India Update: January - February, 2013

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Companies can merge with foreign firms via IDRs; RBI to issue norms

The government has allowed Indian companies to merge with firms overseas through the issue of Indian Depositary Receipts (IDRs) and the Reserve Bank of India has been asked to issue detailed guidelines on the process.

The Companies Bill 2012, which has been passed in the Lok Sabha, has permitted local firms to merge with foreign companies in "select jurisdictions". The shareholders of the merging company can be paid in cash or in IDRs or partly in cash or partly in IDRs. The move will facilitate cross border mergers, open options to restructure firms and overseas listing through reverse merger. A final approval will, however, depend on RBI guidelines and rules in foreign countries.

The Companies Act, 1956 allows only the merger of a foreign company into an Indian firm.

Why Singapore scores over India on settlement of corporate conflicts

When Telenor and Unitech had issues related to their partnership, they said they would hold formal talks in Singapore rather than in India. Most of the Videocon Group's contracts with Indian parties provide for arbitration in Singapore, and several recent shipping disputes involving Indian companies are being settled outside the country.

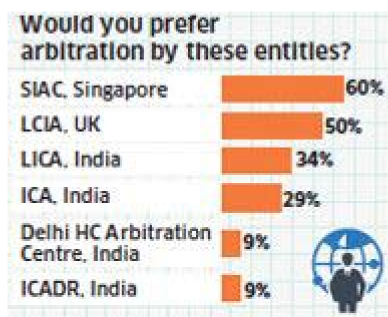
Companies in India, as elsewhere, prefer to resolve their commercial disputes outside courts, through independent third-parties and a process called arbitration. Arbitration is popular among companies as they do not want to enter into long-drawn litigation and also due to confidentiality issues. So does the government as India's courts are submerged under pending cases - about 32 million as of June 2011, according to a Supreme Court publication.

Nine years ago, crucial changes were suggested in the Indian Arbitration & Conciliation Act, 1996. In 2010, the law ministry released a consultation paper on the proposed amendments, but the changes are still on the drawing board.

The lack of legislative action has meant the interpretation of different clauses of the 1996 law has been left to the courts. Till September 2012, even after arbitration was held outside India, either of the parties could challenge it in India, defeating its intended purpose as the means of last resort.

It took a September 2012 Supreme Court verdict in a case between Bharat Aluminium Company Ltd (Balco) and Kaiser Aluminium Technical Service to clarify that the Indian Arbitration Act will not apply if arbitration proceedings are held outside India.

However, for every court decision that furthers the cause of arbitration, there is another that restores the status quo. An example is the Supreme Court ruling in the SBP versus Patel Engineering case on what should be done if one of the parties fails to nominate an arbitrator. The Arbitration Act says that the chief justice or an institution designated by it can appoint an arbitrator. The Supreme Court interpreted this to mean a Supreme Court or High Court judge, again defeating the purpose of keeping arbitration out of the courts.



Sebi proposes overhaul of share buyback guidelines

Companies planning share buybacks from public shareholders might have to comply with stricter rules if the proposals in a discussion paper by the

Securities and Exchange Board of India (Sebi) are implemented.

The capital market regulator, in a paper released today, has proposed a complete overhaul of share buybacks done through the open market route. In India, companies are allowed to buy back shares through the 'tender offer' and 'open market' routes, though a majority of the purchases are through the latter route.

According to the latest proposals, a company would have to purchase at least 50 per cent of the shares it planned to buy back. At present, there is no restriction on quantity.

While buybacks currently are open for a year, Sebi wants firms to complete their buyback offerings within three months.

PROPOSED FRAMEWORK

- **Minimum buyback** of 50% of proposed size
- **Completion** of buyback within three months
- **25% of buyback** amount to be kept in escrow account
- **If buyback** size is 15% or more of paid up capital & free reserves, tender route compulsory
- **No further** capital raising for two years after buyback
- **Stricter** disclosure norms
- **Separate window** for physical shares

Also, to ensure only 'serious players' launch share buybacks, Sebi wants 25 per cent of the maximum buyback amount proposed be kept in an escrow account upfront.

Further, listed companies launching buyback programmes might not be allowed to raise further capital for two years and could also face restrictions on off-market deals during buybacks.

Typically, a company announces buybacks to support its share price, boost its earnings ratios or to return surplus cash to its shareholders. Sebi believes past share buybacks have failed to meet these objectives.

A company would have to compulsorily take the tender offer route if its buyback offer size was more than 15 per cent of its paid-up capital and free reserves, the discussion paper said. Sebi said tender offer buybacks were more equitable way of distributing surplus funds, as shares were bought at a premium under this method.

Indian M&A activity up 12% in 2012

The value of announced mergers & acquisition (M&A) deals involving Indian companies stood at $43.4 billion last year, a 12 per cent rise compared to 2011. M&A volume in the quarter ended December stood at $17 billion, a rise of 99 per cent from the quarter ended September and a 362 per cent rise from the year-ago period. The average deal size for disclosed values rose to $91 million, compared with $76.6 million in 2011, according to a Thomson Reuters research report.

