

LEGAL UPDATE: INDIA

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Private insurance firms allowed to register under the Companies Act

The Government of India is permitting private insurance companies to register under the Indian Companies Act, 1956 ("Act"). In this connection, the Registrar of Companies will allow companies bearing the words 'insurance' or 'risk corporation' to be registered under the Act. However, such registration will be done only after consultation with the Insurance Regulatory Authority and if required, the Reserve Bank of India. This is a further step in the process of privatization of the insurance sector.

Foreign insurance companies which are in the process of entering into joint ventures with Indian insurance companies will welcome this move and seek to register the joint venture companies under the Act.

FII's boost foreign investment inflows in first quarter

Massive portfolio investment by FIIs boosted the foreign investment inflows almost three fold during the first part of this financial year beginning April 1999, off-setting the steep drop in direct investment.

The total foreign investment in the quarter ending June 1999 was \$1,345 million (comprising foreign direct investment of \$423 million, which was less than half of \$ 891 million in April-June 1998) as against \$476 million in the same period last year. However portfolio investment in April-June 1999 stood at \$902

million as compared to \$415 million in the same period last year.

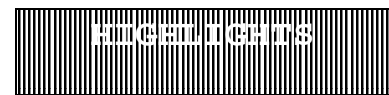
Total inflow of foreign investment in June 1999 amounted to \$198 million, which was higher than \$112 million in June last year.

Y2K team drafts ordinance to tackle fallout

The high level Y2K Action Force, set up by the government under the chairmanship of Mr. Montek Singh Ahluwalia, is formulating a Year 2000 ordinance to deal with issues relating to Y2K compliance and provide a framework for dispute resolution. The Y2K Action Force secretariat has already prepared a draft ordinance, which has been circulated for suggestions and feedback. The ordinance will seek to encourage compliance and disclose computer-processing problems, solutions, test practices, test results and deal with related matters in connection with transition to the year 2000. It will also provide a framework for dispute resolution.

Some important features of the draft ordinance are as follows:

- The draft ordinance provides for the setting up of Y2K crisis management centers fully equipped with logistical and technical support in all major cities, state capitals as well as at the district level for managing Y2K crisis.
- A clearing house is sought to be set up which shall be responsible for collecting and disseminating all Y2K related information in the country. The clearing house would be responsible for managing Y2K crisis and for



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- establishing Y2K crisis management centers.
- According to the draft ordinance, it will be obligatory on the part of IT product and service providers to ensure the Y2K readiness of all IT products and services provided after January 1, 1996 and ensure that all future supplies are Y2K compliant.
 - The draft ordinance gives priority treatment to Indian users and proposes to make it obligatory for the Y2K solution provider to take on priority the request from Indian users for addressing their Y2K readiness problems. The solution provider will be obliged to respond to such requests within two weeks.

Tax break norms for scientific research bodies in India simplified

Under the Indian tax laws, donations given to certain approved scientific research associations are eligible for a 125% tax deduction to the donating entity. However, for this purpose, the Director General Income Tax, Exemptions ("DGITE") should approve the scientific research association. The Ministry of Finance of the Government of India has simplified this approval procedure in order to promote the research activities. As per the circular issued by the Central Board of Direct Taxes, scientific research bodies are allowed to apply directly to the central government instead of the DGITE. Also, there is no need to obtain approval of the secretary, department of scientific and industrial research ("Secretary"). Earlier, the application had to be routed through DGITE, which in turn would get the concurrence of the Secretary.

SEBI relaxes IPO norms for infotech companies

The Securities and Exchange Board of India ("SEBI") has announced relaxations in the rules relating to Initial Public Offerings ("IPOs") for

infotech companies in order to encourage infotech companies to list on Indian stock exchanges, rather than seek a listing on foreign exchanges such as NASDAQ. SEBI has reduced the minimum public offering requirement for infotech companies from 25% to 10% of the issued capital of the company. However this reduction is subject to the following conditions:

- A minimum number of 2 million securities should be offered to the public, excluding reservation, firm allotments and promoters' contribution.
- The net size of the public offer should be at least Rs. 500 million.

Central Government to fund equity in projects under CIB scheme.

For projects under the Critical Infrastructure Balance ("CIB") scheme, the Central Government will provide funds in advance, in the form of equity participation. The move is aimed at expediting export projects by removing bottlenecks. A committee set up by the Ministry of Commerce of the Government of India would clear the proposals.

