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Amendments to Takeover Code

The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (Takeover Code) has recently been amended.

Now, an acquirer (as defined in the Takeover Code) will have to make a public offer for the purchase of at least 20% of the total share capital of the target company after it acquires 15% or more of the total share capital of the target company. Thus, the threshold limit has been increased from 10% to 15%.

The creeping acquisition limit has also been increased from 2% to 5%. Thus, an acquirer holding 15% or more but less than 75% of the total share capital of the target company is now entitled to increase its stake in the target company by 5% of the total share capital of the target company in any twelve month period without attracting the public offer provisions of the Takeover Code.

Trading in Dematerialised Securities

Effective from January 4, 1998, it would be compulsory for all persons to deliver the shares of 12 specified companies in dematerialized form.

Furthermore, with effect from February 15, 1998, it would be compulsory for all persons to deliver the shares of another 19 specified companies in dematerialized form.

The concept of market lot has been abolished in respect of the shares of the above companies, from the date on which the delivery of the shares (in such companies) in dematerialised form would be compulsory for all persons.

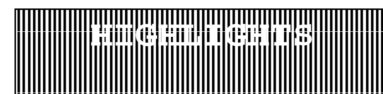
The Companies (Amendment) Ordinance, 1998

The Companies Act, 1956 (Act) has been amended by the Companies (Amendment) Ordinance, 1998 (Ordinance). The provisions of the Ordinance include, among others, the following:

Buy-back of shares

Companies have been permitted to buy-back their own securities subject to the following conditions:

- The buy-back is financed from out of the:
  - free reserves of the company; or
  - securities premium account; or
  - proceeds of an earlier issue other than fresh issue of shares made specifically for buy-back purposes.
- The articles of association authorize the company to buy-back its shares.
- A special resolution (*i.e.* three-fourth's majority) authorizing the company to buy-back its shares has been passed in the general meeting of the company.
- The shares bought back do not exceed 25% of the total paid-up capital and free reserves of the company.
- The debt-equity ratio after the buy-back is not more than 2:1. For this purpose, equity = share capital + free reserves.
- All the shares or other specified securities of the company are fully paid-up.
- The buy-back shall be in accordance with the regulations made by the Securities and Exchange Board of India (SEBI) in that behalf.
- The company extinguishes and physically destroys the securities it buys-back within seven days from completion of the buy-back.



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- The buy-back shall be completed within 12 months from the date of passing the special resolution.
- The company shall not make further issue of securities within a period of 24 months except by way of bonus issue or in discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity.

Nomination facility

Shareholders, debenture holders and deposit holders (Investors) are now provided with a nomination facility pursuant to which, nominees of the Investors would be entitled to the securities upon the death of the Investor.

Amendments to provisions relating to inter-corporate investments and loans

- Sections 370 and 372 of the Act that restricts companies from making inter-corporate loans and investments over and above certain limits respectively, have been deleted. However, a new section 372A, dealing with inter corporate investment and loans, has been inserted.
- The new section 372A restricts a company from making investments, giving loans or providing guarantees (in connection with a loan made by any person to or to any other person by any body corporate), over and above 60% of its paid-up share capital and free reserves or 100% of its free reserves, whichever is more.
- A company intending to make such investment or give loans or guarantee over and above the 60% limit referred to above are henceforth required to obtain the prior approval of its shareholders by passing a special resolution.
- Where any term loan from any public financial institution is subsisting, prior approval of such financial institution shall be obtained.
- A unanimous resolution for sanctioning the loan shall be passed in the meeting of the investor company's board of directors.

The industry's response to the new section 372A of the Ordinance has not been very positive. This is mainly because under the new section 372A, if the 60% limit has been reached, a special resolution would be required for a company to invest even in its wholly owned subsidiaries. Furthermore, investment companies now come under the purview of section 372A. Under the earlier provisions of the Act, companies setting up wholly owned subsidiaries and investment companies were exempt from the restrictive provisions of the Act.

New Securities Act on the anvil

The Securities and Exchange Board of India (SEBI) is proposing to introduce a comprehensive Securities Act which would combine the provisions of the Securities Contracts (Regulation) Act, 1956 with the Securities and Exchange Board of India Act, 1992.