The volume of domestic M&As stood at $12.3 billion, up 69.4 per cent over the year-ago period - the highest annual volume since 2010 ($13.6 billion). Of this, the financial sector accounted for $3 billion, a rise of 54 per cent from 2011. The materials sector accounted for $1.9 billion (15.8 per cent market share), a 116 per cent rise over 2011. Total cross-border deals stood at $26.9 billion, a fall of 11.6 per cent compared to 2011, despite the 177 per cent sequential rise in deal value at $12.5 billion during the quarter ended December, from $4.5 billion in the previous quarter.

The volume of completed M&A deals involving Indian companies, however, declined 62 per cent to $18.3 billion compared to last year, the lowest annual volume since 2005, when it stood at $17.9 billion. Total inbound M&A activity for Brazil, Russia, India and China stood at $97.4 billion. India accounted for 15.7 per cent ($15.3 billion) of this. China's share stood at 36.9 per cent ($35.9 billion).

The materials sector dominated the industry breakdown, accounting for 22.8 per cent of India-involved acquisitions worth $9.9 billion, a 52 per cent rise from 2011. This was primarily driven by the merger of Sea Goa, a 55.1 per cent-owned unit of Vedanta Resources, with Sterile Industries (India) in a deal valued at $3.9 billion, the largest M&A deal involving India this year.

M&A activity targeting India slowed last year, with a deal value of $4 billion, a 22 per cent decline from 2011.

With a volume of $1.1 billion, the energy & power sector accounted for 28.8 per cent of private equity-backed M&A activity in India, a 92 per cent rise from the year-ago period. This was driven by the acquisition of Transocean's 38 water drilling rigs by the UAE's Shelf Drilling International Holdings, in a deal valued at $1.05 billion.

The acquisition of Indian companies by foreign firms slowed, with 307 announced deals worth $15.3 billion, down 23.8 per cent from 2011 and the lowest since 2009 ($7.4 billion).

Indian acquisitions abroad rose 12 per cent, with deal value at $11.6 billion, a 12 per cent rise over last year. In the quarter ended December, deal value jumped 442 per cent compared to the previous quarter and 376 per cent compared to the year-ago period.

The energy & power industry accounted for 43 per cent of India's outbound activity, with $5 billion worth of transactions, up eight times from 2011. This was driven by ONGC Videsh's announced stake acquisitions in Atyrau-based North Caspian Operating Co BV from ConocoPhillips. The deal also made Kazakhstan the most targeted nation for India's outbound activity in terms of deal value, with a 43 per cent market share. The US accounted for 15.5 per cent ($1.8 billion), recording the higher number of acquisitions from Indian acquirers.

M&M's defence JV rejected due to CBI case against Rafael

A six-year-old Central Bureau of Investigation (CBI) case against Israeli defence company Rafael Advanced Defence Systems Ltd for alleged graft in the Rs. 1,150-crore[1] Barak missile deal has torpedoed Mahindra & Mahindra's (M&M) defence sector plans.

The Foreign Investment Promotion Board (FIPB) has rejected the proposal of M&M to form a 74:26 joint venture (JV) with Rafael Advanced Defence Systems. The JV was to develop naval system products.

FIPB's decision came after the ministry of home affairs (MHA) decided not to give security clearance for the proposed alliance for manufacturing a range of defence-related products in the country.

The MHA came to this conclusion after it got inputs from the investigating agencies. The CBI had registered a case on October 9, 2006 on the allegation that commission was paid in the procurement of Barak missiles. Investigations revealed that Rafael, allegedly with its sister concern IAI Israel, had paid bribes to Indian defence officials through middlemen.

M&M already operates a JV with BAE Systems for the manufacture of defence land systems products and has received FIPB approval for a JV with Telephonics Corporation for the development and manufacture of defence radar systems and other defence electronic systems.

ECB norms for infrastructure finance firms relaxed

The Reserve Bank of India (RBI) has relaxed external commercial borrowing (ECB) norms for infrastructure finance companies by allowing them to avail of the overseas borrowings up to 75 per cent of their net worth without its approval, up from 50 per cent earlier.

Indian companies raised $1.34 billion (Rs 7,400 crore today) through ECB and foreign currency convertible bonds (FCCB) in November to fund modernisation, foreign acquisitions, import of capital goods and onward lending.

Of the total amount raised in November, $1.10 billion was via the automatic route, while $240 million was raised through the approval route, which requires case-by-case approval from RBI.

FCCBs are a type of bonds that can be converted into equity at maturity.

RBI has been easing the ECB norms with a view to channelising more external funds to the infrastructure sector. In 2011-12, the annual limit for ECBs under the automatic route was enhanced for companies in the manufacturing, infrastructure, services sectors and NGOs engaged in microfinance activities. Microfinance institutions were also permitted to raise ECBs for onward lending to microfinance activities. In addition, eligible borrowers were permitted to avail of ECBs designated in Indian rupee from foreign equity holders.

[1] *1 crore = 10,000,000*

India-Mauritius trade pact put on hold

India has decided to formally suspend negotiations to finalise a trade liberalisation pact with Mauritius. It has cautioned Mauritius the negotiations will not resume till the island nation expedites revision of its double-taxation avoidance agreement (DTAA) with India.

The two sides have failed to amend DTAA due to differences over capital gains tax, especially the definition of 'enterprise' and the treatment of 'shell companies'.

