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Re-CAP

A weekly mailer encapsulating capital market news

(Feb 16th--21st, 2015)

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IFCI CLOSE TO SELLING PART STAKE IN NSE

IFCI, the Delhi-based government finance company, has postponed its plan to divest 2.5 per cent stake in the National Stock Exchange (NSE). According to two sources in the know of the matter, lower-than-expected bids from investors have forced the company to postpone its plan. IFCI had announced in June that it proposed to engage a consultant to "advise and manage" the partial divestment process. Powerhouse Coopers (PwC) is said to be handling the transaction. An email sent to a PwC spokesperson did not elicit a reply. "With a view to unlock the value of its strategic investments, IFCI intends to disinvest its equity shareholding (direct) in the NSE to the extent of 112,500 equity shares (2.5 per cent out of its shareholding of 5.55 per cent)," according to a PwC note on the divestment reviewed by Business Standard.

PUSHING THE DEADLINE

IFCI announced plans to sell stake in NSE in June this year Part of a larger plan to exit a number of non-core subsidiaries said to have been looking at three bids for the stake However, valuations said to be lower than expectations Plan for which was to conclude by September 30 has now been postponed IDFC was reported to have sold a portion of its stake in the NSE in 2013. The sale is said to have been at a price of Rs 4,200 per share. At the same price, it would have fetched IFCI about Rs 500 crore. The plan might be reviewed in a month's time, said one of the sources. The IFCI stake sale was to be concluded by September 30. IFCI has been working to unload a number of its non-strategic investments. On September 22, the company announced plans to partially sell its stake in the Tourism Finance Corporation of India Limited in the current financial year. It also previously announced plans to sell its entire stake in capital market subsidiary IFCI Financial Services Limited. It had been trying to integrate operations between IFCI Financial Service and Stock Holding Corporation of India (SHICL). It held 52.86 per cent in SHCIL after it completed the acquisition of stake in March this year from IDBI Bank for an undisclosed sum. The largest stakeholder in the NSE is the Life Insurance Corporation of India (holds 10.51 per cent stake), followed by the State Bank of India (10.19 per cent), and according to the NSE annual report .IFCI held 5.55 per cent, while IDFC held 5.33 per cent in the country's largest exchange. Other stakeholders include SHICL, GA Global Investments Limited, GS Strategic Investments Limited, SAIF II SE Investments Mauritius Limited and Aranda Investments (Mauritius) Pte. Ltd - all with five per cent each. The NSE's income rose from Rs 887.95 crore in the financial year ending in March 2013 to Rs 998.95 crore in March 2014. It had a net profit of Rs 937.97 crore compared to Rs 841.79 crore the previous year. The exchange and IFCI did respond to the emails sent by Business Standard.

(Source: Business Standard, February 19, 2015)

SHARES WITH DIFFERENTIAL VOTING RIGHTS RALLY

Shares with differential voting rights (DVRs) rallied sharply on Thursday, a day after the BSE allowed their inclusion in benchmark indices. Investors bought into DVRs, which trade at substantial discounts to their main shares, in anticipation these would make it to the main indices soon. DVRs are similar to ordinary shares, except they offer higher dividend to investors in lieu of voting rights. Companies issue DVRs to raise capital without diluting the voting rights of promoters and existing shareholders. So far, four companies have issued DVRs in the Indian market. On Thursday, the DVRs of rose 6.6 per cent, while those of Gujarat NRE Coke, Jain and Future Retail gained 19 per cent, six per cent and two per cent, respectively. The ordinary shares of these companies either fell about one per cent or rose marginally. Gujarat NRE Coke was the only exception; its ordinary shares hit the upper circuit during Thursday's trading session. "Because of lack of visibility, these DVRs often fall under the radar of investors. So, if these DVRs are given a berth in the main indices, it will allow for increased retail participation in these instruments," said Deven Choksey, managing director of K R Choksey Securities. The price differential between the ordinary share and DVRs, currently 45-60 per cent, could fall in time, making these more attractive. Globally, DVRs trade at a 10-15 per cent discount to their respective ordinary shares. Inclusion in the main indices could raise demand for DVRs, eventually reducing the price differential and boosting demand for the entire product segment, experts say.

