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YOUR PEEK INTO THE INDIAN LEGAL SCENE
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Union Budget 2001-2002

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INTRODUCTION

The Indian Economy has undergone nearly ten years of economic reform guided by three finance ministers and implemented by five governments. The process of economic reform was initiated in 1991 by the then Prime Minister Mr Narasimha Rao along with Finance Minister Dr. Manmohan Singh to meet the dire need to invigorate a deteriorating economy on the verge of bankruptcy. This process brought about sweeping changes resulting in liberalization and the opening up of the Indian economy to foreign investment in various sectors.

The subsequent finance ministers Mr. P. Chidambaram and Mr. Yashwant Sinha continued the process of implementing economic reform during a period of perilous political instability. The uncertainty caused by a change of 3 Governments in two years and the resultant economic decline made the task of continuous implementation of reforms tougher. Despite these tough years, the process of reform continued and the second generation economic reforms were introduced by the present Finance Minister Mr. Yashwant Sinha during 1999 and 2000.

The year 2000-2001 witnessed a fall in the GDP growth rate for the second consecutive year from 6.6% in 1998-99 to 6.4% in 1999-2000 to 6% in 2000-2001 and an increase in the cumulative inflation rate. (4.8*% as on 27 January 2001 as compared to 3% in 2000-01*). The BSE Sensex declined by 13.5% during the past financial year as compared to the buoyant conditions in 1999-2000 largely due to the IT bubble burst resulting in erosion of prices of technology stocks the world over.

Important legislation was passed and implemented in the past year to implement the second-generation reforms in the foreign investment, information technology and corporate sectors. The hitherto closed insurance sector was finally opened up to private investment. The Securities and Exchange Board of India also took the process of capital market reform further with a view to have a more investor friendly and globally competitive market. However, national tragedies such as the cyclone in Orissa and the recent earthquake in Gujarat and the operations against insurgency in various states have caused a strain on the economy.

The key developments in the Indian economy over the last decade have been summarized in Part 1 of this note. Part 2 summarizes the developments of the financial year 2000-2001 and Part 3 deals with the main features of the Economic Survey and proposals in Budget 2001. We hope you find this booklet useful and informative.

Aliff Fazelbhoy
Partner

PART I – 10 YEARS OF REFORM ... **3**

1991-1992 ... 3
1992-1993 ... 3
1993-1994 ... 3
1994-1995 ... 3
1995-1996 ... 4
1996-1997 ... 4
1997-1998 ... 4
1998-1999 ... 5
1999-2000 ... 5
2000-2001 ... 5

PART II – 2000-2001: AN OVERVIEW ... **5**

NEW STATUTES ... 5
The Foreign Exchange Management Act (FEMA) ... *5*
The Insurance Regulatory Development Authority (IRDA) Act ... *6*
The Information Technology Act, 2000 ... *7*
The Patents (Amendment) Act, 1999 ... *8*
The Trademarks Act ... *9*
PROPOSED LEGISLATION ... 10
Proposed Competition Law in India ... *10*
The Convergence Bill ... *11*
Key developments in other areas ... *12*
Companies Act ... *13*
Infrastructure ... *14*
Civil Aviation ... *15*
Banking ... *16*
Direct Tax ... *16*
Venture Capital Funds ... *17*
Mutual Funds ... *17*
Stock Exchanges ... *17*

PART III - HIGHLIGHTS OF THE BUDGET ... **18**

HIGHLIGHTS OF THE ECONOMIC SURVEY ... 18
BUDGET 2001-2002 - HIGHLIGHTS ... 18
I. Direct Taxation ... *19*
II. Indirect Taxation ... *20*
III. Investment Overseas ... *21*
IV. Capital Markets ... *22*
V. Infrastructure ... *22*
VI. Banking and NBFC's ... *24*
VII. Labour and employment law ... *24*
VIII. Agriculture and Rural Development ... *25*
IX. Miscellaneous ... *25*
X. Proposed Statutory Reforms and Amendments ... *25*

PART I – 10 Years of Reform

So much has happened since the day in July 1991 when the then Prime Minister Mr Narasimha Rao and Finance Minister Dr Manmohan Singh announced the new Industrial Policy. We have attempted to cull out five important events over the last 10 years that trace the progress of reforms.

1991-1992

- Automatic approval introduced for up to 51% foreign equity in 35 high priority sectors to be granted by the Reserve Bank of India (RBI);
- Use of foreign trademarks permitted and automatic approval for technology transfers in high-priority industries;
- Establishment of the Foreign Investment Promotion Board (FIPB) with unfettered discretion to consider proposals not falling within the automatic route guidelines;
- Industrial licensing abolished for all but 18 industries;
- Landmark amendments to the Foreign Exchange Regulation Act (FERA) and the Monopolies and Restrictive Trade Practices Act (MRTP) and setting up of Securities and Exchange Board of India (SEBI).

1992-1993

- Value-added telecom services, i.e. paging, cellular and radio opened up to private sector;
- Foreign institutional investors (FIIs) permitted to invest in Indian capital markets;
- Lowering of tax rates begins along with fewer tax slabs and higher exemptions;
- Many import tariffs lifted and peak import duty reduced to 110%;
- Banking reforms such as cut in number of lending rates, freeing of deposit rates, etc.

1993-1994

- Indian companies allowed to access overseas markets by issue of GDRs;
- SEBI designated as market regulator and the Controller of Capital Issues is abolished to make issue price market-determined;
- Rupee made partially convertible on current account;
- De-licensing of car and white goods manufacturing;
- Banks allowed to access capital markets and debt recovery tribunals set up.

1994-1995

- In a landmark period for infrastructure, cellular operators begin operations in metro cities - Private operators to be allowed in fixed line telecommunications also in addition to cellular and paging;
- Enron signs Power Purchase Agreement with Government of Maharashtra;

- Private proposals for road building invited and National Highways Act amended to provide for road tolls;
- SEBI introduces the Substantial Acquisition of Shares and Takeovers Regulations (the 'Takeover Code');
- The disinvestment process is initiated and the target of Rs 4,000 crores[1] is easily exceeded.

