LEGAL EYE

Your peek into the Indian legal scene

A.R.A. LAW

Advocates & Solicitors

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Dear Readers

In our continued desire to keep our readers abreast of the latest breaking legal news as well as to bring out topical newsletters on topics of interest to our readers, this issue of the Legal Eye is dedicated to Tax. Transfer pricing has become a requirement of most international transactions. We have endeavoured to give our readers an insight into transfer pricing issues as well as on the tax aspects of futures and options and some of the recent developments in the tax arena.

As always we are overwhelmed by the response to various issues of the Legal Eye by our clients and friends. We take this opportunity to request our readers to suggest topics on which they would like something more from us. We will make our best efforts to try and accommodate such requests in the forthcoming issues of Legal Eye.

We trust you will find this newsletter very informative and interesting.

Rajesh N. Begur, Editor-in Chief, Legal Eye

Offshore Financial Centres (OFC)

The role and demand for OFCs has grown manifold. A recent report mentioned that over half of the world's financial transactions involve OFCs and they hold over half of the world's financial assets.

The term OFC is generally understood to mean jurisdictions that are used for keeping assets overseas. The benefits arising out of OFCs outweigh their running and maintenance costs. OFCs provide a wide scope for international tax planning, good commercial and financial infrastructure with mild exchange control regulations, liberal regulations to overcome cumbrance regulations at home and facilitate easy and quick formation and winding up of various kinds of entities.

Normally an OFC are equated with tax havens. The OECD report on "Harmful Tax Competition" lists the criteria for determining tax havens these include jurisdictions that;

(i) Impose no or nominal effective tax and provide opportunities to non resident taxpayers to escape their home taxes;

(ii) Prevent an effective exchange of tax information under their laws or administrative practices and lacks transparency in their operations;

(iii) Attract investment or transactions that are purely tax driven with insufficient activity or economic substance;

(iv) Levy taxes on its resident population but levy no tax at all, or at low rates, as profits from foreign sources;

(v) Grant special tax privileges or incentives to certain persons or for certain transactions.

The three major categories of OFCs are:-

(A) Base Havens- These jurisdictions have limited treaty networks, nil or lower taxes with liberal exchange control laws. Some of the base havens are Bahamas, Bermuda, British Virgin Islands, Cayman Islands, and Gibraltar.

(B) Treaty Havens- these jurisdictions have wide treaty network, nil or lower taxes and liberal exchange control laws. Some of the treaty havens are Cyprus, Malta, Mauritius, and Netherlands.

(C) Special tax concession Havens- these jurisdictions provide preferential tax regime in the form of special tax benefit such as tax exemption or tax relief to attract international business activities.

The high tax countries are the sufferers as a result of dimunition of their tax revenues and hence take measures, through their tax laws, to deter their taxpayers from using tax havens. Some of such anti tax avoidance measures are:-

(a) Beneficial ownership requirements, which implies a division between the legal rights and the rights of enjoyment over the economic benefits.

(b) Controlled foreign corporation rules to avoid any tax deferrals arising due to non-distribution of income by OFCs.

(c) Thin Capitalisation rules to overcome hidden equity capitalization through excessive loans.

(d) Transfer Pricing to overcome the differences arising due to transactions between associated enterprises at other than arms length price.

(e) Other measures are transparency and exchange of information, exit taxes and transfer of tax residence, exchange controls, branch profits tax on repatriation.

From an Indian perspective in addition to other tax havens, Mauritius is considered to be one of the predominant tax haven for all inbound investments into India. The India Mauritius treaty provides for taxability of gains from sale of financial assets, in the country of residence. Mauritius under their domestic tax laws levies a negligible effective tax on such gains from sale of overseas financial assets. Hence, more than half of the total inbound investments into India are routed through Mauritius. The Mauritius investor stands on a favourable footing as compared to a resident Indian investor due to the advantage of tax differential.

