access to a large pool of capital:* India boasts arguably of the largest population of middle class families, which collectively have a substantial amount of savings. In the last two decades, the Gross Domestic Savings rate has increased consistently to reach close to 25 per cent of household income adding net amount of about USD 240 billion worth new savings each year<sup>10</sup>. Combined with India's 135 years of experience in investing in the stock markets, the opportunities are ample for foreign companies to tap into this large pool of capital for their equity needs.
- *Brand recognition in India:* Using IDRs as a fund raising and investment diversification strategy is expected to bring significant intangible benefits. Instant visibility and sustained brand recall among Indian investors is a sure gain from an IDR listing as has already been proven in the case of Indian debutants in the global markets (eg. Infosys in NASDAQ, Wipro on NYSE etc.)
- *Facilitates acquisitions in India:* Since an IDR is a rupee denominated instrument, foreign companies, which intend to acquire business or assets in India, can use it to finance acquisitions of any business or asset in India through share swap. Also, IDRs can be used as an instrument to structure various investments and acquisition transactions in India. With the option of being redeemed for equity shares of the Issuing Company, IDRs may prove to be a useful instrument for the Issuing Company to raise capital without actually providing management control to financial investors, while the investor still has economic interest in the Issuing Company along with an option to redeem IDR for equity shares at a later date, after the initial lock-in of one year from the date of issue of the IDRs.
- *Provides an exit route for existing shareholders:* At present it appears that the regulations governing IDRs do not require an Issuing Company to make a fresh issuance of equity shares in order to list IDRs. Therefore, existing shareholders of Issuing Company can seek an exit by tendering their shares as underlying equity shares for issuance of IDRs.
- *Enables participation of Indian employees:* Employees of Indian subsidiaries of foreign companies have an additional option to participate in the capital of such foreign company by subscribing to IDRs as part of a foreign company's employee benefit scheme. Subscribing to IDRs provides a more flexible option than subscribing to the equity shares of the foreign company which involves compliance with foreign exchange regulations. While, the Issuing Company has the benefit of expanding its investor base, with the help of IDR offerings.

---

<sup>10</sup> <http://indiabudget.nic.in/es2008-09/chapt2009/tab16.pdf>

- *No obligation to pay an assured return:* Unlike debt instruments, the Issuing Company is not under any obligation to provide assured returns on IDRs. As IDRs derive their values from the underlying common equity shares of the Issuing Company, this provides flexibility to the Issuing Company in managing its cash flow situation.
- *Provides access to well regulated, open Indian stock markets:* The history of Indian stock markets goes back to the year 1875, when the first stock market 'The Native Share and Stock Brokers' Association' was established in Bombay, now known as The Bombay Stock Exchange. Since then Indian stock exchanges have come a long way. In 1995, the BSE moved from a physical trading system to a seamless electronic platform, which provided the necessary fillip to the growth of the Indian stock markets. The year 2006 saw the introduction of corporatization and demutualization of stock exchanges. Corporatization and demutualization of stock exchanges have ensured proper demarcation between the ownership and management of the stock exchanges and paving the way for industry professionals to manage the governance of the stock exchange in a proficient manner.

Indian stock markets are monitored and regulated by the Securities Exchange Board of India (“**SEBI**”), a governing body similar to Securities and Exchange Commission (“**SEC**”) in the USA. These markets are also compliant with international standards for corporate governance. In addition, listing securities in Indian stock markets involves relatively low expenditure and administrative cost in comparison to other major global stock exchanges.

- *An efficient system comprising regulated market intermediaries:* Market intermediaries viz. stock brokers, custodians, depositories and clearing houses are equally important constituents of the Indian stock markets as they are highly sophisticated and adequately regulated by SEBI and thus ensure seamless functioning of the Indian stock exchanges

### **3.2.2. Benefits to Investors**

The benefits of IDRs for investors are as follows:

- *Portfolio Diversification:* Indian investors can achieve a better investment portfolio diversification, as IDRs provide the ability to invest in foreign companies, a completely new asset class, without the restrictions stipulated under LRS or the ODI Regulations.
- *Ease of investment:* Indian investors interested in investing in foreign companies in the pre-IDR regime were required to open brokerage accounts in foreign countries and remit money. The need for knowledge of the prevalent and necessary procedures relating to trade, clearance and settlement was therefore essential. IDRs being traded on the Indian stock exchanges eliminate these complications and improve the ease of investing in foreign companies for Indian investors.
- *Better enforcement of investor rights:* Prior to listing IDRs, SEBI requires the Issuing Company to enter into a listing agreement with the Indian stock exchanges. The Issuing Company is required to adhere to conditions prescribed under the listing agreement and continuous disclosure norms. By virtue of the

compliance with the terms of the listing agreement by the Issuing Company and the stock exchanges (regulated by SEBI), better enforcement of investor rights is possible as compared to enforcing rights in a foreign jurisdiction.

- Arbitrage opportunity. An Indian investor with the ability to hold both the underlying equity shares as well as the corresponding IDR would be in position to take advantage of any arbitrage opportunity arising out of unsynchronized price fluctuations in both types of securities.
- Disclosure standards at par with IOSCO standards: The disclosure standards specified for IDRs are at par with the guidelines prescribed by the International Organization of Securities Commissions (“**IOSCO**”) relating to cross-border offerings and initial listing of foreign issues.

#### **4. INDIAN DEPOSITORY RECEIPTS - THE LEGAL FRAMEWORK**

##### **4.1. Chronological evolution of IDR provisions**

Since 2000, the Indian Government has taken steps to liberalize India’s corporate and securities laws to permit foreign companies to raise capital in India. As the ADR and GDR instruments became popular among investors globally, the Indian Government amended the Companies Act, 1956 by implementing Section 605-A which permits a foreign company to make a public offer of its shares to Indian investors in the form of IDRs. This amendment gives the Central Government the power to create the rules, regulations and conditions governing:

- The offer and issue of IDRs by a foreign company;
- The disclosure requirements in the prospectus issued for IDRs;
- The rules and regulations governing the treatment of IDRs by the Depository, Custodian and Underwriters; and
- The manner of sale, transfer or transmission of IDRs in the stock exchanges.

In 2004, the IDR Rules were introduced and set the framework for the issuance of IDRs. Additionally, the SEBI introduced guidelines to list IDRs on Indian stock exchanges under Chapter VIA of SEBI (Disclosures and Investor Protection) Guidelines, 2000 (“**DIP Guidelines**”), which have recently been replaced by the by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (“**ICDR Regulations**”). Since then various amendments have been made in the regulatory framework of IDRs , including the recent Circular dated July 22, 2009 (“**RBI Circular**”) issued by the RBI, the exchange control regulator in India, which renders clarity on the exchange control implication for investment in IDRs -- the major ones are detailed in the accompanying table.

Date	Issuing Authority	Legislation	Effect
December 13, 2000	Ministry of Corporate Affairs, Government of India (“MCA”)	Insertion of Section 605A to the Companies Act	Enabling section to permit foreign companies to issue IDRs as security to investors in India
February 23, 2004	MCA	IDR Rules	Created framework for issue of IDRs
April 3, 2006	SEBI	DIP Guidelines	Disclosure requirements for listing IDRs specified
April 3, 2006	SEBI	SEBI Circular SEBI/CFD/DIL/DIP/20/2006/3/4, dated April 3, 2006 (“Model Listing Agreement”)	Provided the model terms and conditions of an agreement between the Issuing Company and the stock exchanges for listing IDRs on Indian stock exchanges
July 11, 2007	MCA	IDR Rules	Relaxation of eligibility criteria for issue of IDRs
November 29, 2007	SEBI	DIP Guidelines	Permitting retail investors to subscribe to IDRs
January 19, 2009 (“January 2009 Amendments”)	MCA	IDR Rules	<ul style="list-style-type: none"> <li>• Removal of one (1) year lock-in for conversion from IDR to Equity Shares</li> <li>• Permitting issue of IDRs to persons other than persons resident in India.</li> <li>• Overseas Custodian Bank need not have a place of business in India</li> </ul>
April 13, 2009	SEBI	Approving proposal in its Board Meeting	Enable a) mutual funds and FIIs to invest in IDRs subject to the Foreign Exchange Management Act, 1999 (“FEMA”); (b) electronic holding of IDRs; and (c) issue of IDRs by custodians on behalf of issuers.
June 9, 2009	SEBI	SEBI Circular SEBI/IMD/CIR No. 1/165935/2009 dated June 9, 2009	Clarification for Mutual Funds for investing in IDRs
June 16, 2009	SEBI	SEBI Circular SEBI/CFD/DIL/IDR/1/2009/16/06 dated June 16, 2009	Simplified Model Listing Agreement for Issuing Companies, whose securities market regulators are signatories to the Multilateral Memorandum of Understandings of International Organization of Securities

