ALMT Legal
ADVOCATES AND SOLICITORS

india brief

September, 2013

Red Carpet Reforms

Is India heading for early elections? The slide of Rupee to over 20% in the last few weeks compared with US Dollar has only heightened the speculation further. As they say, what is good for politics is not good for the economy. The economy has certainly slowed down, with growth forecasts reduced to 5.4% (2013-14) by international agencies. However, despite the slowdown, the red carpet welcome rolled out by the present Government for foreign investors, in sectors such as telecom, multi-brand retail etc. have shown positive results if one were to strictly go by the figures of the first quarter. Not only that, Foreign direct investment ("**FDI**") in India is estimated by agencies to rise by approximately 15% in 2013 on account of policy initiatives to boost investment and growth. Clearly, foreign investors still see a wealth of opportunity in India, and we hope the Indian growth story is here to stay!

SNAPSHOTS

A New Companies Law for India

India has recently adopted a new Companies Law which is expected to make a significant difference in the way business is undertaken in India. The Companies Bill, 2012 (which is now the Companies Act, 2013) received Presidential assent on 29th August after having been passed by both Houses of Parliament earlier this year. Subordinate Rules under the new Act (for 16 chapters) have been framed and put up for public comments on September 10. *While Section 1 of the new Act has been brought into force, the remaining provisions of the new Act are expected to be made effective after all the Rules are finalized (a process that can take up to several months).* The new Act will completely replace the 57-year old law and seeks to make several changes, such as introduction of a one person company, corporate social responsibility norms, stricter auditor regulations, stricter winding up norms, statutory recognition to the Serious Fraud Investigation Office, etc. For more details, see March 2012 edition of India Brief *(available on our website).*

Capital Control Measures

The Reserve Bank of India ("**RBI**") has recently announced lower caps on outbound investments by resident individuals and Indian companies. A restriction has also been put on acquisition of immovable property outside India. For more details, see August edition of News Flash (*available on our website*).

Major FDI Reforms

On August 1, 2013, the Cabinet gave its approval for relaxation of FDI across various sectors and announced some key policy changes in FDI in retail trade. A comparison chart showing the old and new FDI limits is set out below:

SNo	Sector	Existing Caps	NEW CAPS
1.	Petroleum & Natural Gas and Refining	Up to 49% with approval	*Up to 49% - No approval*
2.	Commodity Exchanges	Up to 49% with approval	*Up to 49% - No approval*
3.	Power Exchanges	Up to 49% with approval	*Up to 49% - No approval*
4.	Infrastructure companies in Securities Markets, namely, stock exchanges, depositories and clearing corporations	Up to 49% with approval	*Up to 49% - No approval*
5.	Asset Reconstruction companies	Up to 74% with approval	*Up to 49% - No approval* *49%-100% with FIPB Approval*
6.	Credit Information companies	Up to 49% with approval	*Up to 74% - No approval*
7.	Single Brand Retail trading	Up to 100% with approval	*Up to 49% - No approval* *49%-100% with FIPB Approval*
8.	Courier Services	Up to 100% with approval	*100% - No approval*
9.	Tea Sector (including tea plantations)	100% with approval and divestment of 26% to Indian partner within 5 years	*100% with approval*

Major FDI Reforms - Continued on page 4

Awards and Recognition

We are also pleased to announce that ALMT Legal has recently been awarded the following awards:

- India Business law Journal 2013 - Indian law firm Awards 2013 in Shipping Maritime and Aviation.
- India Business Law Journal's 2012 winner for Privatization/Disinvestment and Shipping & Maritime.
- ALMT has been named Asia Legal Business- Thomson Reuters' leading Private Equity Firm 2013.
- Acquisition International has awarded ALMT the Indian Private Equity Law Firm of the year 2012.
- ALMT Legal was recently ranked fifth in the list of Most Active M&A Advisors and Most Active PE Advisors for Q4 2012 compiled by Venture Intelligence.
- Legal 500 2013 has recommended ALMT in areas of Aviation, Banking & finance, Capital markets, Corporate/M&A, Dispute resolution, Investment funds, Media, Technology & Telecom, Real estate and Shipping.
- Chambers Asia Pacific 2013 has recommended ALMT Legal as a leading firm in Aviation, Corporate/M&A, Employment, Private Equity, Real Estate, Restructuring/Insolvency and Tax.

INDIRECT TRANSFER OF ASSETS – AN INTERNATIONAL (INDIAN) PERSPECTIVE

The provision to tax indirect transfers of Indian assets was officially introduced into the (Indian) Income Tax Act, 1961 (the "Act") in April 2012 following the judgment by the Supreme Court in the case of *Vodafone International Holdings BV vs. Union Of India & Anr (arising Out of S.L.P. (C) No. 26529 of 2010).* This was done by introducing two explanations in section 9 of the Act and in some other related definitions and sections all with retrospective effect from 1962.

