India Update: July – August 2009

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No cap on executive pay

Corporate Affairs Minister Salman Khurshid has allayed all fears of a cap on executive pay and job reservations in the private sector.

Companies can now breathe easy that no cap on executive pay will be introduced in the Companies Bill 2009. Khurshid's predecessor, Prem Chand Gupta, had favoured such a step after the Satyam fiasco and the collapse of global investment banks whose executives took home huge and guaranteed compensation packages.

This had led to fears that the Bill may try to restrict remuneration payable to executives. In the past, Prime Minister Manmohan Singh too has commented on skyrocketing salaries in the corporate sector.

At present, companies cannot pay more than 5 per cent of their net profit, as defined under the Companies Act, to any single director. The combined remuneration for directors, including the managing director, needs to be within the overall ceiling of 11 per cent.

However, this ceiling is proposed to be withdrawn in the new Companies Bill. It was introduced in Parliament last year but lapsed as the Lok Sabha's term got over. It has now been revived as the Companies Bill 2009.

India retains best BPO hub tag: AT Kearney

India continues to be the most preferred destination for companies looking to offshore IT and back-office functions, despite the backlash against outsourcing to the country. It also retains its low-cost advantage and is among the most financially attractive locations when viewed in combination with the business environment it offers and availability of skilled people, according to global management consultancy AT Kearney.

India has retained its numero uno position even as some other well-established outsourcing hubs have dropped in their attractiveness to be replaced by new emerging destinations in AT Kearney's latest ranking of top outsourcing destinations across the globe. "The top three countries in the 2009 Global Services Location Index (GSLI) remain the same - India, China and Malaysia - but the world's volatile economic environment is reflected in the rest of the rankings," the consultancy pointed out. The study evaluates 50 top countries.

The economic meltdown and appreciation of the local currency against the dollar has taken its toll on Central and Eastern Europe that were emerging as important off-shoring hubs for Western Europe. Overall, nine countries dropped nine or more rankings in the attractiveness index. While one-time rising stars such as Poland, Czech Republic and Hungary, lost out, others in the Southeast Asia and Middle East scored. Egypt, Jordan and Vietnam made it to the top 10 rankings for the first time.

India and Philippines together account for 50% of the world's BPO market but Philippines, often spoken of as threat to India, is only 'distant' second, according to the study. Philippines is more call-centre oriented and AT Kearney does not see it growing at the same pace as China and some other South Asian countries.

Significantly, India is also no longer being viewed only as a competitor but also an enabler to industry growth in other regions. Indian companies are dominant players and are increasing their global footprint as clients look for multi-region support.

Foreign data providers' income not taxable

Foreign data service providers' earnings through subscription fees from an Indian company will not be taxed here, the Authority for Advance Rulings (I-T) has said.

However, the AAR has held that providing access to compact information through data retrieval software could be treated as service of a 'technical nature'. Such payments are taxable.

Data service providers, which have databases outside India but subscribers in India, are likely to gain from this ruling.

The AAR has given the ruling in the case of US-based financial data analytics firm FactSet Research Systems, which provides financial and economic information to Indian customers by entering into licence agreements with them, granting them the right to use its database and software tools.

"Providing a client with the use of search and retrieval software and access to a database does not involve the exercise of special skill or knowledge when the software and database is delivered to the client," the ruling has said. Thus, payments by Indian companies cannot be seen as money spent on services of a 'technical nature'. Under the income-tax laws in India, receipts in lieu of technical services are taxable.

While rulings by the AAR are case specific, they have a persuasive impact on tax assessment in cases of other firms under similar circumstances. The income tax department had argued that the money received by FactSet Research was towards consideration of the transfer of copyright held by the company on its database.

Government plans to free royalty, tech fee in foreign tie-ups

Companies that have foreign collaborations and many more that will do so in future stand to benefit as the government plans to free payment of royalty for use of trademark or brand and of technology transfer fees.

At present, if the technology transfer fee exceeds $2 million, it has to be approved by the Projects Approval Board, under the Ministry of Commerce and Industry. For royalty, the limit is 5 per cent of domestic sales and 8 per cent of exports. If there is no transfer of technology, royalty is capped at 1 per cent of domestic sales and 2 per cent of exports.

LOOSENING THE TAPE
1991 POLICY: Automatic approval for technology transfer allowed in high priority areas up to $2 million, royalty of 5 per cent of domestic sales and 8 per cent of exports subject to a total payment of 8 per cent of sales over a 10-year period from date of agreement or 7 years from commencement of production. Specific rules for the hotel

industry
CURRENT POLICY: Automatic approval is permitted for technology transfers only in cases involving payment of $2 million and royalty of 5 per cent of domestic sales and 8 per cent of exports. Royalty up to 2 per cent of exports and 1 per cent of domestic sales is allowed under the automatic route on use of trademarks and brand names of foreign collaborator
PROPOSED POLICY: Allow all payments for royalty, know-how fee for transfer of technology, payments for use of trademark or brand name through the "automatic route" without any restrictions and subject only to the FEMA (Current Account Transactions) Rules of 2000

Since 1991, when the country started to liberalize its economy and industry, the government has approved 8,035 technology collaborations between Indian and foreign companies, the bulk of them with companies in the US, Germany, Japan, the UK and Italy.

A draft Cabinet note prepared by the Department of Industrial Policy & Promotion (DIPP), under the commerce ministry, proposes to put such payments on the "automatic route" without restrictions and subject only to the Foreign Exchange Management Act (Current Account Transactions) Rules of 2000.

The Cabinet note has gone to the Cabinet Committee on Economic Affairs, which is expected to take it up soon.

DIPP's move has been endorsed by both the Planning Commission as well as the Department of Economic Affairs, both of which play critical roles in such policy decisions.

The current policy was formulated in 1991, when the country faced a severe shortage of foreign exchange and had to mortgage its gold. It was relaxed a little in 1996, but remained strict.

According to DIPP, the situation has changed significantly, with the country sitting on foreign exchange reserves of over $300 billion. Therefore, the department says, there is no justification for any restriction on payment of royalty. It has also argued that in a globalised economy the evaluation of technology and assessment of quality and justification for the knowhow and royalty payment need to be left to commercial considerations of the parties entering the contract. The issue should not be in the domain of the government.

However, such payments involve foreign exchange outflows, which are administered through FEMA rules, that decide which transactions cannot be allowed and which require approval of the Reserve Bank of India.

