India Update: July – August 2010

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HSBC to buy RBS' India banking unit

Hongkong and Shanghai Banking Corporation (HSBC) has agreed to acquire The Royal Bank of Scotland (RBS) Group Plc's retail and commercial banking businesses in India for a premium of up to $95 million (Rs 446.50 crore[1], at today's rates) over the net asset value. The acquisition, which is subject to regulatory approvals, is expected to be completed in the first half of 2011.

According to the terms of the agreement, 90 per cent of any credit losses incurred on RBS' unsecured lending portfolio in the two years subsequent to the deal's completion will be deducted from the $95-million premium to be paid over the tangible net asset value of the businesses.

In connection with seeking the required regulatory approvals, HSBC will apply to the Reserve Bank of India (RBI) for the branch licences required to support the acquired businesses. Since foreign banks in India operate as branches of their overseas parents, it is not clear whether RBI would deem the sale of RBS' retail and SME businesses as a bank sale that would entail a branch licence transfer, or a portfolio sale. However, the bank expects to receive a substantial number, if not all, of RBS' branch licences from RBI.

Mauritius treaty beneficiaries may face tougher time

Indian income-tax (IT) authorities can now ask for evidence from the Mauritius government to examine the authenticity of a taxpayer who claims exemption on capital gains tax provided under the Indo-Mauritius Double Taxation Avoidance Agreement (DTAA).

This is a departure from the practice of furnishing a tax residency certificate from Mauritius for claiming exemption from capital gains tax. According to an Income-Tax Appellate Tribunal (ITAT) Delhi order on March 26, more documents are needed from the Mauritius government to support the claim of the taxpayer, SMR Investments, that it is a Mauritius resident. If the order is not rejected by the high court, it will have a bearing on similar cases.

Nearly five years ago, SMR Investments, a company registered in Mauritius, had sold shares of HCL Technologies and BFL Software and generated over Rs 9 crore as capital gains. The taxpayer claimed exemption from capital gains tax under Article 13 of the India-Mauritius tax treaty. The taxpayer further claimed that it did not have a permanent establishment in India, a prerequisite for being liable to pay tax in India, and therefore is eligible for exemption from capital gains tax under the India-Mauritius tax treaty.

But the assessing officer (AO) disagreed. The AO claimed that it is the actual location of the effective management and not the location in which the company ought to be managed, that decides the residency of the company. The company was set up in 1995-96 during which period its founder Suresh Rajpal was working in India. Mr Rajpal was a resident in India when the taxpayer purchased the shares in 1996-97. Therefore, for all practical purpose the taxpayer is not a resident of Mauritius, the AO said.

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

Foreign parent need not pay for marketing intangibles

In a significant judgement for pricing of intangibles, such as use of a multinational brand by an Indian affiliate, the Delhi High Court has set aside an order by income tax authorities that had held that the parent Suzuki Motor Corporation (SMC) should have compensated Maruti Suzuki India (MSIL) for adding value to the Suzuki brand through its promotion campaigns.

The ruling provides clarity on transfer pricing of intangibles, and a clear framework to multinationals for their intragroup arrangement relating to use of trademarks / brand names in India.

The ruling recognises that an increase in the top line or net profitability of the Indian affiliate is adequate compensation for advertising expense incurred towards local brand awareness campaigns and the transfer pricing analysis of the advertising expense would need to take due cognisance of this fact.

The case pertains to assessment year 2004-05. The tax authorities disallowed the expenses incurred on account of the royalty paid to Japan's SMC for use of trademark and the advertising, marketing and promotion (AMP) expenses incurred in promoting Suzuki brand.

The transfer pricing officer held that SMC did not compensate MSIL for developing the marketing intangibles with large advertisement expenses, which benefited the Suzuki brand.

The officer contended that MSIL had higher advertisement expenditure against other comparable companies and hence carried out adjustments to MSIL's total income by disallowing 50% of royalty and excess advertisement expenditure. The officer also ruled that SMC failed to compensate MSIL for the use of its trademark Suzuki, which according to him, was then a weak brand in India whereas Maruti was a strong brand. The co-branded trademark - Maruti Suzuki - led to impairment in value of MSIL's trademark and reinforcement of SMC's trademark in India, the officer held.

The high court held that the approach of tax authorities was erroneous and unsustainable and directed that the transfer pricing officer determine the arm's-length pricing in this case, taking into account the fact that there would be no obligation on Suzuki to pay if the use of logo was at the discretion of MSIL. On the other hand, if MSIL is mandatorily required to use the foreign trademark / logo, appropriate payment should be made by SMC for the benefit it derives in the form of marketing of intangibles, obtained from such mandatory use of its trademark / logo.

The court maintained that even if Suzuki is required to pay towards marketing the intangibles, the arm's-length price of the international transaction has to be determined taking into consideration all the rights and obligations of the parties under the international transaction, including the benefit from the mandatory use of foreign trademark / logo.

Transfer pricing provisions in general require income arising from an international transaction between two or more related organisations to be calculated at an arm's-length price. The basic test of this is that they should be comparable to similar transactions between unrelated parties.

Captive coal miners may get to sell to third parties

Commercial mining may be opened to private sector in a limited way

In a step towards opening commercial coal mining to the private sector, the government may allow companies holding captive mining leases to sell excess coal in the open market to meet the increasing coal demand for power generation.

At present, commercial mining is reserved for state-owned Coal India (CIL), which is not able to ramp up production fast enough, necessitating ever-increasing imports. As a half-hearted solution, the government had allowed private companies to mine coal for captive consumption, but they were not allowed to sell any excess production in open market, or what is called merchant sale. Any surplus production has to be transferred to the nearest CIL subsidiary at a price determined by the coal controller, usually 40-50% below open market price, discouraging extra production.

The coal ministry may now allow companies with captive mines to sell incremental coal from their blocks to other approved end-users of coal — power, steel and cement producers — that are eligible to get captive coal mines on their own. However, the government may still regulate the price of such sales, creating the risk that an unduly low price could discourage companies from producing more than their captive use requirement.

The government has already allowed Reliance Power to divert incremental coal from mines allocated for its Sasan ultra mega power project (UMPP) to the company's 4000 MW power project at Chitrangi in Madhya Pradesh. The government could now go a step further and allow a captive miner like Reliance Power to sell surplus coal to third parties.

This will make coal-based power projects more attractive and could see better participation in bidding and help bring down tariffs.

POWER PROBLEM

- Up to 80% of power generation capacity in the country is coal-based
- Shortage of coal in domestic market as growth in production below increase in demand
- Against 442 MT coal needed by power utilities in 2010-11, only 388.92 MT available domestically

- India imported up to 70 MT of expensive coal, coking and non-coking in 2009-10, expected to reach 80 MT in current year and 100 MT by 2012

No export duty on transfer of goods to SEZs, rules SC

The Supreme Court has ruled that transfer of goods to special economic zones (SEZs) from areas outside these tax-free enclaves would not attract export duty.

SEZs are legal entities meant for increasing the country's exports, while areas within India but outside the SEZs are called domestic tariff areas (DTAs).

A Bench comprising Justice D K Jain and Justice H L Dattu dismissed the contention of the Centre that any transfer of goods from a DTA to an SEZ falls within the definition of exports. The Supreme Court was hearing an appeal filed by the Centre challenging an order of the Gujarat High Court barring export duty on goods supplied to export-oriented SEZs from DTAs.

Passing an order on the plea of Essar Steel, the Gujarat High Court had on November 11, 2009, held that the export duty on the goods supplied by any firm from a DTA to an SEZ was not justified.

This judgment was appealed by the Centre in the Supreme Court.

