India Update: November – December 2010

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Insider trading laws to get legal backup soon

To be made part of Sebi Act; violations to carry up to 10 years jail & Rs. 25 crore[1] penalty

Insider trading regulations will get greater legal sanctity and permanence with the finance ministry looking at amendments to include detailed regulations in the SEBI Act, 1992 ("SEBI Act").

These provisions are contained in the rules, which do not have the same force as an act of Parliament.

"Insider trading" refers to purchase or sale of shares by someone who possesses 'inside' or prior information about a company's performance and prospects which are not yet available to ordinary investors, and which if available might affect its share price.

At present, insider trading is not defined under any legislation - SEBI Act or Securities Contract and Regulation Act. This term has been referred to and prohibited in the SEBI Act, but the definition and other detailed requirements for insider trading have only been provided in relevant regulations framed by the market regulator. The Act merely says that no one should indulge in insider trading and prescribes the penalty for it. The details are contained in the SEBI (Prohibition of Insider Trading) Regulations, 1992.

Such delegated legislation by any authority or the government runs the risk of too much interference and ad hocism. A well debated law passed by Parliament compromises on the flexibility, but acts as a check on excesses by the regulators or authorities.

The standing committee on finance that recently submitted its report on the new Companies bill also made a note of the need for incorporating insider trading provisions in the Act.

Freebies with goods will now come at a cost

After-sales service charges to be included in cost of goods

Freebies such as extended warranty and free maintenance and service thrown in with cars and consumer durables will now be included in the costs of goods and taxed appropriately, pushing their prices higher.

The apex indirect taxes body, the Central Board for Excise and Customs, has said that after-sales service and pre-delivery inspection charges are to be included in the assessable value, the value on which excise duty is levied.

This could push up cost of products if companies do not absorb it themselves. The move may unsettle the principles of taxation in excise duty and is likely to increase litigation.

Dealers of most automobile and durable manufacturers offer many services or

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

benefits to customers on behalf of the producers, the cost of which is usually included in the dealer margin. But the excise department says that these activities are the manufacturer's prerogative and their costs should be added to his price on which excise duty ought to be paid.

The indirect taxes body had been deliberating the move for a while but had put it on hold due to pending cases involving Maruti Udyog in the Customs, Excise & Service Tax Appellate Tribunal (CESTAT). The tribunal recently decided the case in favour of the department and upheld that after-sales service and pre-delivery inspection should be included in the value of the car and excise duty be levied on it.

With the CESTAT backing, the apex indirect taxes body has asked its field formations to get on the issues, implying that manufacturers may face heat on this count.

Harley to assemble bikes in India

Iconic American motorcycle maker cutting cost in bid to gain toehold in booming premium bike market

Iconic American motorcycle maker Harley-Davidson will start assembling select models in India, making them about 20-25% cheaper, in a bid to crack the booming Indian premium bike market dominated by Japanese brands.

The upcoming facility at Bawal in Haryana will become operational in the first half of 2011 with an initial capacity to assemble 200 bikes per year.

The 70,000 square-feet plant will assemble select models including the popular Sportster family from kits of parts imported from the US factories of Harley-Davidson.

Completely knocked-down (CKD) kits attract a lighter net duty and taxes of around 60% compared to the 110% tax being levied on imported bikes.

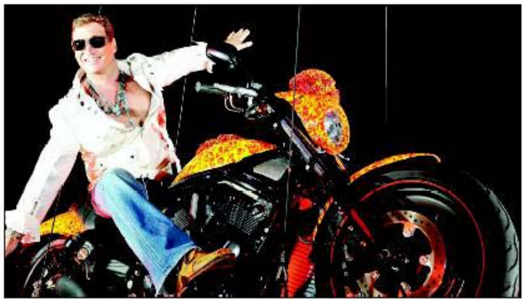
The super bike market in India was estimated at around 1,000 units last year and is growing 20% a year. It's dominated by Japanese companies Suzuki, Yamaha and Honda with Suzuki's Hayabusa in the lead. Kawasaki (by Bajaj Auto) and Italian cult brand Ducati, besides Harley-Davidson, too are selling big performance, designer bikes with engine capacity of 800 cc and more in India. BMW will start selling its Motorrad range of bikes in the country shortly.

Harley-Davidson, which started selling 12 models in India in July this year, hopes to gain an edge over BMW's Motorrad with its assembly plant, which will make its bikes more competitive.

At present, Harley sells bikes with engine capacities of 883cc to 1500cc and priced in the range of Rs 7.8 - 38.7 lakh[2]. The

[2] *1 lakh = 100,000*

company hopes to sell 100 - 200 bikes by the end of 2010.



Five years on, Centre and states agree to stamp duty changes

Reforms critical as duty kept out of proposed GST

Decks have been cleared for sweeping reform of the stamp duties law with states agreeing to an overhaul that will see simpler nation-wide rules reducing the incidence of taxation and making compliance easier.

The Centre and states have concluded consultations on the contours of the new law that will drop several archaic provisions.

Reforms in the century-old Indian Stamp Act, 1899 (the "Stamp Act") are crucial as stamp duty has been kept out of the proposed goods and services tax (GST) that seeks to replace a plethora of state and central taxes.

The existing Stamp Act, which gives powers to states to impose duties on various transactions, can undermine the nationwide GST by dividing the market along state boundaries because of the difference in levies. For instance, Uttar Pradesh had, late last year, asked the Centre to change the duty rate structure for insurance products. Against the existing rate of 20 paisa per 1,000 (0.02%) of sum insured on life products, the state wanted 0.5%. Other states have also demanded a similar duty structure. Stamp duty on property and capital transactions accounts for a substantial portion of states' revenues.

In 2009-10, all states together have budgeted to raise 48,218 crore under this head, or 13% of their total tax revenues and would not want to give up powers readily. So the success of recast would depend on the extent to which the states are willing to surrender their powers to levy stamp duty.

The Stamp Act still contains a number of provisions from the British era, which are proposed to be dropped as part of the overhaul. Apprenticeship deed, article of clerkship, award, cancellation deed, charter party that currently face stamp duty may be exempted from the current draft.

The draft has already been circulated to the states and will be finalised soon in line with their suggestions.

Some states have sought a change in overall duty structure to change it from monetary value to a fixed percentage based rate system. Although the stamp duty on most instruments and transactions is imposed in percentage terms a number of instruments such as insurance still attract specific duty.