			Commissions
June 19, 2009	SEBI	SEBI (Facilitation of Issuance of Indian Depository Receipts) (Amendment) Regulations, 2009	<ul style="list-style-type: none"> <li>• Permitting FIIs to invest in IDRs;</li> <li>• Enabling electronic holding of IDRs; and</li> <li>• Enabling issue of IDRs by Custodians on behalf of Issuing Company.</li> </ul>
July 22, 2009	RBI	RBI Circular RBI/2009-10/106 A.P. (DIR Series) Circular No. 05 dated July 22, 2009	<ul style="list-style-type: none"> <li>• Prior approval required for banking/ finance companies having presence in India</li> <li>• Clarity on procedure for repatriation of IDR proceeds</li> <li>• One year lock-in on redemption of IDRs</li> <li>• Permitting Investment by FIIs / NRIs in IDRs;</li> <li>• Guideline for redemption/ conversion of IDRs.</li> </ul>
July 31, 2009	SEBI	SEBI/CFD/DIL/DIP/37/2009/31/0 7 dated July 31, 2009	<ul style="list-style-type: none"> <li>• Pro rata allotment of IDRs</li> <li>• Audited Financial Statements to be prepared in accordance with Indian GAAP or with the International Financial Reporting Standards or US GAAP, for a period of three (3) financial years immediately preceding the date of prospectus.</li> </ul>
September 3, 2009	SEBI	ICDR	Replaces the DIP Guidelines in entirety
September 22, 2009	SEBI	Approving proposal in its Board Meeting	Permitting issue of IDRs to Anchor Investors

#### 4.2. Eligible Companies

The IDR Rules specify that the Issuing Company would need to fulfill the following conditions in order to issue IDRs:

- i. Minimum paid-up capital and free reserves: The Issuing Company is required to have pre-issue paid-up capital and free reserves of at least USD 50 million and a minimum average market capitalization (during the last 3 years) in its parent country of at least USD 100 million.

The eligibility criteria for an Issuing Company were relaxed on July 11, 2007 by way of an amendment to IDR Rules. Prior to this relaxation, an Issuing Company was required to have at least USD 100 million of paid up-capital and free reserves and an average turnover of USD 500 million during the five preceding financial years preceding the issue. Also, the Issuing Company was required to have a pre-issue debt equity ratio of not more than 2:1.

The July 11, 2007 IDR Rule amendments aligned the requirements for an Issuing Company to have a track record of declaring dividends under the IDR Rules with the Companies Act, and to bring the same at par with certain domestic issues and condition. Further, the requirement to declare a minimum rate of dividend for the previous five years and a minimum 2:1 debt equity ratio were omitted as these conditions were specific to individual companies who may have adopted different dividend policies as per their respective jurisdictions.

- ii. Continuous trading record: The Issuing Company is required to have a continuous trading record or history on a stock exchange in its parent country for atleast three (3) preceding years.
- iii. Track record of distributable profits: Pursuant to the relaxations made in the IDR Rules on July 11, 2007, the Issuing Company is required to have a track record of distributable profits in atleast three (3) out of the preceding five (5) years.

This has been a significant shift from the MCA's earlier requirement of declaring dividends of not less than 10 per cent each year for at least five (5) years preceding the issue – a benefit to several small-cap and mid-cap companies, which prefer to reinvest their profits and strengthen their reserves, instead of distributing such profits among the shareholders by way of declaring dividends.

- iv. Overseas Financial/ Banking companies having presence in India: Until now, the extant IDR Rules and DIP Guidelines did not require an Issuing Company to seek any specific approval from sectoral regulator prior to issuance of IDRs. The RBI Circular has created an exception for financial and banking companies and provides that financial and banking companies having presence in India, either through a branch or subsidiary, would be required to seek prior approval of the sectoral regulator(s) before the issuance of IDRs.

The RBI has always regarded banking and financial services as a sensitive sector for the economy. Though not by way of prohibitory measures, but by way of regulatory measures, the RBI has tried to ensure that banking and financial sector remains in strict compliance with the needs of the regulations/ guidelines issued from time to time. In fact, even Indian entities intending to engage in financial services activities in overseas jurisdictions are required to seek prior approval from the RBI and relevant sectoral regulator(s). The caution that the RBI exercises over financial sector is evident from the RBI Circular as per which financial/ banking companies would be required to seek approval from the sectoral regulator prior to issuance of IDRs. For example, a banking company having subsidiary/ branch in India and desirous of issuing IDRs would be required to seek prior approval from the RBI.

Additionally, as IDRs are listed on the Indian stock exchanges, the Issuing Company is required to adhere to the provisions of Chapter X of ICDR Regulations. The ICDR Regulations require an Issuing Company to fulfill the following prerequisites:



- i. Mandatory listing in home country: The Issuing Company is required to be listed in its home country (in the country of its incorporation);
- ii. No regulatory prohibition: The Issuing Company should not be prohibited from issuing securities by any regulatory body; and
- iii. Good track record: The Issuing Company should maintain a good track record with respect to compliance of securities' market regulations.

The intention of requiring an Issuing Company to have a continuous trading record in its parent country for at least three (3) preceding years is to ensure that the Issuing Company is a registered and regulated entity with a trading track record in its domestic capital market. Such a requirement may prove to be a deterrent as it seems to limit the regime only to companies that are already listed in respective parent countries, and may negate the original objective of providing easy access to small and mid-cap companies to explore the Indian market for raising capital. It is evident that SEBI prefers already registered and regulated companies to explore the Indian capital markets because Indian Regulators rely on home country regulators to ensure that the disclosure standards set forth by the Issuing Companies are in compliance with IOSCO Guidelines.

#### **4.3. Eligible Investors**

The January 2009 Amendments have provided leeway to the Issuing Company to offer IDRs to persons other than resident Indians as it would enable the Issuing Company to issue IDRs to a person other than a person resident in India. Prior to this, only resident Indians were eligible to subscribe to IDRs. The Issuing Company can issue IDRs to non-residents after seeking prior approval from RBI and would be required to comply with the policy or guidelines that may be issued by RBI in this regard.

Prior to issue of notification of ICDR Regulations, the DIP Guidelines provided for list of categories of investors who could invest into IDRs, which were later complemented by the RBI Circular, operationalising the IDR Rules and providing clarity on the exchange control regime governing investment by different category of investors and subsequent redemption of IDRs into equity shares of the Issuing Company by such investors. At present the following categories of investors are permitted to subscribe to IDRs:

- i. Subscription of IDRs by Foreign Institutional Investors: Initially under the erstwhile DIP Guidelines Foreign Institutional Investors (“**FIIs**”) required special permission from the RBI to purchase or possess IDRs.

The proposal to provide less stringent implications to this restriction was considered by SEBI in board meeting dated April 13, 2009 and approved proposals to enable (a) mutual funds and FIIs to invest in IDRs subject to FEMA; (b) electronic holding of IDRs; and (c) issuance of IDRs by custodians on behalf of issuers. These proposals were subsequently notified via an amendment to the DIP Guidelines.

With the introduction of SEBI (Facilitation of Issuance of Indian Depository Receipts) (Amendment) Regulations, 2009 dated June 19, 2009, SEBI amended the SEBI (Foreign Institutional Investors) Regulations, 1995 enabling FIIs to invest in IDRs. With the notification of the aforesaid proposals by SEBI,

FIIIs are not required to seek prior permission from RBI to purchase or possess IDRs. The subscription of IDRs by FIIIs, however, would be governed by FEMA regulations.

The subsequent RBI Circular proposes to make express provisions in FEMA permitting FIIIs including their sub-accounts to invest in IDRs, thus bringing investment by FIIIs/ sub-accounts in IDRs under the automatic route. The RBI Circular operationalises the IDR Rules and the consequent amendments to FEMA (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 ("**TISPRO Regulations**") are expected to include IDRs as instruments that can be subscribed to by FIIIs.

Presently, the ICDR Regulations do not create any specific restriction on any category of investors for their investment in IDRs, therefore, investments into IDRs would be governed by the specific regulations governing such investors and the exchange control provisions provided by the RBI.

