



Nishith Desai Associates  
LEGAL AND TAX COUNSELING WORLDWIDE

MUMBAI

SILICON VALLEY

BANGALORE

SINGAPORE

NEW DELHI

MUNICH / AMSTERDAM

NEW YORK

GIFT CITY

Research

# Doing Business in India

## The Guide for US Businesses and Organizations Entering and Expanding into India

With special Reference to Tax Treaties  
between India and:



Mauritius



Singapore



USA

January 2023

Research

# Doing Business in India

---

## The Guide for US Businesses and Organizations Entering and Expanding into India

With special Reference to Tax Treaties  
between India and:



Mauritius



Singapore



USA

January 2023



Asia-Pacific  
Most Innovative Indian Law Firm: 2019, 2017, 2016, 2015, 2014



Asia Pacific  
Band 1 for FinTech, Technology Media & Telecoms: 2021  
Band 1 for Employment, Lifesciences, Tax, TMT: 2021, 2020, 2019, 2018, 2017, 2016, 2015



Tier 1 for Private Equity: 2020, 2019, 2018, 2017, 2014  
Deal of the Year: Private Equity, 2020



Asia-Pacific  
Tier 1 for Data Protection, Dispute, Tax, Investment Funds, Labour & Employment, TMT, Corporate M&A: 2021, 2020, 2019, 2018, 2017, 2016, 2015, 2014, 2013, 2012



Asia-Pacific  
Tier 1 for Government & Regulatory, Tax: 2020, 2019, 2018



'Outstanding' for Technology, Labour & Employment, Private Equity, Regulatory, Tax: 2021, 2020, 2019



Global Thought Leader – Vikram Shroff  
Thought Leaders, India – Nishith Desai, Vaibhav Parikh, Dr. Milind Antani  
Arbitration Guide, 2021 – Vyapak Desai, Sahil Kanuga  
Eminent Lawyer in Sports and Gaming 2021: Tanisha Khanna



Young Lawyer of the Year (Law Firm) 2022: Aarushi Jain



Winner for Data Compliance and Cybersecurity, Labour and Employment, Media and Entertainment, Pharma and Life Sciences, Taxation (Direct), Taxation (Indirect): 2022



Fastest growing M&A Law Firm: 2018



Asia Mena Counsel  
In-House Community Firms Survey: Only Indian Firm for Life Science Practice Sector: 2018

## Disclaimer

This report is a copyright of Nishith Desai Associates. No reader should act on the basis of any statement contained herein without seeking professional advice. The authors and the firm expressly disclaim all and any liability to any person who has read this report, or otherwise, in respect of anything, and of consequences of anything done, or omitted to be done by any such person in reliance upon the contents of this report.

## Contact

For any help or assistance please email us on [concierge@nishithdesai.com](mailto:concierge@nishithdesai.com) or visit us at [www.nishithdesai.com](http://www.nishithdesai.com).

## Acknowledgements

**Harshita Srivastava**

harshita.srivastava@nishithdesai.com

**Ajay Singh Solanki**

ajay.solanki@nishithdesai.com

**Vasavi Kaparathi**

vasavi.kaparathi@nishithdesai.com

**Harman Khorana**

harman.khorana@nishithdesai.com

**Arijit Ghosh**

arijit.ghosh@nishithdesai.com

**Aarathi Das**

aarathi.das@nishithdesai.com

# Contents

<b>Introduction</b>	<b>1</b>
<b>India’s Legal System</b>	<b>3</b>
A. Nature of the Constitution of India	3
B. Division of Legislative Powers between the Centre and States	3
C. Delegated Legislation	4
D. Court System in India – Hierarchy of Courts	4
<b>Investment into India</b>	<b>6</b>
A. Foreign Direct Investment	7
Prohibited Sectors	
Permitted Sectors	
Key Consideration under FDI Policy	
B. Downstream Investment	14
C. Additional Procedural Requirements	15
D. Other Foreign Investments	16
FVCI	
Foreign Portfolio Investments	
Investment by Non-Resident Indians	
Black Money Act, 2015	
<b>Establishing a Presence in India</b>	<b>21</b>
A. Setting up Unincorporated Entities	21
Liaison Office	
Branch Office	
Project Office	
Partnership	
Trust	
B. Establishment of Incorporated Entities	24
Limited Liability Partnership	
Companies under the Companies Act	
C. Incorporation Process (as per Companies Act)	26
PAN – DSC – DIN	
Name Approval	
Filing of Charter Documents	
Certificate of Incorporation	
Post Incorporation	

<b>D. International Financial Services Centre / GIFT City</b>	<b>28</b>
<b>E. Types of Securities Issued</b>	<b>31</b>
Equity Shares	
Preference Shares	
Debentures	
<b>F. Return on Investments</b>	<b>32</b>
Dividend	
Buyback	
Redemption	
IPO	
Put Options	
<b>G. Important Issues under the Companies Act</b>	<b>33</b>
Duties and Liabilities of Director	
Director’s Report	
Liability of Directors	
Merger of an Indian Company with a Foreign Company	
Related Parties Transactions	
Corporate Social Responsibility	
Class Action Suits	
<b>H. Companies (Amendment) Act, 2015 and Further Changes to the Companies Act</b>	<b>35</b>
Holding Company and Wholly Owned Subsidiary	
Holding Company and Subsidiary	
<b>I. Companies (Amendment) Act, 2017 and Further Changes to the Companies Act</b>	<b>36</b>
Prohibition Category – Section 185(1) of the Companies Act	
Conditional Allowance – Section 185(2) of the Companies Act	
Exempted Category – Section 185(3) of the Companies Act	
<b>J. Companies (Amendment) Act, 2019 and Further Changes to the Companies Act</b>	<b>38</b>
<b>K. Companies (Amendment) Act, 2020 and Further Changes to the Companies Act</b>	<b>38</b>
<b>L. Setting up and Operating in India</b>	<b>39</b>
Post-Incorporation Activity Plus Timeline	
Setting up a Bank Account	
Accounting and Accounting Rules in India	
Audit	
<b>Mergers and Acquisitions</b>	<b>43</b>
<b>A. Companies Act</b>	<b>43</b>
Mergers / Demergers Regime in India	
Acquisition Regime in India	
<b>B. Takeover Code</b>	<b>45</b>
<b>C. Listing Regulations</b>	<b>46</b>
<b>D. Insider Trading Regulations</b>	<b>47</b>



<b>E. Competition Law</b>	<b>48</b>
<b>F. Exchange Control Regulations</b>	<b>53</b>
<b>G. Overseas Direct Investment</b>	<b>54</b>
<b>H. Applicable Taxes and Duties</b>	<b>54</b>
<b>Capital Markets in India</b>	<b>57</b>
<b>A. Public Offerings</b>	<b>57</b>
Eligibility Requirements for IPO	
Minimum Offer Requirements	
Promoters' Contribution	
Lock-in Restrictions	
Offer for Sale	
Credit Rating	
Pricing	
Disclosure Requirements	
Filing of the Offer Document	
<b>B. Preferential Allotment</b>	<b>61</b>
Lock-in Restrictions	
Conditions for Preferential Issue	
Pricing	
Disclosures and Appointment of a Merchant Banker	
Consideration and Utilization of Proceeds	
Other Conditions (in a Comparative Form)	
<b>C. Qualified Institutional Placements</b>	<b>64</b>
Pricing	
Placement Document	
Transferability	
<b>D. Recent Relaxations to Stressed Companies</b>	<b>66</b>
<b>E. Overseas Listing of Indian Companies</b>	<b>67</b>
<b>F. Listing of Foreign Companies in India</b>	<b>68</b>
<b>G. Small and Medium Listing Enterprises (SME)</b>	<b>69</b>
<b>H. Issue and Listing of Depository Receipts</b>	<b>70</b>
<b>I. Capital Raising</b>	<b>70</b>
<b>J. Promoter's Contribution and Lock-in</b>	<b>70</b>

<b>Tax Considerations in Structuring Investments</b>	<b>71</b>
<b>A. Corporate tax</b>	<b>71</b>
Dividends and Share Buy-Back	
Capital Gains	
Investments by FPIs	
Interests, Royalties & Fees for Technical Services	
Withholding Taxes	
Wealth Tax	
Personal Income Tax	
Taxation of VDAs	
Sovereign Wealth Funds and Pension Funds	
Double Tax Avoidance Treaties	
Anti-Avoidance	
Obtaining Certainty and Risk Mitigation	
<b>B. Structuring Investments</b>	<b>80</b>
<b>C. Indirect Taxation</b>	<b>82</b>
Goods and Services Tax	
Value Added Tax	
CENVAT	
Customs Duty	
Equalization Levy	
<b>D. TDS Obligations on E-Commerce Operators</b>	<b>86</b>
<b>Human Resources</b>	<b>87</b>
<b>A. Employment Legislations</b>	<b>88</b>
<b>B. Employment Documentation</b>	<b>91</b>
Employment Agreements	
Confidentiality & Non-Disclosure Agreement	
Non-Compete & Non-Solicit Agreements	
HR Policy / Employee Handbook	
Stock Options	
<b>C. Recruitment and Salary Benchmarking</b>	<b>94</b>
<b>D. Onboarding</b>	<b>95</b>
Orientation	
<b>E. Employee Management</b>	<b>96</b>
<b>F. Payroll</b>	<b>97</b>
<b>G. Performance Management</b>	<b>98</b>
<b>H. Offboarding</b>	<b>98</b>



<b>Intellectual Property</b>	<b>100</b>
<b>A. International Conventions and Treaties</b>	<b>100</b>
<b>B. Patents</b>	<b>101</b>
<b>C. Copyrights</b>	<b>103</b>
<b>D. Trademarks</b>	<b>104</b>
Obtaining a Trademark in India	
Certification Marks	
Collective Marks	
Internet Domain Names	
Assignment of Trademarks	
Recognition of Foreign Well- Known Marks & Trans-Border Reputation	
The Madrid Protocol	
<b>E. Trade Secrets</b>	<b>107</b>
<b>F. Designs</b>	<b>107</b>
<b>Privacy and Data Protection</b>	<b>108</b>
<b>A. Current Framework</b>	<b>109</b>
General Data Protection Law	
Industry Specific Regulations	
<b>B. Recent Focus on Non-Personal Data Governance</b>	<b>115</b>
<b>Environmental Laws</b>	<b>116</b>
<b>A. Environment (Protection) Act, 1986</b>	<b>116</b>
Environmental Impact Assessment (“EIA”) Notification	
Coastal Regulation Zone (“CRZ”) Notification	
Hazardous Substances	
<b>B. Air &amp; Water Act</b>	<b>117</b>
<b>C. Municipal Authorities</b>	<b>118</b>
<b>D. Litigation &amp; Penalty</b>	<b>118</b>
<b>Dispute Resolution in India</b>	<b>120</b>
<b>A. Judicial Forums – Courts and Tribunals</b>	<b>120</b>
<b>B. Jurisdiction of Courts</b>	<b>121</b>
Territorial Jurisdiction	
Pecuniary Jurisdiction	
Jurisdiction as to Subject Matter	
Original and Appellate Jurisdiction	

<b>C. Law on Interim Relief</b>	122
Prima Facie Case	
Irreparable Injury	
Balance of Convenience	
<b>D. Specific Relief</b>	123
<b>E. Law on Damages</b>	124
<b>F. Dispute Resolution by Arbitration</b>	124
Ad-hoc Arbitration	
Institutional Arbitration	
Statutory Arbitration	
Foreign Arbitration	
<b>G. Enforcement of Foreign Arbitral Awards</b>	127
<b>H. Enforcement of Foreign Judgments in India</b>	130
<b>I. An Overview of Insolvency and Bankruptcy</b>	131
Time-Bound Resolution	
Streamlined Processes	
Regulatory & Legislative Impetus	
<b>Trade with India</b>	133
<b>A. Trade Models</b>	133
Marketing	
Marketing and Distribution	
Agency	
Teaming Agreements (Joint Development)	
Subcontractor	
<b>B. Implications Under Tax Laws</b>	136
<b>C. Customs Duty</b>	136
<b>D. Special Schemes</b>	137
EOU Scheme	
SEZ Scheme	
<b>Sector-Specific Regulations</b>	140
<b>A. Healthcare Sector</b>	140
<b>B. Education Sector</b>	141
<b>C. Research Papers</b>	143
<b>Conclusion</b>	144

**Investing into India:  
Considerations from a Mauritius – India Tax Perspective** 145

**A. Mauritius – India Relations: Background** 145

**B. Mauritius – India Tax Treaty: Special Considerations** 146

- Residence and Entitlement to Treaty Relief
- PE Risks
- Taxation of Royalty and FTS
- Taxation of Interest
- Taxation of Capital Gains
- Exchange of Information and Assistance in the Collection of Taxes
- Mauritius – India Bilateral Investment Promotion and Protection Agreement

**Investing into India:  
Considerations from a Singapore – India Tax Perspective** 151

**A. Singapore – India Relations: Background** 151

**B. Singapore – India Tax Treaty: Special Considerations** 152

- Residency of Partnerships and Hybrid Entities
- PE Risks
- Exemption for Capital Gains Tax on Sale of Shares
- Taxation of Royalty and FTS
- Exchange of Information

**Investing into India:  
Considerations from a USA – India Tax Perspective** 156

**A. US – India Relations: Background** 156

**B. US – India DTAA: Special Considerations** 157

- Residency of Companies
- Residency of Partnerships and Trusts.
- Capital Gains
- Credit Rules: Double Taxation of the Same Income?
- PE Issues
- Fee for Included Services
- Limitation on Benefits
- FATCA
- Mutual Agreement Procedure and Transfer Pricing

# Introduction

Since the starting of economic liberalization in India in 1991, India has emerged as a top destination for investments globally. In terms of its economic growth, India is one of the fastest growing large economies and experts are predicting that if India maintains its momentum soon it will be the fastest growing economy of the world. While COVID-19 disrupted the growth path in 2020, India is expected to roar back to annual growth nearing 7% each year in coming five years.<sup>1</sup>

This increase in the economic growth in India is primarily attributed to the sweeping changes that have been ushered in by the reforms brought by governments both at the central (similar to the federal level in the US) and state levels. Some of the most prominent reforms and changes are as follows.

- Introduction of a unified indirect tax law system.
- Introduction of insolvency and bankruptcy code to turn around stressed assets.
- Improvement in the flow of money in the economy primarily through banking and financial institutions.
- Stabilization of government's outlook towards imposing taxes on foreign investors.
- Liberalization of the framework for foreign investment.

The state and central governments have been proactive in enhancing the attractiveness of India as a global business destination by introducing new laws and policies and prioritizing their implementation. The goal is to make India a desirable avenue for businesses and aligning them with the socio-economic progress. This evolution of laws has led to a significant growth of India, as a global economy.

To increase the ease of doing business in India, the Government of India has also set up a special agency, National Investment Promotion & Facilitation Agency ("**Invest India**"). Invest India provides valuable information about key sectors and states of India, which is very useful for foreign businesses and organizations looking to expand into India.

The biggest testament of effectiveness of all the initiatives and changes that have been introduced by the government is India's continuous scaling up to a greater ranking in the World Bank's ease of doing business report. In 2020, India jumped 14 positions and was ranked 63rd for doing business in India.<sup>2</sup>

On February 1, 2022, the Indian Finance Minister, Nirmala Sitharaman, presented the Union Budget ("**Budget**") of India for the financial year 2022-23. This was a crucial Budget for the Government, especially against the backdrop of the contraction of the GDP caused by the COVID-19 pandemic. We have integrated key reforms presented in the Budget in this book with a special reference.<sup>3</sup>

---

1 Statista (2022). India: Real gross domestic product (GDP) growth rate from 2017 to 2027, available at: <https://www.statista.com/statistics/263617/gross-domestic-product-gdp-growth-rate-in-india>.

2 The World Bank (2020). Ease of Doing Business in India, available at: <https://www.doingbusiness.org/en/data/exploreconomies/india>; however, the World Bank Group has discontinued Doing Business Reports on September 16, 2021.

3 For a comprehensive insight on the Budget 2022, please see our Hotline (February 1, 2022) available at [https://www.nishithdesai.com/fileadmin/user\\_upload/Html/Hotline/India\\_Budget\\_Analysis\\_M\\_2022\\_23.htm](https://www.nishithdesai.com/fileadmin/user_upload/Html/Hotline/India_Budget_Analysis_M_2022_23.htm).

## 1. Introduction

### The Budget 2022: Key Reforms on the Government's Agenda

The Finance Minister, in her Budget speech, mentioned the intention of the Government to:

- Introduce a trust-based governance for ease of doing business in India. In this regard, the Budget has announced that necessary amendments to the Insolvency and Bankruptcy Code, 2016 will be carried out to increase the efficiency of the resolution process and facilitate cross-border insolvency resolution along with reduction in time period for the voluntary winding up of companies from 2 years to 6 months.
- The Budget has announced that an expert committee would be set up to holistically examine the regulatory hurdles and other frictions that prevent further scaling up of private equity and venture capital investments in the start-up eco-system .
- To encourage Defence R&D, the Government also plans to allow design and development of military platforms and equipment to be taken up by private industry in collaboration with Defence Research and Development Organisation.
- The Budget proposes to tax transfer of virtual digital assets at the rate of 30% irrespective of the period of holding and does not allow for any deduction in respect of expenses incurred aside from the cost of acquisition.
- The Finance Bill, 2022 ("Finance Bill") proposes to levy withholding tax on perquisites provided to Indian resident taxpayer at the rate of 10% of the value of the perquisite.
- Developments in relation to the Gujarat International Finance Tec City ("GIFT City") include setting up of foreign universities and an international arbitration centre.

This book sheds light on the basic legal regime regarding the conduct of business in India and provides guidance on commonly raised questions by overseas investors. This book is intended to act as a broad legal guide, with an overall focus on the multiple facets of law that need to be taken into consideration with the goal of aiding your decision making process when deciding to foray in India. However, it should not be used as a legal opinion on any specific matter. The laws discussed here are subject to change and the regulatory environment in India is dynamic. Therefore, we would recommend that you contact us, when you would like to invest in India or expand your operations in India. We would be happy to assist you.

# India's Legal System

India has always been an enigma in a multiplicity of ways and the Indian legal system is no different. Understanding the Indian legal system is pivotal in order to establish successful businesses in India.

India follows the common law system. Hence, India incorporates essential characteristics of common law jurisdictions into its legal system, for instance, courts in India adhere to previous decisions on the same legal issue and decisions of the appellate court are binding on lower courts. Adoption of these principles have resulted in the Indian legal system being akin to the English legal system. However, unlike England, India has a written constitution.

## A. Nature of the Constitution of India

The Constitution of India (the “**Constitution**”) is quasi-federal in nature, or one that is federal in character but unitary in spirit. The Constitution possesses both federal and unitary features and displays both these traits simultaneously depending on the requirements of the time and circumstances.

The federal features of the Constitution include distribution of powers between the national (or federal) government and the government of the various constituent states. There are two sets of governments, one at the central level and the other functioning at a state level. The distribution of powers between the governments is enshrined in the Union, State and Concurrent lists of the Constitution.

The Constitution also possesses strong unitary features such as the unified judiciary with the Supreme Court at the apex in India, which is in stark contrast to the federal principle envisaging a dual system of courts as in the US, and the authority to appoint key positions (for example, governors of states, the Chief Election Commissioner, the Comptroller and Auditor General, etc.) resting with the central government.

## B. Division of Legislative Powers between the Centre and States

The legislative powers are divided between the federal and state legislature. The Constitution identifies and allocates the “fields of legislation” between the federal and state legislatures through 3 distinct lists:

1. the Union List has 100 entries that are exclusively reserved for the federal parliament and includes subjects such as, national defense, incorporation of companies, banking and the RBI etc.;
2. the State List has 61 entries that are exclusively reserved for various state legislatures and includes subjects such as, agriculture, land and trade and commerce within the state's territories; and
3. the Concurrent List contains 52 entries and includes subjects such as contracts, bankruptcy and insolvency, trust and trustees etc., on which both the federal and states legislature may legislate; however, in case of a conflict, the federal law shall prevail.