Global F&B giants planning healthy tag for Indian market

To adopt common nutritional labelling standards to address health awareness

Indian subsidiaries of global food and beverage companies such as Unilever, Kellogg, Coca-Cola, PepsiCo and ConAgra are planning to adopt common nutritional labelling standards to address growing health awareness and concerns about obesity.

The move, aimed at pre-empting the integrated foods law that is expected by the year-end, is in line with the strategy adopted by their parent companies at the global level.

Hindustan Unilever (HUL) has already initiated the move for brands such as Kissan, Knorr and Annapurna. Others such as Kellogg, Coca-Cola and PepsiCo are evaluating their options on the issue.

Most food companies in India have started reducing portion sizes, reformulating existing products to reduce saturated fat, cholesterol, added sugars and sodium in line with global trends.

HUL has begun putting a 'Smart Choices' front of-pack stamp on key food products. The company's relaunched range of Knorr soups has excluded preservatives and has seen a 7-35% reduction in sodium content.

Globally, Unilever, Kellogg's, Coca-Cola, ConAgra Foods, General Mills, Kraft Foods, PepsiCo and Wal-Mart have come together in the US to voluntarily accept the controversial nutrient profiling food-labelling system and use a common logo to flag products that are deemed healthy. So has Kellogg, which leads the small but rapidly growing Rs 400 crore breakfast cereals category.

Coca-Cola and PepsiCo, both global signatories to the agreement, are currently in the process of evaluating the options of labelling their brands. PepsiCo already puts a Snack Smart logo on some of its foods brands under foods arm Frito-Lay.

PepsiCo categorizes its products as 'good for you', 'better for you' and 'treat for you'. Most of its new launches fall in either of the first two categories, since the company has said in the past that it is 'committed to portfolio transformation'. For Coca-Cola, the Choices logo could be utilized for some of its non fizzy beverages like juices, water, tea and coffee.

Food and beverage companies are gearing up to meet the requirements of the integrated food law that will be mandatory this year. The unified food law plans to set up, among other things, mandatory labelling of ingredients, and a scientific panel to audit the claims made by functional foods flooding the market as well as set standards for organic foods.

The food law will also include a feature called 'food recall'. The new labels will have to declare ingredients, weight, total calories (energy value), amounts of protein, carbohydrate, fat, sodium (salt), sugars, dietary fibre, vitamins and minerals, and amount of transfats in all foods and beverages. In addition, a fruit juice that does not contain a specified amount of fruit juice or pulp cannot be described as a fruit-based product.

Safety net proposed for independent directors

The government proposes to protect independent directors from being held responsible for the wrong-doing of their company, through a number of proposed changes in the Companies Bill. The Bill, which was introduced in the latter half of 2008 but eventually lapsed, has been re-introduced. The Ministry of Corporate Affairs is willing to introduce further changes to the Bill in respect of the provisions that will guide the performance of independent directors, a move that has been prompted by the large scale resignation of such directors over ambiguity on their role.

The government will set an outline as to what will be an independent directors' role vis-a-vis his company's decision-making process. The idea is to safeguard them against any legal action when they are not directly at fault for their company's wrong-doing.

The ministry, which in the Companies Bill 2008, first introduced the concept of independent directors and also made provisions for their mandatory one-third representation on company boards, is mulling changes into the proposed legislation so that such directors can have a defined role to play. Even as independent directors are expected to act in the interest of the company's ordinary shareholders, the law does not specify the exact nature of their duties.

The ambiguity on the nature of duties of an independent director often leads to situations where they are blamed for all wrong-doings of the company. Therefore it is necessary to bring clarity to the law so that degree of accountability against those directors can be clearly drawn. The ministry has also invited recommendations from industry bodies such as CII and FICCI, and is considering incorporating in the new Bill.

CII, for instance, has urged the ministry to clearly define an independent director and bring it in conformity with the definition under clause 49 of the equity listing agreements of stock exchanges. It has also suggested that the need for appointment of such directors in closely-held public companies and subsidiaries of any public companies should be governed by the materiality and scale of operation of such companies. Thus, in case of an unlisted public company or a private company, which is subsidiary of a public company, the requirement related to such appointments should only arise if they exceed the prescribed thresholds of size and scale.

Under the proposed changes, these directors can be held responsible only in those circumstances where the company takes a decision wherein they were actively involved. To put in simple words, independent directors may not be asked to serve as an overall watchdog of the company, a notion which the government now sees as overtly ambiguous.

The reason for the change has been a spurt in resignations by independent directors from the board of companies that followed the Satyam financial scandal wherein such directors on the erstwhile Satyam's board were blamed for their inaction to safeguard the company's general interest. The idea is to provide independent directors with a clearly defined way of performance, so that they cannot be acted against in case they are directly not at fault.

DoT for evergreen mobile licences

The Department of Telecommunications has asked the Telecom Regulatory Authority of India to recommend terms and conditions for extending the licence periods forever.

This applies to the cellular mobile telephony licences issued initially, as well as the unified access service licences issued in later years after a policy change. Both were granted for 20 years and could be extended by another 10.

Eight licences in the four lucrative metropolitan markets are slated to expire in 2014, followed by another set in the subsequent three years. Mobile phone licences two in each of the four metros were first issued in 1994, on payment of a fixed fee, for 10 years. Between 1995 and 1998, 14 companies obtained 34 more licences for 18 circles across the country. The New Telecom Policy of 1999, which moved this industry to a revenue-share model, also extended the life of licences to 20 years.

The fresh view of DoT, the government arm that formulates telecommunications policy, is that licences should stay valid in perpetuity so long as their owners keep paying the annual revenue share and meet all the other conditions.

The issue of validity was becoming complicated with the imminent start of the third generation of mobile services, or 3G, which enable high-speed data transfer. The government is auctioning 3G spectrum this year for 20 years. Many of the initial operators could be in a situation where they could have the spectrum, for which they are going to pay a high licence fee (the price suggested by the finance ministry is Rs 4,040 crore), but not have the licence to operate. By making the licences valid in perpetuity, this apprehension would be addressed.

Sweeping changes in mining policy

After releasing a much hyped mineral policy last year that failed to see the light of day, the government is back to the drawing board again. On the anvil is a refurbished policy that would give specific directions on controversial aspects like royalty, mining leases and even mineral exports. The policy is likely to be tabled in the winter session of Parliament.