The dispute relates to the period between August 2007 and January 2008, when Essar supplied 600,000 metric tonnes of iron ore pellets from its Vizag-based unit to an SEZ unit at Hazira in 12 shipments. The firm did not pay any export duty on the supply of the iron ore pellets from the DTA unit to the SEZ unit.

Indian Rupee gets an identity symbol

Finally, the Indian Rupee has got its identity! The design selected by the Indian government aims in placing the country parallel to the top country symbols like 'Dollar' and 'Pound'. The newly selected symbol has been designed by a postgraduate of Indian Institute of Technology (popularly known as IIT), D Udaya.

The approved design includes 'Ra' from Devnagiri and 'R' from Roman with two parallel lines running at the top. Equality is reflected in parallel lines. With this, India has entered into the group of countries having unique currency identity.
D Udaya explained that the symbol is based on Indian Tricolour. It has two lines on the top and white space in between. It has been decided that the symbol will be used by all individuals/entities within and outside the India after the incorporation of 'Unicode Standard', ISO/IEC 10646 and 'IS 13194'.

With this decision, the Indian currency has now got a distinct identity that will distinguish the currency from that of other Asian countries like Sri Lanka, Nepal, Pakistan, Mauritius, Seychelles, Indonesia and Maldives (whose currencies are also called Rupee).

Honda to invest Rs. 300 cr in Tapukara unit

Honda Siel Cars India (HSCI) plans to invest 300 crore in its second plant at Tapukara (Rajasthan) to make engine & transmission components (power train) that will help it cut cost of critical car components.

Till now, these components were imported from Indonesia and Thailand. Spares made in India could be 15-20% cheaper compared to imported products.

The new facility would start operations early next year and will help HSCI build volumes in the country's small-car segment.

The fresh investment would result in better utilisation of HSCI's 600-acre facility, which was inaugurated in September 2008 and was scheduled to start operations in Q4 of 2009. However, it remains unutilised as it coincided with global economic slowdown that also resulted in sluggish car sales in India for almost a year.

Honda is currently utilising the facility to export crankshaft and connecting rods to Japan. Honda is looking at making the Indian manufacturing facility a significant production base for critical components by leveraging the low-cost manufacturing here for its global operations.

Take-out financing via ECBs okayed

Reserve Bank of India (RBI) has allowed take-out financing through external commercial borrowings for loans to the infrastructure sector. The relaxation comes in the wake of banks complaining that they were facing an asset asset-liability mismatch in extending loans to the core sector.

RBI has said that it will permit take-out financing arrangements through ECB, under the approval route, for refinancing of Rupee loans availed of from the domestic banks by eligible borrowers in the sea port and airport, roads and bridges, and power sectors for the development of new projects.

Although banks have not been short of liquidity they have been wary of lending to projects with 10-12 year gestation period considering that their longest term deposit was around five years. Overseas borrowers are slightly wary of projects that involve land acquisition and other government approvals. If domestic lenders provide support in the initial years, foreign lenders will have a greater level of comfort in such loans.

As of now, borrowers are not allowed to refinance their existing loans with foreign currency loans.

The conditions for take-out financing set by RBI include a requirement that there should be a tripartite agreement between the borrowers and the overseas lenders. The takeover of the loan can be conditional, which means that the foreign lender can commit to refinance only if the project achieves certain milestones. However, the take-out has to take place within three years of the scheduled commercial operation date. RBI has said that the loan should have a minimum average maturity period of seven years and that the domestic bank financing the infrastructure project should comply with the extant prudential norms relating to take-out financing.

India plans to launch shale gas auction in August 2011

The identification of the gas producing areas will be done by early next year

Major Indian energy companies like Reliance Industries Ltd (RIL), which have so far been scouting overseas for shale gas resources, may get a chance to bid for domestic shale gas blocks in about a year. The country is looking to launch its first-ever auction of shale gas areas in August 2011.

The identification of the gas producing areas will be done by early next year. This will be followed by carving out suitable blocks.

This will be the second unconventional natural gas source in India after coal bed methane. Several basins — Cambay (in Gujarat), Assam-Arakan (in the North-East) and Gondwana (in central India) are known to hold shale gas resources.

In March this year, the ONGC board approved a pilot project for exploration of shale gas in the Damodar Basin at an expenditure of Rs 128 crore.

DGH and the ministry would study worldwide fiscal and contractual regimes before framing a shale gas policy. It is being worked out and is likely to be in place by the end of the current financial year.

The Petroleum and Natural Gas Rules, which govern the oil and gas exploration activity, will be amended prior to the floating of the first round of auction.

India is also likely to sign a cooperation agreement with the US Geological Survey later this year for knowledge sharing in the area of shale gas.

MAT relief for foreign companies sans permanent office

Minimum alternate tax — a levy typically aimed at collecting tax from companies enjoying exemptions — is not payable by foreign companies who do not have a permanent establishment in India, according to a recent verdict by the Authority for Advance Ruling (AAR).

The AAR's verdict, dated July 23, 2010, was on an application filed by Mauritius-based Praxair Pacific. The foreign company asked AAR to clarify whether it is liable to pay MAT under section 115 JB of the Income Tax Act, on account of the transfer of shares to its Indian subsidiaries. The Mauritius company was proposing to transfer 74% of its shareholding in Indian subsidiary Jindal Praxair, to its wholly-owned Indian subsidiary Praxair India.

MAT was incorporated into the Income Tax Act with the specific purpose of bringing under the tax net, companies who avoid paying taxes by taking advantage of the various incentives offered by the government.

The AAR clarified that Praxair Pacific is not liable to pay MAT in India. AAR's contention is based on section 115 JB of Income-tax Act, which is not applicable to foreign companies. The AAR pointed out that amendments in section 115 JB brought in by the 2002 Finance Bill had clarified that MAT is applicable only to domestic companies. The AAR further said that Section 115 JB of Income Tax Act is not designed to be applicable to a foreign company who has no presence or permanent establishment in India.

At the same time the AAR also ruled that the company is not liable to pay tax in

India on account of the capital gains arising from transfer of shares to Indian companies. The AAR considered the spirit of circular 789 issued by the Central Board of Direct Taxes in 2002 which stipulated that a certificate of residence issued by Mauritian authorities would entitle an entity to claim benefits under the India-Mauritius tax treaty.

Moody's upgrades India's sovereign currency rating

Global ratings agency Moody's Investors Service has raised India's sovereign currency rating one notch citing the economy's resilience and the country's commitment to fiscal reforms.

The ratings upgrade is expected to galvanise more foreign investments into the country even though the revised 'Ba1' rating is still a level below investment grade.

The gross domestic product (GDP) expanded 7.4% in the year ended March as the economy showed resilience during the global economic downturn. In its outlook for the current fiscal year to March 2011, the Prime Minister's Economic Advisory Council had raised its growth forecast to 8.5% from 8.2%. The projection is in line with the government's expectations, but higher than RBI's forecast of 8%.

The Centre has laid out a stringent road map for fiscal consolidation in the budget for 2010-11 after the fiscal stimulus measures to revive the global financial crisis hit economy and the sixth pay commission bill derailed the fiscal deficit.

For 2010-11, the government has estimated the fiscal deficit at 5.5% of the GDP and revenue deficit at 4% of the GDP. The fiscal deficit more than doubled to 6.9% of the GDP in 2009-10, forcing many agencies to downgrade the currency's ratings.

Moody's is confident that measures such as disinvestment in state-run firms, fuel subsidy reforms and the proposed tax reforms (goods and services tax and direct taxes code) will help the Centre better its deficit targets.

Meanwhile, the ratings agency has retained India's foreign currency rating at Baa3, which is the lowest investment grade. Moody's said the outlook on the local currency rating remains positive, while the outlook on the foreign currency rating remains stable.

