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Business

Foreign JV partners make merry as FERA provides I-T loophole

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THE GOVERNMENT is losing income-tax running into crores of rupees due to loopholes in the guidelines for change of foreign partners in the newly incorporated joint ventures for telecom services and the Foreign Exchange Regulation Act (FERA).

The loopholes have encouraged outgoing foreign partners to avoid paying taxes to the Income-Tax Department by indulging in overseas transactions relating to renunciation of right to invest in a joint venture in favour of incoming foreign investor.

According to some analysts, if the new Government does not take a policy stand on this issue, such revenue leakages may acquire serious dimensions as the same problem is expected to recur in the case of other infrastructure projects such as power, road and port projects awarded to joint ventures through competitive bidding or licensing.

The internal guidelines for change of foreign collaborators in joint ventures for telecom services, approved by Congress (I) Government in March-April, are silent on how and where an outgoing foreign partner should receive premium from incoming partner and his associates for renouncing the right to acquire shares in the joint ventures.

Similarly, while FERA and SEBI rules provide for permission from Reserve Bank for transfer of foreign shareholding at a premium in a operating joint venture, they do not provide for such permission to transfer the right to invest at a premium in a start-up venture.

In the latter cases, an Indian partner can thus arrange an approval from RBI for investment by a new partner in an innocuous manner. The possibility of an Indian promoter himself making payment to outgoing partner through hawala route cannot be ruled out, sources say.

They say that there will always be a premium on sale of investment opportunity in a project won through the licensing or competitive bidding route. This is akin to sale of licences by companies holding permission to set up sugar or beer units governed by industrial licensing regulations.

It is logical that a transaction relating to receipt of premium by an outgoing foreign partner through a legal or an illegal channel is accounted for in India and taxed accordingly before allowing the receipt to repatriate the proceeds arising out of the sale of an opportuntity to do business in India.

The outgoing Government had failed to plug loopholes in the laws and rules of the land to ensure that the Income-tax Department levies a tax on overt or covert premium changing hands abroad including in tax havens.

This can be done by stipulating that all such transactions relating to a prospective economic activity in Indian should be undertaken and registered in the country.

Sources say that it is still not late for the new Government to order intelligence agencies to investigate published and unpublished cases of millions of dollars changing hands between foreign companies with the connivance of Indian partners. It is possible that the companies involved in such transactions may try to show such dealings as reimbursement of expenditure incurred by an outgoing partner on pre-project activities.

In such cases, the tax authorities should ask for satisfactory documentary proof of the expenditure and also know whether this expenditure is being accounted for in the books of the joint venture or in the books of the incoming foreign partner or their companies registered in tax havens.

This is essential to bring about transparency in economic decisions. This is an issue on which BJP has harped both inside and outside the Parliament. In the tendering competition for cellular, radio-paging and basic services, the outgoing Government forced Indian entrepreneurs to enter into a marriage of convenience with foreign companies to qualify for participation in the competition.

In serveral cases, the marriages turned sour even before the actual investment of money by foreign partner in the share capital of the company.

In certain cases, the outgoing foreign partner refused to let in a new partner without payment of compensation for sacrifice of opportunity to do business in India.

Following lobbying by influential Indian companies, the outgoing Government laid internal guidelines for change of foreign collaborators to give an upper hand to them in their fights with foreign partners in the joint ventures.

The guidelines say: "There should be no objection for looking at a request for change of foreign collaborator or change in this equity on a case-to-case basis where an application is made by the licensee company duly supported by the resolution of the board of directors or the shareholders by a simple majority or the shareholders by a special majority, as may be prescribed under the Indian Companies Act, 1956."

Even before the formulation of guidelines, Government turned a blind eye to change of foreign partners in the two joint ventures incorporated for provision of cellular mobile services. In the Sterling Cellular /Essar Cellphone, the outgoing foreign partner, Cellular Communications International (CCI) of the US was quoted by *Wall Street Journal* in December 1995 as telling its shareholders that it had received $40 million for giving up its claim to participate in a cellular venture in New Delhi. CCI did not disclose who made the payment.

Neither Essar nor Sterling nor the incoming partner, Swiss Telecom, are willing to shed light on this lucurative payment. In another joint venture that had tendered under the second round of bidding for issue of cellular licences, a deal has been struck for change of foreign partners at a premium of $5 million. None of the companies involved in this joint venture have yet denied this transaction.

Corporate intelligence sources say that some more such transactions are under negotiation. They do not rule out the existence of such secret transactions in the other infrastucture projects.