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ANALYSIS OF THE AMENDMENTS TO THE INDIAN STAMP ACT

In order to augment its source of revenue and bring some uniformity to the duty levied on financial instruments, the Union Government, through the Finance Bill 2019 ("**Bill**"), has proposed substantial amendments to the extant stamp duty law i.e. the Indian Stamp Act, 1899 ("**Stamp Act**"). The proposal is part of the Finance Bill 2019-20 introduced by Finance Minister Piyush Goyal after presentation of the Interim Budget. Under the Constitution of India, the Union Government is empowered to collect stamp duty on all the documented financial instruments such as cheques, bills of exchange, promissory notes, policies of insurance, transfer forms for transfer of shares, debentures, bills of lading, proxies, letter of credit, etc., while the State Government is empowered to prescribe a stamp duty on other instruments that fall within its ambit i.e. 'the State List'.

The Finance Bill 2019 ('**Bill'**) had been assented by both the Houses of Parliament on 12th and 13th February 2019 respectively.[1] The Bill proposes that stamp duties now would be levied on one instrument relating to one transaction. The stamp duty will be collected at one place through the market infrastructure institutions/ agencies such as Stock Exchanges or its Clearing Corporation or Depositories. These market infrastructure institutions will act as an additional checkpoint to ensure the stamp duty compliance. The duty so collected will be shared with the State Governments on the basis of domicile of the ultimate buying client. After the securities transaction tax, the stamp duty would be an additional levy on the cost of undertaking securities transaction.

This on one hand would streamline the process of paying stamp duty eliminating the unwarranted layers and cumbersome processes; but at the same time will increase the cost of undertaking securities transactions for the parties involved. The following sections briefly cover the abovementioned points and some other significant changes proposed by the Bill.

Definitions

The Bill proposes few new definitions while amending some existing definitions under the Stamp Act.

a) "**Debentures**": For instance, the term 'Debenture' has been removed from the definition of the term "bonds" and has now been defined under Section 10A[2] to include certificate of deposits, commercial usance bills, commercial papers and other debt instruments of original or initial maturity of one year or as provided by Reserve Bank of India (RBI). In contrast, the definition of debentures under Companies Act, 2013 categorically excludes instruments covered under Chapter III-D of RBI Act, 1939.

b) "**Market Value**": Another important amendment is to the definition of 'Market value', which has now been defined under Section 16B to mean, (a) in relation to an instrument through which any security is traded in a stock exchange, Market Value shall mean the price at which it is so traded; (b) for any security which is transferred through a depository but not traded in the stock exchange, Market Value shall mean the price or the consideration mentioned in such instrument; and (c) for any security which is dealt with otherwise than in the stock exchange or depository, the price or consideration mentioned in such instrument shall be the Market Value.

   It is pertinent to note that the above definition of "**Market Value**" does not envisage a transaction where no consideration is exchanged, as in a case of gift of shares / securities between relatives or from a holding company to a subsidiary company. The question is, whether the legislative intent was to exempt such transaction from payment of stamp duty.

c) "**Marketable Security**": Further, "marketable security" has been defined as "security capable of being traded in any stock exchange".

[1] Supra note 1.

[2] Finance Bill, 2019; https://www.indiabudget.gov.in/ub2019-20/fb/bill.pdf

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d) **"Instrument":** Arguably, the most consequential amendment is to the definition of "instrument" under section 14 of the Stamp Act, which has been substituted and now includes a document, *electronic or otherwise*, created for transaction in a stock exchange or depository by which any right or liability is, or purports to be, created, transferred, limited, extended, extinguished or recorded but does not include such instruments as may be specified by the government, by notification in the official gazette. This brings any kind of electronic securities transaction within the purview of an 'instrument' on which duty may be levied.

   Interestingly, this newly proposed definition of "instrument" creates ambiguity around the levy of stamp duty on specific online securities transactions where no document comes into existence whether electronic or otherwise. So if no document comes into existence, can it be argued that there exists no instrument on which stamp duty can be levied?