The Centre is also trying to convince states to reform the stamp duty structure for financial instruments as a part of the current makeover exercise.

The report of the Committee on Making Mumbai an International Financial Centre had even suggested that all transactions taxes such as stamp duties should be eliminated. While states are unlikely to admit to such a radical reform, a uniform structure is likely to help financial markets.

The stamp duty reform in case of real estate is being tackled as part of the Jawaharlal Nehru National Urban Renewal Mission. Many states have already cut stamp duty on real estate transactions to avail of the incentives provided by the scheme.

UTC to form two India JVs

Plans to manufacture military helicopters, aircraft parts

The $53-billion American conglomerate United Technologies Corp. (UTC) will form separate joint ventures with two Indian companies to manufacture military helicopters and aircraft components in the country. Hindustan Aeronautics (HAL) is one of the two Indian companies it is in talks with.

Connecticut-based UTC, that makes Pratt and Whitney aircraft engines, Otis brand of elevators and Carrier air conditioners, is targeting revenues of $2.5 billion from Indian operations in the next five years from the projected $600 million this year, powered by high growth potential of the Indian economy.

Last year, UTC's subsidiary Sikorsky Aircraft Corp. formed a joint venture with Tata Advanced System Ltd, a subsidiary of Tata Sons, to make helicopter cabins. The company has business relationships with other Indian companies such as Larsen & Toubro and Infotech.

Currently, UTC has over 5,000 employees spread over three factories and 113 offices at 60 locations in India but India currently contributes only 1% to the firm's revenue while China accounts for 5%. Otis and Carrier contribute most to company's India business.

Disclosure norms to be tightened to curb speculation

The government plans to keep a tight vigil on foreign investment inflows by making it mandatory for companies bringing in foreign equity to periodically disclose the end-use of such funds.

The Economic Intelligence Council (EIC) has called for 'full disclosure' of FDI details by the industry. The Department of Industrial Policy & Promotion (DIPP) is working on a format for submitting information to the government.

Currently, there is no mechanism for monitoring the actual use of FDI and regulatory agencies do not go beyond mandatory clearances at the time of approving foreign investment proposals. This has the government worried since it does not want FDI flows to be exploited for money laundering or diversion of foreign investment flows for speculation in the stock market or real estate.

The government wants to put in place a detailed system to make companies come out with full details of ownership, background of promoters, sourcing of funds and investment history.

The home ministry and the working group on intelligence apparatus, a co-ordination committee set up under the leadership of the revenue secretary, are also involved in the discussions. Mandatory disclosures would mean additional paperwork for the companies. If deviations are found during monitoring, penal action will be taken against erring companies. The National Security Council has been working on an umbrella legislation to ensure that FDI policy does not clash with national security concerns. Since work on the proposed legislation has slowed down due to differences of opinion within the government, the EIC is now handling some of the issues like monitoring of FDI.

The EIC's mandate is to improve co-ordination among enforcement and intelligence agencies dealing with economic offences and the income tax/ customs wings of the department of revenue. The Council is supposed to come up with an oversight mechanism to evolve policy responses to economic offences.

While 100% FDI is allowed in some sectors through the automatic route, these segments are subject to sectoral norms. Since no clearances are required for these sectors, the companies concerned keep the RBI informed.

JAYEETA

Must amend rules to bring domestic deals under transfer pricing laws: SC

The Supreme Court has asked the finance ministry and Central Board of Direct Taxes (CBDT), the apex body in charge for administering India's taxation system, to amend transfer pricing (TP) laws if it wishes to bring domestic transactions under their ambit.

Currently, India's TP rules cover cross-border transactions between related parties, such as Indian arm of a foreign company and its overseas parent. They are silent on related party transactions between entities within the country.

The apex court's ruling came in an order last week on an appeal filed by the Income-Tax department in a case relating to pharma major GlaxoSmithKline Asia. The issue centred around a transaction between GlaxoSmithKline Asia and its service provider. The I-T department claimed the company and its service provider are related parties and asked for records and clarifications from the company. In this case, the I-T department sought to apply the same rules it applies for cross-border transactions between related parties. But the SC concluded that the parties were not related and dismissed the special leave petition filed by the I-T department. However, the observation made by the apex court that TP rules should be amended if the department has to apply the same rules to domestic transactions can widen the scope of India's transfer pricing rules, if the finance ministry decides to modify the rules.

The SC has observed that since the prevailing rules apply only to cross-border transactions, laws require to be changed if the tax payer is to be asked to maintain records and obtain an audit certificate from a chartered accountant authenticating that related parties' domestic transactions are at arm's length.

Sovereign funds invest in India story

Turn top bidders in Coal India, Power Grid issues

Sovereign wealth funds from Norway to Abu Dhabi are increasing bets on India by buying into the Coal India and Power

Grid issues as they increase their share of emerging market assets when the West is grappling with shaky sovereign ratings and tepid growth.

Norway's Norges Bank Investment Management, the world's second-biggest sovereign wealth fund built on revenues from oil and gas, was among the top bidders for Power Grid shares. GIC of Singapore, which owns a stake in ICICI Bank, bid for $500 million worth of shares in Coal India. Mubadala, the world's wealthiest fund from oil-rich emirate Abu Dhabi, also bid.

Sovereign funds with welfare commitments to their people are rebuilding their assets after losing money during the credit crisis. Globally, assets managed by these funds rebounded about 9% in 2009 to $3.51 trillion, according to data provider Preqin. Some 85% of the funds have exposure to equities.

There are some 60-odd sovereign funds that have a direct account to invest in Indian equities through their registration with the market regulator, Sebi. These funds have traditionally been active investors in the secondary market. High secondary valuations, the disinvestment ministry's sales pitch and prospects of getting a huge block drew them.

Foreign institutional investors own $118 billion net of sales in Indian equities, according to Sebi data. With sovereign credit risks such as Ireland, Spain and Portugal, long-term investors such as sovereign funds are chasing countries with stable policies and strong economic growth. With Indian state-owned companies seen as stable ones and when attractively priced, they draw top investors.

Swiss Re looks for Indian partner for insurance

Swiss Reinsurance, the world's second-largest reinsurer, said it was looking for a local partner in India as it considered entering the country's life and health insurance market.

According to the company, property and casualty reinsurance in emerging markets offer the maximum growth potential for the company as Asian governments spend more on infrastructure projects requiring coverage.