One of the criteria for inclusion into the main indices is the DVRs outstanding of the companies concerned should account for at least 10 per cent of the total shares outstanding. As of now, only the Tata Motors DVR qualifies for inclusion, as its DVR shares outstanding are about 17 per cent of the its overall shares. Besides, DVRs will be permitted into the index only if the ordinary share is already part of any of the S&P BSE Sensex, S&P BSE 100, S&P BSE 200 and S&P BSE 500 indices. Currently, except for Gujarat NRE Coke, all other shares of companies with DVRs are part of at least one of these. “Companies will look at increasing their DVR holdings to be made a part of the indices. Also, issuing DVRs is a much more convenient way of raising capital without much stake dilution," said Rikesh Parikh, vice-president (equities), Motilal Oswal Securities. Analysts believe DVRs could soon become a regular form of fund-raising for companies, especially those with lower promoter holding.
(Source: Business Standard February 19, 2015)

SEBI CHAIRMAN KEEPS MARKETS GUESSING ON TRADING ON BUDGET DAY

Finance Minister Arun Jaitley will present the first full Budget on Feb 28, which is a Saturday

Sebi is yet to take a call on opening stock markets on Budget day, which falls on a Saturday, its chairman UK Sinha said today. Finance Minister will present the first full Budget of the Prime Minister Narendra Modi-led government on February 28 amidst heightened expectations that the government will go for major reforms.

"We have received some requests in this regard and we are examining that. Consultations are going on. So, have a little more patience. We will be guided by the precedents and regulation," Sinha said on the sidelines of an event organised by Sebi-promoted NISM at its upcoming campus at Patal Ganga near here. Calling for developing more in-house market research talent, Sinha said the Sebi and our stock exchanges are sitting on a mount of very valuable data but all the analysis of such data is being done outside the country. Explaining further, he said based on the market data generated here lots of research are taking place outside the country as there is no forum through which that research can be done here. For instance, Sinha said: "We have no clue about the data analysis from high frequency trade. We do not know what the trends are and what are the learnings from these trends that are happening here, as there is nobody here who can analyse them." So, all the inputs that we are getting from experience and research are done outside the country, he said, adding that there is a need to create a strong research at the National Institute of Securities Market and the research should be available to all. Sinha also said Sebi has committed Rs 225 crore, out of its Rs 325-crore budget, for constructing a new campus for NISM at Patalganga near here on the call for extending the currency derivatives trading to 7.30 pm, Sinha said the matter is under discussion between the RBI, the Sebi and the Finance ministry. Sebi plays rather a smaller role in this.
(Source: Business Standard, February 20, 2015)

MSMEs TO HAVE LEVEL PLAYING FIELD IN OPEN TENDERS

VAT amount to be excluded while evaluating price bids

In a bid to provide level playing field to the state-based (MSEs), the state government is likely to exclude (value added tax) payable in state by MSEs participating in open tenders while evaluating the comparative price statements for finalisation of the tenders. This incentive would be incorporated in the new soon."For open tenders, the comparison will be made on the basic price and VAT payable in state will be excluded while finalizing the tenders since the VAT amount accrues back as revenue to the state. It will be of immense help to the local units," said Panchanan Dash, secretary, MSME department, on the sidelines of *Business Standard* Smart Business event organised in association with Odisha Young Entrepreneurs Association, here. This step will open up opportunities for the local units as out of the state units are bagging orders by quoting CST (central sales tax) rates which is lower than VAT rate, he added. The purchase of goods from out of the state units by the government departments also erodes the state's consumption base. The local players are losing out opportunities to outside units. With price comparison to be made only on the basic price for finalising the open tenders on the cards, it will fulfil the long standing demand of industry bodies of the state for a level playing field and will open up marketing avenues for local players battling for exporting the products. The MSME procurement policy is likely to be unveiled by chief minister Naveen Patnaik during the Entrepreneurship Week to be held in March this year. The policy, among others, will also mandate the state government departments and state public sector undertakings (PSUs) to purchase 20 per cent of their requirements from MSEs in Oidsha which is likely to give a boost to the sector. In addition, the MSME department is also in talks with e-commerce players like Amazon, Flipkart for linking with the department website for marketing the products of the local MSME units. To address the infrastructural needs of the MSMEs in Odisha, the department is contemplating to provide plug and play facilities for MSME units at 45 panchayat industry clusters, after the Odisha Small Industries Corporation Ltd (OSIC) is handed over the responsibility of development of infrastructure for MSME units.
(Source: Business Standard February 15, 2015)