Investment norms for FDI-funded companies likely to be relaxed

Companies may get to invest internally-generated funds in arms without prior FIPB approval

The government may relax norms governing investments by Indian companies having foreign direct investment, allowing them to invest internally generated funds in subsidiaries without prior approval.

Investment proposals funded through internal accruals of such companies currently need approval from the Foreign Investment Promotion Board (FIPB), the apex inter-ministerial body that clears foreign investment proposals.

The finance ministry and the Department of Industrial Policy and Promotion (DIPP) are considering lifting this restriction and a decision is expected shortly. The permission may be given only for investment in sectors on the automatic route that do not require FIPB nod.

The current thinking in the finance ministry is that FIPB approval for using internal accruals, or accumulated profits and depreciation charges, is an unnecessary hurdle for companies looking to invest in the country.

The requirement has its roots in the fact that internal accruals of a company having foreign investment are counted as FDI in government and RBI statistics. The country also allows for repatriation.

The reinvested FDI in India, or profit generated from foreign investment that is not repatriated, amounted to nearly $6 billion in 2009-10. This amount is theoretically available for investment in downstream venture, apart from depreciation charge of such companies.

The finance ministry had, in an earlier review of FIPB proposals, asked the DIPP, the nodal government body on foreign direct investment policy, to amend the FDI policy. However, the new FDI policy made public on April 1, 2010 by the DIPP continued with the earlier provision specified through Press Note 9 issued in 1999.

The restrictions on allowing a company having FDI from making downstream investments will continue, as the country needs foreign capital to fund its large current account deficit.

The PM's Economic Advisory Council has projected net in-bound FDI of $30 billion in 2010-11.

Hard-to-find independent directors force companies to rush for liability cover

Listed firms from the public as well as the private sector have begun buying insurance cover for their independent directors so that they can operate without fear, a trend triggered by the Satyam Computer Services fraud, which came to light in early 2009.

India Inc is relying on Directors' & Officers' (D&O) liability insurance cover to attract and retain directors at a time when their regulatory role is rising but their supply is fast shrinking.

The exodus of independent directors seen in the immediate aftermath of the Satyam scam hasn't abated. Data compiled by research firm Prime Database along with the Bombay Stock Exchange show that there have been over 300 resignations from independent directors since January 2010 in listed firms.

Even before this exodus started, availability of competent professionals to join boards as independent directors has been a problem. Many public sector firms have never managed to fill their boards with the requisite number of independent directors.

A diktat by the market regulator, Securities Exchange Board of India (Sebi), requires listed firms' boards to have around 50% independent directors. The government and SEBI are pressing for greater accountability from independent directors to ensure compliance with regulatory norms.

In fact, a Sebi panel has proposed to make it mandatory for a committee of independent directors of a target company to give its views on open offer pricing.

The idea is aimed at increasing transparency and protecting shareholder interests during such buyouts.

Companies are feeling the need to safeguard independent directors against consequences of corporate wrongs to which they may not be party.

India, Switzerland ready new tax draft

The government has concluded the renegotiation for widening the ambit of its tax treaty with Switzerland to access information on Swiss bank accounts, a big step towards tracing Indian money stashed away overseas.

The tax treaty has been amended on the lines of the OECD Model Tax Convention, which means it will not provide for roving enquiries, or 'fishing expeditions' as they are commonly called.

The revised agreement is expected to be taken up by the Cabinet shortly.

The new treaty will be notified by India immediately after it is signed, but the Swiss authorities will be able to put the agreement into effect only after it is ratified by their Parliament.

India's income-tax authorities will be able to access information on Swiss bank accounts of Indians more easily, but only in specific cases where they have a prima facie evidence of wrongdoing.

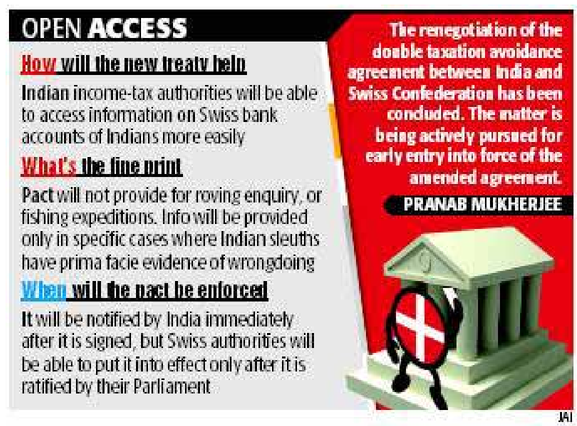
For example, I-T sleuths can now source data on bank accounts used to acquire stakes in some Indian Premier League franchisees. The availability of information would help the I-T department in its investigation.

The Enforcement Directorate has already issued show cause notices to some Indian citizens for maintaining banks accounts in Switzerland and the government has initiated steps to elicit requisite information from Swiss authorities.

The government had approached Switzerland in April 2009 to renegotiate the DTAA to get access to information on bank accounts.

Switzerland has also amended tax treaties with the US, France and Italy.

India is pursuing the issue of exchange of information with other countries as well and would seek amendment in tax treaties with them. The move is in line with a decision taken at the G-20, which took up the issue of tax havens.



Regulators allow currency options on bourses

Nearly two years after the introduction of currency futures, the joint regulators of exchange-traded currencies, RBI and Sebi, have allowed recognised stock exchanges to launch options in dollar-rupee based on the spot rate. As in exchange-traded currency futures, no underlying exposure is mandatory for trading in currency options.

The National Stock Exchange and MCX Stock Exchange will now be able to offer options in the dollar-rupee pair after seeking capital market regulator Sebi's approval. USE, a new stock bourse expected to go live in September, is also expected to seek the approval of the regulator for offering currency options. The Bombay Stock Exchange is the largest shareholder in USE which has over 20 public and private banks as its stakeholders.

The two exchanges now offer futures trading in four currency pairs — dollar, euro, yen and pound versus the rupee, respectively. NSE was the first exchange to launch futures trading in dollar-rupee in August 2008 and was followed by MCX-SX, which went online in October that year.

SC asks HCs to keep off debt recovery proceedings

Interfere only when borrowers have exhausted all alternative remedies: Apex Court

The Supreme Court has asked the high courts not to interfere with the debt recovery proceedings initiated against defaulters, upholding the right of lenders to recover their dues.

All alternatives available to the borrowers should be exercised before the high courts exercise their discretion to interfere with recovery proceedings, said a bench comprising justices GS Singhvi and AK Ganguly, setting aside an Allahabad High Court order.

The high court had, in its interim order, stayed the recovery proceedings initiated by the United Bank of India on the plea of the guarantor of a loan.

"It is a matter of serious concern that despite repeated pronouncement of this court (the Supreme Court), the high courts continue to ignore the availability of statutory remedies under the DRT Act (Recovery of Debts Due to Banks and Financial Institutions Act, 1993) and SARFAESI Act (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002) and exercise jurisdiction under Article 226 for passing orders, which have serious adverse impact on the right of banks and other financial institutions to recover their dues," the court said.

"We hope and trust that in future the high courts will exercise their discretion in such matters with greater caution, care and circumspection," it said.

"In cases relating to recovery of the dues of banks, financial institutions and secured creditors, stay granted by the high court would have serious adverse impact on the financial health of such bodies/institutions, which ultimately prove detrimental to the economy of the nation. Therefore, the high court should be extremely careful and circumspect in exercising its discretion to grant stay in such matters," the court further said.

Stay of an action initiated by the state and its agencies for recovery of taxes, seriously impedes execution of projects of public importance and disables them from discharging their constitutional and legal obligations towards the citizens, the order said.

In this case, the Union Bank had extended a term loan of Rs. 22,50,000 to Pawan Color Lab in November 2004. Satyawati Tondon had furnished a guarantee for repayment of the loan and mortgaged her property situated in Allahabad in UP by deposit of title deeds.