1995-1996

- Telecom Regulatory Authority of India (TRAI) set up;
- Cellular licenses issued outside the metro cities;
- Daewoo becomes the first foreign car manufacturer in India with the launch of the Cielo;
- State Bank of India becomes India's first bank to be listed overseas following a GDR issue;
- Disinvestment programme suffers a setback and sees reality with only Rs 362 crores achieved against a target of Rs 7,000 crores.

1996-1997

- FIPB revamped to make foreign direct investment (FDI) policy more transparent;
- Number of licensed industries reduced to 14 and de-licensing commission set up;
- Private sector allowed into BOT operation in existing ports and BOT guidelines for highway projects announced;
- Further tax reforms by reducing surcharge on corporate assessees, tax holidays for infrastructure projects and further reduction in import duties;
- IPO norms toughened to ensure quality of issue and FIIs allowed to invest in unlisted shares.

1997-1998

- Significant tax rate cuts – peak rate reduced to 40% and lowest rate to 10%;
- Expansion of list of industries qualifying for automatic approval and non-resident Indians (NRIs) allowed 100% investment in these sectors on repatriable basis;
- Software export boom begins;
- Relaxation of norms for raising external commercial borrowings (ECB);
- Telecom and oil exploration gain status of infrastructure which makes them eligible for tax and other benefits – New aviation policy announced.

[1] Rs One crore = Rs 10 million = approximately US$ 220,000

1998-1999

- 100% automatic FDI approval permitted in power generation and some other infrastructure categories;
- FIIs permitted to take forward cover and 100% debt funds allowed;
- Gift tax abolished, but service tax net widened to include 12 more services;
- In a significant move and amidst much controversy, the Insurance Regulatory and Development Bill (IRDA) is first introduced in Parliament;
- Easing of restrictions on deployment/end-use of GDR/ADR proceeds and ECBs.

1999-2000

- Stock market boom sees sensex touching the 6,000 mark;
- Passing of the Foreign Exchange Management Act (FEMA) and IRDA; introduction of Information Technology (IT) Bill in Parliament;
- Companies permitted to fix their own par value on shares in addition to buyback being permitted;
- FDI becomes automatic in all but a negative list – sectoral caps remain in telecom, banking, aviation and some other sectors;
- Several indirect tax reforms including time-frame set for uniform floor sales tax rate and introduction of VAT by April 2001.

2000-2001

- Several new legislations come into force, including FEMA, IT Act, IRDA and a new Companies Act;
- Some panic in domestic industry leads to preemptive and anti-dumping duties levied to try and curb cheap imports particularly from China;
- Two national calamities, viz. the Orissa cyclone and Gujarat earthquake take heavy toll on the economy;
- Privatisation of national airlines, viz. Air India and Indian Airlines is approved;
- Dotcom bubble finally bursts leading to slump in the stock markets. Introduction of divesture does not boost markets.

PART II – 2000-2001: An Overview

New Statutes

The Foreign Exchange Management Act (FEMA)

To facilitate external trade and payments, and promote the orderly development and maintenance of the foreign exchange market in India, the Foreign Exchange Management

Act (FEMA) was passed by Parliament and signed by the President on 6th January 2000 and came into effect from 1st June, 2000. The legislation repealed the Foreign Exchange Regulation Act, 1973 and many of the Draconian provisions, particularly powers of arrest and prosecution have been curtailed.

In order to facilitate the implementation of FEMA, several regulations dealing with various types of current and capital account transactions were passed which also came into effect from 1st June 2000. The primary objectives of these regulations are to facilitate and simplify various aspects of both capital and current account transactions, including investments into India, outbound investments, current account payments, etc.

The Insurance Regulatory Development Authority (IRDA) Act

In perhaps the most significant legislation to become law in recent years, the IRDA came into force on _____ 2000. The present IRDA Act has been drafted in accordance with the recommendations of the Malhotra Committee in 1994 which was set up by the Government to recommend changes and make the insurance sector in India more efficient.

The Act envisages the setting up of a statutory body i.e. the Insurance Regulatory and Development Authority (the 'Authority') consisting of a Chairperson and other members appointed by the Central Government. The Act provides the Authority with wide-sweeping powers to act as an effective watchdog and with the duty to regulate, promote and ensure the orderly growth of the insurance sector and insurance business at large.

The Act makes a number of amendments to the Insurance Act, 1938 which was hitherto the main piece of legislation in this sector. These amendments are:

Criteria for entering the insurance sector

- Any company registered in India;
- Non-resident shareholding either directly or indirectly should not exceed 26%; and
- Such an Indian company's sole objective should be to carry on:
  - (i) life insurance business;
  - (ii) general insurance business; or
  - (iii)re-insurance business.

Other than such an Indian insurance company, no other body corporate shall be permitted to begin to carry on an insurance business in India.

Capital requirement

In the case of life or general insurance, a minimum paid-up equity capital of Rs 100 crores is required. In the case of re-insurance, a minimum paid-up equity capital of Rs 200 crores is required.

Manner of divesting excess shareholding by promoters

The Act provides that no promoter shall at any time hold more than 26% of the paid-up capital in an Indian insurance company. However, in case an Indian insurance company begins the business of life insurance, general insurance or reinsurance in which the promoters have a shareholding exceeding 26% of the paid-up capital, then the promoters are required to divest the excess of this 26% in a phased manner within 10 years or within such time as may be prescribed by the Central Government. However, there are certain exceptions to this proviso.

Repatriation

The Act requires that the insurers have to maintain separate accounts relating to shareholders and policy holders. The Act further stipulates that the funds of the policy holder should be retained within the country.

Other Features

Some of the other features of the Act are:

- The insurance companies would be required to invest at least 50% of their investible funds into schemes related to social development programmes particularly in rural and unorganised sectors;
- The Authority would give priority clearance to health insurance companies;
- There is a provision for a penalty if insurance companies do not comply with the directions of the Authority. A provision has also been made for cancellation of the registration of the Company in the case of a second non-compliance;
- The Authority is planning to fix solvency margins for insurance and re-insurance brokers in order to protect the policy holders' funds. It is also proposed to bar foreign insurance agents from operating in the domestic insurance market.

