

ECB – overview- FEMA and Income Tax Implications – for ICAI CPE prog – 29 Apr 24

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ECB – FEMA & Income Tax overview

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- ❖ Forms of ECB
- ❖ Eligible Borrowers
- ❖ Recognised lenders
- ❖ Calculation of minimum average maturity period
- ❖ End use - permitted
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ECB – FEMA & Income Tax overview

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Master Direction & Framework/ Regulations

- ❖ Transactions on account of External Commercial Borrowings (ECB) and Trade Credit (TC) are governed by sub-section 2 of section 6 of the Foreign Exchange Management Act, 1999 (FEMA).
- ❖ Foreign Exchange Management (Borrowing and Lending) Regulations, 2018, notified vide Notification No. FEMA 3R/2018-RB dated December 17, 2018, as amended from time to time; and
- ❖ Foreign Exchange Management (Guarantees) Regulations, 2000, notified vide Notification No. FEMA 8/2000-RB dated May 03, 2000, as amended from time to time.
- ❖ **Borrowing and Lending in Foreign currency by AD and other than AD are covered in FEM(Borrowing and Lending) Regulations 2018 dated 17th Dec 2018**
- ❖ FAQs issued by RBI (updated as on 26 June 2023)

ECB Framework – 3 tracks - merged

Track I	Track II	Track III
Medium term foreign currency denominated ECB with minimum average maturity of 3/5 years.	Long term foreign currency denominated ECB with minimum average maturity of 10 years.	Indian Rupee (INR) denominated ECB (RDBs) with minimum average maturity of 3/5 years.

Parameters	FCY denominated ECB	INR denominated ECB
Currency of borrowing	Any freely convertible Foreign Currency	Indian Rupee (INR)



Forms of ECB

The ECB Framework enables permitted resident entities to borrow from recognized non-resident entities in the following forms

- i. Loans including bank loans;
- ii. Securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares / debentures);
- iii. Buyers' credit;
- iv. Suppliers' credit;
- v. Foreign Currency Convertible Bonds (FCCBs);
- vi. Financial Lease; and
- vii. Foreign Currency Exchangeable Bonds (FCEBs)

Procedures & Available routes for raising ECB

Automatic Route

AD Category 1 Banks
examine cases

Obtain LRN from RBI
by filing Form No. 83
through AD Bank

Monthly filings with
RBI through AD Bank
in Form ECB2

Approval Route

Prior application to the
RBI through AD Bank

RBI Empowered committee
to consider such application

Post approval, obtain LRN
and Monthly filings same
as applicable under
Automatic Route



ECB Ratio

- All eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year under the automatic route.
- In case of FCY denominated ECB raised from direct foreign equity holder, ECB liability-equity ratio for ECB raised under the automatic route cannot exceed 7:1.
- This ratio will not be applicable if the outstanding amount of all ECB, including the proposed one, is up to USD 5 million or its equivalent.
- The borrowing entities will also be governed by the guidelines on debt equity ratio, issued, if any, by the sectoral or prudential regulator concerned.



Eligible Borrowers

- ❖ All entities eligible to receive FDI.
- ❖ Port Trusts; Units in SEZ; SIDBI; and EXIM Bank of India.
- ❖ INR denominated ECB can be raised by registered entities engaged in micro-finance activities, viz., registered Not for Profit companies, registered societies/trusts/ cooperatives and Non-Government Organisations.
- ❖ Registered FPI investing in Non-Convertible Debentures-ECB framework is not applicable.
- ❖ LLPs are not eligible borrower as not eligible to receive FDI.



Recognised Lenders

- ❖ The lender should be resident of FATF or IOSCO compliant country, including on transfer of ECB. However,
 - a) Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognised lenders;
 - b) Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad; and
 - c) Foreign branches / subsidiaries of Indian banks are permitted as recognised lenders only for FCY ECB (except FCCBs and FCEBs).
- ❖ Foreign branches / subsidiaries of Indian banks, subject to applicable prudential norms, can participate as arrangers/underwriters/market-makers/traders for Rupee denominated Bonds issued overseas. However, underwriting by foreign branches/subsidiaries of Indian banks for issuances by Indian banks will not be allowed.

