INDIA

The Indian economy entered financial year 2008-09 with a buoyant growth. The average growth rate during the previous four years namely financial years 2004-05 to 2007-08 has been at close to 9%. There has been a moderation in the growth in the current year due to the fallout of the global crisis. Despite the global financial crisis which began in 2007 impacting most emerging market economies, the GDP growth rate of 7.1% in the current year makes India the second fastest growing economy in the world. The Indian Government has taken several measures in this direction and is expecting that the economy would return to the high growth trajectory.

Against this background, the major tax and regulatory reforms and developments during the last financial year taken place in India are discussed below.

TAX DEVELOPMENTS — DIRECT TAXES

India Budget 2009

India has been scheduled to have general parliamentary elections in April-May 2009. Given that the elections are scheduled after the close of the financial year ended 31March 2009, the current government presented an Interim Budget on 16 February 2009. The Interim Budget does not contain any tax proposals and it is intended that the new government would make the necessary tax proposals. The Final Budget will be presented by the newly elected Government sometime in June-July 2009.

Accordingly, there is no change in the tax rates (corporate, individuals, minimum alternate tax, fringe benefit tax, dividend distribution tax).

Tax holiday deduction to SEZ units under section 10AA of the Act

Section 10AA of the Income-tax Act, 1961 (the Act) provides a deduction from taxable profits to newly established units set up in Special Economic Zones (SEZs) which begin to manufacture or produce article or things or provide services during financial year 2005-06 or any subsequent years. The deduction is available for 15 years, provided certain conditions are satisfied.

The deduction is available with reference to the profits earned by the SEZ unit. In terms of Section 10AA of the Act, the amount of deduction is to be worked out as per the following formula:

$$\text{Profits of the SEZ unit} \times \frac{\text{Export turnover of the SEZ unit}}{\text{Total turnover of the business of the taxpayer}}$$

The total turnover of the business means the entire turnover of the business of the taxpayer from the SEZ unit as well as from other businesses of the taxpayer. Therefore, the taxpayer who has units in both SEZ and Domestic Tariff Areas would be eligible for a proportionate deduction (in the ratio of the export turnover to the total turnover) and accordingly would be unable to claim a deduction on the entire profits earned out of the units located in the SEZ. This results in a discriminatory treatment to such taxpayers vis-à-vis taxpayers who have just one SEZ undertaking.

With a view to settle this anomaly, the Finance Minister, in his reply to the questions on the Interim Budget 2009-10 in Lok Sabha (Indian Parliament), has mentioned that *"it has now decided to remove this anomaly through necessary changes in the Act"*. As such, an amendment in the law with such effect is expected.

TAX DEVELOPMENTS — INDIRECT TAXES

On 7 December 2008, the Indian Government unveiled a INR307 billion fiscal stimulus package aimed at boosting consumption and attempting to restore the growth momentum by rationalising various duty levies. The following are the highlights.

Customs duty

On imports

1. Countervailing Duty ("CVD") on specified goods required for setting up of a crude petroleum refinery has been reduced from 14% to 10% to 8%.
2. CVD on all goods required for the renovation or modernisation of a power generation plant (other than a captive power generation plant) has been reduced from 14% to 8%.
3. CVD on goods required for fertiliser projects, coal mining projects, power generation projects including gas turbine power projects and power transmission, sub-transmission or distribution projects imported under the Project Imports Scheme has been reduced from 14% to 10%.

On exports

1. Export duty has been removed on iron ore fines falling under a specified Chapter Heading 11 of the Export Tariff.
2. Duty rate on exports of iron ores and concentrates of all sorts has been reduced from 15% to 5%.

Excise duty

CENVAT (Excise) — The Central Government reduced the existing CENVAT rates by 4% across the board on all major excisable products, except petroleum products.

1. The three major CENVAT rates of 14%, 12% and 8% have been reduced by 4% points each. The revised rates are now 10%, 8% and 4% respectively.
2. For textile articles the existing rate of 4% has been reduced to nil.
3. Abatement percentage has been reduced across the board for products valued on maximum retail price-based valuation.
4. 10% ethanol blended petrol is exempted from Special Additional Excise Duty and additional duty of excise.
5. Motor spirit intended for use in ethanol blended petrol falling under (CETH 27.10) is exempted from duty leviable under the First and Second schedules to the Central Excise Tariff Act, 1985.

