India Update: September – October 2009

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Policing of tax-haven money flows set to get new byte

As a first step, the government is mulling putting in place Austrac-like anti-money laundering agency to make sure money parked in tax havens doesn't return disguised as foreign investment

Turning the heat on tax havens used to route investments into the country, India is examining a proposal that seeks to create a specialised information tracking system on the lines of Austrac — Australia's anti-money laundering agency.

The information system will collect data on the use of tax havens and abuse of Double Taxation Avoidance Agreements (DTAAs) by overseas investors entering India. It will also keep tabs on Indian investments abroad to ensure tax havens are not being used to bring that money back into the country. This mechanism, called round-tripping, is alleged to be used by some Indian entities to avoid tax on income from their investments in the country.

The Australian Transaction Reports & Analysis Centre (Austrac) is an anti-money laundering and counter-terrorism financing regulator and specialist financial intelligence unit. India already has a financial intelligence unit in place that keeps track of certain transactions, such as bank transactions of value exceeding Rs 10 lakh[1]. However, the income-tax department wants a dedicated agency to monitor the flow of investments from tax havens. The proposal has been mooted by an internal committee of the Central Board of Direct Taxes that was set up to examine investigation issues in abuse of tax havens and tax treaties.

Creation of such a unit becomes important in the backdrop of India looking to amend its tax treaties to expand their scope to include extensive information exchange or enter into specialised Tax Information and Exchange Agreements with tax haven countries.

This special unit would be able to track the flow of investments from tax havens into India and also from treaty countries such as Mauritius, which enjoy special tax benefits. The idea is to closely monitor all cross-border transactions to ensure all taxes legally due to India are paid and action is taken in time, if tax is evaded. The CBDT has set up a task force to look into information exchange with treaty countries. While India has already begun negotiations with Switzerland to amend its tax treaty, it also plans to amend other DTAAs for information exchange.

Energy-efficiency tags for vehicles from 2011

Move to help consumers make informed decision; bureau of energy efficiency to rate on the basis of fuel consumption per kilometre

It will be mandatory for automobile manufacturers to sell vehicles with energy-efficiency tags from 2011.

The rating will be done on the basis of fuel consumption per kilometre. The Bureau of Energy Efficiency (BEE) will be responsible for administration of the programme and label vehicles as per their energy efficiency. The move will help

[1] *1 Lakh = 100,000*

customers take informed decision while buying a vehicle.

The decision has been taken in a recent meeting of the Prime Minister's council on climate change.

The government is now working on guidelines for labelling vehicles. There will be different standards for different categories of automobiles such as small cars and commercial vehicles. Once the guidelines are in place, BEE will start voluntary labelling of vehicles, before making it mandatory.

FDI beyond 24% in micro units to require FIPB nod

Any foreign investment in excess of 24 per cent in an industrial unit, which manufactures items reserved for micro and small enterprises (MSEs), will require prior approval of the Foreign Investment Promotion Board (FIPB), according to Press Note 6 issued by the government.

Moreover, any industry which manufactures items reserved for MSEs will require an industrial licence subject to some general conditions, including export of at least 50 per cent of new or additional production over a period of three years.

Non-MSE units engaged in the production of 21 reserved items like bread, pickles and aluminium utensils will come under this notification.

The Press Note also allows enactment of the Micro, Small and Medium Enterprises Development Act of 2006, which removed the ceiling of 24 per cent foreign equity in these units.

Earlier, any unit having more than 24 per cent foreign direct investment (FDI) had to withdraw its registration as a small-scale unit and obtain industrial licence. However, the new Press Note removed this process which will help in attracting more FDI into the cash-starved MSEs.

The Act defined micro units in the manufacturing sector as those where investment in plant and machinery does not exceed Rs 25 lakh and small units as those in which investment ranged between Rs 25 lakh and Rs 5 crore[2].

In the services sector, if the investment in equipment up to Rs 10 lakh the unit is defined as a micro enterprise and if the investment ranges between Rs 10 lakh to Rs 2 crore, the unit is considered as a small unit.

The MSE sector in India has around 26 million units which employ about 60 million people.

Hydel project curbs on foreign firms may go

The blanket ban on foreign companies and individuals from certain countries to undertake hydel projects in sensitive border areas may soon be lifted. A Cabinet note under circulation has suggested the government should deny visas to only specific foreign individuals or employees of specific companies that need to be watched instead of putting a blanket ban on all foreign firms from countries on the sensitive list by security agencies.

The move will help firms from across the border to undertake infrastructure projects. It is understood that many Chinese companies are interested in developing hydro-electric projects in

[2] *1 crore = 10,000,000*

India. Reliance Industries has already employed a large number of Chinese workers to execute its gas pipeline projects.

Based on inputs from security and intelligence agencies, the government earlier considered identifying a negative list of countries that would be barred from participating in any project in sensitive border areas. This could have applied to countries like China, Bangladesh, Pakistan and a few Gulf countries.

According to proposed guidelines, the government may empower ministries or public sector undertakings (PSUs) to decide on the number of foreign workers to be allowed for a particular project. Foreigners working on sensitive projects would, however, remain under the watchful eyes of security agencies in respective states.

Moreover, a set of generic guidelines have been laid out that must be followed by all companies operating with foreign support in border areas. The non-discriminatory norms will be applicable to all central public sector undertakings, state undertakings and independent power producers.

Apart from regulating companies under its administrative control, the new guidelines also empower the Ministry of Power to direct state governments to incorporate certain conditions while allotting sites for hydro electric projects to developer. The projects located in J&K, North Eastern states, including Sikkim, or within an aerial distance of 50 km on the Indian side of the international border will come under the ambit of new guidelines.

The proposed generic guideline has particularly been framed for hydroelectric projects. It could be extended in other infrastructure-related projects later.

Overseas base enough to avail of DTAA sops

Having an effective management in India is not sufficient ground to deny exemption from capital gains tax to a company that is based in Mauritius, the Delhi Bench of the Income-Tax Appellate Tribunal (ITAT) has ruled.

The ITAT held that under the India-Mauritius Double Taxation Avoidance Agreement (DTAA), being a resident of Mauritius is the ground for claiming exemption. The ITAT relied on an earlier judgement of the Supreme Court in the case of Union of India vs Azadi Bachao Andolan case. In that case, the apex court held that since this DTAA is legal, any attempt to take advantage of these provisions is fully in accordance with the law.

The recent ITAT ruling was in the case of Saraswati Holding Corporation, an entity registered in Mauritius. The company was registered for the purpose of investing in the capital market in India. The income tax department had filed an appeal against the Commissioner (Appeal) who had reversed the department's decision to deny the benefit of tax exemption from capital gains in India. Consequently, the company was asked to pay additional tax of Rs 18 lakh. The department claimed that since effective management of the

company was is in India during the relevant assessment year, the company could not be considered as a Mauritius-based company.

The ITAT also agreed with the argument of the Mauritius-based company that its stand on this issue was in tune with the CBDT circular No. 789, which stipulated that a certificate of residence from the Mauritius government is sufficient proof of residency. The ITAT, therefore, held that the IT department cannot deny the tax benefit that arises on account of being a resident of Mauritius.

I-T lens on buyouts of unlisted foreign firms

Acquisition of unlisted foreign companies by Indian corporates has come under the scanner of income tax (I-T) authorities who plan to scrutinise the deals to ensure they are not being structured to evade tax. Deals involving equity swaps are particularly in focus, as these could be used to transfer part-ownership of Indian companies to overseas jurisdictions.

Valuation of unlisted entities in many countries is an unregulated area as no public interest is involved. This allows acquisition of unlisted foreign companies at inflated valuations. As a result, a large amount of cash or ownership of Indian company moves to a foreign entity and essentially amounts to asset-stripping of the domestic firm, which could have tax implications.