Biotech regulator bill up for Cabinet nod

Proposed authority to deal only with safety & efficacy issues, leaving decisions on commercialisation to ministries

The proposed Biotechnology Regulatory Authority of India (BRAI) seeks to replace the existing multiple mechanisms that are operating under different administrative ministries. The proposed bill — initially prepared in 2008 — has been revised substantially. The proposed authority will now deal only with safety and efficacy issues, leaving the decisions on commercialisation of biotech products to respective administrative ministries. Depending on the field in which the product is to be used, the decision on commercialisation will be taken either by the agriculture ministry, or environment ministry, or health ministry. In some cases, the approval may also be given by the department of science and technology.

The regulatory authority will now be under the administrative ambit of the Department of Science and Technology. However, concerns on the conflict of interest still persist as traditionally, the same minister heads departments of biotechnology and science and technology.

On the insistence of the environment ministry, public consultation has been made mandatory before an approval is granted to use of a biotechnology product.

The proposed authority will function under the supervision of an inter-ministerial governing board, which will comprise of secretaries of the ministries of agriculture, commerce, health, environment, department of science and technology, biotechnology.

The Genetic Engineering Approval Committee (GEAC), currently housed in the environment ministry, would be rechristened as the Environment Appraisal Panel under the proposed BRAI. The panel will be governed by the Environment Protection Act, 1986 in managing and protecting the environment. The chairman and member secretary of this panel will be nominated by the environment ministry.

The chairman of the environment appraisal panel will report directly to the BRAI chairman. In the event of a difference of opinion between the panel and the regulator, the BRAI will pass a speaking order. Similarly, the expert member on environment in the product ruling committee will be selected from a roster prepared jointly by the environment ministry and the BRAI.

Group firm tag if affiliate stake above 26%

Redefinition to affect cash-and-carry ventures such as Bharti Wal-Mart, Tata-Tesco & Future Group-Carrefour

The government will define the term 'group company' clearly to remove the confusion in the foreign investment policy regarding restrictions on sales by wholesale cash and carry companies to related firms.

The new definition may be based on the one given in the foreign trade policy and the Competition Act, 2002 which says a company with more than 26% investment by another company will be considered a group company of the latter.

The Department of Industrial Policy and Promotion (DIPP) is expected to go with the definition of the group company in the foreign trade policy and the Competition Act.

The new definition has implications for wholesale cash and carry ventures such as Bharti Wal-Mart, Tata-Tesco and Future group - Carrefour, which may have to rejig their holding structures to be able to conduct business.

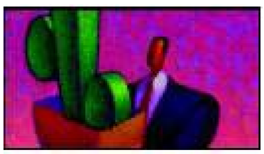
The current foreign direct investment policy says sales of foreign investment funded cash and carry stores to a group company cannot exceed 25% of their total sales, but did not define group company. Bharti Retail is a 100% subsidiary of Bharti Enterprises. Bharti Enterprises and Wal-Mart have a 50:50 wholesale venture, Bharti Wal-Mart. Under the proposed norms, Bharti Retail and Bharti Wal-Mart will be considered group companies, inviting the restrictions mentioned in the FDI policy.

This means Bharti Wal-Mart cannot have more than 25% of its sales going to Bharti Retail.

The government had, in April 2010, put these restrictions to preclude indirect entry of foreigners in multi-brand retail.

The current policy prohibits foreign direct investment in multi-brand retail, but allows 100% foreign investment in wholesale trade.

After intense lobbying and several industry representations, the government had recently removed the condition that sales to group companies must be for internal use. The 25% clause, however, still remains, making the policy restrictive. These restrictions could, however, become redundant if the government decides to open multi-brand retail to foreign investment.



Provident fund for expats not before retirement at 58 years

Expat workers can now withdraw their provident fund balances only on retirement at 58 years of age. Earlier, expats could withdraw their accumulated balances in the provident fund account at the end of their employment in the country.

The move will not impact expats from countries that have a totalisation or social security agreement with India, creating an incentive for other countries to sign similar agreements.

India has signed nearly 12 social security agreement, but only two with Belgium and Germany are currently operational.

Indian workers are allowed to withdraw their PF balances under a number of circumstances. International workers will be able to do so only on retirement at 58 years, as against 55 years for local workers, according to the latest changes made through an amendment to the Employees' Provident Funds Scheme, 1952. However, in the case of permanent and total incapacity to work due to metal infirmity withdrawal will be allowed.

Overseas workers will need to keep their bank accounts in India till the refunds are received in such account. For example, a foreign worker who completes his employment in India at the age of 50 years will have his contribution blocked for 8 years and will have to keep his bank account open till then to claim the amount.

Foreigners will be happy leaving their funds in India, which will earn nearly 9% return as against much lower they get back home. But there is a new rule expected to come into effect from April 2011 under which provident fund accounts inactive for more than three years will not earn any interest. Once this rule comes into effect this extra return will be available only for three years after an expat leaves India.

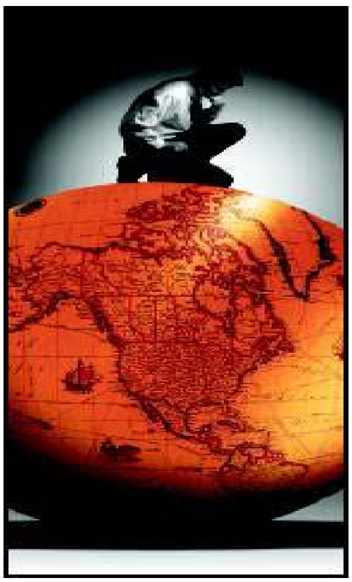
India had, in 2008, made it mandatory for expats to contribute to employee provident fund and employee pension scheme.

Under these schemes an employee contributes 12% of his basic salary plus dearness allowance and his employer makes a matching contribution. When an Indian company sends an employee on an assignment for 2-3 years, he and his employer have to contribute to the social security system prevalent in that country as also to provident fund back home.

This has been a bone of contention between India and the US. India has been trying to convince the US and UK to enter into a totalisation agreement, but no deal has been reached so far. Totalisation or a social security agreement is a reciprocal program that prevents double payment to social security systems between countries.

While this puts an additional burden on an employer, it does not benefit the employee in any way as in most countries the minimum duration for deriving any benefit is 10 years.

According to estimates, Indian IT professionals in the US contribute close to $1 billion every year as social security taxes.