Service tax

1. The rate of service tax has been reduced from 12% to 10% with effective from 24 February 2009.
2. The Indian Government has issued Notification No.9/09 to postulate that SEZ units can claim refund of service tax on all taxable services specified in the Finance Act, provided that the list of such services has been approved by the approval committee.
3. The Central Board of Excise and Customs has issued two important circulars:
   (1) one in the context of export of services, clarifying that the phrase "used outside India" means that the benefit of the services should accrue outside India; and
   (2) the other clarifying that there would be no service tax on builders despite collection of advances for the sale of apartments.

RECENT LEGISLATIVE CHANGES CONCERNING TAX TREATIES

During the last year, the Indian Government has signed a Double Taxation Avoidance Agreement with:

1. Government of Tajikistan, Agreement dated 20 November 2008;
2. Government of Myanmar, Agreement dated 2 April 2008; and
3. Government of the Grand Duchy of Luxembourg, Agreement dated 2 June 2008.

REGULATORY DEVELOPMENTS — COMPANIES BILL 2008

The Government placed the Companies Bill 2008 (the Bill) before the Indian Parliament on 23 October 2008. The Bill, proposing significant changes to the existing provisions of the Companies Act 1956 (the Companies Act) dealing with mergers and acquisitions (M&A) and corporate restructuring, will impact all multi national entities in their inbound/outbound structuring deals.

Merger of small companies

A new provision regarding merger or amalgamation of two or more small companies or between a holding and its wholly-owned subsidiary company has been introduced in the Bill. The provision enables fast track and cost efficient merger of small companies with minimum compliance formalities.

A "small company" is defined to mean a private company whose paid-up share capital does not exceed an amount to be notified (not exceeding INR50 million) or whose turnover does not exceed an amount to be notified (not exceeding INR200 million).

Cross-border mergers

Currently, cross-border mergers are permitted only if the transferee company is an Indian company. Hence, merger of an Indian company with a foreign company (with the foreign company being the transferee) is prohibited. However, cross-border mergers (both ways) seem to be possible under the proposed Bill with those countries as may be notified from time to time by the Central Government. It appears that an Indian company registered under the proposed Companies Act can alone be a party to cross border mergers. The consideration to the shareholders of the merging company may be discharged by issue of shares, payment of cash, or issue of Indian Depository Receipts, or a combination of these.

A foreign company is defined to mean any company or body corporate incorporated outside India which has a place of business in India. The term “foreign company” is not defined under the existing Companies Act. This new definition would restrict mergers of foreign companies which do not have a place of business in India with Indian companies. This is unlike the existing Companies Act based on which various foreign companies (e.g. Mauritius-based companies) could merge into Indian companies.

Merger/Demerger of listed company with unlisted company

Currently, merger/demerger of listed transferor company into unlisted transferee company generally means listing of the unlisted company. Under the provisions of the Bill, it appears that, where the listed transferor company merges/demerges into the unlisted transferee company, such transferee company shall continue as an unlisted company with payment of cash to the shareholders of the listed transferor company who decide to opt out of the unlisted transferee company. There is no specific provision under the existing Companies Act that deals with these matters. Further, in cases of demerger, the Tribunal can order the listed transferor company to become unlisted and the Bill even provides for payment of cash to the public shareholders who decide to opt out of the listed demerged company.

Written consent vis-à-vis voting

The Bill provides that written intimation consent for the merger/demerger should be received from the persons to whom notice of the meeting is sent. The consent should be received within one month from the date of receipt of such notice.

Currently, at the meeting held for the approval of merger/demerger, voting for any arrangement is permitted only in person, and voting by postal ballot is not allowed. The Bill provides for voting by postal ballot as an alternative to voting in person.

However, there seems to be conflict between these as on one side, consent in writing is required and on the other side, voting at a meeting or through postal ballot is also required. These provisions need to be harmonised.

Multiple buy-back offers

Currently, there is a cap on buy-back of equity shares at 25% of the total paid-up equity capital in any financial year. Also, the quantum of funds that can be employed in each buy-back cannot exceed 25% of the total paid-up capital and free reserves in each buy-back. Under the current provisions, a company can execute multiple buy-back trenches in the same financial year, provided that the total number of equity shares bought-back does not exceed 25% of the total paid-up equity capital.

