

LEGAL UPDATE: INDIA

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A step ahead towards convertibility

All current account transfers abroad like payment of dividend, interest, technology and design fee by corporate entities will be cleared automatically by the Reserve Bank of India (RBI) with effect from October 14, 1997. The person making the remittance would have to give an undertaking in duplicate addressed to the assessing office and a certificate from a chartered accountant to the RBI which would in turn forward a copy of the same to the assessing officer. A no objection certificate from the Central Board of Direct Taxes (CBDT) will no longer be required.

Stock options in overseas company hiked

The Reserve Bank of India (RBI) has revised the upper limit of USD 750 to USD 10,000 for remittances (once in a period of five years), by employees of companies (in which the foreign company owns at least 51% of the equity capital) in India to buy shares in the foreign companies.

Moreover, the RBI permits employees in India of branch offices or wholly owned subsidiaries of multinational companies to remit USD 750 in a block of five years, to buy shares of these companies via stock option schemes. The scope of this remittance facility has been extended to joint ventures in India where the foreign stake is 51% and above. The RBI has also hiked the ceiling on the remittance amount from USD 750 to USD 10,000 under the stock option schemes.

The Securities and Exchange Board of

India (SEBI) has also constituted a committee under the chairmanship of Dr. J.R.Verma to frame suitable guidelines for the issue of stock options to employees.

FII's permitted to invest in government securities

Several relaxations as regards investments by Foreign Institutional Investors (FIIs) and Mutual Funds (MFs) were announced in the last Monetary and Credit policy for the second half of 1997-98 announced on October 21, 1997. Mr Bimal Jalan has now taken over as the governor of the Reserve Bank of India, as Mr C. Rangarajan, the former governor has since retired.

Highlights:

- All registered Foreign Institutional Investors (FIIs) allowed to invest in dated Government securities within the overall ceiling of 30% in debt and debt related instruments prescribed by the Securities and Exchange Board of India (SEBI). Earlier, only those FIIs who were registered as 100% debt funds were allowed to invest in such securities. However, FIIs are

Extension of forward cover to NRI depositors

still not allowed to invest in T-Bills.

- Forward cover facility extended to Non-Resident Indian (NRI) depositors in respect of deposits held in

Non-Resident External (NRE) accounts and FCNR(B) accounts.

- Corporate entities allowed to open offices abroad, while project exporters allowed to execute projects abroad without prior approval of RBI.
- Money Market Mutual Funds (MMMFs) permitted to invest in rated corporate bonds and

HIGHLIGHTS

- Forward cover on equity investments likely for FIIs
- Telecom & Infrastructure:
 - ✎ Internet
 - ✎ Paging services
 - ✎ Airports
- Capital markets and RBI policies:
 - ✎ Depository
 - ✎ Derivatives
 - ✎ SEBI-SEC tie up
 - ✎ Warehousing
 - ✎ Consolidation of accounts
 - ✎ Delisting guidelines
 - ✎ FDI investments
 - ✎ Gold imports liberalised
- Court Rulings:
 - ✎ VDIS approved by SC
 - ✎ US court grants damages to Indian co.
- Tax Treaties:
 - ✎ DTAA signed with Oman and Turkey
- Money Laundering Bill

debentures with a residual maturity of up to one year. However, such exposure of MMMFs (including those in commercial papers) should not exceed 3% of the resources.

- The Statutory Liquidity Ratio (SLR) for all scheduled commercial banks made uniform at 25% of their entire net demand and time liabilities.
- New 28 days Treasury Bills (T-Bills) introduced..
- Ready forward transactions (Repo) permitted in bonds of Public Sector Undertakings (PSU) and private corporate debt securities that are held in dematerialized form provided

Mutual funds allowed to invest in overseas market

the transactions are done through recognized stock exchanges.

- Banks allowed to provide credit/non-credit facilities to Indian joint ventures/wholly owned subsidiaries abroad.
- SEBI registered Indian fund managers including, Mutual Funds (MFs), allowed to invest in overseas markets subject to an initial overall cap of USD 500 million. The ceiling for individual funds will be related to the size of the fund, subject to a maximum of USD 50 million per MF.

FII's may be permitted forward cover on equity investments

Foreign Institutional Investors (FIIs) are currently allowed to take forward cover on their dollar investments in Indian debt instruments. The Government is considering allowing them to take forward cover on their dollar exposures in equity investments.

FIIs are at present, holding back their fresh portfolio investments as the Rupee is depreciating against the dollar. If a forward cover is allowed, it will enable FIIs to cover their losses due to any fall in the Rupee value.