Lobbying for a mention in annual reports

Ethical call: government plans to ask companies to name lobbyists

The government plans to ask companies to disclose the names of lobbyists employed by them and their positions on issues affecting their business as it looks to bring in greater transparency into its dealings with companies that are trying to influence decision-making.

Such disclosures will be voluntary and companies may be asked to list these details in their annual reports. They will need to provide an explanation if the information is missing from their annual reports.

The ongoing 2G spectrum controversy has brought the role of lobbyists into the limelight. The alleged role of a corporate lobbyist is being probed by investigative agencies.

The proposed guidelines on lobbying state that lobbying and policy advocacy are important tools for conducting business if done in the right manner.

A committee formed by the Ministry of Corporate Affairs to formulate guidelines for ethical business practices had earlier suggested that companies should be asked to disclose the names of agencies working for them and provide details on their policy advocacy steps.

Five auto giants rev up for India

Chrysler, Kia, Peugeot, Triumph and Scania are finalising their India blueprint.

France's largest car maker PSA Peugeot Citroen has held talks with some state governments for land to set up a manufacturing plant. The company plans an entry through a 100 per cent India subsidiary.

US-based Chrysler is keenly interested in getting its vehicles into India. About 20 per cent of Chrysler shares are owned by Italian auto giant Fiat, which has an industrial joint venture in India with Tata Motors.

Kia Motor, the Korean affiliate company of Hyundai Motor Company, whose India subsidiary is the second-largest car maker domestically, has shown interest in launching its small car and SUV range in India.

Kia is in the initial feasibility study stage and is yet to confirm our plans to enter the Indian market. There is a possibility of their using Hyundai's plants to assemble cars. Hyundai Motor India has two manufacturing plants in India, located in Tamil Nadu.

Sweden's heavy commercial vehicle maker Scania is also trying to make inroads into the country with its range of heavy-duty trucks and buses. The company is not keen on venturing on its own in the highly competitive market and is, therefore, looking to partner with one of the local companies for a foray.

UK-based luxury car maker Aston Martin also appears to be gearing up to launch its cars in India and tied up with a Indian partner to open the first showroom in Mumbai. The cars are likely to cost up to Rs 3 crore.

Fairmont Hotels plans to open six Swissotels in India

Fairmont Hotels & Resorts Inc plans to add six hotels under its Swissotel brand in India in the next five years to tap the growing demand for business travel. The company plans to open two of the Indian properties in 2013 in Gurgaon near New Delhi and Bangalore.

International hotel operators are increasing their presence in India as they seek to benefit from Asia's second-fastest growing major economy, which is set to overtake China as early as 2013. The pace of growth of India's $1.3 trillion economy accelerated to 8.8% in the three months through June, just behind China's 9.6% expansion in the quarter ended September. Marriott International Inc and Carlson, owner of the Radisson brand, each plan to open 100 hotels in India by 2015. Marriott also plans to start its Ritz-Carlton brand in India..

Navi Mumbai airport gets green nod, finally

Clearance from environment ministry comes with 32 conditions & safeguards to counter environmental impact

The environment ministry has given a green light for the construction of the much-delayed Navi Mumbai airport project, paving the way for a second facility to ease air traffic in Mumbai. However, the clearance comes with 32 conditions and safeguards to counter the environmental impact of setting up an airport in an ecologically-sensitive zone.

With the environment clearance in place, the bidding process for the development of the airport would be completed, and contracts for the project would be awarded within 8-12 months.

The Navi Mumbai international project will be developed through Public-Private-Participation mode in which the private party will hold 74% stake, CIDCO and Airports Authority of India (AAI) will have 13% each. The facility is expected to handle up to 40 million passengers a year by the time it is fully operational in 2030.

M&M to acquire 70% stake in SsangYong Motor for USD 463 mn

Mahindra & Mahindra will acquire a 70 per cent stake in the South Korean auto maker SsangYong Motor for USD 463 million (about Rs 2,105 crore) in order to become a global utility vehicle major.

The companies have signed a definitive agreement to this effect and the acquisition process is expected to complete by March 2011. As part of the agreement, M&M will acquire 70 per cent stake in SsangYong Motor Company (SYMC) and out of the total cost of acquisition of USD 463 million, USD 378 million will be in new stocks and USD 85 million in corporate bonds.

Apart from getting access to technology and products, M&M will get an established distribution channel in almost all major SUV markets. M&M will get one more manufacturing base in South Korea, besides a wider network of component sourcing, he added.

This is M&M''s second major takeover deal this year after acquiring a majority stake in Bangalore-based Reva Electric Car Co. In 2008, M&M had lost out to Tata Motors in the race to acquire Jaguar Land Rover.

Chennai may become India's Detroit soon

With investments of $3 billion and a new national testing-R&D facility, the city is putting India on the global auto map.

Chennai is emerging as the country's largest automotive and auto components manufacturing hub in terms of investment. According to a state government official, over $3 billion (around Rs 13,800 crore) will be invested in Chennai by global car manufacturers by end of 2010-11. The proposed investment is significantly higher than other auto hubs like Gurgaon in Haryana.

Tamil Nadu Industry Secretary Rajeev Ranjan said the total installed capacity in and around Chennai would be 1.28 million cars a year by the end of the financial year. But, that figure is expected to go up significantly thanks to projects by Ford, Hyundai, BMW, Renault- Nissan and Mitsubishi-HM coming up in the area.

Every third car produced in India is from in and around Chennai. Similarly, the region will see the manufacture of around 350,000 commercial vehicles a year by the end of 2010-11. In 2008-09, 560,000 passenger cars were manufactured, accounting for 30.6 per cent of India's total production.

Haryana has an installed capacity of around 4.8 million vehicles (1.2 million for Maruti and 3.6 million for Hero Honda). Harley Davidson is also setting up an assembly unit at Bawal in Haryana, which will become operational by the first half of 2011.

Maruti will produce 1.2 million cars from its facilities at Gurgaon and Manesar. Besides, it has plans to add two more plants at its Manesar unit to increase capacity by 0.5 million by 2013. The total investment in both plants is Rs 3,625 crore. Hero Honda, which is the largest producer of motorcycles in the world, has two plants in Haryana: at Gurgaon and Rewari. It produces 6,000 units a day at each.

The automotive industry occupies an important place in the industrial map of Tamil Nadu. The state's innovative policy for the sector offers an attractive package of support to projects investing more than Rs 4,000 crore. As a result, since May 2006, investments attracted by Tamil Nadu in automotive and auto components manufacturing is around Rs 21,900 crore. The employment potential, both direct and indirect, in these new projects is roughly 120,000.