ADR/GDR linked employee stock options

The National Task Force on Information Technology and Software Development (Task Force) has recommended that the ADR/GDR linked employee stock option scheme for software companies be modified to include all companies engaged in Information Technology Software and Information Technology Services. The Government has accepted this recommendation of the Task Force.
Earlier, only companies engaged in the manufacture or production of software where not less than 80% of the company's turnover was from software activities, were allowed to issue employee stock options linked to ADRs/GDRs.

Investment by NRIs/OCBs

Prior approval of the Reserve Bank of India (RBI) will henceforth not be required for Indian companies issuing shares/convertible debentures to Non-Resident Indian (NRIs) and Overseas Corporate Bodies owned to the extent of at least 60% by NRIs (OCBs) under the 24%, 40% and 100% scheme (pursuant to which NRIs/OCBs can invest up to 100% in high-priority list of industries).

The schemes referred to above are as follows:

- Investment in high-priority industries and in Indian companies primarily engaged in export trading activity, under the 100% scheme;
- Investment in Indian companies engaged/proposing to engage in any activity (except agricultural/plantation activities) under the 24% scheme; and
- Investment in Indian companies engaged in an industrial/manufacturing activity (including hospitals, hotels with three, four or five star rating, shipping, development of computer software, oil exploration services) under the 40% scheme.

However, the Indian company issuing shares/convertible debentures to NRIs/OCBs would be required to file a declaration on Form ISD with the RBI within 30 days from the date of issue of such shares/convertible debentures.

Indian overseas investments

The government has recently increased the investment limit of US$ 4 million to US$ 15 million under the fast track route for investments by Indian companies in

Joint Ventures (JVs) and Wholly Owned Subsidiaries (WOSs) abroad.

Now, pursuant to the fast track route, the Reserve Bank of India (RBI) will have the power to approve on an automatic basis, investments up to US$ 15 million by Indian companies in JVs/WOSs abroad. However, this is subject to the existing condition that the amount to be invested abroad does not exceed 25% of the annual average export/other foreign exchange earnings of the Indian company during the preceding three years.

CVC bans post-tender negotiations

The Central Vigilance Commission (CVC) has banned with immediate effect, post-tender negotiations by all government organisations, except those conducted with the lowest tenderer. The CVC has also issued instructions to enhance its scope to intervene in departmental probes into corruption charges.

The CVC has issued these instructions in keeping with section 8 of the CVC Ordinance, which empowers it to exercise supervision over the vigilance administration of Union ministries, corporations, nationalized banks, public sector undertakings and insurance companies.

ISP norms to let cable TV operators give Internet access

The government has finalized guidelines for prospective Internet Service Providers (ISPs), is allowing cable television operators to offer access to the Internet through their networks and has fixed a zero license fee for the first five years.

Without additional licensing, but guided by the cable laws, all cable TV operators can become ISPs either by directly hooking to the earth stations through a Very Small Aperture Terminal (VSAT) or to the local nodes by a wired connection.

Salient features of changes to Internet Policy

The government has announced certain major changes to the Internet Policy to benefit the academic community, scientists, entrepreneurs, and students. The objective of the policy is to see 1.5-2 million subscribers within a period of two to three years.

An Inter-Ministerial Implementation Committee (IMIC) to be set up, will oversee operational problems and will expeditiously implement government decisions relating to the Internet.

The following are the salient features of the Internet Policy:

- The IMIC will work out the exact quantum of the license fee which the ISPs will have to give as a bank guarantee. The quantum of the license fee that will have to be paid by the ISPs after the fifth year will be indicated after three years on a review of the situation.
- There will be no limit on the number of ISPs and charges for leased lines will be fixed at promotional rates.
- Market forces will be allowed to determine the amounts that ISPs will charge their users.
- The access charges payable by ISPs to their respective main carriers like the Videsh Sanchar Nigam Limited (VSNL) will be fixed on a promotional basis.
- The Ministry of Railways, the Power Grid Corporation of India Limited and the State Electricity Boards would be permitted to lease out their surplus/excess capacity for the use of the ISPs.
- ISPs would have the freedom to use the international gateway to VSNL or other gateways to be leased by VSNL, as well as any other gateway as necessary subject to approval and such conditions as may be laid down by the IMIC.
- ISPs may create their own transmission network if authorized by the IMIC.
- Voice on Internet will not be permitted and the duopoly for voice service in the circles and the monopoly of DoT/VSNL for national and international services will not be affected.
- All licensees of the DoT *i.e.* basic service providers, pagers, cellular operators, *etc.* can become ISPs on the same terms and conditions generally applicable to ISPs.
- Electronic mail (e-mail) licensees will be permitted to become ISPs and the license fee for the first five years will be waived for them as in other cases.
- Guidelines with regard to the service area of the ISPs and other eligibility criteria will be worked out soon.