However, Mauritius has been insisting on separating the two issues — of trade liberalisation through the comprehensive economic cooperation and partnership agreement (CECPA); and revision in DTAA. Mauritius is also keen to act to position itself as a preferred route for channelling outward Indian FDI to Africa.

IN LIMBO
India's point Negotiations on CECPA won't resume till Mauritius expedites DTAA revision because the pact would entail monetary concessions to Mauritius, impacting the talks of modifying DTAA
Mauritius' point Extremely eager to sign CECPA; wants trade liberalisation through CECPA and revision of DTAA separated
Sticky point DTAA revision held up due to differences over capital gains tax, especially the definition of 'enterprise', treatment of 'shell companies'
INVESTMENT OVERVIEW
$71 billion FDI from Mauritius to India from Apr 2000 to Oct 2012, the most from any country
$9.942 billion FDI from Mauritius in 2011-12, 27.25 per cent of India's total FDI inflows

The revision of India-Mauritius DTAA is a long-pending issue between the two countries. Article 13 on 'capital gains' of the India-Mauritius DTAA provides for taxation of capital gains only in the country of residence of the investor. The Indian side proposed to amend the treaty to provide source-based taxation of such capital gains (in this case, India) to plug the misuse of the treaty by shell companies formed by third countries' corporate entities.

The Mauritius government issues tax residency certificate (TRC) to companies investing from that country into India and those companies could take the benefit of the treaty — by not paying capital gains tax in India. But, India alleges shell companies in Mauritius have mushroomed because of leniency in issuing these TRCs.

GAAR deferred by 2 years

In a breather to foreign investors, especially those coming via Mauritius, the government has deferred the General Anti-Avoidance Rules (GAAR) by two years, making the norms effective from the 2016-17 assessment year. The Parthasarathi Shome committee had recommended that GAAR be pushed three years further. All other major recommendations of the panel were accepted, with some deviations.

WHEN WOULD GAAR APPLY?

If investment date is…	and transaction date is…	GAAR would…
Before Aug 30, 2010	Before Apr 1, 2016	Not apply
Before Aug 30, 2010	After Apr 1, 2016	Not apply
After Aug 30, 2010	Before Apr 1, 2016	Not apply
After Aug 30, 2010	After Apr 1, 2016	Apply
After Apr 1, 2016	After Apr 1, 2016	Apply

The modified GAAR provisions say an arrangement, the main purpose of which is to obtain tax benefit, would be considered impermissible. The earlier provisions considered impermissible an arrangement "one of the main purposes" of which was tax benefit. It would apply when the tax benefit in an arrangement is more than Rs 3 crore.

Also, GAAR would not apply on non-resident foreign institutional investors and those who don't take tax benefit under a treaty. This means investors availing of benefits under Section 90 or 90A of the I-T Act (which provides relief from double taxation under a treaty) would be covered under GAAR. But those investing in stock markets through instruments like participatory notes would be out of the ambit.

Besides a two-year postponement instead of three, the ministry deviated from the Shome panel recommendations on two other key counts. The panel headed by Shome, now an advisor to the finance minister, had suggested all investments before the commencement of GAAR be grandfathered. But the ministry has chosen the date of August 30, 2010. Second, the committee had said the approving panel's recommendations should be binding on the tax department. But the ministry has said it should be binding on both the assessee and tax department.

Investments made before August 30, 2010 — the day the Direct Taxes Code was introduced in Parliament — will not be taxed, even if the profits are made after April 2016. GAAR will apply on an income after the assessment year beginning April 1, 2016, on investments made after August 2010.

It is expected that GAAR would not override the Mauritius treaty, going by Shome panel's recommendations, because of the validity of tax residency certificates. Shome panel had said where Circular 789 of 2000 with respect to Mauritius was applicable, GAAR provisions should not apply. Where GAAR and the Specific Anti-Avoidance Rules (SAAR) with Singapore are both in force, only one would apply to a given case.

AN IMPROVED GAAR
MAIN PURPOSE: GAAR would be invoked only if the main purpose of an arrangement is to obtain tax benefit
DEFERRAL: Gives businesses an opportunity to review their current investment and operating structures
GRANDFATHERING: Relief to investors who made investments using the regulations prevailing before Aug 30, 2010
GAAR-SAAR TOGETHER: Shome panel suggestion that GAAR should not be invoked where SAAR applies not followed
TREATY PROTECTION: GAAR not to apply on FIIs not claiming treaty protection; no clarity on applicability on entities claiming it

RBI introduces $-Re swap

To enhance flow of credit to the export sector, the Reserve Bank of India (RBI) has introduced a dollar-rupee swap facility to support incremental pre-shipment export credit in foreign currency (PCFC) by banks.

Banks will have the option to access rupee refinance to the extent of the swap with RBI under a special export credit refinance facility.

The facility will be available to banks from January 21 till June 28, 2013, for a fixed tenor of three or six months.

The limits would be communicated to eligible individual banks separately. The limits would be reviewed periodically, based on actual utilisation and other relevant factors. The overall cap for the banking system works out to $6.5 billion.

Under the swap arrangement, a bank can buy US dollars up to its eligible swap limit from RBI and simultaneously sell the same amount of dollars forward as per the term of the swap, at the prevailing market rates for swaps of similar tenor. At the end of the swap term, the bank will exchange with RBI, the dollars against the rupees, the release added.