Mining is one of the sectors that is worst affected by procedures and red tapism that has resulted in delays for some of the country's largest FDI projects like Korean steel major Posco's 12 million tonne steel plant in Orissa and Arcelor Mittal's twin projects in Jharkhand and Orissa.

The new policy, after it takes shape, is expected to more than treble the investment in the sector from Rs 18,000 crore to over Rs 60,000 crore in the next 5 years.

Another significant step would be adoption of ad valorem principal for charging royalty which will create a windfall for states. Accruals for major mineral producing states is likely to increase from Rs 2,014 crore in 2006-07 to Rs 3,943 crore in 2010-11 through this.

No stamp duty in SEZs

Developers of special economic zones (SEZs) will get a blanket exemption from stamp duty on land purchases within the notified area for non-core activities such as building hotels, housing complexes, shopping malls and golf courses.

The exemption had become a contentious issue with states where these projects are located demanding that it be restricted to core manufacturing areas, which have to cover at least 50% of the total SEZ land.

The government has extended this to cover the whole area within the zone and has issued guidelines detailing the circumstances under which the sop can be availed.

For the developers of the 500-odd SEZs in the country, slated to bring in investments of over Rs 100,000 crore, this ends the uncertainty that had cropped up after some states had voiced their opposition.

The exemption, however, will be available only after formal approval of the zone. For land bought after in-principle approval, the state government may either give the exemption upfront or collect the duty and refund it after the zone has been set up. If under some circumstances, notification of a zone is cancelled, the state government will be entitled to withdraw the concession and recover the same from the developer.

India, ASEAN sign free trade agreement

India and the Association of South East Asian Nations have signed a Free Trade Agreement, which took nearly six years to negotiate.

The accord, India's first with a trade bloc, will cover 11 countries with a combined Gross Domestic Product of over $2 trillion. The combined population is of the order of 1.6 billion.

Nine members of the 10-nation regional trade bloc signed the pact. Vietnam would do so after its formal recognition by India as a "market economy." India and Vietnam have already agreed to sign a memorandum of understanding on this issue.

The implementation of the FTA would, therefore, take off from January 1, 2010.

The mutually agreed tariff liberalisation would gradually cover 75 per cent of the two-way trade, beginning from January 2010. India-ASEAN trade was of the order of $40 billion in the 2007-08 accounting year. The regional bloc was now India's fourth largest trading partner.

ASEAN would now seek a "fast-track" approach for talks with India for a "single" follow-up accord on liberalising the two-way flow of services and investments. The ASEAN's expectation was that the agreed tariff cuts under the FTA, as now signed, would be fully implemented by the end of 2013 and 2016 in respect of two normal tracks. A timeline had also been agreed upon for the sensitive list of items.

Under the trade pact, India has included 489 items from agriculture, textiles and chemicals in the negative list, meaning these products will be kept out of the duty reduction.

Addressing concerns of domestic planters, black tea, coffee, pepper and rubber have been included in the sensitive list, which could mean duties will be cut by 2019 only. However, duty on these items at no time will be eliminated. Farmers in South India, especially Kerala, fear lower duty on plantation crops like coffee and pepper would lead to a deluge of imports from ASEAN members like Indonesia, Malaysia, which could leave domestic farmers vulnerable to competition.

The agreement was in harmony with India's Look East Policy. The bulk of trade between the two regions include textiles, steel, processed food, plantation crops, iron and steel, ready-made garments and chemicals.

Magna International mulls multi-product unit in India

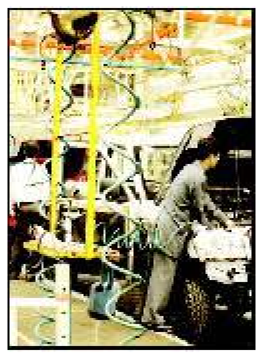
Magna International, the world's largest contract manufacturer of cars, plans to set up an integrated manufacturing facility in India to function as a mother plant for all business divisions, a company executive said. The company, which reported revenues of $23.7 billion in 2008, builds cars like BMW X3, Mercedes Benz E Class, Aston Martin Rapide and Jeep Grand Cherokee on contract and also makes auto parts.

It already has eight business divisions in India including manufacturing joint ventures with component makers Lumax, Amtek Auto and Rico Auto and full-fledged engineering centres to design and develop cars and ancillary products.

All its manufacturing facilities in India are joint ventures. An integrated facility will help the company leverage the overheads costs. The facility would develop components and automotive designs for Magna's customers. In the long-term, Magna could be manufacturing cars on contract for various premium carmakers eyeing the Indian market.

Top-end carmakers like BMW, Porsche that import their vehicles to India and others like Aston Martin, Peugeot and Chrysler that eye the Indian market could use Magna's proposed unit to increase exposure in the world's second fastest growing car market after China.

Auto sales have picked up in India after a slump in late last year following a stimulus package from the government in December and overall recovery in the economy.



Power equipment companies to set up base in India

In a move that will give a boost to power generation in the country, private power equipment makers, such as Alstom and Toshiba, will set up their power manufacturing base in India in the next three-four months. This decision will help the power ministry in its objective to add 78,700 MW power generation capacity by March, 2012.
Alstom, Toshiba, Mitsubishi Heavy Industries and others have taken land for

setting up their manufacturing facilities and in three-four months these projects would become operational. India will be adding more than 100,000 MW of power in Twelfth Plan period starting in 2012. Already orders for equipment to generate 25,000-30,000 MW in the next plan have been placed.

The government would soon give its nod to bulk tendering of supercritical equipment by NTPC and DVC. This has evinced interest from new joint ventures such as L&T –Mitsubishi, JSW-Toshiba, Bharat Forge- Alstom and Ansaldo - GB Engineering. New ventures are expected to bring investment to the tune of Rs 5000 crore.

Representatives of new joint ventures sought the help of government by providing concessions available for Ultra Mega Power Projects to all supercritical power projects supplied by indigenous manufacturers and concessions in custom duty on import of manufacturing machinery.

Changi buys 26% in India's first airport city project

After one failed attempt, Singapore-based Changi Airport International (CAI) finally made an entry into India's airport development business by announcing that it had bought 26 per cent for $20 million (approximately Rs 96 crore) in Bengal Aerotropolis Projects Ltd (BAPL).