Removal of Monopolies

The Act provides for withdrawal of the exclusive privileges granted to the Life Insurance Corporation of India (LIC) for carrying of the business of life insurance in India and the General Insurance Company (GIC) for carrying on the business of general insurance in India. Henceforth, GIC and LIC would be required to carry on the business of life and general insurance respectively in accordance with the Insurance Act, 1938.

The Information Technology Act, 2000

The Information Technology Act, 2000 (the Act) has been passed by Parliament and awaits the assent of the President and a notification to put it into effect as an Act. The main features of the Act are as follows:

- The Act provides that a person may authenticate an electronic record by affixing his digital signature to it. The Act grants recognition to a digital signature that has been verified by means of an asymmetric crypto system and a hash function.
- The Act grants recognition to electronic records, digital signatures, the use of electronic records and digital signatures by the Government and its agencies,

documents, records or information stored in electronic media, rules, regulations etc. published by the Government in an electronic Gazette.

- The Act grants recognition to electronic agreements and describes the parameters for attribution, acknowledgement and dispatch of such electronic contracts.
- The Act provides for the appointment of a Controller of Certifying Authorities to exercise control over the activities of certifying authorities.
- The Act empowers a Certifying Authority to issue, suspend and revoke a Digital Signature Certificate.
- The Act provides that any person who is responsible for (a) unauthorized access to a computer; (b) causes a virus to be released in a computer; or (c) causes damage to a computer, etc, would be liable to a penalty of not more than Rupees 10 lakhs.
- The Central Government is empowered by the Act to appoint an adjudicating officer, not below the rank of a Director to the Government of India, to adjudicate upon any disputes arising under the Act.
- Any person who is aggrieved by an order of the adjudicating officer under the Act may appeal to a Cyber Appellate Tribunal set up by the Central Government.
- The Act also applies offences committed inside India as well as to all offences committed outside India, provided that the offence or contravention involves a computer, computer system or network in India.

The Act has also amended the provisions of several existing Acts, such as the Indian Penal Code, the Evidence Act, etc. The Information Technology Rules, 2000 have also been passed.

The Patents (Amendment) Act, 1999

In order to fulfill the obligations undertaken by India in the TRIPS Agreements and the WTO Agreement, the Patents (Amendment) Act 1999 was made law retrospectively with effect from 1st January 1995. The Act provides inter alia:

- an application can be filed in the Patent Office claiming a substance or article itself intended for use or capable of being used as a medicine or drug;
- such applications will be taken up for examination after 31st December, 2004;
- however if such application is accompanied by an application for grant of Exclusive Marketing Rights (EMR) the Controller shall refer the application for patent to an examiner for making a report on certain terms and conditions. any one of these the Controller will refuse to grant EMR;
- According to the report the Controller may or may not grant EMR;
- EMR should not include an article or substance based on the system of Indian medicine;

- where a claim is made for an invention made in India for a substance or article itself capable or intended to be used as a medicine or drug and before filing such claim a claim is made for the method or process of manufacture after 1st January, 1995 of an identical substance or article and a patent therefore has been granted in India and the substance or article has received the approval of the authority specified by the Central Government then the applicant shall be granted EMR in relation to the substance or article;
- where an invention has been made and before filing such a claim the applicant has filed an application for the invention in a convention country after the 1st January, 1995 and a patent and the approval to sell the substance in that country has been granted for a substance or article intended or capable of being used as a medicine or drug EMR may be granted in India;
- as a consequence of the Act being made retrospective applicants who have filed applications claiming a substance or article (commonly known as black box applications) after 1st January, 1995 have become entitled to EMR under the new dispensation provided they satisfy the conditions laid down in the Act.
- the Central Government has reserved to itself the right to appoint a person other than the person to whom EMR is granted to sell or distribute the substance or article at a price to determined by an authority specified for the purpose.

Note: The Patents (Amendment) Act, 1999 though passed by Parliament has not been notified and hence is not law as yet

The Trademarks Act

The Trademarks Act, 1999 ("the Act") provides for statutory protection to trade marks in relation to 'services', besides trademarks for goods which are already protected in the existing Act. As a result of the introduction of service marks, a number of consequential changes have been incorporated in various other clauses of the Act. Apart from protection of service marks, the Act also provides for the following:

- Maintenance of a single register of Trade Marks
- Publication of an alphabetical index of classification of goods and services
- Absolute grounds for refusal of registration of the trade marks
- Relative grounds for refusal of registration
- Registration of a mark in several classes of goods or services by means of a single application
- Renewal of registration permissible for successive periods of 10 years, from the date of the original registration or the last renewal.
- Grounds of infringement increased
- That the proprietor of the earlier trade mark or other earlier right cannot contest the validity of registration of a subsequent trade mark, if he has acquiesced in the use of

the subsequent trade mark of a continuos period of five years, unless he can prove that the registration of the subsequent trade mark was not obtained in good faith.

- Unregistered permitted user not to have the right to institute proceedings for infringement
- Registration of collective trade marks
- Registration of certification trade mark to vest with the Registrar as opposed to the Central Government
- Establishment of an Intellectual Property Appellate Board

Note: The Trademarks Act, 1999 though passed by Parliament has not been notified and hence is not law as yet

Proposed Legislation

Proposed Competition Law in India

THE S.V.S. Raghavan Committee on Competition Policy and Law has recommended enactment of an Indian Competition Act, along with the setting up of a Competition Commission of India (CCI), repeal of the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 and the winding up of the MRTP Commission. The Department of Company Affairs has decided to accept the S.V.S. Raghavan Committee Report on Competition Law. The decision is also backed by the Prime Minister's Office and would be introduced in Parliament shortly. The key recommendations of the Committee are as follows:

- Establishment of an independent authority (the Competition Commission of India or "CCI") to look into and adjudicate on such matters; The CCI will be the sole recipient of all complaints against infringement of the Indian Competition Act from any source whatsoever, be it an ordinary citizen, business firm or any other entity including the Central and State Governments.
- Repeal of the MRTP Act and winding up of MRTP Commission.
- The Industrial (Development and Regulation) Act, 1951 may no longer be necessary except for location (avoidance of urban centric location) for environmental and for monuments and national heritage protection consideration etc.
- No reservation for the small-scale sector of products, which are on Open General License for imports. There should be a progressive reduction and ultimate elimination of reservation of products for the small scale industrial and handloom sectors. Cheaper credit in form of bank credit rate linked to the inflation rate should be extended to the small-scale sectors to enable them to become and be competitive.
- Government should divest its shares and assets in state monopolies and public enterprises and privatise them in all sectors other than those subservient to defense and sovereign functions.