- ii. Subscription of IDRs by Non-Resident Indians: Under the erstwhile DIP Guidelines Non-Resident Indians ("**NRIs**") required special permission from the RBI to purchase or possess IDRs. With the operationalisation of IDR Rules *vide* the RBI Circular, investment in IDRs by NRIs has been included under the automatic route. The RBI Circular further mentions that NRIs may invest, purchase, hold and transfer IDRs of Issuing Companies subject to ODI Regulations. The RBI Circular further provides that NRIs are permitted to invest in IDRs out of the funds held in their Non-Resident (External) Rupee Account Scheme ("**NRE Account**") which is essentially an Indian currency denominated account and Foreign Currency (Non-Resident) Account (Banks) Scheme ("**FCNR(B) Account**"), which is a foreign currency (Pound Sterling, US Dollar, Japanese Yen, Euro, Canadian Dollar and Australian Dollar) denominated account.
- iii. Subscription of IDRs by Qualified Institutional Buyers: Under the ICDR Regulations at least 50 per cent of the IDR issued is required to be allotted to qualified institutional buyers on proportionate basis. Issuing Company can draw a reference to illustration given in Part C of Schedule XI of ICDR Regulations<sup>11</sup>. While, the balance 50 per cent may be allocated among the categories of non-institutional investors and retail individual investors including employees at the discretion of the issuer and the manner of allocation shall be disclosed in the prospectus. Allotment to investors within a category shall be on proportionate basis;

Per clause 2(1)zd of the ICDR Regulations, a QIB is defined as:

- i. *a mutual fund, venture capital fund and foreign venture capital investor registered with the Board;*
- ii. *a foreign institutional investor and sub-account (other than a sub-account which is a foreign corporate or foreign individual), registered with the Board;*
- iii. *a public financial institution as defined in section 4A of the Companies Act, 1956;*
- iv. *a scheduled commercial bank;*
- v. *a multilateral and bilateral development financial institution;*
- vi. *a state industrial development corporation;*
- vii. *an insurance company registered with the Insurance Regulatory and Development Authority;*
- viii. *a provident fund with minimum corpus of twenty five crore rupees;*
- ix. *a pension fund with minimum corpus of twenty five crore rupees;*

---

<sup>11</sup> <http://www.sebi.gov.in/guide/sebiidcreg.pdf>

- x. *National Investment Fund set up by resolution no. F. No. 2/3/2005-DDII dated November 23, 2005 of the Government of India published in the Gazette of India;*

#### Anchor Investors for Indian Depository Receipts

Recently SEBI had introduced the novel concept of an anchor investor (“**Anchor Investor**”) in Initial Public Offer (“**IPOs**”) by Indian companies. Anchor Investors are qualified institutional buyers who commit to invest a fixed amount<sup>12</sup> and are roped in by the issuers to boost the confidence of the investors in the offering. SEBI permits a company to allocate on a discretionary basis up to 30 per cent of overall QIB allocation limit in favour of multiple Anchor Investors, provided each Anchor Investor agrees to subscribe at least INR 100 Million, of which 25 per cent is to be brought up front and the balance within two (2) days of the closure of the public issue. Promoters and other entities related to the promoters are excluded from investing as an Anchor Investor.

In an attempt to encourage issuance of IDRs and listing of foreign companies on the domestic bourses, SEBI has proposed to extend this facility of Anchor Investors even to issuance of IDRs by foreign companies. The Anchor Investor with its brand power and upfront fiscal commitment is expected to serve as a catalyst to ensure the success of the offering. It is also proposed to reserve not less than thirty per cent of the issue size of the IDRs for retail investors.

Extension of benefit of roping Anchor Investor in an IDR issue will not only expedite the process but also render a higher degree of guaranteed financial commitment at a rather early stage of the IDR offering process. By rendering its brand power and upfront financial contribution, the Anchor Investor will serve as a catalyst, thereby ensuring that the success criteria for the IDR issue process are achieved.

- iv. Subscription of IDRs by retail investors: Under the ICDR Regulations, in an issue of IDR the remaining 50 per cent quota (other than quota for QIBs) can be subscribed to by non-institutional investors, which includes investors other than QIBs and retail individual investors. As per ICDR Regulations, employees of the Issuing Company are covered under the category of retail investors and are eligible to subscribe to IDRs.

ICDR Regulations provides for allotment of IDRs to QIBs and Retail Investors on a proportionate basis. Thus, limiting the discretion of Issuing Company on proportionate allotment of IDRs

- v. Subscription of IDRs by Mutual Funds

Until now, under SEBI (Mutual Funds) Regulations, 1996 domestic mutual fund schemes registered with SEBI were permitted to invest only in:

- a. *Securities;*
- b. *Money market instruments;*
- c. *Privately placed debentures;*
- d. *Securitized debt instruments, which are either asset backed or mortgaged backed securities;*

<sup>12</sup> As per Reg. 2(c) of the ICDR Regulations an ‘anchor investor’ must make a minimum commitment of Rupees Hundred Million in an IPO.

- e. *Gold or gold related instruments; or*
- f. *Real estate assets.*

Pursuant to SEBI's aforesaid board meeting, SEBI has vide Circular<sup>13</sup> dated June 9, 2009 clarified that IDRs are regarded as securities for the purposes of SEBI (Mutual Funds) Regulations, 1996. Thus, domestic mutual funds registered with SEBI can freely invest in IDRs, subject to the investment restrictions provided under the SEBI (Mutual Funds) Regulations, 1996.

At present the following entities might not be able to invest in IDRs:

i. Subscription of IDRs by Foreign Venture Capital Investor

A Foreign Venture Capital Investor (“**FVCI**”) registered with SEBI is included in the definition of QIBs. FVCIs, however, are required to primarily invest in venture capital undertakings, which are unlisted domestic companies. Since FVCIs are restricted to only investing in IPOs of domestic companies, they may not be able to subscribe to IDRs.

ii. Subscription of IDRs by Insurance Companies

Insurance Companies registered with the Insurance Regulatory and Development Authority of India (“**IRDA**”) are regarded as QIBs under ICDR Regulations. However, the investment of policy holders' funds either directly or indirectly outside India is prohibited under the current Indian insurance laws. Thus, insurance companies despite being categorised as QIBs might not be able to subscribe to IDRs.

#### **4.4. Minimum subscription amount**

Investments made by Indian Companies in IDRs must be within the investment limits, if any, prescribed by applicable laws. The minimum application amount in an IDR issue is prescribed as INR. 20,000.

The Issuing Company is under an obligation to disclose the manner of allocation and the procedure to be followed by each class of applicant that applies in the prospectus.

## **5. IDR MECHANISM - THE PROCESS**

### **5.1. Procedure prior to issue of IDRs**

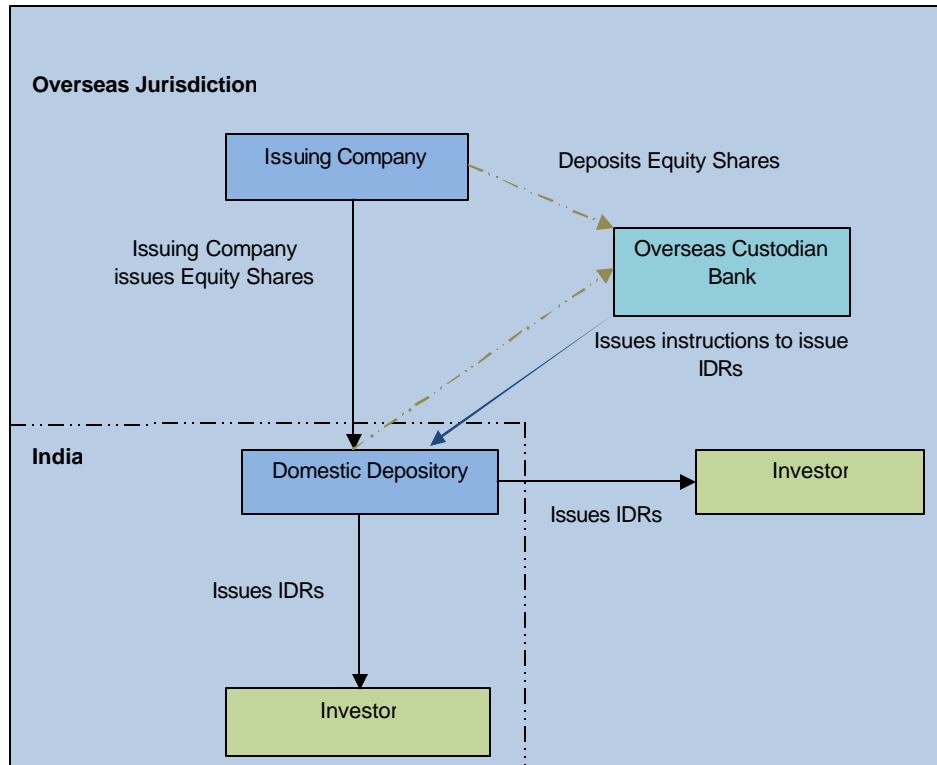
The actual process for the issuance of IDRs by a foreign company is similar to the process followed by companies looking at listing an ADR on American stock exchanges and GDR on the European stock exchanges. The IDR is a negotiable instrument denominated in Indian Rupees representing the underlying securities of the foreign company, which are listed in an international stock exchange. Hence, the foreign company would issue its securities in IDRs to an Overseas Custodian Bank, which in turn authorizes the Domestic Depository in India to issue IDRs to investors. As part of the IDR process, the Issuing Company will

---

<sup>13</sup> SEBI/IMD/CIR No. 1/165935/2009 dated June 9, 2009

is required to appoint a Merchant Banker and file a due diligence report with SEBI and the Registrar of Companies. Such a requirement is similar to the domestic IPO process where Merchant Bankers are required to file due diligence reports in a prescribed format per SEBI regulations prior to the IPO.