The facility will be operationalised by RBI's financial markets department.

Depending on the market conditions, the central bank would decide the number of banks that can avail of the facility, the maximum amount of swap that RBI would undertake with banks and the maximum quantum each bank can do on a particular day.

FSSAI extends deadline for licensing, registration of restaurants

The Food Safety and Standards Authority of India (FSSAI) has further extended the licensing and registration deadline for food business operators (FBOs) to February 4, 2014. This is the third time

the country's apex food regulator has granted an extension to FBOs.
Even after a one-and-a-half-year time frame, which included a six-month extension, FSSAI was able to register 11 lakh[2] out of the country's 5 crore FBOs and gave licence to only 3 lakh FBOs so far against the target of 50 lakh. Even though FSSAI was not in favour of extending the deadline, the pressure from the health ministry compelled it to extend the deadline for registration and licensing for one more year.

The first deadline to obtain licensing and registration was extended from August 4, 2012, to February 4, 2013, under the Food Safety and Standards Authority of India (FSSAI) and now the deadline has been extended to February 4, 2014.

As per the new rules, anybody who was engaged in selling anything edible – roadside tea stalls, dhabas, fruit and vegetable hawkers, grocery shops, milk vendors, canteens, caterers, restaurants, hotels and food processors failing to get licence or register by February 4, 2013, were to be penalised by the food regulator.

One of the objectives of enforcement is to ensure that registration/licensing provisions are fulfilled and food items are hygienic, wholesome and free of contaminants.

Indian IT companies will continue to get tax benefits

The finance ministry has said software development at client locations and deployment of personnel abroad by Indian IT companies such as Infosys, Wipro, and TCS will continue to get tax exemptions.

The Central Board of Direct Taxes said 'onsite' work at client locations by software firms would be treated as deemed exports, making them eligible for tax benefits. It also said deployment of manpower abroad and transfer of a software unit from one special economic zone to another would not impact these concessions.

The clarifications are based on the recommendations of a panel headed by former CBDT Chairman N Rangachary, set up by Prime Minister Manmohan Singh following representations from industry.

Software companies enjoy tax exemptions under special economic zone scheme and software technology park scheme, but disputes arose between the industry and the tax department after exemptions available on export of software services were denied on various grounds.

Different interpretations of existing laws gave rise to disputes and litigation.

It has been clarified that tax benefits would not be denied merely on the grounds that a separate and specific master service agreement, which firms enter into with their clients for specific works, does not exist.

Exemptions will not be denied to a unit in case it changes hands from one owner to another. CBDT has also done away with the requirement to maintain separate books of accounts for units enjoying tax exemptions under different schemes. Research and development activities embedded in engineering and design will be covered under computer software and enjoy tax benefits.

Traders get Supreme Court notice on imported Samsung goods

The Supreme Court has issued notices on a complaint filed by South Korea's Samsung Electronics against the sale of imported Samsung-branded products without its authorisation, an issue which has major implications for trade and business in the country.

The company claimed that such sales by traders was an infringement of its trademark, whereas local traders claimed they were within their rights to sell goods legally bought abroad and imported into India.

A three-judge bench, led by Chief Justice Altamas Kabir, had issued the notices. Samsung had earlier sought an order from a lower court seeking an injunction restraining the traders from infringing and diluting its trademarks, but failed. The Delhi High Court had on October 3, 2012, ruled that local traders can import goods bearing a registered trademark into India and sell it further without any authorisation from the registered proprietor. It held that such sales were legal under the Trade Marks Act, 1999.

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[2] *1 lakh = 100,000*

But the company claimed that the High Court had erroneously interpreted the provisions of the 1999 Act. In its appeal, the company claimed that the court had failed to distinguish between domestic and overseas markets and that it had wrongly applied the principle of international exhaustion to the Indian market.

Under this principle, where parallel imports are legal, it becomes "extremely easy for counterfeiters to mix non-genuine goods with parallel imports and introduce them into the commercial stream in India". This principle, the company claimed, will also cut into domestic sales of the trademark proprietor, not only adversely affecting authorised channels of trade but also reducing its incentive to further invest in the market. It will also have the adverse effect of causing a loss to the economy and hamper employment opportunities that can be created for the local populace.

Moody's maintains stable outlook on India's sovereign ratings

Unlike the views held by two of its peers — Standard & Poor's and Fitch — Moody's Investors Service has retained stable outlook on India's sovereign ratings, at Baa3, the lowest level in investment grade. It has, however, said government finances are the "weakest aspect of India's macroeconomic profile".

"The stable outlook on India's rating balances Moody's assessment of its credit strengths and weaknesses, relative to other rated sovereigns," the agency said in its latest credit analysis on India.

Earlier, S&P and Fitch had also given India Baa3 ratings, but later downgraded the outlook on these ratings, indicating there were chances of downgrade of these ratings to junk.

Moody's counted India's potential GDP growth, robust savings rate and a dynamic private sector as strengths, and high fiscal deficit, debt ratios and supply constraints in the form of infrastructure, policy and administrative inefficiencies as constraints on the credit profile.

On institutional strengths, Moody's included long tradition of checks and balances between the legislature, the judiciary and the executive.