KNOWLEDGE-BASED MSMEs IN SERVICE SECTOR GROW FASTER

CRISIL has analysed the performance of 726 micro, small, and medium enterprises (MSMEs) in the service sector, which were rated on the basis of their financials for 2013-14 (financial year

April 1 to March 31). The study revealed that MSMEs in knowledge-based segments - that is, consulting, education, health care, and information and communication technologies (ICT) - registered higher growth, as compared to other segments in the same sector, such as construction, logistics, and printing.The average income of knowledge-based MSMEs increased to Rs 13.97 crore in 2013-14, from Rs 9.10 crore in 2011-12, at a compound annual growth rate (CAGR) of 21 per cent. In comparison, the average income for the other service segments increased to Rs 23.84 crore in 2013-14, from Rs 18.37 crore in 2011-12, at a CAGR of 14 per cent Of the knowledge-based MSMEs, those in health care registered an impressive CAGR in average income of 41 per cent, supported by a boost in the number of surgeries undertaken and patients covered by state-funded health care insurance schemes. That of MSMEs in ICT grew by 25 per cent, followed by those in consulting at 20 per cent, while those in education grew at 19 per cent. Based on the study, CRISIL expects that with improvement in overall economic prospects, knowledge-based MSMEs should continue to perform well.

(Source: Business Standard, February 16, 2015)

WHERE ARE THE PROFITS

Unlike the jubilant markets, India Inc's performance for the quarter ended December has been dismal, with aggregate net profit of 2,941 companies shrinking nearly 17 per cent over a year ago. Earnings of companies forming part of the Sensex, as well as broader indices like BSE500, were under pressure. Among the most notable trends was a weak show by information technology (IT) and pharmaceuticals, two sectors that had so far held up overall corporate profits quarter after quarter. The IT sector's profit, for instance, grew by only four per cent, weakest since the March 2012 quarter. Even after adjusting for one-off gains by Strides in the year-ago period, the pharma sector's aggregate profit was down about a per cent, it's weakest in five quarters. The trend looks worrying, as the number of companies that fell short of expectations was much more than those that beat estimates and that too across sectors - capital goods, metals and automobiles. Even fast-moving consumer goods, a so-called defensive play, saw its performance come under pressure. In contrast, banking did well partly due to a low base effect that helped State Bank of India post a strong rise in profit. Most private banks did well.

(Source: Business Standard February 17, 2015)

DOMESTIC HEDGE FUNDS' ASESTS DOUBLE SINCE 2012

Despite being smaller in size, domestic players have outpaced India-focused foreign hedge funds in growth; however, barriers to market's growth remain

The assets under management for hedge funds based in India have grown faster than their foreign peers since they came into

Being in 2012. This was the year when the capital markets regulator, Securities and Exchange Board of India (Sebi), recognised hedge funds as a category for the first time. The S&P BSE Sensex is up a little less than 80 per cent since the regulations were enacted, while the hedge fund assets have more than doubled. Interestingly, India-focused foreign hedge funds' assets are up only 44 per cent in the same period, according to data from hedge fund tracker Eureka hedge. The faster growth of domestic players could also be on account of the difference in size of the foreign versus the India-based segment. The money managed by hedge funds which have a mandate to invest only in the Indian market scaled a multi-year peak in 2014. The total amount managed by such funds reached $3.45 billion. And, $3.06 bn of this came from funds based outside India. Local funds accounted for $392 million. Local players have also tended to outperform their foreign peers. Their return in 2014 was 50.8 per cent. India-dedicated hedge funds based outside the country had a return of 44.19 per cent. "Broadly, it definitely helps to have feet on the street. There is no substitute to be on the ground in the market that one invests in. That being said, information is widely available today, which allows for informed decision making from anywhere in the world. I would have to say there is a small edge to generate alpha by being present in the market one invests in," said Anuj Didwania, managing director, Redart Capital Advisors, which runs an Indian hedge fund.

