India: Some Recent Legal Developments

RAM T. MADAAN AND R. NATH MADAAN*

In 1991, India greatly opened its economy to foreign investment. Every year since opening up the economy, more laws and policies have been adopted leading toward further privatization and liberalization. The year 1997 was considered as the second landmark since 1991, as far as changes in the investment and tax laws are concerned. The following are some of the major changes announced in 1997.

I. Income Tax Rates Reduced

The reduction in individual and corporate tax rates in India was an unexpected but pleasant surprise for taxpayers. The individual tax rate has been reduced to a maximum of 30 percent. The other two tax slab rates for personal income tax are 10 and 20 percent. There is no state income tax in India. The corporate income tax effective rate for domestic companies has been reduced to 33 percent, while the profits of branches in India of foreign companies are taxed at 48 percent. Companies incorporated in India, even with 100 percent foreign ownership, are considered domestic companies under Indian law. This reduction in tax rates, compounded with liberal deductions, has made India an attractive place for investment from a tax point of view.

II. India and the United States Sign Investment Pact

India and the United States have recently signed an investment incentive agreement in a bid to promote and protect U.S. investments in India by facilitating investment support to U.S. investors from the Overseas Private Investment Corporation (OPIC), a designated agency of the U.S. Government.

*Ram T. Madaan, a graduate from Harvard Law School and G.N.D. University in India, is admitted to practice in New York and India. He concentrates on international transactions and international arbitrations and chairs the South Asia Law Committee. R. Nath Madaan, an attorney with a leading law firm in India, concentrates on corporate law and international transactions.

III. New Internet Policy

Recently, India announced sweeping changes in its internet policy to permit an unlimited number of private service providers. The present public sector service provider, Videsh Sanchar Nigam Limited (VSNL), however, will continue to provide internet services in major cities.

The new policy allows private operators to set up their own internet access servers. But to connect to an internet node, these operators will have to go through the VSNL gateway. The service providers who lease lines from VSNL will be charged promotional rates for port facilities and for the leasing of lines. The fee that will be charged by the service providers to the final customer is to be determined by the market. The new policy also seeks to allow, in due course, access to multiple gateways for international connectivity, if necessary.

The selection of the service providers will be done by the Department of Telecommunication, possibly through a tendering process. The technical and financial strengths of the bidders will be the primary consideration in short-listing them. Initially, as a promotional measure, the service providers will not be charged licence fees. They will, however, be expected to make a security deposit and give a bank guarantee.

In another development, the Telecom Regulatory Authority of India (TRAI) has released a consultative paper on internet tariffs that incorporates a proposal by the Telecom Commission to reduce tariffs for Transmission Control Protocol/Internet Protocol dial-up services in order to promote the use of the internet. The TRAI has suggested that an interim tariff for internet access be framed and implemented until the operators are able to charge the highly reduced tariffs recommended by the Telecom Commission.

IV. Withholding Tax on Dividends

Prior to changes in Indian tax law effective this year, the withholding tax on dividends paid by an Indian company was different for different countries, depending upon tax treaties with those countries. For example, the withholding tax on dividends for a Mauritius parent company was 5 percent. It was 15 percent for a U.S. parent company. However, recent changes in Indian tax law effective as of June 1997 have abolished the disparities. Instead of taxing the shareholders, India is now taxing the companies paying dividends at a uniform rate of 10 percent, irrespective of the country of the parent company. This will reduce the advantage of using a Mauritius subsidiary to invest in India.

V. New Priority Industries

The entire hydrocarbon sector, including exploration, producing, refining and marketing of petroleum products, has now been opened to foreign participation. The government had recently allowed foreign investment up to 51 percent in mining for commercial purposes and up to 49 percent in the telecommunication sector. The government is also examining a proposal to do away with the stipulation that foreign equity should cover the foreign exchange needs for import of capital goods. The President of India has re-promulgated the Income-Tax Amendment Ordinance, which provides for continuing certain tax incentives to undertakings engaged in infrastructure activities, including the twenty year tax holiday for highway projects.

VI. New Automobile Policy

The Indian cabinet has announced that all joint venture car makers in the country would be required to enter into agreements with the government for the import of completely knocked down (CKD) and semi-knocked down (SKD) kits. These "Memorandums of Understanding" would be based on certain conditions, one of which would be the setting up of actual production facilities and not for the mere assembly of imported kits/components. According to new automobile policy, the joint ventures must procure locally 50 percent of the components by the third year after signing the agreement with the government and 70 percent by the fifth year. The new joint ventures will also have to fulfill export obligations from the third year of the start of production until the date of termination of the agreement.

VII. The Companies Bill, 1997

In response to global competitive conditions, the government of India has recently introduced the Companies Bill, 1997 in the parliament of India. Instead of the present two classes of companies, the bill proposes three classes of companies: private, public listed and public unlisted. The bill aims at giving greater flexibility to companies and at the same time prescribes stricter norms for public listed and public unlisted companies in the fields of raising capital, internal management, company accounts and audit, and disclosures. The main provisions of the bill include the following: (1) minimum capital requirements will be raised to Rupees 100,000 for private companies and Rupees 500,000 for public companies; (2) the companies will be permitted to buy back their own shares subject to certain conditions. For example, the buy back should not result in a debt-equity ratio exceeding 2:1; (3) the equity shares could be issued with differential voting/dividend rights; (4) the quorum will be two members personally present in case of private companies and for the public unlisted company and public listed company the quorum would be 5 and 50 members personally present respectively unless a higher number is provided in the bylaws of the company; and (5) the limit on intercorporate investment or loans will be raised to 60 percent of a company's capital and free reserves, or 100 percent of its free reserves, whichever is greater.

This bill has lapsed because of the dissolution of the parliament in India and the announcement of fresh elections. Most likely, the new government will reintroduce this bill with some modifications.