

MAHESHWARI & CO.

ADVOCATES AND LEGAL CONSULTANTS

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❖ Cap on single holding in bourses may rise to 15%:

Market regulatory or Sebi is examining a proposal to raise the equity holding limit in stock exchange from 5% to 15%. The revised cap will be applicable for single investors-both local and foreign. The decision to revisit the norms on investment in stock exchanges was prompted by the fact that the present cap could deter potential promoters of new exchanges, an official explained.

Both Sebi and the government want to foster competition among bourses. The proposal seeking to revise the norms was discussed at Sebi's last board meeting, the official said. It was decided that a final view should be taken after seeking wider comments, he said.

If the proposal is approved, foreign investors such as New York Stock Exchange, Deutsche Borse and Singapore Exchange, which have acquired shares in Indian stock exchanges, will be able to raise their holdings in these entities.

In November 2006, Sebi had notified demutualization of stock exchanges, making it mandatory for at least 51% of the equity to be continuously held by the public.

The guideline capped individual investment, both direct and indirect at 5%, besides putting in place a stringent criterion for persons acting in concert. The norms stipulate that no person can acquire more than 1% in the paid-up capital of a stock exchange unless he is "fit and proper", which implies the investor must satisfy all the requirements set by the regulator. Prior Sebi approval is necessary for acquiring even 1% equity stake.

Foreign investment in stock exchanges was allowed in December 2006. While the overall limit is pegged at 49%, the cap for foreign direct investment is 26%. For foreign institutional investors, the investment limit is 23%.

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❖ Leniency on treaty shoppers :

- ↪ It has also objected to a proposal from Kanodias to bring in \$50 million through a Mauritius-based holding entity.
- ↪ Several proposals, especially those involving FDI flow from Mauritius and Cyprus, have been put on hold during recent weeks.

TO CHECK tax losses arising from treaty shopping or 'round tripping'—routing of domestic funds overseas to bring them back through tax havens like Mauritius—the government has stepped up scrutiny of FDI proposals. Several proposals, especially those involving FDI flow from Mauritius and Cyprus, have been put on hold during recent weeks. The finance ministry wants to prevent treaty shopping—channeling of investments through countries like Mauritius with which India has double taxation avoidance treaties to evade capital gains tax.

The proposals recently put on hold include those of UK-based investment firm Ashmore, which manages funds worth about \$37.5 billion, OP Jindal Group and brokerage house CLSA. The department of revenue in the finance ministry has objected to the Jindal'

proposal of bringing in FDI through a Mauritius-based entity for JSW Infrastructure, as it believes the deal involves round tripping. It has also objected to a proposal from Kanodias to bring in \$50 million through a Mauritius-based holding entity.

❖ Private Equity cut smart deals :

PRIVATE equity (PE) firms favor clubbing when it comes to striking deals. Unlike in the past, when PE firms were single investors in a company, they now prefer to join hands in putting money in firms.

Early this year, Temasek Holdings, an investment arm of the Singapore government which is the only foreign institutional investor in Tata Teleservices, seemed to be content being one of the investors in an eight-way deal to invest close to Rs 4,800 crore in Bharti Infratel.

If eight is fine, then consider Idea Cellular's transaction. The telecom company struck a nine-way deal with private equity funds, which is probably the largest 'club deal' in India by private equity firms. Similarly, Reliance Telecom roped in seven foreign institutional investors including New Silk Route, Galleon, Fortress, GLG, Quantum, DA Capital and HSBC Principal Investments. Although there is nothing unusual about PE firms adopting the group approach, what is striking this time is the coming together of a varied number of investors.

Says a senior official with a large buyout fund, "Multiple set of investors helps in diversifying the risk specially linked to new business model such as the telecom tower business and also in getting more knowledge on the board of the company." Globally, this practice is followed by PE funds as it enables them to execute large buyouts at a good price. Besides, it minimizes the competition for targets. In India, such a trend is slowly emerging. "While conducting our second fundraising exercise, we wanted to see the retail chain to be valued at a superior notch. This is better realized with a fresh set of investors who justify the new price too," a senior executive from Cafe Coffee Day said.

Recently, at Cafe Coffee Day, two new investors walked in and invested \$95 million. Instead of clicking a deal with existing investors such as Sequoia Capital and International Finance Corporation, the coffee chain opted for new sponsors in Deutsche Bank and Templeton Darby Investments.

The company executive added that having multiple investors would also help the company as and when it decides to hit the capital market. "It is a long-term benefit." According to some analysts institutional investors are not willing to put all their eggs in one basket. Unlike in the past when funds preferred to have the 'exclusive' tag with a company, they now prefer clubbing together to clinch a deal. The change in business approach is because of the volatile stock markets, which has impacted valuations of many companies. Funds that had earlier invested at high valuation are not too keen to increase their exposure, given the change in scenario.

