# India Update: May – June 2009

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## India to renegotiate DTAA with Switzerland

The central government, in an affidavit filed in the Supreme Court, said it had approached the Swiss government to renegotiate the Double Taxation Avoidance Agreement (DTAA) between the two countries.

The move came after the West European nation agreed to comply with the Organisation for Economic Co-operation and Development's (OECD'S) model tax convention in March this year.

Adopting the tax convention would mean that countries like India would be able to seek account details of their citizens. However, "fishing or roving enquiry is not permissible" even under the OECD standards.

In the past, Swiss authorities have refused to share bank details under the DTAA, saying that such information was enforcement of India's own tax laws and not the Swiss laws.

For example, when the Income Tax Department sought verification of the contents of the bank documents seized from Hassan Ali Khan, accused of having illicit deposits in UBS Bank, Swiss authorities did not provide the information.

Further the government informed the court that "… in view of the fact that no criminal case was pending against Ali Khan, recourse could not be taken to the Mutual Legal Assistance Treaty in Criminal Matters (between India and the Swiss government) and thus no headway could be made."

The affidavit did not say whether it would be possible to get the account information after the DTAA is reworked with the Swiss government.

Countries like Switzerland, which had a bank secrecy clause, and other known tax havens have agreed to comply with the OECD's tax convention after the Group of 20 nations (G-20), which constitute more than 85 per cent of the world output, threatened to take action against uncooperative nations.

*Information from German authorities:* The German government, which had obtained details of account-holders of the LGT Bank in Liechtenstein, had shared information on the Indian account-holders with the Centre in April this year.

But the government refused to share the details obtained from German authorities, saying they were obtained on the condition of "strict confidentiality of contents under the Double Taxation Avoidance Agreement".

The information obtained has been forwarded to various taxation authorities for action. The said authorities have initiated the process of reopening the assessments under the Income Tax Act, 1961 and Wealth Tax Act, 1957

## L&T, EADS form JV to tap defence market

Larsen & Toubro (L&T), India's largest engineering company, has formed a joint venture with European major EADS Defence & Security to make products for the Indian defence segment. The aim is to subsequently develop the JV as a manufacturing hub for the global market.

L&T said it estimates to earn Rs 2,500

crore[1] in revenue from the defence market, over the next seven years and will invest about Rs 2,000 crore to grow the business.

The joint venture with EADS will be based in Talegaon near Pune. The two companies have not given a clear indication of the shareholding, saying that the final structure would be in conformity with government guidelines (presently 26% FDI is permitted in the defence manufacturing sector).

## Cigarette packets to carry pictorial warning

The Supreme Court has recorded the undertaking of the central government that the Cigarette and Other Tobacco Products (Packaging and Labelling) Rules, including the rules related to pictorial warning on cigarette and tobacco products, will be implemented from May 31 and there will be no further extensions.

The court further stated that in view of this promise, no court in the country shall pass any order inconsistent with this order.

The order is an interim one, and the petition is still pending for further hearing.

## Tunnelling via red tape may end for miners

Companies may get all necessary government approvals when they are allotted new coal blocks, thus saving them around five years of bureaucratic red tape. The move will benefit companies that are looking to develop captive coal mines.

The coal ministry is finalising the new guidelines in consultation with the ministry of railways and ministry of environment & forest. The ministry is looking at ways to reduce the time taken in developing a captive coal block allotted to companies, mainly power utility firms. It has already received suggestions from the Central Electricity Authority.

According to the draft guidelines, companies allotted captive coal blocks would also get an in-principle approval for prospecting (identifying the mineral potential of mining block) and mining. At present, the developer has to get an in-principle approval from the coal ministry for exploration, and later seek the government's permission to start mining.

The Centre would also allow exploration without mandatory forest clearance for drilling over 15 holes per square kilometre. But this waiver would be given only when the developer gives an undertaking that no trees would be cut while exploration. The proposal also includes development of a master rail network for moving coal from captive mines, besides the rail network being planned for transporting coal from the mines of Coal India. The changes are vital as it usually takes almost five years for coal production to start from an unexplored mine from the date of allocation. Of this, about three-and-a-half years are spent obtaining government approvals and the rest in carrying out environment impact studies, exploration and actual mining of coal.

[1] 1 crore = 10,000,000

## Government may levy spectrum transfer fees on telcos going in for M&As

Telecom operators buying another telco may have to pay 10–20% of the acquisition price to the government. A government committee looking into spectrum-related issues is examining the possibility of specifying a certain percentage of the deal size as spectrum transfer fee in case of a merger and acquisition (M&A) in the telecom space.

The committee was also considering another option of charging a portion of the market value of the spectrum held by the seller as the spectrum transfer fee. The market value could be determined based on a recent spectrum auction in that particular telecom circle or a comparable one, or after extrapolation from past auctions. In this case, the fee would differ from circle to circle.

The committee has also recommended that the government provide a significant discount on the spectrum transfer fee for a period of 12 months from the date of announcing the new policy to stimulate consolidation in the industry.

Current regulations don't encourage M&A in the telecom space. For instance, if a large operator like Bharti Airtel were to buy out a new player, then the combined entity would have to return excess spectrum within three months. At present, airwaves are allotted to telcos based on their subscriber base. In this instance, if Bharti has about 8 MHz of airwaves across the country, the acquisition of a new telco, which has 4.4 MHz of start-up spectrum, will take its figure up to 12.4 MHz Since Bharti will not have the requisite subscriber base to hold onto so much spectrum, it would then have to return spectrum held by the new player. The government had also rejected an alternate framework that would have allowed operators to hold on to this excess spectrum after the merger until they reach the subscriber-linked eligibility criteria.

In its earlier draft report, the government committee had conceded that some new players may sell their spectrum or merge with another company, thus making huge profits without rolling out any network. The committee added that the market should be allowed to determine the optimum number of operators by facilitating spectrum transfers and mergers.

## Details of sick companies up for sale to be put online

In a bid to usher in transparency into the sale of assets of about 450 Indian companies, the government has initiated an e-governance programme that will make all relevant information on the sale of the distressed assets available online to all stakeholders. The programme will also allow online bidding, and enable bidders to track the status of their applications. The government is currently screening tenders of private software vendors who shall be asked to develop the software for implementing the proposed programme.