BAPL is a special purpose vehicle that is developing India's first airport-city project at Andal, around 200 km from Kolkata, at a cost of around Rs 10,000 crore. The company has been promoted by Pragati Social Infrastructure and Development Ltd, Lend Lease Company (India) Ltd, Citystar Infrastructures Ltd and Pragati 47 Development Ltd.

CAI and BAPL had signed a technical services agreement (TSA) in February 2008, according to which CAI would review the master plan of the Greenfield airport and supervise the execution of the project. It would also train the senior management of BAPL at the Singapore Aviation Academy.

The debt-equity ratio for the project was 1:2.25 for the initial investment of Rs 675 crore in the first phase, of which the airport alone would require an investment of around Rs 230 crore. The land required for the total project is 3,100 acres. The West Bengal Industrial Development Corporation Ltd is in the process of acquiring the land.

Bid process for core projects fast-tracked

To speed up infrastructure creation, the finance ministry has streamlined the process of inviting and processing financial bids from private parties for highway projects.

The ministry has taken away the flexibility of individual ministries, departments and state agencies executing public-private-partnerships to decide their own timeframe for different stages in the process. It has stipulated that the last date of receiving any query on the RFP, the document inviting bids, will be 25 days from the date of the RFP. The authority inviting bids has to respond swiftly and all queries have to be answered within 35 days of calling the bids. The authority also should give at least 45 days to the developers to place their financial bids. The fee for obtaining the documents inviting financial bids is raised 10-fold to

Rs 100,000, as per a copy of the revised RFP.

The ministry has also brought several changes to the new bid-inviting document to align it with the recently modified norms to shortlist developers for making financial bids. The ministry raised the limit for crossholding among bidding companies from 1% of the paid-up capital to 5%. The cross-holding limit in the original criteria was kept at 1% fearing that it might lead to bid-rigging. The ministry has taken the view that up to 5% cross-holding may safely be allowed without fear of collusion among the bidders.

The new norms, finalized by the finance ministry in consultation with the Planning Commission, say the changes would lend more transparency and predictability to the entire bidding process, allowing decisions to be made objectively and expeditiously. The document also says the changes are the critical requirements that must be observed while conducting a credible selection process.

Planning Commission sets out guidelines for infrastructure JVs

Selecting a private partner to be done in a competitive basis

The Planning Commission has worked out broad guidelines for establishing joint venture companies between public sector undertakings (PSUs) and the private sector in infrastructure.

The draft guidelines are being prepared to provide PSUs with clear directions that they lacked so far when they sign joint venture agreements with private companies for large infrastructure projects and will be put up for Cabinet clearance soon.

The proposed joint venture code of conduct

- Select a potential private partner through an open, competitive basis with equal opportunity to competing players rather than through negotiations
- Disallow government officials from chairing joint ventures in which the private company has the majority shareholding
- Encourage public sector companies to provide grants instead of contributing to the equity of joint ventures to make a project viable
- Reliance on shareholders' agreements should be avoided. Rights, obligations and duties should be incorporated in the concession agreement.
- Discourage 50-50 joint ventures
- Valuation of tangible and intangible assets in companies in which the public sector company's contribution in a joint venture is its assets should be approved by a competent authority such as the PIB

Sanofi snaps up Shantha Biotech

France's biggest drug maker Sanofi-Aventis has agreed to buy Shantha Biotechnics in a deal whose generous

valuation is seen as tempting other Indian vaccine makers to consider a sell-out if similar offers come their way.
The deal between Sanofi and Shantha Biotech's French owners, Mérieux Alliance, values the unlisted Indian company at Rs 3,740 crore, or about eight times its projected sales of Rs 440 crore for this fiscal.

Mérieux Alliance bought a 60% stake in Shantha Biotech in 2006 and subsequently increased it to about 80%.

The deal involves Sanofi's vaccine arm Sanofi Pasteur acquiring ShanH—which owns nearly 79% stake in Shantha Biotech—from Mérieux Alliance. Mérieux will retain about 5-10% in Shantha.

Exports account for nearly two-thirds of the country's vaccine market, estimated at nearly $1 billion.

Tax sop proposal for green appliances hits finance ministry roadblock

Energy-efficient products have huge price variation under different brands

The government has declined to provide tax relief on the expensive energy-efficient consumer durables certified by the Bureau of Energy Efficiency (BEE), the purchase of which it has made mandatory from January 6, 2010.

The energy-efficiency certification body had proposed zero central excise duty on five and four star-rated appliances, and less than 4% excise duty on three and two star-rated appliances. Single-star and unrated appliances would continue to attract the regular tax rate of about 15%, said the proposal.

The BEE, a body working under the power ministry, rates appliances on the basis of their energy consumption where higher efficiency attracts more stars.

The finance ministry has said the BEE proposal would be difficult to implement as the products sold under its star rating have a huge price variation under different brands.

The finance ministry's decision comes even as the government has made energy-efficiency star-rating mandatory for air-conditioners, refrigerators, tube lights and transformers from July 7, 2009, with a gestation period of six months.

Manufacturing and selling electrical appliances without energy efficiency certification would be illegal from January 6, 2010, and would invite legal action.

During the 11th Five-Year Plan (2007-12), the government aims to save 10,000 MW power of which it has already saved 2,100 MW. While BEE has saved 1,500 MW during 2008-09 through its saving programmes, it has set a target of 2,600 MW for 2009-10 and 3,000 MW for 2010-11.

In the absence of tax incentives for these expensive appliances, the government's initiatives on energy efficiency may face a setback.

SUBROTO

Government re-introduces Companies Bill

The government has re-introduced the Companies Bill in the Lok Sabha to replace a 52-year-old law and simplify regulations dealing with formation, mergers and acquisitions and winding up of companies.

Besides other things, the new Companies Bill 2009 will be shorter and will try to harmonise the company law framework with sectoral regulations.

The proposed Bill will have 480 sections compared to over 600 sections in the Companies Act, 1956 in addition to providing for greater shareholder democracy and less government intervention.

The new legislation will try to promote shareholders' democracy with protection of rights of minority shareholders, responsible self-regulation with adequate disclosure and accountability and lesser government control over internal corporate processes, said the statement of objects and reasons of the new Bill.

It will also make it mandatory for listed companies to have 33 per cent independent directors and provides for the formation of One Person Company (OPC), while empowering the government to provide a simpler compliance regime for small companies.

The Bill also proposes to make stringent provisions for companies seeking to raise money from the public. They would not be allowed to raise deposits from the public without obtaining permission from the relevant regulator.