After one year and six months, the bank sent a letter to the company and the guarantor pointing out that repayment of loan was highly irregular. It issued notices to both the borrower and the guarantor under section 13(4) of the SARFAESI Act.

Faced with the imminent threat of losing her mortgaged property, Ms Tondon challenged the decision of the bank.

Turning down the plea of the bank that the alternative remedy was available to the petitioner under section 17 of the SARFAESI Act, the high court passed the order restraining the lender from taking action. The order was challenged by the bank in the Supreme Court.

Ruling in favour of the bank's plea, the apex court said the high court order had the effect of defeating the very object of the legislation enacted by Parliament for ensuring that there are no unwarranted impediments in the recovery of the debts due to banks, financial institutions and secured creditors.

Fresh arbitration allowed in case of nullification

The Bombay High Court has ruled that fresh arbitration is permissible in case of nullification of the award passed by the arbitrator to resolve the disputes between parties. For such fresh arbitration, the consent of both the warring parties is not required, it said. "A fresh arbitration is permissible at least in the event of an award being set aside for reasons other than on merits," said a bench of justice SJV Vazifdar in its order.

The court said: "Having held that the parties are free to begin arbitration again there is nothing in the Act (Arbitration and Conciliation Act, 1996), the judgment (of the Supreme Court) or in principle that warrants restricting the enforcement of this right (fresh arbitration) to any particular stage, point of time or proceeding."

The court perused an earlier ruling of the apex court on the aspect of a fresh arbitration to resolve the disputes. "The Supreme Court has not specified as to the manner in or the stage at which the parties are free to begin the arbitration again," it said.

The court also turned down the plea of Mormugoa Port Trust which had said that after an award is set aside a fresh arbitration can begin again only with the consent of both the parties. It had drawn attention of the court that the arbitration clause ceased to have any effect pursuant to the setting aside of the award.

However, the other party, Associated Constructions, had approached the high court for appointment of an arbitrator in view of the quashing of an earlier award passed to resolve the dispute.

Allowing the plea for a fresh arbitration, the court said: "Where an award is set aside as in the above case, the commencement of the arbitration again is pursuant to and under the existing arbitration clause. The same is neither based on nor dependent upon a fresh arbitration agreement between the parties".

The trust and the company had entered into a construction contract on October 8, 1996. Later disputes had cropped up and an arbitral tribunal was appointed by the parties in accordance with the arbitration clause. It passed an award on September 24, 2004 and awarded an aggregate sum of Rs. 42,86,135 to be paid payable by the trust to the company after adjusting the amount it had paid.

The trust challenged the award which was set aside in some respects. But as per the provision of the Act, an award cannot be modified and can only be either upheld in its entirety or set aside if found to be bad even in part, the award held to be illegal in some respects virtually amounted to setting aside of the entire award.

Aggrieved by it, the company had filed an application before the high court. Allowing the application, the court appointed a sole arbitrator to resolve the dispute between the parties.

Indian rival in works to take swipe at Visa, MasterCard

State-backed IndiaPay to go onstream in two years

Visa and MasterCard, the American giants that play a role nine out of ten times when anyone uses a credit card in the world, will face an unusual rival in India.

IndiaPay, a new state-backed payment processing platform, will be up and running within the next two years. Once it goes onstream, the IndiaPay card will not only dilute the dominance of Visa and MasterCard in the payment processing space, but also bring down transaction charges for banks. At present, close to fort million plastic cards (credit and debit cards put together) are in circulation in the country, with the majority of them being serviced by the two entities. IndiaPay, being developed with Reserve Bank of India's active support, will be India's first indigenously developed card payment service provider.

Global payment technology firms like MasterCard and its bigger rival Visa process the payments between the merchant's and the customer's bank. In India, the platform is being developed by the National Payments Corporation of India (NPCI) — the agency entrusted with the task of steering the project by the central bank.

Every time card holders use credit or debit cards at ATMs, point-of-sale terminals or for making online payments, banks pay have to pay fees to Visa and MasterCard for facilitating the processing of such transactions. Since plastic money may gain currency as more and more Indians go for cashless transactions, an alternative payment infrastructure provider quoting significantly lower charges and backed by the banking regulator will be welcomed by the banking industry.

Countries like Malaysia and China have put in place their domestic payment processing platforms. While the former established Malaysian Electronic Payment System (MEPS) in 1997, the latter came up with China UnionPay (CUP) in March 2002.

The NPCI is promoted by major Indian banks including State Bank of India, Punjab National Bank, ICICI Bank, HDFC Bank as well as foreign banks like Citibank and HSBC. The idea was born after the central bank released a vision document in 2005 containing a proposal to set up an umbrella institution for all retail payment systems in the country.

BGR Energy inks two JV pacts with Hitachi

Chennai-based BGR Energy Systems, a leading player in the power sector, has signed two joint venture agreements with Hitachi to set up separate plants for the manufacture of steam turbines and boilers for super critical thermal power plants. The projects, slated to come up closer to ports in Tamil Nadu, will entail an investment of Rs. 4,400 crore.

The first JV with Hitachi, Japan called BGR Turbines Company is for design, manufacture, installation and commissioning of supercritical steam turbines. Of the Rs. 3,000-crore outlay, Rs. 900 crore will be equity with BGR investing Rs. 666 crore (74% stake) and Hitachi Rs. 234 crore (26% stake). It will have a capacity to manufacture five units per annum of 660 MW, 800 MW and 1,000 MW. The plant employing about 1,200 people will go on stream in 2012.

The second venture with Hitachi Power Europe GmbH, Germany styled BGR Boilers is for producing supercritical steam generators. Of the Rs. 1,400-crore outlay, equity portion will be Rs. 420 crore with BGR investing Rs. 294 crore (70%) and Hitachi Power Rs. 126 crore (30%). The plant will have a capacity to manufacture five units of 660 MW, 800 MW and 1,000 MW. Production is slated to start in 2012. It will employ about 2,100 people.

The two projects will be set up on 250 acre each. The locations will be finalised in consultation with the Tamil Nadu government.

Goods for mega power projects can be imported duty-free

The conditions for grant of excise duty exemption for goods supplied to mega power projects have been amended. Now, the project developers, instead of the manufacturers, have been made liable to pay the duty in case they do not ensure that exempted goods are used only in their projects. Besides, the power to attest the list of goods required for setting up the projects has been given to the chief engineer of the Central Electricity Authority.

Thermal power projects that can generate 1,000 MW power and hydel power projects that can generate 500 MW power are referred to as mega power projects. The threshold limits are 700 MW and 350 MW for projects located in Jammu and Kashmir and states in the North-East. Goods required for such mega power projects can be imported duty free. Locally produced goods, which are supplied to such projects, can be cleared without excise duty payment.

Excise exemption notification number 6/2006-CE dated March 1, 2006 has three different dispensations for power projects. S. No. 91 exempts all goods supplied against International Competitive Bidding, if such goods can be imported at zero duty. This entry covers a wide range, including supplies, to mega power projects. This entry in the notification does not prescribe any documentation but the trade proceeds on the basis that documents to show eligibility for duty-free imports for the project should be adequate.

S. No. 91A of the notification exempts goods required for setting up ultra mega power projects based on the super-critical coal-thermal technology, with installed capacity of 3,960 MW or above, from which power procurement has been tied up through tariff-based competitive bidding. The prescribed documentation includes a an undertaking from the chief executive officer of the project that the exempted goods will be used only in the said project and not for any other use and that in the event of failure to do so, the project developer will pay the duty which would have been leviable at the time of the clearance of goods, but for this exemption.