Section 9 provides the categories of income of a non-resident that is deemed to accrue or arise in India and hence taxable in India. The relevant part of section 9 which deals with capital gains reads as under: "*income accruing or arising whether directly or indirectly through the transfer of a capital asset situated in India*".

The Vodafone Case and the after-effects

In the Vodafone case (*supra*) the Indian income tax authorities contended that the language of section 9 was wide enough to cover an indirect transfer of an Indian business. They contended that the transfer of the one share of the Cayman Islands company from HTI (BVI) Holdings Limited (located in British Virgin Islands) to Vodafone NL (located in the Netherlands) resulted in the effective transfer of the control and management of the Indian entity, Hutchinson Essar Limited (HEL) and hence was subject to tax in India under section 9 as gains arising directly or indirectly from the transfer of a capital asset situated in India. The tax authorities inter alia contended that the control and management rights in the Indian entity was a capital asset in India which, consequent to the transfer of the Cayman Islands company share, resulted in the taxable gains arising in India.

After a long drawn battle at various levels of tax authorities and at the Mumbai High Court, the Supreme Court *inter alia* held that –

- a "look at" approach should be adopted as opposed to a "look through" approach;
- absent any sham entities, the words "directly or indirectly" used in section 9 referred to the income and not the asset; and
- unless the capital asset itself (in this case the shares) that were actually transferred, was situated in India, section 9 was not attracted.

To overcome this judgement, the government promptly introduced two explanations in section 9 with retrospective effect. The significant explanation being explanation 5 which says "as a clarification" that a capital asset being a share or interest in a company or entity incorporated outside India shall be deemed to have been situated in India if the share or interest derives, directly or indirectly, its value "substantially" from assets located in India.

These changes were (presumably) intended to clarify that situation like Vodafone case was covered by section 9 and taxable in India which is borne out of the explanatory notes to the Finance Bill, 2012. However, what effect this could actually have could be quite absurd because of the language used in the explanation and the non-clarity of terms used.

Non-clarity in the amended Section 9?

The term 'substantial' used in Section 9(1)(i) has not been defined or linked to any percentage of assets located in India. This is the biggest worry due to the very subjective nature of this term. The Act itself in different sections where the term 'substantial' has been used, has defined it differently from 20% to 25% or 50%. In some places the term has been left undefined as in the case of Section 9 and thus the interpretation of the same would be at the mercy of the assessing officers and ultimately for the courts to decide. This is more so since the section does not use the word "majority" and there is nothing in law that suggests that the word "substantial" must be read to mean exceeding 50 per cent of the whole. The result of these uncertainties is that an investor in any asset situate anywhere in the world that has anything to do with India is under threat from the Indian taxman.

Effect of Section 9 vis-à-vis Tax Treaty

The Act provides that when an assessee is located in a country with which India has a tax treaty, the assessee can choose to be governed by the provisions of the Act or the applicable treaty whichever is more beneficial to the assessee. Hence when the income earner is located in a country with which India has entered into a tax treaty, the question arises whether section 9 as now amended will apply or no?

The Sanofi Case

In the context of indirect transfers the matter was recently considered by the Andhra Pradesh High Court in the case of *Sanofi Pasteur Holding SA vs. Dept of Revenue (W.P.Nos. 14212 of 2010, 3339 and 3358 of 2012*,).

ALMT welcomes new Partners and firm promotions

The firm is pleased to announce the induction of Mr. Satish Srinivasan as a partner in the Bangalore Office and elevation of Mrs. Chhaya Virani of our property team to partner in the Mumbai office, both with effect from August 1, 2013.

Satish Srinivsasan

Chhaya Virani

Satish has over 13 years of professional experience having headed the corporate practice at Dr. Kainth and Associates, Bangalore. Satish has joined the ALMT team to strengthen, grow and expand the emerging areas of joint ventures, offset documentation, structuring for clients in defence, aerospace and avionics apart

from strengthening ALMT's strong and highly regarded corporate practice.

Chhaya brings with her 30 years of experience and will further strengthen the Real Estate team and practice. She is a qualified solicitor and was a former partner at the prestigious and traditional solicitor firm in Mumbai, Haridas & Co solicitors for 25 years.

The firm also elevated Mumbai senior associate Ms. Subashini Radhakrishnan to Partner with effect from April 1, 2013.

With these additions, the total partner strength of the Firm stands at 22 across its offices at Mumbai, Bangalore, New Delhi and London.

In this case shares of Shan H, a French company with an Indian subsidiary were transferred by its two French shareholders to Sanofi Pasteur Holding (" Sanofi") which is another French company. So the question before the Court was that would the transfer of shares of one French company which derived value from its Indian subsidiary to another French company be taxable in India under the provisions is section 9?