Calculation of Minimum average maturity period

- ❖ MAMP for ECB will be 3 years
- ❖ Call and put options, if any, shall not be exercisable prior to completion of minimum average maturity.
- ❖ Calculation of MAMP for ECB is calculated as per the following formula
- ❖ ECB for 6 Million USD is taken as an example
- ❖ Prescribed MAMP in certain cases is prescribed
- ❖ For the categories mentioned at (b) to (e) –
 - (i) ECB cannot be raised from foreign branches / subsidiaries of Indian banks
 - (ii) the prescribed MAMP will have to be strictly complied with under all circumstances.



Microsoft Excel
Worksheet

Sr No.	Category	MAPM
a	ECB raised by manufacturing companies up to USD 50 million or its equivalent per financial year.	1 year
b	ECB raised from foreign equity holder for working capital purposes, general corporate purposes or for repayment of Rupee loans	5 years
c	ECB raised for (i) working capital purposes or general corporate purposes (ii) on-lending by NBFCs for working capital purposes or general corporate purposes	10 years
d	ECB raised for (i) repayment of Rupee loans availed domestically for capital expenditure (ii) on-lending by NBFCs for the same purpose	7 years
e	ECB raised for (i) repayment of Rupee loans availed domestically for purposes other than capital expenditure (ii) on-lending by NBFCs for the same purpose	10 years



End use not permitted

❖ The negative list, for which the ECB proceeds cannot be utilised, would include the following:

- a) Real estate activities.
- b) Investment in capital market.
- c) Equity investment.
- d) Working capital purposes, except in case of ECB mentioned at (b) (c) above.
- e) General corporate purposes, except in case of ECB mentioned at (b) (c) above
- f) Repayment of Rupee loans, except in case of ECB mentioned at (d) (e) above.
- g) On-lending to entities for the above activities, except in case of ECB raised by NBFCs as given at (c), (d) and (e) above.



Terminologies

❖ **All-in-Cost** – It includes rate of interest, other fees, expenses, charges, guarantee fees, ECA (export credit agency) charges, whether paid in foreign currency or INR but will not include commitment fees and withholding tax payable in INR. In the case of fixed rate loans, the swap cost plus spread should not be more than the floating rate plus the applicable spread. Additionally, for FCCBs, the issue related expenses should not exceed 4 per cent of the issue size and in case of private placement, these expenses should not exceed 2 per cent of the issue size, etc. Under TC Framework, all-in-cost shall include rate of interest, other fees, expenses, charges, guarantee fees whether paid in foreign currency or INR. Withholding tax payable in INR shall not be a part of all-in-cost. Various components of all-in-cost have to be paid by the borrower without taking recourse to the drawdown of ECB/TC, i.e., ECB/TC proceeds cannot be used for payment of interest/charges



Terminologies

- ❖ **Benchmark rate:** Benchmark rate in case of FCY ECB/TC refers to 3 any widely accepted interbank rate or ARR of 6-month tenor, applicable to the currency of borrowing. Benchmark rate in case of Rupee denominated ECB/TC will be prevailing yield of the Government of India securities of corresponding maturity.
- ❖ **ECB liability-Equity ratio:** For the purpose of ECB liability-equity ratio, ECB amount will include all outstanding amount of all ECB (other than INR denominated) and the proposed one (only outstanding ECB amounts in case of refinancing) while equity will include the paid up capital and free reserves (including the share premium received in foreign currency) as per the latest audited balance sheet. Both ECB and equity amounts will be calculated with respect to the foreign equity holder. Where there is more than one foreign equity holder in the borrowing company, the portion of the share premium in foreign currency brought in by the lender(s) concerned shall only be considered for calculating the ratio. The ratio will be calculated as per latest audited balance sheet.



