FOREIGN COLLABORATION & INVESTMENTS IN INDIA

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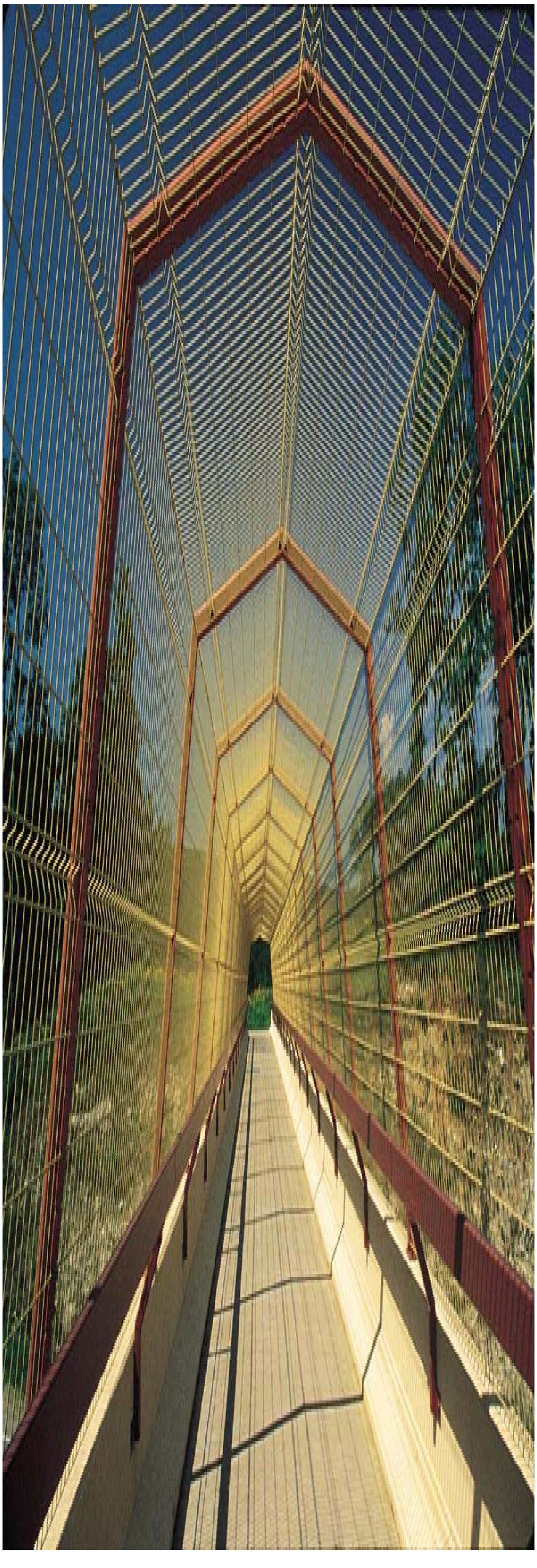

Way to Global Destination INDIA

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Contents

Chapter -1 INDIA - AN OVERVIEW

Location	:	Northern hemisphere, latitudes 8 deg. 4' and 37 deg. 6' north, longitudes 68 deg. 7' and 97 deg. 25' east
Land area	:	7th Largest nation total: 3,287,590 sq km land: 2,973,190 sq km ; water: 314,400 sq km
Climate	:	Winter (Jan-Feb), Summer (March-May), Rains (June-Sep) (Post-monsoon, Oct-Dec).
Time	:	IST is 5½ hrs ahead of GMT
Population	:	1,095,351,995 (July 2006 est.). Over One Billion 2nd most populous nation
Life Expectancy	:	Total population: 64.71 years: male: 63.9 years : female: 65.57 years (2006 est.)
Literacy Rate	:	Definition: age 15 and over can read and write total population: 59.5% male: 70.2% female: 48.3% (2003 est.)
Maritime Claim	:	Contiguous zone: 24 nm , Continental shelf: 200 nm or to the edge of the continental margin, Exclusive economic zone: 200 nm Territorial sea: 12 nm
State Religion	:	There is no state religion - Secular State
Religion Pie	:	Hindu (83%); Muslim (11%); Christian (2%); Buddhist (1%); Jain (1%)
Political Set Up	:	Parliamentary Democracy
Fundamental Rights	:	Guaranteed by Constitution
Union of India	:	28 Federal States and 7 Union Territory
Parliament	:	Two Houses - Lok Sabha (Lower House) & Rajya Sabha (Upper House)
Head of State	:	President
Head of Govt.	:	Prime Minister
Language	:	Official Language is Hindi, but English continues to be used for all official purposes and widely spoken.

Governments view on Foreign Investment

Indian government keeps very positive attitude towards the Foreign Investment, due to which India is going through lot of liberalization and is one the best choice of Foreign Investors. Indian government is committed towards economic development of the country and for which Foreign Investment is required.

At present in India the Government is of UPA and Congress Party is the lead Party in UPA lead by Dr. Manmohan Singh as Prime Minister. India is a democratic country and whichever government may be in power, there will be no looking back on Foreign Investment Policies.

Projected Indian Potential Growth

It is expected that India would touch more than GDP of 6% in next few tears.

Chapter -2 INDUSTRIAL POLICY

2.01 Historical Background

Soon after India attained Independence in August, 1947, enunciations of principles for industrial development were made by the Government in its Industrial Policy Resolution in 1948. This resolution envisaged a progressively dominant role for the State in the country's industrial development, within the context of planned development of the Indian economy. These policies sought to accelerate the rate of economic growth, develop basic industries and lay down a sound economic foundation, thereby increasing employment opportunities and improving the standard of living and the working conditions of the masses. The policy also sought to reduce the disparities in income and prevent the concentration of economic power. The new Government reposes faith in industrial growth and has further undertaken to reduce bottlenecks of any kind and set up committees to minimize bureaucratic hurdles.

2.02 Industrial Policy

The Industrial Policy, 1991, announced by the Government of India on 25th July, 1991, liberalized the laws regulating domestic industry and took measures to promote foreign investment with a view to make Indian economy more dynamic and to provide free business environment. The new policy aims at encouraging domestic as well as international entrepreneurs to invest in business activities, increase competition and establish a free market-oriented economic system. Private sector can now enter all industrial and manufacturing activities; industrial licensing has been done away with for all industries except a few strategically sensitive areas such as defence, atomic energy, etc., irrespective of the level of investment. Approval for direct foreign investment is granted upto 51% foreign equity in high priority industries. Some of the salient features of the Industrial Policy of 1991 are as follows:

- Abolition of industrial licensing in all but sixteen industries.
- Dilution of the provisions of the MRTP Act.
- Opening up of the general core and basic industries to the private sector.
- Oil and natural gas sector open for foreign investment and sophisticated technology.
- No investment limit for large Indian/Foreign companies.
- Investment limit in small scale sector Rs. 60 lakhs (US$ 142, 86,000)
- Automatic approval for foreign investment upto 50 per cent in the mining sector.
- Private participation has been invited in leasing of port equipment operation and maintenance of container terminals, cargo landing terminals, creating warehouse and storage facilities, transportation within ports, setting up of the private berths by coast based industries, ship repairs and maintenance.
- Without prior approval, foreign investors can now own upto 24 per cent equity in any Indian firm and upto 20 per cent in a new private bank.
- Automatic permission will be given by Reserve Bank of India (RBI) for foreign technology agreements in high priority industries up to a lump sum payment of Rs.1 crore (US$ 238,000), 5% royalty for domestic sales and 8% for exports subject to total payment of 8% of sales over a 10 year period from date of agreement or 7 years from the

commencement of production. The prescribed royalty rates of taxes and will be calculated according to standard procedures.

2.03 Policy on Small Scale Industries

Small scale industries were given special treatment under Indian law. This began with the Industrial Policy Resolution of 1956, which emphasized the need for developing small and village industries to the maximum extent possible. The Small Industries Development Organization (SIDO) has been given the task of implementing the Government's policies. Many incentives have been created in the form of financial assistance, purchases, marketing facilities, assistance for exporting and tax exemptions. Small-scale industries need not be registered with the Director-General of Technical Development to avail of various concessions.

A list of items has been reserved for the exclusive manufacture by small scale industries. These include specified items in various areas, including the areas of food, textiles, chemicals, machine tools and automobile parts.

The investment limit for small scale undertakings is Rs. 6 lakhs (US$ 1 4,286) and in the case of ancillary undertakings is Rs. 7.5 lakhs (US$ 17,857) in plant and machinery excluding the value of moulds, jigs, tools, etc. Value of factory building and furniture is also excluded. Exemption from licensing provisions is also provided, subject to the condition that such an undertaking shall not be a subsidiary of or owned or controlled by any other undertaking. Small scale units which undertake to export at least 30 per cent of annual production by the third year are permitted to step up their investment in plant and machinery to Rs. 7.5 lakhs (US$ 17,857).

Large houses are restricted to an equity holding of 26 per cent in small scale industries.

The total number of small scale industries in India in 1997-98 was 30.14 lakh compared to 28.57 lakh in 1996-97. The production of small scale units in 1997-98 was worth 4, 65,171 crore. The volume of employment in small scale sector as of end-March 1998 was 167.2 lakh. Exports from the SSI sector account for about 35% of India's total exports. In 1997-98, SSI exports was valued at Rs.43,946 crore which was an increase of 12% over 1996-97.

The Union Budget, 1998-99 announced de-reservation of farm implements and tools from the list of items reserved exclusively for manufacture by the small scale sector, with the objective of offering a wider range of farm tools and implements at competitive prices and requisite after sales services to the farmers. Subsequently, six items (crowbars, levelers, mowers, reapers – upto 5 HP motive power, seed drills—upto 5 HP motive power) have been de-reserved. Three other items (sole leather, Kattari and bun-war leather and picking band leather) and electronic toys have also been removed from the purview of reservation.

2.04 Salient Features of The Monopolies and Restrictive Trade Practices (Amendment) Act, 1991

The salient features of the Amendment Act are as under:

(i) The Monopolies And Restrictive Trade Practices (Amendment) Act, 1991 (MRTP Act) has been restructured and pre-entry restrictions have been removed with regard to prior approval of the Government for establishment of a new undertaking, expansion amalgamation, merger, takeovers and appointment of Directors in certain circumstances as also registration of undertaking, under Sections 20 to 26 of Part-A of Chapter-III of MRTP Act.

(ii) In Chapter-III, Sections 27, 27A and 27B of the Act, relating to concentration of economic power have been retained to enable the Government to direct division of an undertaking and severance of interconnection between undertaking, if it is of the opinion that the working of an undertaking is prejudicial to the public interest, or has led, or is leading or is likely to lead to the adoption of any monopolistic or restrictive trade practices. Since the concept of MRTP undertaking is being removed, these provisions will now be applicable to all undertakings. At present, the Government can make a reference to the MRTP Commission under these provisions. As per the Amendment Act, the Commission may make an enquiry suo moto or on complaint of trade association or consumer or a registered consumer's association or any State Government.

(iii) The provision of Chapter III A (Section 30-A to 30-G) regarding restrictions on acquisition or transfer of shares have been transferred as Sections 108-A to 108-I of the Companies Act, 1956. These provisions will apply in cases where the acquirer or transferor is a dominant undertaking, as defined under the MRTP Act.

(iv) Additional powers have been given to the MRTP Commission to require the Director-General of the MRTP Commission to make a preliminary investigation of companies of all types involving monopolistic, restrictive or unfair trade practices. Similarly, the Director- General of MRTP Commission has been empowered to make an application to the Commission regarding monopolistic trade practices.

(v) Penal punishment has been provided under Sections 48C and 50 of MRTP Act for contravention of the orders passed by the MRTP Commission and the Central Government. At the same time, a new Section 53A has been incorporated empowering the MRTP Commission to compound offences relating to contravention of orders passed by the MRTP Commission either before or after launching prosecution proceedings.

(vi) The definition of "goods" has been enlarged to include issue of shares before allotment. The scope of the definition of "service" also covers chit fund and real estate.

(vii) The definition of “unfair trade practice" under Section 36 A of the MRTP Act has been enlarged and includes false representation in respect of quantity of goods also. It is now not necessary to establish loss or injury to the consumer.

(viii) Section 55 of the MRTP Act has been amended to provide for appeal before the Supreme Court against temporary injunction granted by the Commission under Section 12-A of the MRTP Act.

Competition Act, 2002

The Competition Act, 2002 differs in many respects from the MRTP Act, 1969 and seeks to replace MRTP Act 1991 and is in transition phase and the changes are taking place. Once the transition takes place then all the aforementioned propositions will be governed by the propositions of The Competition Act, 2002.

2.05 Delicensing

Guidelines for Industrial Licence Applications received for the industries falling outside Compulsory Licensing but involving Locational Angle:-

Under the new Industrial Policy, industrial licensing is compulsory only for 18 specified categories of industries. This exemption from licensing is, however, subject to certain locational restrictions as clarified in para 4(a) of Press Note No. 9 (1991 Series) issued by the Department. As per that Press Note, the proposed project should not be located within 25km from the periphery of the standard urban area limits of a city having a population of more than 1 million (23 cities listed in the above mentioned Press Note) according to 1991 census. However, if the industrial units were to be located in an area designated as an 'Industrial area' by the concerned State Government before July 25, 1991, this restriction on location will not apply. Industrial units other than electronics, computer software or printing which are to be located outside such a designated 'industrial area' and within the 25km limit mentioned above will require an industrial licence even if they are otherwise delicensed.

In accordance with the above policy on location, applications are being received for grant of industrial licences from industries for relaxation of locational angle. It is notified for guidance and information of all prospective entrepreneurs that capacity is not a constraint in consideration of industrial licence applications received for delicensed industries due to locational restrictions as mentioned in para 1 above. It is only the environmental safety, land use, urban planning and related factors that are kept in view while considering the industrial licence applications received for such industries. The concerned Administrative Ministries/Departments have been advised to keep in mind these guidelines while examining the applications received for delicensed industries for issue of letters of intent.

2.06 Privatization

In the Industrial Policy, 1991, the Government announced its intention to divest itself of a percentage of its equity in the public sector. Section 39D (iii) states, "In order to raise resources and encourage wider participation, a part of the Government's shareholding in the public sector would be offered to mutual funds, financial institutions, general public and workers." This percentage was later set at 20 per cent. In November 1991, the Government identified 40 Public Sector Undertakings (PSUs) for disinvestment up to 20 per cent. Further the Government has privatized banking, telecommunication, power and air transportation.

- The national mineral policy was revised and mines and mineral development set to be amended.
- The national telecom policy, allows private provisions of basic telecom services.
- The New Air Corporation Act, 1994 enables private Air Taxi Companies to operate as regular domestic airlines.

Chapter -3 HOW FOREIGN COMPANIES CAN ENTER INDIA

A foreign company can enter into India through following vehicles

1. Liaison Office/Representative Office
2. Branch Office
3. Project Office
4. Site Office
5. Joint Ventures; or
6. Wholly Owned Subsidiaries

3.01 Liaison Office

There are quite a few foreign companies who want to first study the Indian markets and obtain relevant information before they expand their operations in India. Some foreign companies establish a liaison office as an intermediate step before entering into a Joint Venture (JV) or setting up a Wholly Owned Subsidiary (WOS). The establishment of liaison offices is governed by the Reserve Bank of India (RBI). By its very nature, a liaison office in India can act only as a communicative channel for the parent company to supply information on the Indian market and customers, and cannot carry on any business activities in India. As a result, the liaison office cannot generate any revenue in India and all the expenses of running and maintenance of the Indian office are required to be met out of the foreign exchange remitted from abroad.