The Indian company surrenders cash or equity and receives shares in a foreign company, the real value of which may be a lot less, which is effectively a net asset loss for the Indian firm. The income tax department wants its officials to closely examine such deals to ensure the tax due to the domestic authorities is not avoided.

The department is particularly training its guns on acquisitions carried out through equity swaps instead of cash. Manipulated swap ratios can be used to transfer ownership and thereby profits to foreign companies and avoid tax.

The need for a closer look at cross-border transactions has been increasingly felt with India becoming a hotbed of such deals in the past few years. According to Grant Thornton deal tracker, the total number of mergers and acquisitions in calendar year 2008 stood at 458 involving a total announced value of USD 30.95 billion.

A proposal to set up a specialised investigation unit to investigate cross-border transactions is being examined by the apex direct tax body, the Central Board of Direct Taxes. Field formations have been asked to remain vigilant to such transactions and take action in suspect cases.

DCGI approval mandatory for drug export

Central regulatory body sole authority on GMP certification too

Domestic pharmaceutical companies cannot export medicines without the approval of central drug regulator Drug Controller General of India (DCGI) from October.

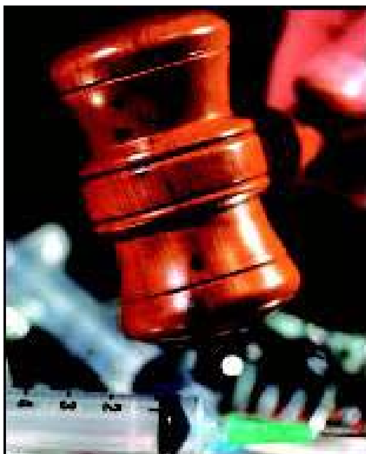
The move is on the lines of the World Health Organisation's (WHO) directive that discourages multiple certifying authorities in one country.

At present, companies can take state drug regulators' approval to export medicines.

DCGI has asked all state drug regulators to stop issuing export certificates (technically known as certificates of pharmaceutical product or COPP). DCGI has also curbed the power of state drug regulators for issuing the WHO compliance certification for good manufacturing practices (GMP). The central drug regulator will now be the sole authority to issue the GMP certification.

In a letter to the state regulators, DCGI has said that certificates will be issued by the Central Drugs Standard Control Organisation (CDSCO) after inspection of manufacturing facilities by CDSCO regulatory officials. The office of the central drug regulator DCGI is known as CDSCO.

Exports constitute about 40% of the Rs 75,000-crore Indian pharmaceutical market. Medicines manufactured in India are in demand in various parts of the world due to cost advantage. India also imports medicines worth Rs 15,000 crore.



300 firms to pay RBI penalty for violating FDI sectoral limits

The Foreign Investment Promotion Board (FIPB) has advised 300-odd companies to pay the Reserve Bank of India (RBI) a penalty (known as "compounding") for breaching sectoral limits on foreign direct investment (FDI).

These companies struck joint ventures with foreign partners before the government relaxed FDI sectoral limits by issuing Press Notes 2 and 4 in February this year, and had approached FIPB for approvals later.

FIPB sent a note to this effect to the RBI in August, advising the central bank to deal with such cases. Before this, FIPB, the nodal agency for approving FDI proposals, only asked companies for fresh applications without insisting on compounding.

In June 2009, FIPB had rejected applications by direct-to-home entrant Bharti Telemedia and Tata Teleservices to waive fines incurred for not taking permission for indirect foreign investment in their companies last year.

Compounding, which entails settling a breach of rules and regulations that are non-criminal in nature with the regulatory authority concerned, used to be the board's prerogative and was either waived or imposed depending on the seriousness of the issue.

Compounding is essential for all such cases in which approvals have been sought for foreign joint ventures in contravention of limits imposed for foreign investment, otherwise, RBI will forward the cases to the Enforcement Directorate for further action and hold it

as a violation under the Foreign Exchange Management Act (Fema) in its records for future reference.

The companies concerned will be allowed to apply again for FDI relaxations under Press Notes 2 and 4 only after they have paid RBI the penalty, which is fixed as a proportion to the monetary value of the violation (that is, the extent to which the sectoral limit has been breached).

Although FIPB had made it clear that the new rules for calculating direct and indirect FDI in Indian companies specified in Press Notes 2 and 4 are not retrospective, there was initially some ambiguity over dealing with *de facto* approvals.

The two press notes of 2009 state that foreign investment routed through an Indian company owned and controlled by resident Indians will not be taken into account while calculating the FDI limits. An Indian-owned company is defined as one in which resident Indians or Indian companies have more than a 50 per cent beneficial stake and control means the power to appoint the majority of directors.

Takeover code set for complete makeover

India's takeover code, which was responsible for a big wave of M&A activity and corporate consolidation in the country after being introduced in 1997, is set for an overhaul. The Securities and Exchange Board of India (Sebi) has set up a special committee to review its key provisions after realising the need to make it relevant to current needs of investors and companies.

C Achutan, who has handed out many a ruling on mergers and acquisitions as a former presiding officer in the Securities Appellate Tribunal, will head the panel as the regulator examines the possibility of making changes to some of its key provisions such as the trigger limit for open offers. It will also look at doing away with the provision of non-compete fee and reviewing norms relating to indirect acquisition.

Sebi last did a review of the code in 2002 when it made greater disclosures at every level of holding mandatory and exempted preferential issues from the purview of the code. At that time, Sebi wanted to introduce greater transparency to help investors.

The purpose this time is similar. But there are also other important considerations. For instance, both industry and financial institutions such as private equity funds have been clamouring for greater leeway when it comes to making small but significant purchases into companies. Current provisions with a trigger limit of 15% don't give them enough room. They also don't want to make an open offer as they don't actually try and control the company though they are given veto rights.

For instance, a private equity fund cannot buy 20% in a company without triggering the takeover code. It has to restrict itself to a less than 15% stake. If two or more funds are involved, the investment will have to be split among them. Either way, private equity funds cannot make large investments into a company.

The regulator may look at increasing the trigger limit for open offers from the current 15%. Countries such as the UK have a trigger limit of 30%. The only issue that the committee will face is that a 26% shareholding in India gives the acquirer

the powers to block special resolutions at annual general meets. Therefore, it is expected that the committee may set a level of about 25% trigger limit to avoid legal confusion.

The committee may also review the norms relating to indirect acquisition, when an overseas acquisition triggers a change in management of a local entity. Indirect acquisition has always been a controversial issue. Overseas transactions have often led to a change of control in local entities, a development that requires an open offer as per Sebi regulations. But foreign firms have found fault with the norms complaining that they are too rigid. In some cases such as BP Amoco's takeover of Castrol, the pricing for the offer was controversial. The committee is expected to delve into the issue and suggest changes.

Another provision that is likely to have a close scrutiny is the non-compete clause. Under current rule, a non-compete fee up to 25% of the deal size could be paid to the seller that will not be included in the open offer price. Several investors group have raised objection to this and Sebi may looking at discarding this provision. Open offer pricing norms may also come under review.

REWRITING THE CODE

CP Any purchase above 15% triggers the takeover code, making an open offer by the acquirer mandatory
LC The trigger may be hiked to 25%
I Will make it easier for PEs, financial institutions to pick up significant stakes in cos
CP Any management change in local entity due to acquisition of the parent globally triggers the takeover code
LC May be tweaked in line with the court's decisions
CP A non-compete fee of up to 25% of the deal size could be paid to the seller, and this is not included in the open offer price
LC Sebi may discard this provision
I It will bring in more transparency
CP: CURRENT PROVISION; LC: LIKELY CHANGE; I: IMPACT

These rules (takeover guidelines) keep evolving & we are forming a committee to review the entire takeover rules
CB Bhave
SEBI CHAIRMAN

No capital gains tax exemption for IDRs

Revenue Department rules out special status for Indian Depository Receipts as draft tax code does away with such exemption

The plan to encourage overseas firms to raise capital in India through Indian Depository Receipts (IDRs) appears to have hit a road block, with the Revenue Department not in favour of granting long-term capital gains tax benefits for such issues.