Telecom & Infrastructure

Five year waiver on licence fees for Internet firms

The Government, on October 20, 1997, decided to exempt Internet Service Provider (ISP) firms from paying license fees for a period of five years. It has also decided to restrict the foreign equity component in the ISP firms to 49%. The Government will not impose any ceiling on the tariff structure charged by the ISP firms for Internet access. A further boost is given by introducing 100% duty concessions on imports.

The Department of Telecommunication (DOT) will, in consultation with the ISPs, work out the quantum of license fees to be paid by the ISP firms. Licenses will be provided for a period of ten years. However, the ISP firms will have to provide a bank guarantee equivalent to a year's license fee. Videsh Sanchar Nigam Limited (VSNL) will allocate bandwidths to the new entrants based on DOT's guidelines.

Paging service companies can switch partners

The Department of Telecommunications (DOT) is now allowing paging service companies to change their Indian and foreign partners. Earlier, the original partners were not allowed to reduce their equity stakes to below 10%. Now the DOT is permitting a change in the equity structure only if the company has provided services for at least three years from the effective date of license and the foreign direct investment in the company has not exceeded 49%.

Full flexibility on airport's

ownership allowed by government

The Government, on November 7, 1997 announced its decision to permit foreign equity participation up to 74% in airport infrastructure under the automatic approval route.

Automatic foreign equity participation upto 74% in airport infrastructure.

100% foreign equity participation will however be allowed only on a case-by-case basis. Under the new policy, airports could be owned or managed by the Central government, Public Sector Undertakings (PSUs), state governments, urban local bodies, private companies, individuals and

National Stock Exchange (NSE) limit for listing raised from Rs. 100 million to Rs. 200 million.

even joint ventures.

The operating company would have to be a joint venture between the foreign equity partner and any of the government bodies described hereinabove, and would function on a build own transfer (BOT), build own lease transfer (BOLT), build own operate (BOO) or lease develop and operate basis.

Capital markets and RBI

Depository route for institutional transactions mandatory

The Securities and Exchange Board of India (SEBI) has made it compulsory for all institutional investors to go in for settlement of trades through the depository from January 15, 1998. The institutional investors include banks, financial institutions, mutual funds and foreign institutional investors having a minimum portfolio of securities worth Rs. 100 million as on the latest balance sheet date.

Relevant amendments will be made to the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995 to enable domestic mutual funds, including the Unit Trust of India (UTI), and FIIs to trade through the depositories. Later compulsory dematerialization will be extended to other scrips (identified by SEBI) depending upon the shareholding pattern and trade volume.

On another front, the Justice D. R. Dhanuka Committee constituted by the SEBI has also recommended that a public issue of over Rs. 100 million should be made *via* the depository mode. It has also suggested that stamp duties on transactions in shares and debentures held in physical form should be done away with.

Derivatives may be treated as securities

The Ministry of Finance (MOF) is likely to amend the Securities Contracts (Regulation) Act, 1956 (SCRA), to define derivatives and indices as securities. The objective is to pave the way for trading in index based futures and options. The L. C. Gupta Committee, constituted by the Securities and Exchange Board of India (SEBI) has recommended the introduction of index based derivatives.

SEBI has also given a sense of finality to the proposal for introduction of derivatives. D.R. Mehta, chairman of the SEBI has stated that derivatives trading will commence once the regulations are in place by the end of fiscal 1997-98.

SEBI-SEC tie-up plan approved

The Government has cleared the proposed Memorandum of Understanding (MOU) between the Securities and Exchange Board of India (SEBI) and the Securities and Exchange Commission (SEC) of the U.S. This is the first MOU to be

entered into by the SEBI with any other regulatory agency. It envisages sharing of information, enforcement co-operation and technical assistance between the two regulators.

SEBI permits warehousing by brokers for institutions

Mandatory consolidation of accounts and segmental reporting suggested

On November 13, 1997, the Securities and Exchange Board of India (SEBI) has issued a notification permitting brokers to enter into warehousing transactions for orders of institutional clients within a trading cycle. However, warehousing is restricted to the general segment. This facility will enable brokers to issue a confirmation note at the end of each trading day to the client for the orders executed on that day, calculated at the weighted average price.

Consolidation of accounts recommended

The C. B. Bhawe Committee (Committee) set up by the Securities and Exchange Board of India (SEBI) in its report on "continuing disclosure standards by corporate entities" has recommended mandatory consolidation of accounts of holding companies and their subsidiaries. It has also suggested that segment-wise reporting be made compulsory. Initially this requirement may be imposed only on companies having equity capital of more than Rs. 1 billion. The Committee has also suggested that all material events, including revisions in credit ratings, should be intimated to the stock exchanges within 48 hours of its occurrence.