'Liaison Office' means a place of business to act as a channel of communication between the Principal place of business or Head Office by whatever name called and entities in India but which does not undertake any commercial /trading/ industrial activity, directly or indirectly, and maintains itself out of inward remittances received from abroad through normal banking channel;

Permitted activities for a Liaison Office in India

i) Representing in India the parent company/group companies.
ii) Promoting export import from/to India.
iii) Promoting technical/financial collaborations between parent/group companies and companies in India.
iv) Acting as a communication channel between the parent company and Indian companies.

Procedure to Set up a Liaison Office in India.
Foreign companies intending to set up a liaison office in India for undertaking liaison activities on behalf of the parent company or foreign trading companies intending to set up liaison offices in India for promotion of exports from India should submit their application in Form FNC 1 to the Central office of RBI, Mumbai (Foreign Investment Division). In approved cases, permission is granted initially for a period of 3 years. However, application for renewal of application should be made to the concerned regional office of the RBI under whose jurisdiction the office is situated.

Form FNC 1

1. The application should be completed in quadruplicate and submitted to the Chief General Manager, Exchange Control Department (Foreign Investment Division), RBI, Central office, Mumbai - 400 023.

2. English version of the certificate of incorporation / registration attested by Indian Embassy / Notary public in the country of registration.

3. Latest balance sheet of the Applicant Company / firm.

4. Certified photo-copy of the agency Agreement, if any, with parties in India.

5. Photo-copy of the Agreement / draft- Agreement / correspondence indicating the terms of appointment of the proposed representative duly authenticated by the applicant.

6. Where applicable, certified photocopy of Government of India's approval for undertaking projects in India.

7. Where applicable, certified photocopy of the contract / Agreement for undertaking activities / rendering services.

Conditions Imposed While Granting Permission

The conditions precedents for setting a liaison office in India are as follows:

1. No commission / fee will be charged or any other remuneration received by the Indian office of the foreign company for its liaison activities in India.

2. Except the liaison work, the office will not undertake any activity of a trading, commercial or industrial nature without the prior permission of RBI

3. The entire expenses of the Indian office will be met exclusively by remittance from abroad through normal banking channels.

Zero Tax Liability

Since a liaison office is not allowed to earn any income, there is no tax liability of a liaison office or its parent company for this representative office.

Maintenance of Bank Accounts

A liaison office in India is permitted to maintain and operate bank accounts in India but only with authorized dealers. Following are the documents required for opening such account:

1. Account opening Form duly completed and signed by all authorized signatories.
2. Complete address and telephone number filled in account opening Form.
3. Account opening Form duly introduced (name, account No. and signature of the introducer).
4. Specimen signature (s) on the signature card by all authorized signatories.
5. One photograph of each authorized signatory.
6. Board resolution authorizing opening of account (duly attested by Notary / Banker).

7. Copy of the Government approval for setting up of a liaison office / branch office in India or RBI approval to carry on activity in India.
8. Memorandum and Articles of Association (duly certified as true copy).
9. If the Memorandum and Articles of Association is in any other language other than English, a copy of Memorandum and Articles of Association duly translated in English and Notarized.
10. List of Directors along with their photographs.
11. Copy of Power of Attorney vesting authority to operate the account in case of liaison / branch office (duly Notarized).
12. Copies of passport of the signatories

3.02 Branch Office

Branch Office in relation to a company means

1. any establishment described as a branch by the company: or
2. any establishment carrying on either the same or substantially the same activity as that carried on by the head office of the company: or
3. Any establishment engaged in the production processing or manufacture; but does not include any establishment specified in any order made by the Central Government.

Permitted activities for a branch in India of a person resident outside India

i) Export/Import of goods
ii) Rendering professional or consultancy services.
iii) Carrying out research work, in which the parent company is engaged.
iv) Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
v) Representing the parent company in India and acting as buying/selling agent in India.
vi) Rendering services in Information Technology and development of software in India.
vii) Rendering technical support to the products supplied by parent/group companies.
viii) Foreign airline/shipping company.

Restrictions on operations of the Branch Office

The RBI usually imposes the following conditions while granting permission to establish a Branch Office:

- The Branch Office would not expand its activities or undertake any new trading, commercial or industrial activity other than that is expressly approved by the RBI
- The entire expenses of the Branch Office in India will be met either out of the funds received from abroad through normal banking channels or through income generated by it in India
- The Branch Office will not accept any deposits in India;

- The commission earned by the Branch Office from parties abroad for any agency business will be repatriated to India through normal banking channels.

Repatriation of profits

A Branch Office can remit the profits (net of any withholding tax) generated out of its operations in India on production of the prescribed documents and on establishing that it has earned a net profit by undertaking the permitted activities. The Branch Office need not retain any profits as reserves in India

3.03 Project Office

'Project Office' means a place of business to represent the interests of the foreign company executing a project in India but excludes a Liaison Office;

The procedure for opening such an office is to apply to the RBI with details of the project to be executed and the details of the project office to be set up. RBI will accord approvals specific to the project. The project office cannot operate after the completion of the specified project.

3.04 Site Office

'Site Office' means a sub-office of the Project Office established at the site of a project but does not include a Liaison Office

3.05 Joint Venture / 100% Subsidiary

A foreign company can also form a Joint Venture with any existing Indian company or it can set up its 100% owned subsidiary subject to Law, Procedure and guidelines and foreign investment policy of India as mentioned in this book in further chapters.

Chapter -4 TYPES OF COMPANIES IN INDIA

4.01 Incorporation, procedure, requirements & time Involved

In India a company can be incorporated either as a Private Limited or Public Limited. The incorporation procedure all over India is same. One has to submit to the Registrar of Companies (ROC) along with the application for incorporation, the Memorandum and Articles of Association in addition to other necessary prescribed documents.

The Articles of Association contains the rules and regulations of the company for the management of its affairs. After examining the documents the Registrar of Companies approves the name of the company and thereafter issues a Certificate of Incorporation. Thereafter a private company becomes entitled to commence its business and a public company after obtaining the certificate of commencement of business from ROC.

The procedure for incorporating a company in India is as under

Once the documents have been prepared, vetted, stamped and signed, they must be filed with the Registrar of Companies for incorporating the Company. The following documents must be filed in this connection: -

1. The MA & AA
2. An agreement, if any, which the company proposes to enter into with any individual for appointment as its managing director or whole-time director or manager.
3. A statutory declaration in Form 1 by an advocate, attorney or pleader entitled to appear before the High Court or a company secretary or Chartered Accountant in whole - time practice in India who is engaged in the formation of the company or by a person who is named as a director or manager or secretary of the company that the requirements of the Companies Act have been complied with in respect of the registration of the company and matters precedent and incidental thereto.
4. In addition to the above, in case of a public company, the following documents must also be filed: -
    1. Written consent of directors in Form 29 to agree to act as directors
    2. The complete address of the registered office of the company in Form 18
    3. Details of the directors, managing director and manager of the company in Form 32.

Certificate of Incorporation

Once all the above documents have been filed and they are found to be in order, the Registrar of Companies will issue Certificate of Incorporation of the Company. This document is the birth certificate of the company and is proof of the existence of the company.

4.02 Comparison of Private and Public Company

	PRIVATE COMPANY	PUBLIC COMPANY
Governing Acts	Companies Act, 1956	Companies Act, 1956 SEBI Act, 1992 and allied laws.
Incorporation Time	2 to 3 weeks	2 to 3 weeks
Definition	Which is by its article restricts: Numbers of members 50 Transfer of shares Invitation of public to subscribe its debenture, shares etc. Acceptance of deposits from person other than its shareholders and directors	Which is not * private
Minimum No. of Subscribers	2 (Two)	7 (Seven)
Maximum No. of shareholders	50 (Fifty)	No limit
Minimum Paid up Capital	INR 1,00,000/-	INR 5,00,000/-
Transferability of Shares	Restricted	Freely. If company is listed then through stock exchange(s)
Public Reporting	Registrar of Companies (ROC)	Registrar of Companies (ROC), Regional Director, Central Government, SEBI & Stock Exchange, if the company is listed.
Statuary Meeting	No	Yes, (not earlier than one month and not later than six month from the date of commencement of business). Once in life time.
Annual General Meeting	Yes (with in six month from closing of accounting Year) i.e. before 30th September of that year	Yes (with in six month from closing of accounting Year) i.e. before 30th September of that year

Extraordinary General Meeting	Any time	Any time
Board Meeting	4 (Once in each quarter)	4 (Once in each quarter)
Buy Back of shares	Yes	Yes, If company is listed then Guideline of SEBI is applicable
Minimum No. of Directors	2 (two)	3 (three)
Whether a Foreigner can be Director	Yes	Yes
Whole Time Director/ Managing Director: Appointment	Appointment not compulsory and No restriction on appointment	Appointment not compulsory If paid up capital < Rs. 5 crores Appointment Compulsory If paid up capital => Rs.5 crores
Whole Time Director/ Managing Director: Remuneration	No restriction	As per schedule XIII, otherwise permission of Central Government.
Whether a Foreigner can be Managing Director / WTD	Yes	With the approval of Central Government
Loan to Director etc.	Yes	With the previous approval of Central Government
Contracts with Director etc.	Yes	With the consent of Board, If paid up capital of the company is One Crore or more, approval of Central Govt. is necessary
Loan, Investment & Guarantee by the company	No restriction	With some restriction

4.03 Board and Shareholders meeting

	Statutory Meeting	Annual General Meeting	Extra Ordinary General Meeting	Board Meetings
When Held	Within a period of not less than one month nor more than six months from the date at which the Company is entitled to commence business	Every year	As and when either requisitioned by the members, or by the board.	Whenever requisitioned by the directors but at least four in every year.
Frequency	Once in the life time of the Company	Each year & not more than fifteen months shall elapse between the date of one annual general meeting of a company and that of the next.	As and when either requisitioned by the members, or by the board	At least once in every three months and at least four such meetings shall be held in every year
Place	Registered office of the Company	Either at the registered office of the Company or at some other place within the city, town or village in which the registered office of the Company is situated	Any where	Any place as decided by the Directors. It can be outside India as well.
Time	During Business Hours	During Business Hours	During Business Hours	Any time
Notice of Meeting	21days Clear notice	21days Clear notice	21days Clear notice	No specific time

Chapter – 5 FOREIGN DIRECT INVESTMENTS

5.01 I. List of Activities or items for which Foreign Direct Investment is prohibited.

i. Retail trading (except Single Brand Product retailing)
ii. Atomic energy
iii. Lottery business
iv. Gambling and Betting

II. All Activities / Sectors would require prior Government approval for FDI in the following circumstances:

i. where provisions of Press Note 1 (2005 Series) are attracted;
ii. where more than 24% foreign equity is proposed to be inducted for manufacture of items reserved for the Small Scale sector.

5.02 In the following sectors/activities, FDI upto the limit indicated below is allowed subject to other conditions as indicated. In Sectors /Activities not listed below, FDI is permitted up to 100% on the automatic route subject to sectoral rules / regulations applicable.

5.03

Sl.	Sector	FDI Cap/ Equity	Description of Activity / Items / Conditions
1	Airports		
A	Greenfield projects	100%	Subject to sectoral regulations notified by Ministry of Civil Aviation www.civilaviation.nic.in
B	Existing projects	100%	Subject to regulations notified by Ministry of Civil Aviation www.civilaviation.nic.in
2	. Insurance	26%	FDI upto 26% in the Insurance sector is allowed on the automatic route subject to obtaining licence from Insurance Regulatory & Development Authority(IRDA)
3.	Telecommunications	49 %	i) In basic, Cellular, Value Added Services, and Global Mobile Personal Communications by Satellite, FDI is limited to 49% subject to licencing and security requirements and adherence by the companies (who are investing and the companies in which the investment is being made) to the license conditions for foreign equity cap and lock-in period for transfer and addition of equity and other license provisions. ii) ISPs with gateways, radio paging and end-to-end bandwidth, FDI is permitted upto74% with FDI, beyond 49% requiring Government approval. These services would be subject to licensing and security requirements iii) No equity cap is applicable to manufacturing activities. iv) FDI upto 100% is allowed for the following activities in the telecom sector: a) ISPs not providing gateways (both for satellite and submarine cables)

			b) Infrastructure Providers providing dark fibre (IP Category 1) c) Electronic Mail, and d) Voice Mail The above would be subject to the following conditions; a) FDI upto 100% is allowed subject to the condition that such companies would divest 26% of their equity in favour of Indian public in 5 years, if these companies are listed in other parts of the world. b) The above services would be subject to licencing and security requirements, wherever required. c) Proposal for FDI beyond 49% shall be considered by FIPB on case to case basis.
4.	Petroleum Refining (Private Sector) Petroleum Product Marketing Petroleum product pipelines	100% 100% 100 %	FDI permitted upto 100 % in case of private Indian companies. Subject to the existing sectoral policy and regulatory framework in the oil marketing sector Subject to Govt. policy and regulations
5.	Housing and Real Estate	100 %	Only NRIs are allowed to invest upto 100 % in the areas listed below : a) Development of serviced plots and construction of built-up residential premises b) Investment in real estate covering construction of residential and commercial premises including business centres and offices c) Development of townships d) City and regional level urban infrastructure facilities, including both roads and bridges e) Investment in manufacture of building materials f) Investment in participatory ventures in (a) to (e) above g) Investment in Housing finance institutions which is also opened to FDI as an NBFC
6.	Coal & Lignite		i) Private Indian companies setting up or operating power projects as well as coal and lignite mines for captive consumption are allowed FDI upto 100%. ii) 100% FDI is allowed for setting up coal processing plants subject to the condition that the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing. iii) FDI upto 74% is allowed for exploration or mining of coal or lignite for captive consumption. iv) In all the above cases, FDI is allowed upto 50% under the automatic route subject to the condition that such investment shall not exceed 49%of the equity of a PSU.