S. No. 91 B of the notification exempts goods supplied to mega power projects from which supply of power has been tied up through tariff-based competitive bidding or a mega power project awarded to a developer on the basis of such bidding. The documentation is similar to that under S. No. 91A but the manufacturer was required to pay duty in case the goods were not used only in the project. As manufacturers could not ensure such end use, that condition has now been amended making the project developer responsible for duty payment in case of such violation.

S. No. 91B prescribed documentation that called for a certificate from Joint Secretary in the Union Ministry of Power that the goods are required for a mega power project from which the supply of power has been tied up through tariff-based competitive bidding or a mega power project awarded to a developer on the basis of such bidding. As the trade expressed practical difficulties in obtaining the certificate from the power ministry, the amendment now prescribes a certificate from the chief engineer in the Central Electricity Authority that the goods are required for setting up the said mega power project under the central government initiative, indicating the quantity, description, and specification thereof

Late foreign travel tax payment liable to fine

In a setback to foreign carrier companies, the Bombay High Court has ruled that delayed payment of foreign travel tax (FTT) could attract penalty under the provisions of the Finance Act, 1979.

Rejecting the plea of petitioners Malaysian Airlines, Saudi Arabian Airlines, North West Airlines and Kenya Airlines, the court said that the power to impose penalty under section 38(3) of the Act could be exercised only in case of "failure to pay the tax" and not where there is only a delay in the payment of tax.

A bench comprising Justice KK Tated and Justice VC Daga said: "the said concept (failure to pay) has not been defined under the Act (Finance Act, 1979) or Rules (Foreign Travel Tax Rules, 1979).

'Failure to pay' means non-payment. The concept of failure to pay can be quoted with non-payment. Non-payment is nothing but failure to pay when due". It said, "as per the provisions of the act, amount of FTT collected becomes due within fifteen days from the date of collection thereof. Failure to pay within this prescribed time frame would mean non-payment or failure to pay. If any person fails to pay within the statutory period of fifteen days, then such person is well within the sweep of the words 'failure to pay'".

The petitioner carriers had said that mere delay in payment of FTT cannot be within the sweep of 'failure to pay'. Hence delayed payment does not attract penalty, they had said.

In the present case, Malaysian Airlines had collected FTT from passengers going abroad in accordance with the Finance Act and Foreign Travel Tax Rules of 1979. But, the company, for the months of April, August, September and December, 2001 failed to pay the FTT within the stipulated period. The government, in view of such failure, issued four separate show-cause notices to the company. It had also imposed a penalty of Rs. 4,19,700 on the company for late payment.

Aggrieved by such order, the company filed two separate appeals before the Commissioner (Appeals). It, however, dismissed such appeals. The government had also imposed a penalty of Rs. 24,000 on Saudi Arabian Airlines, Rs. 9,62,300 on North West Airline and a fine of Rs. 11,71,100 on Kenya Airlines for delayed deposit of FTT.

Private equity finds new ways to protect downside risks

Large private equity (PE) players are back at the deal-making table. However, they are also focused on protecting their investment against downside risk. This is true even for late-stage funding that has seen a pick-up recently.

Take the instance of Singapore-based Temasek. Recently, when it invested in GMR Energy, it did so through a structured paper, compulsorily convertible into equity. It invested $200 million (Rs 935 crore) in GMR through its wholly-owned subsidiary, Claymore Investments.

A lot of funds are now looking at principal protection as the basic guarantee, with some upside. People are becoming more risk-averse and most large deals are being structured.

HEDGING THE BETS
TOP PE LATE STAGE INVESTMENTS OF 2010

Company	Investors	Amount (USD mn)	Date
Shriram Capital	TPG Capital	217	Apr-10
Coffee Day Resorts	New Silk Route, StanChart PE, KKR	217	Mar-10
NSE	Temasek	175	May-10
Avnija	KKR	167	May-10

Properties			
Lilliput Kidswear	Bain Capital, TPG Growth	86	Apr-10
Metropolis Healthcare	Warburg Pincus	85	Jun-10
Monnet Power	Blackstone	60	Jul-10
Integreon Managed Solutions	Actis	50	Feb-10
Financial Software & Systems	NEA, NYLIM India	50	Mar-10
Famy Care	AIF Capital	50	Apr-10
Source: Venture Intelligence			

In the convertible structure, the most popular route, a PE fund keeps getting the coupon for two-three years and then converts it into equity at a pre-decided price. There are exit structures under which the PE fund's stake is bought out by the promoters.

In the case of Coffee Day Resorts, the promoters have assured 18 per cent return to a clutch of PE firms that include New Silk Route, Standard Chartered PE and KKR. The three have collectively put in $217 million (Rs 1,009.05 crore) in the company.

PEs also prefer to get into structured deals when they are not comfortable with the promoters' return projection. This is how the downside gets protected. Another route to protect the downside is a built-in clause which mandates that the stake goes up if the company does not perform as promised.

Earlier, Shriram City Union allotted warrants to a clutch of PE funds, including ChrysCapital, Bessemer and India Advantage Fund. The investors later raised their holding through conversion of warrants, resulting in fresh fund infusion.

PE players are looking at various convertibles, based on profitability. There are claw-back situations. There are also earn-out structures, where a PE investor agrees to share the upside of any return the company earns over and above a minimum targeted internal rate of return.

RBI pushes for stiff bank entry norms

The Reserve Bank of India favours stringent eligibility conditions for allowing new private banks, once again laying bare its deep unease at the prospect of allowing industrial houses into the banking business.

The banking regulator, which plans to approve a limited number of banking licences in line with the announcement in this year's Budget by finance minister Pranab Mukherjee, has outlined a few policy approaches, or options, which if translated into rules may make it difficult for many big business houses to promote banks. In a discussion paper on the entry of new private banks, RBI has said that one option could be to allow only those industrial groups which have a diversified ownership base and without any direct or indirect exposure to real estate. If some of the other suggestions too — such as the need for corporate houses to obtain a clean chit from agencies such as the Central Bureau of Investigation, the Enforcement Directorate, income tax and other regulators, denial of the business group's brand name and logo for the new bank's brand and a board packed with independent directors — are endorsed later, very few large business groups may make the cut.

The paper, which invites comments till September-end, also says that it is important for the government to put in place enabling legislations to empower RBI to supersede the boards of private banks if the regulator feels that the bank is not functioning in the interest of depositors or financial stability. RBI last issued banking licences to YES Bank and Kotak Mahindra Bank well over seven years ago after it opened up banking to the private sector in 1994 during Manmohan Singh's tenure as finance minister. Since then, a few expert committees, including one headed by former RBI deputy governor SS Tarapore and advisor to the Prime Minister Raghuram Rajan, had made out a case for allowing industrial houses to promote banks.

Investment and holding companies under RBI net

Companies face borrowing curbs, will have to maintain capital floor

Holding companies and investment firms of large Indian business houses will for the first time come under the regulator's glare. All such entities with assets above 100 crore will have to register with the Reserve Bank of India, maintain a minimum level of capital and will be restricted from borrowing beyond a point.

Huge fund-raising by corporate investment companies with a shallow capital base has been a growing concern for RBI, which has finalised a new regulatory framework for these 'core investment companies' (CICs).

A core investment company, as per RBI's definition, means a nonbanking finance company that holds not less than 90% of its total assets in the form of investment in equity shares, preference shares, debt or loans in group companies.

In recent times, Indian corporates have borrowed aggressively through investment arms and holding firms to fund growth. Often holding companies pledge shares of a group company to borrow from a bank or a finance firm and, then, invest the money to fund another group entity. In the second stage, the shares of the newly-capitalised entity are pledged for fresh borrowings to fund yet another company. The holding company can do this as long as it pays interest on the loans and maintains margins with the lenders.

