



INDIAN LEGAL AND BUSINESS UPDATE

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1. New Model Code of Taxes

The Government has unveiled the draft of a brand new direct tax law that would represent a radical review of the existing Income Tax Act, 1961. The purpose is “to improve the efficiency and equity of our tax system by eliminating distortion in the tax structure, introducing moderate levels of taxation and expanding the tax base”, according to finance minister Pranab Mukherjee, who released the draft. The tax code makes radical changes in all areas of taxation; it lowers the incidence of tax on corporate and individual incomes but reintroduces wealth tax on all assets and tax on long term capital gains, albeit at lower levels. It also proposes to bring a uniform pattern of taxation to bear on all long term savings: EET, which is exempt at the stage of contribution, exempt during accumulation and taxed during withdrawal.

The tax measures would impact personal incomes, companies and investors. If a reasonable level of discussion happens on the code, a bill could be placed in the winter session of Parliament. The government is hoping to implement the new code from 2011. The code proposes to exempt an individual from paying tax if his income is up to INR 160,000 a year. An income about that and up to Rs. 10 lakh would attract tax at the rate of 10 percent. Income above INR 1 million and up to INR 2.55 million would be taxed at 20 percent and that above INR 2.5 million at 30 percent. These represent significantly lower levels of taxation, compared to the present structure.

2. Double tax treaties under a cloud

The Direct Taxes Code, if implemented the way it has been drafted, can override each of the 75 double tax avoidance agreements (DTAAs) that India has signed. This is because the code has proposed that neither a DTAA nor the code shall have a preferential status by reason of it being a treaty or law. Instead, the code adopts the later in time doctrine, implying that the provisions of the new 2011 law could override every tax treaty that India has signed in the past. Under the present law, the tax treaty overrides the Income Tax Act if more beneficial. Now, it is proposed that later changes in the Direct Taxes Code can override the treaty. Therefore, in the case of conflict between the provisions of a treaty and the provisions of the code, the one that is later in point of time will prevail. This means whenever there is some dispute regarding the provisions of the treaty the code will prevail with respect to all 75 treaties signed in past. The GAAR provisions also permit the

tax authorities to disregard provisions of DTAA that India has signed.

3. High Court gives settlement commission a lease of life

In a major relief to over 3,000 companies all over India seeking arbitration in tax cases with the Settlement Commission, the Bombay High Court has termed as “unconstitutional” the government’s decision to suggest a cut off date of March 31, 2008, for all cases filed before June 1, 2007. In its judgement in response to a petition filed by STAR television News Ltd., the High Court said the choice of March 31, 2008, as the cut off date for the settlement of all cases filed before June 1, 2007, is not supported by any rationale. Tax experts say the decision is important since it will restore immunity to assesseees from prosecution under any Central Acts or the Indian Penal Code (IPC). Also, the disclosures made to the settlement commission will not be passed on to the income tax department for further enquiry and scrutiny. This sets to rest a major fear that arose among companies after Budget 2007 announced the commission would be wound up after March 31, 2008 since the Finance Bill had provided cases and disclosures to be passed back to the income tax department if the commission fails to settle the cases. Earlier, the commission used to clear cases within four years from the date they were filed. After the 2007 amendment, the time was reduced to one year.

4. Bill allows merger of Indian Companies with foreign firms.

The Companies Act Amendment Bill which was recently tabled in Parliament has proposed to allow Indian companies to merge with overseas companies, a move that could introduce greater flexibility in cross border merger and acquisitions (M&As). At present Sections 391-394 of the Companies Act, 1956 allow only foreign companies to merge with Indian ones. The Bill has introduced Section 205 that also allows the reverse and stipulates that payment to shares holders of listed Indian companies being merged can be in the form of cash, shares or Indian Depository Receipts (IDRs) issued by the overseas companies.

The amendment was first suggested in 2005 by an expert committee on company law chaired by Tata Sons Director JJ Irani. The report had stated “both contract as well as court based mergers between an Indian company and a foreign company, where the foreign company is the transferee, needs to be recognized in Indian law. The committee recognizes that this would require some pioneering work between various jurisdictions in which such mergers and acquisitions are being executed / created”. Legal experts said the merger of an Indian company with a foreign one can help structure M&A deals in many ways. The provision may also make it easier for promoters of Indian companies to raise funds abroad by setting up listed entities abroad and merging their Indian operations with them.

5. Stiff penalties for software pirates in new copyright law

Those dealing in pirated software may soon face stiff action from the rightful owners as the government will soon amend the copyright law, making software piracy an offence punishable with up to two years imprisonment. Besides imprisonment, amendments to the law also propose monetary penalty, which will be specified at a later stage through the rules. A bill to amend the five decade old Copyright Act, proposed by the human resources development ministry and the copyrights office is likely to be tabled in Parliament soon.