Hedging Provision

- ❖ The entities raising ECB are required to follow the guidelines for hedging issued, if any, by the concerned sectoral or prudential regulator in respect of foreign currency exposure.
- ❖ Infrastructure space companies shall have a Board approved risk management policy. such companies are required to mandatorily hedge 70 per cent of their ECB exposure in case the average maturity of the ECB is less than 5 years.
- ❖ The designated AD Category-I bank shall verify that 70 per cent hedging requirement is complied with through form ECB 2.
- ❖ Operational aspects with respect to hedging
 - ❑ Coverage
 - ❑ Tenor and rollover
 - ❑ Natural Hedge



REPORTING REQUIREMENTS

- ❖ **Form ECB:** Borrower is required to submit Form ECB in duplicate with AD Bank. AD Bank will forward one copy to the Director, Balance of payments statistics division, Department of Statistics and Information Management, RBI.
- ❖ **Loan Registration Number (LRN)** - Any draw down in respect of ECB as well as payment of any fee/charges for ECB should happen only after obtaining LRN from RBI.
- ❖ **Changes in terms and conditions of ECB** - Revised Form ECB should be submitted with RBI DSIM in any case not later than 7 days of such changes.
- ❖ **Monthly Reporting of actual transactions -**
 - ❑ The borrowers are required to report actual ECB transactions through **Form ECB 2** Return through the AD Category I bank on monthly basis so as to reach DSIM within seven working days from the close of month to which it relates.
 - ❑ Changes, if any, in ECB parameters should also be incorporated in Form ECB 2 Return.

ECB compliances – Income tax

- ❖ Interest income earned by a non-resident from an Indian borrower is taxable in the hands of such non-resident in India and the Indian borrower is required to withhold taxes on such interest pay-outs by them
- ❖ The IT Act prescribes specific withholding rates (*i.e.*, 5% or 20%, as the case may be) subject to Double Tax Avoidance Agreement (DTAA) benefits.
- ❖ The characterisation of income earned by such non-residents on ECB is attributable to business profits and generally taxable at 40% under the Act by the revenue authorities.
- ❖ Section 194LC of the IT Act provides for the deduction of tax at source (TDS) on income by way of interest payable to a non-resident. The person responsible for making the payment, shall at the time of credit of such income or at the time of payment deduct tax thereon at the rate **of 5%**.
- ❖ In case of interest other than covered in section 194LC of the IT Act, section 115A of the IT Act provides for TDS at **20%** of the gross amount on interest payable by the Government or an Indian entity to a non-resident on the sum borrowed or debt incurred by it in foreign currency.



ECB compliances – Income tax

- ❖ Interest rate benchmarking from transfer pricing perspective;
- ❖ Applicability and impact (if any) of Thin capitalisation rules – Interest deduction limitation. Section 94B.
- ❖ Interest recipient company shall obtain Permanent Account Number in India
- ❖ Withholding of tax on payment of interest - Withhold tax rate would be as per rates mentioned in DTAA or Income-tax Act, whichever is beneficial
- ❖ India entity to file Form 15CA, obtain Form 15CB (if applicable) and file Form 27Q
- ❖ Applicability of Form 61A (Specified financial transaction) and Form 3CEAA (Master file)
- ❖ India entity and interest recipient company shall file Form 3CEB disclosing ECB loan transaction and interest transaction.
- ❖ Liability of interest recipient company to file Income-tax return in India.

Delay in Reporting -LSF

Sr. No	Form	Particulars/ Period of Delay	Applicable LSF
1	Form ECB 2	Upto 30 calendar days from due date of submission	INR 5,000
2	Form ECB 2/ Form ECB	Upto three years from due date of submission/ date of drawdown	INR 50,000 per year
3	Form ECB 2/ Form ECB	beyond three years from due date of submission/ date of drawdown	INR 100,000 per year
4	Method of Payment	Through DD in the name of Reserve Bank of India	
5	Non-Payment	Shall be treated as contravention of reporting will lead to Compounding or adjudication.	



