

Structuring of debt instruments under Deposit Rules

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Coverage

- Introduction to deposits and debentures
- Applicable laws
- Types of debt securities permissible to be issued under Deposit Rules
- Structure of debt securities
- Specific requirements in respect of each of the structures
- Tax implications on each kind of debt securities

Meaning of deposits

Under the Companies Act and allied Deposit Rules

- Rule 2(c)
- Includes any receipt of money by a company
- Except specifically excluded

Under NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 2016 read with RBI Act, 1949

- Any receipt of money except as specifically excluded

Under Banning of Unregulated Deposit Schemes Act, 2019 (“BUDS”)

- An amount of money received in any form
- With a promise to return after a specified period/otherwise
- Either in cash/kind/security
- With or without benefit in form of interest, profit, bonus etc
- *For companies and NBFCs, definition under the specific regulations apply*

Meaning of debentures

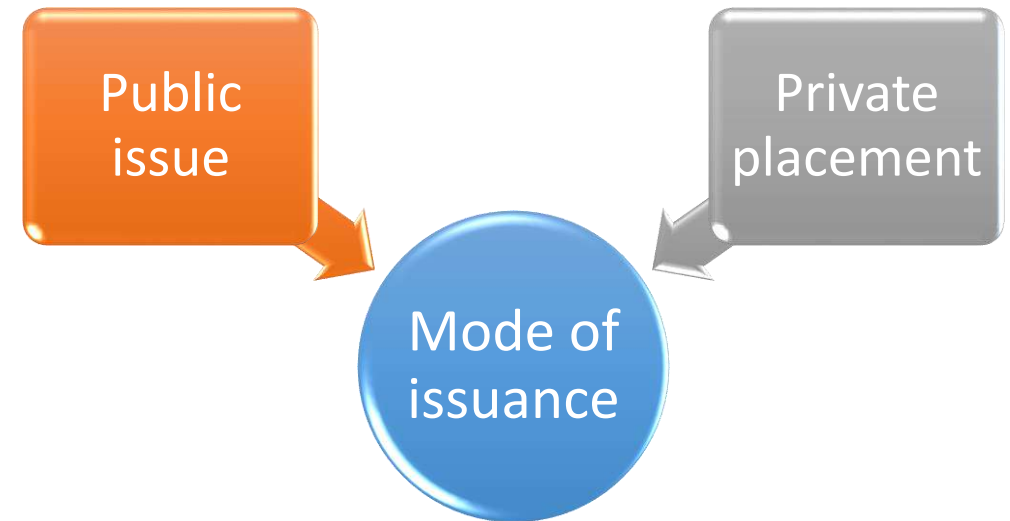
- Section 2(30) of the Companies Act, 2013 defines debentures

