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**ADVOCATES AND LEGAL CONSULTANTS**

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**❖ Private PF investment in equities to be tax-free**

**CBDT Aligns Investment Pattern with that set by Finance Ministry**

PRIVATE provident funds and superannuation funds, which were last year allowed to channelise a larger chunk of their corpus into equity, will not attract income tax following a change in tax rules. The tax-free status would allow more retirement savings to flow into shares.

The Central Board of Direct Taxes (CBDT) has issued a notification, aligning the investment pattern prescribed in its rules with the new one given by the Department of Economic Affairs, to allow these funds' equity investments tax-free status. The DEA, under the finance ministry, had announced the new investment formula for these funds in August 2008, permitting them to invest up to 15% of their corpus in the stock market instead of the earlier 5%.

The new investment pattern comes into effect from April 1, 2009. Therefore, aligning the CBDT investment pattern with the one prescribed by the DEA was crucial for these entities to retain their tax-free status. Income-Tax Rule 67 prescribes an investment pattern for private provident funds and superannuation funds which must be followed to avail tax benefits. Income earned on investments not in line with the pattern prescribed by the tax body attracts tax.

According to the new pattern, equity investments can be made in shares of companies on which derivatives are available on BSE and NSE. The funds would also be able to channelise up to 55% of their funds in central and state government securities and units of mutual funds investing in such securities.

The new pattern also allows these entities to park up to 40% of their funds in debt securities with maturity of not less than three years issued by companies, banks and public financial institutions, term deposits of scheduled commercial banks and rupee bonds having an outstanding maturity of at least three years issued by multilateral institutions such as the International Bank for Reconstruction and Development, International Finance Corporation and the Asian Development Bank. Investment in money market mutual funds has been capped at 5% of the total corpus.

**❖ 30 MNCs get nod to bypass FIPB**

THE wait is over for 30 foreign firms to get foreign exchange promotion board's (FIPB) nod for making downstream investments. The government has allowed them to escape the board and make direct investment in downstream activities by merely informing the Reserve Bank of India (RBI). So far, a foreign company operating in India needed a prior FIPB approval before taking any such decisions.

But the company will be required to inform the board, department of industrial policy and promotion (Dipp) and the secretariat for industrial assistance (SIA) about its investments within 30 days of funding the project, a senior official in the commerce and industry ministry told ET.

Last week the government had issued an instruction (Press Note 4) doing away with the FIPB approval for downstream investments. But it was silent on the fate of cases pending with the board. Nimbus Communications, DSR Realtors and Intertoll Consultants are some of the companies to have approached FIPB of late seeking its approval for making downstream investments.

According to the Press Note 4, a foreign owned or controlled Indian company that either runs a business (operates, in government parlance) or runs a business and also invests in other companies down the line will no longer have to seek clearance from FIPB for making investments in yet another company.

An Indian company simply means a company registered in India, regardless of ownership and control. A foreign owned Indian company means a company registered in India with a majority foreign holding. And, a foreign controlled Indian company means a company registered in India having majority of directors on the board appointed by non-residents.

## ❖ Redo of Accounts likely if Auditors Object

### Cleaner books: Proposal Part of ICAI Bid to Improve Financial Reporting Standards

Companies will have to restate financial statements to accommodate auditors' objections to any figure in their annual accounts, if the country's accounting rule maker, the Institute of Chartered Accountants of India (ICAI), has its way. If the government accepts the proposal, annual reports will contain financial statements that fully satisfy the auditor's scrutiny – signaling the end of qualified company accounts.

The proposal has been cleared by a special group set up by ICAI to suggest ways to improve financial reporting by companies. ICAI will forward the recommendations to the government. According to the proposal, a company that does not restate its accounts, accommodating the statutory auditor's suggestions, would be barred from paying dividends or raising funds.

