

# LEGAL UPDATE: INDIA

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## **General permission for foreign investment under the "automatic route"**

The Reserve Bank of India (RBI) has simplified the procedure for foreign investors investing in India under the automatic route.

Through its notification dated January 13, 1998, the RBI has granted general permission to Indian companies to issue and export shares to foreign investors in respect of investments up to 50%/51%/74%, as the case may be, in the priority industries/activities listed in Annexure III to the New Industrial Policy, 1991 (which was expanded during January 1997). Thus, Indian companies will no longer require prior clearance from the RBI.

In addition, trading companies primarily engaged in export activities are also eligible for foreign investment up to 51% under the automatic route of the RBI.

Existing Indian companies are also permitted to raise foreign equity to the level permissible under the automatic route in case the Indian companies are engaged in the manufacture of item/s included in the Annexure III industries or the proposed expansion of capital is for undertaking an activity covered under the Annexure III industries.

However, the Indian companies will have to file a declaration on form FC (RBI) together with the required documents with the concerned regional office of the RBI under whose jurisdiction their registered office is situated, within thirty days

from the date of issue of equity shares to foreign investors.

In another significant development, the RBI has also issued a notification stating that foreign investors who have obtained the approval of the Foreign Investment Promotion Board (FIPB) for foreign direct investment in Indian companies would no longer have to approach the RBI for its "in-principle" and "final" approvals.

## **FDI surges to US\$ 3.2 billion**

The actual inflow of foreign direct investment (FDI) into India has risen sharply to touch US\$ 3.2 billion in the eleven months ending November 1997.

The trend shows that the fuel sector remained the hot favorite by accounting for 29% of the total approvals. The telecom sector stood second with 20.2%. The services sector was a poor third with 6.7%.

## **Merchant bankers may be allowed to widen activities**

The Securities and Exchange Board of India (SEBI) will be issuing a clarification allowing merchant bankers to undertake all existing businesses except leasing. Last year the SEBI issued a notification stating that merchant bankers registered with it would have to segregate their fund and non-fund based activities as they would not be permitted to undertake fund based activities.

The Reserve Bank of India (RBI) has

also decided to exempt all debentures raised by merchant bankers from the definition of "public deposits".

The SEBI clarification follows the conflict between the SEBI regulations and the RBI regulations with regard to non-banking finance companies (NBFCs). While the RBI insists that all merchant bankers who undertake underwriting activities would be classified as NBFCs and would therefore have to be registered

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with it the SEBI took the stand that merchant bankers would not come under the RBI's regulatory purview and that they should therefore not get registered with the RBI.

### **SEC recognizes SHCIL as a global custodian**

The Stock Holding Corporation of India Limited (SHCIL) has received a global custodian status from the Securities and Exchange Commission (SEC) of the U.S.

SHCIL can now directly solicit business from U.S. based foreign institutional investors. According to the "no-action letter" from the SEC, the U.S. regulator will not take any action against U.S.-based funds under section 17F(v) of the U.S. Investment Companies Act of 1940 if they avail of custodial services from SHCIL.

### **SEBI, SEC to sign MoU**

The Securities and Exchange Board of India (SEBI) is expected to sign a Memorandum of Understanding (MoU) with the Securities and Exchange Commission of the U.S. (SEC) on March 6, 1998.

The MoU would be the first of its kind to be signed between the Indian capital markets regulator and its counterpart in the world.

The MoU would help in sharing of information about common market players. It could also result in imparting of training and exchange of information on other technical matters like surveillance, stock watch, etc.

### **SEBI plans drive to create depository awareness**

The Securities and Exchange Board of India (SEBI) is planning a major campaign aimed at popularizing

depository operations among retail investors. The SEBI will ask the two major stock exchanges, The Stock Exchange, Mumbai (BSE) and the National Stock Exchange (NSE) to ask their stock brokers and investors to open accounts with depository participants.

Late last year, SEBI issued a circular stating that all financial institutions and Foreign Institutional Investors (FIIs) managing a portfolio of more than Rs. 100 million would compulsorily have to trade in the dematerialized segment. SEBI also announced a list of eight scrips wherein FIIs would have to trade in the dematerialized form. Recently however, with a view to eliminate immediate liquidity problems in the dematerialized segment, SEBI has extended the deadline (earlier January 15, 1998) and is now permitting FIIs to purchase and sell in the physical trading segment.