7.	Venture Capital Fund (VCF) and Venture Capital Company (VCC)		Offshore Venture Capital Funds/ companies are allowed to invest in domestic venture capital undertaking as well as other companies through the automatic route, subject only to SEBI regulations and sector specific caps on FDI.
8.	Trading		Trading is permitted under automatic route with FDI upto 51% provided it is primarily export activities, and the undertaking is an export house/ trading house / super trading house/ star trading house. However, under the FIPB route: (i) 100% FDI is permitted in case of trading companies for the following activities: a) exports; b) bulk imports with export/ ex-bonded warehouse sales; c) cash and carry wholesale trading; d) Other import of goods or services provided at least 75% is for procurement and sale of the same group and not for third party use or onward transfer/ distribution/sales. ii) The following kinds of trading are also permitted , subject to provisions of Exim Policy. a) Companies for providing after sales services(that is not trading per se) b) Domestic trading of products of JVs is permitted at the wholesale level for such trading companies who wish to market manufactured products on behalf of their Joint ventures in which they have equity participation in India c) Trading of hi-tech items/ items requiring specialised after sales service d) Trading of items for social sector e) Trading of hi-tech, medical and diagnostic items. f) Trading of items sourced from the small scale sector under which, based on technology provided and laid down quality specifications, a company can market that item under its brand name g) Domestic sourcing of products for exports h) Test marketing of such items for which a company has approval for manufacture provided such test marketing facility will be for a period of two years, and investment in setting up manufacturing facilities commences simultaneously with test marketing. i) FDI upto 100% permitted for e-commerce activities subject to the condition that such companies would divest 26% of their equity in favour of the Indian public in five years, if these companies are listed in other parts of the world. Such companies would engage only in business to business (B2B) e-commerce and not in retail trading.
9.	Power	100%	FDI allowed upto 100 % in respect of projects relating to electricity generation, transmission and distribution, other than atomic reactor power plants. There is no limit on the project cost and quantum of foreign direct investment.
10	. Drugs & Pharmaceuticals	100 %	FDI permitted upto 100 % for manufacture of drugs and pharmaceuticals provided the activity does not attract compulsory licensing or involve use of recombinant DNA

			technology and specific cell/tissue targeted formulations. FDI proposals for the manufacture of licensable drugs and pharmaceuticals and bulk drugs produced by recombinant DNA technology and specific cell/tissue targeted formulations will require prior Govt. approval.
11.	Road and highways, Ports and harbours	100%	In projects for construction and maintenance of roads, highways, vehicular bridges, toll roads, vehicular tunnels, ports and harbours.
12.	Hotel & Tourism	100 %	The term hotels include restaurants, beach resorts and other tourist complexes providing accommodation and/ or catering and food facilities to tourists. Tourism related industry include travel agencies, tour operating agencies and tourist transport operating agencies, units providing facilities for cultural, adventure and wild life experience to tourists, surface, air and water transport facilities to tourists, leisure, entertainment, amusement, sports and health units for tourists and Convention/Seminar units and organisations. For foreign technology agreements, automatic approval is granted if (i) Upto 3% of the capital cost of the project is proposed to be paid for technical and consultancy services including fees for architects, design, supervision, etc. (ii) Upto 3% of the net turnover is payable for franchising and marketing/publicity support fee, and Upto 10% of gross operating profit is payable for management fee, including incentive fee.
13.	Mining	74 % 100 %	(i) For exploration and mining of diamonds and precious stones FDI is allowed upto 74 % under automatic route (ii) For exploration and mining of gold and silver and minerals other than diamonds and precious stones, metallurgy and processing FDI is allowed upto 100 % under automatic route (iii) Press Note 18 (1998 series) dated 14/12/98 would not be applicable for setting up 100 % owned subsidiaries in so far as the mining sector is concerned, subject to a declaration from the applicant that he has no existing joint venture for the same area and/or the particular mineral.
14.	Advertising	100 %	Advertising Sector FDI upto 100 % allowed on the automatic route
15.	Films	100 %	Film Sector (Film production, exhibition and distribution including related services/products) FDI upto 100 % allowed on the automatic route with no entry-level condition
16.	Airports	74 %	Govt approval required beyond 74 %
17.	Mass Rapid	100 %	FDI upto 100% is permitted on the automatic route in mass

	Transport Systems		rapid transport system in all metros including associated real estate development
18.	Pollution Control & Management	100 %	In both manufacture of pollution control equipment and consultancy for integration of pollution control systems is permitted on the automatic route
19.	Special Economic Zones	100 %	All manufacturing activities except (i) Arms and ammunition , Explosives and allied items Of defence equipments, Defence aircrafts and warships, (ii) Atomic substances, Narcotics and Psychotropic Substances and hazardous Chemicals, (iii) Distillation and brewing of Alcoholic drinks and (iv) Cigarette/cigars and manufactured tobacco substitutes.
20.	Any other Sector/Activity (if not included in Annexure A)	100 %	

5.04 Industries for which industrial licensing is compulsory under Industries (Development & Regulation) Act, 1951

1. Distillation and brewing of alcoholic drinks.
2. Cigars and cigarettes of tobacco and manufactured tobacco substitutes.
3. Electronic Aerospace and defence equipment: all types.
4. Industrial explosives including detonating fuses, safety fuses, gun powder, nitrocellulose and matches.
5. Hazardous chemicals.
    a. Hydrocyanic acid and its derivatives
    b. Phosgene and its derivatives
    c. Isocyanates and di-isocyanates of hydrocarbon, not elsewhere specified (example: Methyl Isocyanate)
6. Drugs and Pharmaceuticals (according to modified Drug Policy issued in September, 1994 and subsequently amended in February, 1999)

Chapter – 6 FOREIGN COLLABORATIONS & DIRECT INVESTMENTS

There are two types of foreign collaborations:

a) Financial collaboration (foreign equity participation) where foreign equity alone is involved:

b) Technical collaboration (technology transfer) involving licensing of technology by the foreign collaborator on due compensation. -

There are two approving authorities

1) Reserve Bank of India, and

2) Department of Industrial Development in the Ministry of Industry, Government of India.

6.01 Government Policy

The Government of India's policy on foreign private investment is based mainly on the approach adopted in 1949. The basic policy is to welcome foreign private investment on a selective basis in areas advantageous to the Indian economy. The conditions under which foreign capital is welcome are as follows:

a) All undertakings (Indian or foreign) have to conform to the general requirements of the Government's Industrial Policy.

b) Foreign enterprises are to be treated at par with their Indian counterparts.

c) Foreign enterprises would have the freedom to remit profits and repatriate capital, subject to foreign exchange considerations.

The Industrial Policy 1991, is based on the view that while freeing Indian Industry from official controls, opportunities for promoting foreign investments in India should also be fully exploited. It is felt that foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports.

6.02 Liberalization – Transition from FERA to FEMA

Government of India has taken a commendable step towards liberalization by introducing Foreign Exchange Management Act, 1999 (FEMA), which has replaced Foreign Exchange Regulation Act, 1973 (FERA). While the FERA was a law, which sought to 'control' Foreign Exchange transactions, FEMA seeks to 'regulate' the same.

The draconian regulations under FERA related to unbridled powers of Enforcement Directorate. These powers enabled Enforcement Directorate to arrest any person, search any premises, seize documents and start proceedings against any person for contravention of FERA or for preparations of contravention of FERA. The contravention under FERA was treated as criminal offence and the burden of proof was on the guilty.

FEMA has reduced the rigors of exchange control by removing / diluting these provisions. The contravention has been treated as civil offence. Primarily, for an offence, the accused cannot be arrested. He can be arrested only for non-payment of the penalty imposed for contravention. Specific provision has been made by fixing a time limit of twenty-four hours for bringing the arrested person before the Adjudicating Authority. Similarly, in respect of appeals filed before the Appellate Tribunal, a period of 180 days has been stipulated for final disposal of the appeals. No such time limit was laid down under FERA. The powers of Enforcement Directorate have been substantially reduced and new provisions for Adjudicating Authority and Compounding of cases have been introduced.

Convertibility

Now under section 5, all current account transactions are permitted under FEMA. RBI/govt of India may regulate certain payments by issuing notifications / circulars. If there is a current account payment on which no notification has been issued, prima facie, it is permitted. This is an important, positive change in the approach.

Indian Rupee is now partly convertible. It is convertible on "current" account and non-convertible on "capital" account.

This partial convertibility was brought in August 1994 by RBI circulars. RBI informed the International Monetary Fund (IMF) that India has adopted article VIII. Status under the IMF regulations. This was followed up by circular No. 18 dated 19th August, 1994. Now the concept has been introduced in the Act itself by defining the terms "capital account transaction" and "current account transaction", and by providing for convertibility in Section 5.

The concept of current vs. capital account is different under FEMA from the concept in accounts and income-tax. Under accounts a machine purchased by a factory would be considered a capital account transaction. It would be a fixed asset lasting for more than the year of purchase. If that machine were imported, under FEMA, it would become a current account transaction. Import of goods (any goods), and payment of the import price completes the transaction. There is no carry forward. If the machinery was imported on credit and liability was created, then it would be a capital account transaction under FEMA.

6.03 Areas of Foreign Collaboration

The Government of India issues from time to time a list of industries indicating where foreign investments may be permitted. The lists so issued are illustrative only (refer chapter 5). The Government of India (Foreign Investment Promotion Board) also considers import of technology in Industries listed in Annexure A & Annexure B of Schedule 1 of Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000 subject to compliance with the provisions of the Industrial Policy and Procedures as notified by Secretariat for Industrial Assistance (SIA) in the Ministry of Commerce and Industry, Govt. of India, from time to time

6.04 Protection of Minority Interests

Even though now the foreign equity participation in majority is allowed freely, yet in cases where the foreign partner is not desirous of having a majority holding, there are a number of provisions of Indian law which protect the minority interest of foreign partner, as laid down under the Indian Companies Act, 1956.

(i) Though the Board of Directors of a company, as its governing body, is entitled to exercise all the powers of the company, the Act stipulates several exceptions to this rule. These exceptions relate to important matters in respect of which the Board has to act subject to the approval of the general meeting of the shareholders and of the Central Government. These matters include appointment of a Managing Director, loans to Directors, disposing of the whole or substantially the whole of the undertaking, borrowing monies in excess of paid up capital and free reserves, or contribution to political/charitable funds. Then there are certain powers that cannot be exercised by the Board and can only be exercised by shareholders in general meetings. These include: (a) alteration of share capital, (b) change in the articles, (c) cancellation of shares, and (d) removal of a Director.

Apart from these and several other powers statutorily provided to be exercised by the shareholders in the general meeting, the Articles may specify other powers to be exercised by the shareholders in the general meeting. Thus, even if the minority shareholders have no representation on the Board, it is not as though they will have no protection at all.

(ii) Minority participation does not necessarily mean that Indian majority participation can monopolies all the Directorships. Section 265 of the Companies Act, provides the right to proportional representation on the Board. Apart from this provision under section 255 of the Act, Directors upto one third of their total number can be Directors who need not retire by rotation. In financial cum technical agreements it is not unusual to provide therefore, that the foreign collaborators will have a right to nominate, appoint or remove one or two Directors who shall not be liable to retire by rotation. These provisions ensure representation of foreign collaborators on the Board and enable them to participate in the management of the company's affairs.

(iii) The Articles normally provide decisions by majority vote of Directors at Board Meetings. However, in certain cases it is required by the Companies Act that Board resolution must be passed unanimously. This includes the case of investment in shares of other companies. Apart from such statutory provision, there is no bar in the Act to the Articles providing that decisions in certain specified matters will be taken by two-third or three-fourth majority only of the Board. To safeguard the interest of the Foreign Collaborators it can be provided in the Articles that decision on matters affecting their interest can be taken only with the concurrence of their nominee Director, on the Board.

(iv) For special Resolutions three-fourth majority vote of the share-holders is necessary and required in most of the matters that vitally affect the affairs of the company. A special resolution is required for example, to alter the Articles of the Company, to reduce share capital, to make loans to companies under the same management, etc. thus providing a very effective protection to minority shareholders holding 26 per cent or more of the equity capital.

(v) Sections 397, 398, 408, and 409 of the Act provide protection and relief to minority shareholders in cases of oppression and mismanagement of the affairs of the company. These provisions afford comfort to foreign minority interest holders in Indian Companies.

Only some of the important provisions of the Companies Act of interest to foreign collaborators with regard to protection of the minority shareholders' interest are discussed above. There are besides, host of other provisions of the Companies Act, such as full disclosure in the prospectus, the annual statements, right to receive copies of documents & information and auditors and their duties, appointments and removal, etc. which protect the interest of minority shareholders.

The Government has decided to re-codify the Indian Companies Act, in view of the liberalized industrial policy.

6.05 Technical Collaboration

The Industrial Policy, 1991, also provides that equity collaboration need not necessarily be accompanied with technical collaborations. The salient features of the Policy relating to Foreign Technology Agreements are outlined below:

Paragraph 39C - Foreign Technology Agreements.

I. Standard Conditions Attached to Approvals for Foreign Investment & Technology Agreements

1. The total non-resident shareholding in the undertaking should not exceed the percentage(s) specified in the approval letter.

2. (a) The royalty will be calculated on the basis of the net ex-factory sales price of the product, exclusive of excise duties, minus the cost of the standard bought-out components and the landed cost of imported components, irrespective of the source of procurement, including ocean freight, insurance, customs duties, etc. The payment of royalty will be restricted to the licensed capacity plus 25% in excess thereof for such items requiring industrial licence or on such capacity as specified in the approval letter. This restriction will not apply to items not requiring industrial licence. In case of production in excess of this quantum, prior approval of Government would have to be obtained regarding the terms of payment of royalty in respect of such excess production.

   (b) The royalty would not be payable beyond the period of the agreement if the orders had not been executed during the period of agreement. However, where the orders themselves took a long time to execute or were executed after the period of agreement, then in such cases the royalty for an order booked during the period of agreement would be payable only after a Chartered Accountant certifies that the orders in fact were firmly booked and execution began during the period of agreement and the technical assistance was available on a continuing basis even after the period of agreement.

   (c) No minimum guaranteed royalty would be allowed.

3. The lumpsum shall be paid in three instalments as detailed below, unless otherwise stipulated in the approval letter:-

    (i) First 1/3rd after the approval for collaboration proposal is obtained from Reserve Bank of India and collaboration agreement is filed with the Authorised Dealer in Foreign Exchange.

    (ii) Second 1/3rd on delivery of know-how documentation.

    (iii) Third and final 1/3rd on commencement of commercial production, or four years after the proposal is approved by Reserve Bank of India and agreement is filed with the Authorized Dealer in Foreign Exchange, whichever is earlier.

    The lumpsum can be paid in more than three instalments, subject to completion of the activities as specified above.

4. All remittances to the foreign collaborator shall be made as per the exchange rates prevailing on the date of remittance.

5. The applications for remittances may be made to the Authorised Dealer in Form A2 with the undernoted documents:-

    (a) A "No Objection" certificate issued by the Income-tax authorities in the standard form or a copy of the certificate issued by the designated bank regarding the payment of tax where the tax has been paid at a flat rate of 30% to the designated bank.

    (b) A certificate from the Chartered Accountant in Form TCK/TCR (depending upon the purpose of payment).

    (c) A declaration by the applicant to the effect that the proposed remittance is strictly in accordance with the terms and conditions of the collaboration approved by RBI/Government.

6. The agreement shall be subject to Indian Laws.

7. A copy of the foreign investment and technology transfer agreement signed by both the parties may be furnished to the following authorities:-

    (a) Administrative Ministry/Department.

    (b) Department of Scientific and Industrial Research, New Delhi.

    (c) Concerned Regional Officer of Exchange Control Department, RBI.

    (d) Authorised Dealer designated to service the agreement.

8. All payments under the foreign investment and technology transfer agreement including rupee payments (if any) to be made in connection with the

engagement/deputation of foreign technical personnel such as passage fare, living expenses, etc. of foreign technicians, would be liable for the levy of cess under the Research and Development Cess Act, 1986 and the Indian Company while making such payments should pay the cess prescribed under the Act.

9. A return (in duplicate) in Form TCD should be submitted to Regional Office of the Reserve Bank of India in the first fortnight of January each year.

II. Hiring of Foreign Technicians:

No permission is necessary for hiring of foreign technicians and no application need be made to Government for this purpose irrespective of whether the hiring of foreign technician is under an approved collaboration agreement or not. As regards release of foreign exchange either against blanket permits or in free foreign exchange, the Reserve Bank of India/Authorised Dealers may be approached, as per RBI guidelines.