The Indian tax authorities made a study and passed a detailed order of assessment against such conduit companies investing via Mauritius into India for insufficient activity or economic substance. This generated a lot of panic in the investment community with threats of pulling out by major investors. To overcome such steps of the tax authorities, the Ministry of finance of the Government of India issued a circular (no.789 dt. 13 April 2000) clarifying that a certificate of residence issued by the Mauritius authorities would constitute sufficient evidence for accepting the status of residence as well as beneficial ownership. Certain associations filed a writ petition by way of public interest litigation against this circular before the Delhi High Court. The judiciary after discussing the pros and cons of the issue at length decided that the impugned circular be quashed and that a mere production of a residential certificate cannot entitle the holder to avail of the benefit of the treaty and the statutory power of the assessing authority cannot be taken away by reason of the impugned circular. The exact implications will only be known once the tax authorities takes steps or begins assessing such investors.

Local entities in India have incorporated Overseas Corporate Bodies (companies which are not less than 60% controlled or held by non resident Indians) (OCBs) in Mauritius in order to claim the exemption from capital gains tax on investments in India. The authorities in India are likely to cull out such OCBs, which are post box companies from the purview of the treaty benefits. Further there is talk of reviewing the Indo-Mauritius treaty next year.

The above developments have created an environment of uncertainty on the period up to which the benefits available under the present Indo Mauritius treaty shall prevail.

Narendra Joshi

Home

Compliances Requirements for Transfer Pricing Regulations - An Overview

Prior to 2001, the Indian tax laws contained very sporadic provisions on transfer pricing, many of which often went unnoticed by both assessees and the department.

The Finance Act 2001 introduced for the first time detailed regulations on transfer pricing including the concept of arms length price by inserting sections 92 to section 92F in Chapter X of the Income Tax Act with effect from Assessment year 2002-03 i.e. financial year 2001-02. However, these provisions are limited to countering tax avoidance in international transactions only. Domestic transactions continue to be governed by the earlier provisions, which are not comprehensive in nature.

International Transactions

Section 92 of the Act specifically recognizes the concept of “arms length price” and contains six follow up sections (A to F) dealing with various aspects of arms length pricing as follows:

- Section 92A defines an associated enterprise;
- Section 92B defines an international transaction;
- Section 92C provides the methods for computation of arms length

prices;

- Section 92D provides for maintenance of records and keeping of information and documents;
- Section 92E requires certification from a chartered accountant with regard to international transactions between associated enterprises; and
- Section 92F provides definitions of various terms relevant to the computation of arms length price, etc.

Sections 271AA, section 271BA and section 271G provide for specific penalties for non-compliance with the above provisions.

Domestic Transactions

The relevant provisions in the Act are briefly enumerated below:

1 Section 40A (2)(b), which disallows deductions in respect of certain payments made in relation to transactions between associated enterprises (which is defined differently from the definition of the same provided in Chapter X for international transactions).

2 Section 80-IA and 80-IB which provides that where dealings between associated enterprises are so arranged that larger profits are booked in the hands of one of them which is entitled to special tax deductions, the tax authorities can take this factor into account when assessing the income of the entity that is not entitled to the tax deduction.

3 Section 93 which gives powers to the tax authorities to assume income in the hands of a resident, in cases of transfer of assets in consequence of which the income becomes payable to a non resident.

Overview of Chapter X – Transfer Pricing in International Transactions

All International transactions between associated enterprises have to be at arms length price and the parties to such transactions need to comply with the regulations on transfer pricing prescribed under the Income Tax Act.

The term "associated enterprise" has been defined very widely. Besides the usual concepts of voting control and equity exceeding 26%, associated enterprises also include companies where one company has guaranteed more than 10% of the borrowing of another company.

Arms Length Price

The Act provides for different methods depending on the nature of the transaction to determine the "arms length price". Section 92C(1) of the Act provides that, the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as may be prescribed, namely:-

(a) comparable uncontrolled price method;

(b) resale price method;

(c) cost plus method;

(d) profit split method;

(e) transactional net margin method;

(f) such other method as may be prescribed by the Board.

Rule 10C of the Income-tax Rules provides that, the most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to the international transaction.

There are no methods prescribed specific to the nature of a transaction. It is always preferable to compare the price charged for a related international transaction with the price charged in an independent transaction for the same goods or services. In the absence of such price being available due to any reason whatsoever depending on the facts of the case the resale price or cost plus method should be used.

Maintenance of Records and Documentation

Section 92D of the Act read with Rule 10D provides onerous responsibilities on every person undertaking international transaction with associated enterprises on maintenance of records and other documents. Briefly stated, these include a description of the ownership structure of the assessee; legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into; the nature and terms (including prices) of international transactions entered into with each associated enterprise; a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a hearing on the international transactions entered into by the assessee; a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into; a description of the methods considered for determining the arm's length price in relation to each international transaction; etc. This information must be supported by authentic documents, which may include official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country, etc.