Dematerialisation

Until now, dematerialised shares were exempted from payment of stamp duty, while those in physical form attracted a levy of 0.25% on the consideration value. However, the Bill proposes to bring transactions involving dematerialised shares, as well as derivatives (including commodities, currency and interest rates) within the ambit of the stamp duty law. It may be pertinent to note that one of the major reasons for investors to adopt dematerlisation of securities after the same was made mandatory for public unlisted companies was the stamp duty exemptions on transactions through demat mode. This has now been taken away under the Bill.

Clarity on burden of obligation

The proposed amendments bring sufficient clarity in respect of the person responsible for payment of stamp duty. In case of sale of security through stock exchange, it is the buyer; in case of sale of security otherwise than through a stock exchange, it is the seller (as against the current practice of levying the duty on both), and so on.

More importantly, institutions like stock exchanges and clearing corporations have been cast with an obligation to collect stamp duties on behalf of the State Governments in the first instance, and then transfer the same to the State Governments transferred within three weeks from the end of each month. So in case of sale of any securities made through a stock exchange, the exchange itself or the clearing corporation appointed by it is responsible for collecting stamp duty. In case of issue of securities leading to creation or change in the records of depository, the depository involved must collect the stamp duty.

While such a systematic, centralized approach to collection of duty may have its advantages, there could potentially be issues when it comes down to implementation. For instance, are depositories allowed to enter into arrangements with or delegate their functions to depository participants? This question is especially pertinent in respect of electronic transactions taking place in remote areas where depositories or exchanges may not have their own offices but have to rely on the services of the depository participants.

Beneficial Ownership of Securities

The Bill substitutes the existing Section 8A in the Stamp Act. The newly substituted section provides that securities transactions which lead to the transfer of registered ownership from a person to a depository or from a depository to a beneficial owner shall not be subject to payment of stamp duty. However, transfer of beneficial ownership of securities and the beneficial ownership of mutual fund units which are dealt with by a depository shall now be chargeable with duty. Such transactions were exempted from payment of stamp duty thus far. This would result in increase in the cost of acquisition of the mutual fund investors while undertaking investment transactions as the stamp duty costs will be ultimately loaded on them by the scheme's asset management company.

Penalty for non-compliance:

The Bill also imposes penalty of not less than one lakh rupees, which can be extended up to one percent of the collection on the collection agencies (such as Stock Exchange, Depositories and Clearing Corporation) for failure of collection of the duty

or transfer the same within 15 days of the specified time period. Submission of false document, or failure to submit information or making any declaration, by the above mentioned entities, shall be subject to a fine of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Conclusion

Considering that the stamp duty is being kept out of the ambit of the Goods and Services Tax, these proposals showcase the government's efforts to increase ease of doing business.

Though the collection of stamp duty has been proposed to be streamlined, the interplay of the powers to prescribe stamp duty as divided between the Centre and State Governments is yet to be seen. Some of the ambiguities in respect of the proposed amendments have been discussed above this may need further examination by the legal experts and if challenged in future, by the Hon'ble Judiciary.

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Amendments to the Insider Trading Regulations: Whether new defence for the devil?

Introduction

The Securities and Exchange Board of India ("**SEBI**"), the securities market regulator, extended a rather stormy welcome to 2019 with multiple amendments to the SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**PIT Regulations**"). The first set of amendments, issued vide notification dated December 31, 2018 will be effective from April 1, 2019, whereas the SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2019, published on January 21, 2019 came into force from the date of publication (collectively, the "**Amendments**"). These Amendments are a fruition of the recommendations of the Report of Committee on Fair Market Conduct, set up by SEBI in 2017 and chaired by Dr. T.K. Viswanathan ("**Viswanathan Committee Report**").

From a practical perspective, the most significant amendments may be categorised into three heads – clarification on the concept of "legitimate purpose", compliances for listed companies and the introduction of new defences to insider trading.

Communication of UPSI for "legitimate purpose":

The Amendments seek to bring greater clarity to some existing concepts where ambiguity has led to some debate in the past. One of the most consequential clarifications is the "Explanation" to Regulation 3(2A), which throws some light on what is considered a "legitimate purpose" for sharing unpublished price sensitive information ("**UPSI**").