includes

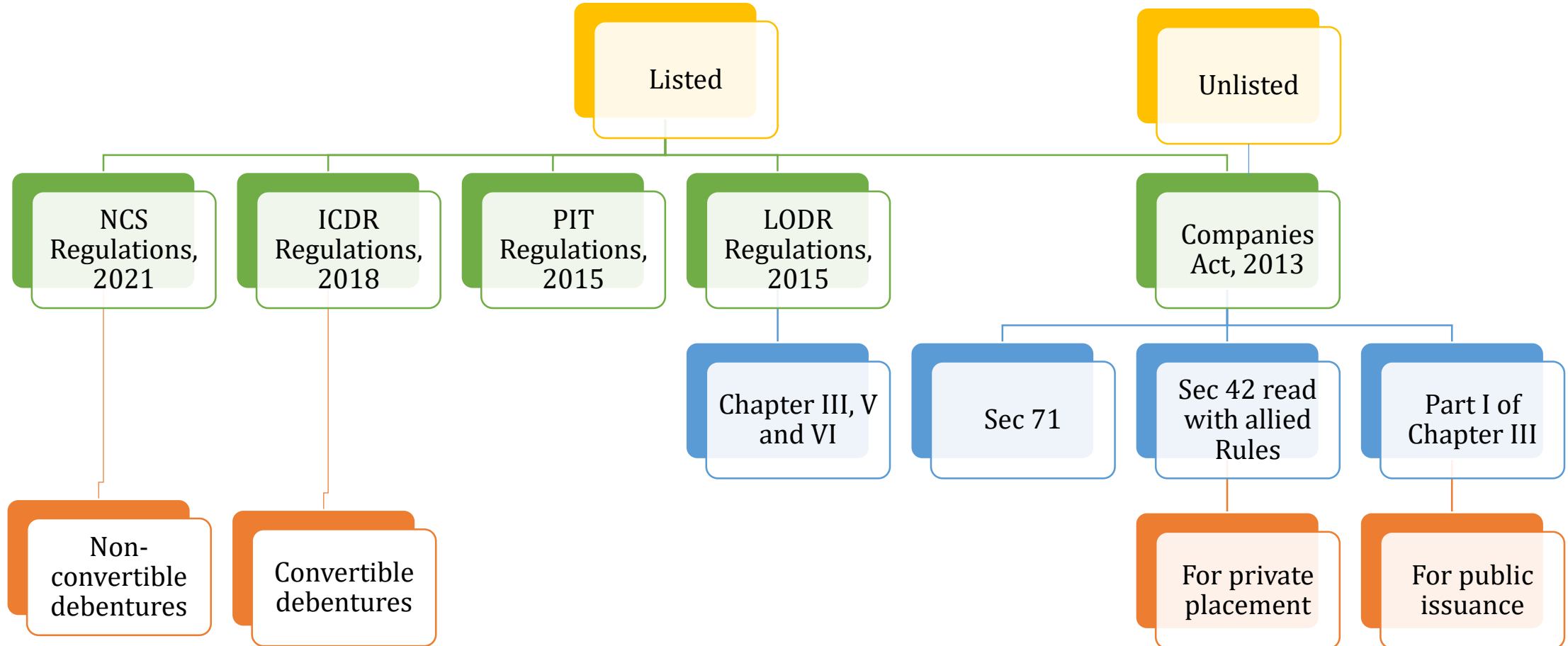
- debenture stock, bonds or any other instruments of the company evidencing debt
- Whether constituting a charge or not

excludes

- Instruments under Ch III-D of RBI Act
- Derivatives, money market instruments etc
- Such other instrument as may be prescribed



Applicable provisions on debentures



Case Study – Brief facts

- Resistance Tyres Pvt Limited (“RTPL” or “Company”) is a company incorporated under the provisions of the Companies Act, 1956.
- There are three (3) directors on the board of the Company –
 - Mr. Ramesh Jha
 - Miss Shreya Bansal
 - Mr. Rajesh Sharma
- Shareholding pattern of the Company –

Name Of shareholder	Paid-up capital (Rs.)	Percentage of holding (%)
Vaibhav Automobiles Ltd (“VAL”)	60,00,000	60
Mr. Ramesh Jha	20,00,000	20
Mr. Sourav Goenka and Mr. Keshav Goenka	20,00,000	20
	1,00,00,000	100

- Relevant extracts of balance sheet are given below

Particulars	Amount (Rs.)
Liabilities	
Paid-up share capital	1, 00,00,000
Reserves & Surplus	30,00,000
Assets	
Non-current investments	15,00,000

- Further, the Company has non-current investments in the following subsidiaries –
 - Rekha Rubber Mills Ltd (“RRML”) – 50,000 shares of Rs. 10 each – Rs. 5 lacs
 - Quantum Electronics Pvt Ltd (“Quantum”) – 10, 000 shares of Rs. 100 each – Rs. 10 lacs
- The Company is evaluating various means of raising finance. Further, there are surplus funds lying in the books of its subsidiary companies.
- **The funds required to be raised are upto a tune of Rs. 5 crores.**