Significantly, RBI has restricted business groups from splitting their holdings in multiple investment outfits to sidestep the regulations. The regulator has spelt out that all core investment companies belonging to a group will be aggregated. While core investment companies do not accept public deposits, they are identified as 'systematically important' by RBI. According to the RBI communiqué, at all times such companies will have to maintain a "minimum capital ratio whereby its adjusted net worth shall not be less than 30% of its aggregate risk weighted assets on balance sheet and risk adjusted value of off-balance sheet items". Thus, besides loans and investments, guarantees and non-fund exposure of CICs will have to be taken into account to arrive at the minimum capital requirement.

Non-compete fees taxable, rules ITAT

Non-compete fees are capital expenditure and therefore liable to tax, according to a recent ruling by the Income-tax Appellate Tribunal, Delhi.

The special bench of ITAT, Delhi gave this ruling on July 30, 2010, on an appeal filed by Tecumseh India, the Indian arm of the US based Tecumseh. The transaction in question was the acquisition of Whirlpool assets at Faridabad and Ballabgarh and the non-compete fees it paid to Whirlpool. The assets were purchased on July 2, 1997 but the agreement for non-compete fees of Rs 2.65 crore was signed on July 10, 1997.

Since the non-compete fee was claimed by Tecumseh as revenue expenditure, it accordingly deducted the amount from computation of taxable income. The I-T department did not agree with the taxpayer's contention and held that the payment of non-compete fee was capital expenditure and therefore tax has to be paid. The assessing officer, therefore added the expenditure back into the income computed for purpose of levying tax.

The company had cited the Delhi High Court decision in the case of Eicher to support its case. In the case of Eicher, the Delhi High Court had held that the non-compete fees are mainly for protecting the profitability and business interest of the company. Further, since no profit-making apparatus was created through the payment of non-compete fees, such expenditures could be classified as revenue expenditure, and therefore tax was not payable on this count. The tax payer company had also argued that the acquisition of Whirlpool assets and the agreement for the non-compete fee were made on different dates and therefore the latter could not be construed as part of the acquisition.

The I-T department contented that though MoU and the agreement for paying non-compete fees, are signed on separate dates, they are part of the same transaction that could be classified as capital expenditure. The I-T department cited section 6 of the Indian Evidence Act which stipulates that courts should take note of facts which formed part of the same transaction though they may have occurred at different places and time. It said the non-compete clause was part of the same transaction.

PMO circulates note on IPR tweaks for drug MNCs

The government is considering a set of proposals by global drugmakers that seeks certain changes in the country's intellectual property rights regime (IPR) that can compromise Indian drugmakers' ability to sell low-cost medicines.

The Prime Minister's office (PMO) has sought views from the ministries of commerce, health & family welfare and department of legal affairs on the proposals. As per the PMO note, the proposals include changes in controversial matters such as 'legislative review' of the section 3(d) of the Indian patents Act and clearly redefining 'efficacy criteria.'

Section 3(d) of the Indian Patent Act restricts grant of patents for incremental innovations, unless it provides significant therapeutic advantages to existing molecules. Indian courts and patent offices have shot down patent claims of several global drugmakers using this provision.

The PMO note follows a meeting with top executives representing Indian units of global MNCs such as Novartis, BMS, Eli Lilly and Pfizer besides executives of Organisation of Pharmaceutical Producers in India (OPPI) a lobby group of international drug innovator companies.

In the meeting, it was agreed that OPPI will prepare the note on these proposals. The proposal that have been sent to the other ministries is based on the recommendations of the OPPI.

Global MNCs also seek 'alignment in applicable statutes' to implement patent linkages, a provision that will allow global MNCs to prevent Indian drug regulator from permitting local companies from launching generic versions of patented medicines. This is another vexed issue between foreign drugmakers and local firms, who say the provision will delay launch of generic or low cost drugs.

Global drug makers want legislative changes to protect MNCs from interim injunctions during patent revocation challenges saying that this opportunity is already provided during grant of patents. After India adopted a new product patent regime in 2005, the government provides exclusive marketing rights for 20 years. But, global drugmakers have repeatedly voiced their concern about the implementation of the IPR regime, alleging it does not encourage innovation

Chinese, Japanese truck companies ready India plans

In the last two decades, Indian carmakers have had to grapple with severe competition from Chinese and Japanese players who stepped into the country's auto market with sleeker and better fuel efficient products. Now it's the turn of the local truck makers who may be forced to change their stodgy ways as two Japanese players—Isuzu and Hino—and two Chinese firms—FAW and Foton—are giving finishing touches to their India plans.

Top executives of these companies have in recent months held a series of discussions with potential dealers to set up joint ventures or enter distribution and marketing tie-ups with companies, said industry watchers and dealers.

Hino Motors, part of Toyota group, has already imported around 200 odd premium range vehicles. Likely to be priced at Rs. 35 lakh[2] apiece, the vehicles will initially target the mining and infrastructure segment. The Japanese truck maker is now looking at setting up a manufacturing facility in the country.

Chinese truck maker Foton is entering the Indian commercial vehicle market with competitively priced models in the low-to-medium range, popularly called the

[2] *1 lakh – 100,000*

Forland series. It is planning to directly enter the Indian market by setting up a plant in Pune.

China-based FAW has a tie-up with Ural India to market buses and manufacture dumpers, trucks and low floor buses. Recently SAIC, another Chinese auto major which picked a majority stake in General Motors India, is planning to launch its Wuling range of trucks in the country by 2011.

These foreign companies are lured by the demand potential in the Indian truck market which grew 50% to 2.01 lakh units in April-July this year compared to the year-ago period, and expected to sell 8- 10 lakh units in the year ending March 2010, compared to last year's 5.3 lakh units.

Copyright to attract service tax: Government tells HC

The revenue department has contested the petition filed by PVR Pictures in the Delhi High Court against the government's decision to levy service tax on copyright services such as sale of music rights, sale of direct-to-home satellite TV rights, and screening in cinemas. In a counter affidavit filed in the court, the department has said that temporary transfer of rights to copy in a limited manner will be chargeable to service tax.

"While complete transfer or rights to use any goods (where the original owner completely forgoes the title to a copyright) may be deemed to be considered as sale of goods, the temporary transfer of rights or just the transfer of rights to use or enjoy that copyright for specified purposes is a service provided by the person who is the holder of the copyright," the government said in its affidavit.

In a rejoinder, PVR Pictures, the film distribution and production arm of PVR Ltd, said the government had incorrectly stated that it had power to tax temporary transfer of copyrights and such kind of transfers were not taxed by states.

According to a finance ministry official, transfer of copyright is a composite transaction, which involves service provided in relation to goods. "In all other countries it is taxed as a service. The United Nation Central Product Classification also treats it as a service. When I'm transferring my rights to copy as per terms and conditions of a contract, there should be a service tax," he told Business Standard.

On July 1, the finance ministry had introduced tax on copyright services through a notification, which said all entities transferring for use the copyright in a film or sound recording would be liable to pay service tax at 10.3 per cent. States are already levying value added tax on sale of copyright.

PVR Pictures, Balaji Telefilms, Yash Raj Films, UTV Motion Pictures and Reliance Big Entertainment had challenged the tax, saying it was beyond the Centre's power under the Constitution and would lead to dual taxation. The producers argued that copyrights are treated as goods and the transfer of copyrights as sale of goods, which falls within the domain of taxation by states under Article 246.

The tax department will lose at least Rs 100 crore in revenue in the first year if the court's decision goes in favour of the producers. The department had estimated that its revenues will go up further in the coming years from the $1-million industry on transfer of copyrights.