For context, as per Regulation 3(1), an insider is prohibited from communicating, providing or allowing access to the UPSI to any person, unless the same is done "*in furtherance of legitimate purpose*." The Amendments state that sharing of unpublished price sensitive information *in the ordinary course of business* by an insider with partners, collaborators,[3] lenders, customers, suppliers, legal advisors, auditors, insolvency professionals or other advisors or consultants would amount to "legitimate purpose", as long as such information has not been shared to circumvent the provisions of the PIT Regulations.

While the abovementioned text is part of an "Explanation" to Regulation 3(2A), it is essentially a crucial, yet open-ended, guidance to listed companies, who are now required to formulate policies for determination of "legitimate purpose", as elaborated in the section below.

Further, SEBI has introduced Regulation 3(2B), which requires a due notice to be issued to any person who has received UPSI in furtherance of a "legitimate purpose" to ensure maintenance of confidentiality in respect of such UPSI in compliance with PIT Regulations and such person shall be considered as 'insider'[4]. The conundrum here is the fact the Amendments do not specify who it is that is required to issue such notice. SEBI is arguably the most active regulatory body and is fairly quick to penalise any form of non-compliance. In such circumstances, it is perhaps a cause of concern when there is ambiguity in respect of the person/officer on whom the obligation of compliance is cast.

Compliances for listed Companies:

The Amendments impose a range of compliance requirements on listed entities, largely to do with formulating a code of conduct and maintenance of records.

a) **Determination of "Legitimate Purpose"**: As mentioned above, Regulation 3(2A) now imposes an obligation on the board of directors of listed companies to prepare a policy for determination of "legitimate purposes" for which UPSI may be shared as a part of Codes of Fair Disclosure and Conduct formulated under the Regulation 8 of PIT Regulations. The concept of legitimate purpose by its very nature is subjective, and the move to allow companies to define the ambit of such 'legitimate

[3] https://www.sebi.gov.in/legal/regulations/dec-2018/securities-and-exchange-board-of-india-prohibition-of-insider-trading-amendment-regulations-2018-dated-december-31-2018_41570.html

[4] Supra note 4.

purpose' is not only practical, but also a step forward in encouraging healthy corporate governance.

b) **Maintenance of digital database; setting up internal controls**: Next, as per Regulation 4(5), the board of directors of a listed company is required to record the details along with Permanent Account Numbers (PANs) of persons who receive UPSI in a structured digital database and maintain the same with adequate internal controls and checks (such as time stamping and audit trails) to safeguard it from any tampering. Further, Regulation 9A sets out a framework for putting in place internal controls within a company for prevention of insider trading. This includes identification of employees with access to UPSI as designated employees, maintenance of a list of employees and other persons with whom UPSI is shared, entering into confidentiality agreements with such employees/persons, and formulation of a whistle blower policy for reporting leaks of UPSI.

c) **Identification of "designated persons"**: Regulation 9 read with Schedule B of PIT Regulations impose an obligation on the Chief Executive Officers or Managing Directors of listed entities and intermediaries to formulate a code of conduct "to regulate, monitor and report trading by its employees, connected persons **("designated persons")** and immediate relatives of designated persons. The board of directors is required to specify such **'designated persons'** on the basis of their role and function in the organisation, which includes, *inter alia*, promoters, employees of material subsidiaries with access to UPSI, Chief Executive Officers, etc.

   There are two significant changes to note here. Firstly, the Chief Executive Officer/Managing Director has been specifically identified as the persons on whom the obligation of compliance is cast. Secondly, listed companies and intermediaries are now prescribed separate codes of conduct. "Fiduciaries" are also required to adhere to the code of conduct prescribed for intermediaries under Schedule C of the PIT Regulations. The term "fiduciaries" has been explained in the Explanation inserted in substituted Regulation 9 (2) to include professional firms such as law firms, accountancy firms, analysts, auditors, insolvency professional entities, banks and others who assist or advise listed entities.

In essence, these requirements push for increased accountability, a more diligent corporate culture and the establishment of institutional mechanisms within each listed company to prevent leak of UPSI.