III. Deputation of Indian Personnel for Training Abroad:

For deputing Indian personnel for training and other purposes abroad, the entrepreneur may approach only the RBI/Authorised Dealers as per RBI guidelines.

IV. Foreign Testing of Indigenous Raw Materials And Products And Indigenously Developed Technology:

Entrepreneurs may approach RBI/Authorised Dealers for authorising payments either against blanket permits or in free foreign exchange, as per RBI guidelines.

V. Classification System

Entrepreneurs may note that the description of article(s) to be manufactured should be stated according to the Indian Trade Classification System.

Copies of the Indian Trade Classification (based on Harmonised Commodity Description and Coding System), published by the Ministry of Commerce, Directorate General of Commercial Intelligence and Statistics, Calcutta, can be obtained on payment from the Controller of Publications, 1, Civil Lines, New Delhi-110054 or from any of the agents authorised to sell Government of India Publications.

6.06 Procedure for Setting Up Collaboration

Proposals for foreign investment and technical collaborations would require Government approval as per the Government Policy and Foreign Exchange Laws in force. However, with the Industrial Policy, 1991 and the subsequent amendments to laws regulating foreign collaborations and industry, this procedure has been simplified. With the enactment of FEMA foreign collaborations and investments have become further easy.

Clearance for the foreign collaboration proposal under MRTP is also now unnecessary and approval is no longer needed for hiring foreign technicians in India.

Foreign companies can directly submit applications for foreign collaboration approvals in their own name without tying with an Indian party or forming a company. In such cases, a letter will be issued to foreign companies conveying approval "in principle". The approval will later be transferred to a company incorporated in India by the foreign company.

6.07 Approval of Collaboration Proposals

Approval for Foreign Collaboration / Joint Venture

At present in India most of the Foreign Collaboration or Joint Venture do not require any approval prior approval from Government of India. However any Joint Venture or Foreign Collaboration where the Foreign Equity Participation exceeds the prescribed limit allowed for automatic route would require prior approval as per the provisions of FEMA and Government Investment Policy.

Approval for Foreign Technology Agreements

The Government now provides for automatic approval most of the technology agreements as subject to FEMA. Applications for automatic approval must be made to the Reserve Bank of India (RBI) and must clearly state the description of the goods to be manufactured in the Indian Trade Classification System. After RBI approval, the entrepreneurs may approach authorized dealers for foreign exchange release along with a copy of the technology agreement. All other proposals must comply with general procedures in force.

In order to give Indian industries more freedom in negotiating foreign technology agreements, the government no longer requires the companies to obtain approval for the hiring of foreign technicians and foreign testing of indigenously developed technologies.

6.08 Foreign Investment Policy

Changes have been made in the foreign investment policy to create a more favourable fiscal environment for foreign collaborations and investment in virtually every sector of the economy except those selected industries reserved for the public sector. The obstacles that once stood in the way of foreign collaborations are becoming things of the past. The procedures for approval from the Government are being constantly simplified to make investments more attractive and beneficial.

FDI policy is reviewed on an ongoing basis and measures for its further liberalization are taken. Change in sectoral policy/sectoral equity cap is notified from time to time through Press Notes by the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion. Policy announcement by SIA are subsequently notified by RBI under FEMA. All Press Notes are available at the website of Department of Industrial Policy & Promotion.

FDI allowed in without prior clearance of RBI

The RBI has allowed Indian corporates to accept FDI under the 'automatic approval" route without its prior clearance. Companies will only have to report their issue of shares to foreign investors by filing the documents concerned with RBI within a month. The RBI has further dispensed with the need for prior approval under such proposals. Indian companies have been given general permission to accept investments under this scheme as per policy guidelines laid down by the Government of India.

6.09 Foreign Investment Promotion Board (FIPB)

The Foreign Investment Promotion Board (FIPB) has been constituted by the Government with a view to promote and attract foreign investment in India. The FIPB is a high powered committee comprising the Principal Secretary to the Prime Minister (Chairman), Finance Secretary and Commerce Secretary, and is located at the Ministry of Industry.

The FIPB is empowered to consider proposals for investment in India which do not fall within the parameters of the existing policy.

The functions of the Board include:

(a) Expeditious clearance of proposals;

(b) Establishment of contacts with and inviting select international companies for investment in the country in appropriate ventures and to periodically review the implementation of the projects cleared;

(c) The Board's programmes of investment include a variety of activities such as marketing, designing and export promotion, energy conservation, technology upgradation and modernisation, infrastructure development, better utilisation of raw materials and natural resources and substantial increase in employment.

The Indian Government has allowed foreign investment in the areas of transport, communications, electronics, energy, oil and gas exploration, chemicals, fertilizers, biotechnology, telecommunication, civil aviation, industrial, agricultural and electrical machinery.

Application for Approval

Prescribed application [FORM FC (SIA)] for approval of such foreign investment proposals setting out relevant details, is to be submitted in a form without payment of any fee to the Foreign Investment Promotion Board, Secretariat for Industrial Assistance, Ministry of Industry, Udyog Bhavan, New Delhi. Applications are also received by all Indian missions abroad and forwarded to the SIA(secretariat for industrial assistance) for further processing. Approvals are normally available within 4 to 6 weeks of filing the application.

Changing role of FIPB

The Government is keen to gradually reduce the quantum of projects being referred to the FIPB and instead ensure that the bulk of foreign investment proposals are approved automatically by the RBI. The aim is to bring only selected large or sensitive projects for clearance to the FIPB. The role of FIPB is being altered from merely issuing clearances to carrying out policy reviews and promotion.

The effort now being made is to ensure firstly, that proposals already in the pipeline are quickly cleared and secondly that step should be taken to attract investment in selected thrust areas of the economy. The FIPB may thus become a more proactive institution in terms of trying to seek out foreign investment rather than just approving projects.

6.10 Amendments to the Companies Act, 1956 , in 2000

Section 108A to 108H, were originally introduced in the Companies Act, 1956, (hereinafter referred to as 'The Act') by the Amendment Act of 1974 to regulate the acquisition and transfer of shares of a body corporate owning any undertaking to which the provisions of Part A of Chapter III of the MRTP Act apply. They were intended to prevent the acquisition or takeover of companies leading to further concentration of economic power.

The provisions of sections 108A to 108H of the Act were omitted and incorporated in Chapter III-A (Sections 30A to 30G) of MRTP Act, 1969 by the MRTP (Amendment) Act, 1984, as recommended by Sachar Committee.

An ordinance was promulgated on 27th September, 1991 to further amend the MRTP Act, 1969 and the Companies Act, 1956. The ordinance was replaced by the MRTP (Amendment) Act, 1991. The MRTP Act has been restructured and the concept of MRTP undertakings has been removed by another Section 20 to 26 of Part A of Chapter III. The provisions of Chapter III-A (Section 30A to 30G) have been re-transferred to the Companies Act as Section 108 A to 108 1 of the Act. These provisions apply where the acquirer or transferor of shares is (or would be) the owner of dominant undertaking, as defined in Section 21 (d) of the MRTP Act, 1969, or as a result of acquisition of shares, the dominance of the acquirer increases, vide Section 108G of the Act.

Restriction On Acquisition Of Certain Shares

108 A. (1) Except with the previous approval of the Central Government, no individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management, shall jointly or severally acquire or agree to acquire, whether in his or its own name or in the name of any other person, any equity shares in a public company, or a private company which is a subsidiary of a public company, if the total nominal value of the equity shares intended to be so acquired exceeds, or would, together with the total nominal value of any equity-shares already held in the company by such individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management exceed twenty-five per cent of the paid-up equity share capital of such company.

(2) Where any individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management (hereinafter in this Act referred to as the acquirer), is prohibited, by sub-section (1),

from acquiring or agreeing to acquire except with the previous approval of the Central Government, any share of a public company or a private company which is a subsidiary of a public company; or

(a) company in which not less than fifty-one per cent of the share capital is held by the Central Government or

(b) corporation (not being a company) established by or under any Central Act; or

(c) financial institution;

shall transfer or agree to transfer any share to such acquirer unless such acquirer has obtained the previous approval of the Central Government for the acquisition, or agreement for the acquisition, of such share.

Restriction On Transfer Of Shares

108B. (1) Every body corporate or bodies corporate under the same management, holding, whether singly or in the aggregate, ten percent or more of the nominal value of the subscribed equity share capital of any other company, shall, before transferring one or more of such shares, give to the Central Government an intimation of its or their proposal to transfer such share, and every such intimation shall include a statement as to the particulars of the share proposed to be transferred, the name and address of the person to whom the share is proposed to be transferred, the share holding, if any, of the proposed transferee in the concerned company and such other particulars as may be prescribed.

(2) Where, on receipt of an intimation given under sub-section (1) or otherwise, the Central Government is satisfied that as a result of such transfer, a change in the composition of the Board of Directors of the company is likely to take place and that such change would be prejudicial to the interests of the company or to the public interest, it may, by order, direct that-

(a) no such share shall be transferred to the proposed transferee:
Provided that no such order shall preclude the body corporate or bodies corporate from intimating, in accordance with the provisions of sub-section (1), to the Central Government its or their proposal to transfer the share to any other person, or

(b) where such share is held in a company engaged in any industry specified in Schedule XV, such share shall be transferred to the Central Government or to such corporation owned or controlled by that Government as may be specified in the direction.

(3) Where a direction is made by the Central Government under clause(b) of sub-section (2), the share referred to in such direction shall stand transferred to the Central Government or to the corporation specified therein, and the Central Government or the specified corporation, as the

case may be, shall pay, in cash, to the body corporate or bodies corporate from which such share stands transferred, an amount equal to the market value of such share, within the time specified in sub-section(4).

Explanation - In this sub-section, "market value" means in the case of a share which is quoted on any recognised stock exchange, the value quoted at such stock exchange on the date immediately preceding the date on which the direction is made, and, in any other case, such value as may be mutually agreed upon between the holder of the share and the Central Government or the, specified corporation, as the case may be, or in the absence of such agreement, as may be determined by the court.

(4) The market value referred to in sub-section (3) shall be given forthwith, where there is no dispute as to such value or where such value has been mutually agreed upon, but where there is a dispute as to the market value, such value as is estimated by the Central Government or the corporation, as the case may be, shall be given forthwith and the balance, if any, shall be given within thirty days from the date when the market value is determined by the court.

(5) If the Central Government does not make any direction under sub-section (2) within sixty days from the date of receipt by it of the intimation given under sub-section (1) the provisions contained in sub-section (2) with regard to the transfer of such share shall not apply.

Restriction on the transfer of shares of Foreign Companies

108C. No body corporate, or bodies corporate under the same management, which holds, or hold in the aggregate ten per cent or more of the nominal value of the equity share capital of a foreign company, having an established place of business in India, shall transfer any share in such foreign company to any citizen of India or any body corporate incorporated in India except with the previous approval of the Central Government and such previous approval shall not be refused unless the Central Government is of opinion that such transfer would be prejudicial to the public interest.

Power of central government to direct companies not to give effect to the transfer

108D. (1) Where the Central Government is satisfied that as a result of the transfer of any share or block of shares of a company, a change in the controlling interest of the company is likely to take place and that such change would be prejudicial to the interests of the company or to the public interest, that Government may direct the company not to give effect to the transfer of any share or block of shares and—

(a) where the transfer of such share or block of shares has already been registered, not to permit the transferee or any nominee or proxy of the transferee, to exercise any voting or other rights attached to such share or block of shares; and

(b) where the transfer of such share or block of shares has not registered, not to permit any nominee or proxy of the transferor to exercise any voting or other rights attached to such share or block of shares.

(2) Where any direction is given by the Central Government under sub-section (1) the share or the block of shares referred to therein shall stand retransferred to the person from whom it was acquired and thereupon the amount paid by the transferee for the acquisition of such share or block of shares shall be refunded to him by the person to whom such share or block of shares stands or stand re-transferred.

(3) If the refund referred to in sub-section (2) is not made within the period of thirty days from the date of the direction referred to in sub-section (1), the Central Government shall, on the application of the person entitled to get the refund, direct, by order, the refund of such amount and such order may be enforced as if it were a decree made by a civil court.

(4) The person to who m any share or block of shares stands or stand retransferred under sub-section(2) shall, on making refund under sub-section (2) or sub-section (3) be eligible to exercise voting or other rights attached to such share or block of shares.

Time within which refusal to be communicated

108 E. Every request made to the Central Government for according its approval to the proposal for the acquisition of any share referred to in section 108 A or the transfer of any share referred to in section 108 C shall be presumed to have been granted unless, within a period of sixty days from the date of receipt of such request, the Central Government communicates to the person by whom the request was made, that the approval prayed for cannot be granted.

Nothing in Sections 108A to 108D to apply to the Government Companies, etc.

108F. Nothing contained in section 108 A [Except sub-section (2) thereof] shall apply to the transfer of any share to, and nothing in section 108 D or section 108 C shall apply to the transfer of any share by—

(a) any company in which not less than fifty-one per cent of the share capital is held by the Central Government;
(b) any corporation (not being a company) established by or under the Central Act;
(c) any financial institution.

Applicability of the Provisions of Sections 108 A To 108 F

108G. The provisions of sections 108 A to 108 F (both inclusive) shall apply to the acquisition or transfer of shares or share capital by, or to, an individual, firm, group, constituent of a group, body corporate, or bodies corporate under the same management, who or which -

(a) is, in case of acquisition of shares or share capital, the owner in relation to a dominant undertaking and there would be, as a result of such acquisition, any increase-

(i) in the production, supply, distribution or control of any goods that are produced, supplied, distributed or controlled in India or any substantial part thereof by that dominant undertaking, or

(ii) in the provision or control of any services that are rendered in India or any substantial part thereof by that dominant undertaking, or

(b) would be, as a result of such acquisition or transfer of shares or share capital, the owner of a dominant undertaking; or

(c) is, in case of transfer of shares or share capital, the owner in relation to a dominant undertaking; or

Construction of Certain Expressions Used In Sections 108A to 108G

108H. The expressions "group," "same management", 'financial institution", "dominant undertaking" and "owner" used in sections 108A to 108G (both inclusive), shall have the meanings respectively assigned to them in the Monopolies and Restrictive Trade Practices Act, 1969.

Penalty for Acquisition or Transfer of Share in Contravention of Sections 108A to 108D

108I.(1) Any person who acquires any share in contravention of the provision of section 108A shall be punishable with imprisonment for a term which may extend to three years or with fine which may, extend to five thousand rupees, or with both.

(2) (a) Every body corporate which makes any transfer of shares without giving any intimation as required by section 108B, shall be punishable with fine which may extend to five thousand rupees.

(b) Where any contravention of the provisions of section 108 B, has been made by a company, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to five thousand rupees, or with both.

(3) (a) Every body corporate which makes any transfer of shares in contravention of the provisions of section 108C, shall be punishable with fine which may extend to five thousand rupees.

(b) Where any contravention of the provisions of section 108C has been made by a company, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to five thousand rupees or with both.

(4) (a) Every person who transfers any share in contravention of any order made by the Central Government under section 108B, or gives effect to any transfer of shares made in contravention of any direction made

by the Central Government under section 108D, or who exercises any voting right in respect of any share in contravention of any direction made by the Central Government under section 108D, shall be punishable with imprisonment for a term which may extend to five years, and shall also be liable to fine.

