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TOPICS

» Foreign Currency Exchangeable Bonds

Background

Foreign Currency Exchangeable Bond ("FCEB") is a bond expressed in foreign currency, the principal and interest in respect of which is payable in foreign currency, issued by an issuing company and subscribed to by a person who is a resident outside India in foreign currency and exchangeable into equity share of another company, to be called the offered company, in any manner, either wholly, or partly or on the basis of any equity related warrants attached to debt instruments.

FCEB is a quasi- debt instrument that allows large corporate houses with multiple subsidiaries to raise money without actually selling shares. FCEB will provide corporate groups more flexibility to raise funds abroad as they can leverage value of holding of a company in group firms too.

Exchangeable bonds would come in handy for companies to help fund overseas acquisition by one of their group companies. The FCEB Scheme seeks to help Indian promoters raise money abroad by issuing foreign currency bonds against the value of their investments in shares of listed group companies.

FCEBs are comparable to FCCBs but the difference is that in case of FCCB, the bond gets converted at the instance at the option of the holder into the equity share of the issuing company; and in the case of an FCEB, the bond gets converted not into the equity share of the issuing company, but into the equity share of the offered company.

Following are some of the salient features of the Issue of Foreign Currency Exchangeable Bonds Scheme, 2008:

Salient Features

- The Finance Minister in his Budget Speech 2007-2008, announced to put in place an enabling mechanism to permit Indian companies to unlock a part of holding in group companies for meeting their financing requirements by issue of Exchangeable Bonds. Pursuant to the announcement made by the Finance Minister, Government has notified a scheme on February 15, 2008 for Issue of Foreign Currency Exchangeable Bonds (the "**Scheme**").

- **Promoter Group:** Another salient feature is that the issuing company shall be part of the promoter group of the offered company and shall hold the equity share/s being offered at the time of issuance of Foreign Currency Exchangeable Bond.
- **Listed Company:** The offered company shall be a listed company which is engaged in a sector eligible to receive Foreign Direct Investment and eligible to issue or avail of Foreign Currency Convertible Bond or External Commercial Borrowings.
- **Compliance with FDI and ECB Policies:** The investment under the scheme shall comply with the Foreign Direct Investment (FDI) policy as well as the External Commercial Borrowing (ECB) Policy requirements.
- **End Use:** The proceeds of FCEB can be invested by the issuing company in the promoter group companies and shall be used in accordance with end uses prescribed under the ECB policy. The promoter group company receiving such investments will not be permitted to utilize the proceeds for investments in the capital market or in real estate in India.
- The proceeds of the FCEB shall be retained and/or deployed overseas in accordance with the policy for the proceeds of External Commercial Borrowings.
- **Overseas Direct Investment:** The proceeds of FCEB can also be invested by the issuing company overseas by way of direct investment including in Joint Ventures or Wholly Owned Subsidiaries subject to the existing guidelines on Indian Direct Investment in Joint Ventures or Wholly Owned Subsidiaries abroad.
- **Interest Rate:** The rate of interest payable on FCEB and the issue expenses incurred in foreign currency shall be within the all in cost ceiling as specified by Reserve Bank of India under the External Commercial Borrowings policy i.e. capped at interest payable on 3-5 year borrowings at 150 basis points above six-month Libor (London Inter-bank Offered Rate) and for above five years at 250 basis points.
- **Exchange Price**: At the time of issuance of FCEB the exchange price of the offered listed equity shares shall be as per FCEB Scheme.
- **Minimum Maturity**: The minimum maturity of the FCEB shall be five years for purposes of redemption. The exchange option can be exercised at any time before redemption.

Tax Implication

- Interest payments on the bonds, until the exchange option is exercised, shall be subject to deduction of tax at source as per the provisions of sub-section (1) of section 115 AC of the Income Tax Act, 1961 i.e. at the rate of 10%.
- Moreover, dividend on exchanged portion of the bond would also attract tax as specified under Section 115 AC (1), which is the provision dealing with tax on income from bonds purchased in foreign currency.
- The FCEB scheme also specifies that exchange of such bonds into shares would not give rise to any capital gains that would be liable to income tax in India.
- Similarly, FCEBs transferred outside India by an investor who is resident outside India to another investor resident outside India would not give rise to capital gains liable to tax in India.
- The Finance Bill 2008 has proposed that conversion of FCEBs into shares or debentures of any company shall not be treated as a transfer under the Income Tax Act. This implies that the transfer of shares would not attract capital gains tax. The provisions will be applicable from April 1, 2008, after the passage of the Bill. Capital gain tax would be leviable only on further sale of these shares by the bondholder as per the rules in his country of residence. The cost of acquisition of share under the FCEB would be the price at which a subscriber buys the

bonds.

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