The computerization programme will be done across the offices of the country's official liquidators (OLs), which oversee such liquidation schemes. The e-governance drive in the OLs, which work under the directions of state high courts, is aimed at making these offices better governed. The new software will be integrated with the MCA-21 computerization project of the ministry of corporate affairs and the websites of high courts.

## Supreme Court strikes down two CERC regulations

The Supreme Court has declared unconstitutional two rules under which the Central Electricity Regulatory Commission (CERC) could disqualify companies that trade in power across states.

According to one of these rules, if the company, its promoters, directors or associates are involved in any legal proceedings, and the CERC feels a grant of licence may, therefore, adversely affect the interest of the sector or consumers, it can be denied a licence.

The CERC may also do so if the company is not considered a "fit and proper person" for a licence for any reason to be recorded in writing.

For determining if a company is a "fit and proper person", the Commission may take into account factors like its financial integrity, competence, reputation, character and its efficiency and honesty.

These rules are found in clauses (b) and (f) of Regulation 6A of the Central Electricity Regulatory Commission (Procedure, Terms and Conditions for Grant of Trading License and other related matters) (Amendment), Regulation 2006.

A two-judge bench of the Supreme Court headed by Justice S B Sinha (partnered by Justice Cyriac Joseph) passed the order in an appeal filed by Global Energy Ltd against CERC for first granting, but later cancelling its licence, invoking the amended regulations. The CERC decision was also upheld by the High Court.

The judgment said involvement in legal proceedings by the company and its directors may not by itself be sufficient to disqualify a company. The commission must be satisfied that grant of licence in the circumstance may adversely affect the interest of the electricity sector or of the consumers.

Commenting on this and the other disqualification criteria, the judgment said these were too vague. "A disqualifying statute, in our opinion, must be definite and not uncertain; it should not be ambiguous or vague. Requisite guidelines in respect thereof should be laid down under the statute itself," the court emphasised.

Regarding consumer interest and privatisation, the judgment said: "The power of the regulatory commission to impose qualification/restrictions should be read in line with the larger object of the Act. The consumer tariff is to be laid down by the commission. A trader of electricity does not deal with consumers; he is merely an intermediary between a generating company and a distribution licensee. The tariff that a distribution licensee will charge from its consumers is regulated. Even the margin that a trader can make is regulated. It is, therefore, not correct to contend that Regulation 6A is in consumer interest, as it has not been shown how it will protect the consumer interest."

Rules framed by the government must be free of uncertainty and arbitrariness, and the two clauses in question fail the constitutional test, held the judges. It struck both down and directed CERC to consider the case afresh as though these two clauses had never been there.

## Government may trip foreign power equipment companies' India plan

A foreign company planning to set up supercritical power equipment manufacturing facility in India may have to hold at least 75% of the land before bidding for the project. The move is likely to prevent wider participation from many foreign companies that do not have a footprint in the country.

The land could be held by the joint venture company or the Indian subsidiary of the foreign player. The move has been proposed by the Prime Minister's Committee on Infrastructure (CoI). The committee includes representatives from ministries of finance and power and the Planning Commission. The proposal will be soon placed before the Cabinet for its approval.

Large and fuel-efficient 'supercritical' equipment are not manufactured in India at present. So far, only state owned power equipment maker Bharat Heavy Electricals Ltd (BHEL) has large-scale power equipment manufacturing capability. The government has decided to invite bulk tenders for these equipment from global companies with local manufacturing clause to get maximum participation in domestic manufacturing.

While the government's intention is to attract more equipment manufacturing companies to India, such a provision, mandating companies to have a footprint in India before participating in bid, is aimed at keeping a check on the companies participating in the bid.

Current norms governing power equipment manufacturing do not have any provision to stop fly-by-night operators. The sector is open to 100% foreign direct investment under the automatic route. The government's move is significant as a bulk tender will soon be floated by NTPC and Damodar Valley Corporation for new generation power equipment.

So far five companies — BHEL, L&T-Mitsubishi combine, Alstom-Bharat Forge, Toshiba-JSW, and Italian company Ansaldo Caldie — have expressed interest in taking part in the bulk tender for supercritical equipment.

However, with the new provision in place, the government may prevent many Chinese and Russian firms to join the fray as they may not have a physical presence in the country.

As part of its monitoring process, the government has also mandated that prior to submission of the bid, the manufacturing company must be registered in India and should have obtained certificate for commencement of business. The companies winning the bulk tendering bid will also have to adhere to a phased manufacturing programme (PMP) with milestones and indigenisation.

## Competition watchdog operational

*Two sections of the Competition Act still to be notified*

After a long wait of five years, India's official anti-monopoly body, the

Competition Commission of India (CCI), has become operational.

Sections three and four of the Competition Act were notified by the government to enable CCI to start its enforcement activities.

While section three deals with anti-competitive agreements, section four deals with abuse of dominant position. However, sections five and six dealing with mergers and acquisitions have yet to be notified, as the Commission is still said to be studying the effects of these sections.

An independent body responsible for investigating mergers, market shares and conditions, beside regulating firms, CCI would ultimately replace the Monopolies and Restrictive Trade Practices Commission (MRTPC). It was created under the Competition Act, 2002, later amended by Parliament in September 2007. MRTPC will continue to deal with pending cases for two years before being dissolved. However, it would not admit any new cases from May 20.

At present, there are five CCI members, including the chairman. Dhanendra Kumar, former executive director of the World Bank, is the chairman. The others are Geeta Gauri, ex-director (tariffs), Andhra Pradesh Electricity Regulatory Commission; P N Parashar, former judicial member of the Income Tax Appellate Tribunal; HC Gupta, former coal secretary and R Prasad, former chairman of the Central Board of Direct Taxes.

Eventually, there would be seven members in all. The process of selection for two additional members is already on. These three shortlisted members are — MCA secretary Anurag Goel, Planning Commission secretary Subhas Pani and M L Tayal, principal secretary to the Haryana chief minister.