(b) If any company gives effect to any voting or other right exercised in relation to any share acquired in contravention of the provisions of sections 108B or which gives effect to any voting right in contravention of any direction made by the Central Government under section 108D, the company shall be punishable with fine which may extend to five thousand rupees, and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to five thousand rupees, or with both.

Chapter-7 TAX LAWS & INCENTIVES FOR FOREIGN COLLABORATIONS

7.01 Introduction

India has a well developed tax structure with a three-tier federal structure, comprising the Union Government, the State Governments and the Urban/Rural Local Bodies. The power to levy taxes and duties is distributed among the three tiers of Governments, in accordance with the provisions of the Indian Constitution. The main taxes/duties that the Union Government is empowered to levy are Income Tax (except tax on agricultural income, which the State Governments can levy), Customs duties, Central Excise and Sales Tax and Service Tax. The principal taxes levied by the State Governments are Sales Tax (tax on intra-State sale of goods), Stamp Duty (duty on transfer of property), State Excise (duty on manufacture of alcohol), Land Revenue (levy on land used for agricultural/non-agricultural purposes), Duty on Entertainment and Tax on Professions & Callings. The Local Bodies are empowered to levy tax on properties (buildings, etc.), Octroi (tax on entry of goods for use/consumption within areas of the Local Bodies), Tax on Markets and Tax/User Charges for utilities like water supply, drainage, etc.

Since 1991 tax system in India has under gone a radical change, in line with liberal economic policy and WTO commitments of the country. Some of the changes are:

- Reduction in customs and excise duties
- Lowering corporate Tax
- Widening of the tax base and toning up the tax administration

7.02 Direct Taxes

Personal Income Tax

The rates of personal income tax are :

Income range (Rupee)	Tax rate(%)
0-100,000	NIL
1,00,000-1,50,000	10
1,50,000- 2,50,000	20
2,50,000 and above	30

Surcharges of 10% is levied on income exceeding Rs.8,50,000. Senior citizens with income up to Rs.1,50,000 are exempt from Income Tax.

Corporate Income Tax

For domestic companies, this is levied @ 35% plus surcharge of 5%, where as for a foreign company (including branch/project offices), it is @ 40% plus surcharge of 5%. An Indian registered company, which is a subsidiary of a foreign company, is also considered an Indian company for this purpose.

7.03 Depreciation and interest deductions:

Depreciation rates

ASSETS	RATES (%)
Buildings	5-100
Plant and Machinery	25-100
Furniture and Fittings	15
Vehicles (Other than for commercial use)	20
Pollution Control Equipment	80
Energy Saving Devices	80
Ships	25
Intangible assets	25

7.04 Withholding Tax for NRIs and Foreign Companies:

Withholding Tax Rates for payments made to Non-Residents are determined by the Finance Act passed by the Parliament for various years. The current rates are:

(i) Interest	20%
(ii) Dividends	Dividends paid by domestic companies : Nil
(iii) Royalties	10%
(iv) Technical Services	10%
(v) Any Other Services	Individuals: 30% of the income Companies: 40% of the net income

The above rates are general and in respect of the countries with which India does not have a Double Taxation Avoidance Agreement (DTAA).

7.05 Double Taxation Relief:

India has entered into DTAA with 65 countries including countries like U.S.A., U.K., Japan, France, Germany, etc. These agreements provides for relief from the double taxation in respect of incomes by providing exemption and also by providing credits for taxes paid in one of the countries. These treaties are based on the general principles laid down in the model draft of the Organization for Economic Cooperation and Development (OECD) with suitable modifications as agreed to by the other contracting countries. In case of countries with which India has double taxation avoidance agreements, the tax rates are determined by such agreements and are indicated for various countries as under:

Country	Dividends %	Interest %	Royalties %
Australia	15	15	15

Austria	20	20	30
Bangladesh	15	10	10
Belarus	15	10	15
Belgium	15	15	20
Brazil	15	15	15
Bulgaria	15	15	20
Canada	25	15	15
China	10	10	10
Cyprus	15	10	15
Czechoslovakia	20	15	30
Czech Republic	10	10	10
Denmark	20	15	20
Egypt	20	20	30
Finland	15	10	20
France	10	15	10/20
Germany	10	10	10
Greece	20	20	30
Hungary	15	15	30
Indonesia	15	10	15
Israel	10	10	10
Italy	20	15	20
Japan	15	15	20
Jordan	10	10	20
Kazakhstan	10	10	10
Kenya	15	15	20
Korea	20	15	15
Kyrgyzstan	10	10	15
Libya	20	20	30

Malaysia	20	20	30
Malta	15	10	15
Mauritius	15	20	15
Mongolia	15	15	15
Morocco	10	10	10
Namibia	10	10	10
Nepal	15	15	15
Netherlands	10	10	10
New Zealand	15	10	10
Norway	15	15	30
Oman	12.5	10	15
Philippines	20	15	15
Poland	15	15	22.5
Portugal	15	10	10
Qatar	10	10	10
Romania	20	15	22.5
Russian Federation	10	10	10
Singapore	15	15	15
South Africa	10	10	10
Spain	15	15	20
Sri Lanka	15	10	10
Sweden	10	10	10
Switzerland	15	15	20
Syria	0	7.5	10
Tanzania	15	12.5	20
Thailand	20	20	15
Trinidad and Tobago	10	10	10
Turkey	15	15	15

Turkmenistan	10	10	10
United Arab Emirates	15	12.5	10
United Kingdom	15	15	15
United States	20	15	15
Uzbekistan	15	15	15
Vietnam	10	10	10
Zambia	15	10	10
Non treaty countries	0	20	20

7.06 General Tax Incentives for Industries

100% deduction of profits and gains for ten years is available in respect of the following:

i) Development or operation and maintenance of ports, airports, roads, highways, bridges, rail systems, inland waterways, inland ports, water supply projects, water treatment systems, irrigation projects, sanitation and sewage projects, solid waste management systems.
ii) Generation, distribution and transmission of power which commence before 31.3.2006.
iii) Development, operation and maintenance of an Industrial Park or Special Economic Zone before 31.3.2006.

Following tax exemptions are available in different sectors:

Deduction of 100% of the profit from business of

a) Development or operation and maintenance of ports, air ports, roads, highways, bridges etc.
b) Generation, distribution and transmission of power
c) Development, operation and maintenance of an Industrial Park or SEZ
d) By undertakings set up in certain notified areas or in certain thrust sector industries in the North-eastern states and Sikkim.
e) By undertakings set up in certain notified areas or in certain thrust sector industries in Uttaranchal & Himachal Pradesh
f) Derived from export of articles or software by undertakings in FTZ / EHTP / STP
g) Derived from export of articles or software by undertakings in SEZ
h) Derived from export of articles or software by 100% EOU
i) An offshore banking unit situated in a SEZ from business activities with units located in the SEZ.
j) Derived by undertakings engaged in the business of developing and building housing projects. Deduction of 50% of profits derived from the business of building, owning and operation of multiplex theatres of convention centre is also available.

k) Derived by an undertaking engaged in the integrated business of handling, storage and transportation of food grains.

l) Derived by an undertaking engaged in the commercial production or refining of mineral oil

m) Derived by an undertaking from export of woodbased handicraft

- 100% deduction for seven years for undertakings producing or refining mineral oil.
- 100% deduction from income for first five years and 30% (for persons other than companies: 25%) in subsequent five years is available in respect of the following:
  - Company which starts providing telecommunication services whether basic or cellular including radio paging, domestic satellite service, network or trunking, broad band network and internet services before 31.3.2003.
  - Industrial undertakings located in certain specified industrially backward states and districts.
  - Undertakings which begin to operate cold chain facilities for agricultural produce before 31.3.2003.
  - Undertakings engaged in the business of handling, storage, transportation of food grains.
- 50% deduction for a period of five years is available to undertakings engaged in the business of building, owning and operating multiplex theatres or convention centres constructed before 31.3.2005.
- Tax exemption of 100% on export profits for ten years upto F.Y. 2009-10, for new industries located in EHTPs and STPs and 100% Export Oriented Units. For units set up in Special Economic Zones (SEZs), 100% deduction of export income for first five years followed by 50% for next two years, even beyond 2009-10.
- Tax exemption of 100% of Export profits for ten years for new industries located in Integrated Infrastructure Development Centres or Industrial Growth Centres of the North Eastern Region.
- Deduction of 50% of export profits from the gross total income. The deduction would be restricted to 30% for financial year 2003-04 and no deduction is allowable subsequently.
- Deduction from the gross total income of 50% of foreign exchange earnings by hotels and tour operators. The deduction would be restricted to 30% for financial year 2003-04 and no deduction is allowable subsequently.
- 50% deduction of export income due to export of computer software or film software, television software, music software, from the gross total income. Deduction in respect of certain inter-corporate dividends to the extent of dividend declared.
- Exemption of any income by way of dividend, interest or long term capital gains of an infrastructure capital fund or an infrastructure capital company from investment made by way of shares or long term finance in any enterprises carrying on the business of developing, maintaining and operating infrastructure facility.

7.07 Sales Tax

Central Sales Tax (CST)

CST is 4% on manufactured goods.

Local Sales Tax (LST)

Where a sale takes place within a state, LST would be levied. Such a tax would be governed by the relevant state tax legislation. This is normally up to 15%.

7.08 Excise Duty

Excise duty on most commodities ranges between 0 to 16%. Only on seven items duty is imposed at 32%, viz., motor cars, tyres, aerated soft drinks, air conditioners, polyesters filament yarn, pan masala and chewing tobacco. Duty is charged at 30% on petrol with additional excise duty at Rs. 7 per litre. The said rates are subject to exemptions and deductions thereon as may be notified from time to time. Central VAT (CENVAT) is applicable to practically all manufactured goods, so as to avoid cascading effect on duty.

Small Scale Sector is exempted from payment of excise duty from annual production upto Rs.10 million.

7.09 Customs Duty

- Reduction in peak rate of customs duty from 50% to 40% except on dried grapes, alcoholic beverages, ball or roller bearings, passenger baggage and imports by couriers
- Reduction in customs duty on:
    a. Oleopine resin from 20% to 10%;
    b. Wool grease from 40% to 20%;
    c. Vegetable or animal fats and oils (excepting coconut oil) from 40% to 30%
    d. Food preparations for infant use from 15% to 10%;
    e. Specified food items imported by approved hotels from 50% to 25%
- Duty on general machinery and parts reduced from 25% to 20%.
- General rate of basic duty under the Project Import Scheme reduced from 25% to 20%.
- Reduction in duty on ships imported for breaking-up from 10% to 5%.
- Duty on import of specified equipment by hotels reduced for 35% to 25%.
- Customs duty on litharge, a material used for producing glass shells and parts of colour picture tubes, reduced from 20 to 10%.
- Reduction in peak duty on organic/inorganic chemicals from 40% to 30%.
- Reduction in customs duty on baggage from 60% to 50%.
- Prescribing uniform duty of 100% prescribed on beer made from malt, wines and other specified fermented beverages.
- Reduction in customs duty on phenol form 30% to 25% and methanol from 30% to 20%.
- Increase in customs duty on FRP rod from 10% to 20%.
- Reduction in customs duty on specified filter paper and paper board from 50% to 20%.
- Extending project import benefit to road development projects of the National Highway Authority of India.
- Duty on catalytic converters and their parts reduced from 25% to 5%.

- Customs duty on CNC systems reduced from 30 to 20% on demand from domestic manufacturers of machine tools.
- In respect of capital goods in the telecom sector not produced within the country, there will be customs duty of 20% plus 2% special customs duty, but they will be exempted from CVD for two years.
- Increase in custom duty on specified motor vehicle parts for light commercial vehicles of payload not exceeding 4,000 Kg from 25% to 40% .
- Customs duty on ferro nickel reduced from 20 to 10% in order to provide further relief to the steel industry.
- Duty concession extended to capital goods imported by ONGC and OIL under the New Exploration Licensing Policy.
- Full exemption from custom duty on -
    - equipment for refinery projects;
    - specified life saving drugs/medicines and diagnostic kits imported for personal use by air/post;
    - specified goods imported for the manufacture of ELISA kits;
    - plans, designs and drawings;
    - wood logs, fuel wood, wood chips and wood charcoal;
    - goods required for establishing new projects with non- ozone depleting substances technology;
    - ammonia for non-fertiliser use;
    - raw, tanned or dressed fur skins of lamb;
    - computer software and on Braille printer/embossers and Braille displays specially designed for computer systems; and
    - linear accelerators of beam energy 15 Mev and above.

Custom duty chart of certain other specified items are as follows-

Items	**Rate of duty (%)**
Electronic	
Computer parts (excluding printed Cartridge tape drives and digital video disk drives)	10
Integrated circuits and micro assemblies	10
Colour data/graphic display tubes	10
Colour picture tubes	30
Telecommunications	
Finished telecommunication equipment	30
Parts and sub-assemblies	20
Parts of cellular telephones and pagers	20
Metals	
Cold rolled coils of steel	25

Ferro alloys	20
Pig iron	10
Nickel and articles thereof	10
Tin and articles thereof	20
Unwrought aluminium	20
Coal and coke	
Coking coal of ash content less than 12%	3
Coal with ash content of more than 12% and coke	10
Textiles	
Dyes, specified pigments, paints and varnishes	30
Albuminoidal substances, glues, enzymes and modified starches	30
Parts and components of specified processing machinery	10
Miscellaneous	
Photographic goods	25
Parts of camera and photo copiers	25
Optical fibre for optical fibre cables	25
Toys, games and sports requisites	25

7.10 Deduction In Respect Of Export Turnover

To promote exports, an Indian Company or a person who is resident in India, engaged in the business of export of goods or merchandise from India, would be allowed, while computing the total income of the assessee, a deduction of the specified percentage of profits derived by the assessee from such export. This deduction is available under Section 80 HHC of the Indian Income Tax Act provided the sale proceeds of such exports are realized in convertible foreign exchange. The percentage of deduction for various Assessment Years has been amended as follows:

For A.Y. 2002-03	: 70% of such profits
For A.Y. 2003-04	: 50% of such profits
For A.Y. 2004-05	: 30% of such profits
From A.Y. 2005-06 onwards	: 70% of such profits

Note: This benefit is withdrawn with effect from 1st April 2006 as provided under section 80 HHC

7.11 Special Tax Provisions applicable to Non-residents / Foreigners

A person who is non-resident is liable to tax on that income only which is earned by him in India. Income is earned in India if -

i. It is directly or indirectly received in India; or

ii. It accrues in India or the law construes it as having accrued in India.

Following are some of the instances when the law construes and income to have accrued in India:-

i. income from business arising through any business connection in India ;

ii. income from property if such property is situated in India;

iii. income from any asset or source if such asset or source is in India;

iv. income from salaries if the services are rendered in India. In such cases salary for rest period or leave period will be regarded as earned in India if it forms part of service contract.

v. income from salaries payable by the Government to a citizen of India even though the services are rendered outside India;

vi. income from dividend paid by an Indian company even if the same is paid outside India;

vii. income by way of interest payable by Government or by any other person in certain circumstances ;

viii. income by way of Royalty if payable by the Government or by any other person in certain circumstances;

ix. income by way of fees for technical services if such fees is payable by the Government or by any other person in certain circumstances.