- All state monopolies and public enterprises will be under the surveillance of the Competition Policy to prevent monopolistic, restrictive and unfair trade practices on their part.
- All foreign companies operating in India will fall within the ambit of the Competition Law and there will be universal applicability of the Competition Law whether it is a domestic company or a foreign company.
- Mergers resulting in entities with assets of Rs 500 crores in India and/or Rs. 1500 crores worldwide and groups with assets of Rs.2000 crores and/or turnover of Rs. 6000 crores in India and/or assets of $1bn and/or turnover of $3bn worldwide; must go through a pre-notification process. If no reasoned order prohibiting the merger is received within 90 days, it should be deemed approved. In adjudicating a merger, potential efficiency losses from the merger should be weighed against potential gains.
- High penalties for non-compliance of the Competition laws are being provided for. Penalties are as high as Rs. 1 crore for failures on the part of corporates to comply with the proposed Competition legislation. Failure on the part of a person liable to notify a qualifying merger could invite a fine of Rs. 2 lakhs for each day of failure. If a person who is required to furnish any document or information knowingly makes a false statement, or omits to state a fact to alter, suppress or destroy a document required to be furnished, he could be penalised to the extent of Rs. 10 lakhs.

The Convergence Bill

The group of ministers on information technology and telecom, headed by the Finance Minister Mr. Yashwant Sinha, has approved the draft Communications and Convergence Bill, 2001, which proposes to set up a super convergence regulator subsuming existing regulators such as the Telecom Regulatory Authority of India and the proposed broadcasting authority. The super regulator to be called the Communications Commission of India will be along the lines of the US Federal Communications Commission. The sole licensing authority for the information technology, broadcasting and communications sectors, it will also manage and allocate spectrum for commercial purposes. The function of the Commission would be to facilitate and regulate all aspects of telecommunication and broadcasting and other communications, including all aspects of convergence in these services and to protect consumer interests.

The Bill, if enacted, will result in the repeal of the Telecom Regulatory Authority of India (TRAI) Act, 1997, Indian Telegraph Act, 1885 and Cable Television Networks (Regulation) Act, 1995. The CCI will be a single-window clearing house for cellular mobile, basic telephony, Internet, TV, radio, audio, satellite broadcasting and other services.

Key developments in other areas

Foreign Direct Investment

- No approvals are now required for foreign direct investment (FDI) in all sectors except for a restricted list, where the total sum does not exceed Rs 600 crores (approx. US$130m), subject to sectoral caps and other specified conditions.
- Foreign investment proposals in the IT sector will be eligible for automatic investment irrespective of whether the foreign investor has an existing joint venture or technical collaboration in the country. For other sectors, if the foreign investor has a previous venture, specific approval from FIPB will be required.
- The ceiling limit for Foreign Direct Investment in Internet Service Providers (ISP's) with gateways, end to end bandwidth and radio paging segments has been raised by the Government to 74% from 49%.
- 100% Foreign Direct Investment has been permitted by the Government in voice mail and audiotext services without any restrictions in the form of licence fees or entry fees for service providers, these services have further also been permitted to be provided as a value added service by basic, cellular and cable service providers.
- 100% foreign equity in crude oil refining and e-commerce is now permitted. Foreign equity up to 100% will be permitted in e-commerce ventures provided the overseas promoters agree to divest 26% of their holding in favour of the Indian public within a period of 5 years. FDI in e-commerce will be restricted to business-to-business ventures only.
- The government has removed the multi-stage clearances necessary for foreign direct investments (FDIs) into the insurance sector. Foreign investment up to 26% has now been brought within the automatic route. The joint venture insurance companies will henceforth be required to only inform the Reserve Bank of India of the foreign equity participation.

Investments overseas

- Proposals for direct investment up to a total of US$50 million in a joint venture or wholly-owned subsidiary abroad by a public/private limited company will be entitled to automatic route approval without prior reference to RBI, subject to the company having made profits in the preceding three years and the proposal's being related to its core activity.

External Commercial Borrowings (ECBs)

The Finance Ministry has announced the External Commercial Borrowings (ECB) Policy for 2000-2001. Under this new policy the Reserve Bank of India (RBI) is empowered to approve ECBs upto $100 million. Further, the Government has decided to operationalise the automatic route for fresh ECB approvals upto $50 million and all refinancing of existing ECB's. Only ECB above $100 million would now require Government approval.

The new policy also provides that non-banking finance companies would now be eligible for ECBs subject to certain conditions. These conditions include registration with the RBI, earning profits for the last three consecutive years and 'AA' credit rating. The new policy also permits companies to raise ECBs in seven sectors, including power, telecommunications, railways, roads, ports, industrial parks and urban infrastructure. Projects in any of these sectors would qualify for ECBs up to $200 million.

Companies Act

Companies (Second Amendment) Act

The Companies Second Amendment Act, 2000 (the 'Act'). Has been passed recently. Some of the important features of the Act are:

- **Deemed public companies**: The Act removes the provision (Section 43A) regarding 'deemed public companies'.
- **Only Two Types of Companies**: After the Act there would now be only two types of Companies
  1. A Private Limited Company
  2. A Public Limited Company
- **Minimum paid-up capital**: Now private companies are required to have a paid-up capital of at least Rs 1 lakh and similarly public companies are required to have a paid up capital of Rs 5 lakhs. If companies do not have such minimum capital and do not attain it within the time allowed, their names will be struck off the register. Only non-profit making companies are exempted from this provision.
- **Equity Shares with differential Rights:** The Act has deleted Section 88 and has amended Section 86 and now companies can issue only two kinds of share capital i.e.
  1. Equity Shares
     a) with voting rights
     b) with differential rights as to dividend, voting, capital or otherwise in accordance with such rules and conditions as may be prescribed.
  2. Preference Shares.
- **Directors Responsibility Statement:** After the Act the Board' s report shall now have to include a Director's Responsibility Statement in respect of the preparation and maintenance of the annual accounts.
- **Audit Committees**: An audit committee is to be formed to consider certain matters relating to finance. If the audit committee's recommendations are not accepted by the Board then it should be communicated to the shareholders. In such a case the view of the shareholders shall be final.
- **Change of registered office by a company**: Change in registered office would require confirmation only where the registered office is shifted from the jurisdiction of one registrar to another.

