

New Procedures in India

Changing government attitudes encourage technology transfer; opportunities improve

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India is a land of paradoxes.

The country ranks 165th in the list of per-capita incomes but 15th in GNP; it has a literacy rate of only 30% yet the total *literate population* in India is more than the *total population* of several European countries put together and equals almost three fourths of the total population of the United States; it belongs to the group of 77 as a developing country yet it ranks as the tenth-largest industrial power in the world; its growth rate is less than 5% but its savings rate of 24% of GNP compares favorably with that of advanced countries like Japan (30%); it ranks first in the production of cotton yarn, second in the manufacture of scooters, has the third largest engineering manpower in the world, its railways rank fourth in the world, its coal production fifth and its sugar output sixth.

The foregoing are not just economic clichés. They emphasize at once the need for and the advantages of technology transfer to India. They also provide the socioeconomic tapestry against the background of which the rest of this paper dealing with the national and international perspective, the legal, governmental and tax aspects and the relevant procedures are dealt with.

NATIONAL PERSPECTIVE

The concept of technology transfer in India is neither new nor of recent origin. In the very first few years after independence in 1947, there were over 500 agreements for such transfers from foreign companies to Indian companies. With the progressive increase in both the need and the demand for technological inputs, there has been a steady increase in such transfers and the figures from 1957 to 1982 indicate over 7,000 such agreements. These assume, diversely, the form of joint ventures, licensing, outright purchase, one-time know-how imports, etc.

Despite the continuing increase in the number and diversity of agreements, there is an ever-increasing demand for technology transfers and there are still technological gaps in many industries. These are felt progressively more as the infrastructure and technical capability to absorb technology increases.

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Transfers of technology, in a way, generate their own need for more. The industries where significant gaps exist were until recently referred to by the National Committee on Science and Technology and identified as such by the Ministry of Industry for the purposes of determining whether foreign technology and investments in a particular field is *prima facie* required or not. However, with the change in government attitudes and policies, the government now publishes only the list of industries where adequate technology is presumed to exist. All other industries are open for technology transfers and even investments by foreign companies.

India's efforts to bridge the technological gap is a continuing process. At the corporate level, efforts to achieve a certain level of technological sophistication, although by no means enough, are also on the increase. R&D-related expenditures on innovation and advances increased from a mere \$4.7 million in 1950 to \$85 million in 1965 and \$450 million in 1978.

It has been said that the bulk of this expenditure is defensive R&D, compared to competitive R&D, and is largely related to developing capabilities to absorb imported technology rather than creating new technology. But, even if this is so, the concept of increasing R&D efforts and expenses is indisputable. It also may be that "defensive" R&D is a necessary process in technological growth. Japan had reportedly spent nearly \$9 billion to \$10 billion in absorption of imported technology, changing only where necessary, before shifting her sights to basic innovations.

At the governmental level, there is a discernible encouragement to the inflow of foreign technologies. Tangible changes have been made in the recent past. Principal among these are the increase in the permissible duration of agreements by foreign companies from eight to ten years, increase in permitted payments to a maximum of an aggregated 8% for the lump sum and royalties and freedom to have the tax on the lump sum paid by the Indian party thus, in effect, allowing a tax-free payment of lump-sum amounts.

With the advent of the current government there has been a visible and positive change in perception of the role of technology in national development. Many of the earlier inhibitions are being discarded and a bold, new and dynamic approach is being adopted.

The very real, though intangible, changes this has brought about in what is sometimes referred to as "attitudinal" or "directional" change in government policy are perhaps the most significant experienced in India in recent times. Increasing pragmatism in the higher echelons, a quickening of the bureaucratic processes and a desire to reach decisions quickly and favorably within the overall policy framework are clearly perceived by the

"New Delhi Watchers."