IDRs are derivative instruments like Global Depository Receipts (GDRs) and American Depository Receipts (ADRs) which have shares as the underlying asset and denominated in the local currency - the Indian rupee. These instruments will help foreign companies raise capital in India by listing IDRs on local exchanges. Standard Chartered Bank was working on an IDR issuance, which could have helped the bank raise close to USD 700 million. A host of institutions and corporates are also said to be watching the developments on this front, given their interest in raising money from the local capital market.

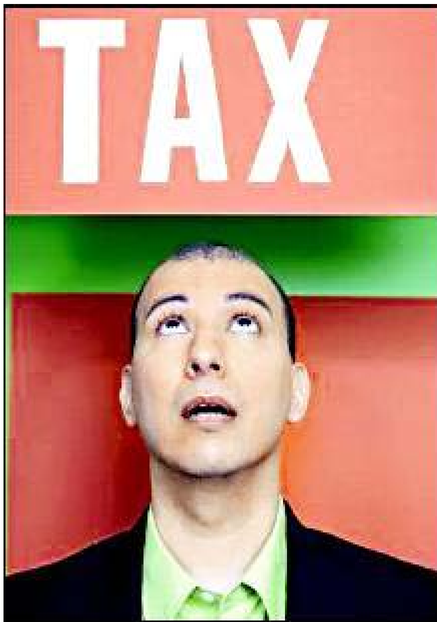
The Revenue Department and the Department of Economic Affairs - two separate wings of the finance ministry handling policy issues and taxation, respectively, hold different views on taxation of these instruments.

IDRs would not be exempted from long-term capital gains tax. The direct tax code comes into effect from 2011 and it does not exempt securities from capital gains tax. So, there is no reason to exempt IDRs from capital gains tax.

According to investment bankers, one of the major problems in promoting IDRs

was the lack of capital gains tax benefit for investors. Currently, income tax laws provide for a capital gains tax exemption for securities which are held for over a year. For less than a year, capital gain tax is levied at 15%.

However, bankers say they are just seeking tax parity for IDRs with local shares till the new tax code comes into effect. IDRs should be treated like other shares. Currently, both insurance companies and banks cannot invest in IDRs. This leaves only domestic institutions, retail investors and foreign institutions which can invest in these issues.



Update Fema for Press Notes 2&4, government tells RBI

Ends ambiguities in February guidelines relaxing sectoral limits in FDI rules

The government has sought to put an end to the ambiguities in the implementation of Press Notes 2 and 4, which significantly relaxed foreign direct investment guidelines, with the commerce ministry requesting the Reserve Bank of India (RBI) to make changes in the Foreign Exchange Management Act (Fema) to operationalise the guidelines.

The direction from the government follows a number of references and queries from investors, who have pointed out that the changes have not been incorporated in the Fema or notified in the annual master circular on foreign direct investment (FDI) issued by the RBI.

The significance of the circular, issued earlier this week, is that it sets at rest RBI's opposition to the Press Notes, which were issued in February, on grounds that they would encourage investors to breach sectoral FDI limits.

The ministry has also requested the RBI to incorporate the changes in Fema following Press Note 6, which made changes in FDI rules for the small scale and micro scale industrial undertakings.

Press Notes 2 and 4 state that FDI routed through an Indian company owned and controlled by resident Indians will not be taken into account while calculating sectoral limits. An Indian-owned company is defined as one in which resident Indians or Indian companies have more than a 50 per cent beneficial stake. Control has been defined as the power to appoint the majority of directors.

The guidelines also include rules for transfer of ownership or control of Indian companies in sectors with FDI limits from resident Indian citizens to non-resident Indian citizens.

In a sharp divergence from its initial opposition to Press Notes 2 and 4, even the finance ministry recently made it clear

that it is not planning to recommend further changes to the guidelines. The statement comes a few months after the Department of Economic Affairs (DEA) in the finance ministry had raised objections to the new guidelines, saying they rendered sectoral FDI limits meaningless.

Government sets up non-profit company to attract FDI

The government has approved the formation of a non-profit company, Invest India, in collaboration with industry body Federation of Indian Chambers of Commerce and Industry (Ficci) and state governments in order to promote foreign investment in the country even as foreign direct investment (FDI) to India increased by 56 per cent in July against the corresponding month last year.

Invest India would act as the first reference point for any investor interested in India and would facilitate setting up business within the country. The government's equity share will be 49 per cent which it will reduce in a span of time to 35 per cent by giving half per cent stake to state governments over a period of time. Ficci will have a 51 per cent stake.

The company would be an advisory body and would have sector-wise consultants who will coordinate with state governments on feasible measures. It will conduct capacity-building exercises at state levels to create an investor-friendly environment. The functions of this company would not coincide with the functions of the Foreign Investment Promotion Board. The company will basically try to bridge the information gap and will help foreign investors.

It would be a permanent executive set-up and the major beneficiaries will be small and medium investors who are interested in investing in India. The management will constitute six members each from DIPP and Ficci. This will provide multiple benefits such as technology transfer, market access and will give insight into new organisational skills.

Pick-&-drop facility not taxable, says ITAT

Income Tax Appellate Tribunal Points to specific law that clears point-to-point transport as not part of perquisites

Pick-up and drop transport facility provided by employers is not a perquisite and hence not liable to tax, according to a recent ruling by a tax tribunal. In a decision that has implications for sectors such as BPO and IT, the Mumbai Income Tax Appellate Tribunal has held that companies providing such a facility were not liable to deduct tax on the expenditure incurred on it.

The ITAT has held that a specific explanation had been provided in the Income Tax Act, which does not consider point-to-point transport facility provided by employers to employees a taxable perquisite. It said that collective transport benefit was not even taxed as salary or as a fringe benefit under the FBT regime. Moreover, it was not possible to compute the value of transport facility attributable to each employee as the service was in the nature of a composite service collectively provided to employees throughout the year, it said adding that no tax was required to be deducted at source on expenditure incurred by a company on transport facility.

The ruling was given in a case pertaining

to an ITeS and a BPO company - Transworks Information Services. The company gave a transport allowance of Rs 800 per month to its employees as well as provided a conveyance facility. The income-tax department had contended that the company was an 'assessee in default' for not deducting tax at source on the expenditure incurred on the pick-up and drop facility and transport allowance given to employees. As an assessee in default, the company would have been liable to pay tax as well as penal interest on the tax for the period it was not deducted. The Commissioner had upheld the order given by the assessing officer that had held the company an assessee in default. It had said that employees could not enjoy double benefit by way of conveyance facility and transport allowance, and tax was needed to be deducted on the expenditure incurred on the transport service.

Online registration of companies gets e-stamp

Entrepreneurs can pay stamp duty at ministry website; 22 states on board

Entrepreneurs can now pay stamp duty sitting anywhere in India electronically by logging on to the Ministry of Corporate Affairs' website. This removes the last hurdle for electronic incorporation of new companies without visiting a government office.

The online payment facility, which does away with the need to buy, paste and submit physical stamps with the Registrar of Companies (RoC), is now available in 22 states. The government expects to extend it to the rest of the country soon.

Electronic payment of stamp duty for setting up a company, which has been introduced from September 13, 2009, will become compulsory from January 1, 2010.