A diagrammatic representation of the IDRs mechanism is depicted below:



### 5.1.1. Conditions of an IDR Issue

Along with the eligibility criteria required to issue IDRs as applicable to the Issuing Company and the investors, the IDR Rules specify the following mandatory conditions:

- i. Minimum Size of Issue: The size of an IDR issue cannot be less than INR 500 Million (Approximately USD 11 million at current exchange rates);
- ii. Number of underlying equity shares offered: The number of underlying equity shares offered in a financial year through IDR offerings cannot exceed 25 per cent of the post-issue number of equity shares of the Issuing Company (prior to the July 11, 2007 amendment to the IDR Rules, this limit was capped at 15 per cent)
- iii. Minimum subscription required: SEBI has provided for a classification in respect in respect minimum subscription requirements for underwritten and non-underwritten IDR issues.

- *Non-underwritten IDR issues:* If the minimum subscription of 90 per cent of the issued amount on the date of closure of the issue is not received by the Issuing Company, a refund becomes inevitable. Failure to refund the entire subscription amount within fifteen (15) days from the date of the closure of the issue imposes a liability to refund the entire amount with interest to the investors at the rate of 15 per cent per annum for the period of the delay.
  - *Underwritten IDR issues:* If the minimum subscription is below 90 per cent of the net offer to public including devolvement of Underwriters within sixty (60) days from the date of closure of the issue, the Issuing Company is required to refund the entire subscription amount received with interest to the investors at the rate of 15 per cent per annum for the period of the delay beyond sixty (60) days.
- iv. Indian Rupee Denominated: Though the ICDR Regulations provide that at any given time, there shall be only one denomination of IDR of the issuing company, the RBI Circular specifies that it is mandatory that the IDRs are rupee denominated.

### 5.1.2. Regulatory Approvals

Under Section 603 of Companies Act, no foreign company is permitted to issue, circulate or distribute in India any prospectus offering for subscription shares in or debentures of a company incorporated outside India, unless such prospectus is dated and registered with the Registrar of Companies as required under Companies Act. Not having a presence in India does not create an exception to this rule. Section 605A enables the Central Government to issue rules and procedures regarding issuance of IDRs.

Accordingly, the offer and issue of IDRs by a foreign company, the disclosure requirements in the prospectus issued for IDRs and the manner of sale, transfer or transmission of IDRs in the stock exchanges are provided in the IDR Rules.

#### Filing of draft prospectus

In order to raise funds in India by issuing IDRs, an Issuing Company is required to obtain prior written approval from SEBI on an application made in its behalf along with the draft prospectus at least ninety (90) days prior to the opening date of the IDRs issue, in such form and furnishing specified by SEBI from time to time.

SEBI may, within thirty (30) days of receipt of the application call for such further information and explanations, as it may deem necessary, for the disposal of the application. SEBI is required to dispose the application within sixty (60) days of its receipt. However, if within sixty (60) days from the date of submission of application or draft prospectus, SEBI specifies any changes to be made in the draft prospectus, the prospectus cannot be filed with SEBI or Registrar of Companies unless the desired amendments have been incorporated.

#### Conditions for issue of prospectus and application

No application form for the securities of an Issuing Company can be issued unless the form is accompanied by a memorandum containing the salient features of the prospectus in the specified form. However an application

form may be issued without the memorandum if it is issued in connection with an invitation to enter into an underlying agreement with respect to the IDRs. The contents that must be specified in the memorandum (abridged prospectus) are specified in Part B of Schedule XIX of the ICDR Regulations<sup>14</sup>.

The IDR Rules prohibit circulation of the prospectus for the issuance of IDRs which contain a statement purported to be made by an expert, unless the statement by the expert is coupled with a statement by him/her that that he/her has given his/her written consent to the issue and has not withdrawn such consent before the delivery of a copy of the prospectus to SEBI or the Registrar of Companies.

### **5.1.3. Other procedural requirements**

An Issuing Company is also required to carry out the following procedures in order to obtain a grant of approval from SEBI.

- (i) Approval in home country: The Issuing Company is required to obtain necessary approvals or exemption from the appropriate authorities from the country of its incorporation under the relevant laws relating to the issuance of capital, if required under the laws of that jurisdiction;
- (ii) Appointment of underwriters: The Issuing Company is required to appoint underwriters registered with SEBI to underwrite the issue of IDRs, if applicable;
- (iii) Filing of certified prospectus: The Issuing Company is required to file prospectus, certified by two authorized signatories of the Issuing Company, one of whom shall be a full-time director and the other the Chief Accounts Officer, stating the particulars of the resolution of the Board by which it was approved, with the SEBI and Registrar of Companies, New Delhi, before such issue. At the time of filing of the prospectus with the Registrar of Companies, New Delhi, a copy of approval granted by SEBI and the statement of fees paid by the Issuing Company to SEBI are required to be attached.

### **5.1.4. Regulatory Costs**

The Issuing Company is required to pay a non-refundable fee of USD 10,000 to SEBI along with the application seeking prior written approval for raising funds in India through an IDR mechanism.

Further, upon the approval being granted, the Issuing Company is required to pay SEBI an issue fee of half a per cent of the issue value subject to a minimum of INR 10 lakhs where the issue is up to INR 1000 million. In the event the issue value exceeds INR 1000 million, every additional value of issue is subject to a fee of 0.25 per cent of the issue value.

---

<sup>14</sup> <http://www.sebi.gov.in/guide/sebiidcreg.pdf>

### 5.1.5. In-Principle Listing Permission

The Issuing Company is required to obtain an in-principle listing permission from one or more stock exchanges having nationwide trading terminals in India, prior to raising funds in India. At present, the NSE and BSE have nationwide trading terminals and therefore would be the only eligible exchanges for listing IDRs.

### 5.1.6. Appointment of Intermediaries

The Issuing Company, for the purpose of issuing IDRs, is required to appoint:

- an overseas custodian bank;
- a domestic depository; and
- a merchant banker.

The role and duties of each of them are stated as follows:

#### Merchant Banker

A merchant banker is primarily entrusted with the responsibility to structure the issue and arrange for marketing. Under the IDR Rules, a Merchant Banker is defined as:

#### *Merchant Banker*<sup>15</sup>

*“...means a Merchant Banker as defined in clause (e) of Rule 2 of SEBI (Merchant Bankers) Rules, 1992<sup>16</sup>”*

Presently, Merchant Bankers are regulated as per SEBI (Merchant Banker) Regulations, 1992 as per which Merchant Banker<sup>17</sup> is defined as:

*“...means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management”*

The Issuing Company is required to appoint a Merchant Banker for filing purposes or for providing the Domestic Depository a due diligence report with the Registrar of Companies and with SEBI.

#### Overseas Custodian Bank

---

<sup>15</sup> Rule 3(i)(e) of IDR Rules

<sup>16</sup> Rescinded *vide* Notification S.O.1455 (E) dated September 7, 2006

<sup>17</sup> Regulation 2(cb) of SEBI (Merchant Banker) Regulations, 1992



An overseas custodian bank is a banking company which acts as custodian for the ordinary shares of an Issuing Company. Under the IDR Rules an overseas custodian bank is defined as:

*Overseas Custodian Bank*<sup>18</sup>

*“...means a banking company which is established in a country outside India and which acts as custodian for the equity shares of Issuing Company, against which IDRs are proposed to be issued by having a custodial arrangement or agreement with the Domestic Depository or by establishing a place of business in India.”*

The above-mentioned definition is a departure from the earlier definition of Overseas Custodian Bank, which required a banking company intending to act as an Overseas Custodian Bank to have a place of business in India and seek prior permission from the Ministry of Finance for doing such business in India.

The Overseas Custodian Bank acts in coordination with the domestic depository. When the shares are issued by Issuing Company, such shares are registered in the name of the domestic depository and physical possession is handed over by the Issuing Company to the Overseas Custodian Bank.

