

LEGAL UPDATE: INDIA

FOR THE INTERNATIONAL BUSINESS COMMUNITY

ISSUE: 26

September - October 2000

Insurance Act enacted

The Insurance Regulatory and Development Authority (IRDA) Act, 2000 has been enacted. The holding of foreign companies, their Indian subsidiaries and nominees in domestic private insurance companies has been capped at 26%. Consequently Indian subsidiaries of foreign companies will not be able to participate in insurance ventures as "domestic companies".

Each Indian promoter who holds an excess of 26% stake, would have to reduce its stake to 26% at the end of 10 years (or a period prescribed) from the date of commencement of business. However the maximum permissible foreign equity would remain the same.

The minimum capital for life and non-life businesses is pegged at Rs. 100 crore and is Rs. 200 crore for re-insurance.

The 26% foreign capital permitted will have to include the stake of foreign multilateral agencies as well. Further, the IRDA has now decided to de-link the 26% cap in foreign equity from Foreign Institutional Investor (FII) holdings in insurance joint ventures. Thus foreign companies will be able to acquire up to 26% equity in the proposed joint venture with an Indian Company, even if the partner has a substantial FII holding. The FII holding would be in the Indian parent and not in the joint venture formed for the insurance business.

Changes in Cable Act okayed

The Cabinet on July 18, 2000 approved the proposed amendments of certain provisions of the Cable Television Networks (Regulation) Act, 1995 namely:

- Enforcement of uniform broadcasting and advertising code on all television channels to stop obscene advertisements
- Mandatory distribution of two terrestrial and one regional language channel of Doordarshan (DD) by cable operators
- Adherence to a programming and advertising code followed by DD (which does not allow airing of any liquor/tobacco advertisements).

CBDT Circular on India-Mauritius Tax Treaty

The Central Board of Direct Taxes (CBDT) has issued a circular, which reaffirms the capital gains tax exemption under India-Mauritius tax treaty. The circular states that companies incorporated in Mauritius which are liable to tax in Mauritius and which hold a 'tax residency certificate' in Mauritius will be considered as Mauritius residents for the purposes of the treaty and will be entitled to capital gains tax exemption in India on sale of capital assets in Indian companies. However, a petition under public interest litigation is pending against this circular.

HIGHLIGHTS

- ☛ IRDA Bill cleared
- ☛ Changes in Cable Act okayed
- ☛ CBDT Circular on India-Mauritius Tax Treaty
- ☛ Employees Stock Option Plans (ESOPs)
- ☛ SEBI announces new regulations for Venture Capital Funds
- ☛ Taxation of income of units set up
- ☛ PSU Privatization
- ☛ Developments in the Infrastructure sector
- ☛ Developments in the Infrastructure sector
- ☛ FEMA 1999
- ☛ FDI liberalisation
- ☛ Foreign stake in PSUs to be equal to sectoral FDI
- ☛ Conditions on ECB approval may go
- ☛ Norms relating to FIIs eased
- ☛ National Long Distance Service opened to the private sector
- ☛ Cabinet allows uplinking by Indian companies
- ☛ Net trading IT Act passed
- ☛ ICEAI to closely monitor ICE space
- ☛ Stiff investment norms for foreign film Cos.

Employees Stock Option Plans (ESOPs)

The two-point tax incidence on ESOPs issued by a company to its employees has been finally removed. The employee would now be taxed only at the time of sale of the shares acquired under ESOP as capital gains. The difference between the sale price and the exercise price would be taxed as capital gain. Depending upon the period of holding, the gain would be taxed as long term or short term.

SEBI announces new regulations for Venture Capital Funds

SEBI by its notification dated September 15, 2000 has announced the SEBI (Venture Capital Funds)(Amendment) Regulations, 2000 and also the SEBI (Foreign Venture Capital Investors) Regulations, 2000. The highlights of the regulations are:

- VCFs incorporated in India will have to exit a company within a year of it going public. It could however, stay invested if it agrees to forego the tax pass through benefit.
- If VCFs invest in India either by either setting up their own venture funds or through a domestic fund, then that fund will get the pass through benefit.
- Maximum investment in a company by a VCF would be 25% of its total corpus.
- Foreign funds investing into India without going through an Indian fund, can do so by registering itself with SEBI. These funds will get the benefit of automatic FIPB approval for investments within sectoral cap. They will not be bound by the RBI's exit pricing norms for foreign investors.