The 22 states that have authorised the central government to electronically collect stamp duty on their behalf will be paid back the amount by the Centre.

Collection of stamp duty falls under the exclusive domain of state governments. The states which are yet to authorise the Centre to collect stamp duty on their behalf include Chandigarh, Daman and Diu, Himachal Pradesh, Kerala, Goa, Jammu & Kashmir, Dadra and Nagar Haveli, Lakshadweep, Puducherry, Mizoram, Nagaland and Tripura.

The facility of e-stamping is being extended through the web portal of the Ministry of Corporate Affairs. Having rolled out the facility, the said ministry has laid down a transition period of over three months, till the end of 2009, by which time companies can exhaust their stamps.

The Centre expects to get the authorisation from the remaining 12 states and Union territories before January 1, 2010. States that do not authorise the Centre by then will continue to collect stamp duty through the physical mode.

Companies can bring in foreign capital without government approval before starting operations

Domestic companies that are allowed to bring in foreign capital without prior approval can now bring in these monies even before they start operations or invest in other firms.

The finance ministry and the Department of Industrial Policy and Promotion (Dipp) have taken a view that if a company has been incorporated to undertake business in a sector where foreign entities can invest without government approval, it can raise direct or indirect foreign investment before setting up business without prior approval.

Press Note 4, which was issued in February this year, requires companies without operations or downstream investments to take approval from the government or the Foreign Investment Promotion Board (FIPB) before bringing in overseas capital.

Such companies can now raise foreign investment up to the limit allowed in that business activity since the intention of doing business is evident from a company's charter filed with the Registrar of Companies.

The government has decided that a newly-formed company 'not having operations or downstream investments' should not attract para 5 of Press Note 4 if its proposed field of business is clearly defined and does not require prior approval.

FIPB recently advised Fishman Realty Management Services, which was set up in 2008, to bring in foreign investment from Cyprus through the automatic route.

Press Note 4 divides foreign investment-seeking companies into four classes: ones that undertake only business operations, ones that undertake business as well as investment, ones that undertake only investment and ones that do neither.

The companies that undertake only investment activities or the ones that have neither investment not business operations need government approval for foreign investment, according to guidelines. The conditional relaxation is for the second category.

Government to set up autonomous environment regulator

The Ministry of Environment and Forests has proposed to set up a National Environment Protection Authority to grant environmental clearances to different projects, besides ensuring compliance with environmental laws.

The paper proposes various models that can be used to structure and position the authority within the environmental regulatory framework of the country. Ramesh emphasised on the polluter-must-pay model apart from a system of incentives for environment management.

The ministry is also looking at accreditation and certification of the Environment Impact Assessment (EIA) by a consultant.

FII investment norms set for a makeover

An overhaul of the portfolio investment regime is on the cards. Capital markets regulator Sebi is giving finishing touches to a detailed concept paper that seeks to simplify and further relax norms governing foreign institutional investment in Indian equities. The proposed move could give individual foreign investors direct access to the Indian stock markets.

The concept paper, which is expected to be taken up by the Sebi board shortly, will unveil a new Qualified Foreign Investor Framework (QFIF) to replace the existing one on foreign institutional investors (FIIs). At present, a foreign individual seeking to invest in Indian stocks has to be registered as a sub-account of an FII, which in turn has to apply to Sebi on the behalf of the sub-account holder. Besides, the validity of the sub-account registration is co-terminus with the registration of the FII. This is onerous and often expensive.

The idea behind the concept paper was to remove unnecessary hurdles in FII investment and make it simpler, and also to bring foreign investors on a par with domestic ones. It is also expected to encourage more investors to come through the front door instead of the participatory note (PN) route. PNs are overseas derivative instruments with Indian shares as the underlying asset that allow foreign investors to invest in Indian equities indirectly without revealing their identity to Indian authorities.

Chill on foreign bank branch licensing

A discussion document readied by the central bank on relaxing branch licensing norms is silent on giving further space to foreign banks to expand in the country.

The discussion paper skirts the issue of further liberalising norms for foreign banks to open branches amid concerns over the lack of reciprocity from other countries.

The RBI is adopting a conservative approach because of restrictive rules in many countries in their treatment of Indian banks. Several private sector banks, including the country's largest private lender ICICI Bank, have complained that foreign countries are becoming more protectionist in the financial services sector while the central bank in India is very accommodative. But the RBI's view is at variance with that of the finance ministry, which is in favour relaxing branch licensing norms for foreign banks without linking it to reciprocity, the official said. There are 30 foreign banking companies operating in India and having 300-odd branches. In 2005, RBI released a four-year road map setting out the norms for the presence of foreign banks in India. It was to have implemented the second phase - where the regulations be further loosened - starting April 2009 but this was delayed because of the global financial crisis.

Under World Trade Organisation (WTO) rules, India is committed to permitting the opening of 12 branches of foreign banks every year but the RBI has allowed more than this number to be opened.
India issues a single class of banking licence to foreign banks and does not require them to move up from a lower to

a higher category of banking licence over a period, as is the practice in several foreign countries.

One of the conditions which the RBI considers when a company incorporated outside India applies for a banking licence is whether the government or law of the country in which the company is incorporated discriminates in anyway against banking companies registered in India.

Chinese semi-skilled run into India wall

The government has decided to stop Chinese welders, plumbers and other semiskilled workers from working in India in a move that is aimed at opening up more jobs for Indians but may end up delaying key power projects using Chinese equipment.

The government has also asked about 25,000 Chinese, who have been working in India on business visas, to apply for work visas. This will cause an exodus as most of these business visa employees are semi-skilled people working in power, telecom and oil & gas that have seen the influx of Chinese skilled and semi-skilled workers in recent years.

A few thousand Chinese workers have been helping lay the pipeline between Kakinada in Andhra Pradesh and Hazira in Gujarat for Reliance Industries. Similarly, in the power sector, most Chinese manufacturers bring in their own manpower to set up power plants for Indian utilities that source equipment from China. As many as 30 power projects being implemented by companies including Reliance Power, Essar Power, Adani Power, Tata Power and Lanco Infratech are sourcing equipment from Chinese suppliers.

As per government estimates, about 20% of the 80,610 MW new capacity under construction in the Eleventh Plan (2007-12) is using Chinese equipment. Further, 31% of Twelfth Plan projects under construction now have ordered Chinese equipment.

The decision to shut doors on semi-skilled Chinese workers, taken jointly by the ministries of labour and home, has already been put into effect with the government refusing to clear at least 800 applications for work visas over the past couple of months. As for the business visa workers, the government set a September 30 deadline to obtain employment visa. They are now offered a week's extension. India has promised to process new applications and decide on extending work visa within 45 days.

As per government figures, 69,084 Chinese were issued business visas in 2008 against 58,406 in 2007. About 32,700 Chinese have been issued business visas this year till June.

Law ministry clears new FDI screen test

The long-pending proposal to enact a new law to screen foreign investment for security reasons has been cleared by the law ministry. Finishing touches are being given to the proposed legislation, and the final draft is expected to be ready by the year-end. The Cabinet secretariat is working on the proposed law, which will be critical for sensitive sectors such as telecom.

There is a view of having a new empowered legislation that has the backing of the law ministry. There will be sectors that would be strategic, in which FDI would not be allowed through the automatic route. In some cases, the government will not allow FDI. In some, it will use the Foreign Investment Promotion Board (FIPB) route to further scrutinise. And in some cases, the automatic route will be allowed, but there will be post-sanction scrutiny.

Unlike the Exon-Florio Amendment Act in the US that gives sweeping rights to the President to stall any deal - without giving a reason - that could be a threat to national security, the proposed law would lay down definite guidelines and wouldn't be that arbitrary.

The new law would outline guidelines by which security screening of FDI on the basis of sensitive locations and sectors would be conducted.