ECB conversion to Equity

- ❖ Conversion of ECB, including those which are matured but unpaid, into equity is permitted subject to the following conditions.
 - ❑ Activity of the borrowing company covered under FDI policy under automatic or approval route as per extant FDI policy.
 - ❑ With lenders consent
 - ❑ Applicable pricing guidelines for shares are complied with.
 - ❑ Partial Conversion – Reporting of FCGPR & ECB 2
 - ❑ Full Conversion – Reporting FCGPR and discontinue ECB 2
 - ❑ If the borrower concerned has availed of other credit facilities banking guidelines on restructuring have to be complied with. Consent of other lenders, or information regarding conversions is exchanged with other lenders of the borrower.
 - ❑ Exchange rate prevailing on the date of the agreement between the parties concerned for such conversion or any lesser rate can be applied with a mutual agreement with the ECB lender.
 - ❑ The fair value of the equity shares to be issued shall be worked out with reference to the date of conversion only

Security of ECB

Sr. No	Parameters	Conditions
1	Allowability	AD Category I banks are permitted to allow creation/cancellation of charge on immovable assets, movable assets, financial securities and issue of corporate and/or personal guarantees in favour of overseas lender / security trustee
2	Conditions	<ol style="list-style-type: none">1. Underlying ECB is in compliance.2. there exists a security clause in the Loan Agreement3. No objection certificate from the existing lenders in India
3	Creation of Charge on Immovable Assets	<ol style="list-style-type: none">1. Such security subject to FEM (Acquisition and Transfer of Immovable Property in India) Regulations, 20172. Permission should not be construed as a permission to acquire immovable asset3. In case of enforcement property will have to be sold only to a person resident in India
4	Creation of Charge on movable Assets	<ol style="list-style-type: none">1. Movable asset can be taken over abroad subject to the outstanding claim against the ECB after obtaining NOC from domestic lender.

Security of ECB

Sr. No	Parameters	Conditions
5	Creation of Charge over Financial Securities	<ol style="list-style-type: none">1. Pledge of shares of borrowing company held by the promoters and other financial securities, viz. bonds and debentures in the name of borrowing company is also permitted.2. Security interest over all current and future loan assets and all current assets including cash and cash equivalents, including Rupee accounts of the borrower.3. Transfer of financial securities shall be in accordance with the extant FDI/FII policy including provisions relating to sectoral cap and pricing
6	Issue of Corporate or Personal Guarantee	<ol style="list-style-type: none">1. Board Resolution for the issue of corporate guarantee for the company issuing such guarantee .2. Specific requests from individuals to issue personal guarantee indicating details of the ECB should be obtained.

Eligibility- Entity recognised as a Startup by the Central Government as on date of raising ECB.

Amount - \$ 3 Mil or equivalent per financial year in INR/any convertible FCY or a combination of both.

Form-Loans or nonconvertible or optionally convertible or partially convertible preference shares.

Ratio – Liab/equity ratio not is not appl

Maturity -MATM – 3 years

All-in-cost Mutually agreed between the borrower and lender.

End Use-For any expenditure in connection with the business of borrower.

Startup- ECB

Currency and conversion Denominated in any freely convertible currency/INR or a combination thereof. (Hedging recommended but not mandatory)

Conversion of ECB into equity- freely permitted–rate as per date of agreement

Other provisions of ECB continue to apply and start-ups not eligible as above can choose **normal ECB route** as well. Start-up to have appropriate **risk management** policy for FX exposure arising from FCY ECB.

Security - movable, immovable, intangible assets(including patents, IPRs),financial securities , etc.

Issuance of corporate or personal **guarantee** is allowed. NR guarantee only if Eligible Lender as above. Banks /FIs/NBFCs cannot issue any guarantee, LoC, etc.

Trade Credits

Sr No.	Parameters	FCY Denominated TC	INR Denominated TC
1	Forms of TC	Buyers' Credit and Suppliers' Credit	
2	Eligible borrower	Person resident in India acting as an importer	
3	Amount under automatic route	a. Up to USD 150 million or equivalent per import transaction for oil/gas refining & marketing, airline and shipping companies b. For others, up to USD 50 million or equivalent per import transaction	
4	Recognised Lenders	a. For suppliers' credit: Supplier of goods located outside India. b. For buyers' credit: Banks, financial institutions, foreign equity holder(s) located outside India and financial institutions in IFSCs located in India.	
5	Period of TC	a. Reckoned from the date of shipment, shall be up to 3 years for import of capital goods b. For non-capital goods , this period shall be up to 1 year or the operating cycle whichever is less. c. For shipyards / shipbuilders, the period of TC for import of non-capital goods can be up to 3 years .	