Audit requirement

A report from an accountant in the prescribed manner and form (Form No. 3CEB) is required to be furnished to the assessing officer generally on or before the due date of filing the return.

Investigative powers of tax authorities

The assessing officer under section 92C(3) of the Act has the powers to determine the arms length price in accordance with the above provision and methods on the basis of the material or information or document in his possession in various circumstances where he believes that the assessee has not complied with its obligations.

The CBDT has issued a circular whereby during the initial years the Assessing officer shall not make any adjustment to the arm's length price determined by the taxpayer, if such price is upto 5% less or upto 5% more than the price determined by the assessing officer. In such cases the price declared by the taxpayer may be accepted.

Consequences of Non Compliance

The consequences arising on a violation of the transfer pricing regulations are;

1. The difference in price is added to the income of the payer.

2. The benefits of deductions and exemptions shall not be available on the increase in income arising by virtue of applying the transfer price as computed by the assessing officer.

3. The payee of the income shall not be entitled to the corresponding deduction arising on adjustment to the transfer price of the payer.

4. The assessee shall also be liable to penalties as under;

a) Two percent of the value of transaction on failure to keep and maintain any information and document as prescribed.

b) Two percent of the value of the transaction on failure to furnish information or document as required by the assessing officer

c) Rs. 100,000 for failure to furnish the report in the prescribed form

Conclusion

Whilst the objective of the regulations are commendable, the actual level of regulation leave much to be desired on various issues and in particular the obligation of the assessee to maintain a plethora of records, papers and analysis to justify the transfer pricing method adopted by him.

Aliff Fazelbhoy

Home

Some open issues and interesting judicial rulings in International Taxation

Some Open Issues and Interesting Judicial Rulings in International Taxation

Open Issues

1. Non discrimination Clause

The intention of this clause in a tax treaty is to restrict the jurisdiction from giving preferential treatment to residents vis-à-vis non residents. In India, the foreign companies are taxed at a rate higher as compared to domestic Indian company. The issue that arises is whether in light of the non-discrimination clause the foreign companies cannot be taxed at a rate higher than the rate applicable to domestic Indian company. Amongst the various controversial decisions on the above issue by different authorities, the Calcutta tribunal in the ABN Amro case has ruled favourably that the non-discrimination clause would be applicable even for the rate of tax. The Indian Parliament in a recent amendment to the domestic tax law has carved out an exception, with retrospective effect, to exclude from the authority delegated to enter into a treaty the benefit on account of rate of tax. The issue has arisen as to whether unilateral change by one of the contracting state can override the benefits available under an existing treaty.

2. Most favoured Nation Clause (MFN)

The India-France and India-Netherlands treaties have a MFN with respect to rate or scope on fees for technical service (FTS) as regards any OECD member state. India subsequently entered into a treaty with Germany and USA wherein the rate and scope of FTS has been restricted. Consequently the Indian authorities issued notification to restrict the rate and scope for Netherlands treaty while in a similar notification for France treaty has only restricted the rate but not the scope. We are given to understand that the France authorities have issued a similar notification. The issue has arisen as to whether in light of the silence in the notification issued by the Indian and French authorities to restrict the scope of FTS, MFN clause in the India-France treaty can still applied to restrict the scope of FTS.

3. Treaty Characterisation

The Internet Exchange Company (IEC) facilitates inter connection between the Internet Service Provider (ISP). The OECD report has determined the revenue of IEC to be a service income since it cannot be termed Royalties, as the customer does not have the physical possession or control over the infrastructure or equipment used by the IEC. However, the Indian high powered committee on E-commerce considers such payments as Royalties. It is unclear as to which of the above two contrary views should hold good. There are many more such contrary views between the OECD report and the Indian high powered committee report.

4. Call Centres/Telemarketing services

An issue has arisen regarding the taxability of revenue generated by a Call Centre in India from services provided to non resident manufacturer/service generators. What test needs to be applied to determine the existence of a permanent establishment and whether in the absence of a PE, can such service be treated as technical services.