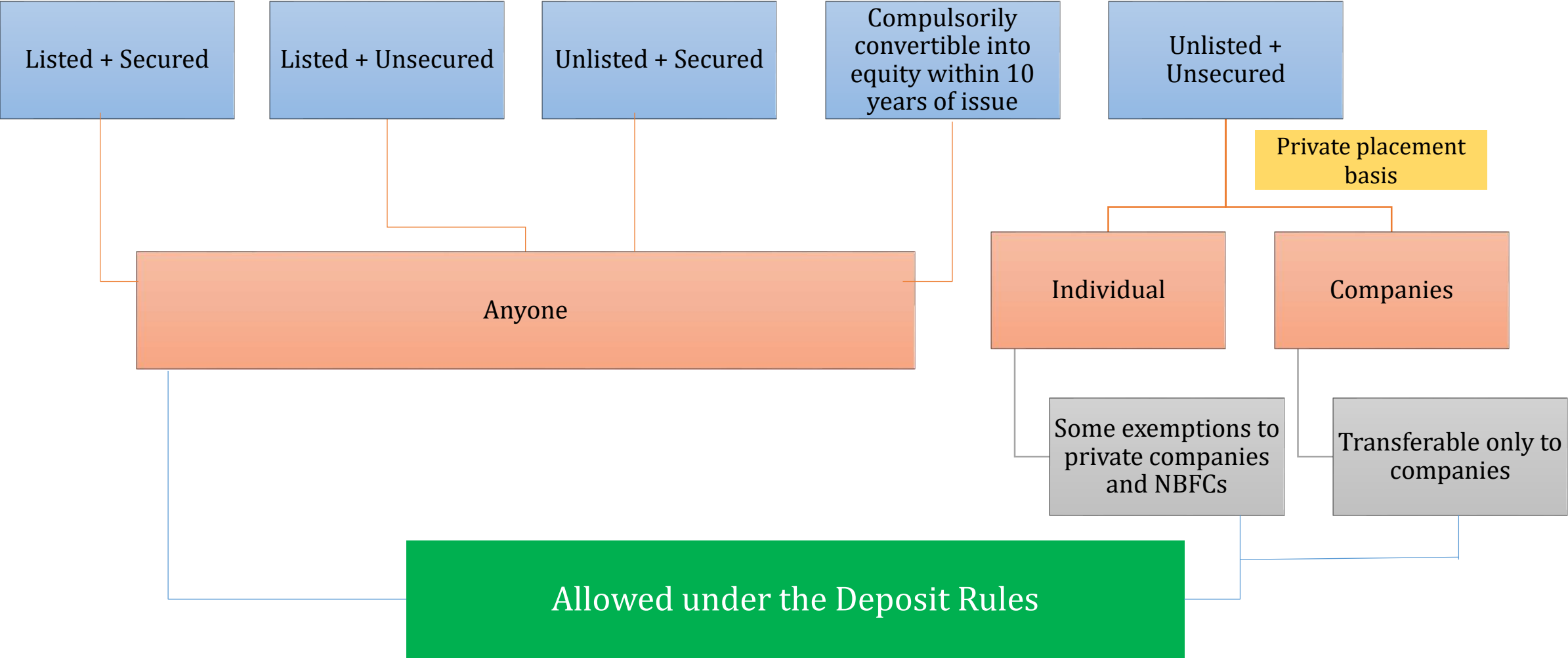
Case Study – Alternatives and solutions

1. Issuance of unsecured and unlisted non-convertible debentures (NCDs) to Mr. Ramesh Jha and his wife (director and relative).
2. Issuance of unsecured and unlisted NCDs to VAL (holding company).
3. Issuance of unlisted and secured NCDs to selective individuals (other than those mentioned in the facts) on private placement basis.
4. Issuance of unlisted and unsecured NCDs to Mr. Sourav Goenka and Keshav Goenka (joint shareholders).
5. Issuance of transferable NCDs to Quantum (subsidiary).
6. Issuance of compulsorily- convertible debentures (CCDs) to RRML (subsidiary)

- Consider the Company as I – private company, II – public company and III – NBFC and identify whichever is possible without attracting compliances of the Deposit Rules

Serial No.	Case I – Pvt Company	Case II – Public company	Case III - NBFC
1	Yes	No	Yes/No
2	Yes	Yes	Yes
3	Yes	Yes	Yes
4	No	No	No Can be issued to only one
5	Yes	Yes	Yes
6	No	No	No

Types of debentures permissible under Deposit Rules



Specific exemptions to private companies and NBFCs

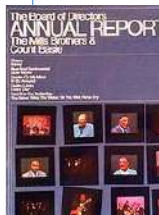
Specific requirement for NBFC for issuing unsecured and unlisted NCDs



Issued to directors/ relatives



Funds not borrowed for purpose of subscription



Disclosure in board's report

Minimum subscription amount \geq Rs. 1 crores



Minimum maturity period $>$ 1 year



No loans against security of own debentures



Use proceeds for deployment of funds on own balance sheet and not group entities



In case of NBFC, the above exemption extends to the shareholders of the issuer as well

Exemptions to private company

- Vide [MCA Circular dated 13.06.2017](#)