INTERNATIONAL PERSPECTIVE

The sources of technology transfer to India range from countries at all ends of the economic and political spectrum such as Poland and Bulgaria on the one hand to the U.S.A. and the U.K. on the other. Table A demonstrates this:

COLLABORATION WITH INDIA

1957 - 1982

COUNTRY	NUMBER OF AGREEMENTS
U.K.	1,617
U.S.A.	1,391
West Germany	1,253
Japan	593
Switzerland	427
France	337
Italy	247
Sweden	134
East Germany	123
Netherlands	112
Czechoslovakia	77
Denmark	69
Austria	64
Belgium	57
Canada	43
Hungary	39
Poland	33
Finland	26
Yugoslavia	22
Others	392
Total	7,056

Table A

The technologies transferred under the above agreements range in fields from sophisticated high-tech items such as petroleum refining, petrochemicals, pharmaceuticals, oil exploration equipment, engineering goods and railroad equipment to relatively simple cosmetics. Similarly, the size of the transferor and recipient companies vary from some of the largest foreign multinationals to the small-scale Indian companies (then defined as companies with fixed assets of less than \$60,000).

While India's own efforts, policies and expenditures on importing and developing technology are impressive and encouraging, there is still a tremendous potential in India for foreign as well as local companies.

On the R&D front, for example, while India's expenditure increased 100 times over the last 25 years the absolute amounts were rather small. Even a small country like Norway with about one hundredth the population spent an almost equal sum, whereas Austria spent marginally more. While the world leader in the field, the U.S.A. spent 86 times as much as India, other smaller but technologically-advanced countries also spent more than India, Germany 22 times, France and U.K. 13, and Netherlands 4.

The potential, therefore, for more import of technology and greater collaborative effort between foreign and local Indian companies in joint R&D is very large. The latter should be particularly attractive in view of the low cost of highly-qualified research personnel in India.

The international perspective on technology transfer in India would, of course, not be complete without the mention of one important factor: Indian technology has also

come of age.

Through their efforts and experience, Indian companies and entrepreneurs have made technological advances and innovations, a great number of them being more suitable for adaptation in developing countries than the technologies available from the West.

While India is essentially an importer of technology, it recently also started exporting it. Presently, Indian companies have formed nearly 200 joint ventures abroad and while a great majority of them are in developing countries, some of them are also in the advanced countries like the U.S.A. and the U.K.

Table B indicates the geographical spread of joint ventures abroad.

JOINT VENTURES ABROAD

COUNTRY	NUMBER OF JOINT VENTURES
Indonesia	18
Kenya	13
Malaysia	34
Mauritius	9
Nigeria	12
Nepal	7
Oman	6
Philippines	5
Saudi Arabia	7
Singapore	11
Sri Lanka	7
Thailand	6
U.A.E.	17
U.K.	6
U.S.A.	9
Others	24
Total	193

Table B

LEGAL ASPECTS OF TECHNOLOGY TRANSFER

The legal aspects of technology transfer in India are quite important and significant, particularly because they are intertwined with governmental guidelines and policies that require certain clauses and provisions in the legal contract.

General Legal Provisions

To begin with, there are no express statutory provisions dealing with agreements for technology transfer (or "collaboration" as they are called in India) and the general Indian principles of contract law, akin to the common law, would apply. Therefore, provisions relating to such matters as training, confidentiality, warranties, and quality control would follow the pattern of such clauses elsewhere.

In particular, India has a highly developed body of intellectual property laws. There is the Patents Act, which provides for the protection of inventions and also empowers the government to declare a country as a convention country to enable any application in such a country to get the same priority date in India as in that country if a patent application is filed in India within 12 months of the original filing. India however is not a signatory to the Paris Convention.

The Copyright Act protects original literary works and India is a signatory to the Berne as well as the Universal Convention on Copyrights. Recently the Copyright Act was amended to extend protection to computer programs.

The Trade and Merchandise Marks Act enables the registration of marks and the protection of registered

marks. Unregistered brand names or works may in certain circumstances be protected by the common law "passing off" doctrine.