Also in place is the three-member Competition Appellate Tribunal, to which appeals against the Commission's orders can be made. Justice Arijit Pasayat, retired judge of the Supreme Court, is chairman of the Tribunal. Ex-secretary, personnel, Rahul Sarin and Praveen Tripathi, former Deputy Comptroller & Auditor General would be the two other members.

## SEZs get service tax relief

*Get exemption for services availed within special economic zone*

The government has exempted special economic zones (SEZs) from the purview of service tax for the services availed within the zone. This restores the relaxation which was available to investors in SEZs earlier, but was taken away for a brief period starting early March, when the government tried to bring parity between the tax applicable on services availed inside and outside the SEZ.

The notification says unconditional exemption would be available to the services utilized within the SEZ without following the refund route.

The exemption by way of refund would be limited to situations only when taxable services provided to SEZ are consumed partially or wholly outside the SEZ.

# Single agency to monitor voice & data traffic

*Government to invest Rs 450 crore in setting up centralized interception & monitoring system*

The government will soon invest Rs 450 crore to establish a central autonomous agency that will monitor all communication traffic to tighten the country's security and surveillance setup, and make sure no early warning of terrorist attacks is lost in the medley of agencies currently tracking them.

The agency, to be called 'centralized lawful interception and monitoring system', will monitor transmission through wireless and fixed lines, satellite, internet, e-mails and voice over internet protocol (VoIP) calls.

The ministries of law, defence, home, and communications and IT have already been asked to put it in place as soon as possible.

According to officials in the Department of Telecom, a top priority of the new Union cabinet will be to allot Rs 450 crore for this initiative that would be operational by year-end.

The Centre will commit additional funds for this project after the initial allotment has been utilized. Setting up such an agency has assumed critical importance after the 26/11 terror attacks in Mumbai last year.

The proposed centralized agency will be modelled on similar set-ups in several western countries, including the US, UK, France and Germany. The National Security Agency is entrusted with the job in the US, while the Government Communications Headquarters monitors all communication within the UK.

The centralized system aims to be a one-stop solution as against the current practice of running several de-centralized monitoring agencies under various ministries, where each one has disparate processing systems, technology platforms and clearance levels.

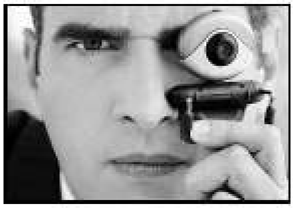
At present, the defence ministry, the police department, the Intelligence Bureau and other agencies associated with national security, all have separate surveillance systems. In addition to duplication of work, they often refuse to share information with each other as they compete with each other.

With no centralized system in place, officers of the Vigilance Telecom Monitoring (VTM) cells of the Department of Telecom assist different security agencies in monitoring mobile, fixed, satellite and internet services offered by both private and government companies.

The VTM cells of the DoT also act as the technical interface between telecom service providers and security agencies.

VTM cells also have a director-level representative from each of the different security agencies. There is also a committee of officers from the ministries of home affairs, defence, IT and telecom, and the Intelligence Bureau, that recommends the nature of monitoring activities that can be carried out.

The police, IB, defence ministry and other agencies also operate their independent surveillance systems. The centralized lawful interception and monitoring system will combine all these parallel systems into a single entity.



## CCI not at odds with cost-efficient cartels

*Complainant must prove cartelization charges*

The country's newly formed competition regulator is unlikely to consider agreements among companies aimed at boosting efficiency as anticompetitive, unless it can be conclusively proved that such pacts hamper fair competition.

Starting May 20, the government made it punishable for companies to enter anti-competitive agreements or abuse their market dominance, but the nuanced approach that will be followed by the regulator will make it easier for companies to defend such deals.

The Competition Commission of India (CCI) is to soon start taking up cases where corporate behaviour stifles competition in the market.

Agreements that will not be considered anticompetitive are called vertical agreements, which include deals between a manufacturer and a distributor or a retailer aimed at reducing cost and enhancing efficiency.

Such agreements will not be considered as anticompetitive unless proved otherwise. The onus of proving that such agreements hamper competition will lie with the complainant and the burden of proof will not lie with the person charged with the offence.

However, another class of agreements called horizontal agreements, or a cartel, will be presumed as anti-competitive, with the onus of proving innocence lying with the company charged with cartelization.

The kind of agreements that will come under the CCI's radar broadly include those among companies to share markets or sources of production, tying the sale of one product with the sale of another product, bid rigging, refusal to sell or insisting that a retailer cannot sell a product at a price lower than the one indicated on the product.

The other key provision that the government has enforced is abuse of dominance. This includes predatory pricing, limiting production of goods or provision of services, restricting the entry of new players or using the dominant position in one market to protect or to enter into another market.

## Tax on expat salary paid outside India

Expatriate employees' salary for working in India is chargeable to tax in India. The tax is charged on the basis of working in India whether the salary amount is received in India or outside India. There may be cases where a part of salary and other allowances and facilities may be paid outside India. There may yet be another class of employees whose salaries are paid by foreign employers but the facilities and allowances are provided in India by their Indian counterparts.

The salary and the perquisites received outside India are also taxed in India by making a legal presumption that when a person is in India, his entire salary income including the value of perquisites, accrues in India.

The above issue was raised in a recent Supreme Court case of CIT V Eli Lilly & Co. (India) P Ltd. which was decided by Supreme Court on 25th March 2009. The Supreme Court finally held that if the home salary/special allowance payment made by the foreign company abroad is for rendition of services in India then such payment would come under Section 192(1) i.e. for deduction of tax at source read with Section 9(1)(ii) (accrual of income in India). Hence the payments made abroad will also be liable to tax in India as well as for deduction of tax at source in India. The Hon'ble Supreme Court rejected the contention:

- That provision of deduction of tax at source will not apply if the salary is paid by a foreign company outside India is *dehors* the contract between the foreign company and the expatriate.
- That the contract under which salary was paid in foreign currency stood executed outside India.
- That there is no territorial nexus with the person located outside India for payments made abroad.