Limit based	Condition based
Upto 100% of paid up capital, free reserves and securities premium	On satisfaction of all three conditions – <ul style="list-style-type: none">• Not a subsidiary or associate of other company• Borrowings < 2*paid-up capital OR Rs. 50 crores – LOWER• No default in repayment of subsisting borrowings

- Not exempted deposits only exempted from compliances of clauses (a) to (e) of Section 73(2) –
 - Issuance of circular (DPT-1)
 - Filing of same with ROC
 - Creation of Deposit Repayment Reserve
 - Certification of no existing defaults on deposits in the last five years

Debenture Trustee

Protecting the Interests of Debenture Holders

Listed



Public issue



Private placement*

Secured



Public issue



Private placement

Unsecured



Public issuance - invitation to >500



Private placement

*In the erstwhile ILDS Regulations, there was an ambiguity as to whether the requirement of debenture trustee applied in case of unsecured debentures on private placement basis



DTD to be executed within 3 months of closure of issue



Appointment of DT to be made before issuing offer letter / prospectus



Consent of DT to be taken

Additional requirements for issue of listed debt securities

Eligibility conditions

- Issuer/promoter/promoter group/ director not debarred from accessing securities market
- Promoter/director of issuer is of a company that is debarred from accessing securities market
- Issuer/ promoter/ director is wilful defaulter (*for public issue only*)
- Promoter/WTD of issuer is promoter/director of a company is a wilful defaulter (*for public issue only*)
- Promoter/director is fugitive economic offender
- Fines/ penalties levied to Board/ SEs pending

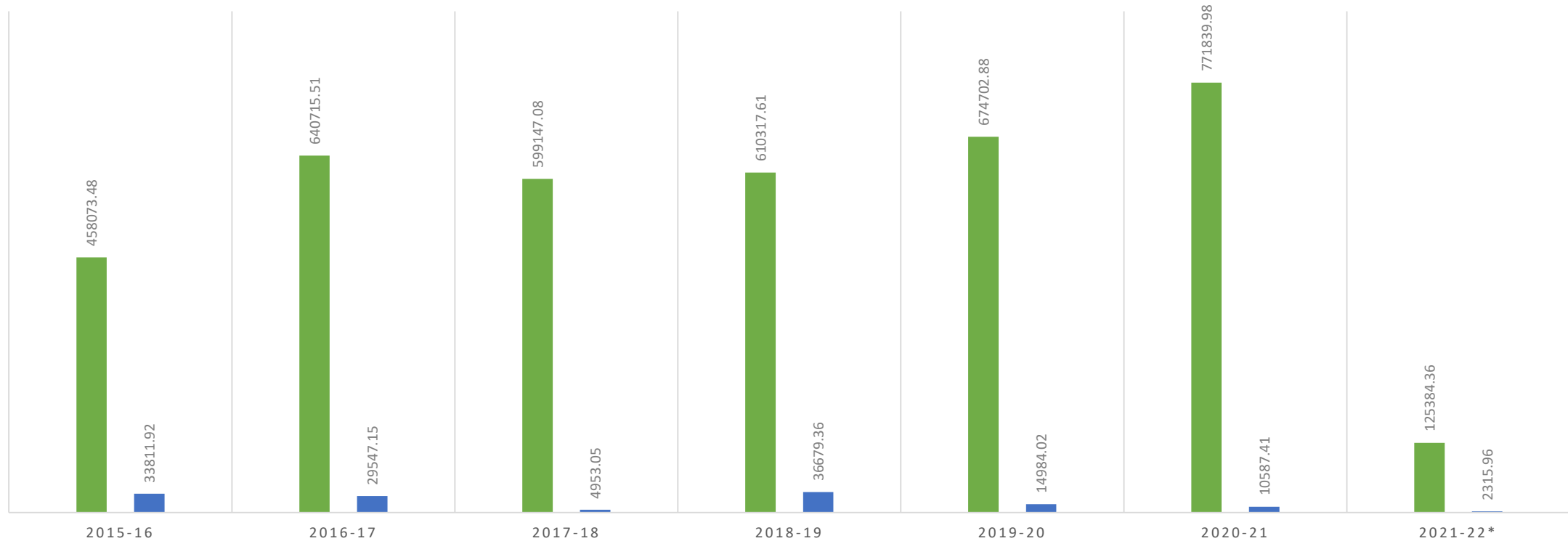
Issue and listing conditions

- In-principle approval from recognised stock exchange
- Appointment of merchant banker (*for public issue only*)
- Appointment of Registrar and Share Transfer Agent
- Application for listing to stock exchanges
- Credit rating from reg. Credit rating
- Agreement with depository (dematerialization mandatory)
- Advertisement in national newspaper (*for public issue only*)
- Appointment of merchant banker (*for public issue only*)