On appeal via a writ, the Hon' ble Andhra Pradesh High Court set aside the AAR ruling and held that absent a sham company or structure, the transaction could not be taxed in India. The Court *inter alia* held that –

- Article 14(5) of the India France tax treaty squarely applied. Article 14(5) states that gains arising from transfer of shares representing more than 10 percent shall be taxable only in the country where the company whose shares are transferred is registered;
- The treaty does not speak about indirect transfers;
- Article 14 of the treaty does not permit a see through approach. The company whose share are transferred is registered in France and therefore as per the treaty only France had the right to tax ;
- There was no suggestion that Shan H as an SPV had been set up with the intent to avoid Indian taxes;
- Taxes in France had been paid as the intent of the treaty is to avoid double taxation; and
- The treaty provisions override the provisions of the Act.

This was indeed a welcome judgement and would provide some relief to the concerned investors. However the matter has been appealed to the Supreme Court and judgment is awaited. Further, in this case all the non-resident entities were from a single country i.e. France and the treaty was clear in its applicability to the situation at hand. So the question that remains unanswered is as to what would be the position if different countries were involved?

Constitution of the Shome Committee and its Recommendations

The Shome Committee was set up on 13 June 2012 initially to look at the General Anti Avoidance Rules (" GAAR") provisions and its scope was expanded in September 2012 to examine the retrospective amendments relating to indirect transfer. The committee submitted its draft report in October 2012 and some of the important recommendations include:

- The amended provisions should be applied prospectively.
- The term ' substantially' should be suitably defined akin to the DTC 2010 provisions.
- No person should be treated as an assessee in default (under section 201) or as a representative assessee of the non-resident.
- No interest should be charged and no penalty should be levied.
- The phrase ' directly or indirectly' may be clarified as representing a ' look through' approach.
- Income arising from sale of listed securities should not be subject to capital gains tax provided the foreign company is listed on a recognised stock exchange and the share of the foreign company are frequently traded shares.
- Only that portion of the gains should be taxable in India which is Gains proportional to the total gains which the Indian assets bear to the global assets should be taxable in India.
- Where capital gains arises to a non-resident on the indirect transfer principles and there is a DTAA with his country of residence, then such capital gains shall not be taxable in India unless-
  - ✓ The DTAA provides a right of taxation of capital gains to India based on its domestic law; or
  - ✓ The DTAA specifically provides right of taxation to India on transfer of shares or interest of a foreign company or entity.
- Intra group restructuring involving the transfer of an asset in India should not be taxed in India provided that such transfers are not taxable in the jurisdiction where such company is resident.
- Non-resident investor making investments, directly or indirectly, in an FII should not be taxable in India.

Current Status

The Shome committee has submitted its final report and government action is now awaited. No clarifications were issued in this Budget which was certainly one of the disappointing factors.

It is thus clear from the above discussion that the position on how the law will be implemented still remains unclear and many questions remain unanswered. Clearly the government has a lot to do to repair the damage. One hopes that corrective steps to clarify the legislation and make it more reasonable will be done sooner than later.

Contributed by Aliff Fazelbhoy (Senior Partner, Mumbai office).

Major FDI Reforms – Continued from page 1

SNo	Sector	Existing Caps	NEW CAPS
10.	Defence Production	Up to 26% with approval	*Up to 26%, no change i.e., through FIPB and CCEA if FDI exceeds Rs. 1200 crore. Above 26% to Cabinet Committee on Security, on case to case basis*
11.	All telecom services including Telecom Infrastructure Providers Category-I, viz. Basic, Cellular, United Access Services, Unified license etc., all types of ISP licences, Voice Mail/Audiotex/UMS, Resale of IPLC, Mobile Number Portability services, Infrastructure Provider Category-I except Other Service Providers.	Up to 49% – No approval 49%-74% with FIPB Approval	*Up to 49% – No approval* *49%-100% with FIPB Approval*

Single Brand Product Retail Trading (SBRT)

Revision of policy to allow multiple non-resident entities to undertake SBRT in India as opposed to the earlier policy which only permitted one non-resident entitv to trade.

Relaxation of Multi-Brand Retail Trading Policy (MBRT)

- Earlier, at least 50 per cent of the total FDI brought in was required to be invested in back-end infrastructure within 3 years. Under the new policy, this rule of minimum 50% investment in back-end infrastructure has been limited to apply only to the first tranche of $100 million, and not to any subsequent tranches of FDI.
- Further, previously it was mandatory to source at least 30% of the total value of products (manufactured/processed) purchased for retail purposes from Indian ‘small industries’ i.e., industries which have a total investment in plant & machinery not exceeding $1 million. Under the new policy, the 30% sourcing requirement has been made mandatory from micro, small and medium industries with a total investment in plant & machinery not exceeding $2 million.
- The new policy also provides that this requirement will be reckoned only at the time of first engagement with the retailer and such industry shall continue to quality as a small industry even if it outgrows the investment of $2 million during the course of its relationship with the said retailer, something which was not permitted in the earlier policy.
- Two more States, i.e., State of Karnataka and Himachal Pradesh, have recently given consent to implement the MBRT policy in their States, taking the total tally to 12 States/Union Territories that currently permit MBRT.

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Law Briefing from ALMT Legal

September 2013

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