India unbound

Emerging markets see 25% rise in M&A deals in H1, India leads

Portraying a strong rebound in their deal making confidence, emerging markets led by India saw a 25% rise in merger and acquisitions deals targeted towards developed markets in the past six months, a study by global consultancy KPMG said. According to the latest Emerging Markets International Acquisition Tracker (EMIAT) report, 243 Emerging-to-Developed (E2D) deals were recorded in the first half of 2010, compared to 194 in the second half of 2009. The 25% increase in E2D deals was in no small part due to a resurgent India. After three relatively quiet six month periods, India recorded 50 deals - well up on the 21 of the previous six months.

China was also up by nine deals to 39, while South East Asia jumped from 34 to 47 deals. Although there has been a rise in emerging to developed market deals in the past six months, the number of deals from western markets targeting developing market firms' remains higher. The report revealed that 748 Developed-to-Emerging (D2E) deals have been witnessed in the past six months showing a nine per cent increase over the previous six-month period.

The findings suggest that deal-making confidence is returning far quicker in emerging economies than in developed market. In absolute terms, E2D deals still only equate to 32% of D2E deals in the past six months, but it is apparent that they have worked through their financial crisis hangover far quicker.

The research analysed deal flows between 13 emerging economies, including India, China, Brazil, Russia, South Africa, Central & Eastern Europe and 15 developed economies such as US, UK, Canada, Spain, France, Japan among others.

Interestingly, an average of 202 Emerging-to-Emerging (E2E) cross-border deals per year has been witnessed since the start of 2003. This represents 1,518 deals struck in 7.5 years driven by growing stature of emerging economy trade buyers. On the E2E front, analysis of the numbers going back to 2003 reveals that South East Asia has been the most popular destination, registering 302 inbound deals. China was the next most popular market with 197 deals, while India registered 167 deals.

Government starts review of compulsory licensing norms

The Department of Industrial Policy and Promotion (Dipp) has started a discussion on various compulsory licensing (CL) provisions enshrined under India's intellectual property laws.

The move is significant in the backdrop of increasing acquisition of domestic pharmaceutical companies by foreign players and the concerns expressed by the Parliamentary panel on health over the availability of life-saving medicines at affordable prices in its report early this month, officials said.

Using CL, the government can allow third parties (other than the patent holder) to produce and market a patented product or process without the consent of the patent owner. This mechanism enables timely intervention by the government to achieve equilibrium between two objectives — rewarding inventions and, if required, making these available to the public during the term of the patent.

In a discussion paper, Dipp sought stakeholders' views on the scope of CL provisions to know if new guidelines were necessary to develop a predictable environment for such measures.

For instance, the paper notes that despite the presence of about 2–2.5 million cancer patients in the country, the cancer medicine market is estimated to be only Rs 150 crore and not Rs 5,000 crore, a conservative estimate of the average annual cost of anti-cancer medicine per patient as Rs 25,000. The paper attributes this to the high price of cancer medicines and consequent low demand. It also wants to know if it is a fit case for issue of CL under the Indian Patents Act.

The discussion paper also talks about the possibilities of issuing CL under the competition law if the company's dominant position is affecting the availability of medicines.

An attempt has also been made to define a "working patent". While some countries define this as the patent protection given to medicines manufactured in the country, others consider a patent as "working" if the medicine is made available in the country, though imported.

Dipp has also sought views on whether publicly-funded Indian research organisations should stipulate (while selling/ transferring patents to Indian private sector companies) that the ownership of patents will revert to these organisations in case the ownership of those companies passes on to foreign hands.

The department wants the stakeholder comments to reach by September 30. The Indian Pharmaceutical Alliance, the industrial association representing leading domestic drug firms, said it would respond after studying the discussion paper.

After the Doha Declaration on the TRIPS agreement and Public Health of the World Trade Organization, about 52 countries have issued CLs. These include Brazil (2007 for an anti-AIDS drug); Thailand (2006 and 2007 for anti AIDS drugs), Malaysia (2003 for anti-AIDS drugs), South Africa (anti-AIDS drug) Kenya (voluntary licences issued in 2004 after threat of CL), and most recently Ecuador (April 2010 for an anti-AIDS drug).

Since TRIPS does not stipulate the grounds under which CLs can be issued, countries have adopted different procedures for different circumstances. The Dipp attempt is to prepare an Indian framework for CL for use in emergency situations.

Foreigners may get to set up LLPs in sectors open to FDI

The government may soon allow foreigners to set up limited liability partnerships in sectors where 100% foreign investment is allowed, taking a decisive step after much flip-flop over funding guidelines for this form of business organisation, favoured globally for its flexibility.

The Department of Industrial Policy and Promotion (DIPP), the nodal agency for foreign investment policy, has written to the finance ministry giving the broad contours of the proposed foreign investment framework for LLPs. It has suggested that foreign investment be allowed in LLPs with prior approval.

LLPs share many of its features with normal partnerships, but partners will have reduced personal responsibility for its business debts as the partnership itself is responsible for such liabilities. A discussion paper is expected to be put up in public domain soon. This would be third in the series of discussion papers released by the DIPP. The earlier ones were on foreign investment in defence production and multi-brand retail.

DIPP had, after initial discussions earlier this year, taken a view against opening up this form of business organisation to foreigners. During those discussions, the Reserve Bank of India had favoured FDI up to 49% in LLPs in select sectors, while the finance ministry was in favour of a more liberal regime, but with prior approval.

As per the policy proposed by the DIPP, foreigners will not be allowed to set up LLPs in sectors such as real estate where conditions such as minimum capitalisation and lock-in period are applicable. It also bars foreigners in sectors where FDI is prohibited or restricted with caps on investment.

Indian companies having foreign investments will not be eligible to make investments in LLPs. Similarly, LLPs having foreign investment will not be allowed to make downstream investments or raise overseas debt, said a senior government official.

LLPs incorporate the features of companies and partnerships. The liability of partners is limited to the extent of their stakes in the entity. It also has various advantages over present corporate structures. Unlike private limited companies where number of shareholders is limited to 50, an LLP can have unlimited number of partners. Compliances relating to meetings and maintenance of statuary records are not applicable for LLPs. Currently, FDI is not permitted in partnerships firms, but is allowed in companies depending on sectoral cap. FDI is allowed up to 100% in a number of sectors such as manufacturing through the automatic route.

Sole proprietorship firms can get non-resident investment on a non-repatriable basis. Globally, 100% foreign investment is permitted in LLPs though they are not allowed to undertake certain sectoral activities in some countries.

Advisory services get tax waiver under Singapore treaty

The fee paid by an Indian company for technical services of a foreign company will not be taxed in India under the India Singapore Tax Treaty. The Authority of Advance Ruling (AAR) has held that advisory services such as comments and suggestions do not fall within the definition of the term 'Fee for Technical Services' under Article 12 of the treaty.

AAR, deciding on the case of payment made by Bharti AXA General Insurance to AXA Asia Regional Centre Pvt Ltd (ARC) of Singapore for consultancy and IT support services, said the payment did not amount to 'fee for technical service' and 'royalty'. It said since AXA ARC did not have a permanent establishment in India, the payment could not be taxed as business profits under the treaty.

The revenue department had argued that AXA ARC provided technical services on the basis of the provisions of the Article 12 of the treaty and fees received for such services are taxable in India attracting withholding tax provisions. It said Bharti AXA utilised the technology provided to it by AXA ARC and thus the life insurer could act independently to develop its own business.

Bharti AXA, on its part, said the services were merely advisory in nature and procured with the intention of carrying out business in line with the best practices followed by other AXA group entities globally.

AAR said the services rendered by AXA ARC could be brought under the definition of 'Fee for Technical Services' under the I-T Act, but in order to be taxed in India the services should fall within the purview of the definition under the treaty and "make available technical knowledge, experience, skills, know-how" which facilitates the Indian company apply the technology embedded in its own business.