Trends in listed NCDs

TRENDS IN LISTED NCDS

■ Private placement ■ Public issuance



Data has been taken from the official website of SEBI (sebi.gov.in)

*for FY 21-22, the data shows issuance till the month of July, 2021

Creation of DRR and DRF

- **Debenture Redemption Reserve (DRR)**
 - Created out of profits of the company
 - Adequacy – 10 % of outstanding debentures
 - Applicable only on unlisted companies
 - Other than NBFC and HFC
- This is merely an accounting entry in the books of issuer

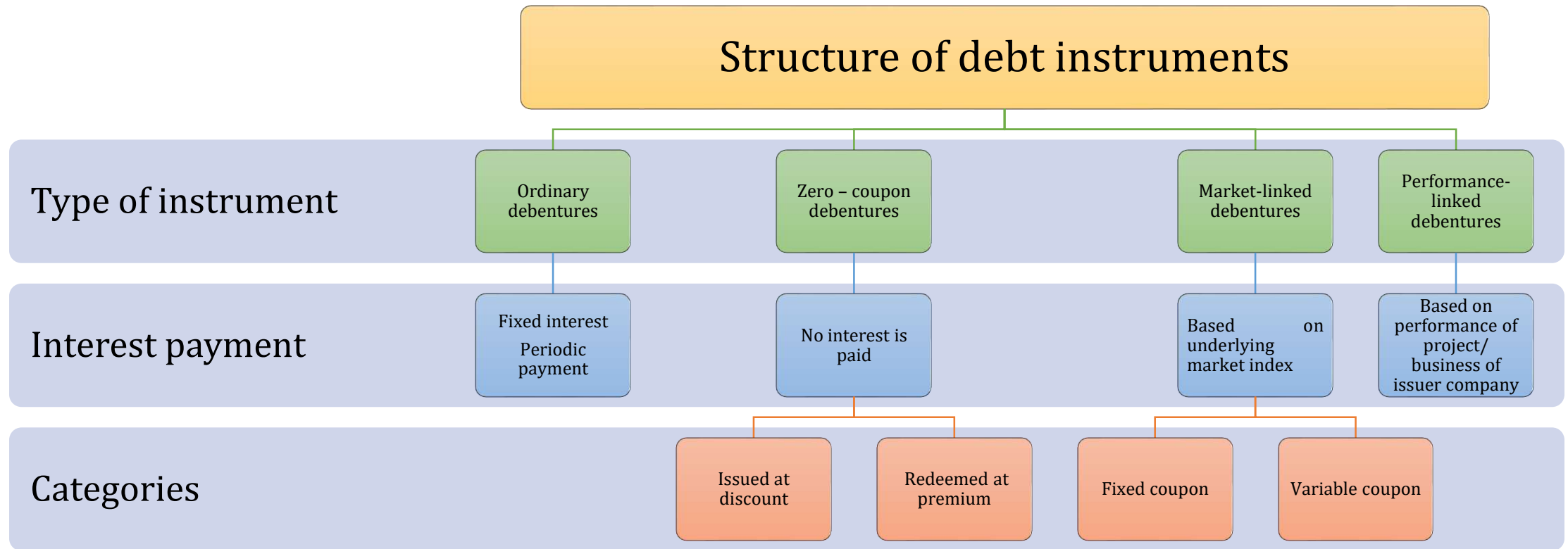
THINK

Debt listed companies no more fall under the definition of listed companies. Therefore, whether the same shall be considered as “unlisted “ and the creation of DRR shall apply?

Considering that the provisions exempting the listed companies from requirement of DRR creation came into effect at a time when debt listed companies were still listed within the meaning of the Companies Act and this provision, therefore, the same should not be said to be applicable.