Following income even though appearing to be arising in India are construed as not arising in India:-

i. If a non-resident running a news agency or publishing newspapers, magazines etc. earns income from activities confined to the collection of news and views in India for transmission outside India, such income is not considered to have arisen in India.

ii. In the case of a non-resident, no income shall be considered to have arisen in India if it arises from operations which are confined to the shooting of any cinematography film. This applies to the following types of non-residents:-

    a. individual who is not a citizen of India; or

    b. firm which does not have any partner who is a citizen of India or who is resident in India; or

    c. company which does not have any shareholder who is resident in India.

Exempted income of non-residents

Certain income of non-residents is totally exempt from income tax. Such incomes are mentioned in Chapters IX to X.

To avoid difficulties in working out the net income of a nonresident from his gross receipts in India, the law provides for taxation or most of the income of non-resident on 'Gross income basis', which means that the tax liability is determined on the basis of gross receipts without going into the question of expenses incurred in earning those receipts. Such 'Gross receipt basis' taxation operates in two ways.

a) By laying down the rate of tax to be applied on gross receipts. The rates are determined at a figure lower than the general rate of tax applicable to total income as it takes account of the possible expenses in earning the income. Such provisions are:-

i. Tax on dividend (other than dividend from domestic companies), interest, royalty, fee for technical services and income from Units (Sec. 115A).

ii. Tax on income and capital gain in respect thereto from units purchased in foreign currency by off shore funds (Sec. 11 SAB).

iii. Income and capital gain in respect thereto from Bonds and shares purchased in foreign currency or acquired in resulting or amalgamated company as a result of demerger or amalgamation (Sec 115 AC.).

iv. Tax on income other than dividend of Foreign Institutional Investors from Securities & Capital gains arising from their transfer (Sec. 115 AD).

v. Income of sportsman or Sports association (Sec. 115BBA).

b) By laying down a percentage to be applied on gross receipts to determine the net income. The tax is then calculated at the normal rate of tax on such presumptive income. Such provisions are:-

i. Profits of shipping business (Sec. 44B)

ii. Profits of business of providing services etc. to be used in the business of prospecting, exploration or production of mineral oils (Sec. 44BB)

iii. Profits from operation of aircraft (Sec. 44BBA)

iv. Profit from business of civil construction etc. in certain turnkey power projects (Sec. 44BBB)

Non-Resident Indians

With a view to attract investment by Non-resident Indians and Indian Nationals living abroad, special provisions exist in Chapter XIIA providing incentives in the form of reliefs and concessional tax rate as also simplifying the tax assessment procedure for such persons. Non-resident Indian has been defined as an individual, being a citizen of India or a person of India origin, who is not a resident. A person is of Indian origin if he or either of his parents or any of his grand parents was born in undivided India. These special provisions are dealt with in Chapter XI.

Provisions for tax avoidance

When in a business carried on between a resident and non-resident, the course of business is arranged in a manner that the business produced to the resident either no profits or less than the ordinary profits, the Assessing Officer would determine the profits which may reasonably be deemed to have been derived therefrom. This problem arises where the dealings between the two are not at arms length and arrangement through transfer pricing is resorted to reduce the profit taxable in India. In such situations, the assessing officer can take recourse to estimation of income on any rational basis. Rules 10 and 11 of Income Tax Rules govern the estimation of such income.

Assessment of non-residents through 'Agents' (Sec. 163)

A non-resident may be assessed to tax in India either directly or through agents. Persons in India who may be treated as 'agent1 of a non-resident are:-

i. employee or trustee of the non-resident;

ii. any person who has any business connection with the non-resident;

iii. any person from or through whom the non-resident is in receipt of any income;

iv. any person who has acquired a capital asset in India from the non-resident.

A broker in Indian who has independent dealings with a non-resident broker acting on behalf of a non-resident principal is, however, not treated as an 'agent' of the non-resident, if the transactions between the two brokers are carried on in the ordinary course of their business.

Before any person is treated as an 'agent' of non-resident, he is given an opportunity of being heard and any representation from him in the matter is considered.

Tax clearance certificate before departure from India

The following categories of persons are required to produce a tax clearance certificate from the concerned assessing officer prior to their departure:-

a) persons who are not domiciled in India, and in whose case the stay in India has exceeded 120 days;

b) persons of Indian or non-Indian domicile whose names have been communicated to the airlines/shipping Companies by the Income Tax authorities;

c) persons who are domiciled in India at the time of their departure; but

i. intend to leave India as emigrants; or

ii. intend to proceed to another country on a work permit with the object of taking any employment or other occupation in that country; or

iii. in respect of whom circumstances exist, which in the opinion of the income tax authorities render it necessary for him to obtain the Tax Clearance Certificate.

Such certificates is granted where there are no outstanding taxes under the Income Tax Act, the Excess Profits Tax Act, the Business Profits Tax Act, the Wealth Tax Act, the Expenditure Tax Act or the Gift Tax Act against him or where satisfactory arrangements have been made for the payment of any such taxes. Obtaining guarantee from the employer of the person leaving the country is one of the methods of ensuring satisfactory arrangement for payment of taxes. For those who have to go abroad frequently for employer's work, facility of one-time Clearance Certificate has been provided to the foreign employee who has a fixed tenure of service in India or upto 5 years on furnishing an employer's guarantee in the prescribed form for payment of any tax that may be found due against him during the entire period of contract plus two years.

Advance Rulings

With a view to avoiding dispute in respect of assessment of income tax liability in relation to the transaction undertaken by or with a non-resident, a scheme of Advance Ruling has been introduced by incorporating Chapter XIX-B in the Income Tax Act, 1961. The Scheme now enables the parties to obtain, in advance, a binding ruling from the Authority for Advance Rulings on issues which could arise in determining their tax liabilities.

Such Advance ruling:-

i. Helps non-residents in planning their income tax affairs well in advance.

ii. Brings certainty in determining tax liability.

iii. Helps avoiding long drawn and expensive litigation.

The advance ruling can be sought on any question of law or fact specified in the applications in relation to the concerned transaction.

Advance ruling cannot, however, be sought where the question:-

- is already pending in the case of the applicant before any income tax authority, the Appellate Tribunal or any court; or
- involves determination of fair market value of any property; or
- relates to a transaction which is designed prima facie for avoidance of income tax.

The applicant may seek advance ruling by making an application to the Authority in quadruplicate in the prescribed Form No. 34C either in the person or by an authorised representative or by registered post. The applicant is entitled to represent his case before the Authority either personally or through an authorised representative. If the applicant desires to be represented by an authorised representative, a duly authenticated document authorising him to appear for the applicant should be enclosed. The applicant may withdraw his application within 30 days from the date of filing the application.

The application should be accompanied by a free of Rs. 2,500/- (two thousand five hundred Indian rupees) through a bank draft drawn in favour of the Authority for Advance Ruling payable at New Delhi.

The advance ruling is required to be pronounced by the Authority within six months of the receipt of the application.

Advance ruling pronounced by the Authority would be binding in respect of the transaction(s) in relation to which ruling has been sought:-

I. on the Commissioner and the income tax authorities subordinate to him in respect of the applicant; and
II. on the applicant who had sought it.

Deduction of Tax at Source from payments to Non-residents

Any person responsible for making any payment (except dividend declared after 1.6.97) to a non-resident individual or a foreign company is required to deduct tax at source at the prescribed rate at the time of credit of such income to the account of the payee or at the time of payment thereof. If, however, person responsible for making the payment is the government, public sector bank or public financial institutions, deduction is to be made at the time of payment only.

Where the person responsible for making such payments considers that the whole of such sum would not be income chargeable in the case of recipient, he may make an application to the assessing officer to determine the appropriate proportion of such sum which will be chargeable to tax and upon such determination tax is required to be deducted only on the chargeable proportion.

The rate at which tax is to be deducted at source will be the rates as specified in the Finance Act of the relevant year or the rate specified in any agreement for avoidance of double tax whichever is beneficial to the assessee.

In respect of income of the nature referred to in para 7.2(iii) arising to Offshore Funds and of the nature referred to in para 7.2(iv), tax is deductible at the rates at which such income is taxable.

For certain remittances, the Reserve Bank of India Exchange Control Manual requires production of a no objection certificate from the Income-tax authorities. The Central Board of Direct Taxes, vide circular No. 759 and 767, has simplified the procedure by dispensing with such requirement. The person making the remittance has only to furnish an undertaking (in duplicate) addressed to the Assessing Officer which should be accompanied by a certificate from a Chartered Accountant in the prescribed form. The undertaking should be submitted to the Reserve Bank of India or the authorised dealer in foreign exchange who will forward a copy to the assessing officer.

Any tax deducted in excess of the required amount is normally refundable to the non-resident on making a proper claim for it. Sometimes the non-resident returns the amount in respect of which tax was deducted or, circumstances occur in which tax is found to be non-deductible or, in which tax is found to have been deducted in excess and the non-resident is either not able to claim refund or does not show initiative in claiming such refund. In such cases, the CBDT has by circular No. 790 dated 20.4.2000 permitted refund of excess tax to the person making the deduction.

7.12 Taxation of income of Non-residents from transfer of Technology - Tax treatment of Royalty and fees for technical Services

Royalty has been defined to mean consideration for transfer of rights in respect of or for use of intellectual property viz. patent, invention, model, design, secret formula, process or trade mark and similar property. It includes consideration for imparting of information concerning the working or use of those properties and also for imparting of information concerning technical, industrial, commercial or scientific knowledge or skill. It makes no difference whether the consideration is by way of lump sum payment or in the form of recurring payments based on production or any other factor. It, however, does not include an income which arises from the transfer of the asset itself and is liable to be taxed in the hands of the recipient as 'Capital Gain'.

Fees for technical services' means any consideration for the rendering of any managerial, technical or consultancy services, whether such consideration is paid in lump sum or in any other manner. It also includes consideration for providing services of technical or other personnel as part of their service contract. It, however, does not include consideration for any construction, assembly, mining or like projects undertaken by the recipient or consideration which would be income of recipient chargeable under the head 'salary1 by virtue of the existence of employer-employee relationship between the parties.

Royalty is taxable in the hands of non-residents if the same are received in or accrued in India. Incomes of these natures are considered as always accruing in India if the same is payable by the Government. If the income is payable by any other person, it is the place of use of the intellectual property that governs the place of accrual. If the right property or information for which royalty is payable is used for the purposes of business or profession in India or for earning income from any source in India, royalty is considered as accruing in India and, accordingly chargeable to tax.

The above position, however, does not apply in relation to lumpsum royalty payment made by a resident for transfer of right in respect of computer software which is supplied by a non-resident manufacturer along with the supply of computer or computer-based equipment under any scheme approved under the policy on Computer Software Export, Software Development and Training 1986 of the Government of India. Such lumpsum payment is treated as business income of the manufacturer.

Similarly ' Fees for technical services' is taxable in the hand of non-residents if the same is received in India or it accrues in India. It is considered as always accruing in India, if the income is payable by the Government. In respect of payment made by others, it is the place where the services are utilised that determine the accrual of income in India. If the services are utilised in business or profession in India or for purpose of earning income from any sources in India, the fees accrues in India regardless of any other factor existing.

Rates of taxation: In respect of agreement made upto 31st March 1976, incomes from royalty and fees for technical services was computed on actual basis after deduction of expenses which could not have exceeded 20% of the gross receipt. Such income of foreign companies received in pursuance of agreement after 31st March, 1976 but before 1st April, 1997 became taxable on Gross receipt basis without deduction of any expenses at the flat rate of 30%. Royalty and fees for technical services received in pursuance of agreement made after 31st March, 1997 is taxable at 20% of gross receipts. The agreement with Indian concern is required to be approved by the Central government but if it relates to a matter included in the industrial policy of the Government of India and the agreement is in accordance with that policy, such approval is not necessary. In the case of non-resident non-corporate persons, this income is taxed at the normal rate prescribed in the Finance Act on net income basis i.e. after deduction of incidental expenses.

In case of royalty in consideration of the transfer of rights in respect of Computer Software permitted to be imported under OGL a flat rate of 20% on Gross receipts is applied without there being any requirement of approval or without any requirement of the agreement being in accordance with the industrial policy.

Exemptions from tax: The following income from royalty/fee for technical services is exempt from tax:-

In case Royalty or Fees for technical services is received free of tax under an agreement which relates to a matter included in the industrial policy and is in accordance with such policy, or where the agreement is approved by the Central government the tax paid by the payer viz. the Government or the Indian concern will not be considered as income derived by the recipient. In other words, the requirement of grossing up applicable to net of tax payments will not apply to such income. [10(6A)]

Fees for technical services received by notified foreign companies in pursuance of an agreement for providing services in or outside India in projects connected with the Security of India is exempt from tax. [10(6C)]

7.13 Transfer Pricing Laws in India

Increasing participation of multi-national groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multi-national group. With a view to provide a detailed statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of such multinational enterprises, the Finance Act, 2001 substituted section 92 with a new section and introduced new sections 92A to 92F in the Income-tax Act, relating to computation of income from an international transaction having regard to the arm's length price, meaning of associated enterprise, meaning of information and documents by persons entering into international transactions and definitions of certain expressions occurring in the said section.

Section 92: As substituted by the Finance Act, 2002 provides that any income arising from an international transaction or where the international transaction comprise of only an outgoing, the allowance for such expenses or interest arising from the international transaction shall be determined having regard to the arm's length price. The provisions, however, would not be applicable in a case where the application of arm's length price results in decrease in the overall tax incidence in India in respect of the parties involved in the international transaction.

Arm's length price: In accordance with internationally accepted principles, it has been provided that any income arising from an international transaction or an outgoing like expenses or interest from the international transaction between associated enterprises shall be computed having regard to the arm's length price, which is the price that would be charged in the transaction if it had been entered into by unrelated parties in similar conditions. The arm's length price shall be determined by one of the methods specified in Section 92C in the manner prescribed in Rules 10A to 10C that have been notified vide S.O. 808 E dated 21.8.2001.

Specified methods are as follows:
a. Comparable uncontrolled price method;
b Resale price method;
c. Cost plus method;
d. Profit split method or
e. Transactional net margin method.

The taxpayer can select the most appropriate method to be applied to any given transaction, but such selection has to be made taking into account the factors prescribed in the Rules. With a view to allow a degree of flexibility in adopting an arm's length price the proviso to sub-section (2) of section 92C provides that where the most appropriate method results in more than one price, a price which differs from the arithmetical mean by an amount not exceeding five percent of such mean may be taken to be the arm's length price, at the option of the assessee.

Associated Enterprises: Section 92A provides meaning of the expression associated enterprises. The enterprises will be taken to be associated enterprises if one enterprise is controlled by the other, or both enterprises are controlled by a common third person. The concept of control adopted in the legislation extends not only to control through holding shares or voting power or the power to appoint the management of an enterprise, but also through debt, blood relationships, and control over various components of the business activity performed by the taxpayer such as control over raw materials, sales and intangibles.

International Transaction: Section 92B provides a broad definition of an international transaction, which is to be read with the definition of transactions given in section 92F. An international transaction is essentially a cross border transaction between associated enterprises in any sort of property, whether tangible or intangible, or in the provision of services, lending of money etc. At least one of the parties to the transaction must be a non-resident. The definition also covers a transaction between two non-residents where for example, one of them has a permanent establishment whose income is taxable in India.

Sub-section (2), of section 92B extends the scope of the definition of international transaction by providing that a transaction entered into with an unrelated person shall be deemed to be a transaction with an associated enterprise, if there exists a prior agreement in relation to the transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined by the associated enterprise.