In 2013, too, local hedge funds outperformed. Hedge funds based abroad gave a negative return, of 10.17 per cent. Those based in India gave a positive return, of 6.43 per cent. The outperformance has continued. "Indian hedge funds were the top performers with gains of 6.8 per cent while Eastern Europe and Russia mandated funds delivered the worst results, down 2.46 per cent for the month," according to a statement from Eureka hedge. The nature of participation so far might be the cause that the assets of local hedge funds are much lower than those of India-dedicated funds abroad. "Institutions don't invest in alternative assets (of which hedge funds are a part) in India. Globally, the biggest investors in hedge funds are not HNIs (wealthy individuals) but institutions like pension funds and endowments… therefore, the room to grow (in India) is very limited," added Didwania.However, the interest does seem to be building. "There is some interest from corporate treasuries and family offices," said Vaibhav Sanghavi, managing director, Ambit Investment Advisors, which runs its own hedge fund. But there are plenty of kinks to be worked out before hedge funds can attract foreign capital."Foreign investment in Indian hedge funds, organised as trusts and LLPs (limited liability partnerships), require Foreign Investment Promotion Board approval, which generally has been challenging to obtain. In addition, there is a tax arbitrage in favour of offshore funds directly investing from favourable treaty jurisdictions, as compared to tax challenges and ambiguities for Indian hedge funds. These factors have deterred foreign investments in Indian hedge funds," said an official with one of the big four accounting firms.

(Source: Business Standard February 16, 2015)

COUNTDOWN TO BUDGET- MORE OF YOUR MED EXPENSES MAY BE FREE

The government is reviewing the tax-free medical reimbursement limit, currently fixed at Rs 15,000 a year, besides looking at making it more attractive for individuals to buy medical insurance policies.

Sources said both the issues are being looked at ahead of the Budget with some indicating that there is a possibility that the limit on tax-free medical reimburse ment from employers may be raised to Rs 25,000 a year, given the rising medical costs in the country.

Similarly, the government, which allows a deduction of Rs 15,000 a year for medical insurance premium paid for spouse, children as well as the policyholder, is looking at encouraging individuals to buy a higher cover. In case of senior citizens the limit is Rs 20,000.

The review comes as the limits were fixed several years ago and costs have gone up significantly since then .For instance, in the wake of rising claims, insurance companies have increased the premium on medical insurance on several occasions over the past few years. There is also a view that medicine costs have increased and an Rs 15,000 annual limit on tax-free medical reimbursement often does not meet hospitalization requirements. While getting admission in government hospitals is difficult due to pressure on beds, charges at private hospital are very high, as a result of which the limit is easily breached. The encouragement given to insurance is also aimed at reducing pressure on state run hospitals, while encouraging people to cover their risks Often individuals buy insurance policies only to ensure they are able to claim tax deductions and end up having lower than-required cover for family in case of a health emergency .

The Centre has repeatedly said it is against high taxation and wants to leave more money in the pockets of individuals to help increase investment. The review of benefits for health spending is aimed at making the limits realistic and in sync with current requirements.

(Source: The Times of India Feb 16, 2015)

INDIA IN NOT SURE HOW GOVT.WILL FUND RS.60L INFRA PROJECTS

Debt-Hit Cos Hope Budget Will Offer Financing Solutions

The Narendra Modi-led government is working on infrastructure projects worth $1 trillion, or Rs 60 lakh crore, but a majority of India Inc, burdened with debt and stretched balance sheets, appears sceptical. Most have the same refrain: Where is the money, honey? Of the $1 trillion, power and road alone account for one-third — or $330 billion.