The ruling would be helpful to those foreign companies who render services to Indian companies but does not qualify 'make available'. Even if one was to say that the services rendered 'make available' the technical knowledge, one needs to examine how the recipient of services can apply the technology to his business.

AAR relied on the recent decisions on Intertek Testing Services India Private Ltd and Ernst & Young Pvt Ltd to conclude that the services provided by AXA ARC could not be taxed in India.

New telcos may exit, set off consolidation

The telecom department (DoT) is examining proposals that would allow new mobile operators, who were given licences and airwaves under controversial circumstances two years ago, to sell out or exit, paving the way for a possible consolidation in the 14-player domestic telecom market.

A senior DoT official said 'exit options' were being discussed after some new entrants approached the telecom department seeking a refund of their Rs. 1,651-crore entry fee in return for them surrendering their licences and spectrum to the government. While the official declined to name any particular company, he added that some players wanted to selectively surrender licences and spectrum in specific circles as they faced 'several' constraints, including funding, in launching mobile operations across all 22 geographies in the country.

The official said several possibilities were being considered, including allowing new companies to merge with larger operators, shortening the three-year period during which the promoter of a new company cannot sell out, and relaxing rules to allow incumbents to retain airwaves held by these new companies if a buyout or merger were to happen. He added that these discussions were still at an 'initial stage' and nothing had been finalised.

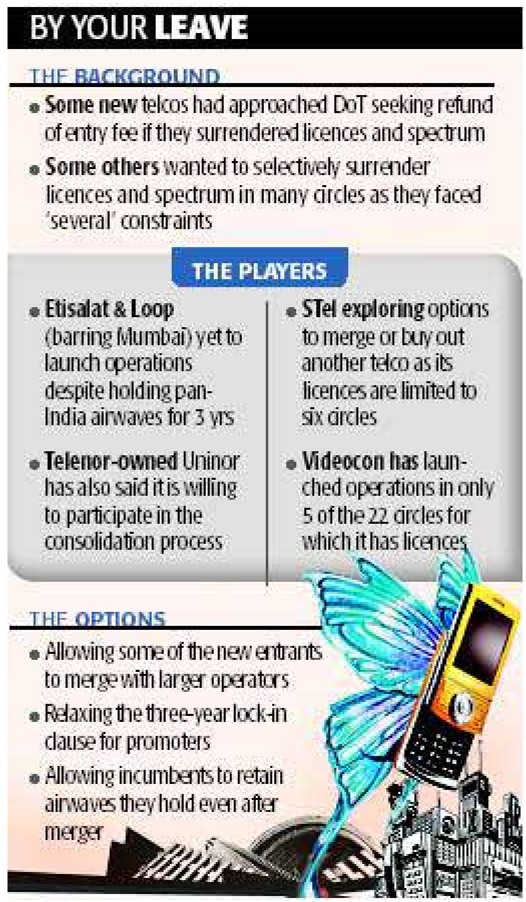
Stringent M&A restrictions had been imposed on the telcos a few years ago to prevent new players, who had got pan-India licences and spectrum at a flat fee of Rs. 1,651 crore, from selling out at huge profits. Earlier this year, the telecom regulator issued a new set of M&A guidelines which were criticised by some of the big telcos as these recommendations effectively shut them out of the consolidation process. But the Solicitor General of India has recently said that it is no longer mandatory for the telecom department to seek the telecom regulator's recommendations while making policy changes, giving DoT the power to unveil new M&A norms on its own.

New players have struggled with their rollout plans and their rate of adding new subscribers has slowed down. Etisalat and Loop (except in Mumbai) are yet to launch commercial operations despite holding pan-India airwaves to launch mobile services for nearly three years. Videocon has launched in only five of the 22 circles. STel, another new player, is also exploring options to merge or buy out another telco as its licences are limited to just six small circles.

Uninor, STel, Loop, Etisalat DB, Videocon and Sistema together added less than 12% of 18 million customer additions in June, according to data released by Trai. This is in sharp contrast to last year's numbers when Uninor added a million users within 30 days of launch. STel managed to clock one million subscribers in 90 days from three small circles. While Videocon added 1.39 million users in May, it could add only a third of that in June. The new entrants together account for less than 3% of India's 600 million mobile users.

While their growth rates may have slowed down, the bruising price war launched by the new companies has adversely impacted the profits and revenues of the established players.

This led to combined revenues for the telecom sector in March 2010 being lower than the industry's total revenues for the quarter-ended December 2008, despite the addition of over 200 million new users during this period.



Tax code only from 2012

The Direct Taxes Code (DTC) Bill that was introduced in Parliament proposes some relief to individuals and companies. But a closer read suggests that women taxpayers, developers of special economic zones and units in these areas, as well as those investing in unit-linked insurance plans, are in for harder times.

The only saving grace is that these individuals and companies will get an additional year's breather, as the new legislation to replace the Income-Tax Act, 1961, is slated to come into force only from April 2012. Like the Goods and Services Tax, this is again a case of missed deadlines, since the original schedule was to shift to DTC from April 2011.

Under the new regime, companies will pay 30 per cent corporation tax, including cess and surcharge, instead of the present combined levy of 33.2 per cent. Besides, the tax rate for foreign companies will now be the same as domestic companies.

The Bill — the result of two rounds of consultations and factors in 1,600 comments — proposes to increase the exemption limit for individuals from Rs 1.6 lakhs to Rs 2 lakhs. Accordingly, the slabs have also been reworked. Those with a taxable income of Rs 2-5 lakhs will be taxed at 10 per cent; those in the Rs 5-10 lakhs bracket will have to pay 20 per cent; while taxable income of over Rs 10 lakhs will attract a 30 per cent levy.

Though this is lower than what was proposed in the first discussion paper released last August, exemption on saving instruments, which were proposed to be withdrawn, has been retained. In fact, there have been a few additions to the list such as investment in the New Pension Scheme.

Senior citizens are in for some relief, but 'gender equality' has meant that the additional exemption limit so far available to women taxpayers will be withdrawn once DTC comes into effect.

By widening the ambit of the minimum alternate tax (MAT), the government is hoping to make up for some revenue loss caused by giveaways to individuals (Rs 14,343 crores) and companies (Rs 38,829 crores). Despite this, tax buoyancy will come to the aid of the exchequer.

The reworked slabs are expected to benefit a majority of taxpayers.

For companies paying MAT, there is relief in the form of a continuation of the system of assessment on book profits. While MAT credit can be carried forward for 15 years, the rate is being increased to 20 per cent from 19.93 per cent, including cess and surcharge.

In the case of SEZ developers, the government has decided to limit profit-linked benefits for zones that are notified after March 2012. In case of units, the cut-off date has been fixed as March 2014. SEZ developers and units are also included under the MAT regime under the DTC.

In order to garner more resources from fund houses that have a bulk of assets under management in debt schemes, the government proposes to increase the tax rate for them from the present 25 per cent to 30 per cent, which is the corporation tax rate.

BlackBerry will have to set up India server

Google, Skype must also fall in line

Blackberry maker Research in Motion (RIM) has got a 60-day reprieve from the government to continue services in the country, but the Canadian firm will have to ultimately set up a local server to keep providing full services beyond November.

For now, the government has accepted RIM's proposal for 'lawful access by law enforcement agencies' of encrypted BlackBerry data. The Canadian smartphone maker will implement 'full and partial solutions' for different applications, including messenger services and corporate emails, which the security agencies will test over the next 60 days. At the same time, the telecom department (DoT) has been asked to study the feasibility of providing such services only through a server located in India.

The government, to rule out any allegation of discrimination against BlackBerry, has decided to also take other service providers such as Google, Skype, MSN Hotmail or VPN—to task for inadequate access to data traffic routed through India. They would be asked to set up servers here to enable lawful interception.

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