An illustration of such a transaction could be where the assessee, being an enterprise resident in India, exports goods to an unrelated person abroad, and there is a separate arrangement or agreement between the unrelated person and an associated enterprise which influences the price at which the goods are exported. In such a case the transaction with the unrelated enterprise will also be subject to transfer pricing regulations.

Documentation: Section 92D provides that every person who has undertaken an international taxation shall keep and maintain such information and documents as specified by rules made by the Board. The Board has also been empowered to specify by rules the period for which the information and documents are required to be retained. The documentation has been prescribed under Rule 10D. Such documentation includes background information on the commercial environment in which the transaction has been entered into, and information regarding the international transaction entered into, the analysis carried out to select the most appropriate method and to identify comparable transactions, and the actual working out of the arm's length price of the transaction. The documentation should be available with the assessee by the specified date defined in section 92F and should be retained for a period of 8 years. During the course of any proceedings under the Act, an AO or Commissioner (Appeals) may require any person who has undertaken an international transaction to furnish any of the information and documents specified under the rule within a period of thirty days from the date of receipt of notice issued in this regard, and such period may be extended by a further period not exceeding thirty days.

Further, Section 92E provides that every person who has entered into an international transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form and manner. Rule 10E and form No. 3CEB have been notified in this regard. The accountants report only requires furnishing of factual information relating to the international transaction entered into, the arm' s length price determined by the assessee and the method applied in such determination. It also requires an opinion as to whether the prescribed documentation has been maintained.

Burden of Proof: The primary onus is on the taxpayer to determine an arm's length price in accordance with the rules, and to substantiate the same with the prescribed documentation: where such onus is discharged by the assessee and the data used for determining the arm's length price is reliable and correct there can be no intervention by the Assessing Officer (AO). This is made clear in sub-section (3) of section 92C which provides that the AO may intervene only if he is, on the basis of material or information or document in his possession of the opinion that the price charged in the international transaction has not been determined in accordance with the methods prescribed, or information and documents relating to the international transaction have not been kept and maintained by the assessee in accordance with the provisions of section 92D and the rules made there under, or the information or data used in computation of the arm's length price is not reliable or correct ; or the assessee has failed to furnish, within the specified time; any information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D. If any one of such circumstances exists, the AO may reject the price adopted by the assessee and determine the arm's length price in accordance with the same rules. However, an opportunity has to be given to the assessee before determining such price. Thereafter, the AO may compute the total income on the basis of the arm's length price so determined by him under sub-section (4) of section 92C.

Section 92CA provides that where an assessee has entered into an international transaction in any previous year, the AO may, with the prior approval of the Commissioner, refer the computation of arm's length price in relation to the said international transaction to a Transfer Pricing Officer. The Transfer Pricing Officer, after giving the assessee an opportunity of being heard and after making enquiries, shall determine the arm's length price in relation to the international transaction in accordance with sub-section (3) of section 92C. The AO shall then compute the total income of the assessee under sub-section (4) of section 92C having regard to the arm's length price determined by the Transfer Pricing Officer.

The Transfer Pricing Officer means a Joint Commissioner/Deputy Commissioner/Assistant Commissioner authorized by the Board to perform functions of an AO specified in section 92C & 92D.

The first proviso to section 92 C(4) recognizes the commercial reality that even when a transfer pricing adjustment is made under that sub-section the amount represented by the adjustment would not actually have been received in India or would have actually gone out of the country. Therefore no deductions u/s 10A or 10B or under chapter VI-A shall be allowed in respect of the amount of adjustment.

The second proviso to section 92C(4) provides that where the total income of an enterprise is computed by the AO on the basis of the arm's length price as computed by him, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise, where the tax has been deducted or such tax was deductible, even if not actually deducted under the provision of chapter VIIB on the amount paid by the first enterprise to the other associate enterprise.

Penalties: Penalties have been provided as a disincentive for non-compliance with procedural requirements.

Explanation 7 to sub-section (1) of section 271 provides that where in the case of an assessee who has entered into an international transaction any amount is added or disallowed in computing the total income under sub-sections (1) and (2) of section 92, then, the amount so added or disallowed shall be deemed to represent income in respect of which particulars have been concealed or inaccurate particulars have been furnished. However, no penalty under this provision can be levied where the assessee proves to the satisfaction of the Assessing Officer (AO) or the Commissioner of Income Tax (Appeals) that the price charged or paid in such transaction has been determined in accordance with section 92 in good faith and with due diligence.

Section 271AA provides that if any person who has entered into an international transaction fails to keep and maintain any such information and documents as specified under section 92D, the AO or Commissioner of Income Tax (Appeals) may levy a penalty of a sum equal to 2% of the value of international transaction entered into by such person.

Section 271BA provides that if any person fails to furnish a report from an accountant as required by section 92E, the AO may levy a penalty of a sum of one lakh rupees.

Section 271G provides that if any person who has entered into an international transaction fails to furnish any information or documents as required under section 92D (3), the AO or CIT(A) may levy a penalty equal to 2% of the value of the international transaction.

Above mentioned penalties shall not be imposable if the assessee proves that there was reasonable cause for such failures.

Chapter -8 REPATRIATION AND REMITTANCE FACILITIES

8.01 Advance Remittance-Import of services

Remittance for providing services under current account transaction for which the release of foreign exchange is admissible is now permitted in India.. However, where the amount exceeds USD 100,000 or its equivalent, a guarantee from a bank of International repute situated outside India or a guarantee from an authorized dealer in India, if such a guarantee is issued against the counter-guarantee of a bank of International repute situated outside India, should be obtained from the overseas beneficiary.

8.02 Liberalized Remittance Scheme of USD 25,000

This facility is available for making remittance up to USD 25,000 per calendar year for any current or capital account transactions or a combination of both. Remittances by the individuals upto USD 25,000 per calendar year for any permissible current or capital account transactions or a combination of both, is now permitted. Resident individuals are free to acquire and hold immovable property or shares or any other asset outside India without prior approval of the Reserve Bank. Individuals can also open, maintain and hold foreign currency accounts with a bank outside India for making remittances under the Scheme without prior approval of the Reserve Bank. The foreign currency accounts may be used for putting through all transactions connected with or arising from remittances eligible under this Scheme.

8.03 Acquisition of foreign securities under Employees Stock Option Plan (ESOP)

Resident individuals who are either employees or director of an Indian office or branch of a foreign company in which foreign holding is not less than 51% are permitted to acquire foreign securities under ESOP Scheme without any monetary limit. They are also permitted to freely sell the shares provided the proceeds thereof are repatriated to India.

8.04 Repatriation of sale proceeds of immovable property

Repatriation is permissible provided :

1. the property was purchased in accordance with Foreign Exchange Regulations Act, 1973.
2. repatriation is permissible even in cases where the purchases was made while the NRI was a resident in India i.e. before migration.
3. the balance is held in an NRO account with a bank in India

However, repatriation of sale proceeds of residential property purchased by NRI/PIO out of foreign exchange is restricted to not more than two such properties.

8.05 Remittances towards hiring of transponders by TV Channels etc.

The remittances towards hiring of transponders by TV Channels and Internet Service Providers is now allowed, after obtaining the approval of the Ministries concerned without reference to the Reserve Bank

8.05 Remittance for securing Insurance for Health from a company abroad

1. RBI has permitted remittance upto US$ 1 mn per year out of NRO account towards educational expenses , provided :
.01 Remittance is made to meet medical expenses of the account holder or
.02 to meet medical expenses of account holders' family members and
.03 the balance is held in an NRO account with a bank in India.

8.06 Remittance by Artiste

Earlier remittance by artistes e.g. wrestler, dancer, entertainer, etc., required prior approval of RBI. Henceforth, Banks may freely allow such remittances.

8.07 Commission to agents abroad for sale of residential flats/commercial plots in India

Earlier remittance by way of commission to agents abroad for sale of residential flats/commercial plots in India, exceeding 5 per cent of the inward remittance requires RBI's approval. Now banks may freely allow such remittances upto USD 25,000 or 5 per cent of the inward remittance, per transaction, whichever is higher.

8.08 Short-term credit to overseas offices of Indian companies -

Earlier Short term credit to overseas offices of Indian companies requires prior approval of RBI. Henceforth, Banks can allow such facility without RBI's approval.

8.09 Remittance of royalty and payment of lump-sum fee:

Earlier RBI's prior approval was required if the agreement for technical collaboration has not been registered with RBI. Now banks may allow remittances for royalty and payment of lump-sum fee provided the royalty does not exceed 5 per cent on local sales and 8 per cent on exports and lump-sum payment does not exceed USD 2 million.

8.10 Remittance for use and/or purchase of trademark/franchise in India

Banks can now freely allow remittances for use of trademark/franchise in India. However, RBI's prior approval will continue to be required for remittance towards purchase of trademark/franchise.

8.11 Repatriation of Foreign Capital

Foreign capital invested in India for industrial projects with the approval of the Government of India is allowed to be repatriated from India, along with capital appreciation, if any, subject to RBI Guidelines.

8.12 Remittances of Profits & Dividends

Dividend and profits are now allowed to be remitted with much lesser controls.

Prior approval of the RBI in some cases is required before profits from the foreign subsidiaries can be remitted to the parent company. Taxes must first be paid. Profits retained for more than one year are considered re-invested and their remittance requires special approval..

8.13 Repatriation of Capital Invested In India

Repatriation of investments made in India as per Foreign Exchange Laws is permissible (except where investment was permitted on specific condition that it will not be eligible for repatriation), provided the disinvestment has also been made with the approval of Government of India/Reserve Bank of India. Actual remittances will be permitted subject to fulfillment of such conditions as to quantum and instalments of repatriation, etc., if any, as may be applicable from time to time.

8.14 Payments to Foreign Technicians

Payment to foreign technicians may be made from Exchange Earners Foreign Currency Accounts or free foreign exchange according to the guidelines set forth by the Reserve Bank of India. Release of such payments under Exchange Earners Foreign Currency Accounts is not subject to the Reserve Bank restrictions of per diem rates and duration of agreement.

8.15 Remittance By Individual Foreigners

Foreign nationals temporarily resident in India are permitted to transfer to their own countries, at the time of their departure from India, their current assets such as savings from salary, dividend, commission, provident fund balance, sale-proceeds from personal effects, etc. in full. In addition, they will also be allowed to repatriate the sale proceeds of their investments in India subject to foreign exchange laws

Chapter-9 EXPORT & IMPORT POLICY (2002-2007)

New Exim Policy was announced on 31 March, 2002 the first Five-Year Export & Import (Exim) Policy of the new millennium for the period 2002-2007 containing a comprehensive package intended to give a massive thrust to India's exports. The Policy removes all quantitative restrictions on exports .The new Policy is comprehensive in scope as it encompassed the agricultural sector, cottage & handicrafts and the small scale sectors, thus taking care of more than 80% of India's population living in the rural areas which would also benefit a wide-range of the country's population and give an additional fillip to the country's exports. The new Exim Policy is geared towards doubling India's present exports of around US $ 45 billion to more than US $ 80 billion over the Tenth Five Year Plan by 2007, envisaging a compound annual growth rate of 11.9%. "Therefore, there should be appreciation of the fact that international trade is a vital part of development strategy, and it can be an effective instrument of economic growth, employment generation and poverty alleviation.

HIGHLIGHTS

I-Special Economic Zones (SEZs)

i. Offshore Banking Units (OBUs) shall be permitted in SEZs. Detailed guidelines are being worked out by RBI. This should help some of our cities emerge as financial nerve centres of Asia.

ii. Units in SEZ would be permitted to undertake hedging of commodity price risks, provided such transactions are undertaken by the units on stand-alone basis. This will impart security to the returns of the unit.

iii. It has also been decided to permit External Commercial Borrowings (ECBs) for a tenure of less than three years in SEZs. The detailed guidelines will be worked out by RBI. This will provide opportunities for accessing working capital loan for these units at internationally competitive rates.

II-Employment oriented

(a) Agriculture

i. Export restrictions like registration and packaging requirement are being removed today on Butter, Wheat and Wheat products, Coarse Grains, Groundnut Oil and Cashew to Russia. Quantitative and packaging restrictions on wheat and its products, Butter, Pulses, grain and flour of Barley, Maize, Bajra, Ragi and Jowar have already been removed on 5th March, 2002.

ii. Restrictions on export of all cultivated (other than wild) varieties of seed, except Jute and Onion, removed.

iii. To promote export of agro and agro based products, 20 Agri export zones have been notified.

iv. In order to promote diversification of agriculture, transport subsidy shall be available for export of fruits, vegetables, floriculture, poultry and dairy products. The details shall be worked out in three months.

v. 3% special DEPB rate for primary & processed foods exported in retail packaging of 1 kg or less.

(b) Cottage Sector and Handicrafts

i. An amount of Rs. 5 crore under Market Access Initiative (MAI) has been earmarked for promoting cottage sector exports coming under the KVIC.

ii. The units in the handicrafts sector can also access funds from MAI scheme for development of website for virtual exhibition of their product.

iii. Under the Export Promotion Capital Goods (EPCG) scheme, these units will not be required to maintain average level of exports, while calculating the Export Obligation.

iv. These units shall be entitled to the benefit of Export House status on achieving lower average export performance of Rs.5 crore as against Rs. 15 crore for others; and

v. The units in handicraft sector shall be entitled to duty free imports of an enlarged list of items as embellishments upto 3% of FOB value of their exports.

(c) Small Scale Industry

With a view to encouraging further development of centres of economic and export excellence such as Tirupur for hosiery, woollen blanket in Panipat, woollen knitwear in Ludhiana, following benefits shall be available to small- scale sector:

i. Common service providers in these areas shall be entitled for facility of EPCG scheme.

ii. The recognised associations of units in these areas will be able to access the funds under the Market Access Initiative scheme for creating focused technological services and marketing abroad.

iii. Such areas will receive priority for assistance for identified critical infrastructure gaps from the scheme on Central Assistance to States

iv. Entitlement for Export House status at Rs. 5 crore instead of Rs. 15 crore for others.

(d) Leather

Duty free imports of trimmings and embellishments upto 3% of the FOB value hitherto confined to leather garments extended to all leather products.

(e) Textiles

i. Sample fabrics permitted duty free within the 3% limit for trimmings and embellishments.

ii. 10% variation in GSM be allowed for fabrics under Advance Licence.

iii. Additional items such as zip fasteners, inlay cards, eyelets, rivets, eyes, toggles, velcro tape, cord and cord stopper included in input output norms.

iv. Duty Entitlement Passbook (DEPB) rates for all kinds of blended fabrics permitted. Such blended fabrics to have the lowest rate as applicable to different constituent fabrics.

(f) Gem & Jewellery

i. Customs duty on import of rough diamonds is being reduced to 0%. Import of rough diamonds is already freely allowed. Licensing regime for rough diamond is being abolished. This should help the country emerge as a major international centre for diamonds.
ii. Value addition norms for export of plain jewellery reduced from 10% to 7%. Export of all mechanised unstudded jewellery allowed at a value addition of 3 % only. Having already achieved leadership position in diamonds, now efforts will be made for achieving quantum jump on jewellery exports as well.
iii. Personal carriage of jewellery allowed through Hyderabad and Jaipur airport as well.