Domestic Depository

The Issuing Company is also required to appoint a domestic depository; which is defined under the IDR Rules as:

*Domestic Depository*<sup>19</sup>

*“...means custodian of securities registered with the SEBI and authorized by the issuing company to issue IDRs.”*

The Domestic Depository appointed by the Issuing Company is authorized to issue IDRs against the issue of ordinary shares of the Issuing Company.

With the January 2009 Amendments omitting the definition of a Depository<sup>20</sup>, ambiguity was prevailing as to the definition and role of a Domestic Depository. This ambiguity has been put to rest by the SEBI (Facilitation of Issuance of Indian Depository Receipts) (Amendment) Regulations, 2009, which has amended the SEBI (Custodian of Securities) Regulations, 1996, enabling Custodians registered with SEBI to undertake activities as a Domestic Depository in terms of the IDR Rules and issue IDRs to investors.

---

<sup>18</sup> Rule 3(i)(f) of IDR Rules

<sup>19</sup> Rule 3(i)(b) of IDR Rules

<sup>20</sup> “Depository” means a depository as defined in clause (e) of sub-section (1) of section 2 of Depositories Act, 1996

### **5.1.7. Matters to be Specified in the Prospectus**

The Issuing Company is required to mention certain information in the prospectus to be filed with SEBI. The contents to be specified in the prospectus are provided under the Schedule of IDR Rules. Please refer to IDR Rules provided on the website of the MCA<sup>21</sup>.

### **5.1.8. Disclosure Requirements under ICDR Regulations**

Additionally, ICDR Regulations provide for certain mandatory disclosures which are required to be made in the prospectus. These disclosures are similar to the disclosures required by an Indian company for an Indian listing. The said disclosure requirements are provided under the Part A of Schedule XIX of the ICDR Regulations. There are also additional disclosures required in relation to the Issuing Company's compliance with the foreign securities exchange on which it is listed.

The IDR Rules also permit for the Issuing Company to choose if it wishes to file its prospectus publicly or file it confidentially. Interestingly, this option is not currently available for Indian companies listed in India.

### **5.1.9. IDR Issue Price**

The price of an IDR usually corresponds to the price of the foreign share in the stock exchange in which it is listed, adjusted to the ratio of the IDRs to foreign company shares. Under the ICDR Regulations, the basis of pricing the IDRs needs to be disclosed in a prescribed format and must contain, among other disclosures, information such as earnings per share for the past three (3) years, price earning pre-issue, minimum return on increased net worth required to maintain pre-issue earnings per share, etc. The issue price is conditional upon the fact that the projected earnings will not be used as a measure for the issue price in the prospectus but that the accounting ratios disclosed in the prospectus should support the issue price.

### **5.1.10. Registration of Documents**

The Merchant Banker appointed for the issue of IDRs is required to deliver for registration, the following documents or information to the SEBI and Registrar of Companies in New Delhi, namely:-

- a. instrument constituting or defining the constitution of the Issuing Company;
- b. the enactments or provisions having the force of law by or under which the incorporation of the issuing company was done, a copy of such provisions attested by an officer of the company to be annexed;
- c. if the Issuing Company has an established place of business in India, the address of its principal office in India;
- d. if the Issuing Company does not establish a principal place of business in India, an address in India where the said instrument, enactments or provision or copies thereof are available for public inspection, and if

---

<sup>21</sup> <http://mca.gov.in/MinistryWebsite/dca/notification/notification2004.html?Notifyyear=2004>,  
[http://mca.gov.in/MinistryWebsite/dca/latestnews/Companies\\_IDR\\_Rules\\_2004.pdf](http://mca.gov.in/MinistryWebsite/dca/latestnews/Companies_IDR_Rules_2004.pdf),  
[http://mca.gov.in/MinistryWebsite/dca/notification/pdf/GSR35\(E\)\\_20jan2009.pdf](http://mca.gov.in/MinistryWebsite/dca/notification/pdf/GSR35(E)_20jan2009.pdf),  
[http://mca.gov.in/MinistryWebsite/dca/notification/pdf/GSR251\(E\)\\_15apr2009.pdf](http://mca.gov.in/MinistryWebsite/dca/notification/pdf/GSR251(E)_15apr2009.pdf)

these are not in English, a translation thereof certified by a responsible officer of the issuing company shall be kept for public inspection;

- e. a certified copy of the certificate of incorporation of the Issuing Company in the country in which it is incorporated;
- f. copies of the agreements entered into between the issuing company, the overseas custodian bank, the domestic depository, which shall inter alia specify the rights to be passed on to the IDR holders;
- g. if any document or any portion thereof required to be filed with the SEBI/ Registrar of Companies is not in English language, a translation of that document or portion thereof in English, certified by a responsible officer of the company to be correct and attested by an authorized- officer of the Embassy or Consulate of that country in India, shall be attached to each copy of the document.

The prospectus to be filed with the SEBI and Registrar of Companies, New Delhi should be in accordance with the particulars as prescribed in the Schedule to IDR Rules and shall be signed by all the full-time directors of the issuing company and by the Chief Accounts Officer.

#### **5.1.11. Provisions as to establishment of place of business of India**

As per the provisions of Companies Act, in instances where the Issuing Company has an existing place of business in India, the Issuing Company would be required to furnish, within a period of 30 days of the establishment of the place of business is required to deliver to the Registrar of Companies for registration information relating to the foreign company including the certified copy of the charter documents of the Issuing Company, the full address of the registered office of the registered or principal office of the Issuing Company, a list of the directors and secretary of the Issuing Company and the name and address of one or more persons resident in India, authorized to accept notices and other documents on behalf of the Issuing Company. Additionally, the Issuing Company is also required to furnish financial statements, prepared as the provisions of the Companies Act, with the Registrar of Companies.

### **5.2. POST- IDR ISSUES**

#### **5.2.1. Listing of IDRs**

The IDRs will be listed on a recognized stock exchange in India and may be purchased, owned and freely transferred by holder of IDRs. Issuing Company would be required to enter into an agreement with the stock exchange for listing of IDR. In this regard a Model Listing Agreement has been specified by SEBI<sup>22</sup>.

#### ***Simplified listing agreement for Issuing Companies from countries which are signatory of Multilateral Memorandum of Understanding of International Organization of Securities Commissions***

The Model Listing Agreement has been specified on the basis of the conditions of the equity listing agreement applicable to the domestic issuers. In line with the market feedback urging the amendment of the Model listing Agreement to align it with the listing agreements of the Issuing Company's home country to eliminate/ reduce

---

<sup>22</sup> <http://www.sebi.gov.in/circulars/2006/cir082006.html>

the additional regulatory cost burden to the Issuing Company, SEBI has simplified the listing norms for IDRs vide Circular<sup>23</sup> dated June 16, 2009.

However, with the interest of investors and with a view to ensure that adequate cooperation is extended by the domestic securities market regulator of the Issuing Company, SEBI has, as a first step towards simplification of listing norms, extended the benefit of simplified listing requirements only to Issuing Companies, whose securities market regulators are signatory to the Multilateral Memorandum of Understanding (“**MMOU**”) of IOSCO. A brief about the role of IOSCO in this regard and a list of signatory member countries of IOSCO is annexed as **Annexure**.

SEBI being a signatory to the IOSCO MMOU has issued separate listing requirements for other signatory members<sup>24</sup>. As per the simplified listing agreement, the Issuing Company will have to declare that the underlying equity shares against which the IDRs are issued will be listed in its home country before the listing of the IDRs on the stock exchange. The Issuing Company will also have to obtain an in-principle approval for listing from stock exchanges where its IDRs are listed, before issuing further IDRs.

#### **5.2.2. Repatriation of IDR proceeds**

Under the IDR Rules, the proceeds of issue of IDRs collected by the Domestic Depository are repatriable in favour of the Issuing Company, with prior approval of RBI. The proceeds collected from the issuance of IDRs would be converted into a foreign currency and then remitted in favor of the Issuing Company.

As per the RBI Circular, the proceeds of the issue of IDRs are to be immediately repatriated outside India by the Issuing Company. The RBI Circular specifically provides that the IDRs issued shall be denominated in Indian Rupees.

#### **5.2.3. Distribution of Dividends Attached to IDRs**

Upon receipt of dividends or any other corporate benefit payable with respect to IDRs as specified in the agreements between the Issuing Company and the Domestic Depository, the Domestic Depository is required to distribute the dividends/ corporate benefits to the IDR holders in proportion to their holdings of IDRs.

#### **5.2.4. Transfer of IDRs**

Under the ICDR Regulations as well as RBI Circular, automatic fungibility of IDRs is not permissible, i.e., conversion of IDRs into equity shares or *vice versa*. Further, under the IDR Rules, a holder of an IDR may transfer the IDR or may ask the Domestic Depository to redeem the IDR, subject to the provisions of FEMA and other laws in effect.