There will be a single forum for approval of mergers and acquisitions, whether domestic or with foreign entities. Also the procedure for merger of holding and wholly-owned subsidiaries would be shortened.

The Bill also seeks to prohibit insider trading by company directors or key managerial personnel. Such activities will be treated as a criminal offence.

The Bill also provides for a framework for enabling fair valuations of companies for various purposes.

Capital gains tax blow may soften for foreign firms exiting JVs

Authority for Advance Ruling dispenses with complex foreign exchange indexation requirement

A precedent-setting order by the Authority for Advance Ruling (AAR) could enable foreign companies exiting their India joint ventures to pay long-term capital gains tax at a concessional of 10 per cent rate instead of linking it to a complex indexation formula that requires multiple foreign currency conversions.

AAR's ruling, passed recently in response to an appeal filed by Fujitsu Services, has said that the concessional capital gains tax would be applicable for foreign companies selling shares or debentures when they exit Indian ventures. Such debentures or shares should be listed on stock exchanges and be held for more than 12 months.

Before this, the income tax department used to insist on the computation of long-term tax on the basis of "indexation" to avail of the concessional rate of 10 per cent by foreigners.

Indexation means that capital gains has to be computed by deducting the cost of acquisition and "improvement" from the cost of acquisition of the asset, which in this case are shares and debentures. The "improvement" will be deducted only after converting the cost of acquisition expenditure into the same foreign currency as was initially used for the purchase of shares or debentures. Once that is done, the capital gains computed in foreign currency has to be reconverted into Indian rupees.

Since the Indian rupee has depreciated since these investments were made, the exiting foreign company ends up paying a higher amount as capital gains tax.

AAR's latest ruling has highlighted section 112(1) of the Income Tax Act that confers the benefit of a lower rate of tax on a non-resident foreign company provided the investor has applied indexation to the calculation of tax. The authority has, however, dispensed with indexation as a pre-condition for non-resident companies to avail of the benefit of the lower tax.

The AAR was of the view that the cost of indexation should be applied uniformly to both Indian and foreign companies. "The income tax department should not hold it as a precondition for any company to confer the benefit to of concessional rate of tax," it said in its ruling. AAR pointed out that indexation was provided as a second proviso to section 48, which specifies the computation of capital gains tax.

This ruling would have significant implications on the computation of long-term capital gains tax in cases such as Hutch, which exited its telecom venture in India, and has a tax liability of around $2 billion under legal contention.

Fujitsu exited Zensar Technologies in 2007 after it sold its 26.55 per cent stake to Jubilee Investments and Cyprus-based company Pedriano, which in turn is a wholly-owned subsidiary of Petrochem International (Petrochem). Petrochem is a wholly-owned subsidiary of Jubilee. Fujitsu had acquired Zensar in 1993-94.

The appeal was filed after the income tax department attached the precondition of application of the "principle of indexation" for the foreign company to avail of the benefit of a lower tax rate.

Foreign investment law in the works

The government is working on a proposal to introduce a legislation relating to foreign investment aimed at removing the distinction between various categories of overseas capital, a move intended to ensure stability in policy and help Indian firms attract long-term capital.

The new Foreign Direct Investment Act would seek to remove the distinction between various categories of overseas fund flows such as portfolio investment, venture capital, private equity and direct investment. Rules on external investment in Indian companies make a distinction between portfolio investment, in which an investor buys shares of a company from the secondary market, and foreign direct investment (FDI), in which the investor normally acquires a relatively larger holding directly.

The new legislation would involve major changes to the existing Foreign Exchange Management Act (FEMA), which deals with both inbound and outbound foreign investment. It would remove all confusion and provide stability in terms of policy. The finance ministry has already started work on the new legislation and would seek inputs from the Reserve Bank (RBI), the official said. The new Act will also give clearer guidelines on convertibility.

One view in the finance ministry is to use the new foreign investment act to stop discriminating against investments that take place via debt or quasi-debt instruments.

India's foreign investment norms prescribe separate caps on portfolio flows and FDI in some sectors, such as direct-to-home (DTH) broadcasting services and stock exchanges. In other sectors, notably telecom and insurance, there is a composite cap of 74% and 26% respectively. In many sectors 100% foreign investment is allowed. The plethora of rules leads to confusion and lack of clarity - a dampener to more overseas money flowing to firms which need long-term capital.

An expert committee on foreign institutional investment (FII) had recommended in 2004 that foreign portfolio flows into a company should be separated from foreign direct investment (FDI) flows for policy purposes. FDI is categorised as the type of investment which results in ownership of 10% or more in a company and is relatively more enduring.

In portfolio investment, investors can exit more freely, through the stock exchanges. The RBI has consistently been of the view that in the hierarchy of preferred capital flows, FDI ought to be at the top. The current policy is largely *ad hoc*. It is governed by several rules that are changed through "Press Notes" issued from time to time by the Department of Industrial Policy and Promotion (DIPP) and FIPB. Interestingly, one view is that the Press Notes issued by the DIPP have no legal sanctity since changes to guidelines on foreign investment require changes to FEMA rules, which rarely gets done. Therefore, there is frequently considerable confusion regarding interpretation of policy on foreign investment between different government departments. This is what the proposed legislation seeks to address.

Government stiffens terms for large road projects

An ambitious plan by the National Highways Authority of India (NHAI) to offer 126 road projects worth around Rs 1 lakh crore this year may face serious hurdles owing to a stiff clause introduced in the new Request for Qualification (RFQ) norms that will eliminate many bidders.

Revised guidelines that came into effect in July stipulate that a bidder must have experience of executing projects worth twice the estimated total project cost mentioned in the RFQ document in the last five years.

That means a developer bidding for a project worth Rs 500 crore should have a record of executing projects worth Rs 1,000 crore in the last five years. The earlier stipulation required a bidder to have executed projects equivalent to the estimated value of the project for which bids are being placed.

Seventy to 80 projects that the NHAI is bidding out are worth over Rs 1,500 crore, which means bidders need to have undertaken road projects of over Rs 3,000 crore in the last five years to be eligible for the bidding process.

Industry estimates say only about 40 construction companies in the country stand to qualify under these rules.

Since the RFQ also says no company can bid for more than three projects, the number of bidders for large road projects will fall further.