However, it cautioned against slow policy-making and implementation, besides corruption. On its assessment of the government finances as the weakest aspect of credit profile, the agency said it was based on high debt ratios and fiscal deficits.

Regulator sets deadline for drug launches

Pharmaceutical companies will have to launch drugs within six months of getting approval from the drug regulator, failing which they could lose their manufacturing licence. The Drugs Controller General of India (DCGI) recently issued a notice mandating companies to introduce their products in the market within the specified period to ensure safety and efficacy.

According to the Drugs and Cosmetics Act, for any new drug, pharmaceutical firms should file a periodic safety update report (PSUR) every six months, for the first two years, after getting approval from the DCGI. For the subsequent two years, PSUR needs to be filed annually. This enables authorities to monitor the safety and efficacy of a new drug in a post-marketing scenario for four years, after which it no longer remains a new drug.

It has been observed some manufacturers do not launch the product even after years of getting approval from this office and the manufacturers do not submit the required PSUR, while the drug does not remain a new drug after a period of four years. Therefore, the assessment of safety and efficacy of such a new drug in a post-marketing scenario remains incomplete. Hence, the DCGI has written to state drug controllers asking them to cancel permission to manufacture such drugs in case the company fails to bring the medicine to market in time.

It has been decided in public interest that in case an applicant/manufacturer fails to launch the product for marketing in the country within a

period of six months from obtaining the permission or license, the permission/licence will be treated as cancelled.
In case of new drugs, pharmaceutical companies are mandatorily required to seek a manufacturing licence from the DCGI. Based on that, it gets separate permission from state drug controllers as well. However, once the drug completes four years, permission can be sought directly from the state controller.

To bypass post-marketing surveillance of their products, companies sometimes delay the launch and introduce the drug only after completing four years. The latest move appears to be to close this loophole by making it mandatory for companies to launch their medicines within six months of getting approval..

Revised IKEA proposal gets FIPB approval

The Foreign Investment Promotion Board (FIPB) has given its nod to Swedish home furnishings retailer IKEA's revised Rs. 10,500 crore investment proposal that will allow the company to set up retail stores along with its cafes in India and also sell more categories of products.

FIPB had cleared IKEA's proposal last year but disallowed it from selling many items such as home and office-use products, textiles, apparel and fabric, and also said the company could not set up cafes in the stores. The company had subsequently approached the Department of Industrial Policy and Promotion (DIPP) requesting a review of the FIPB decision.

The company's proposal has been cleared and it can sell 18 product categories compared to 15 categories approved earlier. The company wanted to retail 29 product categories but those contained many duplications that FIPB has removed.

The proposal has been sent to Cabinet Committee on Economic Affairs for final endorsement as the FIPB can clear investments of up to Rs. 1,200 crore only.

First rail freight corridor contract to Tata JV

After a delay of around two years, the Dedicated Freight Corridor Corporation of India Ltd (DFCC) has awarded its first major contract, of about Rs 3,300 crore, to a Tata–Aldesa joint venture (JV) for construction of a 343-km double track line between Bhaupur (Kanpur) and Khurja.
The World Bank has funded $975 million (Rs 5,250 crore) for this stretch, a design-build lumpsum contract requiring implementation within four years.

Morgan Stanley to exit India banking on stricter rules

Morgan Stanley has chosen to surrender its banking licence in India. The decision is driven by a reassessment of business strategy in the face of new regulations and stringent capital rules.

Morgan Stanley, will, however, continue to run its investment bank in India and stay registered as a non-banking finance company with the Reserve Bank of India (RBI).

Morgan Stanley and received its licence to set up a bank in March 2012 received the licence to set up a bank but is now planning to let the licence lapse as it does not want to tie up capital and other resources on account of a review of its strategy.

A banking licence issued by RBI lapses if not used for a year. In the past, a few foreign banks have requested the regulator for an extension to keep licences valid. But Morgan Stanley has decided not to apply for an extension.

Gap readies plans to open stores in India next year

Gap Inc, the largest casual wear retailer in the United States, is readying plans to open stores in India sometime next year, making it one of the highest profile global brands to set up shop in the country after it threw open the single-brand sector to foreign firms

Gap's entry plans into India come at a time its Swedish rival H&M is in the process of filing for government approval to start a fully-owned subsidiary in the country. The two, however, trail Spain's Zara, which has been operating in the country since 2010.

After six years of restricting foreign ownership in single-brand retail companies to 51%, India removed this sectoral cap in January 2012 and allowed global firms such as IKEA and Zara, which sell a variety of products under a single label, to set up fully-owned companies in India. The original policy change came with a requirement of 30% local sourcing, but the government last September diluted that condition after overseas firms raised concerns that it was not feasible.

More than one dozen single brand retailers are said to be sizing up the Indian market for entry, many of them in various stages of researching, partner scouting or filing for government approvals. Some of these include shoemaker Sketchers, French apparel retailer Celio, luxury brand Prada and Japanese fashion brand Uniqlo.

The recent approval for Sweden's IKEA Group, widely viewed as a test case of government intentions, will encourage more single-brand retailers to India's promising retail market.