---

<sup>23</sup> SEBI/CFD/DIL/IDR/1/2009/16/06 dated June 16, 2009

<sup>24</sup> <http://www.sebi.gov.in/circulars/2009/listingagr-ids.pdf>

### 5.2.5. Redemption of IDRs for equity shares in the Issuing Company

In case of a redemption of IDRs for equity shares in the Issuing Company, the Domestic Depository is required to request the Overseas Custodian Bank to obtain the corresponding underlying equity shares released in favour of the holder of an IDR and transfer the shares in the books of the Issuing Company to the name of holder of such IDR and forward a copy of the request to the Issuing Company for information purposes. A holder of an IDR has the discretion to nominate a person to whom his/her IDR shall vest in the event of his/her death. Form No: 1<sup>25</sup> prescribed under the IDR Rules may be used for such purpose.

Prior to the notification of the RBI Circular there existed an element of ambiguity as to the exchange control implications upon redemption of IDRs into underlying equity of the Issuing Company. Under the existing provisions of FEMA, Indian investors are required adhere to certain restrictions imposed on their holdings on foreign securities. The RBI Circular provides for the procedure to be followed upon redemption of IDRs for underlying equity shares of the Issuing Company, so that the Indian investors do not violate provisions of FEMA pertaining to investments in foreign securities.

The RBI Circular provides the guidelines for holding underlying equity shares of the Issuing Company after redemption of IDRs by listed Indian companies, domestic mutual funds and other persons resident in India. The guidelines are explained herein below:

- i. Listed Indian Companies: As per the RBI Circular, a listed Indian Company can sell or continue to hold the underlying equity shares of the Issuing Company subject to the terms and conditions as per Regulations 6B and Regulations 7 of ODI Regulations. Thus, a listed Indian Company can continue to hold equity shares of the Issuing Company (foreign securities) as long as the investments are in compliance with Regulations 6B and Regulations 7 of ODI Regulations.
- ii. Domestic Mutual Funds: Regulation 6C of ODI Regulations provides for Investment by domestic mutual funds as per which, domestic mutual funds registered with the SEBI are permitted to invest within specified limits, in the shares on the rated bonds/ fixed income securities of an overseas company listed on a recognised stock exchange or in Exchange Traded Funds, or other securities as may be stipulated by the RBI from time to time. As per the RBI Circular, domestic mutual funds are permitted to sell or continue to hold the underlying shares equity shares of the Issuing Company, subject to the terms and conditions as per Regulation 6C of ODI Regulations.
- iii. Other resident persons: Until now, it was unclear whether a resident person could invest in foreign securities beyond the limit prescribed under LRS, by virtue of redemption of IDRs for its underlying equity shares. As per the RBI Circular resident individuals are allowed to hold the underlying shares only for the purpose of sale within a period of thirty (30) days from the date of conversion of the IDRs into underlying shares.

---

<sup>25</sup> <http://mca.gov.in/MinistryWebsite/dca/notification/notification2004.html?Notifyyear=2004>

As under ODI Regulations only listed Indian companies are permitted to invest in listed foreign securities, thus, unlisted Indian companies or other entities which have invested in IDRs, would be required to sell underlying equity shares of the Issuing Company within a period of thirty (30) days from the date of conversion of the IDRs into such underlying equity shares.

The RBI Circular clarifies that, the FEMA Regulations would be applicable to FIIs/ sub-accounts only till the time they stay invested in IDRs. Upon redemption of IDRs for the underlying equity shares of the Issuing Company, the FII/ sub-account, would be regarded as holders of foreign securities, thus, outside the purview of RBI.

IDRs have an inherent feature of being redeemed for the underlying equity shares of the Issuing Company at the option of the investor, thus entitling the investor to the equity shares of a foreign company at his will. The RBI Circular provides the procedure for redemption if IDRs for underlying equity shares of the Issuing Company.

#### **5.2.6. Period of redemption of IDRs**

Initially, IDRs were not redeemable into equity shares before the expiry of one (1) year period from the date of the issue of the IDRs. In the January 2009 Amendments were made to the IDR Rules, wherein the aforesaid one (1) year lock-in period on redemption of the IDRs into equity shares was removed. However, the RBI Circular has once again provided for a lock-in on redemption of underlying equity shares into IDRs before the expiry of one (1) year from the date of issue of the IDRs.

The amendment removing one (1) year lock-in was seen as favorable to investors, as it afforded the investors the opportunity to redeem the IDRs into equity shares of the Issuing Company at their discretion, thus affording increased flexibility and liquidity to investors investing in IDRs. The re-introduction of lock-in requirements for redemption of IDRs for underlying equity shares of the Issuing Company would once again impose stringent restriction on the liquidity afforded to the investors.

#### **5.2.7. Continuous Disclosure Requirements**

Initially an Issuing Company was required to furnish to the Overseas Custodian Bank and Domestic Depository, a certificate obtained from the statutory auditor of the company or a Chartered Accountant about the utilization of funds raised and its variation from the projections of the utilization of funds made in the prospectus, if any, at quarterly intervals. Further, the Issuing Company was required to publish such certificate in an English language newspaper having wide circulation in India. The quarterly audited results or unaudited results were then subjected to limited review by the auditors of the company, and were also subject to approval by the Board of Directors of the issuing company. The quarterly audited financial results were to be prepared and published in the manner specified in the listing conditions.

The January Amendments have eliminated the aforesaid continuous disclosure requirements, and the Issuing Company is now only required to adhere to such disclosure requirements prescribed by SEBI. It appears that the said provisions were omitted in order to provide less stringent requirements to the Issuing Company. SEBI provides for such continuous disclosure requirements that are more favorable to the Issuing Company from an administrative perspective.

### **5.2.8. Penalty for Contravention**

#### ***Companies Act***

Under Section 598 of the Companies Act, if any foreign company having a place of business in India, fails to comply with the provisions applicable to them under Part XI of the Companies Act, would be liable to fine which may extend to INR 10,000 and in case of a continuing offence, with an additional fine which may extend to INR 1,000 for every day during which the default continues.

In respect of the wilful disclosures made in the prospectus or the form of application for IDRs, which are in contravention of provisions of Companies Act, a minimum punishment of imprisonment which may extend to six months or with to a maximum of INR 50,000 or both may be levied. Additionally, civil liability imposed under Section 607 of the Companies Act. As per Section 607 of the Companies Act instances of wilful misrepresentation are to be dealt with as per the provisions of Section 62 of the Companies Act. As per Section 62 of the Companies Act, every person who subscribes for any shares or debentures on the faith of the prospectus is entitled to compensation for any loss or damage sustained by reason of any untrue statement included in the prospectus.

As per Section 62 of Companies Act, unless otherwise proved, following persons are liable to compensate the investors of IDRs, in respect of the loss suffered by them:

- a. Every person who is a director of the company at the time of the issue of the prospectus;
- b. Every person who has authorized himself to be named and is named in the prospectus either as a director, or as having agreed to become a director, either immediately or after an interval of time;
- c. Every person who is a promoter of the company; and
- d. Every person who has authorized the issue of the prospectus

#### ***IDR Rules***

As per Rule 13 of IDR Rules, if an Issuing company or any other person contravenes any provision of the IDR Rules for which no punishment is provided in the Companies Act, the Issuing Company shall be punishable with a fine which may extend to twice the amount of the IDR issue and where the contravention is a continuing one, with a further fine which may extend to INR 5,000 rupees for each day during which the contravention continues. In addition, every officer of the company who is in default shall be punishable with the fine which may extend to INR 1,000,000 million and where the contravention is a continuing one, with a further fine which may extend to INR 1,000 for every day, during which such contravention continues.

## **6. TAXATION OF INDIAN DEPOSITORY RECEIPTS**

The Income Tax Act, 1961 (“**ITA**”) as it stands currently has no specific provisions concerning issues pertaining to the taxation of IDRs in India. For the simplicity of understanding we have brought out the various tax issues, implications and concerns which may arise at various stages of the IDR process and which would be important to consider in respect of the IDR regime in India.

## 6.1. Distribution of Dividends Attached to IDRs

In the event of a declaration of dividend on the shares of the Issuing Company, the dividend shall be distributed to the Domestic Depository. The Domestic Depository will in turn distribute such amounts to the Investors. The Investors may be residents of India or with prior approval being taken from RBI may be non residents of India. The first question that would arise in this case is about the legal status of the relationship between the Domestic Depository and the Investors, which in turn would determine the taxation of IDRs.