<u>Additional defences to Insider Trading</u>

Arguably, the most crucial amendments to the PIT Regulations are the introduction of multiple new defences to insider trading.

One such defence is the exercise of stock options at a pre-determined exercise price by employees as per new proviso in Regulation 10.

Another one is in respect of transactions executed on block deal window mechanism between persons who are in possession of UPSI as per substituted Regulation 4.

A third and more interesting defence is off-market trades between insiders with access to the same UPSI, as long as such trades are notified to the company within two working days and the UPSI hasn't been disclosed in relation to a proposed transaction. Prior to the Amendments, this defence was only available to promoters as per new proviso in Regulation 4.

This amendment would be mostly innocuous, but in light of the fact that companies are now allowed to dictate the "legitimate purpose" for which UPSI may be shared, it could be argued that there is a possibility for such a defence to be abused. Now that this defence is available to all insiders, the pool of people to whom this defence is available could potentially be large depending on the policy formulated by the Company for determination of "legitimate purpose".

However the Amendments do put in place safeguards such as mandating companies to share "particulars" of such off-market transactions with the stock exchange within two (2) trading days from the receipt of the information. Furthermore, Regulation 4(1) iterates a presumption of knowledge and motivation against a person in possession of UPSI. As per the Viswanathan Committee Report, the

purpose behind the introduction of provision is to underline the legislative intent to impose strict accountability in case of insider trading.

Conclusion

The Amendments have certainly brought clarity to some ambiguous concepts in the PIT Regulations. They are also clearly a leap forward in encouraging a transparent framework for prevention of insider trading. However, whether or not the Amendments successfully manage to achieve the fine balance between regulations of insider trading and encouraging a more autonomous framework of corporate governance remains to be seen.

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BEWARE – A CLAW CAN DROP YOUR JAW
Enforceability of Clawback Provisions

The term "Clawback" has gained traction in the recent times due to its inclusion in employment agreements. A "Clawback" means a forceful action taken by one party (commanding) to a contract, against the other party, to ensure that the other party acts with due care and fulfills its responsibilities with integrity. This clause, though has its origin in both British and American laws (with India having derived it from the former), it is used for different purposes. While in American law, the practice is to use it as a deterrent against executives at senior level to protect the right of investors, the British law believes that a Clawback (in an employment agreement), especially pertaining to banking sector, will make the employees at higher positions work with integrity and stay focused in their obligations in a fair and transparent manner. Both the nations have the same motive that is to protect the interest of the masses, be it the investors or account holders.

The Clawback clause has its roots in the Sarbanes-Oxley Act, 2002 ("**SOX**") of the United States of America (USA). Section 304 of SOX is also known as Clawback provision. It is an enabling provision for the US Securities and Exchange Commission to impose penalties on the chief executive officer ("**CEO**") and chief financial officer ("**CFO**") of companies in an attempt to recover their incentive compensation if their financial statements are materially inaccurate or misstated. The CEO/CFO has to return the incentives received within 12 months from the misleading statement. Whether the SOX Clawback provision was effective in deterring and reducing the crime of misreporting by the executives has been a question of debate. The major drawback for the SOX Clawback was that it can be enforced only if there was a misconduct. Hence, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**") was passed in the year 2010. It specifically provides for publicly listed companies/ firms to adopt policies that will compel the executives to repay the incentives in case the books are false and cooked. Additionally, in case of restatement of financials the incentives paid to an executive should not exceed the amount he would be eligible to receive under the restated financials. It is also a known fact that there are excess incentive pay-out made to executives acting in good faith and not guilty of any misconduct.