Tribunal's transfer pricing blow for MNCs

A special bench of the Income Tax Appellate Tribunal (ITAT) has ruled that a significant portion of advertising, marketing and promotional (AMP) expenses incurred by their Indian arms to promote the brand and trademarks of the MNC will be taxable in India.

In a majority decision, the bench ruled in favour of the tax department that the taxpayer incurring AMP expenses in excess of amounts spent by comparable companies ought to have been compensated for creation or enhancement of such brand by its associated enterprise (AE), which owns the brand. The decision will be binding on other division benches of the tribunal unless overruled by a high court. The tribunal invoked the retrospective amendment to Section 92CA(2B) inserted by the Finance Act, 2012, effective from June 1, 2002, which grants powers to the transfer pricing officer to look into the transactions that are not reported by the taxpayer and which come to his notice during the course of assessment proceedings. It also upheld the usage of the Bright Line test, which uses the expenses incurred by comparable companies, to decide arms' length pricing.

The ruling came on an appeal by LG Electronics, which faced transfer pricing adjustments of Rs 162 crore for assessment year 2007-08. However, 14 other Indian arms of MNCs also argued as "interveners" against the decision of the transfer pricing officer, which was earlier upheld by a dispute resolution panel. Pepsi Foods, Maruti Suzuki, GlaxoSmithKline, Goodyear India, Bausch & Lomb, Amadeus, Canon, Fujifilm, Star India, Sony, Haier Telecom, Haier Appliances, LVMH Watch and Jewellery and Daikin also faced transfer pricing adjustments on excessive AMP.

CALL FOR ADJUSTMENTS

- I-T dept had raised adjustments of Rs 161 cr on LG's brand building exercise
- 15 MNCs, including LG, were fighting the I-T dept in the case
- Invokes retrospective amendments to uphold transfer pricing officer's powers
- Approves usage of Bright Line test
- Decision binding on other tribunals

Key elements in Bright Line test

- Identifying proper comparables
- Whether the brand is an established one or new
- Understanding the market place, consumer preferences and taxpayer business plans
- Characterisation of the taxpayer - whether entrepreneur, licensee or distributor
- The profit margin earned by the taxpayer against that of comparables

In the LG Electronics case, the transfer pricing officer observed that the assessee's AMP expenses were 3.85 per cent of sales at Rs 6,553.36 crore.

The officer considered similar expenses incurred by Videocon Appliances (0.12 per cent) and Whirlpool of India (2.66 per cent) and computed their arithmetic mean at 1.39 per cent. It was opined that the assessee was promoting LG brand owned by its foreign AE and hence, should have been adequately compensated by the foreign AE.

Applying the Bright Line test, the transfer pricing officer held that expenses up to 1.39 per cent of sales should be considered as having been incurred for the assessee's own business and the remaining, at 2.46 per cent (3.85 per cent-1.39 per cent) on brand promotion of the foreign AE. Such excess at Rs 161.22 crore was proposed as a transfer pricing adjustment on account of AMP expenses for brand building. According to the tribunal, incurring proportionately higher AMP expenses coupled with the advertisement of brand or logo of the AE, gives inference of the existence of some informal or implied agreement. Also, the fact that the taxpayer's marketing strategy was under the directions, guidance and control of the parent implied that it had full control over the AMP expenses of the taxpayer. The tribunal thus, held that there is a transaction between the taxpayer and the AE under which the taxpayer incurred AMP expenses towards promotion of brand, which is legally owned by the AE.

Brookings set to open its centre in India

Brookings Institution, a non-profit public policy organisation based in Washington DC, announced it would open Brookings India as a platform for public policy research and analysis.

The Brookings' India centre will analyse the opportunities and challenges facing India. The operational activities and the funding of Brookings India will be primarily by Indians.

Brookings decided to open a centre here because India is the largest democracy and one of the fastest growing economies in the world.

Vikram Singh Mehta, former chairman of the Shell group of companies, will be the chairman of Brookings India. Mehta began his career with the IAS in 1978 and had earlier worked with Philips Petroleum and Oil India Limited.

Brookings India's research will focus on domestic and global economics, foreign policy, and energy and infrastructure policy.

Government drops contentious asset classification clause

The government has dropped the contentious clause of treating a borrower's accounts with all banks as non-performing if the accountholder is defaulting on repayment to one bank.

The clause, which contrasted with existing norms, was part of the finance ministry's proposed guidelines for a joint lending mechanism for corporate debt.

Under a joint lending agreement (JLA), state-run banks will lend in a consortium to borrowers seeking credit over Rs. 150 crore by way of a term loan, working capital and non-fund-based facilities. It will be mandatory for banks to bring all exposures of a borrower under the JLA within six months of its implementation. The government hopes that the arrangement, designed to insulate state-run banks from sticky loans, will stop borrowers from seeking multiple loans from different banks against inadequate collaterals.

As per the Reserve Bank's guidelines, if a borrower's account turns non-performing with one bank, it does not affect the status of the borrower's accounts with other lenders.

New Companies Bill fuels royalty rush

The proposed changes in the Companies Bill, 2012 has led to a rush among companies to increase royalty payments to their foreign parents. Under the new Bill, if approved, promoters will have to take approval of 75 per cent of the non-promoter shareholders on any such proposal. The new regulations will make it harder for the promoters to charge such fees from the company as royalty payments or technology transfer fee.

