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RBI releases Framework for setting up of WOS by Foreign Banks

The Reserve Bank of India (RBI) on 6th November 2013 released on its website, the framework for setting up of Wholly Owned Subsidiaries (WOS) by foreign banks in India. The policy is released in pursuance of the announcement made in the Second Quarter Review of Monetary Policy 2013-14.

The policy is guided by the two cardinal principles of (i) reciprocity and (ii) single mode of presence. As a locally incorporated bank, the WOSs will be given near national treatment which will enable them to open branches anywhere in the country at par with Indian banks (except in certain sensitive areas where the Reserve Bank's prior approval would be required). They would also be able to participate fully in the development of the Indian financial sector. The policy incentivizes the existing foreign bank branches which operate within the framework of India's commitment to the World Trade organization (WTO) to convert into WOS due to the attractiveness of near national treatment. Such conversion is also desirable from the financial stability perspective. To provide safeguards against the possibility of the Indian banking system being dominated by foreign banks, the framework has certain measures to contain their expansion if the share of foreign banks exceeds a critical size. Certain measures from corporate governance perspective have also been built in so as to ensure that the public interest is safeguarded.

Key features of the Framework

- Banks with complex structures, banks which do not provide adequate disclosure in their home jurisdiction, banks which are not widely held, banks from jurisdictions having legislation giving a preferential claim to depositors of home country in a winding up proceedings, etc., would be mandated entry into India only in the WOS mode.

- Foreign banks in whose case the above conditions do not apply can opt for a branch or WOS form of presence.

- A foreign bank opting for branch form of presence shall convert into a WOS as and when the above conditions become applicable to it or it becomes systemically important on account of its balance sheet size in India.

- Foreign banks which commenced banking business in India before August 2010 shall have the option to continue their banking business through the branch mode. However, they will be incentivised to convert into WOS because of the attractiveness of the near national treatment afforded to WOS.

- To prevent domination by foreign banks, restrictions would be placed on further entry of new WOSs of foreign banks/ capital infusion, when the capital and reserves of the WOSs and foreign bank branches in India exceed 20 per cent of the capital and reserves of the banking system.

- The initial minimum paid-up voting equity capital for a WOS shall be 5 billion for new entrants. Existing branches of foreign banks desiring to convert into WOS shall have a minimum net worth of 5 billion.

- The parent of the WOS would be required to issue a letter of comfort to the RBI for meeting the liabilities of the WOS.

- Corporate Governance – (i) not less than two-third of the directors should be non-executive directors; (ii) a minimum of one-third of the directors should be independent of the management of the subsidiary in India, its parent or associates; (iii) not less than fifty per cent of the directors should be Indian nationals /NRIs/PIOs subject to the condition that not less than 1/3rd of the directors are Indian nationals resident in India.

- The branch expansion guidelines as applicable to domestic scheduled commercial banks would generally be applicable to WOSs of foreign banks except that they will require prior approval of RBI for opening branches at certain locations that are sensitive from the perspective of national security.

- Priority Sector lending requirement would be 40 per cent for WOS like domestic scheduled commercial banks with adequate transition period for existing foreign bank branches converting into WOS.

- On arm's length basis, WOS would be permitted to use parental guarantee/ credit rating only for the purpose of providing custodial services and for their international operations. However, WOS should not provide counter guarantee to its parent for such support.

- WOSs may, at their option, dilute their stake to 74 per cent or less in accordance with the existing FDI policy. In the event of dilution, they will have to list themselves.

The issue of permitting WOS to enter into M&A transactions with any private sector bank in India subject to the overall investment limit of 74 per cent would be considered after a review is made with regard to the extent of penetration of foreign investment in Indian banks and functioning of foreign banks (branch mode and WOS).

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Finance Ministry Notifies Cyprus for Tax Evasion Non-Compliance

The Ministry of Finance has issued a Notification dated 1.11.2013 notifying and blacklisting Cyprus as a "notified jurisdictional area" u/s 94A of the Income-tax Act, 1961. The government has done this to check the flow of black money. Section 94A allows the government of India to notify any foreign tax jurisdiction for non-compliance, with which India does not have effective exchange of tax information, since Cyprus has not been providing the information requested by Indian tax authorities, the two decade old tax benefit pact with Cyprus has been suspended.

The consequences of the Notification are that any transaction with Cyprus will undergo stricter tax scrutiny and tax benefits previously available to residents of India and Cyprus doing business would be withdrawn.

Broadly, the implications of such a Notification are summarized as under:

- If an assessee enters into a transaction with a person in Cyprus, then all the parties to the transaction shall be treated as associated enterprises and the transaction shall be treated as an international transaction resulting in application of transfer-pricing regulations including maintenance of documentation.

- No deduction in respect of any payment made to any financial institution in Cyrus shall be allowed unless the assessee furnishes an authorization allowing for seeking relevant information from the said financial institution.

- No deduction in respect of any other expenditure or allowance arising from the transaction with a person located in Cyprus shall be allowed unless the assessee maintains and furnishes the prescribed information.

- If any sum is received from a person located in Cyprus, then the onus is on the assessee to satisfactorily explain the source of such money in the hands of such person or in the hands of the beneficial owner, and in case of his failure to do so, the amount shall be deemed to be the income of the assessee.

- Any payment made to a person located in Cyprus shall be liable for withholding tax at 30 per cent or a rate prescribed in Act, whichever is higher

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Government to shortly announce Telecom M&A guidelines

Government will shortly announce M&A guidelines for the telecom sector. It has already been cleared by the Telecom Commission. The much awaited policy is expected to bring further investment in the sector.

This policy will give the operators in India telecom sector options to exit and grow, depending on their financial condition and the big players like Vodafone and Airtel has welcomed the move and are expected to make good of the opportunity and further strengthen their position in the sector. The guidelines may allow telecom companies to acquire operators in a manner that market share of the resultant entity does not exceed 50%.

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DIPP proposes stricter steps to tighten FDI in Pharma

Due to a rush by multinationals companies to acquire Indian pharmaceutical (pahrma) companies Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry has proposed certain measures to tighten the foreign direct investment (FDI) in the pharma sector. The proposal includes the following requisites on the part of the foreign company:

- The foreign company, in question would not be allowed to shut down existing R&D centre and would have to mandatorily invest upto 25 % of the FDI in R&D.
- The total investment has to be incurred within 3 years of acquisition.

In addition to above DIPP has also proposed to reduce FDI cap to 49 per cent in rare or critical pharma verticals.

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