ON A ROLL

Name of project	$ mn*	Products
Ford, US	800	Cars
Hyundai, South Korea	1700	Cars
Nissan, Japan	600	Cars
Renault, France	400	Cars
BMW, Germany	45	Cars
HM-Mitsubishi	120	Cars
Daimler, Germany	900	Commercial vehicles
Komatsu, Japan	50	Earth moving machinery
Caterpillar, US	250	Earth moving machinery
Ashok Leyland-Nissan	950	Commercial vehicles

**Investment*
Source: TN govt

On the auto components sides, more than 350 auto component suppliers are located in the state, accounting for over 35 per cent of India's production capacity. Some of the big names include Visteon, Delphi, Robert Bosch, Lear, Hwashin, Motherson, Unipress, Valeo, Mando and many more have large manufacturing facilities in Tamil Nadu. Three Chennai-based industrial groups — TVS, Rane and Amalgamations — constitute more than 25 per cent of India's components production.

The most critical intervention of the central government thus far in the automotive sector has come in the form of an ambitious project to set up world-class automotive testing and R&D infrastructure. This will deepen manufacturing, encourage localised R&D, boost exports and converge India's strengths in IT and electronics with automotive engineering to help the country garner a larger share of the $6-trillion global automotive business.

The Centre is currently implementing National Automotive Testing and R&D Infrastructure Project in Oragdam, Chennai, at a cost of around Rs 450 crore. This project aims to facilitate the introduction of world-class automotive safety, emission and performance standards in the country and ensure seamless integration of our automotive industry with the global industry.

Steel companies eye more expats in new visa regime

Domestic steel companies are looking at hiring a higher number of expats in new steel projects after the government introduced the new visa regime for skilled foreign workers in these sectors.

Under the new regime, a project visa would be valid for the duration of the project and is being seen as a way of matching demand for expats on Indian projects. Earlier, a number of Chinese nationals had come into the country on business visas to work on specific projects. Following this, the government had been debating the introduction of project visas for expats working on new projects or joint ventures in India.

The JSW group and Electrosteel are among the companies in the private sector that are planning to employ foreign skilled workers and technicians in planned projects.

With the country's steel production poised to jump from 65 Mt to 124 Mt by 2012, an increasing number of new projects due for commissioned in the next 1-2 years could be seeking to employ the resources of skilled foreign workers in projects

While there is a growing number of expats working in projects in India, a substantial portion of the people are Chinese workers with a number of Chinese firms taking up turnkey contracts in steel and powers sector

The benefit in hiring expats is basically shorter project execution time. This leads to substantial savings of up to 40% in overall project costs. Apart from the monetary costs, the longer term benefit is the overall improvement in productivity of workers.

Skilled workers can be issued project visas on the basis of sector specific ceilings on the maximum number of visas allowed for each project in the steel and power sectors. This is usually decided upon on a case-to-case basis. However, work visas take a long time to be processed and approved. Concerns about this, leading to delays in projects, have led these companies to urge the government to speed up the process.

No tax on loan interest for foreign entities' India operations

If a foreign company pays interest on loan for carrying out operations in India it will be allowed tax exemption under the Income Tax Act, 1961, a tax tribunal has ruled.

This has put to rest uncertainties on application of thin capitalisation rules that allow tax authorities to reclassify excessive debt as equity and tax it.

The Mumbai Bench of the Income Tax Appellate Tribunal has ruled that interest payments by Belgium-based Besix Kier Dabhol's project office for debt taken to carry out operations in India, is an allowable expense under the Income Tax Act.

The Revenue Department had argued that the debt of the assessee should be re-characterised as equity, but the tribunal said it was not sustainable as thin capitalisation rules do not exist in India.

It said thin capitalisation rules or general anti-avoidance measures, proposed by the Direct Taxes Code cannot be applied to transactions which take advantage of treaty provisions, on the ground that some anti-abuse provisions will be introduced in the law in the future that may render such transactions illegal.

Thin capitalisation is a situation where a higher proportion of funds are infused into a company in the form of debt rather than equity because interest paid on loans is normally deductible for calculating taxable profits, whereas dividends are paid post tax.

The tribunal held that the assessee in this case earns income only from its operations in India, and thus, the income earned by the project office n India will be computed as per the provisions of the Double Taxation Avoidance Agreement (DTAA).

There was no specific provision under the I-T Act which provides for computation of profits attributable to the Indian arm of a foreign enterprise. So the income is computed under normal accounting principles and in terms of general provisions of the Act.

Draft mining Bill gets Group of Ministers' approval

26% profit-sharing with locals in mining projects

The Group of Ministers (GoM) headed by Finance Minister Pranab Mukherjee has approved the draft mining Bill, which will provide for sharing 26 per cent of company profits with local populace in mining projects.

In order to address the concerns of resource-rich states like Jharkhand and Orissa over adequate compensation and traditional rights over minerals, the GoM has asked the ministry to strengthen the clause that provides for competitive bidding for grant of mining leases. States were fearing that the new legislation would provide for adopting a first-come-first-served route for granting large area prospecting licences instead of competitive bidding. The approved draft will now be sent to finance minister for his final approval after which it will be placed before the Cabinet.

IRDA likely to set uniform norms for health cover

The Insurance Regulatory & Development Authority's (IRDA's) awaited health insurance guidelines are expected to include standard treatment norms for diseases, a common list of exclusions and a tightened noose around claim settlement.

Issues such as norms for policy exclusions, claim settlement period and the definition of critical illness will form a part of the health insurance guidelines.

IRDA is working with working committees consisting of members of the Confederation of Indian Industry and Federation of Indian Chambers of Commerce & Industry (FICCI). These bodies are providing suggestions on common problems of policyholders that need immediate attention.

The proposals are currently in draft form, but are likely to be posted on IRDA's website in the next couple months for comments.

IRDA may come out with standard treatment guidelines (STGs) for common causes of hospitalisation like diarrhoea, asthma, cataract surgery and typhoid. Standardisation will help in setting appropriate levels of payout for different types of surgeries in fixed-benefit reimbursement plans. It will also provide a framework for development of appropriate price range.

The move may also help prevent standoffs like the recent one between hospitals and public sector health insurers.

While hospital charges or premiums may not fall within the ambit of the proposals, tackling the problem from the insurers' side will ensure more transparency.