Most of these projects are a legacy of the previous government, though the present one has added some like the Ganga clean-up and river interlinking projects, smart cities and a $250-billion power offensive with renewables alone accounting for $100 billion to create 1 lakh MW of solar power and 60,000 MW of wind capacities. The scepticism in India Inc acquires significance as it is privately quite vocal about things not changing on the ground yet. Few are buying the government's promise of long-term funds coming from abroad.

That's not all. Industry watchers say a lot of companies which had bid for some infrastructure projects earlier are either queuing up to sell or just cutting their losses by paying the earnest money and getting out. A M Naik, chairman, Larsen & Tubro, a company that mirrors India's infrastructure growth, believes that there is no money with India Inc and the PPP model will not work unless the government gives guaranteed returns. "No one has gone ahead.

GMR in Rajasthan had a beautiful project but they did not go ahead. Neither did GVK. Some others which did it earlier, when PPP was a way of life, are now in the market to sell. So there are more road projects in the market on sale than companies wanting to bid. I am a distressed seller also…. I want to make sure that my portfolio is very robust before making any more investment," Naik told TOI. He goes on to add that if this is L&T's position, then how many others would have the money to invest. "Three or four companies?," Naik said, adding that L&T recently got a road project in Orissa on a single bid, which would have been routinely put for a rebid earlier. Things are so bad that L&T actually chose to forfeit about Rs 100 crore in earnest money to the government for not going ahead with a project since it would have had to incur more losses if it had chosen to go ahead with it. Debt Overhang Investment adviser S P Tulsian feels that India Inc is currently reeling under a liquidity crisis comparable to the 2008 crisis. "No major corporate house in India has this kind of money to invest, barring a few, even though business confidence has improved," he said. India Ratings and Research, a Fitch group company, puts this in perspective. Industry needs a minimum equity infusion of $114 billion or will have to wait for at least 3-6 years, according to its survey of top 500 corporate borrowers. Of these, 96 are already tagged as nonperforming assets (NPAs) or are in the process of restructuring their loans while 87 generate income less than their interest liability. Sample the debtors list of

India Inc, which include some of the top corporate houses and it will be clear how staggering they really are.

Raghupati Singhania, CMD, JK Tyre & Industries, believes that despite the heightened confidence from the new government and upbeat foreign investors flooding the stock markets, economic recovery is yet to take off. "Private investments will not be forthcoming unless there is demand revival as most sectors are reeling under overcapacity," Singhania said.

Arguing his case further, Naik said that even in annuity projects, which have guaranteed return, there are only two to four bids these days, because people have no money. "I think people have lost so much money that it's a case of once bitten twice shy," he said. One of India's biggest industrialists, who did not wish to be identified, made the same point of not being able to put money in new projects because of their past experience, which has severely impacted their businesses. Solutions the government, however, continues to be upbeat. Power minister Piyush Goyal, fresh from his return from Davos, had told this paper that global investors were upbeat about investing in India. "We have firm investment commitment of $100 billion in the power sector alone, "he said. Harsh Goenka, chairman, RPG Enterprises, offered some solutions. He believes such high-gestation and capital-intensive projects need the right mix in capital structuring. "For cost of capital to be optimum, taxshieldable debt is important. Industry, therefore, needs more access to credit at globally competitive rates, "he said. Still, most hope the Union budget would provide more solutions.

(Source: The Times of India Feb 21, 2015)

FIRST PHASE ROLLOUT- GOVT NOTIFIES NEW ACCOUNTING STANDARDS

All Companies having net worth of over Rs 500 crore & their subsidiaries will have to report under Ind AS, beginning April, 1 2016

The government has notified new accounting standards (Ind AS) that is benchmarked to upcoming international financial standards, which will alter the way their transactions get accounted in India.