Taxation of income of units set up in FTZs, Technology Parks and 100% EOUs

Units set up in Free Trade Zones (FTZs) or Hardware and Software Technology Parks and 100% Export Oriented Undertakings enjoyed a tax holiday for ten years from the year in which the units started commercial production. Now a sunset clause for this tax holiday has been introduced whereby this exemption will end in the year 2009. Further, a new provision has been introduced to provide that from the year in which there is a change in the beneficial ownership of the undertaking, the benefit of this tax holiday will be lost. In case of companies, if there is a change in the ownership of more than 49% in any year subsequent to the year in which the unit was set up, the beneficial ownership of the undertaking would be presumed to have changed and accordingly the tax benefit would no longer be available to that company in respect of such an undertaking.

PSU Privatization

The Ministry for Disinvestment has proposed that the foreign holding in Public Sector Units after privatization should be not more than the sectoral caps for foreign direct investment.

Developments in the Infrastructure sector

Liquefied Natural Gas Policy (LNG): The Committee of Secretaries working on the new LNG policy has recommended that the Govt. :

- Should freeze all Foreign Investment Promotion Board (FIPB) approvals to LNG projects till there is clarity on existing projects
- Set up a regulatory mechanism to cover all aspects of LNG
- Provide fiscal benefits and rationalize the taxation and duty structure

- Classify LNG projects as infrastructure projects
- Give project import status to all the equipment required to be imported
- Have uniform duties for every customer sector of LNG.

Foreign Direct Investment (FDI) in Telecom: The Union Cabinet has cleared a proposal allowing 100% FDI in internet service providers (ISPs) that offer infrastructure support, electronic mail, voice mail and dark fibre services. However ISPs that set up gateways can have FDI only upto 49%.

FEMA 1999

With effect from June 1, 2000, the Foreign Exchange Management Act 1999 (FEMA) replaced the Foreign Exchange Regulation Act (FERA). FEMA paves the way for liberalisation of current account transactions and the substitution of penal provisions with civil restrictions (fines and civil imprisonment on non-payment of fines). It also seeks to change the role of the Reserve Bank of India (RBI) from a regulator to more of a facilitator of cross border trade and business. This is a significant step taken by India towards relaxing of direct exchange controls. The FEMA lays down areas where the specific permission from the RBI or the Government would be necessary. Greater powers have been delegated to the authorized dealers under the guidelines issued by the RBI pursuant to the introduction of FEMA.

FDI liberalisation

- The Government of India (GoI) on June 13, 2000 has liberalized the norms governing the flow of Foreign Direct Investment (FDI) in e-commerce, power and petroleum refining besides scrapping the dividend balancing norms imposed on foreign investors engaged in the production of consumer goods.

In the E-commerce sector the government has allowed foreign equity up to 100%, provided the overseas promoters agree to divest 26% of their holding in favor of the Indian public within a 5-year period. However this investment will be restricted to B2B ventures only. However, B2C e-commerce ventures require specific approval of the Foreign Investment Promotion Board.

- The GoI laid down norms for further liberalization of the FDI regime in respect of project for electricity generation, transmission and distribution with foreign equity up to 100%.
- The government had earlier made foreign equity up to 100% in such areas permissible provided it did not exceed Rs. 1500 crores. Further, the Govt. has now increased the level of FDI investment in the oil-refining sector under the automatic route from 49% to 100%.
- The GoI has relaxed conditions for automatic approval for FDI in the IT sector whereby IT companies with an existing joint venture or technical collaboration would not have to henceforth seek 'no objection certificate' from existing joint venture partners/associates to float new business. In addition to the above, such approvals are granted for existing companies proposing to induct foreign equity.
- On August 31, 2000, the government eased foreign norms to permit 100% FDI through the automatic route for all but five manufacturing activities under special economic zones (SEZs).

Foreign stake in PSUs to be equal to sectoral FDI

The government, on August 20, 2000 decided to fix a ceiling on foreign equity in public sector units (PSUs) being privatized, pursuant to

which the disinvestment ministry has proposed to set out a formula for foreign direct investment in public sector undertakings wherein the foreign holding (including portfolio investments by FIIs and holdings through GDR/ADR route) in PSUs should be equal to the existing foreign direct investment (FDI) sectoral caps. At present FDI in the manufacturing sector is 74%; Banks-20% (which may go up to 40%); Telecom - 49%; Petroleum refining - 26%; Petroleum products and pipelines - 51%; and Civil aviation - 40%.

Conditions on ECB approval may go

The government is set to announce the guidelines of the automatic approval window where companies can raise up to an overall country wide cap of \$ 50 million, subject to transparent guidelines. The guidelines would permit all companies to raise together up to \$ 50 million annually, without questions asked, so long as the foreign currency debt is raised from registered global banks and institutions, adhere to the interest rate cap prescribed and carry maturities over three years. Short term foreign currency debt however, not be permitted under this window.

Norms relating to FIIs eased

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%. Also, SEBI has permitted domestic Asset Management Companies (AMC) and portfolio managers to register as FIIs and manage accounts of their overseas clients.