Stringent delisting guidelines recommended

The K.R. Chandratre Committee set up by the Securities and Exchange Board of India (SEBI) to look into the existing mechanism of delisting of

securities has suggested doing away with the minimum five shareholder limit per Rs hundred thousand as a reason for delisting. Instead, it has recommended that delisting should be required if the public shareholding is reduced to 10 per cent or less.

U.S. retains FDI lead with USD 8.58 billion investments

According to a recent information release by the Government, the U.S. has emerged as the leading foreign investor in India, accounting for USD 8.58 billion of Foreign Direct Investment (FDI) approvals out of a total of USD 33 billion cleared till the end of the last fiscal year.

The FDI approvals for U.S. investors had shown a spurt in the first three months of 1997 with the figure touching USD 1.3 billion till March 1997, followed closely by the United Kingdom at USD 700 million, South Korea at USD 484 million and Mauritius at USD 264.9 million.

Liberalisation of gold imports

The Ministry of Finance (MOF) has decided to allow eight banks and three canalizing agencies to freely import gold for general retail sales in the domestic markets under a new window. The duty payable under the new window would be Rs. 220 (approximately USD 5.79) per ten grams of gold and Rs. 500 (approximately USD 13.16) per kilogram of silver. The banks will put in place a system to commence retail sales from January 1, 1998.

India accounts for 33% of global gold purchases. This is another step towards full capital account convertibility and will aid in exchange rate management.

Court Rulings

U.S. Court grants USD 2

million to United Phosphorus in trademark suit

VDIS upheld by the Supreme Court. Future heralds strict action against tax evaders.

United Phosphorus Limited, an Indian company, has been awarded USD 2.1 million plus costs by a U.S. district court jury. The Indian company has been selling a product called Aluminum Phosphide Rodenticide (APR) in the U.S. under the Quickphos name since 1983. Midland, its distributor was alleged to have relabeled substandard APR and was passing it off under the brand name Quicikphos. After a prolonged battle lasting six years, damages have been awarded to the Indian company.

VDIS approved by Supreme Court

The Indian Supreme Court (SC) has rejected a public interest litigation petition filed by the All-India Federation of Tax Practitioners (AFTP) protesting against the recently introduced Voluntary Disclosure of Income Scheme (VDIS). AFTP had protested stating that the VDIS would jeopardize the interest of honest tax payers, whereas, errant tax payers could take advantage of a lower current rate of tax and also escape penalties and interest.

However, the SC has directed the Ministry of Finance to give it a written assurance that in the future it would step up its administration to deal with tax evaders.

Tax Treaties

DTAA's with Turkey and Oman notified

The Double Tax Avoidance Agreement (DTAA) signed on February 25, 1997 between India and

Turkmenistan (Turkey) has been notified on September 25, 1997. It comes into effect in India from April 1, 1998 and in Turkey from January 1, 1998. The salient features of the India-Turkey DTAA in relation to dividend, interest, royalties and fees for technical services are set forth below:

- Under Article 10, dividends may be taxed either in the country of residence or in the country of source. In case of the latter, the levy of tax is restricted to 10% of the gross amount of such dividend, provided the recipient is the beneficial owner of such dividend.
- Similarly, under the provisions of Article 11 (Interest) and Article 12 (Royalties and Fees for Technical Services) if such income is taxed in the country of source, the rate of taxation has been restricted to 10% of the gross amount of such income.
- The India-Turkey DTAA also contains a non-discrimination clause.

Another DTAA between India and Oman, signed on April 2, 1997 was notified on September 23, 1997. The India-Oman DTAA replaces the earlier limited agreement signed between these two countries.

- The India-Oman DTAA comes into effect in India from April 1, 1998 and in Oman from January 1, 1998.
- Under the provisions of Article 11 (Dividends), if dividend income is taxable in the country of source and if the recipient who is the beneficial owner of the dividends is a company, the tax so charged shall not exceed 10% of the gross amount of the dividends, provided such beneficial owner owns at least 10% of the shares of the company paying the dividends. Otherwise, the tax rate applicable would be 12.5% of the gross amount of the dividends.

- As regards, Interest (Article 12), Royalties (Article 13) and Technical Fees (Article 14), the right of taxing interest, royalties and technical fees has been given both to the country of residence and the country of source. But the rate of taxation in the country of source has been restricted to 10% of the gross amount of interest, 15% of the gross amount of royalties and 15% of the gross amount of

| <u>COMPLIMENTARY SUBSCRIPTIONS</u> | |
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technical fees.

Money Laundering Bill

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