- **Postal ballots**: Items that require a postal ballot should be specified in the provision itself, while detailed rules for conducting postal ballot may be notified later.

Infrastructure

Insurance

- In addition to the 26% foreign equity in the insurance joint venture company, foreign brokers will be allowed 26% in Indian joint venture insurance brokerage companies. The regulation will be brought out during the winter session of Parliament. This is against the anticipation of market forces and foreign brokers who have been lobbying for a much higher stake than the 26% allowed for foreign insurance companies.
- RBI has removed the mandatory requirement for banks to have non-performing asset levels of one percentage point below the industry average to get into the insurance sector. The revised guidelines state that the net worth of the bank should be more than Rs 500 crores and that the maximum stake a bank can hold in a joint venture will be 50%. No additional stake can be picked up by subsidiaries or associates.
- The Insurance Regulatory and Development Authority (IRDA) has already formulated a code of conduct for insurance brokers. The code of conduct formulated by IRDA covers the entire gamut of activities, including relationship with clients, sales practices duty to disclose information to clients, claims, advertising, sub-brokers and remuneration among others.

Telecom

DoT approval for wireless in local loop (WLL) services

The Department of Telecommunications (DoT) has decided to accept the Telecom Regulatory Authority of India's (TRAI) recommendations of allowing basic telecom operators to offer short-distance mobile telephone services based on WLL technology. This will bring down the cost of short-distance mobile calling to one-twentieth of current cellular rates.

Fourth cellular operators to pay two part license fee

The government has issued guidelines for bids for the fourth cellular operator, thus setting the scene for stiffer competition and leaner margins for cellular operators. The guidelines provide that the license fee for the fourth operator will have two components – first, a one-time entry fee which will be the same as the highest bid, and second the sharing of 17 percent of the operator's annual gross revenue. Successful bidders would have to pay the entry fee before signing the license agreement. The license would be issued for a period of 20 years and further extendable by 10 years. Existing operators cannot bid for a fourth license of the areas they already operate in. The total foreign equity in bidder cannot exceed 49% during the license period. Tenders for the bidding process would be floated shortly and the evaluation process would begin by April 2001.

DoT plans to bring back CPP

In a bid to provide a level playing field to the cellular operators compared to the basic operators in the wireless local loop (WLL) arena, the Department of Telecommunications (DoT) is considering bringing back the concept of "calling party pays" (CPP). Currently, a cellular subscriber has to pay for both the incoming and outgoing calls, while the basic telecom subscriber has to pay for only outgoing calls. DoT is looking at allowing CPP for the cellular subscriber as a sop in light of the fact that it is allowing the basic telecom service providers to offer limited mobile services through WLL.

Basic services thrown open

The Government allowed unlimited competition in basic telecom services with one-time entry fee upto Rs. 115 crores and revenue sharing of up to 12%. Licenses for the basic services would be issued for a period of 20 years and be extendable by another 10 years. The total foreign equity capital in the company is limited at 49%.

VSNL gets national ISP license

The Centre has permitted Videsh Sanchar Nigam Limited (VSNL) to provide Internet services across the country. The much-awaited ISP licence has been sanctioned.

The National ISP licence for VSNL is part of the compensation package the government had worked out in order to compensate VSNL for scrapping its monopoly over international long distance voice telephony in 2002 (2 years earlier than the previous 2004 deadline). In anticipation of this licence, VSNL has brought down its Internet access charges drastically. They have cut leased line tariffs by up to 75%.

VSNL to enter cellular business

VSNL has also asked the government to give it free entry into the fourth cellular operator slot as compensation for taking away its monopoly ahead of schedule. VSNL's plans to float a separate subsidiary for value added services have been put on hold till the government takes a decision on privatisation of international telephony monopoly.

The government has already announced a compensation package for VSNL which consists of a waiver from paying entry fee to enter domestic long-distance and an exemption from paying license fee for the first two years.

Civil Aviation

New Civil Aviation Policy

FDI up to 49% in domestic airlines

The civil aviation ministry has short-circuited the decision of the Group of Ministers (GoM) to allow 51% foreign investment in domestic airlines. The GoM has been forced to reverse the foreign investment limit in domestic airline companies to 49%. The current limit on FDI in domestic airlines is 40% but non-resident Indians/overseas corporate bodies (NRIs/OCBs) could own up to 100% equity. The argument of the ministry of civil aviation is that majority stake in domestic airline companies has to be held by Indians so that they can utilise India's bilateral rights to operate on overseas destinations.

Banking

New law to address cross-border insolvency

The Government has proposed to introduce a separate law with regard to cross border insolvency on the lines of the UNCITRAL model law. Cross border laws are considered necessary to ensure a free flow of capital between countries without fears of bankruptcy and unpredictability about the fate of the lender's funds in a foreign country. A cross border insolvency law has become necessary particularly with the increase in the number of cases of fraud by insolvent debtors. Many debtors are now able to easily conceal assets and transfer them to foreign jurisdictions making recoveries impossible.

New bank licensing guidelines

The Reserve Bank of India (RBI) has barred corporate houses from promoting banks in its new bank licensing guidelines. A number of large corporate groups had drawn up mega plans to enter the banking sector. Like many similar occasions in the past, this time also, RBI does not seem comfortable about letting corporate India into banking. There is however one change. The new rules will allow non-banking finance companies to convert into banks, subject to their meeting certain prudential norms. The guidelines state that RBI will issue only two to three additional licenses within the next three years. The additional licenses will include those granted to non-banking finance companies seeking conversion into banks.

Panel to look into bank frauds

RBI has appointed a high level committee to look into legal aspect of bank frauds and recommend measures for prohibiting 'alienation of assets' or, in other words, siphoning out funds by promoters. The terms of reference to this committee are to define financial fraud and lay down the procedural law to deal with financial frauds. The committee has also been asked to examine the process of investigation of bank frauds and prosecution.