Lens on beneficial ownership transfers

Finance ministry wants to improve disclosure for unlisted companies, especially in sensitive sectors

Non-disclosure of transfer of beneficial ownership by promoters has caught the eye of policymakers. While market regulator Sebi has tightened the noose around listed companies in the wake of Satyam promoters' failure to disclose the pledging of their shares in the company, the focus has now turned to improving disclosure for unlisted companies. Beneficial ownership is conventionally understood to mean right to economic benefit, regardless of legal ownership. However, the Companies Act 1956 does not define the term and it is open to interpretation.

The issue has been deliberated within the Finance Ministry, which is set to take it up with the Ministry of Corporate Affairs. At present, a declaration under Section 187C of the Companies Act has to be filed with the Registrar of Companies if beneficial ownership in a company is transferred. Non-compliance attracts a fine of Rs 500-1000 per day till the default continues. The idea is to effectively monitor these declarations to keep a track of changes in ownership of companies, especially in sectors that have restrictions on foreign investment. As a precursor to the move, the Finance Ministry had enquired from the Ministry of Corporate Affairs about the number of investigations carried out by it with regard to violation of this Section. The new Companies Bill 2009 has continued with the provision under Section 79.

It was being increasingly felt that this disclosure mechanism should be strengthened and made more efficient as it was a comprehensive route for getting information on any change in ownership structure of a company. The need is increasingly being felt after changes in the FDI policy. The policy says any minority foreign investment in an Indian company would not be considered for calculation of total foreign investment in the investee firm, if the investing company is 'majority-owned and controlled' by resident Indian citizens.

CERC unlocks direct transmission links for private power companies

Private power developers will now be able to save on transmission cost of about 50 paise a unit. In a landmark move, the Central Electricity Regulatory Commission (CERC), the apex power sector regulator in the country, has announced measures to ensure adequate transmission links for new power plants.

The commission has notified the long-awaited medium-term open access regulations and norms to ensure grid connectivity for private power developers. Currently, power generating companies have the option of booking power transmission corridors for up to three months (short-term open access) or for more than three years (long-term open access).

The new regulations will ensure that all the grid-connected generators seek medium-term transmission usage for a period between three months to three years. The regulations will provide a "non discriminatory arrangement of transmission", which would mean facilitation of the grid, irrespective of ownership of the power plant.

The new regulations also identify the central transmission utility (CTU) Powergrid Corporation of India Ltd (PGCIL) as the nodal agency for providing transmission linkages for the open access for transferring power through the grid. Traditionally, setting up of a power generating station requires a finalised power purchase agreement (PPA) right from the beginning.

As per the new norms, however, power plants will get transmission facilities just by indicating the region in which the power is to be supplied, in case the beneficiaries are not clearly identified.

Another major feature of the regulations is that PGCIL would provide grid connectivity to all the thermal power plants with at least 500-MW capacity and hydro plants with at least 250-MW capacity, irrespective of the ownership (whether state-owned or private sector).

Currently, PGCIL extends its transmission network to only the government-owned power plants and private developers have to build their own transmission lines for connecting their generation to the national grid, which pushes up the transmission charge payable by them by at least 25 per cent.

For instance, an independent power producer (IPP) located in the northern region has to pay a transmission charge of 20 paise per unit of power to the CTU. In addition, the IPP has to shell out an estimated Rs 40-45 lakh for building a separate line for connectivity to the grid, which leads to a jump of 5 paise per unit in its overall transmission cost. However, the new regulations have made it mandatory for PGCIL to provide transmission links to such IPPs too.

The new regulations would also help in avoiding cases where state governments deny open access to private power generators, on the pretext that there is a shortage of power, using emergency provisions of the Electricity Act.

The new regulations would come into effect after two-three months when PGCIL submits the detailed procedure of implementing the new regulations, following which applications would be invited from private developers for grant of open access in the transmission system.

FIPB blocks L&T defence JVs, says it breaks FDI cap barrier

Engineering and construction firm Larsen and Toubro's (L&T) plan to form two separate joint ventures for manufacturing and servicing of defence equipment with Germany's EADS Deutschland GmbH is facing roadblocks.

The Foreign Investment Promotion Board (FIPB) has noted that although total FDI coming directly in the manufacturing JV is below 26%, the remaining equity is also being routed through the services JV in which the foreign collaborator has 49% stake. The manufacturing JV will be 24.5%-owned by EADS, 51% by L&T Technologies and 24.5% by L&T.

FIPB has stated that although L&T Technologies, the services JV, would be owned and controlled by the Indian partner, it opens the possibility of having foreign equity in the manufacturing JV up to 49.49%. As per existing norms, FDI in a company engaged in the manufacture of defence-related products is allowed up to 26%, but it requires prior approval of FIPB.

The FIPB has added, "It is essential that letter and spirit as embodied in Press Note 2 of 2009 is strictly adhered to." Under Press Note 2 of 2009, if total foreign ownership through FDI or through FIIs in any company is less than 50% it will be treated as an Indian firm.

Any investment made by this firm will be treated as Indian investment. This means that the foreign investment in a company, as long as it is less than 50%, would not be counted as foreign in any subsequent investment made by that company.

The board deferred the proposal at its meeting on July 24. It has directed Department of Defence Production (DoDP) and Department of Industrial Policy and Promotion (DIPP) to verify if the control and ownership of the two JVs will remain with L&T and that foreign equity holding are met.

Tax sops for supercritical technology

The government has proposed to extend the excise waiver and income-tax holiday benefit to power projects based on supercritical technology, including large-sized energy-efficient power equipment. The proposal is part of the new mega power policy being worked out. The existing policy has no provision for giving incentives to the new-generation supercritical power projects.

In addition, the new policy would also allow projects that have completed financial closure but have not tied up requisite long-term power purchase agreements (PPAs) to apply for mega power status and avail incentives.

Under the proposed changes, supercritical power projects would be included in the list of projects to be covered under the mega power benefits. The benefits would be extended only if such projects (supercritical projects) source equipment by inviting international competitive bidding with the mandatory condition that the supplier sets up an indigenous manufacturing facility.

The existing mega power policy allows duty-free import of capital goods and extends deemed export benefit (excise duty waiver) for supplies by domestic bidders. In addition, the income-tax holiday regime under Section 80-IA can also be availed. The incentive is given to hydel power projects of 500 MW and above and thermal projects of 1,000 MW and above.

The changes in the policy have been

proposed to encourage technological innovation and technology transfer for developing indigenous capacity for manufacturing of supercritical equipment.