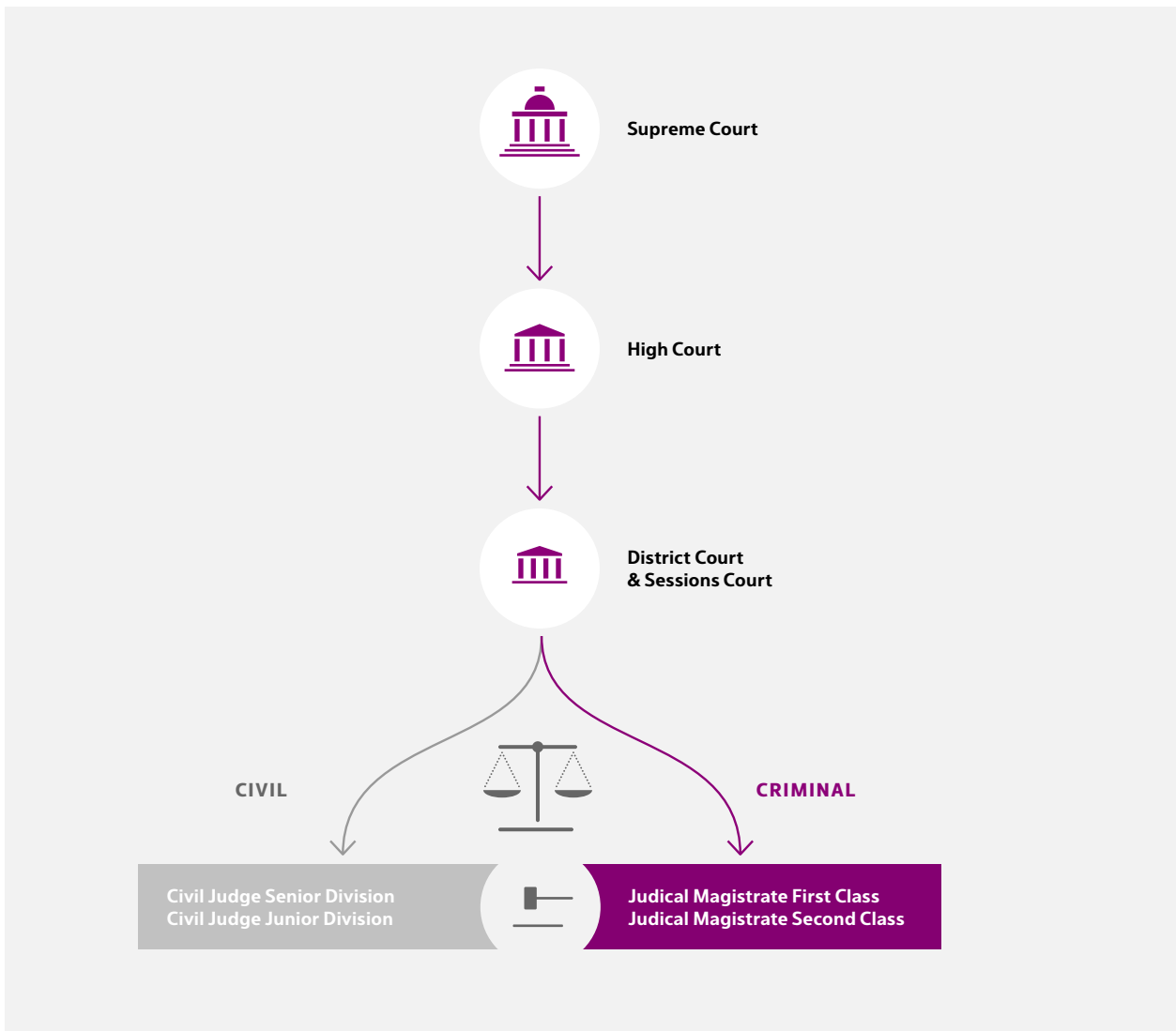
2. India’s Legal System

### C. Delegated Legislation

In addition to the legislative powers conferred on the federal and state legislatures, the Constitution recognizes ‘delegated legislation.’ This includes the exercise of legislative power by a governmental agency that is subordinate to the legislature.

At times, a statute may be incomplete unless it is read with the concomitant delegated legislation. Hence, it is important to examine the delegated legislation which includes rules and regulations supplemental to the statute. Delegated legislation may also vary between two states.

### D. Court System in India – Hierarchy of Courts



The Supreme Court of India is the highest appellate court and adjudicates appeals from the state High Courts. The High Courts for each of the states (or union territories) are the principal civil courts of original jurisdiction in the state (or the union territory) and can try all offences including those punishable with death.



## 2. India's Legal System

The High Courts adjudicate on appeals from lower courts and writ petitions under Article 226 of the Constitution. There are 25 High Courts in India.

The courts at the district level administer justice at district level. These courts are under administrative and judicial control of the High Court of the relevant state. The highest court in each district is that of the District and Sessions Judge. This is the principal court of civil jurisdiction. This is also a court of Sessions and has the power to impose any sentence including capital punishment.

There are many other courts subordinate to the court of District and Sessions Judge. There is a three tier system of courts. On the civil side, at the lowest level is the court of the Civil Judge (Junior Division). On the criminal side, the lowest court is that of the Judicial Magistrate Second Class. The Civil Judge (Junior Division) decides civil cases of small pecuniary stake whilst the Judicial Magistrate decides on criminal cases which are punishable with imprisonment extending up to 5 years.

# Investment into India

With the basic understanding of the Indian legal system, international companies or investors seeking to set up operations or make investments in India need to structure their activities on three pillars:

## Strategy

Observing the economic and political environment in India, at the national and state level, from the perspective of the investment.

Understanding the ability of the investor to carry out operations in India, the location of its customers, the quality and location of its workforce.

## Law

**Exchange Control Laws:** Primarily the Foreign Exchange Management Act, 1999 (“**FEMA**”) and rules, regulations, circulars, notifications and press notes issued under the same.

**Corporate Laws:** Primarily the Companies Act ( the “**Companies Act**”), Limited Liability Partnership Act, 2008 and the regulations laid down by the Securities and Exchanges Board of India (“**SEBI**”) for listed or to be listed companies in India.

**Labour Laws:** India has enacted three new codes on employment conditions, social security and occupational health, safety and working conditions: the Industrial Relations Code, 2020; the Code on Social Security, 2020; the Occupational Safety, Health and Working Conditions Code, 2020.<sup>1</sup> The codes consolidate, subsume and replace 29 national-level labour laws (such as the Industrial Disputes Act, 1947, Minimum Wages Act, 1948). India has state specific labor laws as well. The applicability of such laws is determined by various parameters (such as the nature of work to be performed, type of establishment, number of employees, etc.).

**Sector Specific Laws:** In addition to the abovementioned general legislations, specific Laws relating to financial services (banking, non-banking financial services), infrastructure (highways, airports) and other sectors are also applicable.

## Tax

**Domestic Taxation Laws:** It comprises of the Income Tax Act, 1961 (“**ITA**”); indirect tax laws including laws relating to Goods and Service Tax, (GST), customs, excise etc.

**International Tax Treaties:** Treaties with favorable jurisdictions such as Mauritius, Singapore, the Netherlands, etc.

---

<sup>1</sup> The said Codes are yet to come into effect.

### 3. Investment into India

#### Practitioner Tip: FEMA vs FCRA

While cross-border investments and funding of commercial businesses is governed by FEMA, the nonprofit sector is regulated under the Foreign Contribution (Regulation) Act, 2010 (FCRA).

Implemented by the Ministry of Home Affairs (akin to Homeland Security), the FCRA aims to regulate the receipt and utilization of foreign funds in the nonprofit sector in India. The primary purpose of the act is to ensure that foreign funding into the nonprofit sector is not used to fund any activities that may be detrimental to national interest. The act prescribes that no person can accept foreign contributions or foreign hospitality unless the person has applied for and received approval from the Ministry of Home Affairs in the form of prior permission (for a specific grant from a specific source and for a specific purpose) or registration under the FCRA.

The scope of 'foreign contribution' is wide and includes foreign funding in the form of capital investment, loans, or grants.

## A. Foreign Direct Investment

Setting up India operations or investing in India by non-residents requires conformity with India's foreign exchange regulations, specifically, the regulations governing FDI. Most aspects of foreign currency transactions with India are governed by FEMA and the delegated legislations thereunder. Investments in, and acquisitions (complete and partial) of, Indian companies by non-resident entities and individuals, are governed by the terms of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("**Non-Debt Instruments Rules**"), issued in supersession of erstwhile Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 ("**TISPRO Regulations**"), and the provisions of the annual Consolidated Foreign Direct Investment Policy Circular ("**FDI Policy**")<sup>2</sup> issued by the Department for Promotion of Industry and Internal Trade ("**DPIIT**") in the Ministry of Commerce and Industry, Government of India. With the introduction of Non Debt Instrument Rules, the power to regulate equity investments in India has now been transferred to the Ministry of Finance from the central bank i.e. Reserve Bank of India ("**RBI**"). However, the power to regulate the modes of payment and monitor the reporting for these transactions continues to be with RBI.

FDI limits with respect to the shareholding of non-residents in an Indian company are divided into prohibited and permitted sectors.

2 The latest FDI Policy is the Consolidated FDI Policy Circular of 2020 which is effective from October 15, 2020. Available at [https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020\\_0.pdf](https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020_0.pdf).

### 3. Investment into India

## Prohibited Sectors

The following is the list of sectors where FDI is prohibited:<sup>3</sup>

- Atomic energy
- Railway operations<sup>4</sup>
- Gambling and betting including casinos/ Lottery business including government/lottery, online lotteries etc.<sup>5</sup>
- Chit funds
- Nidhi company
- Real estate business<sup>6</sup> or construction of farm houses
- Trading in Transferable Development Rights
- Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes

## Permitted Sectors

In the sectors/ activities, which don't fall within 'Prohibited Sectors', FDI is (i) either permitted upto the limit indicated against each sector/ activity, or (ii) is permitted upto 100% under the automatic route, subject to applicable laws/ regulations, security and conditionalities. In few sectors, additional conditions are required to be complied with such as minimum capitalization requirements.<sup>7</sup>

Under the automatic route, for investments into an Indian company prior approval of RBI or the approval of the Central Government (through the concerned administrative ministry / department) is not required though certain filings may be required.

However, the Government of India through Press Note 3 (2020 Series) dated April 17, 2020<sup>8</sup> and notification dated April 22, 2020<sup>9</sup> amended its foreign direct investment policy to curb the opportunistic takeovers / acquisitions of Indian companies due to the Covid-19 pandemic. Accordingly, any investment being made from Bangladesh, China, Pakistan, Nepal, Myanmar, Bhutan and Afghanistan or where the *beneficial owner* (which term has not been defined) of an investment into India is situated in or is a citizen of any of the aforementioned countries, shall require prior approval of the Government regardless of the sector/activities in which investment is being made.

Foreign investment in certain sectors is permitted under the automatic route upto certain percentage of investment and investment beyond such percentage is either not permitted or would require prior approval of the government (as indicated in the FDI Policy).

3 Para 2, Schedule I, Non-Debt Instruments Rules.

4 Other than permitted activities mentioned in paragraph (3) of Schedule I of the Non-Debt Instruments Rules.

5 Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for lottery business and gambling and betting activities.

6 'Real estate business' shall not include development of townships, construction of residential/ commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations, 2014.

7 Para 3, Schedule I, Non-Debt Instruments Rules.

8 Available at [https://dpiit.gov.in/sites/default/files/pn3\\_2020.pdf](https://dpiit.gov.in/sites/default/files/pn3_2020.pdf).

9 Available at <https://egazette.nic.in/WriteReadData/2020/219107.pdf>.

### 3. Investment into India

FDI up to 100% is permitted in most sectors under the ‘automatic route’. However, listed below are few examples, which illustrate the sectors with a specific threshold for FDI, sectors which are partially under automatic route and partially under government approval route, sectors where there are conditionalities for FDI etc.:

- **Banking in private sector**<sup>10</sup> – upto 74% foreign investment is permitted, in which up to 49% is under the automatic route and foreign investment beyond 49% and up to 74% is under government approval route. Individual Non-Resident Indians’ (“**NRIs**”) cannot hold more than 5% of the total paid up capital and the aggregate NRI holdings cannot exceed 10% of the total paid up capital. However, NRI holdings shall be allowed up to 24 percent of the total paid up capital subject to a special resolution to this effect passed by the banking company’s general body.
- **Civil Aviation**<sup>11</sup> – 100% FDI is permitted under automatic route for both greenfield and existing projects for “Airports” and for Non-Scheduled Air Transport Service. 100 % FDI in “Air Transport Services” being Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline and Regional Air Transport Service is permitted where up to 49% is under automatic route and beyond 49% requires government approval (automatic upto 100% for NRIs). 100% FDI is also permitted under the automatic route for helicopter services/ seaplane services requiring approval of Directorate General of Civil Aviation, Government of India.
- **Defence**<sup>12</sup> – 100% FDI into defence sector (subject to the industrial license under Industries (Development and Regulation) Act, 1951) and manufacturing of small arms and ammunition under Arms Act, 1959 has been permitted where up to 74% is under the automatic route. For investment above 74%, approval of government will be required wherever it is likely to result in access to modern technology or for other reasons to be recorded.
- **Infrastructure Company in securities market like stock exchanges, commodity derivative exchanges, depositories and clearing corporations,**<sup>13</sup> **Power Exchanges**<sup>14</sup> **and Commodities Spot Exchange**<sup>15</sup> – 49% foreign investment is permitted under automatic route, which should be in compliance with the applicable SEBI Regulations, Central Electricity Regulatory Commission (Power Market) Regulations, 2010 and guidelines prescribed by Central Government.
- **Insurance** – FDI cap into the insurance sector (insurance companies, third party administrators, etc.) is 49% under the automatic route subject to approval/license from Insurance Regulatory and Development Authority of India (“**IRDAI**”) and compliance of other prescribed conditions.<sup>16</sup> Whereas FDI in insurance intermediaries including the likes of insurance brokers, re-insurance brokers, insurance consultants etc. have been allowed upto 100% under the automatic route.
- **Multi brand retail trading** – 51% foreign investment is permitted under the government approval route, which investment shall be in compliance with conditions prescribed including (i) minimum capitalization of USD 100 million, (ii) 50% of the total FDI in the first tranche of USD 100 million to be invested in the backend infrastructure within 3 years, (iii) retail sales outlets may be set up in those States or Union Territories which have agreed or agree in future to allow FDI in multi brand retail trade, (iv) 30% mandatory local sourcing requirement from Indian micro, small, medium industries which have a total investment in plant and machinery not exceeding USD 2 million etc.<sup>17</sup>

10 Sl. No. F.2 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

11 Sl. No. 9 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

12 Sl. No. 6 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

13 Sl. No. F.4 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

14 Sl. No. F.6 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

15 Sl. No. F.5 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

16 For additional conditions refer to Sl. No. F.8 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

17 For additional conditions, refer to Sl. No. 15.4 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

## 3. Investment into India

- **Other Financial Services** – 100% FDI is allowed under the automatic route in other financial services and activities regulated by financial sector regulators, viz., RBI, SEBI, IRDAI, Pension Fund Regulatory and Development Authority, National Housing Bank or any other financial sector regulator as may be notified by the Government of India, subject to conditionalities, including minimum capitalization norms, as specified by the concerned regulator/government agency.<sup>18</sup>
- **Digital Media** – 26% FDI is permitted under the government approval route in companies uploading/ streaming of news and current affairs through digital media.<sup>19</sup>
- **Print Media** – (i) Print media, specifically publishing of newspaper and periodicals dealing with news and current affairs is allowed up to 74% FDI under the government approval route, and (ii) print media, specifically publishing/ printing of scientific and technical magazines/ specialty journals/ periodicals (subject to compliance with the legal framework as applicable and guidelines issued in this regard from time to time by Ministry of Information and Broadcasting) is allowed to have 100% foreign investment with prior approval of government.<sup>20</sup>
- **Railways** – while 100% FDI is allowed in the railways infrastructure sector under the automatic route, proposals involving FDI beyond 49% in sensitive areas are required to be brought before the Cabinet Committee on Security for consideration by the Ministry of Railways (“**MoR**”) from a security point of view.<sup>21</sup> The MoR has issued sectoral guidelines<sup>22</sup> for domestic/ foreign direct investment in railways. The guidelines set out conditions and approvals that are required for private/ foreign participation in the railways sector.
- **Single brand product retail trading (“SBRT”)**<sup>23</sup> – Foreign investment is allowed up to 100% under the automatic route. Foreign investment in SBRT is subject to conditions, namely, (i) products to be sold should be of a ‘single brand’ and the products should be sold under the same brand internationally, (ii) to be covered within ‘single brand’ product retail trading, products should be branded during manufacturing, (iii) non-resident entity/ entities, whether owner of the brand or otherwise, shall be permitted to undertake single brand product retail trading in India for the specific brand, directly or through legally tenable agreement with the brand owner for undertaking single brand product retail trading, (iv) if the FDI is proposed to be beyond 51%, then sourcing of 30% of the value of the goods purchased should be done from India, preferably from Indian micro, small and medium enterprises, (v) single brand product retail trading entity operating through brick and mortar stores, is permitted to undertake retail trading through e-commerce, and retail trading through e-commerce can also be undertaken prior to opening of brick and mortar stores, subject to the condition that the entity opens brick and mortar stores within two years from date of start of online retail, (vi) SBRT entity may set off sourcing of goods from India for global operations against the mandatory sourcing requirement of 30%.
- **B2B E-Commerce** – 100% FDI permitted in companies engaged in the activity of buying and selling through the e-commerce platform only in the business to business (“**B2B**”) segment.<sup>24</sup>

18 For additional conditions, refer to Sl. No. F.10 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

19 Sl. No. 7.2.3 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

20 Sl. No. 8 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

21 Sl. No. 17 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

22 Sectoral Guidelines for Domestic/ Foreign Direct Investment in Railways, bearing reference No. 2012/Infra/12/25/Pt.I, dated November 20, 2014, available at [https://indianrailways.gov.in/railwayboard/uploads/directorate/infra/downloads/FDI\\_10114.pdf](https://indianrailways.gov.in/railwayboard/uploads/directorate/infra/downloads/FDI_10114.pdf).

23 Sl. No. 15.3 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

24 Sl. No. 15.2.1 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

### 3. Investment into India

- **B2C E-Commerce** – FDI in business to consumer (“**B2C**”) segment is permitted in the following circumstances, subject to conditions:<sup>25</sup>

1. 100% FDI under automatic route is permitted in marketplace model of e-commerce. Marketplace based model of e-commerce means providing of an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller.
2. FDI is not permitted in inventory based model of e-commerce. Inventory based model of e-commerce means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.

A few key considerations to be followed by an e-commerce market place entity are:

1. E-commerce entities providing a marketplace based model of e-commerce will not exercise ownership or control over the inventory, as ownership or control over the goods will render the business into an inventory based model (which is not permitted to receive FDI). Inventory of a vendor will be deemed to be controlled by the e-commerce marketplace entity if more than 25% of the purchases of such vendor are from the e-commerce marketplace entity or its group companies;
  2. An entity having equity participation by e-commerce marketplace entity or its group companies or having control on its inventory by the e-commerce marketplace entity or its group companies, will not be permitted to sell its products on the platform run by such marketplace entity;
  3. Services should be provided by an e-commerce marketplace entity or its group companies (in which the marketplace entity has a direct or indirect equity stake or common control) to vendors on the platform on an arms’ length basis, in a fair and non – discriminatory manner;
  4. The e-commerce marketplace entity will not directly or indirectly influence the price of the goods;
  5. An e-commerce marketplace entity cannot mandate any seller to sell any of its products exclusively on its platform only; and
  6. E-commerce marketplace entity will be required to furnish a certificate, together with a report of the statutory auditor, to the RBI, confirming compliance with the e-commerce guidelines by 30th of September every year.
- **Limited Liability Partnerships:** Foreign Investment in Limited Liability Partnerships (“**LLP**”) is permitted under the automatic route, for LLPs operating in sectors/ activities where 100% foreign investment is allowed through the automatic route and there are no foreign investment linked performance conditions. An LLP with foreign investment operating in sectors/activities where (i) 100% foreign investment is allowed through the automatic route; and (ii) there are no foreign investment linked performance conditions, can be converted into a company under the automatic route. Similarly, conversion of a company with foreign investment operating in sectors/activities where (i) 100% FDI is allowed through the automatic route; and (ii) there are no foreign investment linked performance conditions, can be converted into an LLP under the automatic route.<sup>26</sup>

<sup>25</sup> Sl. No. 15.2.2 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

<sup>26</sup> Schedule VI, Non-Debt Instruments Rules.



### 3. Investment into India

## Key Consideration under FDI Policy

### Construction Development sector<sup>27</sup>

100% FDI is allowed under automatic route for construction-development projects (which shall include development of townships, construction of residential/commercial premises, roads or bridges, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure, townships), subject to the following conditions attached to the investment:

- No minimum area requirements or minimum capitalization requirements.
- The investor is permitted to exit from the investment: (i) after 3 years from the date of each tranche of foreign investment, or (ii) on the completion of the project, or (iii) after development of trunk infrastructure.
- Further, transfer of stake from one non-resident to another non-resident, without repatriation of investment will neither be subject to any lock-in period nor to any government approval.
- Each phase of a project to be considered a separate project for the purposes of the FDI Policy.

Further, real-estate broking service does not constitute a real-estate business and hence, FDI in such services is permitted up to 100% under automatic route.

### Investment Companies and Core Investment Companies

FDI into investing companies registered as Non-Banking Financial Companies (“NBFC”) with the RBI, being overall regulated, is under automatic route up to 100%.<sup>28</sup>

Foreign investment in core investment companies (“CICs”) and other investing companies, engaged in the activity of investing in the capital of other Indian company(ies)/LLP, is permitted under government approval route. CICs will have to additionally follow RBI’s regulatory framework for CICs.<sup>29</sup>

### FDI by swap of shares

Any investment involving swap of shares is permitted under the automatic route for sectors which are under automatic route.<sup>30</sup>

### Entities controlled by NRI or OCI

A company, trust and partnership firm incorporated outside India and owned and controlled by NRIs or overseas citizens of India (“OCIs”) can invest in India with special dispensation as available to NRIs and OCIs under the FDI Policy.<sup>31</sup>

<sup>27</sup> Sl. No. 10 under paragraph 3 of the Table under Schedule 1, Non-Debt Instruments Rules.

<sup>28</sup> Para 3(b)(v)(B), Schedule I, Non-Debt Instruments Rules.

<sup>29</sup> Para 3(b)(v)(A), Schedule I, Non-Debt Instruments Rules.

<sup>30</sup> Para 1(d)(i), Schedule I, Non-Debt Instruments Rules.

<sup>31</sup> Para A(1)(a), Schedule IV, Non-Debt Instruments Rules.

### 3. Investment into India

#### Abolishment of FIPB

The process of phasing out the Foreign Investment Promotion Board (“FIPB”) was completed with the release of Standard Operating Procedure (“SOP”) for processing the FDI proposals by the Department of Industrial Policy and Promotion on June 29, 2017. The SOP has thereafter been revised by DPPIT in consultation with administrative ministries departments / sector regulators to guide the administrative ministries / departments in processing of the FDI proposals and ensure consistency of treatment and uniformity of approach across sectors. The focus of the SOP is to process such applications in a time bound manner so that the new regime for foreign investments may be simpler in execution and expeditious in disposal.