Direct Tax

FIIs investing through Mauritius

On 31st March 2000, in a move that created a flutter in the markets, the Income Tax Department, Mumbai slapped a demand notice of several million rupees on 11 FIIs investing through Mauritius. The tax authorities allege that the FIIs were using Mauritius as a tax-avoidance platform, and were not eligible for benefits under the Indo-Mauritius Double Tax Avoidance Treaty (DTA) as they could not be deemed to be "resident" in Mauritius since the actual, effective management of these FIIs was not in Mauritius.

As a result of this move, the sensex fell heavily, recording the second biggest crash after the crash in 1992, causing panic in the markets. Compelled to take rapid corrective action, the Finance Ministry issued a statement on 6th April, 2000 to the effect that capital gains by FIIs, who hold a certificate of residence from the Mauritian government, would be taxed in only in Mauritius. This would ensure that all investments made by FIIs

registered in Mauritius would continue to be exempt from capital gains tax under the DTA.

Venture Capital Funds

FII status for foreign venture capital funds

Foreign venture capital investors (FVCIs) have been given status parallel to FIIs. FVCIs will enjoy the benefits of capital account convertibility and be able to play the primary markets in India on the same level as FIIs.

Tax-free status to VCFs

In the Finance Bill 2000–2001, the Finance Minister had proposed that all domestic venture capital funds (VCF) would be required to pay income tax of 20% on any income not distributed to the investors. This proposal created both disappointment and confusion. In a move that was targeted at providing a major boost to VCFs, the Finance Minister accorded VCFs with a "pass-through status", which means that VCFs will not have to pay tax on the income of such funds. The unit holders on the funds will pay tax at the time they receive anything on distribution.

Mutual Funds

Cap on MF investment up

SEBI has increased the maximum investment limit for mutual funds (MF) in listed companies from 5% of net asset value to 10% for open-ended funds. The cap on close-ended funds continues to be 10%.

MF's will not be able to invest more than 5% of their net asset value in unlisted equity shares or equity-related instruments in case of open-ended schemes and 10% for close-ended schemes.

Stock Exchanges

BSE sets Rs. 10 crores equity cap limit for companies seeking listing

The Bombay Stock Exchange (BSE) announced a threshold limit of Rs. 10 crores issued equity capital and post-issue net worth of Rs. 20 crores for new companies seeking listing on the bourse.

The BSE has also framed separate criteria for listing of high-tech companies including Internet, e-commerce, telecommunications and media. High-tech companies should have earned at least 75% of its total income from technology–related activities during the two preceding years as certified by the auditors of the company. They should have minimum paid-up equity capital of Rs. 5 crores, post-issue net worth of Rs. 20 crores and market capitalisation of Rs. 50 crores.

BSE has fixed a threshold limit of Rs. 3 crores for companies listed on other bourses and seeking listing on the BSE. Such companies should have a profit-making record for at least three years and net worth of Rs. 20 crores.

SEBI approval for derivatives trading

SEBI finally allowed derivatives trading in India. Permission was granted simultaneously to the Bombay Stock Exchange and the National Stock Exchange. SEBI has also allowed respective clearing houses and corporations involved in the trading and settlement procedures to deal in SEBI-approved derivatives contracts. Currently, derivatives are limited to index-based futures.

PART III - Highlights of the Budget

Highlights of the Economic Survey

The Economic Survey 2000-2001, announced on 23 February 2001, highlights certain aspects of the economy, and the measures intended to improve them. Some highlights are:

- The overall GDP growth rate decelerated during 2000-2001, the economy is estimated to have grown by 6% in 2000-2001, 0.6% lower than the growth rate of 6.6% in 1998-99 and 0.4% lower than the growth rate of 6.4% in 1999-2000.
- Inflation has increased in 2000, and continued to remain at high levels throughout 2000-2001. The average (52 week) inflation was 6.6 percent as on January 2001 wile it was 8.2% as on 27 January 2001.
- Exports showed a strong recovery in 2000, growing by 20.4% in April-December 2000 in US$ value.
- Foreign Direct Investment flows continued to be lower in 2000. The provisional FDI flows from April-September 2000 stood at $ 2.5 billion down from $ 3.5 billion in the corresponding period of 1998-99.
- After a decline in net agricultural output in 1999-2000 when the net agricultural growth was 0.8%, the GDP from this sector recovered and has show a marginal overall growth in 2000-2001 and is estimated to be about 0.9%.
- The growth in the services sector is expected to marginally increase from an estimated 8.2% in 1999-2000 to an estimated 8.3% in 2000-2001.
- Industrial production had grown by 5.7% during April - December 2000, 0.7% lower than the 1999-2000 growth rate of 6.4%.during the same period.

Budget 2001-2002 - Highlights

Most of the important proposals relate to direct and indirect taxation and banking reforms. The proposals under various sectors are briefly summarised.

I. Direct Taxation

- In a very significant gesture, the Finance Minister has kept his promise that the surcharges levied during the past two years were temporary measures. All surcharges on corporate and individual income tax (of 10%-15%) have been abolished except for a nominal 2% surcharge, which was specifically levied to provide for the Gujarat earthquake relief. This will reduce the effective tax rates by about 3% to 4%.
- In a move to widen the tax net, all companies have to file tax returns even if they incur a loss. Further, the 1/6 qualifying criteria for being obliged to file tax returns has been extended to all urban areas.
- In order to simplify the tax structure for salaried employees and reduce the scope for tax avoidance, the value of all perquisites will be determined on the basis of cost to employer (rather than the artificial criteria earlier applicable) except in respect of housing and cars, which would continue to have artificial criteria for simplicity's sake.
- In a boost to the IT sector, two important clarifications have been made. Firstly, profits from export of "onsite" services will be eligible for deductions like other export income. Secondly, the conditions which provided loss of benefits in case of transfer of majority ownership, have been abolished for companies in which the public is substantially interested (listed companies and government-owned companies).
- Income from domestic sales by units located in export zones, software technology parks, etc, will now be taxed (formerly 25% of such sales were exempt).
- Interest on external commercial borrowings, which were exempt in most cases, will now be taxed. Such interest may still be exempt under applicable tax treaties subject to conditions specified in the applicable treaty.
- In another welcome move, the rate of tax on distribution of dividends has been lowered from 20% to 10%, both in respect of shares and units of mutual funds.
- In a move to boost the primary markets, long-term capital gains will be exempted if invested in initial public offerings of equity shares by domestic companies.
- Few other changes have been made relating to rates of tax deduction at source, enhanced deductions for certain donations, expenses on research and development, etc.
- Tax holidays have been provided for food storage and transportation businesses along with extending tax holidays for various infrastructure projects.
- Tax holiday for five years and 30% deduction of profits for five years for enterprises engaged in the integrated business of handling, transportation and storage of food grains has been provided.