Foreign firms with a dubious background would also come under the security lens, irrespective of the country of origin or sector of operation. The earlier discussions on sector-specific or country-specific restrictions have been dropped in favour of an intervention wherever necessary, not guided by the sector of investment or origin of funds. Therefore, there would be no list of countries such as China from where foreign investment would be restricted.

Currently, FDI proposals for certain sectors like telecom, defence and aviation are screened by security agencies. FIPB takes inputs from the home ministry before clearing such proposals. However, proposals going through the automatic route do not face this scrutiny. The proposed legislation would bring proposals under the automatic route, which is handled by RBI, also under the security radar.

Credit Suisse likely to get branch licence

The government is set to allow Credit Suisse to launch banking operations in India, indicating that the political heat over black money stashed away in Swiss bank accounts would not come in the way of providing market access to such banks in the country.

A final nod is expected from the finance ministry soon as regulators RBI and Sebi have already conveyed to the government that they have no objection to Credit Suisse setting up a branch in Mumbai.

The Reserve Bank has written to the finance ministry, seeking formal clearance for Credit Suisse to open a branch in Mumbai. The department of financial services has also sought final approval from North Block. The approval process is time-bound and will be cleared in due course if the finance ministry does not have objections.

Credit Suisse currently has a presence in India through Credit Suisse First Boston

(I) Securities and Credit Suisse Securities (I). Two foreign institutional investors (FIIs) of the group were registered with Sebi in June this year. RBI has concluded that Sebi does not have 'regulatory discomfort' with Credit Suisse's arms dealing with the securities business here since the two FIIs were registered in June.

The application of Credit Suisse to open a branch here was processed under the liberalised policy for presence of foreign banks in India that was brought into play in 2005. The final clearance from the finance ministry for Credit Suisse would mean political clearance for Swiss banks in India, paving the way for other banks from that country to get a foothold in India if they comply with regulatory requirements.

Germany to get less taxing for Indians

The some-pain-no-gain era of double payments by Indian workers on temporary assignments abroad will no longer happen in Germany at least. They will now not be required to pay social security taxes there as the India-Germany Social Security Agreement (SSA) signed last year comes into effect. This is the second such pact after the India-Belgium SSA.

A social security agreement, or totalisation agreement, is a reciprocal program that prevents double payment to social security systems. Thus, when India signs such an agreement with a country, Indian workers on temporary assignment will not be required to contribute to the social security system there, if they are already contributing to the Employees Provident Fund Organisation (EPFO). Similarly, temporary workers from that country on assignment to India would not need to contribute to EPFO if they pay social security taxes in their home country.

Contribution to social security systems in most developed countries is mandatory. But temporary foreign workers on short stays rarely qualify for social security benefits as withdrawals are permitted usually after contributing for over 10 years. So, while employees do not get any benefit, it puts additional burden on employers too as they usually have to contribute to the social security system in their country and India. In fact, some countries that get large numbers of temporary Indian workers end up collecting substantial sums on this count, but the employees get no benefit from its proceeds. According to estimates, for instance, Indian IT professionals in the US contribute close to $1 billion every year on social security taxes.

Until last year, it was not mandatory for international workers in India to contribute to EPFO. Now, EPFO is the recognised Indian agency under the totalisation agreements that India is entering into.

IT companies expect big outsourcing deals from Nordic region

Nordea AB, the biggest regional bank in the Nordic region, along with peers

Svenska Handelsbanken and SEB, are among a new set of customers planning to offshore technology work to India as they aim to bring down operational costs by up to 30% and cope with the slump more effectively. Indian tech vendors such as TCS, HCL, L&T Infotech, Wipro, Infosys and Cognizant are in discussion with Nordic customers for outsourcing contracts worth $100 million each over the next few years.

Most Nordic countries, especially Sweden, have high cost structures. This is putting pressure on local customers to seek low-cost resources in locations like India, which will help them tighten belts by up to 30-40%.

Big property deals to be scanned for dirty money

The Financial Intelligence Unit (FIU) has decided to scrutinise real estate deals to track money laundering and related crimes.

The country's anti-money laundering agency has told states to submit monthly data on registration of properties.

FIU is a central agency responsible for receiving, processing and analysing information related to suspect financial transactions. The real estate deals in the country often involve unaccounted cash transactions that lead to money laundering. Money laundering involves disguising financial assets in such a way that they can be used without detection of the illegal activity that produced them. Through money laundering, a fraudster transforms the monetary proceeds derived from illegal activities into funds with an apparently legal source.

All property registrars have to send data on property transactions above Rs 30 lakh to income-tax authorities as part of the annual information return. The FIU too now wants data on all property transactions. The agency also needs the data to coordinate efforts with international intelligence to check money laundering and related crimes.

Since India will soon become a member of the Financial Action Task Force (FATF), it is obliged to keep a track of such transactions that could be used to launder money. FATF an elite inter-governmental body that has been established by the G-7 group to develop policies to combat money laundering and terrorist financing.

The body recommends placing real estate agents and brokers, besides a host of other entities, under reporting obligations. However, India, which recently amended its anti-money laundering law, Prevention of Money Laundering Act, skipped them even as it brought overseas payment gateways such as Visa and MasterCard, money changers and money transfer service providers and casinos under reporting obligation. Banks, stockbrokers and foreign institutional investors are among the entities that already submit data to FIU on a regular basis.

T&D privatisation rider out of mega power policy

The government has amended its mega power policy by removing the pre-condition for states to privatise their power distribution for buying power from mega units. Instead, the states will have to undertake distribution reforms as laid out by the union power ministry. The change in the policy would encourage setting up of mega power plants as well as local production of super critical power equipment.

The requirement of privatising power distribution was a road block for mega power plants as many states have not reformed electricity distribution. States like Delhi and cities like Mumbai, Ahmedabad, Surat, Noida and Kolkata have privatised power distribution, while in other areas, the state controls power distribution.

This allows even states that have a monopoly over power distribution to access power from mega units. Thermal power plants that can produce at least 1,000 MW and hydel plants that can generate at least 500 MW a year are called mega power plants.

The government also decided to drop the requirement of inter-state sale of power for getting mega power status. Earlier, only those projects were given mega power status that had inter-state power sale deals.

The government also extended the benefits of mega power policy to the supercritical power projects to be awarded through international competitive bidding with the mandatory condition of setting up indigenous manufacturing facility.

Supercritical technology is more environment-friendly and efficient. But the developers using this technology have to buy equipment from those having production in the country. At present, only state-owned BHEL has such a facility.

To give a level playing field to private players, the government also decided that the 15% price preference available to local bidders in case of public sector projects would not apply to tariff based competitive bid projects of these state-run companies.

Norms for highway projects pact changed

The threshold limit in the conflict of interest clause in the model concession agreement (MCA) for highway projects has been increased from 5 per cent to 25 per cent, which was recommended by the B K Chaturvedi Committee, set up to find ways to expedite various road projects in the country.

This will allow any two special purpose vehicles (SPVs) with a common partner having up to 25 per cent stake for bidding for the same project.

Earlier, any two SPVs in which any developer had more than 5 per cent shareholding each were barred from bidding for the same project. It was increased to 5 per cent in July this year from the earlier 1 per cent.

Among other recommendations which have been accepted are the introduction of an ‘exit clause’, removal of termination clause, no forfeiting of security money deposited by the bidders if they are not present at the time of bid opening, and

constituting an empowered group of ministers to clear stalled projects.

The exit clause allows the lead partner in an SPV to exit by selling its stake after the construction of the project is over. Earlier, it was mandated to stay till the completion of the concession period (ranging from 20 to 30 years).