At present, an auditor's remarks on any part of the accounts is tagged along the annual report, making it

- 🚩 ICAI'S PROPOSAL: In respect of qualifications given by auditor, company's management should revise the financial statement
- 🚩 Such alterations of financial statements should be made obligatory with respect to declaration of dividends, or submission to financial institutions for obtaining credit facilities
- 🚩 Similar move is already prevalent when cos launch IPOs;
- 🚩 SEBI rules such cos will have to adjust past results to give effect to all audit qualifications against them
- 🚩 Proposal in conformity with global norms

difficult for investors to correlate auditor qualifications with official numbers. If the ICAI special group's proposal is accepted, investors will be spared the trouble and accounts would become more transparent.

The proposal is among a slew of measures aimed at improving financial reporting standards in the country, said ICAI president Uttam Prakash Agarwal. The proposals could be implemented through amendments to the ICAI Act, a move that has been mooted in the aftermath of the Satyam scandal.

SEBI has already made it mandatory for companies going for an initial public offering (IPO) to adjust their past results accommodating all audit qualifications. The practice of revising accounts to accommodate auditors' views is in conformity with globally-followed practices. "In most developed countries, all potential audit qualifications are discussed with the company's management, which revises their accounts to ensure there is no disagreement with the auditor," said Ernst & Young India director Rahul Roy, who is a former president of ICAI.

## ❖ Govt. withdraws license fee cut for telcos

The government has called off its decision to slash the license fee for telecom operators with large network presence by up to a third from April 1, following opposition from the finance ministry, giving a Rs 2,000-crore blow to the industry. The communications ministry will soon notify all telcos that the "license fee cut has been kept in abeyance," said a Department of Telecom (DoT) official, who requested not to be named.

The DoT had, last year, announced that the proportion of the revenues telecom operators pay as license fee to the government would be cut by 2% of their total revenues if they prove that their services are available in 95% of the residential areas in a state or a telecom circle, with effect from April 1, 2009.

At present, telecom operators pay 6%, 8% and 10% (based on the ranking of their circles) of their annual gross revenues (AGR) as license fee. As per DoT plans, these would have come down to 4%, 6% and 8% of AGR for operators with comprehensive networks in 2009-10.

If implemented, the license fee cut would have helped telcos save Rs 2,000 crore next fiscal, according to industry executives, who requested not to be named. The rollback decision would hit Bharti Airtel, Reliance Communications, Vodafone Essar and BSNL the most as their networks cover all census towns and large villages in several states, they added.

According to the DoT official, the department has not decided on any new time frame to implement the fee cut. A decision on license fee cut will now be made by the new government that comes to power after the April-May general elections, officials said. DoT could not secure the Cabinet approval to reduce the percentage of total revenues telcos share with the government before the model code of conduct for elections came into play, they added.

At present, telcos pay 10% of their revenues as license fee in category 'A' circles (Tamil Nadu and Maharashtra, among others) 8% in 'B' zones (Kerala, Punjab and Haryana, among others) and 6% for 'C' circles (Himachal Pradesh, Bihar and Orissa, among others). As per last year's announcement, these would have come down to 8%, 6% and 4% for operators with networks covering over 95% of the residential areas in a circle.

Interestingly, the license fee cut would not have impacted the exchequer as DoT had planned to reduce telcos' contribution to the Universal Service Obligation Fund (USOF) for rural telephony, which is paid out of their licence fee, and which is flushed with funds.

Currently, all operators pay a flat 5% of their total revenues towards USOF. That is half the license fee of an 'A' circle player goes to USOF, while almost 85% of a C circle operator's license fee goes to fund rural telephony. This was to be reduced to a flat 3% for those players whose services are available in over 95% of the residential areas. This would have ensured the 'A' and 'B' circle telcos' contribution to the exchequer remained exactly the same at 5% and 3%, while for the C circle operators it would have gone down from 1% to nil.

As of 2007-08, the size of USOF was Rs 20,500 crore and it is now estimated to have crossed Rs 25,000 crore. And, as of September 2008, just 27% of the amount has been utilised, according to telecom regulator TRAI. Studies have revealed that it would not cost more than Rs 12,000 crore to set up infrastructure for mobile services in all rural areas of the country.