#### Issue of Shares for non-cash considerations

Earlier, issue of equity shares against non-cash considerations like pre-incorporation expenses, import of machinery and others was permitted under government approval route. However, the Government has now allowed the issue of equity shares against non-cash considerations such as pre-incorporation expense, import of machinery etc. under the automatic route in case of sectors under the automatic route.<sup>32</sup>

#### Joint Audits by Indian Investee Companies receiving FDI

If the foreign investor wishes to specify a particular auditor/audit firm having international network for the Indian investee company, then audit of such investee companies should be carried out as joint audit wherein one of the auditors should not be part of the same network.<sup>33</sup> In other words, joint audits are now mandatory for Indian companies that receive foreign investments if an international investor insists on audit by a global firm, or its Indian affiliate.

#### Transfer of shares on deferred consideration basis

A cross border transfer of shares is permitted on a deferred consideration basis subject to complying with the following conditions.<sup>34</sup>

- Up to 25% of the total consideration may be paid on a deferred basis, subject to the total consideration being compliant with the applicable pricing guidelines.
- The deferred consideration should be paid within a period of 18 months from the date of the share transfer agreement.
- The deferred consideration may be paid under an escrow arrangement, whose term shall not exceed 18 months.
- If the total consideration is paid, the seller can furnish an indemnity, valid for a period of 18 months, for the upto 25% of the total consideration.

#### Revised Definition of Medical Devices

Earlier, the definition of ‘Medical Device’ under the FDI Policy was subject to amendment to the Drugs and Cosmetics Act, 1940 (“D & C Act”). It has been decided that the said definition would no longer be subject to the amendment to D & C Act.

<sup>32</sup> Para 1(d), Schedule I, Non-Debt Instruments Rules.

<sup>33</sup> Para 3(b)(viii), Schedule I, Non-Debt Instruments Rules.

<sup>34</sup> Rule 9(6), Non-Debt Instruments Rules.

## 3. Investment into India

## B. Downstream Investment

Foreign investment into Indian companies/ LLPs may be direct or indirect. Foreign investment norms apply to both direct and indirect foreign investments into an Indian company/ LLP. In case of direct investment, the non-resident investor invests directly into an Indian company/LLP.

Indirect foreign investment is referred to as the downstream investment made by an Indian company/LLP, which is owned or controlled by non-residents, into another Indian company/LLP. As per the FDI Policy, such downstream investment is also required to comply with the same norms as applicable to foreign direct investment in respect of relevant sectoral conditions on entry route, conditionalities and caps with regard to the sectors in which the downstream entity is operating. Such downstream investments would be regarded as indirect foreign investment in an Indian entity if they have been made in the following manner:<sup>35</sup>

1. another Indian entity which has received foreign investment and (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India (“either referred to as **Non-Indian Entity**”); or
2. an investment vehicle whose sponsor or manager or investment manager (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India.

Downstream Investment into Indian entities are subject to conditions prescribed under the FDI Policy including prior approval of the board of directors, pricing guidelines and requirement of fund for investments to be brought from abroad or arranged through internal accruals (i.e. profits transferred to reserve account after payment of taxes). Similar conditions have also been included in the Non-Debt Instruments Rules with following additional conditions:

1. Equity instrument of an Indian company held by a Non-Indian Entity may be transferred to:
  - a. A person resident outside India, subject to reporting requirements as specified by the RBI;
  - b. A person resident in India subject to adherence to pricing guidelines.
  - c. Another Non-Indian Entity.
2. The first level Indian entity making downstream investment shall be responsible for ensuring compliance with the provisions of the Non-Debt Instruments Rules for the downstream investment made by it at second level and so on and so forth. Such first level company shall obtain a certificate to this effect from its statutory auditor on an annual basis. Compliance of these regulations shall be mentioned in the director’s report in the annual report of the Indian company. In case statutory auditor has given a qualified report, the same shall be immediately brought to the notice of the regional office of the RBI in whose jurisdiction the registered office of the company is located and shall also obtain acknowledgement from the regional office of the RBI in this regard.<sup>36</sup>

The first level Indian entity shall further file Form DI with the RBI in line with the new Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 (“**Reporting Regulations**”), within 30 days from allotment of equity instruments and must notify the Secretariat for Industrial Assistance, DPIIT within 30 days of such investment, even if allotment has not been done.<sup>37</sup>

<sup>35</sup> Rule 23(7)(i), Non-Debt Instruments Rules.

<sup>36</sup> Rule 23(6), Non-Debt Instruments Rules.

<sup>37</sup> Regulation 4(11), Reporting Regulations.

### 3. Investment into India

## C. Additional Procedural Requirements

The RBI recently notified the Non-Debt Instruments Rules and has replaced the definition of capital instruments with equity instruments, non-debt instruments and debt instruments. The 'equity instruments' are defined to mean equity shares, convertible debentures, preference shares and share warrants issued by an Indian company.<sup>38</sup> Further, the RBI notified the Reporting Regulations, complementing the Non-Debt Instruments Rules. The Reporting Regulations lay down the guidelines regarding mode of payment and remittance of sale proceeds in case of purchase or sale of equity instruments by various entities and reporting requirements in a single regulation, hence consolidating regulatory guidelines relating to payments, remittances and reporting in one single regulation. The investment amount is normally remitted through normal banking channels or by debit to the Non-Resident External Rupee ("NRE") / Foreign Currency Non-Resident (Bank) ("FCNR") account of the non-resident investor with a registered Authorized Dealer ("AD") (a designated bank authorized by the RBI to participate in foreign exchange transactions).<sup>39</sup>

Transfer or issue of shares of an Indian company to a non-resident by a resident will be subject to pricing guidelines. These guidelines have been laid down by the RBI (in the case of companies not listed on a stock exchange) and by SEBI (in the case of listed companies). RBI pricing guidelines prescribe any internationally accepted pricing methodologies for companies not listed on a stock exchange. The pricing guidelines for companies listed on a stock exchange shall be as per SEBI guidelines.<sup>40</sup>

Indian companies are permitted to issue of partly paid shares and warrants to non-residents (under the FDI and the FPI route) subject to compliance with the other provisions.<sup>41</sup> The company is required to report the details of the consideration received for issuing its securities to the regional office of the RBI in the prescribed forms together with copies of the foreign inward remittance certificate ("FIRC"), arranged for by the AD, evidencing the receipt of the remittance along with the submission of the 'know your customer' ("KYC") report of the non-resident investor. A certificate from the merchant banker or chartered accountant indicating the manner of calculating the price of the shares also needs to be submitted.

The Indian company is required to issue its securities within 60 days from the date of receipt of foreign investment. Should the Indian company fail to do so, the investment so received would have to be returned to the person concerned within 15 days from this time-frame.<sup>42</sup> Foreign investments made in Indian companies or LLPs by way of allotment or transfer of equity shares or partnership interest, as the case may be, are required to be reported to the RBI through the AD banks.

---

38 Rule 2(k), Non-Debt Instruments Rules.

39 Regulation 3.1(l)(A)(1), Reporting Regulations.

40 Rule 21(2)(b), Non-Debt Instruments Rules.

41 Rule 2(k)(ii), Non-Debt Instruments Rules.

42 Regulations 3.1(l)(A)(2) and 3.1(l)(A)(3), Reporting Regulations.

## D. Other Foreign Investments

### FVCI

In addition to investing under the FDI regime, foreign investors which are registered with SEBI as a foreign venture capital investor (“**FVCI**”) are allowed to invest in Indian companies in sectors such as biotechnology, nanotechnology, IT related to hardware and software development, seed research and development, poultry industry, production of bio-fuels, hotel-cum-convention centers with seating capacity of more than three thousand, research and development of new chemical entities in pharmaceutical sector, dairy industry, and infrastructure sector.<sup>43 / 44</sup> SEBI and the RBI have extended certain benefits to FVCIs, some of which include:

#### Free pricing

Registered FVCIs benefit from free entry and exit pricing, and are not bound by the pricing restrictions applicable to the FDI investment route.<sup>45</sup> However, under the income tax laws in India, FVCIs may be liable to pay tax on the income generated through equity investments made at a price lower than the fair market value, in a company which does not have substantial public interest. This limits the benefits available to a FVCI especially with respect to exits from unlisted companies through strategic sales or through buy-back arrangements with the promoters and the company.

#### Lock-In

Under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (“**ICDR Regulations**”) the entire pre-issue share capital (other than certain promoter contributions which are locked in for a longer period) of a company conducting an initial public offering (“**IPO**”) is locked for a period of 6 months from the date of allotment in the public issue.<sup>46</sup> However, an exemption from this requirement has been granted to registered FVCIs, provided, the shares have been held by them for a period of at least 6 months from the date of purchase by the FVCI.<sup>47</sup> This exemption permits the FVCI to exit from its investments, post-listing.

#### FVCI investment in start-ups

The FDI Policy allows startups, irrespective of the sector they operate in, to raise 100% funds from SEBI registered FVCI under the automatic route. Start-ups can issue equity or equity linked instruments or debt instruments to FVCI against receipt of foreign remittance. However, if the investment is made through an equity instrument, the FVCI must comply with sectoral caps, entry routes and other specified conditions.

43 The term “Infrastructure Sector” has the same meaning as given in the Harmonised Master List of Infrastructure sub-sectors approved by Government of India vide notification F. No. 13/06/2009- INF, dated the March 27, 2012 as amended or updated.

44 Para 5, Schedule VII, Non-Debt Instruments Rules.

45 Para 3, Schedule VII, Non-Debt Instruments Rules.

46 Regulation 17, ICDR Regulations.

47 Ibid.

## 3. Investment into India

## Foreign Portfolio Investments

Separate and varying degrees of regulations have been prescribed to govern foreign portfolio investment regimes in India. SEBI and the RBI under extant securities and exchange control laws, allow portfolio investments in India by SEBI registered FIIs and by certain qualified foreign investors (“**QFIs**”) without being subjected to FDI restrictions. Subject to applicable conditions, the regulations permit FIIs (and its sub-account) and QFIs to invest in unlisted or listed shares, convertible or non-convertible debentures (listed and unlisted), Indian depository receipts, domestic mutual fund units, exchange traded derivatives and similar securities. SEBI in 2014 harmonized the portfolio investment routes of FIIs and QFIs into a new class of FPI through the SEBI (Foreign Portfolio Investors) Regulations, 2014 (“**Erstwhile FPI Regulations**”).

In 2019, SEBI notified the SEBI (Foreign Portfolio Investors) Regulations, 2019 (“**FPI Regulations**”), replacing the 2014 FPI Regulations, and streamlined the categories of foreign portfolio investors (“**FPI**”) by bringing down the number of categories from three to two. Category-I now includes government and government-related investors such as central banks, sovereign wealth funds, pension funds, university funds, appropriately regulated entities, international or multilateral organizations or agencies including entities controlled or at least 75% directly or indirectly owned by such government and government-related investors, while Category-II includes all the investors not eligible under Category I such as endowments and foundations, charitable organizations, corporate bodies, family offices, individuals, unregulated funds in the form of limited partnership and trusts, appropriately regulated entities investing on behalf of their clients, as per conditions specified by SEBI from time to time and other appropriately regulated funds which are not eligible to be included under Category I.<sup>48</sup> FPI Regulations 2019 are supplemented by the Operational Guidelines<sup>49</sup> which facilitate implementation of the FPI Regulations (“**Operational Guidelines**”). The FPI Regulations 2019 read with the Operational Guidelines seem to have consolidated the feedback from industry on the different circulars that had been issued by SEBI under the FPI Regulations 2014.

An FPI may purchase units of domestic mutual funds or Category III AIFs or offshore funds for which no objection is issued in line with SEBI (Mutual Funds) Regulations, 1996, which shall in turn invest more than 50 percent in equity instruments in India on repatriation basis.<sup>50</sup> An FPI may further purchase units of Real Estate Investment Trusts and Infrastructure Investment Trusts on repatriation basis.<sup>51</sup> Any investment made by a person resident outside India through equity instruments where such investment is less than 10 percent of the post issue paid-up share capital on a fully diluted basis of a listed Indian company or less than 10 percent of the paid-up value of each series of equity instruments of a listed Indian company, it shall be regarded as foreign portfolio investment.<sup>52</sup>

A FPI may purchase equity instruments of an Indian company through public offer or private placement<sup>53</sup> and such investments are subject to the limits and margin requirements specified by the RBI or SEBI.<sup>54</sup> The amount of consideration shall be paid as inward remittance from abroad through banking channels or out of funds held in a foreign currency account and/or a Special Non-Resident Rupee (“**SNRR**”) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016 provided that the balance in the SNRR

48 Regulation 5, FPI Regulations.

49 SEBI, [https://www.sebi.gov.in/sebi\\_data/commondocs/nov-2019/Operational%20Guidelines%20for%20FPIs,%20DDPs%20and%20EFIs%20revised\\_p.pdf](https://www.sebi.gov.in/sebi_data/commondocs/nov-2019/Operational%20Guidelines%20for%20FPIs,%20DDPs%20and%20EFIs%20revised_p.pdf).

50 Para 1(b)(i), Schedule II, Non-Debt Instruments Rules.

51 Para 1(b)(ii), Schedule II, Non-Debt Instruments Rules.

52 Rule 2(t), Non-Debt Instruments Rules.

53 Para 1(a)(v), Schedule II, Non-Debt Instruments Rules.

54 Para 1(a)(vii), Schedule II, Non-Debt Instruments Rules.

### 3. Investment into India

account cannot be used for making investment in units of investment vehicles other than units of a domestic mutual fund, and that the foreign exchange account and the SNRR account can be used exclusively for the purposes of investment as FPI.<sup>55</sup>

The total holding by each FPI or an investor group, shall be less than 10% of the total paid-up equity capital on a fully diluted basis or less than 10% of the paid-up value of each series of debentures or preference shares or share warrants issued by an Indian company and the total holdings of all FPIs put together, including any other direct and indirect foreign investments in the Indian company permitted under these rules, shall not exceed 24% of paid-up equity capital on a fully diluted basis or paid up value of each series of debentures or preference shares or share warrants.<sup>56</sup> Where two or more FPIs have common ownership, directly or indirectly, of more than 50% or common control, all such FPIs shall be treated as forming part of an investor group.<sup>57</sup> The said limit of 10% and 24% are called the individual and aggregate limit, respectively.

Further, post April 01, 2020, the aforementioned aggregate limit shall be the sectoral caps as mentioned under sub-paragraph (b) of Paragraph 3 of Schedule I, with respect to the company's fully paid up equity capital on a fully diluted basis or the paid up value of each series of debentures and preference shares or share warrants. An Indian company which has decreased its aggregate limit to 24% or 49% or 74% before March 31, 2020 may increase such aggregate limit to 49% or 74% or the sectoral cap or statutory ceiling with the approval of its board of directors and general body through a resolution and special resolution, respectively. Once the aggregate limit has been increased to a higher threshold, the Indian company cannot reduce the same to a lower threshold. The aggregate limit in case of an Indian company operating in a sector where FDI is prohibited is 24%.<sup>58</sup> In cases where the investment falls foul of the prescribed limit, the FPIs committing the breach shall divest their holdings within 5 trading days from the date of settlement of trades resulting in the breach, and if the FPI/FPIs do not divest, then the entire investment by such FPI or its investor group will be considered as FDI, and they will not be allowed to make further portfolio investment in the company concerned.<sup>59</sup> A FPI may, further, undertake short-selling as well as lending and borrowing of securities, subject to conditions laid down by the RBI and SEBI.<sup>60</sup>

FPIs are also permitted to invest in non-convertible debentures (“NCDs”) issued by Indian companies and in security receipts issued by asset reconstruction companies. Foreign exchange control regulations currently permit foreign investments into India by way of unlisted or listed NCDs with investment by any FPI, including related FPIs, being subject to a cap of 50% of any issue of a corporate bond.<sup>61</sup>

### Investment by Non-Resident Indians

Non-Debt Instruments Rules allow NRI investors to invest in India, either on repatriation basis or non-repatriation basis. Investments made on repatriation basis are such investments, sale/maturity proceeds (net of taxes) of which are eligible of being fully repatriated outside India. However, such investments are subject to conditions, as prescribed under the Non-Debt Instruments Rules, similar to that applicable to any non-resident investor.

<sup>55</sup> Regulation 3.1(II)(A), Reporting Regulations.

<sup>56</sup> Para 1(a)(i), Schedule II, Non-Debt Instruments Rules.

<sup>57</sup> Explanation to Para 1(a)(ii), Schedule II, Non-Debt Instruments Rules.

<sup>58</sup> Provisos to Para 1(a)(ii), Schedule II, Non-Debt Instruments Rules.

<sup>59</sup> Para 1(a)(iii), Schedule II, Non-Debt Instruments Rules.

<sup>60</sup> Para 1(a)(vi), Schedule II, Non-Debt Instruments Rules.

<sup>61</sup> Investment by Foreign Portfolio Investors (FPI) in Debt – Review, RBI/2017-18/199, A.P. (DIR Series) Circular No.31, available at [https://www.rbi.org.in/scripts/FS\\_Notification.aspx?id=11303&fn=6&Mode=0](https://www.rbi.org.in/scripts/FS_Notification.aspx?id=11303&fn=6&Mode=0).



### 3. Investment into India

On the other hand, investments made by NRIs on non-repatriation basis, as prescribed under Schedule IV of the Non-Debt Instruments Rules, cannot be repatriated outside India and hence, such investments are also deemed to be domestic investment at par with the investments made by resident investors.<sup>62</sup>

#### Start-Up India Initiative

The government's initiative of "Start-Up India" to give boost to ecosystem of entrepreneurship and innovation has garnered a lot of attention and response. A start-up has been defined and the process of its recognition (through mobile application/ portal of DIPP) and eligibility for obtaining tax benefits has been notified by DIPP.<sup>63</sup> An entity (i.e. a private limited company/ limited liability partnership/ a registered partnership firm) incorporated/ registered in India shall be considered as a 'startup':

- a) Up to 10 years from the date of its incorporation,
- b) If its turnover for any of the financial years since incorporation / registration has not exceeded INR 1 billion,
- c) It is working towards innovation, development or improvement of products or processes or services or if it is scalable business model with a high potential of employment generation or wealth creation,
- d) It has not been formed by splitting up or reconstructing an already existing business.

Various ministries have also come forward with measures to ease doing of business in India. Some of these are:

- Real time registration of a company
- No licences/ permits/ approvals/ tax for start-ups in non-risk non-hazardous activities
- Overriding effect on many legislations including legislations on tax (both direct and indirect), environmental legislations, labour legislations etc.
- Tax sops and incentives
- Loans to be treated as priority sector lending
- Credit guarantee for loans
- Strong intellectual property rights ("IPR") regime and strengthening of IPR enforcement
- Simpler listing requirements
- Facilitate easy exit

RBI has also announced a list of clarifications/ reforms/ proposals which would be applicable to foreign investments in start-ups. Some of the key changes are:

- FVCI will be permitted to invest in all startups regardless of the sector that the startup would fall under.<sup>64</sup>
- Transfer of shares or ownership with deferred considerations and facilities for escrow or indemnity arrangements for a period of 18 months is allowed.
- Simplification in the process for dealing with delayed reporting of FDI related transaction by building a penalty structure into the regulation itself.

62 Para A(1)(b), Schedule IV, Non-Debt Instruments Rules.

63 <https://www.startupindia.gov.in/content/dam/invest-india/Templates/public/198117.pdf>.

64 Para 1(iii), Schedule VII, Non-Debt Instruments Rules.

### 3. Investment into India

- Enabling online submission of A2 forms for outward remittances on the basis of the form alone or with uploading/ submission of document(s), depending on the nature of remittance.
- Opened up a new avenue for investments into start-ups in India by allowing foreign investors to invest in Indian start-ups by subscribing to “convertible-notes” issued by such companies subject to specified conditions.<sup>65</sup>

## Black Money Act, 2015

In 2015, the government had introduced the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (“**Black Money Act**”)<sup>66</sup> to bring back to India undisclosed offshore income and assets of residents and non-resident/not ordinarily resident in India.<sup>67</sup> The Black Money Act provides for a penalty up to 90% of the value of an undisclosed asset in addition to a tax at 30%, as well as sentences of rigorous imprisonment, to be imposed in certain cases.

To increase compliance with the Black Money Act, the government have introduced one-time compliance opportunities for persons who were affected by the Black Money Act to voluntarily declare previously undisclosed income and undisclosed foreign assets in return for a reduced penalty rate. The compliance window was open for a limited duration and was available for persons to declare income:

- a) for which they have either not filed income tax returns or not made disclosure in their income tax returns; or
- b) which has escaped assessment of tax by virtue of non-filing of income tax returns or non-disclosure of full and true material facts.

The Black Money Act has ramifications for those foreigners and foreign companies who qualify as ‘tax residents’ under the existing ITA. For individuals, the ITA has a day-count test of physical residence in India. Expats should therefore be covered since there is no exemption on the basis of nationality or citizenship. It is also a matter of concern for dual resident individuals. Even if they are considered non-resident under the double tax avoidance agreements, they may need to disclose their foreign assets and income in India because the Black Money Act connects to the residence test under the ITA.

For foreign companies, the test of residence under the ITA (as amended by the Finance Act, 2015) is whether the company is incorporated in India or has its ‘place of effective management’ in India (“**POEM**”). POEM has been defined to mean “a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made”.

In order to provide some clarity on how to determine the POEM of a company, the Government released a notification on Place of Effective Management Guidelines.<sup>68</sup> The POEM Test is applicable from the financial year 2016-17.

65 Rules 18, Non-Debt Instruments Rules.

66 The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 received Presidential assent on May 26, 2015 and is effective from April 1, 2015.

67 <http://egazette.nic.in/WriteReadData/2019/209695.pdf>.

68 [https://www.incometaxindia.gov.in/news/notification29\\_2018.pdf](https://www.incometaxindia.gov.in/news/notification29_2018.pdf).