As per the corporate affairs ministry road map, all companies, listed and unlisted, with a net worth over of. Rs 500 crore, and their subsidiaries, joint ventures and associate companies are covered in the first phase and will have to mandatorily report under these standards for financial year, beginning April 1, 2016. The second phase, from financial year 2017-18, covers the other companies with a net worth over. Rs 250 crore. Net worth will be measured as of March 31, 2014. However, companies that are listed or in the process of listing on SME exchanges are exempt. Firms can voluntarily follow these from the April 1 this year itself. Ind AS, which is a converged standard with the international financial reporting standards, will have a transformational impact on accounting for financial instruments, business combinations, revenue recognition and consolidated financial statements for entities.

Under the Ind AS, the financial instruments standard will impact the way financial assets and liabilities are classified and measured by entities. Many off balance sheet items like embedded derivate will now have to be reported. India will be the first country to adopt the financial instrument standard as others will do it only in 2017-18.

"The move towards an early adoption of the financial Instruments standard (IFRS 9) is a bold one. The transition will require a considerable implementation ef fort that will af fect multiple business functions, " said Pankaj Chadha, Partner with India member firm of EY Global. "Currently 39 Ind ASs have been notified, including the most significant ones being Revenue Recognition and Financial Instruments. These two standards on its own will have an enormous effect on entities it will not only impact every company's top line and bottom line but will require other organisational and business changes," said Sumit Seth, Partner and IFRS Leader Price Waterhouse.

Moving to new financial reporting standards will make Indian corporate accounts comparable internationally, which could also lead to more investments. Currently about seven of the Nifty 50 companies use IFRS, apart from a few others. Most companies use IFRS because they are also listed in the US. The new standard for consolidated financial statements, which talks about the single control model, may change the way in which entities are included within a group. So, if a company has de facto control over another company irrespective of stake, it has to consolidate under new standards.

(Source: The Economic Times Feb 21, 2015)

REVENUE TARGETS BY FINMIN UNREALISTIC

The Tax Administration Reform Commission (TARC) submitted its fourth and final report to the government on Friday, pointing out a tendency to fix unrealistic revenue targets by the finance ministry, reports Our Bureau. The commission set up by the previous United Progressive Alliance (UPA) government and headed by Parthasarathi Shome gave recommendations on revenue forecasting, predictive analysis and research for tax governance.

(Source: The Economic Times Feb 21, 2015)

ONLY A FEW INVESTORS CLAIM NSEL MONEY

13,000 scam-hit said to. have lost Rs 5,600 cr, but only about 20 have made. claims for less than Rs 20 cr

Only a handful of the 13,000 investors said to have lost Rs 5,600 crore in the National Spot Exchange (NSEL) scam have come forward to claim their money.

The Bombay high court in September 2014 had set up a three-member committee, headed by retired Justice VC Daga, to determine the money to be paid by the alleged defaulters in the NSEL scam. The committee had set a deadline of February 25 for the 13,000 investors to claim their money. Sources close to the committee told ET that only 15-20 investors have so far made a claim for amount that could be less than Rs 20 crore.

“It is a frivolous attempt by NSEL to collect investor data and, hence, we are not submitting any claim, “ said Ketan Shah, who represents NSEL Investors' Action Group. “NSEL has the list of 13,000 investors and they need not collect any further data but just recover the money from borrowers of NSEL and pay back.“NSEL declined to comment.

Sources said some of the 13,000 investors were not traceable. Shah said whatever claim the investors wanted to make has been done through a lawsuit in the Bombay high court. An entity called Modern India filed the lawsuit against Financial Technologies, NSEL's then founder promoter, and 40 other entities to recover investors' money stuck with NSEL. Shah said Modern India, which seeks to recover Rs 5,000 crore at an annual interest of 16%, represents all investors in court. “We have made a representation to the Daga committee and challenged such an order to allow NSEL seek investor claims. Justice Daga will hear us on February 23, “Shah said.

Legal experts, however, pointed out that many of the NSEL clients are averse to giving details as a large amount of cash transactions were involved in the dealings. Also, many NSEL traders had availed margin funding facility from stockbrokers.