Furthermore, 203 items will constitute a likely list of common exclusions under non-medical expenses. This may include costs for a birth certificate, diabetic chart or external durable device like walking aids and cervical collar. Other costs like ward booking, eye kits and X-ray films may also not be payable. But these will be included under sub-limits like charges for operation theatre and radiology. Depending on the plan, most health insurance products cover such expenses.

Typically, dental treatment, psychiatric disorders and healing of sexually transmitted diseases are excluded from medical expenses. This is likely to continue.

The definitions of 11 critical illnesses have been submitted to IRDA. These include cancer, first heart attack, heart and major organ/bone marrow transplant, among others. Insurers may have to cover similar and equal number of illnesses under critical illness plans if this recommendation is adopted.

Illnesses covered by insurers under this plan differ due to different definitions adopted by each one. Moreover, standard definitions also mean that products can be compared.

IRDA is also likely to come out with a common form for claim settlement and will fix the number of days within which a claim must be settled.

Volvo buys partner's stake in Indian JV

Swedish bus maker Volvo Bus Corporation has bought out its joint venture (JV) partner Azad Group's stake in Volvo Buses India Pvt. Ltd. (VBIPL). With this, VBIPL has become a wholly-owned subsidiary of Volvo Bus Corporation.

VBIPL was formed in January 2008 as a 70:30 JV between Volvo Bus Corporation and Azad Group, with its headquarters in Bangalore. The company had invested Rs 100 crore to start operations with a 1,000 buses per annum capacity plant at Hoskote near Bangalore.

Volvo Buses is witnessing increased demand from both private and institutional customers and this strategic move will provide Volvo Buses greater flexibility to expand and put in place ambitious growth plans in the coming years.

Volvo would invest Rs 100 crore to increase the manufacturing capacity of its Bangalore plant to 5,000 buses per annum in the next five years. VBIPL would also introduce one to two new products every year.

To cater to the growing demand and plans, Volvo Buses will augment its factory and establishment, with new facilities for refurbishment operations, customer experience lounge, integral production principles and a competence development centre. As a result of expansion, the company would also increase its headcount by 30 per cent at its plant, he said. The Bangalore plant employs 1,000 people.

Volvo is working on introducing a CNG (compressed natural gas) bus in India. The company is also working on introducing alternative-fuel buses, like hybrid and methane, for the Indian market.

India will be the hub for exports to Saarc (South Asian Association For Regional Cooperation) countries and South Africa. The company, which commenced exports from India this year, expects to export about 15-20 units in 2010 and about 30 per cent of the total capacity in 2011.

Companies take cover for cross-border M&As

Buy special insurance abroad, add new conditions against tax losses

Learning from Vodafone's experience, companies and funds are buying special insurance covers and adding new conditions in cross-border deals to protect themselves from future tax losses.

Such insurance policies, which are valid for 4-6 years, are sold outside the country by international insurance firms which have joint ventures in India. In certain cases, the premium, which can be stiff given the high risks, are shared between the buyer and seller.

Tax claims similar to Vodafone will arise in deals where the buyer and seller are both offshore entities, as well as in transactions where the buyer is a local firm but the seller is non-resident. In the Vodafone deal, where Hong Kong-based Hutchison International sold shares of Hutch Essar to Vodafone, the Indian tax department claimed jurisdiction on the transaction because the company and the business that was sold was based in India, even though the transaction happened offshore between two non-residents.

Demand for cover may pick up

In India, where it is beginning to happen, demand for the cover may pick up. PE investors may also purchase such insurance. Private equity funds distribute the gains from a selloff to fund investors, also known as limited partners. Such a structure makes it particularly difficult to recover money in case of a tax claim a few years later. Besides, limited partners, like mutual fund investors, may exit a fund; and new investors who enter are unlikely to share the burden of an old liability they are clueless about.

In most traditional M&A deals, the share purchase agreement has an indemnity clause that says the seller will make good the loss if the tax office comes after the buyer later for not withholding tax. But here, the buyer has to pay the tax amount and then sue the seller to recover the money. The insurance cover, which allows the money to be recovered from the insurer, is over and above the indemnity clause. Indeed, insurance firms insist on an indemnity clause for selling protection. A common practice is where the seller in an M&A transaction takes the insurance cover, pays the premium upfront and names the buyer as beneficiary.

In standard share purchase agreements, there is a disclosure schedule where all contingent liabilities and potential payment demands are listed. If there is anything outside the disclosure schedule, the buyer can go to a court of law for breach of contract. But in private equity, it is difficult to insert an indemnity clause, as the fund distributes all its capital.

The final outcome of the feud between Vodafone and Supreme Court will influence the fate and future pricing of such insurance covers.

IndiaPay to target merchants

IndiaPay, the country's first indigenous payment gateway, is set to take on the global big boys - MasterCard and Visa - when it launches in the middle of next year. The National Payments Corporation of India (NPCI), the owner of IndiaPay, will fire the first salvo by charging only half what MasterCard and Visa levy on merchant establishments.

At present, merchant establishments are charged Rs 2 for every transaction worth Rs 100. A card's issuing bank gets around 80 per cent of that, while the merchant's bank or acquirer bank gets 15 per cent. The service provider gets the remaining 5 per cent.

The cost of card usage, if borne by a merchant establishment, could eat up 50 per cent of its profit. That is seen as a factor for the low acceptability of cards among small and medium merchants.

There are, however, several issues that need to be sorted out before IndiaPay gains acceptability. Firstly, point-of-sale terminals, in which banks have made huge investments, are configured for MasterCard and Visa cards. But NPCI is confident that this problem can be solved, as it has the backing of the government.

IndiaPay's shareholders consist of 10 banks, six of which are public sector banks. It is promoted by the Reserve Bank of India. The government and the central bank want to promote transactions channelled through banks, rather than in cash, which is an inefficient mode of payment. Money lying as cash in the hands of an individual does not have any multiplier effect, but can be leveraged if it is with banks.

Around 95 per cent of transactions in India are still carried out in cash, and studies suggest underutilisation of debit cards. Although there are 19 million credit cards and 190 million debit cards in the system, there are just 11 transactions per credit card and one transaction per debit card a year.

There are 500,000 point-of-sale terminals in the country. On average, a terminal sees less than one debit card transaction and 1.3 credit card transactions a day.

Studies have also found a correlation between efficiency in monetary transactions and increase in economic growth. A 10 per cent increase in card payments can contribute 0.5 per cent to GDP growth. And that is what the government and the banking regulator is aiming for.