Judicial Rulings

5. Independent Personal Service (IPS)

The Mumbai tribunal in a recent decision in the case of Clifford Chance [82 ITD 106] has held that while counting the number of days in order to determine the taxability of IPS, the number of days spent by employee of the firm also needs to be considered in addition to the number of days spent by partners/members of the firm.

6. Royalty or fees for technical services

The advance ruling authority has recently decided that the consideration for sale of drawings and design without any restrictive clause as to the usage of such design and drawings would not constitute royalty or fees for technical services.

7. Scope of the treaty

The advance ruling authority in a recent ruling on the Indo-UAE treaty in the case of Cyril Pereira [239 ITR 650] has held that the individuals resident in UAE, who are not liable to tax in UAE as per their domestic laws, are not entitled to avail of the benefits under the Indo-UAE treaty.

Narendra Joshi

Home

Taxation of Futures & Options

Introduction

The Securities and Exchange Board of India (SEBI) has introduced, in a phased manner, new derivative instruments, which can be traded on the stock exchanges. These include index futures, stock futures, index options and stock options. With a view to implement the above the Securities Contract (Regulation) Act, 1956 (SCRA) has been amended so as to include derivatives in the definition of `security', `Derivative' in turn has been defined to include a contract which derives it's value from the index of prices of underlying securities (see sec. 2(aa) and sec. 2(h) of SCRA). Further, by way of abundant caution, section 18A has also been inserted in the SCRA legalizing contracts in derivatives, if they are traded on a recognized stock exchange and settled on the clearing house of the recognized stock exchange in accordance with the rules and bye-laws made by such exchanges in this behalf. The fear was that agreements in derivatives may be treated as wagers under sec. 30 of the Indian Contract Act, 1872 and hence such agreements may be treated as void and unenforceable.

All derivative contracts are Marked-to-Market (MTM) on a daily basis.

Tax Implications

The tax laws has not introduced any specific provision to deal with the tax consequences of trading in derivatives which leaves it open for determination on the basis of the general principles and provisions. In this article we would like to discuss the relevant provisions in the Indian Income-tax Act and various issues, which may arise there from. In view of the ambiguities involved, two views could be possible on many issues.

The *first issue* that arises is the head under which the income from derivatives trading should be taxed i.e. Business income or Capital gains.

Whether transactions in index futures could be regarded, as business of the assessee would depend upon the volume, frequency, continuity and regularity of transactions of purchase and sale in the derivatives. A transaction in the course of business would result in business income. There are enormous court rulings on the criteria to determine whether income is business income or capital gains. If the transaction in index futures is considered as an investment rather than a business, the income there from shall be considered as capital gains. One interesting aspect of this matter is that, the basic purpose behind transactions in Index futures is risk management by way of hedging. Thus, where these transactions are entered into, to guard against loss due to price fluctuation in the stock market in respect of capital investments it would be on capital account and if the transactions in index futures are entered into to guard against loss in respect of stock-in-trade, it would be in the course of business. Since, currently, derivatives are allowed to be contracted only for one, two or three months maturity levels even if the transaction is regarded as on capital account there is little advantage as such, since concessional rates of tax and indexation benefit are applicable only to long term capital assets.

In cases where the income is liable as business income then the *second issue* will be whether the income would be taxable as income from speculative transactions or otherwise

Section 43(5) of the Income-tax Act defines “Speculative transactions”. As per said definition in order to be regarded as a speculative transaction, the transaction has to satisfy two conditions -

i) it should be a contract for the purchase or sale of any commodity, including stocks and shares; and

ii) the contract should be periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scrips.

The first requirement is that the derivative instrument must qualify as a commodity. Commodity has been defined by the Oxford English Dictionary, second edition, Vol. III at page 564 to mean `a property of the person', `a thing of use or advantage to mankind esp. in plural useful products, material advantages, elements of wealth', `an article of commerce', `an object of trade; in plural goods, merchandise'. Contracts in derivatives are regarded as securities under the Securities Contract (Regulation) Act. Hence, it is arguable that a derivative instrument is a commodity.