## ❖ Easier PN norms, more independence for SEBI

In an effort to encourage entry of Foreign Institutional Investors (FIIs) in India, the Reserve Bank of India (RBI) Committee on Financial Sector Assessment (CFSA) today said that since FIIs maintain identity records of the entity they issue Participatory Notes (PNs) to and capital market regulator Securities and Exchange Board of

India (SEBI) can obtain this information from them, there should not be any cause for concern from the 'Know Your Customer (KYC)' angle raised by regulators in the recent past.

Raising concerns over the origin and source of investment flowing into the country, CFSA felt that there was a need to take suitable measures which would enhance the confidence of foreign investors and regulators alike in the Indian financial system.

CFSA pointed out that PNs can be issued or transferred only to persons who are regulated by an appropriate foreign regulatory authority. The central bank's concern is that as PNs are tradable instruments overseas, this could lead to multi-layering, which will make it difficult to identify the ultimate holders of PNs. Also, the transactions of FIIs with PNs are outside the real-time surveillance mechanism of SEBI.

Furthermore, the committee called the need for a greater independence of regulatory and supervisory authorities in India. The report said that the central government should not supersede the functions of regulators like SEBI unless absolutely required. Since bodies like SEBI are empowered to frame regulations without the approval of the government, an external political and commercial interference should be avoided.

While a Section of the SEBI Act gives it the right to remove a member after providing him an opportunity of being heard, Section 5(2) of the Act gives the central government the right to terminate the services of the Chairman or a member at any time by giving a notice of three months. Finding a conflict of interest under these two Acts, CFSA suggested to remove the Section 5(2) Act, while giving SEBI independence to remove a member under its own powers and without any intervention of the central government.

CFSA found a significant overlap between SEBI and the government with the latter having the powers to issue directions to SEBI even in areas other than the policy.

## ❖ Supreme Court quashes law on unregistered partnership

The Supreme Court has quashed the law which debarred a partner of an unregistered firm in Maharashtra from filing a suit for dissolution of such a firm. The apex court also held as illegal the law prohibiting the partner to sue for accounts of the dissolved firm or realise properties of such dissolved firm, unless the duration of the firm was only six months or its capital was up to Rs 2,000.

"In our opinion sub-section 2A of section 69 (of the Indian Partnership Act, 1932) inserted by the Maharashtra Amendment violates Articles 14, 19(1)(g) and 300A of the Constitution of India," said a bench comprising Justice Markandey Katju and Justice GS Singhvi.

The court said, "a partnership firm, whether registered or unregistered, is not a distinct legal entity, and hence the property of the firm really belongs to the partners of the firm. Sub-section 2A virtually deprives a partner in an unregistered firm from recovery of his share in the property of the firm or from seeking dissolution of the firm."

"Sub-section 2A virtually deprives a partner of a firm from his share in the property of the firm without any compensation. Also, it prohibits him from seeking dissolution of the firm although he may want it dissolved," court said.

The court further said that the law was clearly unreasonable and arbitrary since by prohibiting suits for dissolution of an unregistered firm, for accounts and for realisation of the properties of the firm, it creates a situation where businessmen will be very reluctant to enter into an unregistered partnership out of fear that they will not be able to recover the money they have invested in the firm or to get out of the firm if they wish to do so. There is no legal requirement, unlike in England, which makes registration of a firm compulsory, rather

in India it is voluntary. Both registered and unregistered are legal though of course registration and non registration have different legal consequences, court noted in its judgment.

The bench set aside Bombay High Court order. It said, "The high court was of the view that the object of the Maharashtra Amendment was to induce partners to register and it was intended to protect third party members of the public. We cannot see how sub-section 2A of section 69 in any way protects the third party members of the public. It makes it virtually impossible for partners in an unregistered firm to dissolve the firm or recover their share in the property of the firm. Hence it is totally arbitrary."

The apex court said that the primary object of registration of a firm is protection of third parties who were subjected to hardship and difficulties in the matter of proving as to who were the partners.