### Can the Domestic Depository be considered to hold the securities of the Issuing Company in trust?

It can be argued that the Domestic Depository is merely a trustee of the Indian Investor, and holds the securities of the Issuing Company in trust for the benefit of the Indian Investors. In such, there will be only a single level of taxation, as per the provisions of the ITA, either in the hands of the Domestic Depository (trustee) or in the hands of Indian Investors (beneficiary). Therefore, for example, in case of a distribution of dividends by a USA Company in respect of IDRs, on account of the there being a single level of taxation in India, the Indian revenue authorities should allow the credit for the tax with held in USA against the tax paid in India, for the distribution of dividend by the Issuing Company.

The validity of this proposition will depend on the exact role played by the Domestic Depository and the agreement which will be entered into between the Investor and the Domestic Depository. Despite amending the definition of Domestic Depository and permitting Custodians registered with SEBI under SEBI (Custodian of Securities) Regulations, 1996 to undertaking activities as a Domestic Depository, more clarity is desired on the role of a Domestic Depository. Once the desired clarity on the exact role played by the Domestic Depository is provided by the Government, one would have to examine the possibility of treating the Domestic Depository as holding the securities of the Issuing Company in trust for the benefit of the Investors.

However, in the event the Domestic Depository is not treated as a trustee, in such cases the taxation of IDRs can result in multi-level taxations which has been described in greater detail below.

### Distribution of dividend to an Indian investor

The declaration of dividends by the Issuing Company to an Indian Investor is a result of two steps, first, when dividend is distributed by the Issuing Company to the Domestic Depository and second, when Domestic Depository undertakes a distribution to the Indian Investors.

As regards the taxation of dividend by the Issuing Company, there may be a withholding tax on the dividend distribution, as per the domestic law of the country in which the Issuing Company is resident. However the withholding rate may be capped under the Double Taxation Avoidance Agreement (“DTAA”) entered into between India and the country where the Issuing Company is situated. For example, if the Issuing Company is a resident of USA, the amount of tax withheld in USA will be capped at 15 per cent or 25 per cent<sup>26</sup> (as the

---

<sup>26</sup> Under the provisions of the India-US DTAA, in case of dividends, if the beneficial owner is a company holding at least 10 per cent of the voting stock of the company paying the dividends, there is a 15 per cent withholding tax. In other cases, the applicable withholding tax rate is 25 per cent.



case may be), as per the India-USA DTAA, on account of the Investor, being the beneficial owner of the dividend distributed, being resident of India.

The treaty withholding provisions contemplate the concept of beneficial ownership. However, the primary right to tax is normally given to the State of residence (India in this case), where generally the look through rules of beneficial ownership may not apply while determining the primary right of a state to tax. Hence, as far as India is concerned, it should be the Domestic Depository who should be regarded as the owner of the IDR and should be taxed on the dividend income in India as *'income from other sources'*. However the Domestic Depository will not be keeping any portion of the dividend and will be distributing the dividend to the Investors. On account of no profits being retained by the Domestic Depository there should not be any tax at this level.

When the Indian Investor receives the distribution from the Domestic Depository, it may not qualify as dividends under the under the ITA. Section 2(22) of the ITA defines the term dividend in relation to shareholders of the company distributing the dividend and since the Indian Investor are not shareholders of the Issuing Company (the underlying shares would be registered in the name of the Domestic Depository), the said distribution cannot be classified as dividend under the ITA. Hence it may be regarded as *"income from other sources"* and be liable to be taxed at the rate of 34 per cent in India.

There may be a potential risk of the non-availability of obtaining a tax credit of the withholding tax paid in the country where the Issuing Company is situated against the tax paid by the Indian Investor in India. To illustrate by way of example, the Issuing Company is a resident of the USA and withholds tax at the rate of 15 per cent or 25 per cent (the case may be) under the India-USA DTAA on the dividend distributed by the Issuing Company and correspondingly Indian Investors pays a tax in India at the rate of 34 per cent on dividend equivalent distributed by the Domestic Depository. In the absence of the beneficial ownership provision in respect of the Article 10(1) of the India-USA DTAA and the tax paid in USA being on dividend distributed by the Issuing Company while the tax in India being paid on dividend equivalent, issues arise as to whether it will be possible to claim a credit for the tax paid in USA against the tax paid in India.

#### Distribution of dividend to non-Indian investor

In case of a non-Indian resident, the said issues will have to be re-examined separately, keeping in mind the domestic law and the DTAA entered into by the country in which the Issuing Country is situated. If the *'dividend equivalent'* is treated as a dividend under the DTAA entered between the country in which the issuing Company is situated and India, then to that extent, there may be a triangular taxation that can arise, first being at the USA level in the form of withholding taxes, second being at the India level as dividend withholding taxes under the DTAA (based on the definition of dividends) and lastly in the third country where the investor is located. Another issue which also may become relevant is whether a Domestic Depository can be treated as a representative assessee for the non-resident Investors, which will enable the Revenue to recover the tax dues of the Investor from the Domestic Depository.

## **6.2. Transfer of IDRs**

Capital assets has been defined under section 2(14) of the ITA to include property of every kind held by an assessee other than a property held as a stock-in-trade. In case of an IDR, it should be treated as an asset

separate from the underlying shares and should fall with the ambit of the definition of capital assets. Further, considering that the IDR is issued in India, it should be regarded as a capital asset situated in India and hence, a transfer of IDR from an Investor to a resident or a non-resident should entail a capital gains tax.

Currently, for taxation purposes capital gains are classified into short-term capital gains and long-term capital gains. In order to be treated as a long term capital asset the relevant factor is the period of holding of the asset before the date of its transfer. A capital asset which is held for not more than 36 months before the date of its transfer is a short term capital asset. However a share held in a company and securities listed on a recognized stock exchange in India will be treated as a short term capital asset if it is held for not more than 12 months before the date of its transfer. As per the provisions of the ITA the meaning of the word “*security*” will be the same as assigned to it under 2(h) of the Securities Contracts (Regulations) Act, 1956. The definition under the said clause is of a very wide ambit and should cover an IDR, thus if an IDR is held by an Investor for a period of more than twelve (12) months it should be considered as a long term capital asset.

Under the provisions of section 10(38) of the ITA, transfer of equity shares of an Indian Company through a recognized stock exchange in India, on which Securities Transaction Tax (“**STT**”) has been paid, will be exempt from paying any tax on such a transfer. Since this exemption is available only to a transfer of equity shares in a company or a unit of an equity oriented fund, this exemption will not be allowed to an IDR.

So to draw an analogy the Government of India with the introduction of the ADR regime in India had incorporated special provisions applicable to GDR and by the introduction of section 47(viia) of the ITA had made transfer of ADRs from a non-resident to non-resident, not liable to be taxed in India.

#### *Transfer of IDR between two non-residents*

In case of a transfer of an IDR by a non-Indian resident to another non-Indian resident, the said issues will have to re-examined separately, keeping in mind the domestic law and the various DTAA's entered into between the country in which the Issuing Country is situated, the country in which the non-Indian resident is situated and India. Since the IDR is situated in India, the transfer of the IDR between two non-residents should also be subjected to tax in India though its tax treatment may be modified based on DTAA's entered into by India. Further, as many of the DTAA's provide that the tax on capital gains will be as per the domestic law of the respective country, there may be a triangular taxation that can arise on transfer of an IDR - the first being in the jurisdiction where the Issuing Company is situated, in the event of the domestic law providing that the transfer of an IDR will be regarded as a transfer of the underlying shares of the Issuing Company and correspondingly the country taxing such a transfer. The second level of taxation would be as per the domestic law of India, as has been illustrated above and lastly as per the domestic law of the third country where the Investor is located.

The Government has failed to address various concerns, both in the budget for the financial year 2009-10 and in the recently released draft Direct Taxes Code pertaining to the taxation of IDR in India. Hopefully, these concerns are likely to be addressed as and when the IDR mechanism gathers momentum.

### 6.3. Redemption of IDRs for equity shares in the Issuing Company

As per the provisions of the ITA, in the event of a transfer of a capital asset will the liability to pay tax in India arise? Under section 2(47) of the ITA, the definition of the term “*transfer*” includes exchange. The redemption of the IDR for equity shares in the Issuing Company may be regarded as being in the nature of an exchange. There are no provisions under the ITA which deal with the computation of capital gains made in the event of an exchange of assets. One school of thought deems the fair market value of the asset received as the amount from which the cost of acquiring the IDR has to be deducted so as to arrive at the amount on which the investor will be required to pay capital gains tax. Another school of thought is that since no method has been prescribed under the ITA for the computation of amount on which tax has to be paid the same is not liable to be taxed in India.<sup>27</sup> The school of thought adopted will determine whether the redemption of IDR for equity shares in the Issuing Company will be taxable in India.