The second requirement as to settlement by actual delivery or transfer are discussed separately for index and stock; (i) Index futures or Index options cannot be settled by actual delivery or transfer and is impossible to perform. It is arguable that the second condition would apply only with regard to the transactions which are capable of settlement by delivery or transfer and not otherwise. (ii) Stock futures and Stock options are capable of settlement by delivery or transfer. There are likely chances of the income from these transactions being liable to tax as from speculative business wherein the transaction is not settled by actual delivery. The related issue that may arise in the case of index futures is as to whether the MTM can be regarded as periodical settlement that is otherwise than by delivery and hence liable as speculative income.

Apart from the above principal issues there may arise further issues in the

Apart from the above principal issues there may arise further issues in the accounting of the derivatives and computation of the income thereon.

Computation Issues

Some of the major issues that may arise in the computation of income from derivatives are;

· Whether the computation needs to be done for all gains or losses which arises on account of MTM?

· Whether the premium paid for options purchased on capital account and not settled by delivery can be claimed as “capital loss”?

· Whether the premium paid for options purchased on capital account and settled by delivery can be added to the cost of acquisition of the security?

· Whether the premium received by the seller of the options wherein contracts are settled by delivery has to offer the amount received on account of premium as consideration for sale of shares and hence liable to long term or short term gains depending on the period for which the underlying shares is held?

· What would be the cost of acquisition for futures contract?

Accounting Issues

Some of the major issues that may arise in the accounting of income from derivatives are;

· How would the valuation be done for the contracts that remains unsettled as of the accounts closing date?

· Whether the seller of the options and the dealers in futures would have to make any disclosure towards contingent liabilities as to the contingencies pertaining as on the accounts closing date for the unsettled contracts?

Legal Snapshots

Home

RBI permits authorise dealers to open Term Deposit Accounts

Reserve Bank of India has permitted authorised dealers to open term deposit accounts for a period not exceeding six months in favour of a branch/project/liaison office of a person resident outside India provided the authorised dealer is satisfied that the term deposit is out of temporary surplus funds and the branch office furnishes an undertaking that the maturity proceeds of the term deposit will be utilised for their business in India within three months of maturity.

Guidelines to Mutual Funds

Mutual funds are required by the Securities and Exchange Board of India (SEBI) to take steps to implement the following guidelines:-

All mutual funds shall enter into transactions relating to Government securities only in dematerisled form

SEBI (Insider Trading) Regulations, 2002 are to be strictly followed by the trustee companies, asset management companies and their employees and directors.

The investments made by mutual funds, which have become non performing asset or illiquid at the time of maturity/closure of the schemes and later realised by the mutual funds at the time of winding up of the schemes are to be distributed, if substantial and is realised within two years to the old investors.

Facilities to NRIs/PIOs and Residents

Authorised Dealers have been permitted to allow the facility of repatriation of funds out of balances held by NRIs/PIOs in their NRO Accounts, for the following purposes :

Upto US$30,000 per academic year, to meet expenses in connection with the education of their children.

Upto US$ 1,00,000 to meet the medical expenses abroad of the account holder or his family members; and

Upto US$1,00,000 per year, representing sale proceeds of immovable property held by them for a period not less than 10 years subject to the payment of applicable taxes.

Code of Civil Procedure (Amendment) Act, 2002

The amendments to the Civil Procedure Code has come into effect as of July 1, 2002. The intention is to bring about speedy and effective disposal of cases. The amendments lays down specific rules, which restricts and limits the discretion given to judges in granting adjournments and also empowers them to reprimand misuse of the procedure resulting in the abuse of process of law.

SEBI circular on MF investments in unlisted companies

Through a recent circular, SEBI has directed domestic mutual funds to follow stringent valuation while investing in unlisted companies. This valuation method would have to take into account the current highly discounted industry P/E as well as a price discount for illiquidity. This circular is an attempt to ensure that funds do not pay unrealistic prices for shares which are not listed.

Review of Cap on Voting Rights in Private Banks

The maximum foreign equity through the FDI route has been raised from 20% to 49% this year, another 49% was allowed for portfolio investments thereby allowing a private bank to raise its foreign holding to 98%. However, the current law stipulates that a shareholder can have maximum voting rights of 10% in a private bank irrespective of actual equity holding in the bank. In the light of foreign banks- with no branch operations in India- being allowed to set up banking subsidiaries, the 10% cap is sought to be removed by a possible executive order from the Finance Ministry ratifying the proposed change.