Although, such provision is missing from the Indian Contract Act, 1872,the labour statutes or securities law, the Reserve Bank of India (RBI) vide notification number RBI/2011-12/349 dated January 13, 2012 issued 'Guidelines on Compensation of Whole Time Directors/ Chief Executive Officers/ Risk takers and Control function staff, etc.'[5] ("**Guidelines**"). These Guidelines are based on the set of principles and standards of compensation brought out by the Financial Stability Board (FSB) in April and September 2009 on sound compensation practices. These RBI Guidelines are specifically for private sector and foreign banks operating in India and require such banks to obtain regulatory approval for grant of remuneration to WTDs/ CEOs in terms of Section 35B of the Banking Regulation Act, 1949. The approval process involves, inter alia, an assessment of whether the bank's compensation policies and practices are in accordance with the extant Guidelines. Among other salient features, the Guidelines also provide for the incorporation of 'Clawback'/'malus' clause in the employment agreement, as follows:

'A malus arrangement permits the bank to prevent vesting of all or part of the amount of a deferred remuneration. Malus arrangement does not reverse the vesting after it has already occurred. A Clawback, on the other hand, is a contractual agreement between the employee and the bank in which the employee agrees to return previously paid or vested remuneration to the bank under certain circumstances. Banks may put in place appropriate modalities to incorporate malus / Clawback mechanism in respect of variable pay, taking into account relevant statutory and regulatory stipulations as applicable'.

The banks in India have incorporated the relevant clauses based on these Guidelines and formed their own code of conduct. Albeit, the legality of these clauses in such contracts remains untested until now. However, this is challenged in

[5] https://rbi.org.in/Scripts/NotificationUser.aspx?Id=6938&Mode=0

the recent case of the leading private sector bank enforcing such a clause against its former CEO accused of violating the code of conduct. In light of the same, the RBI has proposed notable changes to these Guidelines, pertaining to variable pay and stock options. While the Guidelines had given discretion to the banks to put appropriate malus/ Clawback mechanism, the proposed changes are said to make a stricter imposition of these mechanism along with other factors. SEBI, the market regulator is also vigilant in cases where the banks are listed on the stock exchanges and takes strict actions against the violator.

Further, in case of general employment agreements, globally, there are cases on enforcement of such a Clawback clause. A number of employment agreements include Clawback clause wherein the employee is bound to repay his quarterly salary or bonus earned if they leave the organisation within a particular span of time or fail to fulfil certain pre-decided targets. While, the objective of the former is to make the employees stick to the organisation for a longer span of time, in the case of the latter, it is to ensure employee’s dedicated and undivided focus and to extract out their maximum caliber for the efficient working of the company. Some contracts link the Clawback clause to bonus and employee stock options (ESOPs) as well in order to incentivize the employee towards target completion.

It is clear that Clawback clause is more entrapping when it is part of employment contracts. The incentives given by an organisation are enduring to the employee/s, but the invocation of Clawback by employer organisation is leading to jaw-dropping effects on the employee/s especially the senior executives. The employment agreements subsist until the employee is employed in the organisation. It is debatable as to whether the Clawback amount should be calculated from the beginning of the term of the employment or the first date of receipt of incentive/s by the employee or should such clause be enforced only from the date of occurrence of deceit. While the Central Bureau of Investigation (CBI) in a probe calculated it from the date of deceit or wrongful action against the code of conduct, only the Hon’ble judiciary can provide clarity in the matter.

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LEX REVISORS

1. REPEAL OF COMPANIES ACT, 1956

Vide a notification dated January 30, 2019; the Central Government has enforced Section 465 of the Companies Act, 2013 relating to the repeal of the Companies Act, 1956. However, an exception has been provided related to the repeal of Registration of Companies (Sikkim) Act, 1961 (Sikkim Act 8 of 1961).

[Source: http://www.mca.gov.in/Ministry/pdf/NotificationSection465_31012019.pdf]

2. MCA INTRODUCES E-FORM ACTIVE (INC – 22A)

The MCA introduced a new e-form (ACTIVE (INC–22A)) required to be filed by all companies incorporated on or before December 31, 2017. Failure by a company to file the said form before April 25, 2019 will result in the company being marked "Active Non-Compliant". "Active Non-Compliant" companies will not be able to file Form SH-7 (change in authorized capital), Form PAS-3 (return of allotment), Form DIR-12 (change in directors), Form INC-22 (change in registered office) and Form INC-28 (amalgamation, de-merger). However, companies that have not filed its due annual returns (Form MGT-7) and/or its due financial statements (Form AOC-4) are restricted from filing Form ACTIVE (INC-22A). The Companies (Registration offices and fees) Amendment Rules, 2019, the Companies (Incorporation) Amendment, Rules, 2019 and the Companies (Adjudication of Penalties) Amendment Rules, 2019 with relation to the aforesaid have been notified.