As against the plea of territorial nexus, the Supreme Court observed that if the payments of Home Salary abroad by the Foreign company to the expatriate has any connection or nexus with his rendition of service in India then such payment would constitute income which is deemed to accrue or arise to the recipient in India as salary earned in India.

The Supreme Court also held that tax at source had to be deducted from the salary and allowances paid abroad. Where such payment is made by an Indian entity, the tax will be deducted at source by the said Indian entity. But even if the salary/allowance is paid by a foreign entity, tax is to be deducted at source by the Indian entity from the payment made by Indian entity.

The above decision of the Supreme Court sets at rest the divergent views of various High Courts on the subject and directly overrules the decision of Delhi High Court in the case of CIT V Woodward Governor India (P) Ltd (295 ITR 1).

Woodward Governor India Pvt Ltd. was a joint venture between an Indian company and a foreign collaborator. The joint venture entity engaged one Managing Director. Some remuneration was paid by the joint venture entity and some remuneration was paid by foreign collaborator.

The Indian entity did not deduct tax on the salary paid by foreign collaborator not knowing that any payment was made by the foreign collaborator. The Delhi High Court held that the assessee was only liable to deduct tax at source on the payment it was making to its Managing Director and it cannot be burdened with the liability of deducting tax at source on any other payment, either by way of salary or otherwise.

The Supreme Court held that the Indian "tax-deductor is duty bound to deduct tax at source from the home salary/allowances paid abroad by the foreign company particularly when no work stood performed for the foreign company and the total remuneration stood paid only on account of services rendered in India during the period in question".

## Rs 70,000 crore infrastructure projects get finance closure in three months

Despite the economic slowdown and cash crunch in the global markets, nine infrastructure projects worth over Rs 70,000 crore (Rs 700 billion) have achieved financial closure in the last three months. Domestic banks and financial institutions have funded over Rs 40,000 crore (Rs 400 billion) as the debt component for these projects.

The latest to join the list of projects that have achieved financial closure are two power projects -- 1,050 MW GMR Kamalanga Energy of GMR Energy coming up at Dhenkanal in Orissa and the second phase 300 MW Rosa power project in Uttar Pradesh promoted by Reliance Power.

Financial closure for another Rs 100,000 crore (Rs 1,000 billion) worth of projects are likely to be achieved in this calendar year, mainly from the power and infrastructure sector.

The liquidity situation in the country has improved after the stimulus offered by the central bank and the government. The projects that have achieved financial closure are fundamentally strong, with potential corporate back-up. Interest rates fell to 11.5-12.5 per cent from the September-October rate of above 14 per cent.

## No boundaries for SEZ mergers

*New rules lift 5000-ha cap, ease selection of locations*

The government has decided against applying an area limit of 5,000 hectares for special economic zones (SEZs) if two or more such zones are merged, clearing the way for big SEZs in the country.

Amending the SEZ rules, the government has also allowed developers more freedom to select a location by defining 'vacant land' where a special zone can be set up as land where there are no functional ports, manufacturing units, industrial activities or structures in which any commercial or economic activity is in progress.

As per the SEZ (second amendment) rules published in the Gazette of India, the Centre may consider, on merit, the clubbing of contiguous (adjoining) existing notified SEZs even if the total area of the resultant zones exceeds 5,000 hectares.

This is in line with the permission given by the empowered group of ministers (eGoM) on SEZs in the earlier UPA regime to Adani Group's Mundra SEZ in February this year to merge its three SEZs into a single 6,100-hectare entity. The amended rules make room for more such mergers to happen. Developers can now set up two or more zones side by side, respecting the individual caps, and later merge them into a much larger special zone.

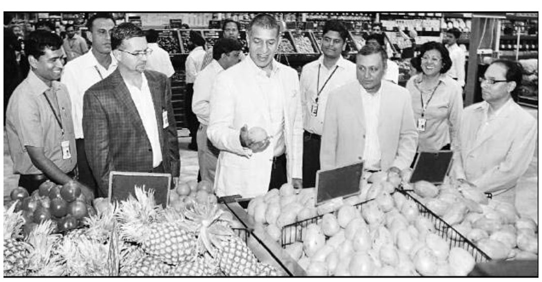
## Bharti Wal-Mart opens first store

Bharti Wal-Mart, an equal joint venture between the world's largest retailer Wal-Mart and the Bharti Group that owns India's largest telecom company by sales, has opened its first Indian cash and carry store in Amritsar. With this, Wal-Mart becomes the second foreign retailer after Germany's Metro to start cash and carry operations in India. UK retailer Tesco's and France's Carrefour are also planning to set up wholesale stores in India. Government policy currently bars foreign companies from setting up retail chains in India.

Bharti Wal-Mart will sell cereals 2-5% cheaper, daily household products 10% cheaper, and higher-margin apparel and general merchandise 25% cheaper.

At the inauguration of its Amritsar based store that cost over $6-7 million, excluding real estate expenses, the company didn't specify by when the store would break even.

Retailers can choose from 3,000 stock keeping units (SKU) in the Bharti Wal-Mart store compared to 700 SKUs in a typical wholesale store. The 50,000-sq-ft Amritsar store has already got 30,000 kirana stores, hotels, restaurants, and offices signed up as members out of a potential 75,000 members in 25-km radius. The company has 800 suppliers, of which 80% are from Punjab. The store employs 200 people, including 60 from the company's retail training school in the city. The company plans to roll out 15 such stores over three years in Punjab, Haryana, Delhi and Uttar Pradesh.



## Can contract be bifurcated to decide tax jurisdiction?

The issue of taxability of offshore services was settled by the Supreme Court in the case of Ishikawa (288 ITR 408) wherein it was observed that there are two conditions which are required to be met in order to bring the income from services in the tax net in India. The two conditions, both of which are to be met, are that services should be rendered in India and that the services should be utilized in India. Thus, where services are rendered/provided outside India, then the consideration therefor will not be taxed in India even if the services are utilized in India.

The Supreme Court also held that whatever was paid by a resident to a non-resident cannot be taxed in India unless there is sufficient territorial nexus with India.