After registering a high of 21,000 in January, the bellwether BSE Sensex, has been on downslide. The public markets have corrected by nearly 40% across sectors this year.

Kotak private equity fund's head Nitin Deshmukh said, "It happens very often in a situation where an investor has invested at a high valuation when the markets were at its peak and later on they are reluctant to invest at a more higher valuation compared to the earlier price." Kotak Realty fund recently checked into Lemon Tree Hotels, an upscale mid-market hospitality chain, which also has Warburg Pincus and Japanese's Shinsei for company.

A lot of time companies in their agreements with financial investors have a covenant which stipulates that the company cannot sell shares to anybody at a price which is lower than the price at which shares were placed with their first set of investors. These covenants are part of the agreements of mostly mid-cap companies since they generally obtain a higher premium.

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According to Venture Intelligence data, in the first half of 2008, PE funds invested close to \$6.7 billion (across 193 deals) compared to \$5.4 billion invested (across 181 deals) in the same period last year. Though the first six months of 2008 has seen a higher rise in terms of quantity and size of deals, the year is likely to end at a slower growth rate compared to 2007. PE funds invested \$14.3 billion (across 420 deals) in 2007.

❖ Services spilling over SEZs may get tax sops

Its celebration time for special economic zones (SEZ). The government has decided to extend service tax exemption to developers and SEZ units for authorized services rendered not just within the zones but outside as well. Right now, the finance ministry provides tax exemptions only for services availed inside SEZs.

The announcement on the extension of the tax sop is expected to be made soon. Once the extension is notified, SEZ developers and units will be relieved from paying service tax on a number of areas such as port handling, inland transportation, courier and banking.

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- ↪ The finance department was not providing exemption on services consumed outside the zone as it was misinterpreting the Act, it said.

The Centre is also working on certain additional incentives for SEZs. These may include benefit of input duty reimbursement schemes (drawback and DEPB) for supply of goods from domestic tariff area (DTA) to SEZ developers.

"The finance and commerce ministries have reached an agreement on exempting SEZs from paying service tax on authorized services availed outside the zones. The announcement is likely to be made shortly," a source said.

SEZ unit owners and developers have been demanding they should be exempted from paying 12% service tax on authorized services provided outside the zone.

The commerce department, pushing the case, argued the SEZ Act provides for exemptions for services consumed either inside or outside an SEZ as long as it is for an authorized operation within an SEZ. The finance department was not providing exemption on services consumed outside the zone as it was misinterpreting the Act, it said.

"As long as the service availed by the developer or unit falls within the list of activities authorized by the government, it should not matter whether it is rendered inside the SEZ or outside," the source said. The finance ministry seems to have agreed to the suggestion.

The Centre may also favorably rule on the proposal to give benefit of input duty reimbursement schemes such as duty drawback and DEPB schemes to supply of goods from outside SEZ to units in SEZ and developers. Since an SEZ is considered a foreign territory, the commerce department had said that sales to SEZs should be considered exports and be eligible for drawback and DEPB benefits. "The proposal is being looked at and may also be given the green signal," the source said.

Appoint legal draftsmen to avoid ambiguities, advises Chidambaram

New Delhi: The government has accepted that there are drafting errors in important laws including the Special Economic Zone (SEZ) Act, Income-Tax (I-T) Act and Prevention of Money Laundering Act. In the SEZ Act the definition of vacant land has not been provided and it needs a redressal by the law ministry, finance minister P Chidambaram said on Wednesday. Mr. Chidambaram said that all types of conundrums arise because of these drafting errors. He also proposed that every ministry should appoint legal draftsmen to avoid ambiguities while bringing notifications or announcement. "What is

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vacant land? A vacant land, for me, is a land, which is vacant. Can there be vacant land, which is not vacant? May be there are, the law ministry will tell," he said at a function of Indian Law Institute here. Referring to the dispute over definition of petroleum and natural gas for the purpose of income tax he said that while section 42, 44 and 293A of the I-T Act define petroleum and natural gas as mineral oil, subsection 9 of section 80 I (b) is silent on that.
– Our Bureau

❖ BLURRED BOUNDARIES

Today, tax incentives are available only for services availed inside SEZ. Benefit of input duty reimbursement schemes, drawback as well as DEPB, for supply of goods from DTA to SEZ developers likely to get incentives too SEZ Act exempts any service for operation within SEZ: Commerce dept SEZ constituents have been demanding tax sop on service outside zone.

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