- The requirement to obtain a tax clearance certificate under Section 230A of the Income Tax Act from the assessing officer before the transfer of immovable property has been done away with.
- Development allowance for replantation, rejuvenation and modernization of tea plantations and processing facilities has been allowed.
- Depreciation rate available in respect of ships and inland water vessels has been increased to 25% for the shipping industry.
- Maximum amount of deduction available for payment of interest on housing loans for self occupied houses has been increased from Rs. 1,00,000 to Rs. 1,50,000.
- Enhancement of deduction of annual value for repairs etc. has been enhanced from 25% to 30% for persons having income from house property. However no other deductions will be allowed.
- Tax incentives allowed by way of deduction or rebate on payments of LIC premium have been extended to all insurance companies approved by the Insurance Regulatory and Development Authority (IRDA).
- Foreign telecasting channels will henceforth be taxed in India on their income computed in accordance with the provisions of the Income Tax Act, 1961.

II. Indirect Taxation

Customs (Import) Duties

- The Finance Minister has reiterated his commitment to bring customs duties down to East Asian levels and to move progressively within three years to have a maximum duty rate of 20%.
- As a first step, the surcharge of 10% on customs duties has been abolished, thus bringing the peak rate down marginally from 38.5% to 35%.
- Duties on various items have been reduced to give a boost to those sectors, particularly on textile machinery, cement, CNG kits, LNG, cinematographic cameras, uncut gems, diamonds and gold.
- Customs duties have been increased on various food-related items to protect the agricultural sector. These include wheat, rice, maize, crude and refined oils. Duties have also been increased on import of secondhand cars.
- The counterveiling duty (CVD) on imported liquor will be levied taking into account the rate of domestic excise duties. Similarly, the CVD on imported consumer products will be charged on the basis of maximum retail price rather than their imported price.
- A new manual of procedures and instructions on Central Excise and Customs is expected to be out by September 2001.

Excise Duties

- The duty structure has been further rationalised to provide for a single rate of duty of 16% on almost all items. The other rates of 8% and 24% have been largely abolished.
- Food preparations based on fruits and vegetables will be exempt from excise duty.
- Additional surcharge has been levied on cigarettes, tobacco and other products harmful to health.
- A duty of 16% has been levied on CNG. A duty of 8% less to be levied on garments sold under a registered trade name.
- In a significant policy announcement, several individual exemptions given to various products over the years, will be removed in a phased manner. For the present, a nominal duty of 4% is imposed on some items like imitation jewellery, rubber mattresses, goggles, etc, which were hitherto exempt. These levels will be brought to 16% over four years. Other exempted items will be brought within the duty net in a phased manner each year.

Service tax

- As expected, the service tax net has been widened by including specified banking and financial services, vehicle service stations, port services, broadcasting services, photographic and sound recording services, telex, telegraph and fax services, scientific and technical consulting services, convention services, services ancillary to insurance, online information and database services, service provided to leased circuit line holder, etc. Lawyers and accountants have not yet been included.

III. Investment Overseas

- Indian companies wishing to invest abroad may now invest up to US$ 50 million on an annual basis through the automatic route without being subject to the three-year profitability condition.
- Companies which have issued ADRs/GDRs, may henceforth make foreign investments up to 100% of these proceeds, up from the current ceiling of 50%.
- Companies with proven track record wishing to invest larger amounts may now get a block allocation in advance from the RBI for investments overseas.
- Indian companies that have issued ADRs/GDRs, may acquire shares of foreign companies up to an amount of US$ 100 million or an amount equivalent to ten times of their exports in a year, whichever is higher.
- Indian companies will now be permitted to list in foreign stock exchanges by sponsoring ADR/GDR issues against block shareholding. This facility would have to be offered to all categories of shareholders.

- Investments by registered partnership firms and companies providing professional services will now be permitted to make overseas investments.
- In a significant boost to ESOP schemes of foreign companies, Indian employees can now make investments abroad under an ESOP scheme in foreign-owned companies up to US$ 20,000 annually instead of US$ 10,000 in a block of 5 years.

IV. Capital Markets

- The investment limit of Foreign Institutional Investors in Indian companies through the portfolio investment route has been increased from 40% to 49%.
- In an effort to boost the primary markets, long-term capital gains from the sale of securities and units will be exempted, provided that gains from such sale are reinvested in the primary issue of shares of public companies.
- The Electronic Fund Transfer (EFT) and Real Time Gross Settlement Systems are to be put into place by RBI by June 2001.
- Clarifications are being issued by the Central Board of Direct Taxes to promote the issuance of STRIPS, zero coupon bonds, deep discount bonds.
- The Public Debt Act is proposed to be replaced by the Government Securities Act.
- A Clearing Corporation is proposed to be set up by the RBI with the State Bank of India as the chief promoter and is expected to be in place by June 2001. This is proposed to enable settlement of forex transactions. Trading of Government Securities through an order driven screen-based system is proposed to be implemented, as also is an Electronic National Dealing System which will be implemented by the RBI by June, 2001 to facilitate transparent electronic bidding.

V. Infrastructure

Telecom

- Almost all policy measures announced in the New Telecom Policy regarding basic and cellular services, national long distance, Internet services and corporatisation of the Department of Telecom Services have been implemented.
- The Convergence Bill is planned to be introduced in Parliament.
- Reintroduction of the concession of a five-year tax holiday and 30% deduction for the next five years on a retrospective basis for units commencing their operations on or before 31 March 2003. This benefit to be extended to Internet Service Providers and Broadband Networks.

