



INDIAN LEGAL AND BUSINESS UPDATE

JUNE 1-JUNE 30, 2009

1. Foreign Investment Promotion Board says Press Notes 2 and 4 not retrospective

The Foreign Investment Promotion Board 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. This clarification arose after the nodal approval agency for foreign direct investment proposals recently rejected applications by some of the applicants 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. 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.

2. Competition Commission of India approval to be must for all mergers & acquisitions.

All mega mergers and corporate restructuring deals in the country will soon require the approval of the competition regulator, the Competition Commission of India (CCI), as the government has set a three month deadline for introducing such regulations for regulating the deals. The merger regulation is likely to be implemented prospectively.

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 business out of the deal to ensure fair competition in the market. 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.

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

3. No boundaries for special economic zone mergers

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. 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.

4. New Public-Private Partnership 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. The finance ministry on June 20, 2009 revised the request for qualification, or RFQ, norms for such projects.

Under the new norms, if a developer is bidding for a PPP project worth Rs. 500 crore (USD 100 million), it should have a record of executing projects worth Rs. 1,000 crore (USD 200 million), or at least double the cost of the new project. Earlier, to qualify, a developer needed to have executed projects equivalent to 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 RFQ. The remaining 37 will follow the new RFQ norms.

The government has increased the number of short listed bidders from 5 to 6 for projects over Rs. 500 crore (USD 100 million), and from 5 to 7 for projects worth less than Rs. 500 crore (USD 100 million) or repetitive projects.

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.

5. 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 (USD 20 million) 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 (USD 4.2 billion) bulk tender documents 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 (USD 18 million) and hold a clear title over 75 per cent 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.

The final proposal would now be placed before the group of ministers headed by the finance minister next month. Companies would be given the go ahead for starting the tendering process, thereafter. 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 (USD 10 million) 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 (USD 20 million) by the date of award. The tender will specify a seven year equity lock in period for foreign companies.

6. Foreign tie-ups of trusts taxable

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 May 29, 2009 order of the AAR was on an application filed by the Chennai based Shri Ramachandra Education & Health Trust, which has an agreement for obtaining service from Harvard Medical International, which is also exempt from taxation under the US laws.

In this application, Shri 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 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.

AAR pointed out that there is a need to ascertain that programmes and work shops 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 Income Tax department and file an application

for determining that part of payment to Harvard Medical from which tax should be deducted by Indian tax authorities.

7. Law ministry to clear Companies Bill soon

The law ministry will soon clear the new Companies Bill, so that the government can introduce the long pending law in the forthcoming session of Parliament. The Bill, which was cleared last year by the Parliament, but lapsed with the change of government, is now lying with the law ministry for its approval. With the ministry of corporate affairs proposing no further changes to the Bill from what it was introduced in 2008, the law ministry's role is merely a formality as the same Bill has already been vetted by it.

8. Swiss Government agrees to share data on tax evasion

The Swiss government has agreed to loosen its banking secrecy laws and share data on tax evasion cases that India may be pursuing, as part of a renegotiation of the Double Taxation Avoidance Agreement (DTAA) that the two countries signed in 1995. Such a reformulated tax agreement will help tighten the legal noose on tax evaders secreting their money abroad. Under present Swiss laws, foreign-held accounts are protected unless there is evidence of proceeds from drugs or bribes.

This means India will be able to seek details of bank accounts kept by citizens who are believed to have evaded taxes in India and deposited the money in overseas bank accounts. Under the existing Indo-Swiss DTAA, information on the Swiss bank deposits of Indian residents was not to be revealed under any circumstances. Earlier this year, however, the Indian government filed an affidavit with the Supreme Court saying it had approached the Swiss government to renegotiate the 1995 DTAA. The Affidavit was filed in response to a public interest litigation saying the Centre did not take adequate steps to get back illegal money kept abroad by Indian citizens.

9. At 8 percent, India to grow fastest in 2010: World Bank

The World Bank has projected an 8 per cent growth for India in the year 2010, which will make it the fastest-growing economy for the first time, overtaking China's expected 7.7 per cent growth.

The multilateral lender has revised upwards the growth rate for the Indian economy this year to 5.1 per cent from an earlier projection of 4 per cent, according to its Global Development Finance Report released on June 22, 2009. India has consistently outperformed growth forecasts by the World Bank in the past.

10. Need for separate Act for Serious Fraud Investigation Office

The Vepa Kamesam Committee, eight member committee, headed by former deputy governor of RBI Vepa Kamesam, set up in 2006 to review the functioning of the investigating agency, has recommended to the Ministry of Corporate Affairs that there should be a whistle blower policy in the Companies Act and in the SFIO Act to detect corporate frauds at early stage.

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The panel has also recommended a separate Act for the Serious Fraud Investigation Office (SFIO), a move that will give SFIO more autonomy and allow it to improve its investigation and enforcement work. During the Satyam investigation, SFIO faced trouble in getting permission from courts to interrogate the suspects or conduct searches, something that has been seen as a handicap for an agency like SFIO.