The highlights of the CIB scheme are as follows:

- Funds would be provided by the Committee, to the union/state government departments, agencies and public sector undertakings on a reimbursement basis (which would be subject to audit by the Comptroller and the Auditor General of India)
- It envisages investments for emergencies/exigencies.
- Investment proposals would have to be supported by estimates duly whetted by the concerned department.
- The benefits accruing would have to be quantified.
- Under this scheme, balancing investment would broadly cover the following:

- Production infrastructure in export enclaves, export processing zones and export intensive areas.
- Transportation chains, e.g. seaports and airports.
- Feeder roads to ports lay-bays for decongestion, warehousing.
- Effluent treatment units
- Service and facilitation sectors

Since its inception 44 projects have been sanctioned by 16 states

SEBI sets up groups to look into Net trading.

In its efforts to modernize the markets, the Securities and Exchange Board of India ("SEBI") has taken the first few steps to lay the foundation for Internet based training, DEMAT, rolling settlement and now, Internet trading. SEBI has set up two working groups to look into the modalities of ushering in Net-trading into India. Technology, connectivity, security, surveillance, and monitoring are among the issues the groups will look into.

MNCs with patented technology free to retain equity in JVs

In a major policy initiative, the Foreign Investment Promotion Board, Ministry of Industry of the Government of India, approved a move to permit foreign companies using proprietary technology to retain their equity and not to divest it in favour of Indian entities. This is a reversal of an earlier stand of the Ministry of Industry which imposed conditions under which 100% foreign owned companies had to divest 26% equity to Indian partners or public within three or five years, as the case may be.

According to sources, the clause to retain 100% equity would obviously depend on the sectoral foreign equity caps.

Benefits of DTAA between Oman and India denied to individuals resident in Oman

The Authority for Advance Rulings ("AAR") has, in recent rulings held that the benefits of the Indo-Oman double Taxation Agreement ("DTAA") will not be available to individuals residing in Oman. It was held that such individuals are not entitled to the benefits of the said DTAA since no taxes were payable by them in Oman, and consequently, their income is not doubly taxed. Earlier, such a stance was taken by the AAR with respect to the Indo - UAE treaty in the case of Cyril Pariera, Machendranath Vishnu Palankar and a few others

Advance Rulings are binding only with respect to the transaction concerned and only on the applicant and the tax authorities. However, they do have a persuasive value on other tax assessments.

Eligibility Criteria for obtaining Advance Tax Rulings widened

The Ministry of Finance has extended the eligibility criteria for obtaining an advance tax ruling under the Income Tax Act, 1961, to public sector companies and persons seeking a ruling on the tax liability of a non-resident for a transaction undertaken or proposed to be undertaken by the resident with the non-resident.

Prior to such notification, only non-residents were permitted to apply for the advance rulings to determine the tax liability of transactions undertaken or proposed to be undertaken in India.

SEBI eases norms relating to FIIs

- The Securities and Exchange Board of India ("SEBI") has relaxed the broad-based criteria

for registration of sub-accounts of Foreign Institutional Investors ("FIIs") from the earlier requirement of at least 50 investors with none of them holding more than 5% of the corpus of the sub-account, to a minimum requirement of 20 investors each holding not more than 10%.

- The Committee on Capital Markets constituted by the SEBI has decided that henceforth, FIIs will be allowed to short-sell if they have shares to back such short sale transactions. They can back such short selling by borrowing shares either through the securities lending and borrowing mode or against global/American depository receipts sent for conversion into equity shares. However, a notification to this effect is still awaited.

Trading in shares of unlisted companies likely soon

The Securities and Exchange Board of India ("SEBI") is said to be favorably inclined to a proposal by the Over-The-Counter Exchange of India ("OTCEI") that trading in shares of unlisted companies be allowed on the bourse. A final decision on this issue is to be taken at the next meeting of the governing body of SEBI, which is to be held in September 1999.

However, trading in unlisted companies will be confined only to qualified institutional traders who have adequate research facilities.

ISP Gateways have to connect systems to intelligence bodies.