As per section 47(x) of the ITA, a conversion of bonds, debenture, debenture stock or deposit certificate into shares and debenture of company is not liable to be taxed in India. However due to the lack of specific provisions exempting the conversion of an IDR into the equity shares of the Issuing Company it may be liable to be taxed in India.

### 6.4. Transfer of equity shares in the Issuing Company.

Once the IDR is redeemed into equity shares of the Issuing Company and the equity shares are sold, there would be an incidence of tax on the capital gains made on such a transfer. The amount which will be allowed to be deducted will be the price at which the IDR has been purchased (in the event no tax is paid at the stage of redemption) or the fair market value of the equity shares at the time of redemption (in the event capital gains tax is paid at the stage of redemption).

As can be seen from the above, there are a number of issues pertaining to the taxation of IDR that have not been addressed till date. There exists a lot of ambiguity regarding IDR taxation and specific provisions need to be introduced to deal with it.. In the absence of such provisions, the lack of clarity will still be one of the major road blocks preventing foreign companies from successfully listing IDRs in India.

#### **ISSUES WHERE FURTHER CLARIFICATION/ RELAXATION IS REQUIRED**

- Mandatory listing for Issuing Company in its home jurisdictions for atleast a period of three (3) years;
- One (1) year lock-in for redemption of shares
- Clarity in respect of taxation of IDRs
- Clarity in respect of de-listing of IDRs
- Clarity in respect of certain corporate actions viz., merger of the Issuing Company with another company, delisting of the Issuing Company in its home jurisdiction

<sup>27</sup> ACIT v. K. B. Investment and Finance Co. Ltd.

## **7. CONCLUSION**

The utility of Depository Receipts as an instrument for raising capital is acknowledged worldwide and has been extensively used by companies to raise capital in overseas jurisdictions. In the Indian context, the concept of raising capital through the Depository Receipts route is not novel to Indian companies either. Several Indian companies viz., Rediff, Infosys have tapped overseas pool of capital by listing ADRs/ GDRs of their companies on overseas stock exchanges. With the introduction of the IDR regime, not only is there an additional avenue for foreign companies to raise capital in India, but also, an additional flexible route for Indian investors to invest in global corporations in an easy manner. With the ambit of eligible investors being expanded to include foreign investors as eligible investors to subscribe to IDRs, one can expect a surge in popularity of IDRs as a route for foreign companies reaching out to India as a destination for raising capital.

Furthermore, from the recent amendments it can be said that the Government and regulatory authorities have been taking progressive steps to facilitate issue of IDRs by doing away with several stringent requirements that were applicable to certain category of investors, viz., domestic mutual funds, NRIs and FIIs from investing in IDRs and by introducing simplified procedure for listing of IDRs. SEBI can be credited for being prompt in aligning its regulations with the policy of the Government in respect of IDRs, with the RBI following suit.

The IDR framework, however, is at a nascent stage and clarity is required on several issues such as the circumstances in which IDRs can be delisted from the stock exchanges and the procedure thereof. Also, from an investor perspective, appropriate guidelines are necessary in respect of the extent of SEBI's intervention for protecting the interest of investors in the event of a merger of the Issuing Company with another company, or delisting of Issuing Company in its home jurisdiction.

In an ideal economic environment, a progressive regulatory regime and immense pool of untapped capital, the Indian markets are bound to get the attention of foreign companies as a favourable destination to raise capital.

### ***Annexure<sup>28</sup>***

IOSCO is an international organization that brings together and provides a joint forum to the major securities regulators of the world. While, the IOSCO MMOU, adopted in May 2002, represents IOSCO's seminal work in the area of regulatory cooperation and information sharing, reflecting years of work in this field. The IOSCO MMOU sets a new international benchmark for cross-border co-operation critical to combating violations of securities and derivatives laws. The following 55 member nations have signed the IOSCO MMOU

1. Albanian Financial Services Authority (AFSA), Albania
2. Alberta Securities Commission (SC), Alberta
3. Australian Securities and Investments Commission (ASIC), Australia
4. Central Bank of Bahrain, Kingdom of Bahrain
5. Banking, Finance And Insurance Commission, Belgium
6. Bermuda Monetary Authority, Bermuda
7. British Columbia Securities Commission (BCSC), British Columbia
8. Financial Services Commission of the British Virgin Islands, British Virgin Islands
9. Cayman Islands Monetary Authority (CIMA), Cayman Islands
10. China Securities Regulatory Commission, China
11. Czech National Bank, Czech Republic
12. Denmark Financial Supervisory Authority (Finanstilsynet), Denmark
13. Dubai Financial Services Authority (DFSA), Dubai
14. Financial Supervision Authority, Finland
15. Autorite des Marche Financiers, France
16. Bundesbank and German Financial Supervisory Authority (BaFin), Germany
17. Capital Market Commission (CMC), Greece
18. Guernsey Financial Services Commission, Guernsey
19. Securities and Futures Commission, Hong Kong
20. Hungarian Financial Supervisory Authority, Hungary
21. Securities and Exchange Board of India (SEBI), India
22. Financial Supervision Commission, Isle of Man
23. Israel Securities Authority (ISA), Israel
24. Commissione Nazionale per le Societa e la Borsa, Italy
25. Financial Services Agency (FSA), Japan
26. Jersey Financial Services Commission (FSC), Jersey
27. Jordan Securities Commission, Jordan

---

<sup>28</sup> <http://www.sc.com.my/main.asp?pageid=632&menuid=&newsid=&linkid=&type=>

28. Capital Markets Authority of the Republic of Kenya
29. Lithuanian Securities Commission, Lithuania
30. Commission de surveillance du secteur financier of Luxembourg, Luxembourg
31. Securities Commission of Malaysia, Malaysia
32. Malta Financial Services Authority (MFSA), Malta
33. Comision Nacional Bancaria Y De Valores (CNBV), Mexico
34. Securities Commission of Montenegro, Montenegro
35. Conseil deontologique des valeurs mobilieres (CDVM), Morocco
36. The Netherlands Authority for the Financial Markets (AFM), The Netherlands
37. Securities Commission of New Zealand (SC), New Zealand
38. Securities and Exchange Commission of Nigeria (NSEC), Nigeria
39. The Financial Supervisory Authority of Norway (Kredittilsynet), Norway
40. Ontario Securities Commission (OSC), Ontario
41. Polish Securities and Exchange Commission (PSEC), Poland
42. Comissao do Mercado de Valores Mobiliarios (CMVM), Portugal
43. Autorite des marches financiers, Quebec
44. Romanian National Securities Commission, Romania
45. Monetary Authority of Singapore, Singapore
46. The National Bank of Slovakia, Slovak Republic
47. Financial Services Board (FSB), South Africa
48. Comision Nacional del Mercado de Valores (CNMV), Spain
49. Securities and Exchange Commission, Sri Lanka
50. Securities and Exchange Commission (SEC), Thailand
51. Capital Markets Board (CMB), Turkey
52. Financial Services Authority (FSA), United Kingdom
53. Commodity Futures Trading Commission (CFTC), United States of America
54. Securities and Exchange Commission (SEC), United States of America
55. Conseil regional de l'epargne publique et des marches financiers (CREPMF), West African Monetary Union

**For more information, please contact:**

**Siddharth Shah, Principal**  
[siddharth@nishithdesai.com](mailto:siddharth@nishithdesai.com)

**Vyapak Desai, Senior Associate**  
[vyapak@nishithdesai.com](mailto:vyapak@nishithdesai.com)

**Shikhar Kacker, Associate**  
[shikhar@nishithdesai.com](mailto:shikhar@nishithdesai.com)

93 - B Mittal Court  
Nariman Point  
Mumbai 400 021 India  
Tel: +91 22 6669 5000  
Fax: +91 22 6669 5001

Prestige Loka, G01  
7/1, Brunton Road  
Bangalore 560 025, India  
Tel: +91 80 6693 5000  
Fax: +91 80 6693 5001

220 S California Avenue,  
Suite 201  
Palo Alto, CA 94306, USA  
Tel: +1 650 325 7100  
Fax: +1 650 325 7300

Level 30,  
Six Battery Rd  
Singapore - 049909  
Tel: +65 6550 9855  
Fax: +65 6550 9856

---

**Email: [nda@nishithdesai.com](mailto:nda@nishithdesai.com)**

---

**DISCLAIMER:** This report is a copyright of Nishith Desai Associates. No reader should act on the basis of any statement contained herein without seeking professional advice. The authors and the firm expressly disclaim all and any liability to any person who has read this report, or otherwise, in respect of anything, and of consequences of anything done, or omitted to be done by any such person in reliance upon the contents of this report.