The Supreme Court, in the context of territorial nexus, further observed that where there are different severable parts of a composite contract which are performed in different places, the principle of apportionment should be applied to determine fiscal jurisdiction. This helps determine where the territorial nexus lies.

However, a careful analysis of a recent ruling of Authority for Advance Rulings (AAR) (312 ITR 317) reveals that despite reasonably clear wordings of the Supreme Court, the controversy is far from over. In the said case an Australian company entered into a contract with Sterlite India for setting up a refinery in Orissa.

The Australian company was responsible for development of a set of basic engineering documents which involved preparation of various diagrams, designs, drawings and lay out plans. The Australian company has its design centre at Perth, from where the design services were performed. However, for the purpose of gathering inputs for the preparation of designs and documents, the personnel came to India. The staff of the Australian company also visited India to "explain deliverables to the officers/engineers of Sterlite". Therefore, there were three steps involved in the whole process i.e. collection of data, preparation of deliverables and transfer of deliverables and testing the same.

The Australian company averred that the collection of data and transfer of deliverables had taken place in India. However, preparation of deliverables, which is the crucial activity in the transaction, was done in Perth, Australia.

The case of the foreign company was that on the application of principles laid down in the Ishikawa case, the services rendered outside India cannot be taxed in India. Thus, according to the Australian company, only that part of the receipts attributable to Indian operations which relate to services rendered and utilized in India could be taxed under the Income Tax Act.

The AAR, however, made a distinction from Ishikawa case in the following words: "We cannot understand the observations of the Supreme Court as extending the principle of apportionment to a situation where there is a single Agreement covering only one particular type of work/services, as in the present case. It does not follow from what has been stated by Supreme Court that the services or work covered by such agreement should be split up depending on the actual place of performing them and the profits should be apportioned accordingly. Proportionate deemed income in respect of a single agreement which does not have severable elements was not contemplated by the Supreme Court as a concomitant of the principle of apportionment."

As per the AAR, even a small portion of work in India will provide sufficient territorial nexus for the entire work including activities performed outside India. Further the principle of apportionment of various services in a contract cannot be applied where there is a single agreement covering only one particular type of work or services.

## Non-shareholders not liable to pay deemed dividend tax

The income tax appellate tribunal (ITAT), a quasi judicial tax authority, has held that "deemed dividend cannot be taxed in the hands of non-shareholders." In order to avoid paying dividend distribution tax (DDT) of 17.5%, profit-making, closely-held (unlisted) companies, many a time, resort to granting loans to interested shareholders—those with over 10% shareholding in the companies—instead of paying them dividend after deducting DDT.

Alternatively, to avoid paying DDT, the companies resort to giving loans to any concern in which such a shareholder holds substantial interest, or in excess of 20% stake. However, in the latter case, since the shareholder is the ultimate recipient of such a payment, it is he and not the concern (which is a non-shareholder in the firm making the advance) that is liable to pay tax.

The ITAT's ruling pertained to a privately-held company, Interventional Technologies, which is engaged in the business of trading in life-saving medical devices. This company (assessee) is part of a group of five closely-held, profitable companies, which frequently borrowed from and lent funds to each other.

Interventional Technologies received loans from group companies and was selected for scrutiny by an assessing officer (AO), who was of the opinion that the amounts received by it were to be treated as deemed dividend within the meaning of Section 2 (22) (e) of the IT Act. The AO therefore made an addition of Rs 1.01 crore to the total income of the assessee as deemed dividend under the relevant section for the assessment year 2005-06, thereby taxing it at a higher rate of 33.99%.

The company approached the ITAT after the Commissioner Income Tax (Appeals) confirmed the addition made by the AO through an order dated September 16, 2008.

Counsel for the company argued that since Interventional Technologies did not hold any shares of the group companies from which it received the loans, the amounts received could not be treated as deemed dividend.

An ITAT Mumbai bench comprising J Sudhakar Reddy and RS Padvekar held that definition of dividend under section 2(22)(e) of the act is an inclusive definition that "enlarges" the meaning of the term "dividend" according to its ordinary and natural meaning to include even a loan or advance.

## Foreign tie-ups of trusts taxable

*Cross-border transactions of trusts will not get tax exemptions, rules AAR*

In a verdict that will have a bearing on tax exemptions given to Indian trusts, especially educational trusts, the Authority for Advance Ruling (AAR) has held that tax is to be paid in India on all cross-border transactions, even if the parties involved are exempt from taxation in their respective countries.

The order of the AAR was on an application filed by the Chennai-based Sri Ramachandra Education & Health Trust, which has an agreement for obtaining services from Harvard Medical International, which is also exempt from taxation under the US laws.

In this application, Sri Ramachandra Education & Health Trust sought to clarify whether tax has to be deducted from the annual fee payable to the Harvard Medical International. The trust claimed before the AAR that as both the parties are exempt from taxation in their countries, the annual fee payable to the US party is exempt from taxes in India and hence no TDS be deducted from the payment to Harvard Medical.

The AAR held that it is not possible to conclude that tax is not payable in India on the payment made to Harvard Medical merely on the ground that both are exempt from taxation in their respective countries. It stated that various transactions that took place between the parties should be scrutinized thoroughly before determining what proportion of the payment is liable to be taxed in India.

The I-T department claimed that though

Sri Ramachandra trust is exempt from the Indian Income-Tax Act, the US-based Harvard Medical International is not exempt from taxation in India. Further, Sri Ramachandra Education & Health Trust may be exempt under section 12AA of the I-T Act, which exempts tax on teaching/educational activities, but the "annual alliance development and administrative/maintenance fees" that the trust has agreed to pay to Harvard Medical International do not come under the classification of payment for teaching or educational purposes.

The department further pointed out that there are several such transactions between parties that cannot be classified under teaching or educational purposes such as those for making available technical knowledge, skills, experience etc., which are not exempt under the Income-Tax Act of India.

AAR pointed out that there is a need to ascertain that programmes and workshops jointly held by the two parties are directly related to the educational activity of the trust. It said determination of taxability of payments towards such purpose would depend on further scrutiny by the department. Therefore, AAR directed the trust to return to the IT department and file an application for determining that part of payment to Harvard Medical from which tax should be deducted by Indian tax authorities.