The Government has finalized guidelines for Internet Service Providers ("ISPs") to set up private gateways for international connectivity. It will now be mandatory for the private gateway

providers to connect routers above 2 Mbps with the monitoring facilities of national security agencies such as the Intelligence Bureau and the Research and Analysis Wing. Gateway operators would also be responsible for installing the monitoring equipment. The Department of Telecommunications will be the nodal agency for security clearances.

The implementation mechanism has the following conditions:

- No permission is required for use of encryption up to 40 bit key length.
- For stronger encryption, the decryption key will have to be split into two parts and have to be deposited with the telecom authority.
- For every gateway or for large ISP nodes, the ISPs will have to provide monitoring equipment for security provisions, costing up to Rs 400,000.
- ISPs will have to provide office space and local telephone line.
- Small ISPs need not provide the monitoring equipment.
- For ISPs having multiple nodes, or in case of national ISPs, monitoring is to be done from central locations.

Companies accorded the flexibility to fix any Rupee denomination for issue of equity shares

The Securities and Exchange Board of India ("SEBI") has relaxed its earlier norms on the denomination of shares issued by a company as follows:

- Companies shall have the freedom to issue shares in any denomination to be determined by them in accordance with section 13(4) of the Indian Companies Act, 1956 after amending their Memorandum and Articles of Association. While doing so, companies will have to ensure that their shares

are not issued in denomination of less than a rupee or a decimal of a rupee.

- Existing companies, which have issued shares at Rs.10 and Rs.100 may also change the standard denomination into any denomination not below Re.1 by splitting or consolidating the existing shares after amending their Memorandum and Articles of Association.
- This benefit is extended only to companies whose shares are dematerialized.
- With a view to enable the investors to take informed investment decisions, the stock exchanges have been directed to reflect the denomination value of the shares as fixed by the company along with the market quotations.
- A Company can have only one denomination for all its shares.

Ministry drafts cyber crime laws. No free gateway for cyber criminals.

The Ministry of Commerce, in its draft cyber laws, has defined cyber crime and has laid down penalty provisions for cyber criminals. Any person found to be wrongfully obtaining control, damaging, concealing or blocking access, either temporarily or permanently to any computer, database or computer network will be guilty of computer crime. This has also been defined as an activity done knowingly and with the intent to defraud, make false representation, give a false statement or unauthorised charging to another account. It also includes intentionally introducing computer viruses on a computer system or network under its purview. The definition of cyber crime is based on the Indian Penal Code which covers all the acts of larceny. The draft cyber laws also contain a provision to prevent unauthorised copying, controlling or damaging any intangibles like electronic records or data. The draft cyber laws have also suggested

penalties for persons found guilty of committing cyber crimes.

As for litigation, the cyber laws have proposed that such crimes should be bailable, non-cognizable, and triable exclusively by Chief Metropolitan Magistrates, Additional Metropolitan Magistrates, Chief and Additional Judicial Magistrates.

Software companies scrutinized by Income Tax Department

The income tax department ("Department"), in its nation wide investigation in respect of possible tax evasion of highly paid employees by companies, has now turned its attention to software companies. This move is to ensure that revenues due to the Department on account of high salary packages of computer software professionals are indeed accounted for. The items under scrutiny are 'outfit allowance' and 'technical journal allowance' in the pay package for their exempt status under section 10(14) of the Indian Income Tax, 1961 (ITA). Section 10(14) of the ITA exempts certain allowances and benefits offered by employers. Currently, such allowances are not regarded as perquisites and are specifically granted to meet the expenses exclusively incurred in the performance of the duties.

The Income tax authorities are now exploring the possibility of asking the companies to pay TDS under section 17 Clause II (which defines perquisites) of the ITA, arguing that these payments are in fact perquisites and are not covered under section 10(14) of the ITA.

State cabinet brings more power projects under the mega power status

The Maharashtra cabinet has notified the benchmark for mega power projects, which would enable more power projects to have the 'mega power' status and would be able to avail of the tax incentives like customs duty waiver, tax holidays

etc. The inter-state thermal projects tax sops limit has been lowered to 1000MW from earlier limit of 1500 MW and above.

In the notification, there is a mandatory requirement that the power generated in one state must be supplied to other states in order to ensure greater flexibility in the distribution of electricity. The mega power policy allows the power developers to take a 10-year tax holiday (as against the existing 5-year tax holiday) in any given 10-year block within the first 15 years of the project.

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