Under the earlier law, a third party obtaining a decree was often put to expenses and delay in proving that a particular person was a partner of that firm. The registration of a firm provides protection to the third parties against false denials of partnership and the evasion of liability. Once a firm is registered under the Act the statements recorded in the register regarding the constitution of the firm are conclusive proof of the fact contained therein as against the partner.

### ❖ SEBI to tighten share pledging norms

The Securities and Exchange Board of India (SEBI) is planning to tighten disclosure norms relating to shares pledged by promoters. On Friday, SEBI chairman CB Bhave said promoters who have pledged shares in investment companies – which, in turn, hold shares of the parent company – would also have to disclose details to stock exchanges. "The Primary Market Advisory Committee (PMAC) had discussed the issue of promoters pledging shares of investment or holding companies to raise funds," Mr Bhave said. "At that time, we were not sure about how many banks or financial institutions would lend money to such shares. So, we decided to go ahead with the current disclosure practice for the time being," he said, adding the regulator was awaiting data on pledged shares for April, before finalising the proposed norm.

Current SEBI rules require promoters to disclose the quantum of pledged shares in listed entities, but not of pledged shares holding companies, which, in turn, has a stake in the listed company. Often, promoters hold shares in the listed company through a privately-held company. Technically, it's possible for them to raise money by pledging the equity of an unlisted company, which holds shares of the listed company.

Market watchers say promoters of many mid-cap companies have managed to circumvent SEBI norms by pledging shares in holding companies. On the issue of physical settlement in the equity derivatives segment, Mr Bhave said the regulator was considering the matter.

### ❖ Strict US disclosure norms for offshore a/cs

#### **Non-Residents Required To Declare Overseas Financial Accounts If Aggregate Value Exceeds \$10,000 during Calendar Year**

For Indian tax authorities, who have so far not mustered courage to ask taxpayers to disclose their bank accounts abroad despite speculation over Indians having huge deposits in Swiss banks, here's something to take a cue from. The tax authority in the US has now made disclosure of offshore accounts mandatory even for non-resident individuals or corporates who have significant business in the country. This has ramifications for Indians working or having business interest in the US and also the subsidiaries of Indian companies registered there.

Apart from bringing individual wealth into the open, the amendment would also increase the compliance costs of non-residents and companies working out of the US. "This amendment is likely to cover a large population of Indian IT and other professionals working in the US, who will have to file details of their bank accounts henceforth or face penalty. Indian companies doing business in the US would also need to be aware of and comply with this regulation," said partner in Ernst & Young Amitabh Singh. Indians going on work visas like L-1 or H1B and short-term business travelers to the US would be required to declare their bank accounts in India.

The Internal Revenue Service, the agency responsible for collection and administration of taxes in the US, has recently expanded the scope of a provision that makes it mandatory for residents to disclose their offshore accounts. The expanded regulation requires certain non-residents to declare their 'financial account' in a foreign country if the aggregate value of these accounts exceeds \$10,000 (about Rs 5,00,000) at any time during the calendar year. However, artists, athletes, and entertainers, who are not citizens or residents of the US and occasionally visit the country to participate in exhibits, sporting events, or performances, are exempted from making this disclosure. Hitherto, the provision called report of foreign bank and financial account (FBAR), first introduced in October 2008, applied only to US citizens and green card holders. The measure is a part of the US government's efforts to combat offshore tax evasion, but could increase cost of compliance for these entities, as the FBAR has to be filed separately and not with tax return. A financial account would include securities, securities derivatives, savings, demand, and checking deposit – an account identical to current account in India, used to securely and quickly providing frequent access to funds on demand but account balances in which do not fetch interest – or any other account maintained with a financial institution. Individual bonds, notes or stock certificates held by the filer are not covered under financial account.

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Failure to file an FBAR, can be onerous and result in civil penalties, criminal penalties, or both. The civil penalty amount could be as high as \$1,00,000 per violation while criminal violation can result in a fine of up to \$ 2,50,000 or five years in prison, or both.