National Long Distance Service (NLDS) opened to the private sector

The Telecom Commission in its guidelines for issue of licence for NLDS operators released earlier this month, opened the NLDS for private sector participation in both inter-circle and intra-circle participation. The salient features of the new policy are:

- The applicant must be an Indian company with the total foreign equity not exceeding 49%. Further the applicant company must have a minimum paid up equity capital of Rs. 250 Crores on the date of the application and the promoters (persons who have at least 10% equity stake in the total equity of the company) must have a combined networth of Rs 2500 crores.
- The license shall be on a non-exclusive basis for a period of 20 years, extendable by 10 years at a time, for inter-circle long distance operations.
- The licensee will have a right to carry inter circle traffic. However intra-circle traffic may be carried where such carriage is with mutual agreement with existing fixed service providers.
- The applicant has to pay a one time entry fee of Rs 100 crores before the signing of the licence, which shall be non-refundable, along with Rs 400 crores bank guarantee linked to network rollout. In addition, the applicant will also pay a licence fee in the form of 10% of the revenue share, plus prescribed contributions towards the Universal Service Obligation Fund (USO fund) with a total cap of 15%

Cabinet allows uplinking by Indian companies

The Union Cabinet on July 26, 2000 cleared direct uplinking for Indian broadcasting and non-broadcasting

companies provided its foreign holding does not exceed 49% (including non-resident Indians and overseas corporate bodies), thereby making India an uplinking hub in the Asian region and simultaneously making uplinking of television channels from India cheaper and easier. These companies would now be allowed to set up uplinking hub or teleport facilities for the purpose of using it for themselves or hire it out to other broadcasters, provided it adheres to Indian broadcasting codes. They would also be permitted to directly uplink to both Indian and foreign satellites, provided that only those Television Channels specifically approved by the Government would be permitted to directly uplink.

Net trading

Securities and Exchange Board of India (SEBI) cleared trading of shares through the Internet (to be carried out through an order routing system) thereby allowing placing of orders through the Internet and would lead to greater volumes of trading. Currently, SEBI is close to finalizing the second stage of Internet trading reforms which include:

- developing standards for use of Wireless Application Protocol (WAP) for net trading
 - allowing online redemption and repurchase of mutual fund units
 - subscribing to public issues through the internet
- online reporting by companies to stock exchanges.

IT Act passed

The Information Technology Bill received the President's assent on June 16, 2000 giving an impetus to e-commerce and Internet related business in the country. The salient features of the Act are:

- the legal recognition of digital signatures, apart from authentication and origin of electronic records

- provisions for licensing of certification authorities to license, certify and monitor digital certificates;
- the appointment of a controller to oversee the activities and regulation of the certifying authorities;
- the promotion of e-governance by allowing government records to be kept in electronic form and allowing for electronic filing of applications and forms with the government;
- the definition of cyber crimes and provisions for punishment for such cyber crimes.

ICEAI to closely monitor ICE space

The Fali Nariman Committee comprising of the secretaries of the Ministries of Information & Broadcasting, Information Technology and the Department of Telecom have prepared a draft Information, Communication and Entertainment (ICE) Bill 2000 (Bill).

The Bill seeks to merge the communication, technology and telecommunication laws (the Bill will incorporate the Telecom Regulatory Authority of India (TRAI) Act 1997 and the TRAI Amendment Act 2000) and proposes to vest the ICE Authority of India (ICEAI) with significant powers presently enjoyed by the Department of Telecommunications (DoT). This would make ICEAI a more powerful body than the TRAI.

Stiff investment norms for foreign film companies

The Government has imposed stiff norms for foreign investors seeking entry into the domestic film industry which include:

- A minimum paid up capital limit of USD 10 million in the case of majority shareholding; If it is anywhere between the smallest shareholder and the

- largest, the commitment would have to be between USD 2.5 – 5 million
- Curbs on raising debt; and
- Disclosures to prove their credibility.

The eligible activities include film financing, production, distribution, exhibition, marketing and associated activities relating to the film industry.

COMPLIMENTARY SUBSCRIPTIONS

LEGAL UPDATE: INDIA

NAME: _____

FIRM/CO.: _____

ADDRESS: _____

CITY: _____

STATE: _____

PIN CODE: _____

COUNTRY: _____

TEL#: _____

FAX#: _____

EMAIL: _____

NISHITH DESAI ASSOCIATES

93-B, Mittal Court
Nariman Point
Mumbai 400 021
India

Fax#: 91 + 22 + 287 5792

Tel#: 282 0609 or 204 0068

E-mail: nda@nishithdesai.com

WebPage: <http://www.nishithdesai.com>