## Japanese companies may take Singapore route to invest in India

Japanese companies may take the route of Singapore government-funded infrastructure facilities to invest in India.

Many such companies which were waiting for the USD 90 bn Delhi-Mumbai Industrial Corridor (DMIC) to come up, found that the project became almost a non-starter during the last government's tenure. Only a few early bird projects within the corridor finally received a go-ahead before the general elections.

Japan External Trade Organization (Jetro) has now entered into an understanding with government-owned International Enterprise (IE) Singapore, whereby the Singapore government would build infrastructure facilities in India for the use of Japanese companies. Jetro has initiated talks with IE Singapore which has already set up the Bangalore IT Park.

## Tamil Nadu gives nod for Toshiba-JSW unit

*JV will set up supercritical power equipment manufacturing facility near Chennai*

In a move that could boost India's plans for setting up power plants based on supercritical technology, the Tamil Nadu government has given its nod to the Toshiba-JSW joint venture for setting up a supercritical power equipment manufacturing facility near Chennai.

Supercritical plants produce more power, around 3-4 per cent higher, per unit of coal and are thus seen as environment friendly.

Japan's Toshiba Corporation and O P Jindal-promoted JSW Energy had earlier entered into an agreement to manufacture supercritical steam turbines and generators for power plants.

The joint venture partners had sought the state government's help for the project for which the Cabinet has given its approval.

The partners are planning to invest around Rs 800 crore for setting up the facility, which will be able to manufacture 3,200 MW equipment annually. The facility will be in Ennore district of the state.

The joint venture will have an initial capital of USD 50 million. Toshiba will hold 75 per cent, while the O P Jindal group will have 25 per cent. JSW's stake will be held by group companies JSW Steel Limited (5 per cent) and JSW Energy Limited (20 per cent).

The facility will start producing equipment by 2011. Its second phase will start by 2015.

This would be Toshiba's first venture in the Indian power equipment market, which is currently almost entirely dominated by state-owned Bharat Heavy Electricals Ltd (BHEL) and Chinese equipment manufacturers.

Currently, India's overall power equipment manufacturing capacity stands at over 10,000 Mw annually — almost entirely contributed by BHEL. The shortfall is met by manufacturers from China, Russia and France.

Limited capacity has been a reason for delays in commissioning of power plants. The government is considering a proposal to make domestic manufacturing mandatory for overseas power equipment suppliers. This has prompted foreign firms to set up local manufacturing units in collaboration with Indian companies.

Around 33,000 MW of equipment manufacturing capacity is expected to be added by the end of 2015, according to the latest data from the Central Electricity Authority (CEA).

While this would help the country meet its target of adding over 80,000 MW generation capacity in the current Plan period and 100,000 MW each in 12th and 13th Plan periods, it would also end the monopoly of BHEL.

## CCI blessing to be must for M&As, rejigs

*Merger norms to be notified in 100 days; to cover all domestic, cross-border & offshore deals*

All mega mergers and corporate restructuring deals in the country will soon require the competition regulator's approval as the government has set a three-month deadline for introducing such a regulation.

Once enforced, competition law provisions on mergers would require all mega deals—domestic, cross-border and totally offshore—to seek the approval of CCI. The regulator can ask the parties involved to modify or keep certain businesses out of the deal to ensure fair competition in the market.

The merger regulation is likely to be implemented prospectively, that is, past deals would not require CCI's approval.

For instance, proposed deals such as the Bharti-MTN merger will not need CCI's approval if the boards of directors of both the companies approve the merger before these regulations are notified.

The competition regulator will scrutinize big transactions only as per the deal size prescribed in the law. Different threshold levels have been prescribed for individual and group companies depending on their exposure to domestic and overseas markets.

For instance, a domestic transaction in which the combined entity has Rs 1,000 crore in assets or Rs 3,000 crore in turnover will need approval of the CCI. In the case of a group of companies acquiring another one, the threshold increases four times.

CCI will scrutinize offshore deals only if the parties have a minimum market presence in India, called territorial nexus. In such cases, the foreign companies with business presence in India would choose to comply with Indian laws even if the transaction is offshore as they would not take a regulatory risk in an important emerging economy. The new rules for regulating offshore deals prescribe a threshold of Rs 500 crore in assets or Rs 1,500 crore in turnover for the combined entity.

The draft regulations prepared earlier had proposed that CCI approval was needed only if all the parties involved in the deal have an individual presence in India so that only deals that are relevant to competition in the Indian market are regulated. Otherwise, a small acquisition of, say, a coffee shop in a foreign country by a global MNC with an India presence will require CCI's permission, which doesn't appear logical.

CCI is now fine-tuning the draft merger regulations and is planning to introduce automatic approval for deals that are in public interest.

## Chennai unit top producer for Nokia

Nokia's Chennai factory is now the Finnish giant's largest cell phone manufacturing facility by volume in the world, edging past China.

China has two factories while Chennai has one. Nokia's Chennai plant has now gone past the larger of the two Chinese factories, which till date was the company's largest in the world.

The Chennai factory manufactures over 100 million phones every year. Women make up over 70% of the 8,000-strong employee pool at the Chennai plant and are involved in a mix of running productions lines, maintenance and assembly & testing operations.

## DBS seeks licences for eight more branches

Singapore's largest bank DBS has sought licences for eight more branches in India, seeking concessions extended to the city state under the Comprehensive Economic Cooperation Agreement (CECA) signed between the two countries in 2005.

DBS, which is the only Singaporean bank in India, currently has 10 branches. Typically, foreign banks do not get the regulatory nod for setting up more than 2-3 branches in a year within the country. DBS was an exception, as India had agreed to grant 20 branch licences, under the CECA, to Singaporean banks.

## Offshore equipment supply not liable to tax

The profit that a foreign company earns by supplying equipment under a contract to an Indian customer outside Indian Territory cannot be taxed in the country, according to a recent ruling by the Authority for Advance Rulings (AAR).