NCPI is planning IndiaPay only for debit cards to encourage and increase their use among Indians. The risk-free nature of debit card transactions, compared to those of credit cards, is considered more suitable for Indians, most of whom are seen as risk averse.

Munjals to buy Honda holding in JV for USD 1 bn

SPV to divest 60-70% stake to 2-3 PE players

The Munjal family is set to acquire Honda Motors' 26% stake in their joint venture, Hero Honda Motors Ltd., for around $1 billion, or half the current value of the stake in the stock market.

The first phase of the two-tiered deal will see Munjals acquire the foreign partner's stake through a special purpose vehicle (SPV) by raising a bridge loan. The Indian promoters will subsequently divest 60-70% stake in this SPV to a group of 2-3 private equity firms to pay back the loan

While Munjals are acquiring the entire stake at half its current value, the stake sale to the PE firms will also be at a discount. The PE firms are likely to value the SPV at around $1.5-1.6 billion.

The second tier of the deal is not yet frozen as unlike conventional PE transactions, Munjals have asked the PE firms to bid for the stake. Depending upon the valuation, Munjals will select two firms to raise $1 billion, required to pay off the bridge loan.

The deal has been structured in two phases as the joint venture partners have the first right of refusal in case one of them calls it quits. The first phase of the transaction will also not trigger market regulator Sebi's takeover code for a mandatory open offer for buying 20%. This is because the share sale will be between co-promoters of a listed company. Once this two-legged transaction concludes, the Munjals will emerge as the largest shareholder in Hero Honda with a combined direct and indirect holding of 34-36% and the PE funds will own an indirect stake of up to 16-18%.

Honda, on its part, will completely exit the joint venture and focus solely on its wholly-owned company Honda Motorcycles & Scooters India. It will continue to charge the same royalty for technology support to Hero Honda as per the existing agreement that expires in 2014. But if Honda decides to extend the technology agreement thereafter for two years, as demanded by the Indian partners, there will be fresh agreement. Once the deal is consummated, Hero group will start focusing on export market and will also set up a fourth manufacturing facility as the two-wheeler market is currently booming, he said.

Law on cards for e-surveillance

The government, keen to ensure unrestricted access to all terror communication and e-mails, is working on a dedicated law that would make it binding on the service providers, both domestic and foreign, to allow surveillance of data routed through their networks.

The proposed legislation will be modelled on the US law, Communications Assistance For Law Enforcement Act (CALEA), enacted in 2009 to enhance the ability of US law enforcement and intelligence agencies to conduct electronic surveillance. India expects its own law to be in place in 2011.

Also on the cards is a permanent interface between the Telecom Ministry and the security establishment to sort out security issues relating to the telecom sector. The permanent mechanism, on which the Telecom Ministry, the Ministry of Home Affairs as well as business houses will be represented, will share information on security concerns and devise solutions to address them.

The proposed Indian law would make it obligatory for the service providers to have an interception mechanism in place for their services. Any failure to do so may invite stiff penalty and punitive action. Under the current scheme of things, allowing access to calls routed through a particular telecom network is part of the licensing conditions governing the service providers. If they fail to comply, all they face is cancellation of their telecom licences.

Under the US law CALEA, telecom carriers and manufacturers of telecommunication equipment are required to modify and design their equipment and services to ensure that they have built-in surveillance capabilities. The law allows US federal agencies to monitor all telephone, broadband internet, and VoIP traffic in real-time.

India is keen to replicate the US law to enable electronic surveillance of communications, particularly those routed through servers located in a foreign country. Often, the intelligence agencies find it difficult to monitor such data and have to depend on cooperation from the service provider to gain access to suspect calls and e-mails.

Once the CALEA-inspired law is in place in India, the foreign service providers such as Research in Motion will be bound to have an encryption mechanism in place so that each time a request is made by the security agencies for access to their services, they have no choice but to provide a key.

Safe harbour rules hit rough weather

The Finance Ministry may dash the hopes raised by last year's Budget promise of introducing safe harbour rules. Safe harbour rules are designed to make life easier for taxpayers as well as tax administrators by providing simplicity and certainty.

Safe harbour regulations allow a certain category of taxpayers to follow a simple set of rules under which transfer prices are automatically accepted by revenue authorities, doing away with stringent scrutiny. They are of special significance to sectors such as information technology (IT) and business process outsourcing, in which transfer pricing adjustments take place.

The need for safe harbour rules was felt because of increasing disputes between the revenue department and taxpayers over understatement of profits in international transactions between two related firms.

"To reduce the impact of judgemental errors in determining the transfer price in international transactions, it is proposed to empower the Central Board of Direct Taxes to formulate safe harbour rules," Finance Minister Pranab Mukherjee had said in his Budget speech of July 2009.

However, the ministry is now having second thoughts and is taking the view that it is not feasible to have safe harbour provisions in India.

An internal committee of the ministry has recommended safe harbours only for non-core services with international transactions of less than Rs 20 crore. The Finance Ministry, however, is not in favour of introducing the rules in this form.

The panel has recommended a safe harbour rate of cost plus 20 per cent. It has also suggested picking up a sample of companies for audit. The committee has pointed out that only four countries have safe harbour rules and that, too, in non-core business activities.

According to the Finance Ministry, there was no broad consensus among the committee members on how safe harbour rules could be implemented in India. The panel did not specify the sectors that should have safe harbour provisions, only that they should be in peripheral activities such as interest on loans, internal support services or small administrative services.

Some in the Finance Ministry believe that, it is not practical to have safe harbours in India because margins in the IT sector vary from 5 per cent to 90 per cent. According to them, transfer pricing disputes can be tackled with Advance Pricing Agreements, or APAs, which will do away with the need for dispute resolution panels.

In APAs, an ahead-of-time deal is signed between the taxpayer and tax authority to decide the arm's-length price. APAs are proposed to be introduced as part of the Direct Taxes Code in 2011.

DCGI issues norms to make clinical trials more ethical

The apex drug regulator — Drugs Controller General of India (DCGI) — has come out with a comprehensive clinical trial inspection programme for the country.

Specific guidelines and checklists prepared as part of this exercise are expected to make clinical trial regulation more stringent and uniform.

The programme turns significant, as India, with over 500 clinical trials getting approved on an average in a year, is one of the hot destinations for such studies conducted by global pharmaceutical companies.