However, as per the provisions of the Bill, no buy-back offer can be made for a period of one year from the date of the preceding offer for buy-back.

Shares with differential voting rights

The provisions of the existing Companies Act provide for issue of shares with differential voting rights. This section provides flexibility to companies to give voting and dividend rights vis-à-vis specialised funding. Currently, even some listed companies have come up with rights issue of shares with differential voting rights. However, the Bill does not provide for such issue of shares with differential voting rights.

Further issue of shares — Share valuation

The Bill provides that any further issue of shares other than rights issues or those issued under employee stock options is to be made at a price determined by the registered valuer.

Prohibition on issue of shares at discount

The provisions of the existing Companies Act provides that a company can issue shares at a discount of not exceeding 10% of the face value of the share, provided that such issue is approved by the shareholders in a general meeting through a resolution and approved by the Central Government. Under special circumstances, approval of the Central Government for a discount exceeding 10% of face value can be obtained. In the Bill, issue of shares at a discount, except for issue of sweat equity shares, is prohibited.

Redeemable preference shares

As per the provisions of the Bill, a company, if so authorised by its articles, can issue preference shares which are redeemable within 20 years. Further, companies can issue preference shares redeemable beyond 20 years for prescribed infrastructure projects.

Preference shares which are unable to be redeemed by the companies gets fresh lease of life. The Bill provides that companies which are unable to redeem preference shares or pay dividend on preference shares may issue further redeemable preference shares for amounts equal to the amount due with the consent of the 3/4th of such preference shares in value and with the approval of the Tribunal. Tribunal shall order the redemption of preference shares held by shareholders dissenting to further issue of share. On such issuance, the unredeemed preference shares shall be deemed to be redeemed.

Minority squeeze-out

At present, minority squeeze-out is provided under section 395 of the existing Companies Act. The Bill replicates this provision through section 206.

An additional provision (section 207) in the Bill provides that if pursuant to an amalgamation, share exchange, conversion of securities or for any reason, an acquirer acquires more than 90% of the issued share capital of the transferor company, then it can give notice to the remaining minority shareholders of its intention to acquire the remaining shares at a price determined based on valuation by a registered valuer. However, the acquirer will not be able to enforce such a transfer as provided under section 206 and the minority shareholders may negotiate with the acquirer for a higher price.

On the whole, the Bill contains some progressive measures which could give a fillip to the corporate restructuring and M&A activities in India.

Limited liability partnership

The Limited Liability Partnership Act, 2008 (the LLP Act) has come into force with effect from 9 January 2009. The LLP Act seeks to include provisions for the formation and regulation of limited liability partnerships and matters connected therein or incidental therewith.

We believe that the LLP Act would foster the growth of the service sector by providing a platform to small and medium enterprises and professional firms to conduct their business/profession efficiently.

Employees provident fund

The Ministry of Labour and Empowerment of India came out with the Employees Provident Fund (Third Amendment) Scheme, 2008 on 1 October 2008 extending the application of the provisions of the Employees' Provident Fund Scheme and Employees Pension Scheme to international workers. Under the said scheme, a new category of covered employees, International Worker (IW), has been introduced. IW has been defined as:

1. An Indian employee who has worked/or going to work in a foreign country with which India has a social security agreement (SSA) on reciprocal basis, and the employee is an eligible employee under the SSA.
2. An employee, other than an Indian employee, holding other than an Indian passport and working for an establishment in India to which the Provident Fund Act applies.

The definition of the term "excluded employee" has been amended in relation to IW to mean a person who is contributing to a social security programme of his/her country of origin, either as a citizen or as a resident, with which India has entered into a SSA on reciprocal basis.

Under the provisions of the scheme, IW who is employed to do any work in relation to any establishment in India (unless he/she is covered in the category of excluded employee), would be required to be a member and contribute to the fund. The employer would have to make a matching contribution. Contribution by IWs and their employers will be on full salary without any ceiling. Eligible IWs have to enrol with effect from 1 November 2008.

Employers would be required to file a consolidated return with respect to IWs on the commencement of the Scheme and to file monthly returns.

Payment of benefits to employees from countries with which India has entered into a SSA will be governed by such SSAs.

However, since none of the SSAs so far entered into by India (with Belgium, Germany and France) have been notified, IWs from these countries will have to enrol themselves in the scheme, and such IWs and their employers will have to contribute to provident and pension funds.