In addition, the power projects that have completed financial closure would also be able to get mega power incentives even though they are yet to tie up the requisite 85% of power sale under long-term power purchase agreements (PPA) with distribution utilities and trading companies.

Tax breaks for foreign telcos deferred

In a move that is set to impact all foreign carriers that offer long distance services in India, the Department of Telecom (DoT) has deferred plans to do away with the double taxation structure that these international carriers are subjected to here.

The move will impact several foreign telcos such as AT&T, Verizon, British Telecom, France Telecom, Cable & Wireless and SingTel among others that provide the services of carrying national (STD) and international voice (ISD) and data traffic within India as well as to and from the country.

Earlier this year, the DoT had held several rounds of talks with foreign carriers to settle the issue of double taxation and had decided to change existing regulations after the general elections. This is because, the current regulations makes it very difficult for foreign carriers who hold international long distance licenses here to compete with domestic players such as Bharti Airtel, Reliance Communications & BSNL. But, the Communications Ministry has now decided to defer plans for offering relief to international carriers.

The deferment may also imply that the DoT may ask telecom regulator Trai to issue its recommendations on this matter through a consultation process. Current regulations state that the DoT must consult the regulator on all key policy changes, but the department had taken major decisions bypassing Trai in the past.

All foreign players have been demanding that DoT should address the double taxation issue. Earlier this year, the US Telecommunications Subcommittee had also taken up this issue with the Indian government since American companies such as AT&T and Verizon were also impacted by this factor.

At present, these foreign carriers use the infrastructure of existing operators as they don't have comprehensive network. Under current rules, they pay licence fees twice to the government - once when they buy bandwidth from the existing operators and again when they resell it to enterprises and their customers.

For instance, if AT&T were to offer national and international connectivity to say GE offices in India, the US-based telco buys bandwidth from a domestic operator like Bharti. This is because Bharti has a more robust and stronger network in India. When a new player such as AT&T buys bandwidth from existing operators, the 6% revenue share or licence fee is incorporated into the selling price. But, under current laws, AT&T is subject to a tax regime again when it resells the bandwidth to GE effectively paying revenue share twice on the same component and making its offerings uncompetitive. This system puts these international carriers at a major disadvantage and forced corporates and enterprises in India to buy bandwidth directly from the Indian operators since this was a cheaper option.

DoT may now ask Trai to look at two models as a possible solution - the application of an excise tax or a value-added tax - to help avoid double taxation. With regard to the excise tax regime, the 6% revenue share applies only to transactions where the service is provided to an end user. Intermediate or wholesale transactions where the purchaser is another carrier are not counted. For instance, under this system, AT&T will not be subject to revenue share when it buys bandwidth from Bharti. Under a value-added tax regime, all providers would contribute on the basis of all of their sales; however, each carrier would be able to deduct the value of any telecom services it has purchased.

Top firms paid an average 25.8% tax

Even as the government has proposed to bring down the corporate tax rate from 30 per cent to 25 per cent beginning April 2011, the government is not going to lose much tax revenue as Indian companies are at present paying almost what the government plans to fix as corporate tax without any surcharge and cess.

According to a study of 272 companies (from CMIE Prowess database) that form a part in the list of BSE 500 companies and posted a positive profit before tax, the total direct tax paid by these companies amounted to 25.8 per cent of the profit earned in 2008-09. The tax paid amounted to Rs 50,428 crore. However, the tax liability on them at the rate of 33.9 per cent that they are supposed to pay would amount to Rs 66,257 crore. The actual collection was lower by Rs 15,829 crore in 2008-09.

The gap is primarily on account of the exemptions that companies claim as offered by the government.

Under the new tax code, the total tax applicable would be 25 per cent. While it will help reduce the complexity in tax payment, it would not lead to a loss in revenue for the government even at a lower tax rate as the loss on account of exemptions will go away.

Within the list of companies for which the data was available, many companies that earn profits in excess of Rs 1,000 crore, paid direct tax of less than 20 per cent.

Foreign airlines' FDI bid crashes again

Government puts on hold Aviation Ministry's plan to let foreign carriers own 25% in Indian airlines on security fears

The government has put on hold a proposal to allow foreign airlines to pick up stake in domestic carriers on security considerations and chaotic global aviation scenario.

The Civil Aviation Ministry had sent a proposal to the Department of Industrial Policy and Promotion (DIPP) for allowing foreign carriers to invest in domestic airlines to facilitate liquidity at the loss-making domestic airlines.

Indian regulations don't allow foreign carriers to hold equity, either directly or indirectly, in domestic airlines. However, foreign investors other than airlines are allowed to own up to 49% in Indian carriers.

The guidelines also allow foreign direct investment by helicopter operators and ground handling companies into local companies in the same segment.

Creeping acquisition guidelines to stay put

The government and capital market regulator Sebi have decided against rolling back a temporary measure taken in October 2008 that allowed promoters with 51% or more to raise their stake to 75%.

Last year's decision, which allowed promoters to express confidence in their companies by buying more shares from a falling market, was due for a review this year.

The move has ramifications on how the government and Sebi will go ahead with a plan that requires companies to have a 25% public float to remain listed - a proposal finance minister Pranab Mukherjee highlighted in this year's budget speech. If promoters own up to 75%, certain classes of investors such as foreign institutional investors (FIIs), mutual funds (MFs), employees, non-resident Indians (NRIs)/overseas corporate bodies and private corporate bodies will jostle with retail investors for the remaining 25% in companies.

In a discussion paper last year, the government had drawn attention to the need for excluding these classes of investors from the definition of 'public shareholders'. It was concerned that if these entities are counted as public shareholders, floating stock may become insignificant. Besides, the move would affect ordinary retail investors' chances of participating in the corporate sector's fortunes.

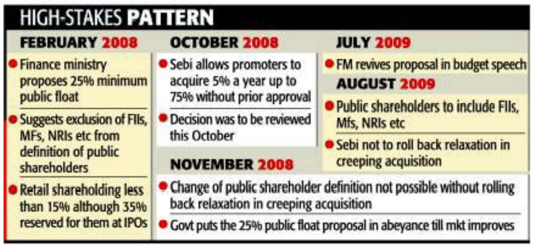
Now, the government has decided against changing the definition of public shareholding in haste. So, when the government notifies the public holding requirements later this year, the required 25% could be jointly owned by retail investors as well as financial institutions.