The 'termination clause' allows NHAI to take back tolling rights from a concessionaire anytime before the concession period is over, if the concessionaire has recovered its investment on the project.

The committee will begin working on the second part of the report. This will deal with a new dispute resolution mechanism, providing financing to road builders and making changes in the company law to make the special purpose vehicles more powerful.

Norms on IPO pricing, fund use in the works

The Ministry of Corporate Affairs and the capital market regulator, Sebi, will soon bring rules for fixing the price-band for companies going public and ensure that the money raised is not used for anything other than for the stated purpose.

Now the issuer decides the price in consultation with the merchant banker based on market demand. Sebi does not play any role in price fixation. The company going public should, however, disclose the parameters based on which the price-band is fixed. These include earning per share, price earning multiple and return on net worth.

The proposed regulatory change will also ensure that funds raised through Initial Public Offers are not diverted. It may take six months for drawing up the norms. The aim is to prevent companies from arbitrarily fixing their IPO price bands, and make the process transparent to a greater extent. Over valuation of IPOs has been an allegation that has been raised against some recent big ticket IPOs.

With no set guidelines for companies to follow, companies fix the value limits based on their own perception of demand for shares, before a final price is arrived at through a process of book building.

The ministry's early warning system, which is being put in place in a phased manner, will keep a track of the money raised through IPOs. This system introduced recently searches for unusual developments in a company's financial operations and decision making process by scrutinising quarterly results of companies, their public announcements, filings with stock exchanges, tax returns and media reports.

Governance code for unlisted companies in the works

The government is likely to put in place a governance code for unlisted companies to make this largely unregulated sector more accountable, as it puts into practice the lessons it learnt from the collapse of Satyam Computers, India's biggest corporate fraud till date.

The measures planned by the Ministry of Corporate Affairs will be in line with the norms for listed companies laid down by the country's top market regulator, the Securities Exchange Board of India (Sebi).

The new proposal is aimed at raising the accountability for unlisted firms, which in

the absence of any specific governance code often breach corporate best practices till the time they are subjected to regulatory scrutiny. Unlisted firms are not required to follow SEBI norms or disclose financials since they have no public shareholding but they often raise capital from banks and public finance institutions, a reason why the government feels it is necessary to keep a tab on them.

The proposed compliance framework may require these firms to have independent directors on their boards, bring in compliance and proper disclosures regarding accounting policies, apart from having a clear-cut whistle blower policy.

As part of the proposal, the government may also ask professional institutes of chartered accountants and company secretaries to rate unlisted firms based on their evaluation. The Institute of Chartered Accountants of India (ICAI) is planning to set up a rating system for corporate governance for listed and well as unlisted entities. For listed firms, clause 49 of SEBI's listing agreement specifies corporate governance norms.

Firms planning investments to get advantage in coal bids

Companies proposing downstream investment in the steel, power and cement sectors will be given a price preference of 5% when auctions for allotment of captive coal mines is initiated.

The new procedure will have to be approved by the Cabinet before it become part of the soon-to-be-amended law governing mines and minerals.

The Mines and Minerals (Development And Regulation) Amendment Bill, 2008, has already been introduced in Rajya Sabha and competitive bidding for captive coal blocks can take place once the Bill is revised and passed by both houses of Parliament.

Captive coal blocks are currently allotted by a government panel. Standalone miners can also apply for captive coal blocks provided they have supply contracts with cement, steel or power companies.

Bidders will be asked to state the amount they are willing to offer to the government for each coal block separately. The bid of the highest value would be declared the winning bid. A system of preference would be followed at this stage to encourage value addition in coal bearing states such as Orissa, Jharkhand, Chhattisgarh, Madhya Pradesh and Andhra Pradesh.

Indo-Thai FTA to cover services too

India and Thailand are planning to expand their limited free-trade agreement (FTA), which includes just 82 items, to services and investments.

India and Thailand signed an early harvest programme which was supposed to be followed by a full-fledged free trade agreement (FTA) in 2004. Under the EHP, the two sides eliminated duties on 82 items, both agricultural and industrial, like television tubes, refrigerators, mangoes, apples grapes and some metals.
The FTA was, however, not signed because of disagreements related to the rules of origin (the rules which determine

which products are to be considered as originating from the partner country and which are to be considered as originating from a third country) and political instability in Thailand.

However, Thailand now seems confident about concluding a comprehensive agreement soon.

Thailand is also part of the ten-member Asean which signed a free trade agreement on goods with India this year. The FTA, which seeks to eliminate duties on more than 4,000 items over the next eight years, is scheduled to be implemented from January 1 2009.

Fema to apply to reverse overseas M&As, says RBI

The Reserve Bank of India has said Indian companies merging with overseas firms will continue to be treated as entities resident in the country under the Foreign Exchange Management Act (Fema).

There is no provision for such a merger under the current Companies Act. But a Bill to amend the Act tabled in the Budget session of Parliament proposes to allow Indian companies to merge with overseas companies, under section 205, a move that could introduce greater flexibility in cross-border merger and acquisitions (M&As).

The amendment to allow Indian companies to merge with foreign companies was first suggested in 2005 by an expert committee on company law chaired by Tata Sons Director J J Irani. If this amendment goes through, it will meet a key demand of many multinationals investing in India.

In its feedback to the Ministry of Corporate Affairs a couple of weeks ago, the central bank said the Indian entity, after its merger with the foreign company, will operate as its branch in India, and therefore has to comply with all provisions of Fema for inward remittance of funds, investments by the foreign company through its Indian entity in any Indian ventures, dividend payment besides repatriation of profit to the foreign company.

The central bank has also clarified that payment by the foreign company to shareholders of listed Indian companies being merged can be made in the form of cash, shares or Indian Depository Receipts (IDRs) issued by the overseas companies.

In this case, RBI has clarified that Fema will have to amended suitably. Besides, IDRs in their existing form do not have voting rights and the law has to be changed to incorporate this change. This will be important if the merger involves allotting voting rights to Indian shareholders or some sort of management control.

Even if the Indian company ceases to exist in India, it will continue to operate as a branch or Indian office of the foreign company and will be taxed in the same way as any Indian branch of foreign company gets taxed on the basis of being a permanent establishment.

Sebi mulls stricter warrant norms

The Securities and Exchange Board of India (Sebi) plans to tighten guidelines under which promoters make preferential allotments of warrants.

The proposals include prohibiting promoters from voting at shareholder meetings at which warrant issues are put to vote and prohibiting warrant issues to promoters who did not subscribe to their earlier warrants.

Till recently, promoters were issuing warrants, which would eventually be converted into shares, to themselves by paying only 10 per cent of the money when warrants are issued. Sebi has raised the 10 per cent advance payment to 25 per cent and added the stipulation that promoters will have to forfeit the advance if they don't subscribe to the full issue.

Last year, the steep fall in the stock market saw many promoters letting their preferential warrants lapse. Between April 2009 and October 6, 2009, promoters of 51 companies — including larger industrial houses and some state government-owned corporations — let preferential warrants lapse and promoters of 12 companies opted for only part conversion.

These norms are expected to be part of larger primary market reforms that the regulator is considering. The proposals are being discussed with Sebi's primary market advisory committee after which public opinion may be sought.

Sebi is also seeking public response to a proposal to ask institutional investors to pay in full for the shares for which they apply in an Initial Public Offer (IPO), against the current practice of paying only 10 per cent upfront. Sebi's contention is that this part-payment results in artificial subscription which impacts investor interest.

Sebi is also planning to simplify the "application supported by blocked amount" (ASBA) process by incorporating an applicant coding mechanism through which demographic and other details of applicants would be pre-filled. This will enable the applicant to key in his code number and get an application form in which he needs to fill up only the number of shares for which he applies and the applicable amount.