III-Technology oriented

(a) Electronic hardware

The Electronic Hardware Technology Park (EHTP) scheme is being modified to enable the sector to face the zero duty regime under ITA(Information Technology Agreement)-1. The units shall be entitled to following facility:

i. Net Foreign Exchange as a Percentage of Exports (NFEP) positive in 5 years.
ii. No other export obligation for units in EHTP.
iii. Supplies of ITA I items having zero duty in the domestic market to be eligible for counting of export obligation.

(b) Chemicals & Pharmaceuticals

i. All pesticides formulations to have 65% of DEPB rate of such pesticides.
ii. Free export of samples without any limit.
iii. Reimbursement of 50% of registration fees for registration of drugs.

(c) Projects

Free import of equipment and other goods used abroad for more than one year.

IV-Growth Oriented

(a) Strategic Package for Status Holders

The status holders shall be eligible for the following new/ special facilities:

i. Licence/Certificate/Permissions and Customs clearances for both imports and exports on self-declaration basis.
ii. Fixation of Input-Output norms on priority;
iii. Priority Finance for medium and long term capital requirement as per conditions notified by RBI;
iv. Exemption from compulsory negotiation of documents through banks. The remittance, however, would continue to be received through banking channels;

v. 100% retention of foreign exchange in Exchange Earners' Foreign Currency (EEFC) account;

vi. Enhancement in normal repatriation period from 180 days to 360 days.

(b) Neutralising high fuel costs

Fuel costs to be rebated by it in Standard Input Output Norms (SIONs) for all export products. This would enhance the cost competitiveness of our export products. The value of fuel to be permitted as a percentage of FOB value of exports for various product groups is as under:

Product Group	**Value of fuel as a % of FOB value of exports**
Bulk Drug and Drug Intermediates	5%
Dye and Dye Intermediates	4%
Glass	5%
Ceramic Products	5%
Paper made from wood pulp/ waste paper	5%
Pesticides (Technical)/ Pesticides formulation from Basic Stage	5%
Refractory items	7%
Ferrous engineering products manufactured though forging/ casting process	7%
Non ferrous basic metal	4%
Plastic and plastic products from basic/ monomer stage	5%
Fibre to yarn	4%
Yarn to fabric/ madeups/ garments	3%
Fibre to fabric/ madeups/ garments	7%

(c) Diversification of markets

i. Setting up of "Business Centre" in Indian missions abroad for visiting Indian exporters/businessmen.

ii. ITPO portal to host a permanent virtual exhibition of Indian export product.

iii. Focus Africa is being launched today. There is tremendous potential for trade with the Sub Saharan African region. During 2000-01, India's total trade with Sub Saharan African region was US$ 3.3 billion. Out of this, our exports accounted for US$ 1.8 billion and our imports were US$ 1.5 billion. The first phase of the Focus Africa programme shall include 7 countries namely, Nigeria, South Africa, Mauritius , Kenya, Ethiopia, Tanzania and Ghana. The exporters exporting to these markets shall be given Export House Status on export of Rs.5 crore.

iv. Links with CIS countries to be revived. We have traditional trade ties with these countries . In the year 2000-01, our exports to these countries were to the extent of US$ 1082 million. In this group, Kazakhstan, Kyrgyzstan, Uzbekistan, Turkmenistan, Ukraine and Azerbaijan to be in special focus in the first phase.

(d) North Eastern States, Sikkim and Jammu & Kashmir

Transport subsidy for exports to be given to units located in North East, Sikkim and Jammu & Kashmir so as to offset the disadvantage of being far from ports.

(e) Re-location of industries

To encourage re-location of industries to India, plant and machineries would be permitted to be imported without a licence, where the depreciated value of such relocating plants exceeds Rs. 50 crores.

(V) Reduction in transaction time & cost

With a view to reducing transaction cost, various procedural simplifications have been introduced. These include:

DGFT

i. A new 8 digit commodity classification for imports is being adopted from today. This classification shall also be adopted by Customs and DGCI&S shortly. The common classification to be used by DGFT and Customs will eliminate the classification disputes and hence reduce transaction costs and time. Similarly, Ministry of Environment and Forests is in the process of finalisation of guidelines to regulate the import of hazardous waste.

ii. Further simplification of all schemes.

iii. Reduction of the maximum fee limit for electronic application under various schemes from Rs. 1.5 lakh to Rs. 1.00 lakh.

iv. Same day licensing introduced in all regional offices.

Customs

i. Adoption and harmonisation of the 8 digit ITC(HS) code.

ii. The percentage of physical examination of export cargo has already been reduced to less than 10 percent except for few sensitive destinations.

iii. The application for fixation of brand rate of drawback shall be finalised within 15 days.

Banks

i. Direct negotiation of export documents to be permitted. This will help the exporters to save bank charges.

ii. 100% retention in EEFC accounts.

iii. The repatriation period for realization of export proceeds extended from 180 days to 360 days. The facility is already available to units in SEZ and exporters exporting to Latin American countries.

These facilities are being made available to status holders only for the present.

(VI) Trust Based

i. Import/Export of samples to be liberalized for encouraging product up-gradation.

ii. Penal interest rate for bonafide defaults to be brought down from 24% to 15%.

iii. No penalty for non-realization of export proceeds in respect of cases covered by ECGC insurance package.

iv No seizure of stock in trade so as to disrupt the manufacturing process affecting delivery schedule of exporters.

v. Foreign Inward Remittance Certificate (FIRC) to be accepted in lieu of Bank Realisation Certificate for documents negotiated directly.

vi. Optional facility to convert from one scheme to another scheme. In case the exporter is denied the benefit under one scheme, he shall be entitled to claim benefit under some other scheme.

vii. Newcomers to be entitled for licences without any verification against execution of Bank Guarantee.

(VII) Duty neutralisation instruments

(a) Advance Licence

i. Duty Exemption Entitlement Certificate (DEEC) book to be abolished. Redemption on the basis of Shipping bills and Bank Realisation Certificates.

ii. Withdrawal of Advance Licence for Annual Requirement (AAL) scheme as problems were encountered in closure of AAL and the significance of scheme considerably reduced due to dispensation of DEEC. The exporters can avail Advance Licence for any value.

iii. Mandatory spares to be allowed in the Advance Licence upto 10% of the CIF value.

(b) Duty Free Replenishment Certificate (DFRC)

- Technical characteristics to be dispensed with for audit purpose.

(c) Duty Entitlement Passbook (DEPB)

i. Value cap exemption granted on 429 items to continue.

ii. No Present Market Value (PMV) verification except on specific intelligence.

iii. Same DEPB rate for exports whether as CBUs or in CKD/SKD form.

iv. Reduction in rates only after due notice.

v. DEPB for transport vehicles to Nepal in free foreign exchange.
vi. DEPB rates for composite items to have lowest rate applicable for such constituent.

(d) Export Promotion Capital Goods (EPCG)

i. EPCG licences of Rs.100 crore or more to have 12 year export obligation (EO) period with 5 year moratorium period.
ii. EO fulfilment period extended from 8 years to 12 years in respect of units in agri-export zones and in respect of companies under the revival plan of BIFR.
iii. Supplies under Deemed Exports to be eligible for export obligation fulfilment along with deemed export benefit.
Re-fixation of EO in respect of past cases of imports of second hand capital goods under EPCG Scheme.

Chapter-10 HIGHLIGHTS OF INDIAN BUDGET (2006 -2007)

ECONOMY:

- Fiscal deficit in 2006/07 likely to be 3.8 percent of GDP, compared to an estimated 4.1 percent the previous year .
- Government revenue deficit seen at 2.1 percent of GDP in 2006/07, compared to 2.6 percent the year before
- Finance minister says economic prospects for 2005/06 just as good as last year
- GDP growth likely to be 8.1 percent in 05/06
- Government aims to raise GDP growth to 10 percent
- Gross budgetary support for 2006/07 at 1.73 trillion rupees
- FDI inflows up to November 2005 at billion
- Defense spending increased to 890 billion rupees in 06/07 from 830 billion in the previous year
- Finance minister says services sector expected to contribute 54 percent of GDP in 06/07

TAXES:

- No new direct taxes to be introduced
- No change in personal and corporate tax
- Services tax raised to 12 percent from 10 percent
- The securities and transaction tax to be raised by 25 percent
- Customs duty on non-ferrous metals to be reduced to 7.5 percent from 10 percent
- India to reduce customs duties on life-saving cancer and AIDS drugs
- Government to raise customs duty on vanaspati to 80 percent
- The excise duty on small cars will be cut to 16 percent
- Excise duties on man-made and filament yarns will be reduced
- The food processing industry will get duty relief
- The levy on crude, called a cess, will be raised to 2,500 rupees per tonne from 1,800 rupees
- The excise duty on cigarettes will be increased by 5 percent
- More services will be brought under the tax net. The new services to be taxed include ATM operations, sponsorship of events other than sports, and international travel other than economy class trips
- The finance minister said that value-added tax had been a resounding success, and that he expects states outside the system to join
- The government will set nationwide goods and services sales tax on April 1, 2010

FINANCIAL SECTOR:

- Plan to let Indian mutual funds invest up to billion abroad
- Government raises FII investment limit in government debt to billion
- To introduce comprehensive bill on insurance in parliament in 2006/07
- Government to set up single exchange for corporate debt trading

RURAL INVESTMENT:

- Farm sector output likely to grow 2.3 percent in 2005/06
- Government to spend 143 billion rupees (.2 billion) on rural jobs guarantee scheme in 06/07, compared to 117 billion the year before.

- Government to allocate 186.96 billion rupees for rural infrastructure projects in 2006/07
- Banks to raise farm credit to 1.75 trillion rupees in 06/07 from 1.42 trillion
- Farmers to receive short-term credit at 7 percent
- Raises corpus for rural infrastructure development fund to 100 billion rupees from 73 billion

HEALTH AND EDUCATION:

- Education spending to be increased by 31.5 percent, and health spending by 22 percent
- Allocation for primary education increased to 100.41 billion rupees from 71.56 billion.
- Allocates more funds for education of minorities, schemes for lower caste people

TRADE AND INDUSTRY:

- Government to promote textiles, automobiles, leather, food processing and tourism for job creation
- Food processing sector to be treated as a priority sector for bank lending
- Petroleum, chemicals and petro-chemicals investment zones to be set up
- India to be promoted as a semiconductor manufacturing hub
- Finance minister says imports in 2005/06 are "high but welcome" as they reflect growing investment and industrial activity
- India aims to double its share of world exports to 1.5 percent by 2008/09

INFRASTRUCTURE:

- Government aims to raise power generation capacity by 15,000 megawatts by March 2007
- Comprehensive review of coal policy needed
- Government expects investment of 220 billion rupees in oil refining over next few years. The government will encourage investment in refineries, pipelines and green fuel.
- Highways development programmed to receive 99.45 billion rupees in 2006/07. The government has identified three new road projects to be built under a new special purpose vehicle.

Chapter -11 1NVESTING THROUGH A MAURITIUS SUBSIDIARY

The tax advantages of using a Mauritius company to invest in India are as given below:

Investing Through Mauritius

If an investor based in the US cannot absorb the full tax credits available to him under the tax treaty between India and USA he can use the Mauritius Offshore Company for treaty establishing purposes.

Rationale

If the Indian Company is located in Mauritius then it would offer the following benefits from the tax point of view:-

- 0% Indian withholding tax on dividends paid to such entity.
- 0% Indian capital gains tax on transfer of shares in the Indian Company by such entity.
- 0% taxation for such local entity; 0% local withholding tax on onward distribution of dividends from such entity and on capital gains.

Under the India-Mauritius tax treaty, a resident of Mauritius deriving income by way of royalty is taxed in India @ 15% of the gross amount. No taxation is prescribed for fees for technical services, There are several decisions which in similar circumstances (for example - France) have stated that fees for technical services in such cases would be taxed as business profits and if there was no permanent establishment in India this would escape taxation altogether.

Precautions

In order to avail the benefit of Double Taxation Avoidance Agreement, the following two requirements need to be met:

1 . A person should be liable to tax in any one of the two countries.
2. The liability should arise by virtue of domicile or place of management in case of corporate body.

An offshore entity in Mauritius, now defined as a tax incentive company, which is incorporated after June 30, 1998 is liable to income-tax at 15 per cent. The Income Tax (Foreign Tax credit) Regulation 1996, permits such companies to claim credit for actual foreign taxes paid or where proof is not provided, a 'deemed' tax credit of 90 per cent of the Mauritius tax payable. This leaves Mauritius tax liability of 1.5 per cent.

Offshore companies set up in Mauritius after June 1, 1998 would have been subject to flat rate of tax of 15 per cent on income from off-shore operations. The offshore companies were however permitted to take credit for foreign taxes paid. On the other hand, the existing offshore companies were given the option to continue with the sliding rate of nil to 35 per cent.

However, if today, the offshore company is unable to produce proof of foreign taxes paid (for example taxes paid in India by an offshore India-oriented fund company) then credit is not totally denied to it. Such an offshore company can claim credit equivalent to 90 per cent of the Mauritius tax payable.

An official of Mauritius Offshore Business Activities Authority (MOBAA) admits that there was some apprehension earlier that Mauritius would lose its charm as a financial centre. The concept of deemed tax credit, has set to rest such apprehension. Besides mitigating the need of furnishing proof of foreign tax paid and thereby saving time and effort, this concept ensures that where a source country gives certain tax exemptions as an incentive for investments into it, such an incentive is preserved in Mauritius.

For example, since India has abolished withholding tax on dividend income in the hands of all shareholders (including foreign shareholders), a Mauritius resident company holding portfolio investments in Indian companies will pay only 1.5 per cent on its Indian dividend income.

Capital gains under the Indo-Mauritius treaty are not taxable in India. Additionally, the Mauritius tax laws do not levy any capital gains tax.

The following precautions should be taken in order to establish residency of the entity in Mauritius:

- Substantial board meetings should be held in Mauritius or if held by teleconference the meeting should be chaired in Mauritius.
- Major decisions must be taken in Mauritius.
- Annual General Meeting and Extraordinary Shareholder's Meeting should be held in Mauritius.
- The company should have a registered address in Mauritius.
- Memorandum and Articles of Association - Minute Book - Share Register Annual Accounts.
- The Company should maintain its bank accounts in Mauritius.
- The Company should have resident auditors and resident secretary.
- The Company should have at least two local directors who will take policy decisions.

It is very apparent from the above that there are substantial benefits arising from investing through Mauritius. To what extent the tax authorities in India will question and for how long it will continue is anybody's guess. As of now there is nothing to indicate that the tax authorities in India have started questioning the use of Mauritius entity and also there is no indication of any change being suggested by Ministry of Finance in India. It also may be pointed out that in several treaties which India has entered into with other countries there are special provisions for anti-treaty shopping (Article 24 of Indo-US Double Taxation Avoidance Agreement). No such anti-treaty shopping treaty exists in the case of Indo-Mauritius Double Taxation Avoidance Agreement.

Payment of Royalty and Included Services

It is advisable for US corporations planning to enter into Royalty/Technical Know-how Agreement with Indian companies to do the same by fixing the consideration on a 'net of tax' basis. This is advantageous for both the Indian as well as the US corporation. For the Indian Corporation the "cost to the company" is lower and the US Corporation does not have to get into the complexity of foreign tax credits. Further, US Corporations can make the amount of Royalty payment as in quite a few cases the total consideration is based on the percentage specified by Reserve Bank of India i.e. 5% of 8% on sale. This can be increased by simply making the agreement of a 'net of tax' basis. This is also permitted by the Reserve Bank of India.