- **Debenture Redemption Fund (DRF)**
 - Requires investments in liquid assets
 - On or before 30th April of each year
 - Atleast 15% of deposits maturing during the year ending on 31st March in next year
- Applicable on –
 - In case of public issuance, if issued by
 - NBFC or HFC
 - Other listed company
 - Unlisted company (other than NBFC and HFC)
 - In case of private placement –
 - Unlisted company (other than NBFC and HFC)

Interest payment on debentures



Market – linked debentures

- Interest rates neither fixed nor regular
- Linked with performance of underlying market index (such as G-sec, Nifty etc)
- Paid-off at the time of maturity
- Maturity period ranges from 3-5 years
- Generally issued to institutional investors



Benefits for issuer

Means of regulatory arbitrage

- EBP mechanism not applicable
- 5 additional ISINs permitted exclusively for MLDs



Benefits for investor

- Chances of higher returns since returns depend on performance of underlying market index
- Principal protected (mandatory for listed MLDs)
- Tax benefits - taxed as LTCG @10% if held for more than 1 year

EXAMPLE –

MLDs issued at a face value of Rs. 10 lacs (principal amount) in Feb, 2021. Maturity period – 3 years

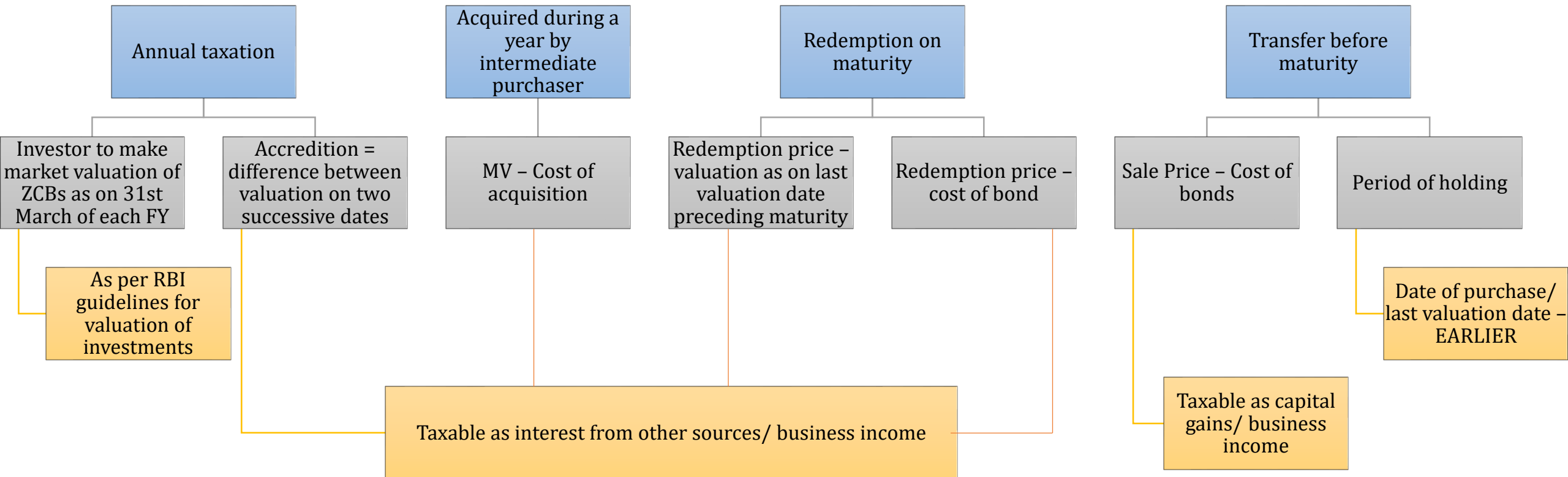
Yield pay-off on redemption – If Nifty increases by 40% from today's value, interest paid shall be 12% of value of Nifty as on maturity date, otherwise no interest, only principal repaid

Taxability in hands of investor –

On redemption, the pay-off is taxable as “income from other sources/ business income” at applicable income tax slabs

If traded in secondary market before redemption, preferably after holding for a period of more than 1 year – taxable as LTCG @10% of Selling Price – Cost of acquisition (without indexation benefits)

Tax treatment of zero coupon bonds (ZCBs)



Alternative for investor holding ZCBs of face value upto Rs. 1 lac

Redemption price - Subscription price = income from other sources/business income

Taxable in the year of redemption

Tax implications on debentures

Interest on debentures

- Periodic or cumulative
- Deducted at source by issuer at the time of payment (Sec 193 of IT Act)
 - NA if debentures are in demat form and listed
- Taxable as income from other sources / business income
- Tax rate – as per applicable tax slabs

In the hands of issuer

The interest/ yield is *deductible* for the purposes of computation of tax.