Sebi is also examining whether the scope of ASBA can be expanded to institutional investors. At present, it is available only for retail investors. Discussions have already begun with intermediaries. Under the ASBA process, applicants to public issues can have their application money blocked in a special account so that they have to pay only when shares are allotted to them.

FDI norms to cover limited liability partnerships

The government is working to bring limited liability partnerships (LLPs) within the scope of foreign direct investment guidelines.

The Ministry of Corporate Affairs, which administers the LLP Act that came into effect in April, and the Department of Industrial Policy and Promotion which administers FDI policy, are working to amend FDI guidelines. The rule change is expected to happen in a few months.

The LLP Act provides for cross-border LLPs but the foreign investment policy, particularly the guidelines for calculating FDI in an Indian company, only covers companies at present. Bringing LLPs within the FDI ambit will facilitate the establishment of cross-border LLPs through which entrepreneurs in India can start business ventures with foreign investors. Since an LLP partner is not

liable for the wrongdoing of other partners, entrepreneurs who do not know each other will be willing to come together and start a business.

Extending the FDI norms to LLPs is expected to give rise to large partnership firms with foreign investment, particularly in the services sector. Nearly 250 LLPs have been registered in India since April, when the LLP Act came into force.

Earlier this year the government provided for the taxation of LLPs under the IT Act on lines similar to general partnerships. LLPs are not required to pay dividend distribution tax or a surcharge.

Banks may be kept out of CCI ambit

The government would examine the possibility of keeping banking and shipping sectors out of the purview of the Competition Commission of India.

The Reserve Bank of India has reportedly written to the finance ministry, asking the banking sector, including that mergers and acquisitions of banks, should be kept out of the purview of the Competition Act, 2002. The banking sector also enjoyed exemption from the regime of erstwhile Monopolies and Restrictive Trade Practices Act.

The ship liners' association has also approached the Ministry of Corporate Affairs seeking anti-trust immunity from the competition watchdog. The ship liners come together to operate cargos on designated routes and agree on prices.

Sections 54 and 55 of the Competition Act, 2002, grant power to the central government to exempt certain sectors or enterprises from the competition watchdog's lens.

The government, however, is yet to notify Sections 5 and 6 of the Competition Act, which will empower the Commission to vet mergers and acquisitions that can have a bearing on the competition in a particular sector.

After notification of Sections 5 and 6, all mergers which would increase the combined assets of the two entities to more than Rs 1,000 crore or raise the turnover to Rs 3,000 crore would require CCI's approval.

L'Occitane to pick up 51% in Indian arm

French cosmetics major L'Occitane is looking to pick up 51% in its India operations - L'Occitane India Private Limited - for single brand retailing.

L'Occitane is a global cosmetics firm that uses natural or organic ingredients to make skincare and fragrance products in the premium segment.

Although foreign investment norms do not allow international companies to get into retail on their own, foreign direct investment (FDI) up to 51% equity is permitted, with prior approval of the government, in single brand retail. A Singapore-based group company of L'Occitane would pick up the equity and the 51:49 JV with domestic investors would market the brand in India.

L'Occitane range is priced between Rs 250 and Rs 2,000 and the entire product range is imported from France. In India, L'Occitane products were launched through exclusive stores in Delhi and Mumbai in 2001. Luxury and lifestyle store, Ravissant, was L'Occitane's distributor in India.

Besides selling products to consumers through its stores, the company also has institutional sales through tie-ups with major hotels and airline operators across the globe. L'Occitane has stores in over 85 countries around the world including Australia, Austria, Belgium, France, China, the UK and the US.

New rules on tax disputes to lead foreign firms out of legal labyrinth

The finance ministry will soon issue detailed guidelines for the new dispute resolution mechanism that it had promised in the budget earlier this year to swiftly settle tax liability disputes of non-resident companies. The proposal envisages setting up of five panels in different cities having powers to pass an order that would be binding on the assessing officer but not on the assessee, drastically reducing the chances of lengthy legal wrangling.

The panel can provide relief on the tax liability calculated and raised by an assessment officer, but not on the penalty imposed for any violation. The government had announced in budget 2009-10 that a new dispute resolution mechanism will be available for foreign companies from October 1.

Each panel will have three income tax commissioners each and be located in different cities instead of one centralised collegium of commissioners. There would be one panel each in New Delhi and Mumbai, said the official. The location of other panels will be decided later.

These panels would decide the tax liability of a non-resident tax payer, removing the subjectivity in the present system of a designated assessment officer taking a decision on whether the tax payer has under-reported his tax liability. As per the proposed system, the assessment officer would give a draft assessment order to the tax payer who gets one month to raise objections before the three-member panel. The panel will be required to give its verdict in eight months from then, which will be binding on the assessment officer but not on the tax payer.

If the assessment officer raises a demand for Rs 100, the tax-payer can explain before the panel and show why it should be less. Thus he gets an instant relief. Under the existing system, to get this relief, one has to first go to the Commissioner (Appeals) and if not satisfied, to the Appellate Tribunal and then to the high courts. Even under the new system, the tax payer has to go through this normal route of grievance redressal in cases where the assessment officer orders penalty for any violation.

Fees to foreign satellite providers taxable: ITAT

A special bench of the Income tax Appellate Tribunal (ITAT), Delhi on

Friday held that fees paid by Indian broadcasting companies to foreign satellite service providers can be taxed in India.

The ITAT bench was ruling on a plea by Dutch firm New Satellite NV and Thailand-based Shin Satellite that they should not be made to pay tax in India because the payment they received in return for transponder services cannot be construed as royalty payment.

The income-tax department has been treating the income earned by foreign satellite companies as royalty and, therefore, levied tax on the receipts. The department also held the view that even under the Double Taxation Avoidance Agreement (DTAA), the services rendered by the satellite companies to Indian broadcasters are a "secret process" and therefore, liable to be taxed.

The foreign satellite companies held the view that the amount received by them from India cannot be taxed in India because they have no material or men or machinery or a combination of them in India.

Therefore, it cannot be construed that the particular income (the fees paid by Indian broadcasters) has neither arisen nor accrued in India and the government has no locus standi for taxing such receipts.

The ITAT, aligning the facts of the case in place, observed that foreign satellite companies earn their income by providing transponder facilities to Indian companies. They operate the satellites situated at a geostationary location, 36,000 kilometres away. Through the transponders installed at these satellites, the satellite companies do facilitate data transmission to the telecasting companies. By an agreement, a fee is paid to the satellite companies by the telecasting companies.

The ITAT held that the scope of "royalty" is not restricted either by the Income-tax Act or the DTAAs. A simple process, even if it is an intellectual property, falls within the ambit of royalty. Telecasting companies are enabled to telecast their programmes by uplinking or downlinking the data/programmes with the help of the transponders.

Since the consideration paid by telecasting companies is for the use of and the right to use the transponder facilities, they can be treated as royalty fees, the ITAT held.

Monsanto gets FIPB okay for GM seeds sale

Global seeds major Monsanto may soon start selling controversial genetically modified (GM) seeds and planting material in India, as the Foreign Investment Promotion Board (FIPB) has cleared the company's proposal subject to the condition of strict compliance to the country's environment protection laws.

The FIPB approval is expected to pave way for Monsanto to bring in its menu of genetically modified food products including GM corn, maize and soya (first generation GM crops which were mostly cash crops) apart from its globally famous "Roundup Ready" brand, which are widely used in several developing countries.

India has immense potential to tap the growing world market for biotech crops currently estimated at USD 7.5 billion. Monsanto India had approached for the FIPB approval with a view to integrating its agro-chemical business in India with its

US parent's seed business. Arguing its case, Monsanto had informed the FIPB that certain companies with FDI were also using GE planting material with prior permission of the local authorities such as the GEAC.