# Establishing a Presence in India

Once the foreign exchange regulations have been complied with, a foreign investor must choose the type of entity to run its operations in India, amongst various options available in India. The entities that foreign investors may set up in India may either be unincorporated or incorporated. In addition, we also discuss establishing an entity at the International Financial Services Center established at the GIFT City near Gandhinagar in Gujarat.

## A. Setting up Unincorporated Entities

A foreign company can use unincorporated entities to do business in India via 'offices' of certain types. These options are as follows:

### Liaison Office<sup>1</sup>

A foreign company can set up a liaison office with the prior approval of the RBI. An application from a person resident outside India for opening a liaison office shall be forwarded by the AD bank to the General Manager, RBI in the following cases: (i) the applicant is a citizen of or is registered/incorporated in Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau and the application is for opening a BO/LO/PO in Jammu and Kashmir, North East region and Andaman and Nicobar Islands, (ii) the principal business of the applicant falls in the four sectors namely defence, telecom, private security and information and broadcasting; however, prior approval of the RBI shall not be required in cases where Government approval or license/permission by the concerned Ministry/Regulator has already been granted, and (iii) the applicant is a non-government organisation (NGO), non-profit organisation, body/ agency/ department of a foreign government. However, if such entity is engaged, partly or wholly, in any of the activities covered under Foreign Contribution (Regulation) Act, 2010 (FCRA), they shall obtain a certificate of registration under the said Act and shall not seek permission under FEMA 22(R). Further, the non-resident entity applying for a liaison office in India should have a financially sound track record or may submit a letter of comfort (LOC) from its parent/ group company, subject to the condition that the parent/ group company satisfies the prescribed criteria for net worth and profit.

A liaison office acts as a representative of the parent foreign company in India. However, a liaison office cannot undertake any commercial activities and must maintain itself from the remittances received from its parent foreign company. The approval for setting up a liaison office is generally valid for 3 years, except in the case of NBFCs and those entities engaged in construction and development sectors, for whom the validity period is 2 years only. The validity of the approval can be extended by making an application to AD before the date of expiry of validity. It is an option usually preferred by foreign companies that wish to explore business opportunities in India.

<sup>1</sup> Master Direction – Establishment of Branch Office (BO)/ Liaison Office (LO)/ Project Office (PO) or any other place of business in India by foreign entities, RBI/FED/2015-16/6, FED Master Direction No.10/2015-16, available at [https://www.rbi.org.in/Scripts/BS\\_ViewMasDirections.aspx?id=10404](https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10404), read with Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016, Notification No. FEMA 22(R)/ 2016-RB, available at <https://www.rbi.org.in/Scripts/NotificationUser.aspx?id=10327&Mode=0>.

#### 4. Establishing a Presence in India

### Branch Office<sup>2</sup>

Similar to a liaison office, a foreign company can set up a branch office with the prior approval of the RBI. An application from a person resident outside India for opening a branch office shall be forwarded by the AD bank to the General Manager, RBI in the following cases: (i) the applicant is a citizen of or is registered/incorporated in Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau and the application is for opening a BO/LO/PO in Jammu and Kashmir, North East region and Andaman and Nicobar Islands, (ii) the principal business of the applicant falls in the four sectors namely defence, telecom, private security and information and broadcasting; however, prior approval of the RBI shall not be required in cases where Government approval or license/permission by the concerned Ministry/Regulator has already been granted, and (iii) the applicant is a non-government organisation (NGO), non-profit organisation, body/ agency/ department of a foreign government. However, if such entity is engaged, partly or wholly, in any of the activities covered under Foreign Contribution (Regulation) Act, 2010 (FCRA), they shall obtain a certificate of registration under the said Act and shall not seek permission under FEMA 22(R). Further, the non-resident entity applying for a branch office in India should have a financially sound track record or may submit a letter of comfort (LOC) from its parent/ group company, subject to the condition that the parent/ group company satisfies the prescribed criteria for net worth and profit.

The branch office is permitted to remit outside India profit of the branch net of applicable Indian taxes. Operations of a branch office are restricted due to limitation on the activities that it can undertake. The tax on branch offices is 40% plus applicable surcharge and the education cess. It is an option that is useful for companies that intend to undertake research and development activities in India.

### Project Office<sup>3</sup>

A foreign company can set up a project office with the prior approval of the RBI. An application from a person resident outside India for opening a branch office shall be forwarded by the AD bank to the General Manager, RBI in the following cases: (i) the applicant is a citizen of or is registered/incorporated in Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau and the application is for opening a BO/LO/PO in Jammu and Kashmir, North East region and Andaman and Nicobar Islands, (ii) the principal business of the applicant falls in the four sectors namely defence, telecom, private security and information and broadcasting; however, prior approval of the RBI shall not be required in cases where Government approval or license/permission by the concerned Ministry/Regulator has already been granted, and (iii) the applicant is a non-government organisation (NGO), non-profit organisation, body/ agency/ department of a foreign government. However, if such entity is engaged, partly or wholly, in any of the activities covered under Foreign Contribution (Regulation) Act, 2010 (FCRA), they shall obtain a certificate of registration under the said Act and shall not seek permission under FEMA 22(R). However, there is a general permission to non-resident companies to establish POs in India, provided they have secured a contract from an Indian company to execute a project in India. Also, the project must have secured the necessary regulatory clearances; and is funded directly by inward remittance from abroad; or the project is funded by a bilateral or multilateral international financing agency, or a company or entity in India awarding the contract has been granted term loan by a public financial institution or a bank in India for the project.

---

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

#### 4. Establishing a Presence in India

A project office is permitted to operate a bank account in India and the AD bank may permit intermittent remittances by project offices pending winding up / completion of the project. The tax on project offices is 40% plus applicable surcharges and the education cess. Project offices are generally preferred by companies engaged in one-time turnkey or installation projects.

### Partnership

A partnership is a relationship created between persons who have agreed to share the profits of a business carried on by all of them, or any of them acting for all of them. A partnership is not a legal entity independent of its partners. The partners own the business assets together and are personally liable for business debts and taxes. In the absence of a partnership agreement, each partner has an equal right to participate in the management and control of the business and the profits / losses are shared equally amongst the partners. Any partner can bind the firm and the firm is liable for all the liabilities incurred by any partner on behalf of the firm. Investment by foreign entities is permitted in Indian partnership firms subject to prior approval of RBI.

### Trust

A trust arises when one person (the “trustee”) holds legal title to property but is under an equitable duty to deal with the property for the benefit of some other person or class of persons called beneficiaries. Like a partnership, a business trust is not regarded as a legal entity. The trust, as such, does not incur rights or liabilities. The beneficiaries do not generally obtain rights against or incur liabilities to third parties because of the transactions or actions undertaken by the trustee in exercising its powers and carrying out its duties as a trustee. If the trustee of a business trust is a corporation, the participants may effectively limit their liability to the assets of the corporate trustee and the assets held by the corporation on trust for the beneficiaries. Investment by a person resident outside India is not permitted in trusts other than in a venture capital fund and an investment vehicle registered and regulated by SEBI.<sup>4</sup>

#### Practitioner Tip: PEO and Local Representation

Unlike other markets, PEO is not a widely popular employment structure in India as tax authorities tend to closely scrutinize the arrangement to assess whether it has led to the foreign organization establishing a tax presence (Permanent Establishment) in India.

Care should be taken while entering into PEO arrangements in India to avoid long drawn and costly litigation with the Indian revenue authorities.

4 Para 3.2.3, FDI Policy, 2020, available at [https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020\\_0.pdf](https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020_0.pdf).

#### 4. Establishing a Presence in India

## B. Establishment of Incorporated Entities

Incorporated entities in India are governed by the provisions of the Companies Act / Limited Liability Partnership Act, 2008.

### Limited Liability Partnership

A LLP is a form of business entity which permits individual partners to be shielded from the liabilities created by another partner's business decision or misconduct. In India, LLPs are governed by the Limited Liability Partnership Act, 2008. LLP is a body corporate and exists as a legal person separate from its partners.

#### Practitioner Tip: LLP

LLP is subject to corporate tax at 30% (exclusive of surcharge and cess). Profit distributions by the LLP to its partners are not taxable in the hands of LLP or the partners.

### Companies under the Companies Act

The Companies Act sets out, inter alia, provisions related to incorporation of a company, issuance of shares, roles and responsibilities of directors, dissolution of a company (winding up), etc.

The authority that oversees companies and their compliances is the Registrar of Companies (“**RoC**”). Companies mainly may either be ‘private limited companies’ or ‘public limited companies’.

#### Private Limited Company

A private limited company has certain distinguishing characteristics. It must, in its articles of association, restrict the right to transfer shares; the number of members in a private limited company is minimum of 2 and a maximum of 200 members (excluding the present and past employees of the company)<sup>5</sup>; its articles of association must prohibit any invitation to the public to subscribe to the securities of the company.

Under the Companies Act, a natural person who is an Indian citizen whether resident in India or otherwise can incorporate a one person company. For the purpose of this, resident in India means a person who has stayed in India for a period not less than one hundred and eighty two days during the immediately preceding financial year.<sup>6</sup>

<sup>5</sup> Section 2(68), Companies Act.

<sup>6</sup> Rule 3, Companies (Incorporation) Rules, 2014.

## 4. Establishing a Presence in India

### Public Limited Company

A public limited company is defined as a company which is not a private company (but includes a private company that is the subsidiary of a public company).<sup>7</sup> A public limited company shall have a minimum of 7 members but may have more than 200 members and may invite public to subscribe to its securities.

A public limited company may also list its shares on a recognized stock exchange by way of an IPO or an OFS. Every listed company shall maintain public shareholding of at least 25% (with a maximum period of 12 months to restore the same from the date of a fall).<sup>8</sup>

An application for registration of a company can be filed, with the RoC within whose jurisdiction the registered office of the company is proposed to be situated, in form SPICe+ (Simplified Proforma for Incorporating company Electronically Plus: INC-32) along with the payment of prescribed fee.<sup>9</sup> This form enables a speedy incorporation service with specified time frames which are in line with international best practices.

SPICe+ form INC 32 also provides an option for allotment of PAN and TAN and few other statutory registrations such as goods and services tax registration, employees state insurance registration and employees provident fund registration for the company along with the incorporation certificate.

A foreign company shall, within a period of 30 days of the establishment of its place of business in India, register itself with the RoC, as either a private or a public company.<sup>10</sup>

#### Practitioner Tip: Local Resident Director and Key Considerations for New Market Entrants

A private limited company is required to have at least two directors at all times, of which at least one should be a person who resides in India for 182 days or more in a year.<sup>11</sup> For organizations new to the market, this can be a challenge for a number of reasons, including not yet having a trusted relationship in India to appoint as the resident director.

Considering many organizations are particularly sensitive to control over the subsidiary, a local non-executive director service is a potential solution. This solution, provided by a third party, places an independent director onto the board of the Indian subsidiary primarily to oversee the compliance aspect of the business.

### Advantages and Disadvantages of a Private Company

- ↑ More flexibility than public companies in conducting operations, including the management of the company and the payment of managerial remuneration
- ↑ Faster incorporation process
- ↓ Restrictions on invitation to public to subscribe to securities.
- ↓ Limited exit options

<sup>7</sup> Section 2(71), Companies Act.

<sup>8</sup> Rule 19A(2), Securities Contracts (Regulation) Rules, 1957.

<sup>9</sup> Rule 12, Companies (Incorporation) Rules, 2014.

<sup>10</sup> Section 380(1), Companies Act.

<sup>11</sup> Section 149(3), Companies Act.

#### 4. Establishing a Presence in India

### C. Incorporation Process (as per Companies Act)

The process for incorporating a company in India is not exceptionally different from the processes in other Commonwealth nations. The important steps with an indicative time frame involved in the incorporation process are:

#### PAN – DSC – DIN

Permanent Account Number (“**PAN**”), Digital Signature (“**DSC**”) preferably with PAN encryption and Directors Identification Number (“**DIN**”) is mandatory for initiating the incorporation process. All forms are required to be filed electronically. No person can be appointed as a Director without DIN and having more than one DIN per director is an offence.<sup>12</sup> DSC should be PAN encrypted as, all filings relating to Income Tax has to be done by a director whose DSC is PAN encrypted.

#### Name Approval

The RoC must be provided with 2 preferred names which should not be similar to the names of any existing companies. A no objection certificate by way of a board’s resolution should be obtained if the name is similar to an existing company. The proposed name must not violate the provisions of the Emblems and Names (Prevention of Improper Use) Act, 1950. MCA has introduced Central Registration Centre having territorial jurisdiction all over India to process and dispose of the name reservation applications and incorporation applications.<sup>13</sup>

#### Filing of Charter Documents

The memorandum and articles of the company have to be prepared in accordance with the needs of the business and the same must be filed with the RoC. Resident Individual subscribers shall file the memorandum and articles of the company in electronic form by digitally signing e-form INC 33 and e-form INC 34. However, non resident individual subscribers and subscribers which are body corporate shall sign the memorandum and articles in physical and file along with SPICe e-form INC 32.

The RoC will need to be provided with certain information, such as the proposed first directors of the company and the proposed address of its registered office. The registered office is required to be finalized within 15 days and intimated within 30 days of incorporation.<sup>14</sup> Consents and declarations to be provided by subscribers and proposed first directors requires notarisation and legalization/apostille in the respective home countries, if they are executed outside India.

---

<sup>12</sup> Section 155, Companies Act.

<sup>13</sup> Notification S.O. 218 (E), Ministry of Corporate Affairs, January 22, 2016.

<sup>14</sup> Section 12, Companies Act.



#### 4. Establishing a Presence in India

A private limited company must have at least 2 shareholders and 2 directors whereas a public limited company must have at least 7 shareholders and 3 directors. One of the directors has to be resident in India, for at least 182 days during the financial year.<sup>15</sup> In case of a newly incorporated companies, number of days shall be calculated proportionately at the end of the financial year in which the company is incorporated.

Companies that meet certain thresholds must have independent directors, key managerial personnel and women director on the board and company secretary as well.

### Certificate of Incorporation

The Certificate of incorporation provided by the RoC at the end of the incorporation process acts as proof of the incorporation of the company.

The company should be capitalized and the corresponding share certificates be issued within a period of 2 months of receiving the certificate of incorporation.<sup>16</sup>

### Post Incorporation

Once a company is incorporated, it must undertake certain other actions in order to become fully functional:

- The company must, within 30 days from incorporation, hold its first board meeting.<sup>17</sup>
- The first auditor should be appointed by the Board within 30 days from the date of its incorporation who shall hold the office till the conclusion of its first annual general meeting. If in case, the Board fails to appoint within 30 days, shareholders can appoint the first auditor, within 90 days of incorporation.<sup>18</sup>
- The company may appoint additional directors (if required).
- The company must register itself with statutory authorities such as indirect tax authorities and labour authorities.
- The company must open a bank account.
- The company must file declaration of commencement of business.<sup>19</sup>
- The company must put in place the contracts with suppliers and customers that are essential to running the business.

Pursuant to various reform measures brought in by the MCA, the procedure for incorporation of a company in India has become single-form and single window with a time frame of less than 96 hours after submission of the requisite documents. Additionally, with the no-minimum capital requirement, zero fee for incorporation of companies with the capital of upto INR 1,000,000, the MCA is looking to attract start-up culture. With many advantages to doing business in India via an incorporated entity, company is definitely one of the leading option.

<sup>15</sup> Section 149(3), Companies Act.

<sup>16</sup> Section 56(4)(a), Companies Act.

<sup>17</sup> Section 173(1), Companies Act.

<sup>18</sup> Section 139, Companies Act.

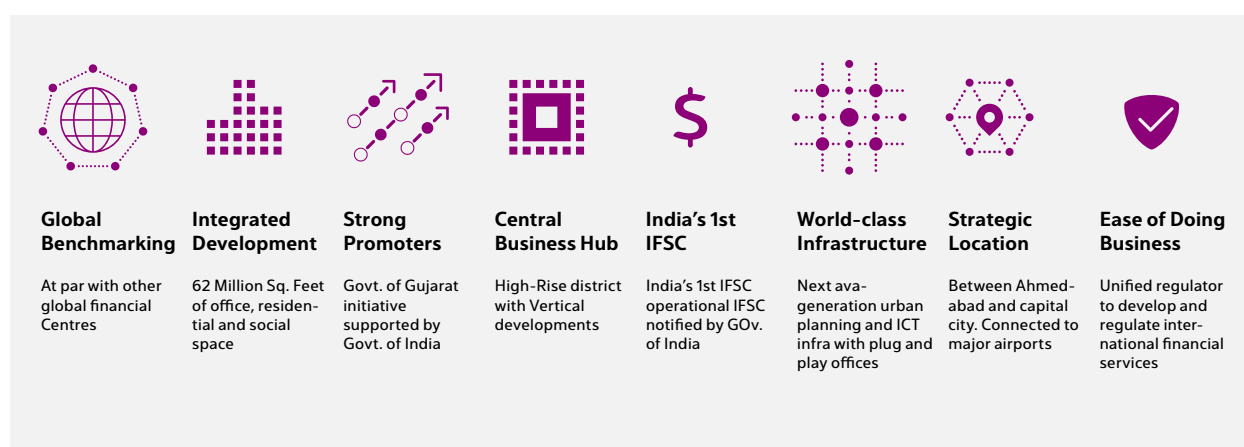
<sup>19</sup> Section 10A, Companies Act.

4. Establishing a Presence in India

## D. International Financial Services Centre / GIFT City

In 2015, the Government of India announced establishment of Gujarat International Financial Tec-City (“GIFT City”), in Gujarat as India’s first International Financial Service Center (“IFSC”). The purpose of setting up the GIFT City is to develop a world class smart city that becomes a global financial hub with the development of an IFSC. The IFSC in GIFT City seeks to bring to the Indian shores, those financial services transactions that are currently carried on outside India by overseas financial institutions and overseas branches /subsidiaries of Indian financial institutions. The GIFT City is an emerging clean and transparent offshore finance jurisdiction for international financial service.

The salient features of the GIFT City are given in the figure below:



The IFSC Authority has been provided statutory recognition under the IFSC Authority Act, 2019 to act as a unified regulatory authority to develop and regulate the financial products, financial services and financial institutions located / performed in the IFSC. The establishment of IFSC Authority to act as a single-window for regulating activities in an IFSC should also help build investor confidence through consistency, transparency and clarity in policy measures.

From a foreign exchange perspective, any financial institution or branch of a financial institution set up in the IFSC is treated as a person resident outside India. A financial institution or branch of a financial institution is required to conduct business in foreign currency other than Indian Rupees (INR), whether with a resident or otherwise.

The SEBI has notified that SEBI registered FPIs, proposing to operate in IFSC, shall be permitted, without undergoing any additional documentation and / or prior approval process.<sup>20</sup> In case of participation of FPIs in IFSC, due diligence process already carried out by a SEBI registered intermediary during the course of registration and account opening process in India shall be considered. FPIs, who presently operate in Indian securities market and propose to operate in IFSC also, shall be required to ensure clear segregation of funds and securities. The custodians shall, in turn, monitor compliance of this provision for their respective FPI clients. Such FPIs shall keep their respective custodians informed about their participation in IFSC.

20 Operational Guidelines for Foreign Portfolio Investors, Designated Depository Participants and Eligible Foreign Investors, available at [https://www.sebi.gov.in/sebi\\_data/commndocs/jan-2020/circular15\\_p.pdf](https://www.sebi.gov.in/sebi_data/commndocs/jan-2020/circular15_p.pdf).

#### 4. Establishing a Presence in India

The FPI Regulations have extended certain leeway to entities established in IFSC, in terms of the eligibility norms required to be fulfilled by FPIs for registration with SEBI.<sup>21</sup>

- a) Exemption in eligibility criteria for FPIs in IFSC: Certain eligibility norms in relation to the registration of an applicant with SEBI as an FPI, under Regulation 4 of the FPI Regulations, i.e. the applicant should (a) not be a resident Indian, (b) be a resident of the country whose securities market regulator is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding or a signatory to the bilateral Memorandum of Understanding with SEBI; and (c) in case the applicant is a bank, then it should be a resident of a country whose central bank is a member of the Bank for International Settlements, have been exempted for applicants incorporated or established in IFSC.
- b) An applicant incorporated or established in IFSC shall be deemed to be appropriately regulated, for the purposes of the FPI Regulations. Therefore, an applicant incorporated or established in IFSC can apply for registration as a Category-I FPI.

The ITA provides several incentives to units located in IFSC, *inter-alia* including 100% tax holiday on business income under Section 80LA, reduced minimum alternate tax, concessional withholding tax on interest income, exemption from capital gains tax on transfer of specified securities etc. In September 2020, the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 provided certain tax incentives for Category-III Alternative Investment Funds (“AIFs”) located in the IFSC to encourage relocation of foreign funds to the IFSC.

---

<sup>21</sup> Regulation 4, SEBI (Foreign Portfolio Investors) Regulations, 2019.