### **Funding takeovers**

Finally, corporate governance has a good chance of transcending fuzzy do-better intentions, and becoming real.

The government is now permitting banks and financial institutions to lend money to fund takeovers. These funds will not be lent directly, but will be raised as bonds or debentures by the predator. This will encourage hostile takeovers which was otherwise unheard of in India.

Recently, the ten year old Indian cable and copper major Sterlite Industries (India) Limited (SIL) announced a public offer to acquire 10% of the total equity share capital of Indian Aluminium Company Limited (INDAL), a sixty year old company, at Rs. 90 a share. As of the date of the offer, SIL did not own any of the shares of INDAL. The market price of INDAL's shares as of the trading day prior to the day on which the offer was made was Rs. 66 per share.

Alcan Aluminium, Canada (Alcan) currently holds 34.6% of INDAL, with 38.3% being held by financial institutions, banks and mutual funds. The public shareholding in INDAL is 9.1% with the remaining 18% being held by Foreign Institutional Investors (FIIs) and Global Depository Receipt (GDR) holders.

This is the first time that a predator has made an open offer without owning shares in the target company.

***The SEBI insisted that SIL make an offer for 20% of the total shares of INDAL instead of 10%.***

Under the SEBI's Takeover Code of 1997, an acquirer is required to make a public offer for 20% of the total share capital of the target company as soon as its holding in the target company touches 10%.

Since the Securities and Exchange Board of India (SEBI) insisted that SIL make an offer for 20% of the total shares of INDAL instead of 10%, SIL revised its offer for 20% instead of 10%.

In light of this most recent development, the SEBI is also planning to revise its Takeover Code of 1997.

In the meantime, Alcan is formally deciding to fight SIL's bid for an equity stake in INDAL. Alcan will submit its counter offer by March 9, 1998.

### **Proposed revisions to the Takeover Code**

The Securities and Exchange Board of India (SEBI) is planning to introduce major changes in the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations,

1997 (Takeover Code). The major changes proposed are as follows:

- The Takeover Code does not provide for any pricing norms for the sale of equity from one promoter to another. Therefore, if a promoter sells his shareholding to another promoter at a price higher than the market price, it will be unfair to the other shareholders. The SEBI now plans to lay down pricing norms which, for instance, could stipulate that the price should be close to the market price.
- Currently, any purchase of shares beyond 51% holding attracts the public offer provisions of the Takeover Code. The SEBI will now stipulate that no public offer will be mandatory for any acquisition beyond the 51% holding.
- The Takeover Code specifies that an acquirer has to make a public offer for 20% till its holding reached 51%. However, there were cases where the acquirer, holding below 51% decided to make a public offer only to the extent that allowed it to reach 51%. The SEBI has now decided to ensure that whatever the holding percentage, the offer will have to be for 20% even if the holding then goes beyond the 51% limit.
- The SEBI is making it mandatory that all conditional offers will have to be for a minimum 20%. This will include negotiated takeovers as well.

### Reporting by foreign companies having Indian liaison offices

The Ministry of Finance, Department of Company Law Administration has issued a notification dated October 6, 1998 regarding reporting requirements under the Companies Act, 1956 by the Indian liaison offices of foreign companies.

Foreign companies having Indian liaison offices set up with the Reserve Bank of India's (RBI) approval and which do not engage in any trading, commercial or manufacturing activity in India are now required to submit to the appropriate Registrar of Companies in India, among other documents, a statement of receipts and payments made by the Indian liaison offices, a statement of the foreign company's assets and liabilities in India and a statement to the effect that the foreign company did not carry out any trading, commercial or manufacturing activity in India.

**India's forex reserves  
stand at US\$ 27.3  
billion**

### "Infrastructure facility" redefined

Section 80-IA of the Indian Income-tax Act, 1961 (ITA) provides certain tax incentives for a business of an industrial undertaking engaged in the development maintenance and operation of any "infrastructure facility".

The term "infrastructure facility" defined in section 80-IA(12)(ca) of the ITA means a road, highway bridge, airport, port, rail system, a water supply project, irrigation project, sanitation and sewerage system.