Recent examples of companies that have planned to raise royalty fee to their parent are Gujarat Ambuja, ACC and Hindustan Unilever Ltd (HUL). Gujarat Ambuja and ACC will pay one per cent royalty against the current 0.5 per cent to Swiss cement major Holcim for providing technical know-how. HUL has more than doubled the royalty to the Anglo–Dutch multinational consumer goods parent, Unilever, to 3.5 per cent.

The new Companies Bill, passed by the Lok Sabha and pending approval of the Rajya Sabha, has tightened the norms for related party transactions, such as introducing the requirement of a special resolution to be passed in favour of the transaction by shareholders. If the resolution pertains to a transaction with a shareholder, such entity or entities with an interest in the outcome have to abstain from voting. Effectively, it means that issues such as royalty payments cannot be decided by a resolution passed with the support of promoters alone and companies will require majority consent from minority stakeholders too.

While this proposal empowers shareholders, an exception has been carved out. If the transaction is in the ordinary course of the business and is at an arm's length, no such resolution is required. The term 'arm's length' has been defined in the Bill to mean a transaction between related parties, conducted as if they were unrelated so that there is no conflict of interest.

Cigarette packs may show nicotine levels

The Food Safety and Standards Authority of India (FSSAI) has proposed to make it mandatory for companies to specify the amount of nicotine and tar on cigarette packs.

The Cigarettes and Other Tobacco Products Act 2003, which regulates trade as well as advertisement of cigarettes and other tobacco-related products, has a provision for declaration of cigarette contents. However, owing to the lack of research laboratories, the government hadn't notified the rule. This anomaly will now be corrected. Six tobacco research laboratories are being set up in Chandigarh, Gujarat, Noida, Ghaziabad, Chennai and Kolkata with the help of World Health Organization.

Listed companies must now seek Sebi approval for all M&A deals

Companies traded on stock exchanges will now need the clearance of the capital market regulator Sebi for all merger, demerger and amalgamation deals. Till now, companies could execute these strategies by obtaining the approval of a high court and no-objection certificate from exchanges.

The regulator believes that many complex merger and demerger transactions that are not in the best interest of minority shareholders are being pushed through by company managements and promoters.

In overhauling the merger-demerger rules, Sebi has directed listed companies to obtain shareholders' approval through postal ballot and e-voting on a special resolution proposed to ratify the transaction. Companies will also have to ensure that they receive the approval from at least two-thirds of minority shareholders.

Sebi has also made it mandatory for companies to disclose the scheme valuation report obtained from independent chartered accountant, fairness opinion's observation on the scheme for public scrutiny for 21 days.

No written approval needed for linear projects now

The environment ministry will exempt roads, canals, pipelines, optical fibre and transmission lines from the mandatory requirement of obtaining the written consent of gram sabhas, or village council under the Forest Rights Act, subject to forest rights being vested.

The ministry is amending the August 2009 order that made it mandatory for the state government to provide written consent from the project-affected gram sabhas that all claims under the Forest Rights Act had been settled and that they approved of the diversion of forest land before it could permit the diversion of forestland.

This move is likely to reduce time required for clearing linear projects. Projects which do not require vast amount of land but go through several gram sabhas, were being held up as getting consent from every single gram sabha along the route was proving to be difficult.

Simpler forest approval norms for mining

The environment ministry has changed forest clearance norms for mining projects to make them simpler and discourage firms from acquiring excess land. In an order issued recently, the ministry said mine developers would have to seek forest clearance for the entire lease area instead of the current practice of seeking nod in phases.

This requires them to seek clearances several times as and when they expand the mining area.

For the government, it would mean getting the net present value of the full forest area required for the mining lease, and the compensatory afforestation for the diversion, instead of the present piecemeal system.

As of now, the environment ministry has no idea how much of the forest land, for which no clearance has been sought or granted, is being held by mining companies. The ministry has asked states to provide details, within three months, of all mines where the developers has sought clearance for only a part of leased forest area. In these cases, clearance for the balance area will have to be obtained within two years. Failure to get the clearance within this period would result in reworking the lease to the area for which clearance has already been granted.

For existing mines, which do not have forest clearance for the entire mining lease area, the ministry said environmental clearance would be considered for the non-forest area and the forest area within the mining lease for which forest clearance is available. Mining in the balance area of the lease will not be permitted. At the end of the two year period, given to developers of existing mines to obtain forest clearance for the entire lease areas, the mines' environmental clearance will be reworked according to the revised mining lease area.

I-T dept to simplify norms on ECB interest payment

The Income Tax (I-T) Department is looking at ways to relax and simplify the rules on tax collection and credit associated with foreign investments into the country, especially via external commercial borrowing (ECB).

Concern has been raised on the method of identification for providing tax credit and the requirement of a permanent account number (PAN) for deduction of withholding tax. Industry had raised these two issues before a Central Board of Direct Taxes committee looking into the matter. The panel is to soon give its report to the ministry and is expected to suggest simpler norms.

The PAN requirement for a lower withholding tax on ECB interest payments was seen as a major trouble area. From April 1, 2010, under Section 206A of the I-T Act, any person entitled to receive a sum or income or amount on which tax is deductible in these cases is required to furnish his PAN to the person responsible for deducting such tax. If the PAN isn't there, tax has to be deducted at 20 per cent.