## 4. Establishing a Presence in India

**The Finance Acts of 2021, and 2022, reflecting the seriousness of the Government in promoting the IFSC, provides for several benefits for units established in IFSC, including:**

- **Provisions to transition of offshore funds to IFSC:** Provides for tax neutrality in case of relocation of offshore funds to the IFSC. Appropriate provisions in order to protect grandfathering, cost and period of holding of investors of offshore fund have been proposed.
- **Incentives for aircraft leasing and ship leasing:** Provides for a tax holiday for capital gain income of the leasing company (which has commenced operation in IFSC on or before March 31, 2024) on transfer of aircraft or engine to a domestic company engaged in the business of operation of aircraft before such transfer. This tax holiday is in addition to the tax holiday available for business income of such leasing company in IFSC. Previously royalty income earned by a non-resident from a leasing company in IFSC which is eligible for the tax holiday under the Section 80LA and has commenced its operations on or before the March 31, 2024, was exempted the Finance Act of 2022 (a) extended the tax holiday to income arising on transfer of ship which was leased by a Unit located in IFSC subject to condition that the Unit has commenced operation on or before the March 31, 2024; and (b) exempted any income of a non-resident by way of royalty, on account of lease of a ship in a previous year, paid by a unit of an IFSC if the unit has commenced its operations on or before the March 31, 2024.
- **Incentives for offshore banking units (“OBU”):** All income accrued or arisen to, or received to the investment division of OBU is exempted from tax. Any income accrued or arisen to, or received by a non-resident as a result of transfer of non-deliverable forward contracts entered into with an OBU located in IFSC has also been exempted from tax. The Finance Act of 2022 further extended this exemption to income arising from offshore derivative instruments or over-the-counter derivatives entered with an OBU.
- **Incentives for AIFs in IFSC:** Section 56(2)(viib) of the ITA provides that where a closely held company issues shares at a premium to Indian residents, the amount of money received by the closely held company in excess of the fair market value of the shares of the company is considered as income from other sources. However, provisions of Section 56(2)(viib) are not applicable where consideration for issuance of shares is received by a Category I/ II AIF registered with the Securities Exchange Board of India. The Finance Act of 2022 clarified that this exemption is available to Category I/ II AIF registered with the IFSCA as well.
- **Incentive for encouraging portfolio management in IFSC:** The Finance Act 2022 introduced an exemption to exempt any income received by a non-resident from portfolio of securities or financial products or funds, managed or administered by any portfolio manager on behalf of such non-resident, in an account maintained with an OBU in the IFSC, to the extent such income accrues or arises outside India and is not deemed to accrue or arise in India. The IFSCA has introduced the International Financial Services Centres Authority (Capital Market Intermediaries) Regulations, 2021 (“CMI Regulations”) to provide for a framework for operation of capital market intermediaries in GIFT City. The Finance Act of 2022 extended the aforesaid exemption to portfolio managers registered under the CMI Regulations. Portfolio managers operating in IFSC are permitted to invest in securities and financial products in IFSC, India or foreign jurisdiction (as defined in the CMI Regulations). However, having said this, the exemption provided by the Finance Act of 2022 is available only to non-residents to the extent income is earned from securities outside India.

#### 4. Establishing a Presence in India

## E. Types of Securities Issued

Indian companies may issue various types of securities. The primary types of securities used in foreign investments into India are:

### Equity Shares

Equity shares are ordinary shares in the share capital of a company and are entitled to voting rights and dividend rights. Equity shares with differential rights as to voting and dividend can also be issued in accordance with the applicable provisions.

### Preference Shares

Preference shares are shares which carry a preferential right to receive dividends at a fixed rate as well as preferential rights during liquidation over the equity shares. Convertible preference shares are a popular investment option. Further, the preference shares may also be redeemable.

### Debentures

Debentures are debt securities issued by a company, and typically represent a loan taken by the issuer company with an agreed rate of interest. Debentures may either be secured or unsecured.

For the purposes of FDI, fully and compulsorily convertible preference shares and debentures are treated on par with equity and need not comply with the external commercial borrowings guidelines (“**ECB Guidelines**”).<sup>22</sup>

The ECB Guidelines place certain restrictions and requirements on the use of ECB. Indian companies are permitted to avail ECB, upto USD 750 million per company per year in under the automatic route depending on the sectors the companies are doing business. This limit stands increased from USD 750 million to USD 1.5 billion till December 31, 2022.

In order to raise ECB, the Indian company and the foreign financier must fulfill the criteria of an eligible borrower and a recognized lender respectively, under the ECB Guidelines. Further, there remain restrictions on average maturity period and the non-permitted end-uses, etc.

---

22 Master Direction – External Commercial Borrowings, Trade Credits and Structured Obligations, bearing reference RBI/FED/2018-19/67, FED Master Direction No.5/2018-19, available at [https://rbi.org.in/Scripts/BS\\_ViewMasDirections.aspx?id=11510](https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510).

#### 4. Establishing a Presence in India

## F. Return on Investments

Extracting earnings out of India can be effected in numerous ways. However, it is essential to consider the tax and regulatory issues around each mode of exit:

### Dividend

Companies in India, as in other jurisdictions, pay their shareholders dividends on their shares, which is usually a percentage of the nominal or face value of the share. For a foreign investor holding an equity interest, payment of dividend on equity shares is a straightforward way of extracting earnings.

### Buyback

Buyback of securities provides an investor the ability to extract earnings as capital gains and consequently take advantage of tax treaty benefits. However, buybacks in India have certain restrictions and thus need to be strategically planned. For instance, a company may not, except with a special resolution, buy back more than 25% of its outstanding equity shares in a year. Further, a buyback may be effected only from certain permitted sources.

### Redemption

Preference shares and debentures can both be redeemed for cash. While redemption is perhaps the most convenient exit option for investors, optionally convertible securities, which are effectively redeemable, have been classified as ECB. This entails greater restrictions. Also, there is a restriction on issuing preference shares redeemable beyond a period exceeding 20 years from their issue (except in the case of infrastructure companies).

### IPO

An IPO is the first offer for sale of the shares of a company to the public at large via listing the company's stock on a stock exchange. While an initial public offering may usually be regarded as a long term exit option, it is also usually included as an exit option in transaction documents as it may provide investors with large returns. IPOs are discussed in further detail in the next chapter.

### Put Options

The use of 'Put Options', wherein foreign investors retain a right to 'put' or sell securities to Indian promoters as an exit option, has been a contentious issue for some time. The issue was settled to a certain extent by SEBI recognizing put and call options in shareholders' agreement, subject to certain prescribed restrictions. The RBI has also allowed put options to foreign investors, with certain conditions. In this regard non-resident persons

#### 4. Establishing a Presence in India

holding shares of an Indian company containing an “optionality clause” and exercising the option / right shall be allowed to exit, without any assured return, subject to the following conditions:<sup>23</sup>

##### Lock-in Period

Exit can be achieved only after fulfilling a minimum lock-in of 1 year.

##### Pricing Restriction

Exit price cannot be pre-agreed and will be arrived at using any of the internationally accepted pricing methodology at the time of exit duly certified by a chartered accountant or a SEBI registered merchant banker.

## G. Important Issues under the Companies Act

### Duties and Liabilities of Director

The general duties of a director have been specifically provided for, which include:<sup>24</sup>

- to act in accordance with the articles of association of the company;
- to act in good faith in order to promote the objects of the company and in best interest of stakeholders;
- to exercise his duties with due and reasonable care, skills and independent judgment;
- to not involve in a situation in which his interest conflicts with the interest of the company;
- to not achieve or attempt to achieve any undue gain or advantage to either himself or his relatives, partners or associates;
- to not assign his office and any assignment so made shall be void.

It may be noted that if a director fails in performing his duties mentioned above, he shall be punishable with fine of INR 100,000 to INR 500,000.

### Director’s Report

The Director’s Report is quite detailed and is required to include amongst other statements:<sup>25</sup>

- a statement, on the performance and financial position of subsidiaries, associate companies and joint venture companies, included in consolidated financial statement;
- that directors have devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively;

---

<sup>23</sup> Rule 9(5), Non-Debt Instruments Rules.

<sup>24</sup> Section 166, Companies Act.

<sup>25</sup> Section 134(3), Companies Act.

#### 4. Establishing a Presence in India

- on the risk management policy for the company including identification of elements of risk, if any, which may threaten the existence of the company;
- on the manner in which formal evaluation has been made by the board of its own performance, committees and individual directors (for listed and public companies with Paid up capital of INR 250 million. The liability for contravention includes fine on the company upto INR 2.5 million and every officer of the Company shall be punishable with imprisonment upto 3 years or fine upto INR 500,000 or both.

### Liability of Directors

Every director of a company who is aware of a contravention of the Companies Act or if the contravention was done with his / her consent, shall be liable for the punishment prescribed for the contravention. It is also important to note that the penalty for the directors has increased and a fine of upto INR 20 million may be imposed for certain offences.

### Merger of an Indian Company with a Foreign Company

The Companies Act provides for a merger of an Indian company with a company incorporated in certain notified jurisdictions. The merger will be subject to prior approval of the RBI. The consideration for the merger can be in the form of cash, depository receipts or both.<sup>26</sup>

### Related Parties Transactions

The Companies Act has expanded the scope of the provisions relating to transactions with directors and introduced them within the concept of “Related Party Transactions”. Further, such transactions require consent of the board and ordinary resolution of the shareholders in certain instances.

Definition of “related party” now includes a key managerial personnel or his relative, a public company in which a director / manager is a director or holds along with his relatives more than 2% of its paid up share capital, any body corporate of which a director or manager of the company is a shadow director, a shadow director of the company, any body corporate which is a holding, subsidiary or an associate company of such company.<sup>27</sup>

The contracts that are covered under these transactions have been widened to include selling or disposing of or buying or leasing of property of any kind, availing or rendering of any services, appointment of agents for purchase or sale of goods materials, services or property, the related party’s appointment to any office or place of profit in the company, its subsidiary or associate company etc.<sup>28</sup> It excludes only those transactions which are entered into by the company in its ordinary course of business and which are on an arm’s length basis.<sup>29</sup> The exemption limit for contracts or arrangements in which directors are interested in, that need to be entered in the Register of contracts or arrangements has been increased to INR 500,000.<sup>30</sup>

<sup>26</sup> Section 234, Companies Act.

<sup>27</sup> Section 2(76), Companies Act.

<sup>28</sup> Section 188, Companies Act.

<sup>29</sup> Ibid.

<sup>30</sup> Section 189(5)(a), Companies Act.



#### 4. Establishing a Presence in India

Transactions in the nature of loans to and guarantees on behalf of directors and their related parties are prohibited, unless the same is pursuant to a scheme approved by the shareholders or if the company provides loans in its ordinary course of business.

### Corporate Social Responsibility

Every company with a net worth of INR 5 billion or more, or turnover of INR 10 billion or more, or a profit before tax of INR 50 million or more during the immediately preceding financial year shall constitute the Corporate Social Responsibility Committee (constitution of Corporate Social Responsibility Committee is optional if the contribution to be made towards corporate social responsibility is not more than INR 5 million).<sup>31</sup> The companies satisfying the aforementioned criteria shall also spend at least 2% of the average net profits of the company made during the three immediately preceding financial years towards its corporate social responsibility obligations.<sup>32</sup>

### Class Action Suits<sup>33</sup>

Any class of members or depositors, in specified numbers, may initiate proceedings against the company, or its directors if they are of the opinion that its affairs are being carried out in a manner prejudicial to the interests of the company. Damages as a result of the suit may be claimed against directors, auditors, expert or advisor or consultant. “Expert” includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force.

## H. Companies (Amendment) Act, 2015 and Further Changes to the Companies Act

There have been amendments to certain sections of the Companies Act vide the Companies (Amendment) Act, 2015.<sup>34</sup> Further, notification on exemptions to private companies dated June 5, 2015<sup>35</sup> has provided certain important exemptions to private companies bringing in relief to the business community. Some of the important changes are as follows:

- Requirement of having a minimum paid up share capital has been done away with for public and private companies.
- The requirement of filing a declaration before commencement of business has been done away with (which is re-introduced vide Companies (Amendment) Act, 2019).

<sup>31</sup> Section 135, Companies Act.

<sup>32</sup> Sectors in which spending under corporate social responsibility obligations should be made has been provided in Schedule VII and include, eradication of poverty, malnutrition, environment sustainability, protection of national heritage, promoting education, rural sports, nationally recognized sports, setting up homes and hostels for women, orphans and senior citizens, reducing inequalities in socially and economically backward groups and support to incubators in specified academic institutions.

<sup>33</sup> Section 245, Companies Act.

<sup>34</sup> Available at [https://www.mca.gov.in/Ministry/pdf/AmendmentAct\\_2015.pdf](https://www.mca.gov.in/Ministry/pdf/AmendmentAct_2015.pdf).

<sup>35</sup> Available at [http://www.mca.gov.in/Ministry/pdf/Exemptions\\_to\\_private\\_companies\\_05062015.pdf](http://www.mca.gov.in/Ministry/pdf/Exemptions_to_private_companies_05062015.pdf).

#### 4. Establishing a Presence in India

- A private company can now freely issue hybrid instruments including preference shares with differential rights by virtue of its articles. The issuance of shares with differential rights by a private company are not subject to any conditions.
- Relaxation is provided with respect to ESOPs i.e. obtaining ordinary resolution for approval of ESOP Scheme from shareholders in place of special resolution required earlier.
- Section 185 of the Companies Act<sup>36</sup> prohibits companies from advancing loan including in form of book debt, giving guarantee or security to its directors and to persons in whom directors are interested. However, the provisions of Section 185 are not required to be complied with by a private company satisfying the following conditions:
  - a) in whose share capital, no other body corporate has invested any money; and
  - b) its borrowings from banks, financial institutions or body corporate do not exceed twice the amount of paid up share capital or INR 500 million, whichever is lower; and
  - c) there are no subsisting defaults in repayment of such borrowings at the time of making transaction.

The compliance of Section 185 is exempted for all companies when the transaction is between holding company and its wholly owned subsidiary and between holding company and its subsidiary as stated below.

### Holding Company and Wholly Owned Subsidiary

Any loan, made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company is exempted from the compliance of Section 185 of the Companies Act. Provided that the loan advanced by the holding company is utilized by the subsidiary company for its principal business activities.<sup>37</sup>

### Holding Company and Subsidiary

Any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company is exempted from the requirements of Section 185 provided that such loans made are utilized by the subsidiary company for its principle business activities.<sup>38</sup>

## I. Companies (Amendment) Act, 2017 and Further Changes to the Companies Act

There have been amendments to certain sections of the Companies Act vide the Companies (Amendment) Act, 2017<sup>39</sup> which came into effect from May 7, 2018. Some of the important changes are as follows:

<sup>36</sup> Section 185 was substituted with the new Section 185 vide Companies (Amendment) Act, 2017 which came into effect from May 7, 2018. This is discussed in detail below.

<sup>37</sup> Section 185(3)(c), Companies Act.

<sup>38</sup> Section 185(3)(d), Companies Act.

<sup>39</sup> Available at [https://www.mca.gov.in/Ministry/pdf/CAAct2017\\_05012018.pdf](https://www.mca.gov.in/Ministry/pdf/CAAct2017_05012018.pdf).

#### 4. Establishing a Presence in India

- Insertion of new Section 3A – members severally liable in certain cases.
- Extraordinary general meetings of wholly owned subsidiary of a company incorporated outside India can be held outside India.
- Substitution of Section 185 – Loans to Directors. Companies (Amendment) Act, 2017 brought significant changes, which are detailed below.

Granting of loans, providing of guarantee or security under new Section 185 of the Companies Act has been classified under three broad categories i.e. (1) prohibition of granting of loans, providing of guarantee or security; (2) conditional allowance of granting of loans, providing of guarantee or security; and (3) exempted granting of loans, providing of guarantee or security.

#### Prohibition Category – Section 185(1) of the Companies Act

Company shall not grant loans, provide security or guarantee to the below mentioned persons which is strictly prohibited:

- a) Director of the company
- b) Director of its holding company
- c) Partner of director
- d) Relative of director
- e) Firm in which director or his relative is a partner

#### Conditional Allowance – Section 185(2) of the Companies Act

Company may grant loans, provide security or guarantee to any person in whom the director of the company is interested, subject to prohibition category, by (a) passing special resolution at the general meeting; (b) explanatory statement to the notice of general meeting should disclose full particulars of the loans given, guarantee or security provided including the purpose of loan, guarantee or security and any other relevant facts (c) if the borrower is a company, loan should be utilized for its principal business activity.

In this category, company can grant loans, provide security or guarantee to –

- a) a private company of which any such director is a director or member;
- b) any body corporate at a general meeting of which not less than 25% of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together;
- c) any body corporate, the board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the board, or of any director or directors, of the lending company.

#### Exempted Category – Section 185(3) of the Companies Act

The requirements of Section 185(1) and Section 185(2) shall not apply to:

#### 4. Establishing a Presence in India

- a) Loan to managing director / whole-time director as a part of service condition extended to all its employees or pursuant to a scheme approved by members by special resolution;
- b) Loan, guarantee or security provided in the ordinary course of company's business by charging interest as per tenor;
- c) Loan, guarantee or security by holding company to its wholly owned subsidiary and guarantee or security by holding company in respect of loan made by any bank or financial institution to its subsidiary company with a condition to use it for its principal activity.

## J. Companies (Amendment) Act, 2019 and Further Changes to the Companies Act

There have been further amendments to certain sections of the Companies Act vide the Companies (Amendment) Act, 2019<sup>40</sup> which was notified on July 31, 2019 (except few sections) with a retrospective effect of November 2, 2018. Some of the important changes are as follows:

- Re-categorization of compoundable offences to an in-house adjudication framework.
- Stiffer penalties for repeated defaults.
- Re-introduction of filing of declaration of commencement of business.
- Holding directorships beyond the permissible limits to disqualification of such individual as director.
- Physical inspection of registered office of the company by the RoC.
- Clarifications and new provisions in relation to corporate social responsibility.

## K. Companies (Amendment) Act, 2020 and Further Changes to the Companies Act

The Companies Act is further amended vide the Companies (Amendment) Act, 2020<sup>41</sup> which was notified on September 28, 2020. Some of the important changes are as follows:

- Imprisonment as a consequence of contravention of certain provisions of the Companies Act is done away with for various offences under the Act.
- The time period for providing offer letter to the existing shareholder under the rights issue process is reduced to less than 15 days or such lesser number of days that may be prescribed. Earlier, the time period was between 15 to 30 days.
- If a company has spent excess amount in any financial year, beyond the 2% statutorily mandated corporate social responsibility contribution, then such company is allowed adjust the amount of corporate social responsibility spend in the subsequent years to set-off the excess amount spent.

40 Available at [https://www.mca.gov.in/Ministry/pdf/AMENDMENTACT\\_01082019.pdf](https://www.mca.gov.in/Ministry/pdf/AMENDMENTACT_01082019.pdf).

41 Available at [https://www.mca.gov.in/Ministry/pdf/AmendmentAct\\_29092020.pdf](https://www.mca.gov.in/Ministry/pdf/AmendmentAct_29092020.pdf).

#### 4. Establishing a Presence in India

Section 418A is newly inserted with the objective of setting up more benches of National Company Law Appellate Tribunal.

## L. Setting up and Operating in India

While there are many legal aspects to setting up presence in India, operationally there are many considerations too for organizations that are accessing the Indian market. Some of these requirements may be statutory and some are best practice. This section covers some of the key aspects to operating in India, including setting up bank accounts, accounting standards and practices, payroll, and managing audits.

### Post-Incorporation Activity Plus Timeline

Apart from holding the first board meeting, additional requirements to make the company operational include completing Know Your Customer (KYC) requirements of the bank to make the bank account operational, transferring the committed equity capital into the bank account (once the account is operational), allotment of shares against the capital received, completion of compliances under FEMA and the Companies Act, payment of stamp duty, and obtaining applicable registrations such as Import Export Code, State Shop & Establishment, and State Professional Tax registration.

### Setting up a Bank Account

Companies now need to apply for a bank account in one of the approved banks listed in the incorporation form. Post-incorporation, the bank may ask for additional information or documents to complete their internal KYC requirements and activate/operationalize the bank account.

Activating the bank account of a foreign subsidiary can be a time-consuming process and can take over 15 to 30 days. Post-incorporation, companies have the right to close the account or open additional accounts in other banks in India.

### Accounting and Accounting Rules in India

#### Financial Year

The fiscal year begins on April 1 and ends on March 31 of the following year. However, where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate, allow any period as its financial year, whether or not that period is a year.<sup>42</sup>

---

<sup>42</sup> Section 2(41), the Companies Act.

## 4. Establishing a Presence in India

### Accounting Standards

Accounting standards issued by the Institute of Chartered Accountants of India (“ICAI”) have been adopted by the Companies Act. Financial statements must be prepared annually in accordance with the accounting standards prescribed under the Companies Act. There are lots of differences between these accounting standards and US GAAP/IFRS.

### Accounting Reports

Companies are required to prepare financial statements comprising a Balance Sheet, Statement of Profit & Loss, Cash Flow Statement, as may be applicable each year, as per the provisions of the Companies Act, and to have them audited by a practicing chartered accountant or a firm of chartered accountants registered with the ICAI. The audited financial statements must be approved and adopted by the members in an annual general meeting. All companies are required to file their audited financial statements with the RoC after they have been approved and adopted by the members.

### Certification and Auditing

Companies must seek a statutory auditor to conduct an annual audit regarding the financial health of their organization.

### Preservation of Company Records

At present, the Companies Act requires companies to preserve the books of accounts, together with the vouchers relevant to any entry in them, in good order, relating to at least 8 years immediately preceding the current year.<sup>43</sup>

### Form of Accounting Records

Companies maintain their books of accounts on an accrual basis and double entry method of book keeping.<sup>44</sup>

### Maintenance of Records Outside the Country

As of now, companies do not have an option to keep records outside the country; they are required to be available within the country and at the registered office and written notice is given to the RoC of the place where the records are kept if they are not kept in registered office.<sup>45</sup>

## Audit

All public and private companies and certain LLPs are mandated to get their accounts audited each financial year. Statutory audits are governed under the Companies Act. The purpose of the statutory audit is to determine whether a company is providing an accurate representation of its financial situation by examining the information, such as books of account, bank balance, and financial statements.

All public and private limited companies have to undergo a statutory audit. Irrespective of the nature of the business or turnover, these companies are mandated to get their annual accounts audited each financial

---

<sup>43</sup> Section 128(5), the Companies Act.

<sup>44</sup> Section 128(1), the Companies Act.

<sup>45</sup> Section 128(1), the Companies Act.