The Indian seed industry is valued roughly at Rs 3,000 crore with about 150 organizations, both in the public and private sectors. Of late, many private companies with turnovers ranging from Rs 35-100 crore have got engaged in agro-biotech research and development programs either individually or in joint ventures. Biotechnology research involves substantial investments, leading to a trend in JVs.

Security body sniffs at PN path to havens

The National Security Council Secretariat has called for measures to trace the origin of inflows through participatory notes (PNs) and entities registered in tax havens like Mauritius, Cyprus and Cayman Islands, a move that can impact both portfolio flows and foreign direct investment (FDI). Unchecked flow of funds through these routes could result in country-specific restrictions being rendered useless. If the traceability condition does not materialise, the government should make prior government approval mandatory for investment from all known tax havens.

This means that investment in sectors where 100% FDI is allowed through the automatic route would also need approval from the Foreign Investment Promotion Board (FIPB) if the government accepts the council's suggestion, highly-placed government sources said on condition of anonymity.

In the case of PNs, the council has called for more disclosures as actual source of funds remain unknown even after extensive investigation. There is also a need to distinguish investment by private funds as compared to sovereign funds, the council has said in a note, recommending measures to step up security screening of FDI in view of the increase in cross-border terror attacks and escalation in money laundering.

PNs are used by overseas investors, who are not registered with Sebi, to invest in the Indian market through registered foreign institutional investors (FIIs). Despite recent efforts to discourage investments through PNs, flows through this route continue. It is estimated that more than Rs 1,00,000 crore of investments entered the market through the PN route. Almost 44% of the equity FDI inflows into the country originate from Mauritius while Cyprus accounts for nearly 2.93% of the FDI flowing into India. Cayman Islands is the 12th-largest source of FDI flows into India, accounting for nearly 0.71% of the foreign investment into India. The revenue department has also been objecting to FDI from tax havens on grounds of 'treaty shopping' or use of these destinations to route funds flows with the objective of gaining a tax advantage.

Taxing times ahead for foreign BPO ops

The Central Board of Direct Taxes (CBDT) has withdrawn a 40-year-old circular, in a move that has the potential to increase the tax India can claim on a foreign company with operations here through a "business connection".

This could impact, for example, foreign companies that engage BPO units in India. There are over 300 foreign IT-BPO companies in India that account for about 35% of the USD 50-billion revenues of the industry. However, it is not just captives of foreign companies that could be impacted by CBDT's present move. The tax authorities will now find it easier to tax a portion of the income of the parent company arising from the activities of the BPO, even if that income is not generated in India. This flows from Section 9 of the Income Tax Act, which says "income accruing or arising directly or indirectly, through or from any business connection in India, shall be deemed to be income accruing or arising in India, and hence where the person entitled to such income is a non-resident, it will be includable in his total income".

A BPO can be treated as a business connection. Circular no. 23 of 1969 offered an escape route from falling within the ambit of Section 9 to non-resident companies with BPO units in India. The circular, which now stands withdrawn, said, among other things, "if the agent's commission fully represents the value of the profits attributable to his service, it should, prima facie, extinguish the assessment". This portion of the circular had been interpreted to mean that if a foreign company pays for its BPO services as if these services were rendered by a third party, i.e. at 'arms-length', then there is no cause for assessment.

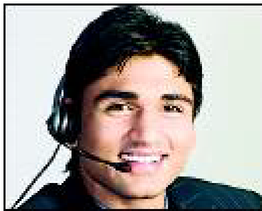
With this illustration now being withdrawn, the path is open for the tax authorities to lay claim to the income of the parent deemed to arise from the activity of its business connection, i.e. the BPO, arms-length transaction or not.

CBDT, however, is very clear about the intention behind the withdrawal of the circular. An income-tax department official said the circular had opened a can of worms as it was being misused by foreign companies. It was only intended to provide clarity on what the government's intention behind Section 9 of the I-T Act was, and that foreign companies were taking shelter behind it to avoid tax.

In fact, even when the circular was in force, the income-tax department has argued in appeals, references and petitions that the circular would be interpreted to allow relief to the taxpayer, which is not in accordance with the provisions of Section 9 or the intention behind the issue of the circular.

CBDT has not just withdrawn Circular 23 of 1969, but also other two related circulars - no. 163 of 1975 and no. 786 of 2000. Withdrawal of circular no. 786 will hit the exporting community hard as it dealt with taxability of the commission that an Indian exporter received outside the country for carrying out the services of an overseas agent.

Withdrawal of circular 23 will also strengthen the hands of the I-T department in the Sony Entertainment Television, Singapore, case. The case is to come up for hearing in the Supreme Court soon. In this case, the Mumbai tribunal had held that even if arms-length remuneration had been paid to the agent, the non-resident would still be assessed in respect of any additional profits attributable to the dependent agent having permanent establishment. The high court, however, reversed it basing its decision on circular no. 23.



FDI plug to ensure Indians call the shots

The government has started insisting that the power to legally direct the actions of a company should at all times be in Indian hands if the investments it makes in other companies are not to be classified as foreign investment.

The attempt to plug the loophole in the foreign direct investment (FDI) rule follows widespread criticism that the new rules will allow foreign investment in excess of the allowed limit and effectively transfer ownership and control to foreigners even in sectors restricted to them. The Foreign Investment Promotion Board (FIPB), the apex body that clears FDI into the country, is putting this new rider to ensure that the spirit of the new liberalised FDI norms is not defeated through undeclared arrangements between the Indian and foreign partners in ventures with local companies.

The rider is at the suggestion of the Department of Industrial Policy and Promotion which framed the FDI policy.

The move is to stall possibilities of foreigners effectively controlling the decisions of the investing company even when on paper the reins of the company stay with Indian promoters.

The idea is to remove the chances of firms in key sectors such as retail and defence being controlled by foreigners above the levels allowed by the law.

Government to reiterate ban on FDI in multi-brand retail

The government plans to expressly clarify that foreign direct investment (FDI) in multibrand retail is no-go territory.

Under the revised FDI policy announced in February, a joint venture company in which the Indian entity has more than 50% stake and the right to nominate majority of its directors will be deemed to be an Indian company.

If such a joint venture makes investment in another company, the entire investment in that company will be counted as Indian investment. Under the earlier policy, downstream investment by such a joint venture was counted as indirect foreign investment.

The new rules, it was argued, allow indirect entry into forbidden sectors such as multi-brand retail through layered corporate arrangements where initial foreign investment is kept below 50%.

It will now get clarified that the intent of the revised policy is not to allow FDI into

multi-brand retail where it has been prohibited.

CLEAR STAND

Clarification
No foreign money into multi-brand retail through Indian-owned/ controlled firms

Purpose
No unintended opening up of the multi-brand retail sector

Impact
Retail chains have to look elsewhere for capital

- **Clarification** on the impact of revised FDI norms on banks expected
- **Defence ministry** unlikely to be exempted from purview of liberalised FDI policy considering the safeguards already in place
- **Government** cannot have too many exemptions to the policy

GST may miss April 1 tryst, rollout in July or Sept, 2010

The rollout of goods and services tax (GST) is likely to miss its April 1, 2010 deadline. The GST, which is a consumption tax, seeks to create a seamless pan-India market by allowing both manufacturers and service providers to offset state taxes paid on inputs sourced from another state. The alternative dates that are being considered for the rollout are July 1 and September 1.

The Centre and states are yet to converge on the rate of GST and the items that will be taxed, the most crucial aspects of any tax structure. Although, the Centre has given up on its demand for having a single rate structure and agreed to a dual rate structure to make the new tax more acceptable politically, the nitty-gritty remains to be finalised.

Source

Press clippings

About Chadha & Co.

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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