DoS okays VSAT up-linking to foreign satellites

The Department of Space (DoS) is understood to have given its no-objection to private Very Small Aperture Terminal (VSAT) operators to up-link to foreign satellites. According to sources, the decision arises out of an acute shortage of C-band transponders for VSAT use on Indian satellites (Insat). The DoS proposal on VSAT usage will come up for discussion in a meeting of the Insat Coordination Committee (ICC) to be held soon. The ICC decides the transponder allocation on Insat.

IT task force meets with new mandate on telecom

The National Task Force on Information Technology (task force) met with a new mandate to look into the license fee structure for basic and cellular operators. It is expected to submit its recommendations in November.

The task force is expected to look into the problems faced by private companies with regard to their inability to pay the high license fees to the government. The task force already has a mandate to look into the convergence of technologies - telecom, IT and broadcasting. The task force has also considered the hardware report prepared by its panel and will have to get it cleared by the Cabinet. This would give a boost to local manufacturing companies and make them competitive by 2003 when duties on IT products will become nil.

MAT applicable to PE of foreign company in India

The Indian Authority for Advance Ruling (AAR) has ruled on the applicability of section 115JA of the Indian Income-tax Act, 1961 (which deals with Minimum Alternative Tax (MAT)) to a Permanent Establishment (PE) of a foreign company in India.

Section 115JA was introduced by the Finance Act, 1996. It provides that if a company's taxable income is less than 30% of its book profits, the company would, for tax purposes, be deemed to have a taxable income equal to 30% of its book profits and taxed accordingly.

In the instant case, the foreign company was a tax resident of The Netherlands, having a PE in India. As required by the tax authorities, the foreign company prepared its accounts for its operations in India. Due to the provision of a substantial amount as depreciation, the company had a substantial amount of carry forward losses to set off future losses. As a result, the company became a zero tax company and sought a ruling from the AAR as to whether section 115JA applied to the PE.

The company submitted to the AAR that since it was a foreign company, controlled and managed in The Netherlands, it was not required to prepare its accounts as per the Companies Act, 1956 for the purpose of presenting the same to its shareholders, and also since many of the provisions of section 115JA did not apply to the company, the section itself would not apply to the company.

The AAR however disagreed with the company's arguments. It maintained that the company was required to prepare accounts for submission to the tax authorities. It was not necessary that all the provisions in the section should apply to a company for section 115JA to be applicable. The section applied to a company as defined in the Income Tax Act, 1961, which included a foreign company. Hence, the AAR ruled that section 115JA applied to a PE of a foreign company.

Tribunal nullifies retroactive amendment to treaty

The Mumbai tribunal (Tribunal) nullified a retroactive amendment to the double taxation avoidance agreement (treaty) with Germany which sought to put the taxpayer in a worse off position than if he were covered by the provisions of the original treaty.

The Tribunal invoked the principle of promissory estoppel and ruled that the Executive did not have the power to amend the treaty with retrospective effect in a manner which made the tax payer worse off, as he had entered into transactions, relying on the earlier provisions of the treaty.

In the instant case, according to the earlier provisions of the treaty, income from royalty and fees for technical services received by a German company would be taxed in India only if the German company had a Permanent Establishment (PE) in India, since this type of income was not separately defined.

The amendment to the treaty was brought into effect by a protocol dated June 28, 1984, ratified on July 10, 1985, to be effective in India from April 1, 1984. The amendment included in the treaty, the definitions of the terms "royalty and fees for technical services" and made it taxable in India. The taxpayer in this case had received payment pursuant to agreements signed in 1982. The tax authority sought to tax these payments under the amended treaty in the assessment year 1984-85. The Tribunal ruled that when a treaty was amended with retrospective effect, the amendment would not apply if it made the taxpayer worse off.

COMPLIMENTARY SUBSCRIPTIONS

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