It is estimated that about 70 percent of all software used in the country is pirated with a revenue loss of over USD 2 billion a year to the original producers. A major change proposed is to make it illegal to circumvent a technical measure used for protecting a software from piracy - its safety feature. Software pirates break this code, access the software and make copies of every kind of software, including operating systems, games and other applications. Another proposed change is on erasing or altering rights management information, or the ownership rights. This also would attract monetary penalty and imprisonment of up to two years. The government, however, will exempt certain types of tampering with security features to encourage genuine research on encryption and software safety.

6. New Act places more faith in trusts

The Government has introduced a bill in Parliament proposing amendments in the 1882 Indian Trusts Act to allow trustees greater autonomy and flexibility in deciding their investments. The move is aimed at bringing the pre-independence law in tune with the times. "Moving the amendment bill, Finance Minister said the amendments would do away with the requirement of case-to-case approval by the government of any security". They also provide to the trustees "greater autonomy and flexibility to take decisions on investments". At present, trusts registered under the legislation can invest their funds only in securities notified by the government or authorized by the trust's charter or under a High Court rule. While new age trusts have tried to provide maximum flexibility to invest options through their charter, older ones, particularly cash-rich religious trusts have been deprived of the change. There are a few thousand trusts in the country, of which about 400 are very big and have phenomenal resources. The bill seeks to empower the Centre to notify a class of securities for Investments by trustees.

7. Government approves panel proposals on patent grant

The central government has accepted the recommendations of an expert committee headed by former Council of Scientific and Industrial Research (CSIR) chief, R. A. Mashelkar on patent laws. The committee had concluded that limiting the grant of patents for pharmaceutical substances to new chemical entities would be a violation of the TRIPS

agreement of the World Trade Organisation (WTO). In effect, the committee endorsed the current position taken by India, in allowing patenting of known medicines if they have substantial new therapeutic uses. The Mashelkar committee was formed after the government passed the Patent Bill in 2005. It was assigned to see if the demand for narrowing the patent laws would breach India's obligations under the WTO agreement..

8. No more 50:50 JVs in PPP core projects

The government has barred equal joint ventures in public private partnership (PPPs) in the infrastructure sector as it looks to fix responsibility on the majority partner to ensure timely implementation of such projects. A newly issued set of guidelines for infrastructure PPPs also prohibits regulators from entering directly into such partnerships and bars government employees from becoming chairpersons of projects majority held by private partners. The guidelines have been considered by a committee of secretaries and approved by the finance minister and deputy chairman of Planning Commission. It would now apply to all central ministries and departments, statutory entities and central public, sector undertakings.

The bar on equal partnerships between private and public entities and also public and public entities in the infrastructure space aims to prevent a deadlock on matters of public interest by fixing responsibility of the project with the majority owner. The rules also prohibit regulators and entities such as Port Trusts, Air ports Authority of India, Indian Railways and National Highways Authority of India that have regulatory functions from undertaking construction and management of PPP projects. They have to create a separate project implementing entity to implement any future PPP projects. The new rules have also barred consultants and advisors of public sector entities from being engaged in similar roles in the private entity created through a joint venture.

The guidelines also provide that the selection of private sector partners should be done in an open and competitive process. The new set of rules addresses issues relating to conflict of interest, accountability of public sector entities, valuation of assets, contingent liability, exit and termination clauses.

9. Government's New Exploration and Licensing Policy (NELP -VIII)

The government has launched the eighth edition of the New Exploration and Licensing Policy (NELP -VIII) and the fourth round of bidding for Coal Bed Methane (CBM-IV) in Mumbai, expecting a commitment of around USD 3 billion. This is a third of the USD 9 billion that has been committed in the first seven rounds of NELP so far. The government is offering a total of 70 oil and gas blocks under NELP-VIII and 10 blocks have been offered under CBM-IV. In an effort to attract more bidders, the 2009 Budget extended tax breaks for gas discoveries, which is in line with existing concessions on oil discoveries. Last year's bidding had not seen active bidding by foreign firms as tax

breaks were put in place for discoveries of oil but not gas. The bid closing date for NELP – VIII and CBM – IV is 12 October. Promotional road shows for NELP – VIII and CBM-IV will be held at Houston, Calgary, London, Perth and Brisbane.

10. India-ASEAN Free Trade Agreement.

The signing of the Free Trade Agreement (FTA) with the Association of South East Asian Nations (Asean) is expected to increase the overall trade turnover between India and the 10 country block by over a fourth to as much as USD 50 billion. Under the pact, which forms a part of the Comprehensive Economic Cooperation Agreement, tariffs on most of the trade between India and Asean will be cancelled by 2016, while duties on 489 “very sensitive” products will be retained. The agreement would come into force from January 2010. Trade between India and Asean has grown at a compounded annual growth rate of 27 per cent since 2000. The pact will give a further impetus to the bilateral trade and investment linkages between India and Asean. The agreement, which was linked after six years of negotiations, calls for gradual elimination of duties on items which account for 75 per cent of the trade between India and Asean. These include electronics, textile, machine and chemical goods. The agreement would provide additional market access to exporters, fuelling the growth in bilateral trade and investment. Indian exporters which stand to benefit from the pact include those dealing in machinery, steel, agriculture products, auto components, chemicals and synthetic textiles.