Financial institutions would be counted as public shareholders, except in cases where they themselves are promoters of companies.

The Finance Ministry and Sebi will also give sufficient time for promoters to prepare for the new regime where companies would face delisting from stock exchanges if public ownership falls below 25% consistently. The authorities will give a 'preparatory time' initially and then a 'transition period' for promoters to implement the minimum 25% public float.

That means the transition period for the new regime would start only from a particular date in the future to be specified in the order prescribing the new mandatory public float.

If the government notifies the changes in say, December, the transition period could start from the beginning or the middle of the next fiscal.



MRTPC to make way for CCI from September

The Monopolies and Restrictive Practices Commission (MRTPC), the country's fair trade regulator for four decades, would begin the process of giving way to the new Competition Commission of India in September 2009.

The Ministry of Corporate Affairs has notified Section 66 of the Competition Act in September, which will lead to repealing the Monopolies and Restrictive Trade Practices Act of 1969.

Section 66 of the Competition Act lays down the principle on which pending cases and investigations under the MRTP Act are to be followed up. After this section is notified, the MRTP Commission would get two years to dispose of pending inquiries, but would not have the jurisdiction to entertain fresh cases. The MRTPC would cease to exist after these two years.

The Competition Commission is expected to notify its merger regulations soon. With merger norms in place, CCI will look into all domestic, cross-border and offshore deals. However, past deals will not be scanned by CCI.

Coke wins landmark service tax case

Pharma and FMCG firms to benefit too

In a judgment that stands to benefit contract manufacturers like fast moving consumer goods (FMCG), pharmaceutical and cosmetic companies, the Bombay High Court has ruled that beverage company Coca-Cola could avail of tax credit on the service tax it pays for advertising and promotions.

The judgment also applies to PepsiCo, which had intervened during the hearing in July this year.

Since the credit rule for service tax is applicable retrospectively (since 2004), Coca Cola stands to make significant gains to its bottom-line. It spends 35 to 40 per cent of its revenue on advertising and promotion.

Soft drink manufacturers can now avail of the service tax rebate as CenVat credit against their excise duty liability on concentrates they supply to their contract manufacturers.

The ruling, passed by a division bench comprising Justice F I Rebello and Justice J H Bhatia of the Bombay High Court, stands to benefit companies from other sectors, too, like cosmetics and pharmaceuticals, since they follow the contract manufacturing model and advertise and promote the end-products.

FMCG companies typically spend 10 to 12 per cent of revenues on advertisements and promotions, so the judgment will see the bottom-line of companies improve in direct proportion to the service tax they pay.

The case dates back to 2006, when Coca-Cola filed an appeal with a tax tribunal for service tax credit against advertising expenditure on soft drinks such as Coca-Cola, Thums Up, Fanta and Sprite. The appeal was, however, rejected on grounds that Coca-Cola's end-product was manufactured by its bottlers.

In 2007, the company filed its appeal in the high court under section 35G of the Central Excise Act.

The basis of the appeal is that the cost of advertising is considered an input cost for manufacturers of packaged and consumer goods, so service tax credit should be allowed.

No more changes to Press Notes 2, 4

In a sharp divergence from its earlier opposition to Press Notes 2 and 4 that relaxed foreign direct investment (FDI) in February 2009, the Finance Ministry says 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.

North Block's decision not to alter the Press Notes eases the way for the complex $23 billion share swap deal between Bharti, India's largest telecom company, and South Africa's MTN, one of the first major test cases of the new policy guidelines.

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.

Some months ago, the DEA raised questions over an application before the Foreign Investment Promotion Board (FIPB) by India Rizing Fund, the country's first defence venture capital fund, promoted by some former bankers. DEA objected to India Rizing, requesting the FIPB to delete a clause stipulating approval for all downstream investments in those areas of defence production that are subject to FDI limits by using the new rules under Press Notes 2 and 4.

The Reserve Bank of India had also opposed the new press notes, arguing they could encourage investors to set up companies in which non-resident entities hold 49 per cent. In this event, downstream investments by such companies might cause them to breach sectoral FDI limits or direct investments into companies in which FDI was prohibited.

In telecom, for instance, the sectoral cap is pegged at 74 per cent and under the older norms the deal would have not passed muster, as it would have breached the sectoral limit. This was one reason the deal between Bharti and MTN did not fructify last year when talks were first held. Under the deal, Sunil Mittal's Bharti is to acquire a 49 per cent "economic interest" in MTN. In return, MTN will acquire 25 per cent "economic interest" for $2.9 billion and MTN shareholders will acquire another 11 per cent in Bharti Airtel.

In all, MTN and its shareholders will acquire 36 per cent in Bharti Airtel in the form of global depository receipts (GDRs) that will be listed on the Johannesburg stock exchange.

More investment leeway for foreign venture funds

RBI opens FDI door for entry in new areas

Indian regulators have opened the doors to foreign venture capital funds (FVCFs) beyond the select investment options they were being offered in recent times.

The decision, reflected in some of the communications between the Reserve Bank of India and custodian banks of VC funds, could not only make life easier for foreign funds and widen the scope for their risk capital, but also boost foreign direct investment (FDI) in the country. In the past one year, FVCFs which were allowed to come in, were specifically told to stick to activities such as infrastructure, bio-technology, nanotechnology, biofuel, IT-related activities for hardware and software development and a few other areas outlined by the government in the list of 10 sectors identified for tax benefits to VCs.

Recently, RBI, while giving the green signal to some of the FVCFs, has said that "if the FVC investor intends to make any private equity investments, then it may have to avail the FDI route". This means that barring a few sensitive sectors, a FVCF registered in India is free to invest in almost any business in the country. For buying into firms which are outside the 10 sectors, the fund will have to either approach the Foreign Investment Promotion Board (FIPB) for FDIs where the board approval is required, or invest directly in areas where FDI is permitted under the automatic route.

According to private equity circles, FVCFs have interest in businesses like BPOs, telecom, media and entertainment among other segments. RBI's latest stand, however, does not pave the way for FVCF investment in the real estate space - something the central bank forbids. Fearing a real estate bubble, RBI generally insists on an undertaking from FVCFs that they will not invest in property firms. This is unlikely to change.

Interestingly, the RBI letter is also a rare instance when a local regulator makes a mention of 'private equity' - a widely used generic term for which there is no regulatory definition in India.

Source

Press clippings

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