Trade Credits

Sr No.	Parameters	FCY Denominated TC	INR Denominated TC
6	All-in-cost ceiling per annum	a. Benchmark Rate plus 350 bps spread: For existing TCs linked to LIBOR whose benchmarks are changed to ARR. b. Benchmark rate plus 300 bps spread: For new TCs	Benchmark rate plus 250 bps spread
7	Exchange rate	Change of currency of FCY TC into INR TC can be at the exchange rate prevailing on the date of the agreement between the parties concerned for such change or at an exchange rate, which is less than the rate prevailing on the date of agreement, if consented to by the TC lender.	For conversion to Rupee, exchange rate shall be the rate prevailing on the date of settlement.

Trade Credits – Structured Obligations

Sr No .	Parameters	FCY Denominated TC	INR Denominated TC
6	Change of currency of borrowing	Change of currency of TC from one freely convertible foreign currency to any other freely convertible foreign currency as well as to INR is freely permitted.	Change of currency from INR to any freely convertible foreign currency is not permitted.

Non-resident guarantee for domestic fund based and non-fund-based facilities

ALL IN-COST CEILING

FCY - ECB

- ❖ Benchmark rate plus 550 bps spread –For existing ECBs linked to LIBOR whose benchmarks are changed to ARR
- ❖ Benchmark rate plus 500 bps spread