Countries across the world place various disclosure requirements on their citizens and other residents with a view to combating tax evasion. Individuals who live in the UK have to declare their all taxable income to tax authorities. Indian tax authorities amended the tax return form last year, making it mandatory for filers to disclose transactions such as

property purchase or sale above Rs 30 lakh, credit card spend of over Rs 2 lakh, mutual fund investments of more than Rs 2 lakh and investment above Rs 5 lakh in RBI bonds, company equity or debentures.

Tax authorities have independent access to information on these transactions through annual information return, filed by third parties or entities such as banks, mutual funds, registrar of properties and others responsible for carrying out these transactions. However, in India it is not required to disclose overseas bank accounts details in the tax return. Former income tax chief commissioner KVM Pai recently made a recommendation to the Central Board of Direct Taxes to include a column in the tax-return form seeking information on bank accounts in foreign countries.

## ❖ Telecom emerges top overseas borrower

THE money-guzzling telecom sector is the highest borrower from overseas as rapid expansion in India, the world's fastest growing market, requires constant infusion of funds. Telecom led the list of overseas borrowers in the infrastructure sector in 11 quarters beginning 2006. The cumulative external commercial borrowings (ECBs) of telecom firms between January 2006 and September 2008 stood at a whopping Rs 32,913 crore, according to data released by the Reserve Bank of India (RBI). The telecom sector was followed by the power sector, which took overseas loans of Rs 23,368 crore, during the period.

According to the CFO of a top telecom firm, the main reason for heavy overseas borrowings is that it is difficult to get rupee borrowing on a fixed rate basis for a long term of more than three years. "Also, when these ECBs were drawn, they were fully swapped and were equivalent to rupee borrowings at a fixed rate. So on a fully swapped basis, they were more attractive than direct rupee borrowings," he told ET.

However, those companies which did not opt for hedging will be hit since the rupee has depreciated against the dollar in the past few weeks. "Companies' debt liabilities in rupee terms must have shot up correspondingly. The more the forex exposure, the more hit a company will take. These companies will book heavy mark-to-market losses in the current quarter if they were not hedged," said an analyst, who did not wish to be named.

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- 🚩 The telecom sector was followed by the power sector, which took overseas loans worth Rs 23,368 crore,
- 🚩 During the period RCOM was the biggest borrower in the telecom sector with ECBs of Rs 4,505 crore in 2006, Rs 12,987 crore in 2007 and Rs 4,323 crore up to September 2008

Anil Dhirubhai Ambani (ADA) group's Reliance Communications (RCOM) is the biggest borrower in the sector. The telco had ECBs of Rs 4,505 crore in 2006, Rs 12,987 crore in 2007 and Rs 4,323 crore up to September 2008. In all, it borrowed Rs 21,815 crore during the period. RCOM was followed by Tata Teleservices, which had overseas loans of Rs 1,925 crore in 2007. Idea Cellular's ECBs stood at Rs 770 crore in 2007 and Rs 957 crore in 2008, Vodafone Essar Rs 944 crore in 2007 while Bharti Airtel's ECBs were Rs 916 crore in 2006. Bharti Airtel has not raised any money from abroad in the last two years.

Borrowers in the infrastructure sector are allowed to avail ECB of up to \$500 million per fiscal under the automatic

route beginning October 22, 2008. Now, payment for 3G spectrum is also considered eligible enduse for the purpose of ECBs.

According to Angel Broking analyst (IT and Telecom) Harit Shah, telecom firms are expanding to newer towns and rural areas and are in need of billions of dollars on a regular basis. "With money being reasonably cheaper abroad and with firms being in a strong position to raise cheaper debt abroad as opposed to from within the country, it is natural to expect them to do so," he said.

Other companies in the telecom sector which took overseas loans include GTL Infrastructure, Spice Communications, Spanco Telesystems and Solutions, Cable & Wireless India, XL Telecom and Shyam Telelink.

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