[Source: http://mca.gov.in/Ministry/pdf/CompaniesRegnOfficesFeesRules21022019.pdf
http://mca.gov.in/Ministry/pdf/CompaniesIncorporationAmendmentRules_21022019.pdf
http://mca.gov.in/Ministry/pdf/AdjudicatioPenalties2019_20022019.pdf]

3. MCA NOTIFIES COMPANIES (SIGNIFICANT BENEFICIAL OWNERS) AMENDMENT RULES 2019

The Central Government vide notification dated 08.02.2019 amended the Companies (Significant Beneficial Owners) Rules, 2018 vide Companies (Significant Beneficial Owners) Amendment Rules, 2019. The primary changes include changes in the definition of control, form, majority stake, partnership entity, reporting company, section, significant beneficial owner and significant influence. Further, the following rules are amended:

i) Rule 2A - Duty of reporting company;
ii) Rule 3 - Declaration of Significant Beneficial Ownership under Section 90;
iii) Rule 4 - Return of Significant Beneficial Owners (SBO) in shares;
iv) Rule 7 – Application to the Tribunal;
v) Rule 8 – Non-applicability;

Further, there is substitution of Form No. BEN 1, BEN 2, BEN 3 and BEN 4.

[Source: http://mca.gov.in/Ministry/pdf/CompaniesOwnersAmendmentRules_08020219.pdf]

4. SEBI RELAXES REQUIREMENT TO FURNISH PAN FOR TRANSFER OF EQUITY SHARES ISSUED BY LISTED ENTITIES EXECUTED BY NON-RESIDENTS

As per Schedule VII of SEBI LODR Regulations, 2015 it is specified that the transferee as well as transferor shall furnish a copy of their PAN card to listed entity for registration of transfer of securities. SEBI on February 11, 2019 has granted relaxation to non-residents from the requirement to furnish PAN in transfer of equity shares held by them in listed entities to their immediate relatives. However, the relaxation shall only be available to non-commercial transactions executed after January 1, 2016 and the non-resident is required to provide a copy of an alternate valid document to ascertain identity as well as the non-resident status.

[Source:https://www.sebi.gov.in/legal/circulars/feb-2019/relaxation-from-requirement-to-furnish-a-copy-of-pan-for-transfer-of-equity-shares-of-listed-entities-executed-by-non-residents_42043.html]

5. **RBI RELAXES 20% CORPORATE DEBT FPI LIMIT**

In order to encourage a wider spectrum of investors to access the Indian corporate debt market, the RBI vide Circular (AP DIR Circular No. 19) dated February 15, 2019 withdrew the provision on exposure of more than 20% (Twenty Percent) of its corporate bond portfolio to a single corporate (including exposure to entities related to the corporate) with immediate effect.

[Source: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11475&Mode=0]

7. **FORM INVI EFFECTIVE FROM FEBRUARY 05, 2019**

With effect from February 05, 2019, Form InVi has been operationalized for filing in Single Master Form. AIFs and other Investment Vehicles, receiving foreign investment, will be required to submit Form InVi within 30 days from the date of issue of units.

[Source: https://firms.rbi.org.in/firms/faces/pages/login.xhtml]

8. **REQUIREMENT TO APPOINT REGISTERED VALUER**

Under Rule 11 (Transitional Arrangement) of the Companies (Registered Valuers and Valuation Rules), 2017, a valuer who has not procured registration under the said rules and was appointed prior to January 31, 2019, can complete the services for which he has been appointed by April 30, 2019. However, from February 1, 2019, only a valuer registered with the Insolvency and Bankruptcy Board of India in accordance with the Companies (Registered Valuers and Valuation) Rules, 2017 may be appointed for conducting valuation services as required under the Companies Act, 2013.

[Source: Rule 11 of the Companies (Registered Valuers and Valuation Rules), 2017]