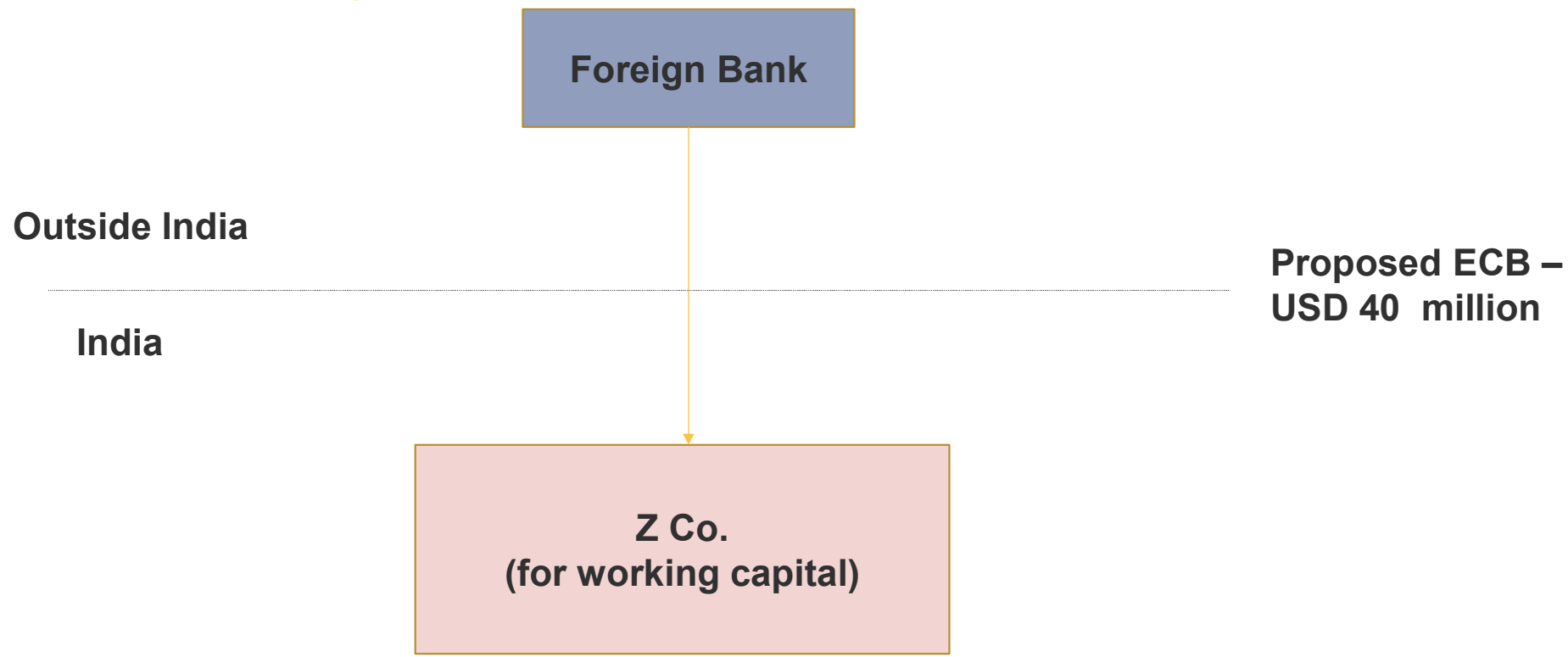
INR ECB

- ❖ Benchmark rate plus 450 bps spread

Others

- ❖ Prepayment charge/ Penal interest, if any, for default or breach of covenants, should not be more than 2 per cent over and above the contracted rate of interest on the outstanding principal amount and will be outside the all-in-cost ceiling

Case Study 1



Case Study 2

A Ltd.

Loan –USD50
million

Interest due

80%

USD 1 Million

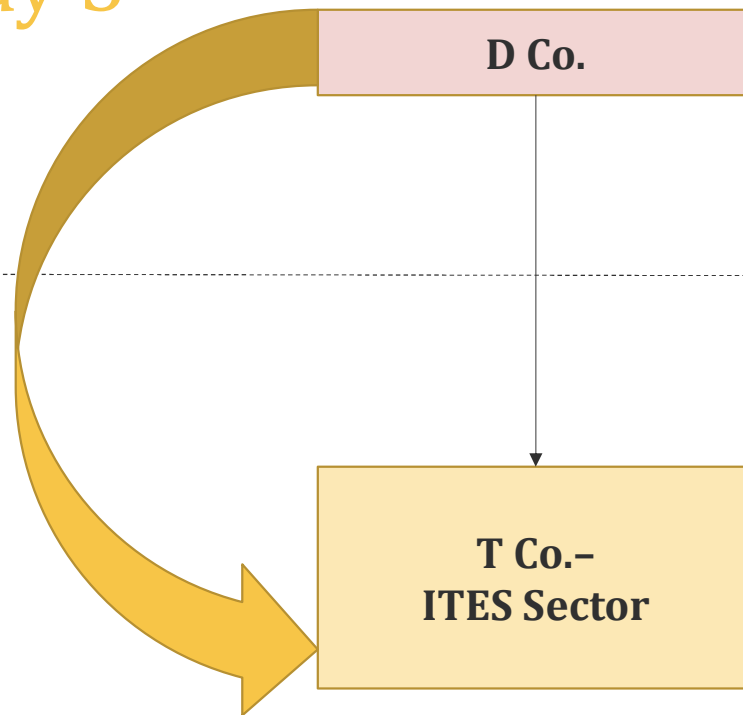
**T Co.–
ITES Sector**

- T Co. is eligible Borrower as per the ECB Guidelines
- A Ltd is Recognised lender as per ECB Guidelines
- A Ltd wants to convert the loan along with interest into equity

**Whether Conversion is permissible?
If T Co. wants to write off the interest amount, is it permissible?**

Case Study 3

T Co. wants to borrow from D Co. USD40 Million for general corporate purpose with the maturity period of 8 years with all-in cost 600 bps.



Outside India

India

Whether the above transaction is permissible?

Case Study 4

Bank

XYZ Private Limited
(Eligible Startup)

- XYZ Private Limited (recognized as Startup by Central Government) wants to borrow USD 2 million from foreign bank. The Equity of ABC Limited is USD 0.25million

Whether the above transaction is permissible?