FDI Policy for trading under review

The Government of India has directed the Ministry of Commerce to review the Foreign Direct Investment (FDI) policy on wholesale trading. As of now, there are no sectoral restrictions under the wholesale trading policy and FDI upto 100% is permitted. Pursuant to demands from various Ministries, the Government is contemplating on fixing a cap on FDI inflow and imposing sectoral restrictions under the wholesale trading policy in order to ward off surge in imports. However, any change in policy has been decided to be of prospective effect only.

Service Tax net being widened

The Government has decided to bring 10 new services within the purview of service tax levy with effect from August 16, 2002. These services include insurance auxiliary business, cargo handling, storage and warehousing, event management, rail travel agents, health club and fitness centers, beauty treatment, fashion designers, cable operators and dry cleaning. However, life insurance policies provided by companies to policy holders and agricultural produce or goods meant for cold storage have been exempt from the service tax levy. The Amendments further provide that in case of the service provider being a non-resident or who does not have an office in India, the receiver of the service in India will be liable to pay the tax.

Y H Malegaon Committee panel wants Companies to disclose loans

The Securities and Exchange Board of India (SEBI) committee on accounting standards has recommended a number of measures to improve corporate disclosures and make it difficult for companies to commit irregularities. The committee has suggested that companies disclose annually the loans and advances given to subsidiaries and associate companies. It further suggested preparation of a limited audit of quarterly results of companies from the first quarter of 03-04 and a full audit of half yearly results from the fiscal year 04-05. Companies would also be required to prepare an annual risk report, which would be a part of the annual report.

Companies may have to consolidate accounts of group companies

The Department of Company Affairs is examining the option of making it mandatory for corporate groups to prepare consolidated accounts of all associate companies, including all subsidiaries under the Companies Act. The proposal if accepted would lead to higher level of disclosures and transparency in profitability figures of companies and a better understanding of the financial performance of corporate houses.

Book-building for buyback suggested

The SEBI Committee on Delisting has recommended that the book-building process be applied to calculate the price for buyback before companies buy-back their shares and de-list from the exchanges. There will be no bar on delisting, provided that the company has been listed at a Stock Exchange for at least 3 years. A separate agency, the Central Listing Authority (CLA) has been mooted to provide quarterly reports to SEBI. CLA will scrutinise listing by new companies and compliance of companies with the Listing Agreement. Exit price is to be the floor price, which is the average of 26 weeks traded price, without a maximum price.

SEBI to monitor IDRs after Listing

Indian Depository Receipts, mooted on the same lines as ADRs and GDRs, after listing on Indian Stock Exchanges, shall be in the ambit of the SEBI. Department of Company Affairs is in the process of forming guidelines for IDRs, which will be similar to ADRs and GDRs.

Not always a good deal- Comments on Securitization Ordinance

Under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002, a “Secured Creditor” has been defined as “any bank, financial institution or any consortium of banks or financial institutions and includes a debenture trustee appointed by any bank or FI, trustees holding securities on behalf of a bank or FI, a securitization or a reconstruction company.”

The terms “bank” and “FI”, as defined in the Ordinance, effectively exclude all those foreign lenders (other than international finance corporations), who don’t have a banking presence in India (collectively “foreign secured lenders”), which is different from the rights given to “secured creditors” under the Act. Foreign banks carrying on banking activity (not by way of a mere liaison office) in India are covered under the definition of “secured creditor”.

Further, the definition of “bank” and “FI” empowers the Indian Government to notify additional “banks” and “FI”. This means that foreign secured lenders have been made subordinate to any Indian secured lender even if the Indian secured lenders are a second or subsequent chargeholder. This would mean that the foreign secured lenders will not have any say in how the rights created in favour of “secured creditors” under the ordinance will be exercised. This Ordinance may be discriminatory against foreign lenders and may discourage foreign banks from lending to projects in India.

Professionals Allowed to Retain Foreign Exchange Earning Abroad

The Reserve Bank of India (RBI) has now allowed individual professionals to retain abroad 100% of foreign exchange earned by them through their services to overseas clients. Professionals will be allowed to retain these funds in exchange earners foreign currency accounts (EEFC). The relaxation was brought about with a view to improve the prospects of Indian professionals who will now be able to expand their profession services abroad by using these funds internationally.