Statutorily Required Approval

There is one legal factor that makes a licensing agreement in India a little different from that in, say, the western countries, namely, that it is required to be approved by the Government of India.

Under the Foreign Exchange Regulation Act 1973 (FERA) no payment can be made to a nonresident without approval of the Reserve Bank of India, and it is this provision that is used to exercise governmental control over the collaboration agreements since they all involve payments to nonresidents. Although, strictly speaking, it is the approval of the Reserve Bank of India (RBI) that is required, the substantive approval is given by the Government of India and the RBI approval is merely a subsequent formality. The position is set forth expressly in the Exchange Control Manual published by the RBI, the relevant extract from which is set forth in Appendix I.

Governmentally Required Clauses

The most important consequence from the legal (and business) viewpoint of the aforesaid approval is that in granting it, the government follows certain policies and requires the agreement to contain clauses in conformity with such policy. The principal clauses so required are discussed below:

Duration of the Agreement: The government itself sets a time limit on the period of the agreement. This is now a maximum period from eight to ten years from the date of the agreement and royalties are permitted to be paid for a maximum of five years in one case and seven years in the other, the balance being the time allowed to get into commercial production.

An initial period of more than 10 years for the agreement is seldom, if ever, negotiable though the government would consider the renewal of the agreement on its own merits at the appropriate time.

Sublicensing: Generally, the licensor is required to agree to the Indian party sublicensing the know-how to another party on the condition that the terms of the sublicensing shall be such as are agreed upon by all parties including the foreign owner of technology. Legally, the wording of the clause protects the licensor adequately if it does not wish to sublicense. Commercially, it is protected even more by the business realities because the licensee is seldom willing to set up its own competitor in India.

Exports: The government requires a clause giving the Indian party the freedom to export freely anywhere. This often forms a serious bone of contention between the parties. The Indian party can, however, be restrained from exporting to countries where the licensor has its own manufacturing or licensing facilities.

Trademarks: Generally, the use in India of foreign trademarks per se is prohibited. However, a clause granting the right to the use of the mark in conjunction with the local company's mark or a label stating, say, "manufactured in technical collaboration with (name of technology transferor)," is not deemed violative of the governmental

requirement and is permitted.

Patent Rights and Continued Right of Manufacture: This is one of the most important clauses insisted upon by the government. It provides that if the item of manufacture is patented in India then the payment during the agreement period shall constitute full payment for the life of the patents, and the Indian licensee shall be entitled to continue manufacturing the licensed product even after the end of the agreement *without further payment*.

A possible lacunae in this may be that it is the patents and not the licensor's know-how whose continued use is permitted. True, the concept of "proprietary information" or "proprietary know-how" is not statutorily recognized or protected as a property right in the same sense as patents and trademarks are in India. However, recent decisions of the courts in India seem to indicate a trend toward such recognition. Therefore, it may only require a logical extension of these decisions to suggest that the property in the know-how cannot be continued to be used after the agreement period even though the patents can be. However, this has not yet been tested in any court, although a California court is presently deciding a similar question relating to an Indian licensee.

Proper Law of Contract: The government requires that the proper law of the contract be Indian. A number of foreign technology owners initially question and endeavor to negotiate this aspect but eventually have to and do accept the requirement.

Arbitration: Although the government does not regulate in any way the procedure for settlement of disputes under the contract, the parties thereto, generally provide for arbitration under the rules of an international tribunal like the International Chamber of Commerce.

The foreign licensor sometimes believes that this clause would give it the protection of the laws of the arbitration situs. This is clearly a mistaken belief. Under Indian law only the procedural law of the arbitration would be that of the forum. The substantive law of contract would continue to be that of India (if as is required this was so specified).

Royalties: The permitted range of royalties is from 3% to 5% of the net ex-factory price of the sales, which is arrived at after deducting the landed cost of the imported components, standard bought out components, local taxes, duties and levies. The royalty is subject to tax. No minimum royalty provision is allowed.