#### 4. Establishing a Presence in India

year. Meanwhile, an LLP has to undergo a statutory audit only if its turnover in any financial year exceeds INR 4 million or its capital contribution exceeds INR 2.5 million.<sup>46</sup>

#### Conducting a Statutory Audit

Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting. Notwithstanding the above, every company and its directors must first appoint an auditor within 30 days from the date of registration of the company, failing which the board shall inform the members of the company, who shall within 90 days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.<sup>47</sup>

#### Auditors

As per the law, only an independent chartered accountant, chartered accountant firm, or an LLP firm with majority of partners practicing in India are qualified for appointment as an auditor of a company.<sup>48</sup>

The Companies Act specifically disqualifies *inter alia* the following individuals or firms from becoming an auditor:<sup>49</sup>

- A body corporate other than the LLP registered under the Limited Liability Partnership Act, 2008;
- An officer or employee of the company;
- A person who is a partner, or who is in the employment, of an officer or employee of the company;
- Any person or his relative or partner who is indebted to a company for a sum exceeding INR 500,000 or who has guaranteed to the company on behalf of another person a sum exceeding INR 100,000;
- Any person or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company, provided that the relative may hold security or interest in the company of face value not exceeding INR 100,000; or
- Any person who has been convicted by a court of an offence involving fraud and a period of 10 years has not elapsed from the date of such conviction.

#### Audit Report

The Companies (Auditor's Report) Order, 2020<sup>50</sup> ("CARO 2020"), which replaced Companies (Auditor's Report) Order, 2016, requires an auditor to report on various aspects of the company, such as fixed assets, inventories, internal audit standards, internal controls, statutory dues, and others.

The auditor must follow the auditing standards as recommended by ICAI. In case the auditor uncovers any fraud during the audit, it must be reported to the government immediately. After the audit is completed, the auditor should submit the audit report to the members and shareholders of the company.

<sup>46</sup> Rule 24, Limited Liability Partnership Rules, 2009.

<sup>47</sup> Section 139, the Companies Act.

<sup>48</sup> Section 141, the Companies Act.

<sup>49</sup> Ibid.

<sup>50</sup> Available at [https://www.mca.gov.in/Ministry/pdf/Orders\\_25022020.pdf](https://www.mca.gov.in/Ministry/pdf/Orders_25022020.pdf).

#### 4. Establishing a Presence in India

##### **Penalty for Non-Compliance**

For non-compliance with a statutory audit, fines range from INR 25,000 to INR 500,000 for the company. For every officer in default, penalties include imprisonment of up to one year, a fine of INR 10,000 to INR 100,000, or both.

##### **Audit Firms Operating in India**

There is a wide array of audit firms available in India registered with ICAI and operating in compliance with its guidelines. As the list of these firms is long and continuously growing, they are highly competitive in nature as well as professional in their approach. Audit firms' competitiveness and professionalism are also enhanced due to increasing regulatory requirements and market pressure on them to demonstrate higher level of credibility in their certifications. The list includes all the global Big4 firms who also have their offices in India and various Tier-I/Tier-II/Tier-III Indian firms, some of which are expanding overseas. Generally, their audit fee varies based on two criteria:

- The nature, size/volume, complexities (risk profile) of the business organizations to be audited, and
- The size/quality of the audit firm (existing clientele, number of partners/offices, credentials).



# Mergers and Acquisitions

The term ‘merger’ is not defined under the Companies Act, the ITA or any other Indian law. A merger in normal parlance means a combination of two or more companies into one. The ITA does however define the analogous term ‘amalgamation’ as the merger of one or more companies with another company, or the merger of two or more companies to form one company. Sections 230 to 232 of the Companies Act deal with the analogous concept of schemes of arrangement or compromise between a company, its shareholders and/or its creditors.

An acquisition or takeover is the purchase by one company of controlling interest in the share capital, or all or substantially all of the assets and/or liabilities, of another company. A takeover may be friendly or hostile, depending on the offeror company’s approach, and may be affected through agreements between the offeror and the majority shareholders, purchase of shares from the open market, or by making an offer for acquisition of the offeree’s shares to the entire body of shareholders. Acquisitions may be by way of purchase of shares of the target, or purchase of assets and liabilities of the target.

The modes most commonly adopted are a share acquisition or an asset purchase:

1. **A share acquisition** may take place by purchase of all existing shares of the target by the acquirer, or by way of subscription to new shares in the target so as to acquire a controlling stake in the target or a combination of the two methods.
2. **An asset purchase** involves the sale of the whole or part of the assets of the target to the acquirer.

There are several laws and regulations that govern a merger or acquisition in India, either directly or indirectly. Given below is a brief on the legal and regulatory landscape of mergers and acquisitions in India.

## A. Companies Act

The Companies Act has introduced a number of changes relating to mergers and acquisitions in India. Most provisions relating to mergers and acquisitions were notified towards the end of 2016.<sup>1</sup> Additionally, the Ministry of Corporate Affairs notified the Companies (Compromises, Arrangements & Amalgamations) Rules, 2016<sup>2</sup> which deals with the procedure to be followed for mergers, amalgamations, compromises etc. We have discussed some of the significant provisions applicable to mergers and acquisitions in India introduced vide the Companies Act.

### Mergers / Demergers Regime in India

Sections 230 to 232 (the “**Merger Provisions**”) of the Companies Act govern a merger of two or more companies under Indian law. The most significant changes, relating to mergers, introduced under the Companies Act are:

1 44 As per the Ministry of Corporate Affairs Notification dated December 7, 2016, Section 230 (except Sub-section (11) and (12)) and Sections 231 to 233 and Sections 235 to 240 have been notified. Sub-sections (11) and (12) under Section 230 have been notified on February 3, 2020.

2 45 As per the MCA notification dated December 14, 2016.

## 5. Mergers and Acquisitions

### National Company Law Tribunal (“NCLT”)

The government constituted the NCLT to consolidate multiple forums which existed for resolving company law matters and bring about speed and efficiency in resolution of company matters. Companies which intend to merge must make an application to the NCLT having jurisdiction over such company for calling meetings of its respective shareholders and/ or creditors. The NCLT may then order a meeting of the creditors / shareholders of the company. If the majority in number representing 3/4th in value of the creditors and shareholders present and voting at such meeting agree to the merger, then the merger, if sanctioned by the NCLT, is binding on all creditors and shareholders of the company. The Ministry of Corporate Affairs on June 1, 2016 issued notifications constituting benches of NCLT and the National Company Law Appellate Tribunal (“NCLAT”). The notification also mandated the transfer of all proceedings pending before the erstwhile Company Law Board to the NCLT. A notification dated December 7, 2016 transferred proceedings pending before the district and high courts to the NCLT.

### Provisions for fast track mergers / amalgamations / demergers

Under Section 233 of the Companies Act, no approval from the NCLT is required for a scheme of merger or amalgamation entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or two or more start up companies or one or more start up company with one or more small company. Small company has been defined as private companies having paid-up capital of less than INR 100 million and turnover of less than INR 1 billion per last audited financial statements and such small companies can apply for a fast track merger. The section relating to fast track merger process was also notified on June 1, 2016. The entities applying for merger will still be required to follow the procedure of notifying the registrar or official liquidator inviting objection and the requisite creditor approval amongst the other procedural compliances stated in Section 233.

### Provisions for merger of an Indian company into a foreign company

Section 234 of the Companies Act provides for merger of a foreign company with an Indian company and vice versa. However, mergers only with foreign companies in permitted jurisdictions shall be permitted and prior RBI approval is required for such cross border merger. Please note that a foreign company means any company or body corporate incorporated outside India whether having a place of business in India or not. In terms of Section 234 of the Companies Act read with rules for the same which have been notified,<sup>3</sup> provides mergers of an Indian company with a foreign company is permissible subject to the following conditions:

- The foreign company should be incorporated in a permitted jurisdiction which meets certain conditions.<sup>4</sup>
- The transferee company is to ensure that the valuation is done by a recognized professional body in its jurisdiction and is in accordance with internationally accepted principles of accounting and valuation.
- Procedures under Sections 230-232 of the Companies Act must be followed.<sup>5</sup>

<sup>3</sup> Available at: [http://www.mca.gov.in/Ministry/pdf/section234Notification\\_14042017.pdf](http://www.mca.gov.in/Ministry/pdf/section234Notification_14042017.pdf).

<sup>4</sup> 48 A permitted jurisdiction shall be one.

- i) whose securities market regulator is a signatory to the International Organisation of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to a bilateral memorandum of understanding with SEBI; or
- ii) whose central bank is a member of the Bank of International Settlements (BIS); and
- iii) a jurisdiction, not identified in the public statement of the Financial Action Task Force (FATF) as:
  - a) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or
  - b) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the FATF to address the deficiencies

<sup>5</sup> Available at: [https://www.mca.gov.in/Ministry/pdf/CompaniesCompromises\\_14042017.pdf](https://www.mca.gov.in/Ministry/pdf/CompaniesCompromises_14042017.pdf).

## 5. Mergers and Acquisitions

### Acquisition Regime in India

In case of acquisition of a company which involves issuance of new shares or securities to the acquirer, it would be necessary for the shareholders of the company to pass a special resolution under the provisions of Section 62 of the Companies Act. A special resolution is one that is passed by at least 3/4th of the shareholders present and voting at a meeting of the shareholders.

RBI has required that all NBFCs will have to take prior approval of the central bank in case (i) there is any takeover or acquisition of control of a NBFC which may or may not result in change in management; (ii) any shareholding pattern changes which results in acquisition/ transfer of 26% or more of the shareholding (iii) any change in the management of the NBFC which results in change of more than 30% of the directors excluding independent directors through mergers and acquisitions.<sup>6</sup>

#### Purchase of an undertaking or part of an undertaking

The Companies Act allows for disposal (including sale) of a specific undertaking of the business, in which the investment of the company exceeds 20% of company's net worth or which generates 20% of the total income of the company. This can be done by passing a resolution by atleast 75% of the shareholders who cast their vote. This is also applicable in case of disposal of 20% or more of the value of any undertaking. However, this resolution needs to be passed only by a public company or subsidiaries of public companies.

#### Practitioner Tip: Due Diligence for Acquisition

The compliance landscape in India is complex, comprising a large gamut of central and state laws. Acquisitions in India require significant due diligence in order to properly value the target and assess its liabilities, including statutory liabilities and exposures. Many companies and organizations will do a deep dive into management practices as well as conduct a detailed legal, financial, and regulatory compliance assessment.

## B. Takeover Code

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“**Takeover Code**”) governs the acquisition of shares in an Indian public listed company. The main objective of the Takeover Code is to regulate direct or indirect acquisition of substantial shares, voting rights, or control of Indian listed companies (including takeovers of Indian listed companies) through a system providing an exit opportunity to the public shareholders and disclosure of information by the acquirers.

<sup>6</sup> Available at: <https://www.rbi.org.in/Scripts/NotificationUser.aspx?id=9934>.

## 5. Mergers and Acquisitions

The Takeover Code requires an acquirer to, *inter alia*, disclose its aggregate shareholding in an Indian listed company held by itself and ‘persons acting in concert’<sup>7</sup> with it, when such aggregate shareholding becomes 5% or more of the shares / voting rights in the company. This disclosure is to be made to the company and to the stock exchanges. Once a shareholder has crossed the 5% mark, there are additional disclosure requirements based on shareholding thresholds.

When an acquirer directly or indirectly acquires shares, voting rights in a target company beyond certain thresholds, or acquires control in a target company, the Takeover Code requires the acquirer (and persons acting in concert with it) to mandatorily offer an exit to the public shareholders vide an open offer. These thresholds are as follows: (a) any acquisition of shares or voting rights, which takes the shareholding of an acquirer and persons acting in concert with him to 25% or more of the target company’s share capital, (b) with respect to an acquirer already holding 25% or more of the target company (by itself and with persons acting in concert), any acquisition of shares or voting rights within a financial year which entitles them to exercise more than 5% of the voting rights of the target company, and (c) any acquisition of control over the target company. However, a temporary relaxation had been provided to promoters who wish to increase their stake in listed companies, and permitted them to acquire upto 10% (instead of the earlier 5%) in the listed company for the financial year 2020-21, without triggering the obligation to make an open offer.

The mandatory open offer to be made by the acquirer (and persons acting in concert with it) upon crossing the thresholds above is required to be made to at least 26% shares of the target. The offer price will be determined on the basis of the parameters laid down in the Takeover Code, and takes into consideration the negotiated price that the acquirer fixes for the underlying acquisition which triggers the mandatory open offer.

## C. Listing Regulations

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the “**Listing Regulations**”) regulates all listed Indian companies and prescribes the mandatory conditions to be complied with by listed companies, which are primarily in the nature of maintaining corporate governance standards and ensuring parity of information among public shareholders. This includes fair, prompt and adequate disclosure of material information for the benefit of the public shareholders. The Listing Regulations also require the companies to execute a listing agreement with a stock exchange for the purpose of listing its shares with the stock exchange and agreeing to abide by the provisions of the Listing Agreement.

In addition, listed entities are obligated to file the draft scheme of arrangement through which a merger/acquisition is occurring, before the stock exchanges and obtain a no-objection letter from them prior to filing the scheme of arrangement before the NCLT for approval. The merger of a wholly owned subsidiary with its holding company can be carried out without such no-objection letter.<sup>8</sup> The transfer of listed securities can only be carried out if the securities are in dematerialized form.<sup>9</sup>

<sup>7</sup> Two persons are said to be acting in concert if they directly or indirectly cooperate with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to a formal or informal agreement or understanding. In certain situations, even a person who finances the acquisition by an acquirer is seen to be a person acting in concert with the acquirer.

<sup>8</sup> Available at: [http://www.sebi.gov.in/sebi\\_data/attachdocs/1487310784475.pdf](http://www.sebi.gov.in/sebi_data/attachdocs/1487310784475.pdf).

<sup>9</sup> Available at: [https://www.sebi.gov.in/legal/regulations/jun-2018/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-fourth-amendment-regulations-2018\\_39263.html](https://www.sebi.gov.in/legal/regulations/jun-2018/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-fourth-amendment-regulations-2018_39263.html).

## D. Insider Trading Regulations

Akin to regulations governing insider trading in other jurisdictions, SEBI (Prohibition of Insider Trading Regulations) 2015 (“**Insider Trading Regulations**”) is intended to restrict insiders from communicating unpublished price sensitive information (“**UPSI**”) and from trading in securities of listed Indian companies when in possession of UPSI. The regulations put in place a legal framework for governing the above activities, and specifically identifies exceptions in which these may be permitted. The regulations also apply to companies which are ‘proposed to be listed’ vide a definitive action such as filing offer documents for listing or filing schemes of arrangement under which they intend to get listed.

Under the Insider Trading Regulations, an ‘insider’ has been defined to mean any person who is (i) a connected person; or (ii) in possession of or having access to UPSI. Here, a ‘connected person’ is a person who is directly or indirectly associated with the company (i) by reason of frequent communication with its officers; or (ii) by being in a contractual, fiduciary or employment relationship; or (iii) by holding any position including a professional or business relationship with the company whether temporary or permanent that allows such person, directly or indirectly, access to UPSI or is reasonably expected to allow such access. An outsider i.e. a person who is not a ‘connected person’ would qualify as an ‘insider’ if such person was ‘in possession of’ or ‘having access to’ UPSI.

UPSI is defined to mean any information relating to a company or its securities which is not generally available to the public, and which is likely to have a material impact on the of the securities if made generally available. Information relating to a company’s merger, demerger, acquisition, financial results, dividends, changes in key managerial personnel, etc. are a few illustrative examples of information which would form part of UPSI.

The Insider Trading Regulations prohibit the following: (i) communication of unpublished price sensitive information by one insider to any person, including other insiders; (ii) procurement of / causing the communication of unpublished price sensitive information; and (iii) trading in securities when in possession of unpublished price sensitive information. Here, ‘trading’ has been defined widely to include the subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, or deal in securities. If an insider trades while in possession of UPSI, the law assumes that the trade was motivated by the UPSI, and the burden lies on the investor to prove otherwise.

Certain relaxations have been provided on the restriction on communication of UPSI, when such communication is in furtherance of a legitimate purpose, performance of duties, or discharge of legal obligations. For determining ‘legitimate purpose’ the board of directors of the company is to formulate “Codes of Fair Disclosure and Conduct” identifying the same.<sup>10</sup> Typically, these legitimate purposes include sharing of information in the ordinary course with partners, collaborators, customers, lenders, financial and legal advisors, etc. Information sharing is also permitted in connection with a transaction which entails a mandatory open offer under the Takeover Code, or which the board of directors of the listed company feels is in the best interests of the company (provided that in the latter case, the information is made public 2 trading days prior to the transaction). In any event, the sharing of UPSI should be allowed only on a need-to-know basis. Any person who is in receipt of information vide the above methods also becomes an ‘insider’ and the company is required to maintain a database of all such persons with whom UPSI is shared.

The Insider Trading Regulations also identify certain limited instances when trading is permitted even by insiders. This includes trades pursuant to a trading plan, and trading between two insiders who are aware of

<sup>10</sup> Regulation 2A of the Insider Trading Regulations: The board of directors of a listed company shall make a policy for determination of “legitimate purposes” as a part of “Codes of Fair Disclosure and Conduct” formulated under regulation 8.

## 5. Mergers and Acquisitions

the same UPSI (either off-market or vide the block deal mechanism). An exception is also provided to non-individual insiders, if it can be proved that the individuals who were in possession of UPSI and those who conducted the trading were segregated by Chinese walls. The company is required to put in place a code of conduct which regulates, monitors, and reports trading by the insiders and designated persons of such company, which places an obligation on all insiders and designated persons (which includes employees) to disclose trades undertaken by them.

The Insider Trading Regulations also mandate continual disclosures by the promoters, members of promoter group, designated person and directors. These disclosures are with respect to their initial shareholding in the company, and subsequent trades which cross certain thresholds.

To encourage individuals to disclose any alleged violation of the Insider Trading Regulations that has occurred, or is believed to be occurring, SEBI has recently<sup>11</sup> put in place a mechanism for such disclosures. Under this new framework, an informant may disclose to SEBI such alleged violations in a prescribed format. The informant shall be protected by confidentiality, and shall be entitled to a reward if found eligible. The informant is also entitled to protection against any discharge, termination, demotion, suspension, threats, harassment, directly or indirectly or discrimination.

## E. Competition Law

The Competition Act, 2002 (“**Competition Act**”), is the primary anti-trust legislation in India, and is administered by the Competition Commission of India (“**CCI**”) – a sector agnostic anti-trust regulator established under the Competition Act. The Competition Act contains specific provisions on (i) anti-competitive agreements (including both horizontal and vertical agreements),<sup>12</sup> (ii) abuse of dominant positions (or unilateral conduct),<sup>13</sup> and (iii) mergers, amalgamations and takeovers (“**Combinations**”).

Similar to anti-trust legislation in other jurisdictions, the enforcement of provisions relating to anti-competitive agreements and abuse of dominant position, is led through an *ex-post facto* investigation process undertaken by the Office of the Director General, CCI (“**DG-CCI**”) in accordance with the provisions of the Competition Act. For the regulation of Combinations, however, the Competition Act adopts an *ex-ante* review mechanism, i.e., Combinations which meet the criteria set forth under Section 5 of the Competition Act, must be notified to the CCI in the manner specified in Section 6 of the Competition Act, read with the Competition Commission of India (Procedure in regard to the transaction of Business relating to Combinations) Regulations, 2011 (“**Combinations Regulations**”).

The Competition Act prescribes a *suspensory regime*, i.e., a Combination once notified to the CCI cannot be consummated up till the receipt of an approval from the CCI, or the lapse of two-hundred and ten (210) days from

<sup>11</sup> Inserted by Securities and Exchange Board of India (Prohibition of Insider Trading) (Third Amendment) Regulations, 2019 (w.e.f. December 26, 2019).

<sup>12</sup> Section 3 of the Competition Act; Section 3(3) deals with horizontal agreements and cartels, whereas Section 3(4) deals with vertical agreements (i.e., agreements between persons or enterprises engaged in activities which are at different stages or levels of a supply chain). Aligned with the approach in other jurisdictions, the Competition Act adopts a ‘per se’ approach (i.e., a contravention is established without considering the competitive impact of the agreement) for horizontal agreements prohibited under Section 3(3), and a ‘rule of reason’ or effects-based approach for agreements specified under Section 3(4).

<sup>13</sup> Section 4 of the Competition Act; The Competition Act defines a “dominant position” as “a position of strength, enjoyed by an enterprise in the relevant market, in India, which enables it to (i) operate independently of competitive forces prevailing in the relevant market; or (ii) affect its competitors or consumers or the relevant market in its favour.” Notably, the fact of enjoying a ‘dominant position’ is not sufficient to establish a contravention under the Competition Act. An abuse of such dominant position, as defined under Section 4, needs to be established through an investigation. While Section 4 does not specifically call for an effects-based approach, the precedents from the CC suggests that a contravention under Section 4 needs to be premised on an evaluation of effects on competition in the relevant market (defined under the Competition Act as an “appreciable adverse effect on competition” or “AAEC”).



## 5. Mergers and Acquisitions

notifying the Combination to the CCI,<sup>14</sup> whichever is earlier. “Gun-jumping”, i.e., failing to notify a notifiable Combination to the CCI, or consummating a transaction pending CCI’s review, may attract penalties under Sections 43A of the Competition Act.

### Definition of Combinations

Section 5 of the Competition Act, defines a ‘Combination’ as a transaction which meets the financial thresholds specified under Section 5 (defined on the basis of asset and turnover values of the parties to the transaction), and involve: (a) the acquisition<sup>15</sup> of control, shares, voting rights or assets of an enterprise by a person; (b) the acquisition of control of an enterprise where the acquirer already has direct or indirect control of another enterprise engaged in identical business; or (c) a merger or amalgamation between or among enterprises;

Section 5 specifies eight (8) separate sets of financial thresholds, defined on the basis of the following parameters:

- a) combined assets of the parties;
- b) combined assets of the group to which the parties belong;<sup>16</sup>
- c) combined turnover of the parties; and
- d) combined turnover of the group to which the parties belong.