Leading players with active presence in India are GlaxoSmithKline, Johnson & Johnson, SanofiAventis, Eli Lilly, Novartis, Bristol Myers Squibb, Bayer Healthcare, Astra Zeneca and Pfizer, and clinical research organisations (CROs) like Quintiles, ICON, GVK BIO Siro Clinpharm, Parexel, PRA International PPD, Covance, Omnicare and Kendle, among others.

The objective of the programme is to verify the good clinical practice compliance and to protect the rights, safety and well-being of the subjects involved in clinical trial. The credibility and integrity of clinical trial data generated and the compliance with various regulatory provisions according to Drugs & Cosmetics Rules will also be ensured through the structured programme.

It will provide a direction to drug department officers for conducting inspection of clinical trial sites, facilities of the company or organisation that sponsors such trials and also the facilities of clinical research organisations that undertake the trials.

According to ministry statistics, the number of deaths among clinical trial volunteers were 132 in 2007, 288 in 2008, 637 in 2009 and 462 up to June 2010. Most of these deaths were due to diseases like cancer as patients undergoing clinical trials were critical or terminally ill. Side-effects of unrelated cause can also prove fatal on some occasions.

Excise sops on expansion in HP, Uttarakhand to stay

Manufacturers in Himachal Pradesh and Uttarakhand will get excise duty exemptions on even the fresh investment they make to expand capacity or launch a new line of business from their existing plants.

The decision will benefit hundreds of companies such as motorcycle manufacturer Hero Honda and consumer products makers Hindustan Unilever and Dabur.

A circular issued by the Central Board of Excise and Customs (CBEC) says companies running factories in these states will enjoy the excise rebate on addition or modification of their plant or if they produce new products from these plants even though the 100% excise duty holiday had lapsed on March 31.

It added that the period of exemption would, however, remain 10 years and not get extended on account of modifications or additions.

The circular follows a Finance Ministry directive to CBEC to clear the air over the scheme as companies were under the impression that they would not get excise rebate if they made fresh investments in their plants after March 31. This had discouraged them to expand their operations in the two states.

Companies in business in the two states can manufacture new products by enhancing their manufacturing capacities now.

Service tax exemption on retail sale of packaged computer software

Waiver conditional to payment of excise on retail price if software is manufactured or imported

The Finance Ministry has exempted service tax on retail sale of packaged computer software to address the problem of double taxation on it. The move comes as relief to the country's Rs. 10,000-crore software retail industry and the customers who will now have to pay less for software such as Microsoft, SAP, Oracle, Norton antivirus and Adobe.

Until now, the government considered packaged software as both goods and service when a license was sold.

Packaged software comes with a license that allows the buyer legal use of the software. Post-manufacture or post-import, dealers and distributors will now not be required to register with service tax department to pay service tax at each level. The ambiguity arose as packaged software attracted a 10% service tax when downloaded and a customer also had to bear excise or customs duty on it if he purchased a CD of the software.

The 2008-09 Budget had made payment of service tax mandatory on packaged software by broadening the definition of software to include 'the acquisition of right to use packaged software'. The licence that came with a CD loaded with the software led to double taxation. It had hit hard the retail industry that operates on thin margins of 4-5%.

There, however, still appears to be an ambiguity in the case of industrial or institutional users. The software industry is allowed to split the license fee and cost of the CD for tax purposes as the cost of packaged software for institutional customers is decided on the basis of the number of licenses or users. But the latest notification has done away with the split provision.

Foreign companies asked to give price details of imported drugs

The country's drug price regulator has asked for pricing details of drugs imported by some foreign drugmakers to find if they take advantage of India's regulatory regime to price their products many times their cost of production.

The National Pharmaceuticals Pricing Authority (NPPA) has asked half a dozen global drugmakers to share details such as cost of manufacturing, ex-factory price in the country of origin, selling price in the home country and price of the same brand in over a dozen other countries.

NPPA regulates the prices of medicines using any of the 74 bulk drugs which are under price control. For medicines made locally, it caps the maximum price chargeable to the consumer based on the raw material cost, conversion cost and an additional margin of up to 100%. But for imported brands, the NPPA goes by the 'landed cost' declared by the global drugmaker, allowing a margin of up to 50% to bear other business cost and provide a reasonable profit margin.

Health activists, medical experts and local drugmakers have for a long time objected to the wide variation in the prices for a medicine made locally and abroad with same inputs. NPPA is now seeking a level playing field for local drugmakers and examining if global companies are arbitrarily charging consumers exorbitant prices.

No QIP for companies with sub-25% float

Promoters holding over 75% can raise funds only via public issue

The market regulator has mandated that companies with less than 25% public float will have to raise funds through a public share sale and not through private placement to institutions, a move aimed at widening retail holding and limiting stock price manipulation.

If the promoters of these companies want to sell their holdings to fulfil the 25% norm, they are permitted to sell on the stock exchanges and to any institution they choose. The regulator's circular sent to investment bankers did not provide reasons for the rule.

The previous guidelines issued in April 2006 had stated that companies could raise funds through prospectus or any other means that would not adversely affect the interest of minority shareholders. This opened the floodgate for companies to raise funds through private placement.

Multi-layered subsidiaries to stay

There may be limit on number of arms even as the government lets industry have its way on structure flexibility

The government will not restrict companies from setting up multiple-layer subsidiaries, or subsidiaries of subsidiaries, giving in to India Inc.'s demand for flexibility in corporate structuring.

Details of the new provision will be spelled out in the reworked Companies Bill that the government expects to get passed in the budget session of Parliament beginning February 2011. However, the bill may put some restrictions on the number of subsidiaries that a firm can have.

The flexibility will also come with the rider that companies will have to make more elaborate disclosures about their dealings with subsidiaries.

In a submission to the parliamentary standing committee on finance that reviewed the Companies Bill 2009, the corporate affairs ministry had mooted the idea that subsidiary companies should not have further subsidiaries.

The parliamentary panel headed by Yashwant Sinha had raised concerns over the incidence of corporate delinquency. Its report, released in August 2010, had sought additional measures, saying the Bill stopped short of addressing the issue.

The Ministry of Corporate Affairs then suggested more measures including restrictions on subsidiary companies setting up their own subsidiaries.

A maze of subsidiaries makes it difficult for investors to figure out financial transactions, allowing companies to divert funds. This was highlighted by the Satyam scandal where investigators found it difficult to track the flow of money from the scam-hit firm, now taken over by Tech Mahindra.

Source

Press clippings

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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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