Lump-Sum Payment: Generally, the government also permits the payment of a lump sum but requires it to be paid in three installments — 1/3 on the agreement being approved, 1/3 on the transfer of know-how, and 1/3 on commencement of commercial production or within 48 months of the agreement being approved, whichever is earlier.

The total of the royalties and lump sum generally is not permitted to exceed 8% of the net ex-factory sales during the period of the agreement.

Since the payments are always subject to Indian tax, (see below) it is important to draft the agreement so as to take advantage of the lower tax on lump sum payments.

Tied Sale of Components: While the government does not permit the sale of components or parts to be linked as a legal condition of the technology transfer, in practice, a substantial and real benefit to the technology owner invariably comes from the almost certain sale of equipments, components, and materials that often accompany the transfer of technology. While, therefore, royalty is an important element in the agreement, its ostensibly low rate is not often a serious impediment to the transaction.

The above are some of the principal clauses that are specially required by the government of India and negotiators of a license agreement in India must be fully cognizant of them so as to expedite the negotiation process and avoid delays in getting governmental approval.

TAXATION

The Tax

The bottom line on all commercial aspects of technology transfer is of course, the take home pay, and hence a great deal of attention is to be paid to the taxation of royalties and know-how fees received by the foreign collaborator.

Under the provisions of the Indian Income Tax Act such of the royalty payments as consists of a lump-sum payment are taxed at 20% where the lump sum is the: "consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trademark or similar property..."

The rest of the "royalty" and the whole of the "fees for technical services" is taxed at the rate of 40%. Both these terms are defined in the act and the definitions are set forth in Appendix II.

The tax rate of 40% is by itself a preferential rate because generally the income of foreign companies is taxed at 70%. However, if one is to take advantage of the 20% tax provision for lump-sum payments, the agreement therefore should be carefully drafted to conform to the statute. Preferably, one should have two separate agreements incorporating the elements of the transaction attracting the 20% and the 40% tax liabilities, respectively, although the transaction as a whole remains one.

On the other side of the coin (i.e. the licensee's), the payments made have, after some judicial vacillation, now been generally recognized as revenue expenditure entitling the payer to a full deduction thereof from its income.

Double Taxation Relief

At present, India has bilateral arrangements for avoidance of double taxation with about 24 countries. These countries are Afghanistan, Austria, Belgium, Denmark, Egypt, Federal Republic of Germany, France, Greece, Iran, Italy, Japan, Lebanon, Norway, Romania, Sri Lanka (Ceylon), Sweden, Singapore, Switzerland, U.K., U.S.A., U.S.S.R., Malaysia and Bulgaria. Out of these 15 agreements are comprehensive in nature covering all types of incomes. The agreement with Romania is only for shipping and aircraft profits, while recent agreements with U.S.S.R. and Bulgaria are confined to shipping profits only. The agreements with the remaining six countries, namely Afghanistan, Iran, Italy, Lebanon, Switzerland and U.S.A. are in respect of aircraft profits only.

The agreements with Sweden, Denmark, Norway, Finland, Belgium, Austria and to some extent the agreement with West Germany, are based on the method of exclusion, i.e. the income from sources allocated to one country is not taxed in the other country, though it can be taken into account for purposes of determining the rates of tax on the basis of tax laws of the country of residence, if the laws of the other country so require.

The agreement with Japan and to some extent the agreement with West Germany is based on the method of tax credit, i.e. tax in the two countries is levied according to their respective laws but credit for tax payable in one country is provided for by the other in respect of income from sources allocated to the first country. These agreements provide for giving credit for tax that would have been paid in India but for certain tax incentives.

PROCEDURE

Generally, all applications for approval of technical collaborations have to be submitted to a separate cell set up within the government, namely the Secretariat for Industrial Approvals in New Delhi. The Secretariat generally estimates a time frame of 90 days for indicating its decision. In practice, however, the applicant may expect a decision in four to six months, if the application is properly prepared and followed up on.