Compounding cases- ECB

- Drawdown of ECB before obtaining Loan Registration Number (LRN)
 - ❖ Lakshmi Packtech India Private Limited
 - ❖ Marari Hideaways resorts and Travels Private limited
 - ❖ PI digital media Networks private limited
 - ❖ Athanese –Dx Private Limited
 - ❖ SNC Lavalin Engineering Private Limited



Compounding cases- ECB

Non-compliance with MAM as ECB guidelines

- ❖ Eastman Powerplant Engineering company Limited

Raising ECB without fulfilling eligible lender criteria

- ❖ Eastman Powerplant Engineering company Limited



Compounding cases- ECB

Availing ECB for end- use that was not permitted –

- ❖ Eastman Powerplant Engineering company Limited
- ❖ SNC Lavalin Engineering Private Limited



Compounding cases- ECB

Non-adherence to ECB reporting requirements –

- ❖ Eastman Powerplant Engineering company Limited
- ❖ Lakshmi Packtech India Private Limited
- ❖ Marari Hideaways resorts and Travels Private limited
- ❖ PI digital media Networks private limited
- ❖ Athanese –Dx Private Limited



Income Tax Cases

- ❖ **DCIT (International Taxation) Vs M/s. Cooperative Rabobank UA, ITA No.2260/Mum/2022 (Mumbai Tax Tribunal)**
- ❖ Interest income from ECB is to be taxed as per the provisions of DTAA and not as business profit
- ❖ This ruling has made a clear distinction on the taxability of interest income from ECBs under the specific Article on interest under the DTAA rather than the business profits. The Mumbai Tax Tribunal has opined that since there is a separate provision i.e., Article 11 for taxability of interest available under the DTAA, the taxpayer should get the benefit of the same.



Income Tax Cases

Hueco Electronics India (P) Limited , now known as Hitachi Automotive systems India P Limited vs DCIT, Pune 2020.

- ❖ Foreign exchange loss arising out of foreign exchange fluctuation in respect of loan in foreign currency used for acquiring fixed assets should be allowed as revenue expenditure by charging the same into Profit and Loss Account and not as capital expenditure by deducting the same from cost of respective fixed assets.



Checklist for ECB Audit as apart of FEMA review

- ❖ Obtain copies of following documents :
 1. Loan Agreement
 2. Form ECB / Form 83 and Loan Registration No. thereon
 3. Monthly ECB-2 Returns filed with AD
- ❖ Check whether the Company has obtained ECB as per prevailing ECB guidelines
- ❖ Check whether the draw-down and utilization has been made as per Form ECB filed
- ❖ In case of any modification, whether revised Form ECB has been filed
- ❖ Check monthly returns filed within 7 days from the end of the month



Comprehensive Checklist for reporting ECB

- ❖ Identify the purpose for which the ECB is taken.
- ❖ Determine the type of ECB, whether it is under the Automatic Route or Approval Route.
- ❖ Ensure that the ECB is taken from a recognized foreign lender.
- ❖ Ensure that the ECB is denominated in an acceptable currency.
- ❖ Ensure that the ECB guidelines structure the ECB.
- ❖ Obtain the necessary approval from the RBI if the ECB is under the Approval Route.
- ❖ Maintain proper documentation and records of the ECB.
- ❖ Ensure that the ECB is utilized for its purpose and by the ECB guidelines.
- ❖ Report the annual utilization of the ECB to the RBI.
- ❖ Repay the ECB in accordance with the repayment schedule.
- ❖ Report any default in repayment of the ECB to the RBI within 30 days.
- ❖ Report the pre-payment of the ECB to the RBI within 30 days.
- ❖ Report the closure of the ECB account to the RBI within 30 days.
- ❖ Report the ECB to the RBI within 60 days of its disbursal.
- ❖ Report any change in the terms and conditions of the ECB to the RBI within 30 days.



Professional Opportunities for CA's

- ECB agreement drafting
- Funding liasoning
- Obtaining LRN
- Monthly certifications for ECB
- Utilisation monitoring and management reporting
- ECB conversion to equity
- Valuation in case of conversions.