Power

- The process of reforms in the State Electricity Boards (SEBs) has been initiated by the Government by building in specific provisions into the memorandums of understanding being entered into by the Central Government with the State Governments. These provisions are:
  - A time bound programme for installation of 100% metering by December 2001;
  - Energy audit at all levels;
  - A specific programme for reduction and eventual elimination of power theft;
  - Tariff determination by SERCs and compliance thereof;
  - Commercialization of distribution;
  - Restructuring of SEBs.
- Proposed introduction of the Electricity Bill, 2001 in the present session of Parliament.

Roads

- The total plan outlay for this sector has been increased by 93% to Rs. 8727 crores in 2001-02.

Ports

- Capacity in major Indian ports is expected to go up to 314 million tonnes this year and to 376 million tonnes by the end of 2001-2002, along with a substantial capacity addition in minor ports. There is now adequate capacity in all major ports.
- Corporatisation of ports has been progressing with the Ennore Port being already corporatised and the Jawaharlal Nehru Port in New Mumbai next in line for corporatisation.

Tax Concessions

- For the core sectors of infrastructure namely, roads, highways, rail system, water treatment and supply, irrigation, sanitation and solid waste management systems, a ten-year tax holiday has been granted which may be availed of during the initial twenty years.
- In case of airports, ports, inland ports and waterways, industrial parks and generation and distribution of power, which also become commercially viable only in the long run, a tax holiday of ten years is being proposed during the initial fifteen years. The period of commencement of business for power and industrial parks in order to be eligible for the tax holidays is also being extended up to 31st March 2006.

- Incomes by way of interest, dividends or long term capital gains from investments by way of long term finance or investing n the equity capital of enterprises engaged in infrastructure facility is now fully exempt.

VI. Banking and NBFC's

- Seven more Debt Recovery Tribunals are proposed to be set up in 2001-02.
- Legislation is proposed to be introduced to facilitate foreclosure and enforcement of securities in cases of default in order to enable institutions to realise their dues.
- Abolition of the Banking Services Recruitment Boards is to be done in association by the Reserve Bank of India by July 31, 2001. All future recruitments will be done by banks themselves.
- Foreign Direct Investment in NBFCs will be put on the automatic route subject to the capitalization requirement and Reserve Bank guidelines.
- The condition that 25% of the 100% foreign direct investment in Non-Banking Financial Companies (NBFCs) is to be divested in the domestic markets is removed, if foreign investors bring in a minimum of US$ 50 million.

VII. Labour and employment law

Reforms in this area, though long overdue, had been by and large ignored in earlier budgets. This time around, however, the Finance Minister has announced proposals to bring about sweeping changes to labour and employment law.

- It is proposed that the provisions of the Industrial Disputes Act relating to layoffs and retrenchment of workers requiring approval of the authorities, will now apply to industrial establishments employing not less than 1,000 workers instead of 100. The separation compensation will be increased from 15 days to 45 days for every completed year of service to discourage employers from indiscriminately firing workmen.
- It is proposed to bring an amendment to the Contract Labour (Abolition and Regulation) Act to facilitate outsourcing of activities without any restrictions as well as to offer contract appointments, while also protecting labour engaged in outsourced activities in terms of their health, safety, welfare, social security, etc.
- New scheme of group insurance is proposed to be introduced – "Ashraya Bima Yojana" – to extend security cover to organised labour force. The policy will provide compensation of up to 30% of last drawn annual pay fore a period of one year to workers who lose their jobs. The policy will initially cover all employees drawing a salary of up to Rs 10,000 per month.

VIII. Agriculture and Rural Development

- Interest rates to be charged by National Bank for Agriculture and Rural Development (NABARD) to be reduced from 11.5% to 10.5%.
- Kisan Credit Cards to be offered to all eligible farmers within the next three years. Personal insurance package to be offered by the banks to the Kisan Credit Card holders to cover them against accidental death or permanent disability upto a maximum amount of Rs. 50,000 and Rs. 25,000 respectively. The premium burden to be shared by the card issuing institutions.
- It is proposed that NABARD reduces its rate of interest for funding the storage of crops, from 10% to 8.5%.
- The condition that 25% of the 100% foreign direct investment in Non-Banking Financial Companies (NBFCs) is to be divested in the domestic markets is removed, however foreign investors will be required to bring in a minimum of US$ 50 million.
- Direct and indirect tax incentives to boost this sector as mentioned above.

IX. Miscellaneous

Petroleum

- Dismantling of the Administered Pricing Mechanism (APM) in the petroleum sector is proposed to be completed by March 2002.

Pharmaceuticals

- The government is considering lessening the present price control mechanism. Towards this end the span of price control will be reduced substantially.
- Government will however retain the power to intervene comprehensively in cases where prices behave abnormally.

X. Proposed Statutory Reforms and Amendments

- Amendments proposed in the Industrial Disputes Act, 1947. Please refer to our section on Labour and Employment Law for the proposed amendments.
- Amendments proposed in the Contract Labour (Abolition and Regulation) Act, 1970. Please refer to our section on Labour and Employment Law for the proposed amendments.
- Proposed repeal of the Sick Industrial Companies (Special Provisions) Act, 1985.
- Proposed amendment of the Companies Act so as to set up a national company law tribunal.
- Comprehensive legislation is proposed to be introduced on securitization.

- Introduction of the Electricity Bill, 2001 to accelerate reforms in the power sector and unify all existing central legislation in the sector.
- Amendments proposed in the Essential Commodities Act, 1955, so as to remove restrictions on the movement and storage of agricultural goods and to remove certain commodities from the list of essential commodities.
- Fiscal Responsibility Bill has been proposed to be introduced.
- Public Debt Act, 1944 to be replaced by the Government Securities Act.

The above is not an exhaustive list of the tax and other new proposals introduced by the Budget, but only an attempt to highlight some of the provisions that would be of particular interest to corporate investors. The summary has been prepared based on the Finance Minister's Budget speech only and is hence subject to clarifications and interpretation of some policies. It is also subject to the various proposals being finally approved and passed by the Parliament.

Should you require any clarifications, please get in touch with us.

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