Each of the above parameters are further sub-divided into categories based on worldwide figures (coupled with an ‘India-nexus’ threshold), and India-specific assets and turnover. Resultantly, and as depicted in the table below, if any of the 8 thresholds are met, a Combination needs to be notified to the CCI in terms of Section 6(2) of the Competition Act.

Notably however,

- a) in the event of a merger or amalgamation, the thresholds need to be evaluated vis-à-vis the resultant surviving entity, or the group to which such entity would belong subsequent to the merger or amalgamation.
- b) in the event of an acquisitions, mergers and amalgamations relating to a portion or division or business of an enterprise, the value of assets of the said portion or division or business and or attributable to it, shall be the relevant assets and turnover to be taken into account for the purpose of calculating the thresholds under Section 5 of the Act.<sup>17</sup> Do note however, that this exemption is valid until March 28, 2027, unless further extended.

<sup>14</sup> Section 6(2A) provides for a “deemed approval” of a Combination in respect of which no Orders are passed by the CCI within two-hundred and ten (210) days of such Combination being notified – “No combination shall come into effect until two hundred and ten days have passed from the day on which the notice has been given to the Commission under Sub-section (2) or the Commission has passed orders under Section 31, whichever is earlier.”

<sup>15</sup> An ‘acquisition’ is defined under Section 2(a) of the Competition Act as “directly or indirectly, acquiring or agreeing to acquire – (i) shares, voting rights or assets of any enterprise; or (ii) control over management or control over assets of any enterprise.”

<sup>16</sup> While the assets and turnover of the ‘acquirer group’ need to be consolidated at the level of the ultimate parent entity, the assets and turnover of the ‘target group’ needs to be consolidated at the level of the target entity (i.e., consolidating the assets and turnover for all entities where the target entity is able to: (a) exercise 26% or more of the voting rights; (b) appoint more than 50% of the members of the board of directors; or (c) control the management and affairs.

<sup>17</sup> This has been clarified by the Central Government vide Notification S.O. 988(E) dated March 27, 2017, available at URL: [https://www.mca.gov.in/Ministry/pdf/Notification\\_30032017.pdf](https://www.mca.gov.in/Ministry/pdf/Notification_30032017.pdf); “The value of the said portion or division or business shall be determined by taking the book value of the assets as shown, in the audited books of accounts of the enterprise or as per statutory auditor’s report where the financial statement have not yet become due to be filed, in the financial year immediately preceding the financial year in which the date of the proposed combination falls, as reduced by any depreciation, and the value of assets shall include the brand value, value of goodwill, or value of copyright, patent, permitted use, collective mark, registered proprietor, registered trade mark, registered user, homonymous geographical indication, geographical indications, design or layout-design or similar other commercial rights, if any, referred to in Sub-section (5) of Section 3. The turnover of the said portion or division or business shall be as certified by the statutory auditor on the basis of the last available audited accounts of the company.”

5. Mergers and Acquisitions

Thresholds For Filing Notice

	Assets			Turnover
<b>Enterprise Level (Acquirer + Target)</b>	<b>India</b>	> INR 20 billion	<b>OR</b>	> INR 60 billion
	Worldwide with India leg	> USD 1 Billion with at least INR 10 billion in India ('India Nexus Threshold')		> USD 3 Billion with at least INR 30 billion in India ('India Nexus Threshold')
<b>OR</b>				
<b>Group Level (Acquirer Group + Target)</b>	<b>India</b>	> INR 80 billion	<b>OR</b>	> INR 240 billion
	Worldwide with India leg	> USD 4 Billion with at least INR 10 billion in India ('India Nexus Threshold')		> USD 12 Billion with at least INR 30 billion in India ('India Nexus Threshold')

The specification of an 'India Nexus' threshold under Section 5, is due to the CCI's extra-territorial jurisdiction under Section 32 of the Competition Act.<sup>18</sup> Resultantly, Combinations outside India, which meet both the worldwide and 'India Nexus' thresholds, will need to be notified to the CCI.

Exemptions from Notification Requirement

There are certain exemptions from the notification requirement under Section 6(2) of the Competition Act. The first is the 'Small Target'/ *De-Minimis* exemption, whereby acquisitions, mergers or amalgamations involving a target entity having less than INR 3.5 billion in assets in India, or less than INR 10 billion in turnover in India, are exempt from the notification requirement under Section 6(2).<sup>19</sup>

Additional exemptions may also be available under the Combinations Regulations. Schedule I of the Combinations Regulations, read with Regulation 5(2) of the Combinations Regulations, specifies eleven (11) distinct categories of Combinations that are not likely to cause an AAEC in India, and resultantly, "*need not ordinarily be notified*" to the CCI under Section 6(2) of the Competition Act. Illustratively, categories of Combinations which may be viewed as non-notifiable based on Schedule I of the Combinations Regulations, *inter alia*, include:

- a) acquisitions of less than 25% of the shares or voting rights of an enterprise, made in the ordinary course of business or solely as an investment, but not leading to acquisition of control.<sup>20</sup> (*Minority Acquisitions*)

18 The CCI's extra-territorial jurisdiction under the Competition Act is premised on the likelihood of AAEC in the relevant market in India. Resultantly, the 'India-nexus' thresholds serve as an indicator of the threshold of economic activity in India, that could, subject to the CCI's review, indicate of a likelihood of AAEC in the relevant market in India.

19 The exemption (Vide Notification S.O.988(E) dated March 27, 2022, available at URL: [https://www.mca.gov.in/Ministry/pdf/Notification\\_30032017.pdf](https://www.mca.gov.in/Ministry/pdf/Notification_30032017.pdf); extended vide Notification S.O.1192(E) dated March 16, 2022, available at URL: <https://www.cci.gov.in/combination/legal-framework/notifications/details/15/0>) has been granted by the Central Government pursuant to its powers under Section 54 of the Competition Act. Section 54 empowers the Central Government to exempt any class of enterprises from the application of any provision of the Competition Act in public interest. Keeping in mind the policy prerogatives of enabling the growth of small and medium enterprises (SMEs), the Central Government has exempted Combinations involving SME-targets.

20 Item 1 of Schedule I to the Combinations Regulations.



## 5. Mergers and Acquisitions

- b) an acquisition of shares or voting rights of an enterprise belonging to the same group as the acquiring entity, except where the target entity is jointly controlled by entities not belonging to the same group.<sup>21</sup> (*Group Exemption 1*)
- c) an acquisition of shares or voting rights of an enterprise where the acquiring entity already holds 25% or more of the shares or voting rights, such that the acquisition does not lead the acquiring enterprise to hold more than 50% of the shares or voting rights of the target enterprise, and does not lead to a change in the nature of control from joint to sole control.<sup>22</sup> (*Group Exemption 2*)
- d) an acquisition of shares or voting rights of an enterprise where the acquiring entity already holds 50% or more of the shares or voting rights of the target enterprise, except where the acquisition leads to a change in the nature of control from joint to sole control.<sup>23</sup> (*Group Exemption 3*)

### Pre-Filing Consultations

Given the non-binding nature of the language under Regulation 5(2), it is possible for the CCI to disagree with parties' evaluation of the applicability of the exemptions listed out under Schedule I of the Combinations Regulations, and proceed against them for "gun-jumping." It is advisable in such cases, that parties to a Combination apply for a Pre-Filing Consultation (PFC) with the CCI.

The PFC mechanism was introduced by the CCI in 2014, as an avenue for obtaining *non-binding* advice on filing requirements, and the interpretation of provisions of the Competition Act and regulations issued thereunder. A request for a PFC may be submitted to the CCI through its portal. While 'no-names' requests for PFC are permitted, the CCI's Guidelines<sup>24</sup> on PFCs indicate that requests with identified parties, and specific (as opposed to hypothetical) queries are likely to be prioritized by the CCI. Ultimately, the CCI retains the discretion to grant an opportunity for a PFC.

### Timelines for Notification to CCI

Section 6(2) of the Competition Act continues to prescribe that a notification to the CCI must be made within thirty (30) days of execution of definitive agreements or other documents for acquisitions, or receipt of board approval for a merger or amalgamation. However, given that most jurisdictions adopt either a *suspensory regime* or prescribe a *filing deadline*, the Central Government has suspended this requirement effective June 2017,<sup>25</sup> retaining only the suspensory regime that flows from Section 6(2A) of the Competition Act.

### Form of Notification

The central regulatory objective for the CCI's exercise of jurisdiction under Sections 5 and 6 of the Competition Act, is the prevention of any AAEC arising or likely to arise from a proposed Combination. Resultantly, the disclosures required of notifying party vary on the extent of overlapping business activities of the parties to a Combination. Depending on the extent of "horizontal" or "vertical" overlaps, parties may be required to notify a Combination in the short-form (Form-I) or a long-form (Form-II), with the latter requiring parties to submit detailed economic evidence relating to the Combination.

<sup>21</sup> Item 8 of Schedule I to the Combinations Regulations.

<sup>22</sup> Item 1A of Schedule I to the Combinations Regulations.

<sup>23</sup> Item 2 of Schedule I to the Combinations Regulations.

<sup>24</sup> See Guidance on Pre-Filing Consultation, available at URL: <https://www.cci.gov.in/combination/pre-filing-consultations>.

<sup>25</sup> Vide Notification S.O. 2039(E), dated the June 29, 2017 ("Filing Timeline Exemption"). The filing timeline exemption has since been extended vide Notification S.O. 1193(E) dated March 16, 2022.

## 5. Mergers and Acquisitions

In case of parties exhibiting “horizontal overlaps” (i.e., where parties are engaged in identical, or similar activities or trades), a notification in Form-II is required if the combined market share in the relevant market of the parties exceeds 15%. Similarly, for parties exhibiting “vertical overlaps” (i.e., where parties are engaged in activities or trades in different levels or stages of the production and supply chain), a notification in Form-II is required if the individual or combined market share of the parties in their respective relevant markets exceed 25%.

### Green Channel

In furtherance of the Government of India’s ease of doing business initiatives, the CCI introduced certain important amendments to its Combination Regulations on August 13, 2019 (“**2019 Amendment Regulations**”) with effect from August 15, 2019. The 2019 Amendment Regulations provide for a “Green Channel” route whereby parties that meet the criteria described below need not wait for the approval of the Commission to consummate a notifiable transaction. Once the acknowledgment of a Form I filed under this Green Channel route has been received by the parties, the transaction will be deemed approved and parties will be able to consummate the transaction immediately.

To avail of the benefit of the Green Channel route, the qualifying criteria is that the parties to the combination, their group entities and each of their, direct or indirect investee entities (even an investment of a single share in a company shall make such company an investee entity) should not: (i) produce/provide similar or identical or substitutable product or service or; (ii) engage in any activity relating to production, supply, distribution, storage, sale and service or trade in product or service which are at different stage or level of production chain or; (iii) engage in any activity relating to production, supply distribution, storage, sale and service or trade in product or service which are complementary to each other. This analysis will also have to be undertaken while considering all plausible alternative market definitions.

The acquirer would also be required to make a positive declaration confirming that the combination falls under the Green Channel (meaning there are no overlaps at any level as discussed above). If it is found that either such declaration or any other statement made by it in the Form I is found to be incorrect then the Form I and deemed approval of the Commission shall both be considered *void ab initio*. The parties will however have an opportunity to be heard before the commission renders the approval *void ab initio*. The CCI entertains PFC requests relating to the availability of a “green channel” approval for Combinations. It is routine practice for parties to approach the CCI for PFC prior to availing of the “green channel” route.

#### Practitioner Tip: Key Points to consider under the Competition Law Regime in India

CCI’s jurisdiction extends to any acquisition where assets/turnover are in India and exceed specified limits even if the acquirer and target are located outside India. Mandatory pre-transaction notification to the CCI of all Combinations that exceed any of the asset or turnover thresholds is required, as stated above.

Subject to qualifying as per the criteria stated above, Green Channel route provides an opportunity for companies to avail benefits of lesser compliance requirements by only having to file Form I, and avoiding a suspensory period by obtaining a deemed approval as on the date of notifying a Combination to the CCI.

## 5. Mergers and Acquisitions

### Proposed Amendments to the Competition Act

The Competition (Amendment) Bill, 2022 (“CAB”) was introduced in the Parliament of India on August 5, 2022.<sup>26</sup> The CAB proposes to introduce several procedural amendments focusing on improving the ease-of-doing business. These include a truncation of the ‘hard-stop’ review timeline from 210 days to 150 days (extendable by a further 30 days), providing a defined procedure for negotiating modifications and remedies for a Combination, and formally incorporating the “green channel” mechanism within the Competition Act.

Notably however, the CAB also prescribes two other substantive amendments which may significantly alter the current regime governing Combinations. The first is the introduction of “deal value thresholds”, and the second, relates to an updated definition of “control”.

- a) **Deal Value Thresholds:** Similar to jurisdictions such as the USA, where the Hart-Scott Rodino Act *inter alia* prescribes notification thresholds based on the consideration for a transaction, the CAB proposes to introduce an additional threshold for Combinations where the value of transaction for an acquisition,<sup>27</sup> exceeds INR 20 billion. The *de-minimis* exemption will not be available to Combinations that breach this threshold. Further, global transactions may also be subject to this threshold, subject to them meeting a local-nexus threshold based on “substantial business operations in India.” The CAB doesn’t define what constitutes a “substantial business operation in India”, and instead leaves this to be determined by regulations to be issued by the CCI.
- b) **Revised Definition of ‘Control’:** While the current definition of “control” adopts a standard of ‘significant/decisive influence’ (i.e., the ability to definitively control the affairs and management of an enterprise), the CAB proposes to replace this with a standard of ‘material influence’,<sup>28</sup> i.e., the lowest level of control that enables a shareholder to influence the affairs and management of an enterprise through factors such as extent of shareholding, special rights, status and expertise of an enterprise, board representation (including observer seats), and ancillary structural and financial arrangements. While the CCI has over the course of the past decade gradually adopted a standard of “material influence” to evaluate acquisition of minority stakes, the CAB would provide this standard a statutory basis, and bring the Competition Act’s standard and notion of ‘control’, closer to that of other jurisdictions such as Germany.

Since its introduction in the Parliament, the CAB has been referred to the Parliamentary Standing Committee on Finance for its review and recommendations. Accordingly, the final contents of the CAB, as and when enacted, may undergo further modifications.

## F. Exchange Control Regulations

Cross border mergers and acquisitions are required to be in conformity with the foreign exchange regulatory framework in addition to the provisions of Companies Act. The Reserve Bank of India published the Foreign Exchange Management (Cross Border Merger) Regulations, 2018, which introduced the concept of ‘deemed approval’ by the RBI for cross border mergers.<sup>29</sup> In order to avoid the requirement of explicit prior approval of RBI, the cross-border merger must satisfy, *inter alia*, the following conditions:

26 The Competition (Amendment) Bill, 2022, available at URL: [http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/185\\_2022\\_LS\\_Eng.pdf](http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/185_2022_LS_Eng.pdf).

27 The CAB adopts a wide and expansive definition for “value of transaction”, defining it as “every valuable consideration, whether direct or indirect, or deferred for any acquisition, merger or amalgamation.”

28 The CAB proposes to replace the phrase “includes controlling the affairs or management of” as it currently exists under Explanation (a) under Section 5(2) of the Competition Act, with the phrase “means the ability to exercise material influence, in any manner whatsoever, over the management or affairs or strategic commercial decisions.”

29 Available at: <https://rbidocs.rbi.org.in/rdocs/content/pdfs/EGAZ20032018.pdf>.

## 5. Mergers and Acquisitions

- In case the resultant company is an Indian company (“**Inbound Merger**”), the issuance or transfer of such company’s securities to a person resident outside India must be in consonance with the conditions in the FDI Regulations;
- In case the resultant company is a foreign company (“**Outbound Merger**”), the acquisition/holding of securities in such company by an Indian resident must be in consonance with the OI Framework (*as defined hereinafter*);
- The guarantees or borrowings from outside sources inherited by a resultant Indian company must conform to the external commercial borrowing norms or trade credit norms, as the case may be, laid down by the RBI under the Foreign Exchange Management Act, 2000, within a period of two years of such merger;
- Impermissible assets (i.e., assets that are not permitted to be held by the resultant company (Indian or foreign as the case may be) under India’s foreign exchange regulations) held by the resultant company (Indian or foreign) as a consequence of the merger, must be disposed of within two years of the sanction of the scheme of amalgamation by the NCLT and the proceeds must be repatriated to India or outside India immediately, as applicable.

Accordingly, any transaction on account of a cross border merger undertaken in accordance with Foreign Exchange Management (Cross Border Merger) Regulations, 2018, shall be deemed to have prior approval of the RBI as required under Rule 25A of the Companies (Compromises, Arrangement and Amalgamations) Rules, 2016.

## G. Overseas Direct Investment

The Ministry of Finance (Department of Economic Affairs) and the RBI respectively released the Foreign Exchange Management (Overseas Investment) Rules, 2022 (“**OI Rules**”)<sup>30</sup> and the Foreign Exchange Management (Overseas Investment) Regulations, 2022 (“**OI Regulations**”).<sup>31</sup> In addition to the introduction of the OI Rules and OI Regulations, the RBI has also issued the Foreign Exchange Management (Overseas Investment) Directions, 2022 (“**OI Directions**”)<sup>32</sup> which are to be read in conjunction with OI rules and the OI Regulations. (collectively the OI Rules, OI Regulations and the OI Directions read as the “**OI Framework**”).

Prior to the notification of the OI Framework, overseas direct investment in India was governed and regulated by the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 and Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015.

## H. Applicable Taxes and Duties

### Income Tax

A number of acquisition and restructuring options are recognized under Indian tax laws, each with different set of considerations:

- Amalgamation (i.e. a merger which satisfies the conditions specified in the ITA)

30 Available at: <https://egazette.nic.in/WriteReadData/2022/238239.pdf>.

31 Available at: <https://egazette.nic.in/WriteReadData/2022/238242.pdf>.

32 Available at: <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT110B29188F1C4624C75808B53ADE5175A88.PDF>.

## 5. Mergers and Acquisitions

- Asset sale / Slump sale (which satisfies the conditions specified in the ITA);
- Transfer of shares; and
- Demerger or spin-off (which satisfies the conditions specified in the ITA).

Share transfers may give rise to capital gains tax at rates which depend on holding period of the securities (rates mentioned in **Chapter 7** of this paper). Capital gains income is computed by deducting the following from the value of the consideration received – (a) expenditure incurred wholly and exclusively with such transfer, and (b) cost of acquisition of the capital asset and any cost of improvement of the capital asset.

Mergers and spin-offs may be structured as tax neutral transfers provided conditions specified under the ITA are met with respect to transfer of assets / liabilities and continuity of shareholding. There are also provisions for carry forward of losses to the resulting entity. Transfer of foreign securities may be taxed if the securities substantially derive value from assets situated in India (indirect transfers discussed in Chapter 7 of this report). This adds an additional element of complication in cross-border M&A with underlying assets or subsidiaries in India. Transfer pricing rules also have to be considered in relation of share transfers as part of a group re-structuring exercise.

Persons acquiring shares of unlisted companies in India may be subject to tax if the consideration paid for the shares is lower than the fair market value of the shares computed using a prescribed formula. Additional tax considerations arise when the deal consideration is structured as earn-outs. Further, withholding tax obligations also create challenges especially in a cross-border context.

As an alternative to a share transfer, acquisitions may be structured in the form of an asset sale or slump sale. A slump sale is a transaction where the seller transfers one or more of its undertakings on a going concern basis for a lump sum consideration, without assigning values to the individual assets and liabilities of the undertaking. The advantage of undertaking a slump sale is that the business as a whole (and not individual assets) qualifies as a long term capital asset so long as the undertaking as a whole is held for more than 3 years. The consideration received for slump sale of a business is characterized as a capital receipt chargeable to tax as capital gains.

The Finance Act, 2021 amended the definition of ‘slump sale’ under the ITA. It defines the term ‘slump sale’ to include the transfer of an undertaking ‘by any means’. The term ‘transfer’ has been defined broadly under the ITA to include specifically an ‘exchange’, ‘relinquishment’ and ‘extinguishment’. This clarification brings certainty with respect to the scope of the term ‘slump sale’, and allows for tax efficient transactions without the risk of litigation.

In an asset sale, the acquirer only purchases specific assets or liabilities of the seller. It does not involve a transfer of the business as a whole. The capital gains tax payable by the seller will depend on the period that the seller has held each of the assets that are transferred. In light of the uncertainties in the tax environment, negotiation of tax indemnities has become a vital component in most M&A deals. Cross-border movement of intangibles may also give rise to potential tax exposures which have to be carefully considered and structured.

### Indirect Tax

Prior to July 1, 2017, a series of central and state taxes were levied at various stages of the production and distribution process. These included central excise duty on manufacture, central sales tax on inter-state sale, sales tax / value added tax on intra-state sale, and service tax on the rendering of services. Moreover, credit for input taxes paid was not uniformly available across central and state levies thereby leading to a cascading of taxes. With the

## 5. Mergers and Acquisitions

introduction of the Goods and Services Tax (“GST”) in 2017, India now has unified indirect tax (rates mentioned in Chapter 7 of this report).system.

### Stamp Duty

Stamp duty is a duty payable on certain specified instruments / documents. The amount of the stamp duty payable would depend on the state specific stamp laws. An insufficiently stamped document is not admissible as evidence in a court of law of India.

When there is a conveyance or transfer of any movable or immovable property, the instrument or document effecting the transfer is liable to payment of stamp duty. Stamp duty is also required to be paid on the order of the Tribunal approving a merger / demerger of two or more companies. The stamp laws of most states require the stamping of such orders. Stamp duty may be payable on an agreement that records the purchase of shares / debentures of a company and on the transfer deeds executed in this regard. This depends on parties of the transaction and if the agreement will be brought in the territory of India.