The Finance Act, 2012, introduced Section 194LC in the I-T Act, providing for a lower withholding tax at five per cent on interest payments by Indian companies on borrowings made in foreign currency by such companies from a source outside India.

With some foreign companies reluctant to get into the process of getting a PAN, this differential treatment was proving an irritant. A possible compromise could be for the government to take the PAN of the aggregator or the custodian through which investments were coming, instead of taking the PAN of individual investors. Further, the department could exempt listed instruments from the PAN requirement for a lower withholding tax. Besides resolution of this issue, the department is also likely to simplify other verification requirements in the case of foreign investments for availing tax credits, said the official.

Connaught Place world's fourth most expensive office location

New Delhi's Connaught Place (CP) has emerged as the world's fourth most expensive office location in 2012, moving up by a notch, in a global study conducted by Cushman & Wakefield. West End Area (London) tops the list, followed by Central Business District (CBD) in Hong Kong and Zona Sul (Rio de Janeiro, Brazil).

London and Hong Kong swapped positions in 2012, as they had occupied the second and first slot, respectively, in 2011. Rio de Janeiro displaced Tokyo's CBD to the fifth position and occupied the third position in 2012.

"India's corporate office space has been limited, with the majority of development being in the information technology/enabled services space. Therefore, locations that offer corporate office space such as CBD, off-CBD, and select micro markets in the suburban districts have witnessed high rental values. Demand for corporate office locations have remained buoyant, especially from sectors such as banking, financial services and insurance (BFSI), engineering and consulting firms, media and entertainment, amongst others leading to an increase in rental values for these locations," said Cushman & Wakefield's report.

CP registered a growth of 25 per cent in rental values over the previous year. Because of its proximity to establishments including government organisations, trading centres and retail location, demand for quality office space has been high in the area. It is also a top priority for sectors such as BFSI, consulting, trade and media. The fresh supply in CP has come up owing to redevelopments and renovations of existing buildings, which have been commanding a premium and becoming instrumental in pushing average rental values upwards.

In the Asia-Pacific, New Delhi, Chennai and Bangalore occupied second, third and fifth slot for cities with largest rental growth. CP recorded a rental growth of 25 per cent with $162 sq. ft per year, CBD in Chennai recorded a growth of 13 per cent with $27 sq ft per year and CBD in Bangalore a growth of eight per cent $35 sq ft per year. The first slot was occupied by CBD in Jakarta, Indonesia, with a rental growth of 46 per cent at $55 sq ft per year, while the fourth slot was taken by Futian Shenzhen (China) with a rental growth of 11 per cent at $60 sq ft per year.

Government clears road to amending Minimum Wages Act

The government has cleared a proposal to make the minimum wages announced by the Centre for workers in the unorganised sector statutory for all states, so as to bring parity in wages paid.

At present, the national floor level minimum wage is Rs 115 a day but since it is not binding on state governments and employers, the Centre merely advises the states to raise wages so that these are at par with the national floor. The Union Cabinet has cleared the proposal to bring in amendment to the Minimum Wages Act, 1948, for incorporating the statutory provision. Currently, 15 states were paying workers less than the national floor level minimum wage.

Assam, Uttar Pradesh, Maharashtra, Tamil Nadu, Orissa and Chhattisgarh are among the states where the minimum wages paid are less than national floor level minimum wages.

RBI welcomes new banks, with caution

The Reserve Bank of India has spelt out norms for new bank licences, allowing business houses, state-run enterprises and non-banking finance companies to set up banks, in a bid to extend banking services to half of the population that is excluded from them.

The final rules allow companies from any sector to apply for new bank licences, dropping language in earlier drafts that would have kept out brokers and those in the real estate business. Though these changes are in line with the views of the finance ministry, which had batted for brokers and realtors, the new guidelines contain enough subjectivity for RBI to reject applications from those it deems unsuitable for the banking business.

RBI will issue licences only to persons deemed to be 'fit and proper', and will seek feedback on applicants from various investigative agencies such as CBI, ED and I-T Department before granting a licence. Further, RBI has empowered itself to reject those whose "business model" and "culture" are not in line with banking.

As per the guidelines, 'Promoter Groups' business model and business culture should not be misaligned with the banking model, and their business should not potentially put the bank and the banking system at risk on account of group activities such as those which are speculative in nature or subject to high asset price volatility.

Rs. 500 crore has been prescribed as the minimum equity capital.

The aggregate non-resident shareholding from FDI, NRIs and FIIs in the new private sector banks is being capped at 49% of the bank for the first five years, even though current norms permit as high as 74%. Applicants will have to furnish business plans when they apply for a licence, which will explain how it plans to achieve financial inclusion that has proved difficult for even state-run banks after more than four decades of nationalisation. The guidelines also require applicants to have run successful business operations for a decade in order to be eligible for a new licence. There are also elaborate rules restricting transactions between banks and promoter group companies.

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Chadha & Co. is a law firm based in New Delhi, India, with a strong Corporate and Commercial practice. The Firm has a specialized inbound practice in advising domestic and foreign corporations doing business in India on all Indian laws and regulations that are relevant to their business.

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