Reflecting its greater interest in attracting foreign technologies into India, the government has delegated its powers to the administrative ministries to sanction foreign technical collaborations in the following cases:

1. Where there is no foreign equity participation.
2. Where the applicant is not a company with existing foreign equity investment.
3. Where the item proposed to be manufactured is consistent with the priorities laid down in the industrial policy statement.
4. Where the royalty payable is not more than 5% and the royalty period is not more than 10 years after the signing of the foreign collaboration agreement. The period of going into commercial production is included in these 10 years.
5. Where the lump sum payment, if any, is to be paid in three standard installments — first on signing, second on the delivery of documents, and the third on commencement of commercial production or within 48 months of the approval of the agreement, whichever is earlier.
6. Where the foreign exchange outgo for the payment of lump sum and royalty together does not exceed Rs. 5 million.

Significantly, an even more expeditious (decision in 30 days) and simplified procedure, exists for the one-time import of:

1. Small value balancing equipment imports having a large impact on quality and quantity output.
2. Technical know-how.
3. Foreign consultancy services, if required.
4. Drawing and designs.

Provided the total outgoing of foreign exchange is not in excess of Rs. 5,000,000 (U.S. \$420,000).

As recently as August this year, the government further streamlined the approval process by announcing that, after its initial approval of the basic terms, the signed agreement would no longer be required to be submitted to the government for "taking on record." They are now

merely filed with the Reserve Bank and the concerned Ministry. This procedure would eliminate a delay of approximately two to three months, which previously was experienced in getting formal RBI approval after the government had already accorded its approval to the basic terms.

CONCLUSION

The foregoing sums up some of the salient features of a technology transfer arrangement and agreement in India. It is evident that, to negotiate such an agreement one would need not only the normal commercial skills but also a certain degree of familiarity with governmental guidelines and regulations. Once so equipped, however, the increasing liberalization of policies, the progressive streamlining of procedures, the developed infrastructure, the abundance of trained human resources and, above all, the substantial market opportunities should make India an attractive and exciting country to transfer technology to.

Appendix I

EXTRACT FROM THE EXCHANGE CONTROL MANUAL OF THE RESERVE BANK OF INDIA

(i) "Persons, firms and companies wishing to establish new industrial units or expand/diversify existing units with foreign technical collaboration should apply on the prescribed form to the Secretariat for Industrial Approvals (SIA), Department of Industrial Development, Government of India, New Delhi, for approval. In cases where the proposal for collaboration is approved by Government, Government will issue its letter of approval to the applicant indicating the terms. The applicant may thereafter execute the collaboration agreement with the collaborators strictly in accordance with the approved terms and furnish requisite number of copies of the agreement to the Government. Government will take the agreement on record if it is in conformity with the approved terms and advise the applicant accordingly under intimation to Reserve Bank. Reserve Bank will thereafter issue its formal authorization under Foreign

Exchange Regulation Act, 1973, to the applicant"

(ii) Remittance of technical know-how fees, royalties falling due under the collaboration agreement will be allowed by Reserve Bank strictly in accordance with the terms and conditions approved by the Government.

Appendix II

EXTRACT FROM THE INCOME TAX ACT, 1961, CONTAINING DEFINITION OF "ROYALTY" AND "FEES FOR TECHNICAL SERVICES"

For the purpose of the Act, royalty means:

"consideration (including any lump-sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for —

- (i) the transfer of all or any rights (including the granting of a license) in respect of a patent, invention, model, design, secret formula or process or trademark or similar property;
- (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trademark or similar property;
- (iii) the use of any patent, invention, model, design, secret formula or process or trademark or similar property;
- (iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- (v) the transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films; or
- (vi) the rendering of any services in connection with the activities referred to in sub clauses (i) to (v);"

Fees for technical services is defined as:

"any consideration (including any lumpsum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services by technical or other personnel) by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries."