

Tax & regulatory services

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Issue of preference shares

Backdrop of guidelines for issue of preference shares

Foreign investment through preference shares is treated as foreign direct investment. Preference shares can be issued under the automatic or government approval route depending upon the activity/sector of the Indian company issuing the shares.

Preference shares are considered to be a part of the share capital and fall outside the purview of External Commercial Borrowings (ECB) guidelines/cap. Further, preference shares carrying a conversion option are considered while calculating the equity cap, if any. The rate of dividend is subject to ceilings as may be prescribed by the Ministry of Finance.

Issue of shares capital to non-residents falls within the purview of the Foreign Exchange Management Act, 1999 (FEMA). As per regulation 7 of Schedule I under Notification FEMA 20/2000-RB dated 3 May 2000 (as amended from time to time), the prescribed rate of dividend on preference shares or convertible preference shares issued under the above regulations shall not exceed 300 basis points over the prime lending rate of the State Bank of India prevailing as on the date of the Board meeting of the company in which issue of such shares is recommended.

Revised guidelines for issue of preference shares

The Department of Economic Affairs, Ministry of Finance, has issued a press release announcing certain key amendments to the guidelines for issue of preference shares. Foreign investment mobilised by Indian companies through issue of preference shares for financial projects/industries, would be subject to the following guidelines:

- Foreign investment in the form of fully convertible preference shares would be treated as part of share capital. Such shares would be included while calculating foreign equity for the purposes of sectoral caps on foreign equity, if any.
- Foreign investment in the form of any other type of preference shares such as non-convertible, optionally convertible or partially convertible preference shares would be considered as debt and shall be required to follow ECB guidelines/caps.
- Any foreign investment in the form of non-convertible or optionally convertible or partially convertible preference shares as on and up to 30 April 2007 would continue to be outside the sectoral cap till their current maturity.
- Issue of preference shares of any type would continue to conform to the guidelines of the Reserve Bank of India, Securities and Exchange Board of India and other statutory bodies, and would be subject to all statutory requirements.

Necessary changes to the relevant FEMA regulations are awaited.

Source: PIB Press Release No. BSC/BY/GN-229/07 dated 30 April 2007

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