“Even though investors do not give all information that the NSEL is asking, it is necessary for them to make a valid legal claim, “said a Mumbai lawyer and a former regulatory official.

NSEL, which provided a platform for spot trading in commodities, had 154 brokers dealing on its platform but police investigations have revealed that 7-10 large brokers constituted 85% of the total outstanding. NSEL investors say they hold contract notes from the exchange as a legal document.

A Bombay HC-appointed panel has set Feb 25 as deadline for investors to claim their money

In the course of hearings based on Modern India's lawsuit, the high court had ordered the formation of the Daga committee. Justice Daga could not be reached for comments. “NSEL has sought details like the source of funding and has asked other such questions, which are in no way related to the matter,“ said Sharad Kumar Saraf, chairman of NSEL Investors' Forum.“We have contract notes from the exchange and do not need to give other details. It is an attempt to derail the recovery process. “

(Source: The Economic Times Feb 21, 2015)

COS FIND SOME DEMANDSIRRATIONAL- NO RESPITE FOR INVESTORS FROM TAX TANGLES

Both outbound and inbound Investments by parents in arms under taxman's lens

New Delhi's well-publicised claim to usher in a non-adversarial tax regime is yet to trickle down to tax offices across the country. Even if salaried individuals are spared of scrutiny notices, many companies are grappling with demands they find strange and irrational. And, it's more than holding back tax refunds.

Several wholly-owned Indian subsidiaries of foreign companies that have received capital infusion from parent have been slapped with notices from the income tax (I-T) department which is asking these companies to justify the transaction. The tax office is describing such share subscription by a foreign parent as “unexplained cash credit“for which the Indian unlisted firm must pay tax on the fund it receives.

While tax laws allow the department to enquire the identity of an investor, source of fund and genuineness of a deal, tax practitioners argue that there is little ground to question the authenticity of a deal if the investor has a standing and the formalities with the Reserve Bank of India are fulfilled. “Under section 68 of the Income Tax Act, if the Indian subsidiary has established the identity of the foreign investor and the capacity to invest, then valuation and genuineness of the transaction should not be tested, “said senior chartered accountant Dilip Lakhani.

According to Bejal Ajinkya, partner at the law firm Khaitan & Co, despite the Bombay High Court in the Vodafone and Shell cases making it clear that a shareholder is free to invest at the price of his calling, an income tax is sought to be levied on such transactions. This kind of capital transaction cannot have any income tax implication, he added.

Interestingly, since the transfer pricing issue has been put to rest by the finance ministry, the tax department is questioning the transaction as "unexplained cash credit" and imposing a 30% tax on share premium received from the foreign shareholder.

"This," felt Ajinkya, "could be a dampener for the governments "make in India" push, especially where capital investment is at the core of any manufacturing activity.

It's a similar story for outbound capital flow – where some of Indian companies have invested in their overseas subsidiaries. Here, the tax office is challenging the equity structure; it's re-characterising the overseas 'equity' investment as 'deemed loan' from the Indian parent.

"The taxman is questioning the capital structure by stating that the Indian company is investing at a premium and hence the premium is a deemed loan, leading to a transfer pricing mark-up for an interest due to the Indian company. It is about time that the finance ministry issues a clarification announcing freedom to Indian companies to capitalise their foreign subsidiaries as per their requirement and end this unnecessary dispute that will strangulate the ability of Indian conglomerates from being truly multinational," said Ajinkya.

The tax office is demanding tax on interest income on the deemed loan, based on State Bank of India's prime lending rate. Here, the taxman is invoking international transfer pricing rules and disregarding the Vodafone matter because (unlike Vodafone) these cases relate to outbound remittance.

"Whenever any Indian holding company invests in its foreign subsidiary, it's by way of share capital and such transactions cannot be construed as a loan," said Lakhani.

Experts feel tighter tax scrutiny could be a dampener to govt's 'Make in India' plans

According to tax circles, close to 30 companies have been impacted by these tax demands

(Source: The Economic Times February 21, 2015)

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