The definition of "infrastructure facility" has now been amended by way of a Presidential Ordinance to include "housing or other activities being an integral part of the highway project". The new definition will come into force from April 1, 1998.

### Double tax avoidance agreements notified

The double tax avoidance agreements (DTAAs) entered into by India with Belgium, Sweden and Canada were notified on October 31, 1997, December 17, 1997 and January 15, 1998, respectively. A few salient points of these DTAAs are set forth below:

- *The India-Belgium DTAA.*

*Dividend.* Dividend may be taxed in the country of residence as well as in the country of source. However, the country of source may tax dividends at the maximum rate of 15%.

*Interest.* Interest income too can be taxed both in the country of source and country of residence. The right of the country of source to tax such income is however, restricted to 15%.

*Capital Gains.* Gains derived from sale of shares in a company would be liable to tax in the country of source if the seller of the shares holds at least 10% shares in the company. If the seller holds less than 10% shares in the company whose shares are sold, the gains would be taxed in the country in which the seller is resident.

- *India-Sweden DTAA*

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*Interest.* Interest income too can be taxed both in the country of source and country of residence. The right of the country of source to tax such income is however, restricted to 10%.

*Capital Gains.* Gains on sale of shares in a company would be

taxed in the country in which the seller is resident provided that country taxes such a gain. If no tax is levied on the gains arising on the sale of shares in the country of the seller's residence, they would be taxed in the country in which the company (whose shares are sold) is located.

• *India-Canada DTAA*

*Dividend.* Dividend may be taxed in the country of residence as well as in the country of source. However, the country of source may tax dividends at the maximum rate of 15% if the recipient of the dividend is a company and holds at least 10% of the shares of the dividend declaring company. In all other cases, the country of source can levy a tax of 25% on the dividends paid.

*Interest.* Interest income too can be taxed both in the country of source and country of residence. The right of the country of source to tax such income is however, restricted to 15%.

*Capital Gains.* Gains derived from sale of shares in a company would be liable to be taxed in both, the country of source as well as the country of residence.

### TRAI stops MTNL's entry into cellular services

The Telecom Regulatory Authority of India (TRAI) has annulled Mahanagar Telephone Nigam Limited's (MTNL) license to provide cellular and paging services.

The license, issued to MTNL in 1986, was amended in October 1997 to include provisions of cellular and paging services.

According to section 11 of the TRAI Act, 1997, it is the TRAI's prerogative to recommend the need and timing of a new service provider and also recommend the terms and conditions of providing licenses to service providers. The primary issue before the TRAI was whether it was mandatory or discretionary for the government to seek the TRAI's recommendations.

The Department of Telecommunication (DoT) contested that MTNL was an existing service provider and not a new service provider. However, TRAI held that MTNL was not an existing service provider of cellular services (for Mumbai and Delhi, where it intends to commence the service). It also clarified that it has not expressed its opinion about the need and timing for entry of additional service providers for cellular operation or about MTNL's eligibility to be a service provider.

Two options are now available to the DoT and MTNL. Either they can ask TRAI for its recommendation or move the High Court against the TRAI's ruling.

### RBI publication for NRIs

The Reserve Bank of India (RBI) has published a booklet titled "Facilities for Non-Resident Indians (NRIs)". The booklet is in a question and answer format and deals with exchange control related issues that NRIs often face. The cost of the booklet is Rs. 25 or US\$6 (inclusive of postage by airmail).

If you are interested in purchasing the booklet, kindly contact Mr. Khizer Ahmed, chief General Manager, Exchange Control Department, The Reserve Bank of India, Central Office, Mumbai 400 001, India.

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MAIL TO: NISHITH DESAI  
ASSOCIATES  
94-B, Mittal Court  
Nariman Point  
Mumbai 400 021  
India

Fax#: 91 + 22 + 287 5792

Tel#: 282 0609 or 204 0068

E-mail: [desai.nishith@gems.vsnl.net.in](mailto:desai.nishith@gems.vsnl.net.in)

Web Page:

<http://www.mindspring.com/~nishith>

*Edited by:* Deanne D'Souza

*Published by:* Nishith Desai  
International Research Center, 201-A  
Milton, Juhu Tara Road, Juhu Beach,  
Mumbai 400 049, India.

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