More Foreign Direct Investment is Likely for Telecom and Aviation

The NK Singh committee on foreign direct investment (FDI) is likely to recommend a relaxation in FDI sector caps for telecom and aviation sectors. The proposed sectoral cap is likely to be at 74% against the existing 49% and that for domestic airlines at 51% from 40%.

Norms for 'vanished companies'

The Department of Company Affairs (DCA) and SEBI have laid down a set of norms for the purpose of identifying vanished companies. According to these norms companies which have raised capital through public issue and have disappeared from their registered offices thereafter can be identified as 'vanished' companies. The implications of such norms are that they will serve to act as a check on flagrant violations of the Companies Act. A number of prosecutions have been reportedly ordered under Sections 63, 68 and 628 of the Act.

Patents Bill receives President's approval

The Patents (Second Amendment) Bill has received the approval of the President of India. The Bill, *inter alia* provides for compulsory licensing of patented drugs during health crises and has laid down provisions for doing research on drugs once they are patented, although the patenting of drugs is yet to be approved.

Protection of commercial data

A US based forum of pharma multi-nationals has reportedly been exerting pressure on the Indian government to treat commercially valuable data that is filed with the Drugs Controller, as confidential information for a period of 5 years from the date of obtaining the approvals for marketing.

Further, the forum wants importation followed by sale/offer/distribution to be treated as the "working of patent" since sections 83, 84 and 85 of the amended act do not specify anything in relation to this. The idea essentially is to ensure that proprietary data filed for registration purposes is not used by subsequent applicants.

ADR/GDR route to fund disinvestment buyouts.

The Finance Ministry has permitted companies to raise ADRs/GDRs/ECBs for funding disinvestments buyouts. The implications of this move are that the bidders have an additional source of funds for the buyout and foreign funds would be a part of the disinvestments process. Although the opening now given to the foreign institutional investors or lenders is not the same as their direct participation, it is clearly a step in that direction.

Disclosures by listed companies

The Department of Company Affairs (DCA) has issued a fresh set of guidelines that call for more disclosure on the part of listed companies. These guidelines are more for listed companies that are not closely held – the idea being that investors should have more information.

Companies would be required to disclose the proportion of the annual turnover paid as remuneration to their promoter families before obtaining statutory clearances for managerial remuneration and appointment from the government. Appointments of whole time or managing directors recruited from the promoters' families are also subject to the stringent guidelines before they are approved. The guidelines also deal with remuneration paid to directors and managers from the promoters' families by companies with inadequate profits.

The appointment of whole time / managing directors would require DCA clearance. Before granting such clearance, the DCA will ascertain if the selection committee making the appointments of the promoters relatives' directors was predominantly composed of independent directors and experts in the field from outside the company.

2 Way Fungibility

The two-way fungibility, which was allowed after an amendment to the Foreign Exchange Management Act in march 2001 has finally been operationalised after the SEBI came out with guidelines to monitor the sectoral caps. Two way fungibility is a scheme by which Depository Receipts (ADRs or GDRs) can be converted into the underlying (local) shares and the local shares can be reconverted into DRs.

One of the measures taken by SEBI is that the shares released on the conversion of the depository receipts (DRs) should be mandatorily credited to a separate depository account called the Depository Receipts account of the particular investor. Depositories have also been required to provide data (including data on the number of shares credited and debited out of an account and the balance in the account) regularly to custodians holding the underlying shares.

Home

Meet the A.R.A. LAW Team:

In each issue, we profile one person who is a part of A.R.A. LAW. They will also be sharing their experiences of being with A.R.A. LAW.

M. P. Madhusoodanan. Born in 1964 in Palghat District of Kerala State, came to Mumbai in 1983 on completing his High School education. Since then Madhu worked with various Mumbai based law firms discharging secretarial and administrative duties. Simultaneously while working Madhu did his further studies in Mumbai. Madhu has been with A.R.A. LAW since June 1996 as Manager Operations and he is the circulation in-charge of Legal Eye. Here is what Madhu has to say:-

"*Working in* A.R.A LAW *has always been a wonderful and memorable experience* to me. Freedom of opinion, opportunity to think and work independently, absence of bureaucracy are some of the fundamental features of A.R.A. LAW. Co-operative nature of the associates, unity and team spirit among support staff and appreciative approach of the partners are the added spirit to work in A.R.A. LAW. "

Home

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Home

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