This decision was delivered in favour of South Korean company Hyosung Corporation, which had supplied offshore equipment to the Power Grid Corporation of India (PGCIL) as part of an agreement. The authority said that the foreign company's income from this contract could not be taxed just because it was engaged in supervisory and testing work in India.

Taking note of the transaction details, the authority said the title of goods had been passed on to PGCIL beyond the Indian Territory and hence, outside the scope of the income-tax net. While this order is based on conditions that were specific in this case, the ruling can have a persuasive effect on tax authorities in cases with similar transactions.

In 2005, PGCIL had invited bids for the execution of works related to the Tehri Pooling Station Package associated with Koteshwar Transmission System, in which Hyosung had emerged as the successful bidder.

As per the bidding norms, the South Korean company was awarded the contract for offshore work while the onshore supply of goods and services was to be conducted by Larsen & Toubro (L&T).

The revenue department said that since a number of offshore activities had taken place in India and, therefore, a part of the profits arose from India, they were liable to be taxed in the country. Hyosung argued that no part of its income relating to the offshore supply contract had been earned in India. AAR also ruled that the association between Hyosung and L&T was not an association of persons. It is difficult for foreign companies to claim tax credit in their country against the tax paid if they are taxed as an association of persons.

AAR ruled that documentary evidence highlighted that the title of the goods was transferred while the goods were outside Indian Territory.

## Minority shareholders can be thrown out

In a far-reaching decision, a division bench of the Bombay High Court has endorsed a special resolution of a company to reduce the share capital of a company on the basis of the identity of the person holding the shares. Majority shareholders can now throw out minority shareholders by effecting a reduction of the capital held by minority shareholders alone.

Normally a reduction of capital is effected uniformly across all shareholders – not in a manner that picks and chooses specific shareholders who would cease to be shareholders. Since the proposed resolution sought to throw out minority shareholders alone as a consequence of the proposed reduction, a single judge had ruled that the proposal was inequitable. The division bench dealt with an appeal against the judgement of the single judge.

The provisions of Sections 100 to 105 of the Companies Act, 1956 (the "Act") deal with reduction of capital. If a company's Articles of Association permit reduction, the company could pass a special resolution (75 per cent vote by shareholders present and voting at a general meeting) approving reduction of capital, and then seek a court's approval to effect the reduction.

The law entitles creditors to object to the proposal under certain conditions. This is logical, because shareholders normally stand last in queue when a company is wound up, and a reduction puts them ahead of the creditors.

There are other provisions in the Act based on which a shareholder could be taken out of a company. The provisions Sections 391-394 of the Act entail propounding of a scheme of arrangement or compromise whereby rights and obligations of shareholders and creditors could be altered, adjusted and modified in an extraordinary or unusual manner. Such schemes of arrangement too are subject to sanction of the High Court, and once approved would bind the world at large including those dissenting to the scheme. Section 395 expressly deals with having to buy out dissenting minority shareholders who do not agree to a scheme approved by the majority.

However, in the instant case, the company's proposal to reduce capital was in effect a proposal to squeeze-out the shareholders other than the promoters and divest them of shareholding.

The promoters were able to comfortably pass the special resolution. In lieu of the reduction, such shareholders would of course be paid money in terms of a fair value to be computed, but these shareholders would lose their right to hold shares although they were not willing sellers.

The division bench has ruled that the "special resolution which proposes to wipe out a class of shareholders after paying them just compensation" is not unfair or inequitable.

"In our opinion, once it is established that non-promoter shareholders are being paid fair value of their shares, at no point of time it is even suggested by them that the amount that is being paid is any way less," the court observed. That an overwhelming majority of the non-promoter shareholders voted in favour of the resolution too weighed with the court, which held that "the court will not be justified in withholding its sanction to the resolution."

The judgement opens up several interesting possibilities and propositions in relation to shareholder rights in India. The company in question was not a listed company – it had already been delisted.

Listed companies would require stock exchange approval for reduction of capital under the listing agreement, and it is unlikely that stock exchanges would approve such a transaction. However, for an unlisted company, regardless of whether a company is a public company or a private company, shareholders' rights can be impacted severely.

Private equity investors holding small stakes without serious rights could easily be thrown out by management using such resolutions. In family-run companies, a segment of the family that holds a minority stake could get thrown by the rest of the family. All that one would need is a special resolution.

The core business issue involved here is not about whether the price paid for the shares would be fair, but whether an owner of shares in India has a vested right to keep his property, or whether other shareholders can force him to divest his property.

While an appeal to the Supreme Court against this judgement is a certainty, for now, this position represents an established precedent.

## New PPP norms to keep out frivolous bids

The government has enhanced the threshold technical capacity of bidders to twice the estimated cost of projects under the public-private partnership, or PPP, model.

Under the new norms, if a developer is bidding for a PPP project worth Rs 500 crore, it should have a record of executing projects worth Rs 1,000 crore, or at least double the cost of the new project.

Earlier, to qualify, a developer needed to have executed projects one-and-a-half times the cost of the proposed project in the last five years.

Of the 60 projects put up for bids last year, only 13 attracted bidders. Of the rest, 10 have been bid under the old Request for Quotation (RFQ). The remaining 37 will follow the new RFQ norms.

The government has increased the number of shortlisted bidders from five to six for projects over Rs 500 crore, and from five to seven for projects worth less than Rs 500 crore or repetitive projects.

The notification says the project authority will be allowed to put a clause, which restricts the number of projects awarded to a single bidder.

According to the new guidelines, each of the consortium members, in addition to holding 26 per cent equity in the special purpose vehicle floated to bid for the project, will also be required to hold equity equal to at least 5 per cent of the total project cost for a period of two years after the commissioning of the project.

## Riders for foreigners setting up supercritical power units

Foreign companies looking to set up supercritical power equipment manufacturing facilities in the country will have to bring Rs 100 crore into the venture as initial capital before getting permission to start operations, according to a new proposal aimed at keeping away non-serious players.

The government has also decided to include a minimum capitalization criterion in the Rs 21,000-crore bulk tender document that is being finalized for the supply of 660 mw power equipment based on supercritical technology. The tender is part of a government initiative to induct the new technology in the country by encouraging companies to set up manufacturing facilities.

The proposal also wants companies to submit a bank guarantee of up to Rs 90 crore and hold a clear title over 75% of land required for the manufacturing project at the time of placing their bid. This clause is expected to limit the race for securing the prestigious tender to a limited number of Indian and overseas companies already having some foothold in the country.

Companies (promoter company) interested in manufacturing supercritical power equipment in the country will be required to employ a minimum subscribed and paid-up capital of Rs 50 crore in the subsidiary or joint venture company interested in supercritical manufacturing. In case the bidder is selected for award of the contract, the minimum paid-up capital in the investing company would have to be raised to Rs 100 crore by the date of award.

The tender will specify a seven-year equity lock-in period for foreign companies.

So far, five companies—BHEL, L&T Mitsubishi Heavy Industries (MHI) combine, Alstom-Bharat Forge, Toshiba-JSW and Italian company Ansaldo Caldie—have expressed their interest in participating in the bulk tendering for supercritical equipment. The government, however, expects participation from even Chinese, Russian and a few East European companies.

The proposals would first be tested in bulk order for 11 units of 660 mw power generation equipment sets. They would then be applied on supercritical equipment. Of the 11 units, nine would be used by NTPC and two by DVC.

## DuPont seeds India biz with Nandi buyout

DuPont, among the world's top five seed companies, has acquired Nandi Seeds and the cotton germplasm business of Nagarjuna Seeds in India, hoping to target the country's $275-million-a-year cotton seed market and marking its maiden entry into the cotton seed business worldwide.

India is the country is the world's second largest producer and consumer of cotton. Significantly, with this deal, DuPont India will now sell dominant player Monsanto's BT cotton through Nandi Seeds, which has a licence from Monsanto India to use BT technology to produce cotton seeds here.

The Rs 40-crore acquisition of Nandi, through DuPont India's subsidiary Pioneer Seeds, will give DuPont an easy entry into a cash crop that has seen yields grow manifold over the last six years. Buying Nagarjuna's cotton germplasm business would allow DuPont to introduce some elite hybrids in India.

Pioneer currently offers corn, rice, pearl millet, sunflower and mustard in the Indian market and has grown revenue

40% annually for the last five years to reach about $70 million in 2008.

## Work kick-off to set tax for foreign realty

The Authority for Advance Rulings (AAR) has cleared the air on taxation of a foreign realtor that has a tie-up with a domestic entity by ordering that the duration of work must be calculated from the day the effective work on the project begins rather than from the date of signing the contract.

Calculating of the number of days of work is crucial for a foreign company as it determines the tax liability of its earnings.

Foreign firms are often signed up by Indian infrastructure developers to do a part of the construction work. Examples of such arrangements include the Dahej LNG project where Petronet LNG awarded contracts to a consortium of foreign companies.

The AAR ruling came in the case of Cal Dive Marine Construction (Mauritius) Ltd, which signed an agreement with Hindustan Oil Exploration Company (HOEC) for laying undersea pipelines in the Cauvery basin. The AAR was hearing the calculation of "the period of activity undertaken" by Cal Dive, a bone of contention between the I-T authorities and the company.

Cal Dive inked the pact with HOEC on December 4, 2007 for USD 59,174,200. As per the double taxation avoidance agreement between India and Mauritius, the construction project undertaken by the foreign company must continue for nine months so as to make its income taxable in India. While the revenue department contended that the duration of operations for Cal Dive should be calculated from the date of signing the contract, the company argued that the period of work was lesser than the nine month period. In a relief to Cal Dive, the AAR ruled that the date of calculation should be the date from when the work has begun.


## FIPB says Press Notes 2, 4 cannot be retrospective

The Foreign Investment Promotion Board (FIPB) has made it clear that Press Notes 2 and 4 issued in February 2009, which changed the way indirect foreign equity would be treated in calculating foreign investment levels in Indian corporations, cannot take effect retrospectively for proposals before the board.

This clarification arose after the nodal approval agency for foreign direct investment proposals recently 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.

The 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 total foreign direct investment or FDI.

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.

In January this year, FIPB had given Bharti Telemedia retrospective approval for indirect foreign holding via Bharti Airtel, subject to a fine that would be determined by the Reserve Bank of India (RBI).

In 2008, Bharti Airtel invested 40 per cent in Bharti Telemedia. Since the telecom service provider has a 21.6 per cent foreign holding, the pro-rata foreign holding in Bharti Telemedia amounted to 8.64 per cent, which the FIPB said required its approval. This was duly given in January after the deal was struck, hence the fine.

After Press Notes 2 and 4 were issued in February, Bharti Telemedia put in a fresh application saying that it was not required to pay the fine because under the new rules, the indirect foreign component was routed through Bharti Telecom, which is owned and controlled by Indians.

In the case of Tata Teleservices, NTT DoCoMo was given approval to acquire 27.3 per cent stake in the company in January this year. The approval, however, was subject to Tata Teleservices paying a fine. This was because FIPB had contended that even before DoCoMo's investment, Tata Teleservices had a foreign investment of 9.98 per cent from Temasek Holdings and had made downstream investments in Virgin Mobile India, Tata Teleservices Maharashtra and Tata Internet Services without FIPB permission.

A few months ago, Tata Teleservices put in a fresh application saying under Press Notes 2 and 4 Tata Teleservices was a resident Indian company and, therefore, did not need to pay a fine.

At its meeting on June 19, FIPB rejected both applications saying the deals were structured before the two press notes were issued.

The deals, FIPB said in a note, "cannot retrospectively change the legal consequences of acts committed or legal status of facts and relationships that existed prior to their enactments. That is why the board has taken a conscious decision to recommend the proposal for rejection".

Significantly, the Department of Industrial Policy and Promotion (DIPP) under the commerce ministry had approved both proposals. The press notes have been the bone of contention between Department of Economic Affairs in the finance ministry and DIPP. DEA has said the norms would violate sector-specific foreign investment limits, a view it shares with the RBI.

## 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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