### Other Taxes

Other taxes that may have to be considered in structuring M&A include potential service tax obligations. For instance, this could be an issue in cases where the seller procures that its employees accept offers of employment with the acquirer. A question may arise as to whether this may be viewed as manpower recruitment services which could be subject to service tax.

While structuring any investment it is necessary to adopt a holistic approach and integrate all possible legal and tax considerations in a manner that best achieves the strategic and business objectives.

# Capital Markets in India

Indian companies are allowed to raise capital and access financial markets through public issues of shares and other instruments within the regulatory confines of SEBI. Some of the permissible methods for raising capital include public issues, private investment of public equity, rights issues, preferential issues, qualified institutional placements, bonus issues, etc. The ICDR Regulations provides conditions and restrictions for these methods of capital raising. The most active stock exchanges in India where companies seek to be listed and access public markets are the BSE Limited (“BSE”) and the National Stock Exchange of India Limited (“NSE”).

## A. Public Offerings

Public issues in India can be classified into two types: an initial public offer (“**IPO**”) or a further public offer (“**FPO**”).

An IPO is the process through which an issuer company makes available its securities to the general public for the first time. This is done either through a primary allotment of fresh securities (“**Fresh Issue**”), or through a secondary sale vide an ‘offer for sale’ (“**OFS**”) of securities which are held by its existing shareholders, or a combination of both Fresh Issue and OFS. This paves the way for the listing and trading of the issuer company’s securities on SEBI-approved and SEBI-registered stock exchanges in India (“**Recognised Stock Exchanges**”).

In the case of an FPO, a company which is already publicly listed on a Recognised Stock Exchange makes further securities available to the public vide an additional primary issuance of its securities to the public, or OFS of its existing securities to the public, or a combination of both. Both IPOs and FPOs require the preparation of offer documents containing detailed information of the company for the public’s review, prior to acquisition of such company’s securities.

In addition to the ICDR Regulations, IPOs and FPOs are governed by the provisions of the Companies Act, the Securities Contracts (Regulation) Rules, 1957 (“**SCRR**”) and the Listing Regulations. The ancillary legislations that may be applicable to an IPO are the FEMA and the various regulations, press releases and circulars issued thereunder from time to time by the RBI and the FDI Regulations.

## Eligibility Requirements for IPO

An unlisted company may undertake an IPO of its equity shares and any convertible securities if it satisfies the following eligibility requirements:

- The issuer company has net tangible assets of at least INR 30 million in each of the 3 preceding years, of which not more than 50% is held in monetary assets.<sup>1</sup> However, the limit of 50% on monetary assets shall not be applicable in case the public offer is made entirely through OFS;
- The issuer company has an average operating profit of at least INR 150 million, calculated on a restated and consolidated basis, during the preceding 3 years, with operating profit in each of these preceding 3 years;

<sup>1</sup> If more than 50% of the net tangible assets are held in monetary assets, the issuer should have made firm commitments to utilise such excess monetary assets in its business or project.



## 6. Capital Markets in India

- The issuer company has a net worth of at least INR 10 million in each of the 3 preceding full years, calculated on a restated and consolidated basis; and
- If the issuer company has changed its name within the last 1 year, at least 50% of the revenue for the preceding 1 year is earned from the activity indicated by the new name.

An issuer not satisfying the above conditions may undertake an IPO only if the issue is made through the book-building process and the issuer undertakes to allot, at least 75% of the net offer to qualified institutional buyers (“QIB”) and to refund full subscription money if it fails to make the said minimum allotment to QIBs. If an issuer has issued SR equity shares<sup>2</sup> to its promoters or founders, it shall be allowed to undertake an IPO of ordinary shares only if certain conditions of the ICDR Regulations are fulfilled. An unlisted public company cannot undertake an IPO, if the company has less than 1,000 prospective allottees and if there are outstanding convertible securities of the company or any other right which would entitle any person to an option to receive equity shares after the IPO.

### Minimum Offer Requirements

The issuer company is required to offer:

- i. at least 25% of each class of equity shares must be offered if the post issue capital of the issuer calculated at offer price is less than or equal to INR 16,000 million;
- ii. at least such percentage of equity shares must be offered equivalent to the value of INR 4,000 million, if the post issue capital of the issuer calculated at offer price is more than INR 16,000 million but less than or equal to INR 40,000 million;
- iii. at least 10% of each class of equity shares must be offered if the post issue capital of the issuer calculated at offer price is above INR 40,000 million but less than or equal to INR 1,000,000 million;
- iv. at least such percentage of equity shares must be offered equivalent to the value of INR 50,000 million and at least 5% of each class of equity shares must be offered, if the post issue capital of the issuer calculated at offer price is above INR 1,000,000 million.

### Promoters’ Contribution

A promoter, under the ICDR Regulations, is defined as a person or persons who are in control of the affairs of the issuer company, whether directly or indirectly and who advises or instructs the board of directors of the issuer company and those whose names are mentioned in the prospectus for the offering as a promoter of the issuer company.

As per the ICDR Regulations, the promoters are required to contribute in the IPO, not less than 20% of the post-IPO share capital of an issuer company. Any shortfall in the minimum contribution by the promoters can be fulfilled by calling in contribution of not more than 10% of the post-IPO share capital from alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with IRDAI.

<sup>2</sup> “SR equity shares” means the equity shares of an issuer having superior voting rights compared to all other equity shares issued by that issuer.



## 6. Capital Markets in India

The promoters have to bring the full amount of the promoters' contribution including premium at least 1 day prior to the issue opening date and such amount is to be kept in an escrow account specially opened for this purpose. However, where the IPO is for partly paid shares and the minimum promoters' contribution is more than INR 1,000 million, the promoters are required to bring in at least INR 1,000 million before the issue opening date and the remainder amount may be brought on pro-rated basis before the calls are made to the public.

There are certain securities which by the nature of their existence are ineligible for the computation of the promoter contribution, including certain bonus shares, pledged securities and shares acquired for consideration other than cash.

### Lock-in Restrictions

A "lock-in" means a freeze on dealing in the securities. The ICDR Regulations specify certain lock-in restrictions with respect to the holdings of the promoters as well as other shareholders in the issuer company. The lock-in applicable to securities held by promoters is necessary to ensure that the promoters retain some interest in the issuer company post-IPO and to avoid fly-by-night operators.

SEBI recently approved to relax the lock-in requirements in relation to promoter shareholding to the extent of 20% of the post issue capital (the "**Minimum Promoter Contribution**"), such that the lock-in has now been reduced to a period of 18 months from the date of allotment in the IPO/ FPO, instead of the erstwhile lock-in requirement of a period of 3 years, only in the following cases:

- i. If the object of the issue involves only offer for sale;
- ii. If the object of the issue involves only raising of funds for other than for capital expenditure for a project (i.e. end use of more than 50% of the fresh issue should not be for capital expenditure for a project); or
- iii. In case of combined offering (fresh issue + OFS), the object of the issue involves financing for other than capital expenditure for a project (i.e. end use of more than 50% of the fresh issue should not be for capital expenditure for a project excluding the offer for sale portion).

Further, in all the above-mentioned cases, the promoter shareholding in excess of the Minimum Promoter Contribution will be locked-in for a period of 6 months, instead of the erstwhile lock-in requirement of a period of 1 year.

With respect to the lock-in pertaining to the pre-IPO securities held by non-promoter shareholders, the lock-in requirement has been reduced to a period of 6 months as against the 1 year lock-in requirement earlier.

### Offer for Sale

Strategic investors, in order to participate in an offer for sale of the securities of an investee company, should have held the equity shares in the investee company for a period of at least 1 year prior to the date of filing of the draft prospectus with SEBI. In case of equity shares issued upon conversion of convertible instruments, the period of holding of such convertible instruments should also be counted towards the 1 year holding period.

## 6. Capital Markets in India

The strategic investors are exempt from this pre-requisite 1 year holding period, if either one of the following conditions is met:

- The IPO is of securities of a government company or statutory authority or corporation or any special purpose vehicle set up and controlled by any one or more of them, which is engaged in infrastructure sector;
- The investors had acquired shares pursuant to any scheme approved by the NCLT under Sections 230 to 234 of the Companies Act in lieu of business and invested capital which had been in existence for a period of more than 1 year prior to such approval.
- The shares offered for sale were issued under a bonus issue on securities held for a period of at least one year prior to the filing of the draft offer document with SEBI and subject to further conditions as per the ICDR Regulations.

### Credit Rating

The issuer company should have obtained a grading from at least one credit rating agency registered with SEBI prior to the date of registering prospectus or red herring prospectus with the RoC. With effect from October 1, 2018, all credit ratings obtained by the company for all its outstanding instruments are required to be updated immediately as and when there is any revision in any of the ratings.<sup>3</sup>

### Pricing

The issuer company may freely price its equity shares or any securities convertible into equity shares, at a later date, before filing the prospectus with the RoC, in consultation with the lead managers (i.e. the merchant bankers) or through book building process.

#### Practitioner Tip: Implications for a Strategic Investor

On account of going in for an IPO, as mandated by the ICDR Regulations, convertible instruments held by investors too shall have to be converted into equity shares at the time of filing of red herring prospectus with SEBI, irrespective of the achievement of the commercially agreed business milestones, if any.

Therefore, this may impact their returns from the company. Further, in the event in which the investee company fails to perform the IPO, then the investor may be saddled with equity shares, which may not yield the same preferred returns as if they were the preference shares or debentures.

Moreover, the investor protection rights that are attached to the convertible instruments and which are then assimilated into the articles of association of the investee company (for ensuring enforceability against the company), may fall away at the time of filing of the investee company's DRHP, because SEBI and the stock exchanges generally require the articles of association of any proposed issuer company to be in a certain form.

<sup>3</sup> Regulation 46(2)(r) substituted by Inserted by the SEBI (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018, available at: [https://www.sebi.gov.in/legal/regulations/may-2018/sebi-listing-obligations-and-disclosure-requirement-amendment-regulations-2018\\_38898.html](https://www.sebi.gov.in/legal/regulations/may-2018/sebi-listing-obligations-and-disclosure-requirement-amendment-regulations-2018_38898.html).

## 6. Capital Markets in India

### Disclosure Requirements

The ICDR Regulations stipulate that the disclosure requirements, in relation to promoters and members of the promoter group, has to be made in the offer documents that is to be filed with SEBI. The offer documents should include sections such as issue details, risk factors (internal and external), capital structure of the issuer company, objects of the offering, terms of the issue, interest of the directors, financial information of the issuer company, charter documents of the company, business of the issuer company, regulatory approvals, outstanding litigations, the issue procedure, etc.

### Filing of the Offer Document

The issuer company has to file a draft red herring prospectus with SEBI and stock exchanges (where securities are proposed to be listed) prior to the filing of the prospectus with RoC. SEBI and the recognised stock exchanges can specify changes / observations on the draft red herring prospectus. At this stage, the issuer company also has to obtain in-principle approval from all the stock exchanges on which the issuer company intends to list the securities through the prospectus. Thereafter, the issuer company has to carry out such changes or comply with such observations in the draft red herring prospectus before filing the prospectus with the ROC.

Overall, doing an IPO is not only a plausible but also a preferred option for exit for strategic investors in Indian companies. However, as mentioned above, they have to be mindful of certain regulatory requirements, compliances and disclosures. In addition to the key pre-issue obligations discussed herein, issuer companies have to comply with a comprehensive list of post-issue obligations as well.

## B. Preferential Allotment

Preferential allotment of shares refers to the procedure of bulk allotment of fresh shares to a specific group of individuals, venture capitalists, companies, or any other person by any particular company. This process is termed as the preferential allotment of shares. This method is certainly unique from other fundraising methods as the entire allotment is made to pre-identified people, who may or may not be the existing shareholders of a company. These are generally the individuals, who are interested in getting a stake in the company.

Preferential allotment of shares option is mainly used by the companies to provide a route to those shareholders, who are unable to buy a large chunk of company shares at affordable prices during IPOs. However, such shareholders do not generally get any voting position in the company and are paid only when the company makes profits. Apart from this, the venture capitalists, financial institutions, and existing shareholders or company promoters are also given an option to increase their stakes in the company by the firm owners through exercising the preferential share allotment option. The companies also use this option to secure the equity participation of those shareholders, whom they believe can be of value as shareholders. The procedure and provisions of preferential allotment of shares are mentioned under Section 62 (focuses on allotment of shares) and Section 42 (focuses on allotment of securities) of the Companies Act and the rules framed thereunder.

## 6. Capital Markets in India

### Lock-in Restrictions

The regulations provide for certain restrictions imposed on such preferential allotment of shares, with regards to lock-in of such shares, so as to not allow such holders to liquidate their shareholding. The regulations provide that the specified securities, which are allotted on a preferential basis to the promoters or promoter group and the equity shares allotted pursuant to exercise of options, will be under a locked-in for a period of 18 months from the date of obtaining the trading approval for such shares. The reason behind such lock-in restrictions for promoters is to ensure their equity participation in the Company and as a form of ensuring commitment of certain valuable shareholders of the company.

Further, equity shares allotted in excess of twenty percent of the total capital of the company, shall be locked-in for six months from the date of trading approval being granted for such shares. In terms of the specified securities allotted on a preferential basis to persons other than the promoters and promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be locked-in for a period of six months from the date of trading approval.

The ICDR Regulations also provide for a lock-in period of one year from the date of trading approval, for any equity shares issued on a preferential basis, pursuant to any resolution of stressed assets or by a resolution plan approved by NCLT under the Insolvency and Bankruptcy Code, 2016. Further, the ICDR Regulations place a lock-in on the entire pre-preferential allotment shareholding of the allottees. Such shareholding, if any, shall be locked in from the relevant date upto a period of 90 trading days from the date of grant of the trading approval.

However, the locked-in securities held by the promoters or the promoter group may be transferred amongst the promoters or the promoter group or any new person in control of the issuer, provided the remaining lock-in period will continue with the transferee.

### Conditions for Preferential Issue

The regulations provide for certain conditions to be satisfied in order to be eligible to carry out such preferential allotment of shares. As per the regulations, a listed issuer must ensure that:

- All equity shares, which are allotted through the preferential issue, are made fully paid at the time of allotment;
- The shareholders have passed a special resolution allowing such issue;
- The shares held by allottees are in dematerialized form;
- Continuing compliance of listing requirements under the regulations or notifications issued by SEBI from time to time;
- Permanent Account numbers of such allottees are with the issuer, except those who are exempted from specifying their permanent account numbers for transacting in the securities market by SEBI; and
- the issuer has made an application seeking in-principle approval to the stock exchange(s), where its equity shares are listed, on the same day when the notice has been sent in respect of the general meeting seeking shareholders' approval by way of special resolution.

## 6. Capital Markets in India

### Pricing

In terms of computing prices for such preferential shares to be allotted at, the method used will depend of the fact, whether the shares are frequently traded shares or are they infrequently traded shares.

In case of the former, the price of the equity shares, which have been listed on a recognized stock exchange for 90 trading days or more as on the relevant date, shall not be less than higher of the following:

- the 90 trading days volume weighted average price of the related equity shares quoted on the recognised stock exchange preceding the relevant date;
- the 10 trading days volume weighted average price of the related equity shares quoted on the recognised stock exchange preceding the relevant date;

provided if the Articles of Association of the issuer provide for a method of determination which results in a floor price higher than price determined under (a) and (b) above, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue.

In case, the shares have been listed for a period less than 90 trading days as on the relevant date, then price shall not be less than higher of the following:

- the price at which the shares were issued during its IPO or the value of the share arrived at in a scheme of compromise, arrangement and amalgamation as provided under the Companies Act;
- the average of the volume weighted average prices of the related equity shares quoted on the recognised stock exchange during the period the equity shares have been listed preceding the relevant date; or
- the average of the 10 trading days volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date;

provided if the Articles of Association of the issuer provide for a method of determination which results in a floor price higher than price determined under (a) and (b) above, then the same shall be considered as the floor price for equity shares to be allotted pursuant to the preferential issue.

However, once these shares complete period of 90 trading days from the date of listing on a recognised stock exchange, the price shall be recomputed by the issuer as per the method provided for shares traded for 90 trading days or more. If in such a case, the recomputed price is higher than the price paid on allotment, then the difference has to be paid by the allottees to the issuer.

In case, wherein the shares are not frequently traded, the computation is carried out taking note of factors such as book value, comparable trading multiples and any other such parameters used for determining value of shares of such companies.

### Disclosures and Appointment of a Merchant Banker

The key difference in the disclosure norms for both modes of issuances is that in case of a preferential issue, the disclosures are required to be made as part of the explanatory statement to be annexed to the notice sent to the unitholders proposing the issuance of units. The disclosures prescribed are similar to disclosures prescribed in case of a preferential issue under the SEBI ICDR Regulations, including, inter alia, objects of the issue, NAV, the maximum number of units to be issued.

## 6. Capital Markets in India

### Consideration and Utilization of Proceeds

Other than where units are proposed to be issued for consideration other than cash, the prospective allottees are required to pay the full consideration for the specified securities (other than warrants), at the time of allotment of such specified securities. All amounts received towards subscription of units are to be kept in a separate bank account and till the listing of such units, such amounts may only be utilized towards adjustment against allotment of units and/or refund of money to the applicants.

### Other Conditions (in a Comparative Form)

Other conditions: Allotment in case of preferential issues is required to be completed within 15 (fifteen) days from the date of passing of the unitholders' resolution whereas in case of an institutional placement, it is required to be completed within 365 (three hundred and sixty-five) days of the unitholders' resolution.

## C. Qualified Institutional Placements

SEBI has introduced the concept of Qualified Institutional Placements, which is quite similar to preferential issue. Equity shares, non-convertible debt instruments along with warrants and convertible securities other than warrants, can be issued to Qualified Institutional Buyers ("QIB"). As per the definition provided by SEBI under ICDR Regulations, QIB include:

- a mutual fund, venture capital fund, alternative investment fund and foreign venture capital investor registered with the Board;
- a foreign portfolio investor other than individuals, corporate bodies and family offices;
- a public financial institution;
- a scheduled commercial bank;
- a multilateral and bilateral development financial institution;
- a state industrial development corporation;
- an insurance company registered with the Insurance Regulatory and Development Authority of India;
- a provident fund with minimum corpus of INR 250 million;
- National Investment Fund set up by resolution no. F. No. 2/3/2005-DDII dated November 23, 2005 of the Government of India published in the Gazette of India;
- insurance funds set up and managed by army, navy or air force of the Union of India;
- insurance funds set up and managed by the Department of Posts, India; and
- systemically important non-banking financial companies.

## 6. Capital Markets in India

In order to be eligible under the ICDR Regulations, an issuer must fulfill the following conditions:

- A special resolution approving qualified institutions placement must be passed;
- the equity shares of the same class, which are proposed to be allotted, should have been listed on a stock exchange for a period of at least one year prior to notice to shareholders for passing of special resolution;
- promoters or directors of such issuer should not be classified as fugitive economic offender.

These types of allotments are governed by the SEBI (Issue of Capital and Disclosure Requirements Regulations, 2018).

### Pricing

The qualified institutions placement has to be made at a price, which is not less than the average of the weekly high and low of the closing prices of the equity shares of the same class, quoted on the stock exchange during the two weeks preceding the relevant date. In instances where, equity shares are issued by way of capitalization of profits or reserves; issuer makes rights issue of equity shares; consolidates its outstanding equity shares into a smaller number of shares; or any such case, the issue price shall be subjected to appropriate adjustments.

### Placement Document

The Placement document shall contain all the necessary information that the buyer must be aware of in order to make an informed choice. The primary objective behind creating an obligation for the placement document is to protect the rights of the buyers and maintain transparency. The information to be disclosed should be as specified in Schedule VII of the ICDR Regulations.

The placement document also has to be published on the website of the relevant stock exchanges with a with a disclaimer to the effect that it is in connection with a qualified institutions placement and that no offer is being made to the public or to any other category of investors.

### Transferability

The eligible securities allotted under such qualified institutions placement cannot be sold for a period of one year from the date of allotment, with the exception of being sold on a recognized stock exchange.

## 6. Capital Markets in India

## D. Recent Relaxations to Stressed Companies

In June, 2020, SEBI issued relaxations for listed companies having stressed assets, in order to help such companies through timely intervention and to protect the interests of shareholders. The circular provided for the following relaxations<sup>4</sup>:

1. Eligible listed companies having stressed assets to be able to determine pricing of their preferential allotments at not less than the average of the weekly high and low of the volume weighted average prices of the related equity shares during the two weeks preceding the relevant date.
2. Allottees of preferential issue in such eligible companies have been exempted from making an open offer if the acquisition is beyond the prescribed threshold or if the open offer is warranted due to change in control, in terms of Takeover Regulations.

Per the circular, a listed entity will come under the ambit of stressed, if it satisfies any two of the following three conditions:

1. Any listed company that has made disclosure of defaults on payment of interest/ repayment of principal amount on loans from banks / financial institutions/ Systemically Important Non-Deposit taking Non-banking financial companies/ Deposit taking Non-banking financial companies and /or listed or unlisted debt securities in terms of SEBI Circular dated November 21, 2019, and such default is continuing for a period of at least 90 calendar days after occurrence of such default.
2. Companies receiving downgrading of the credit rating of the financial instruments (listed or unlisted), credit instruments/borrowings (listed or unlisted) of the listed company to “D”.
3. Existence of Inter-creditor agreement in terms with Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions 2019.

Further, the circular, *inter alia*, lays down other mandatory requirements to be fulfilled in order to avail relaxations:

1. The preferential issue to be made to persons and entities that are not part of the promoter or promoter group.
2. Passing of a resolution, stating the preferential issue at the aforesaid pricing and exemption from open offer shall be passed by majority of minority.
3. Disclosure of the end-use of proceeds should be made. A monitoring agency to be appointed to keep track of such end use of proceeds.
4. The shares issued in such a manner will be under a lock in for a period of three years from the date of trading approval granted.

4 Available at: [http://www.aibi.org.in/Sebipr/Press\\_Release.pdf](http://www.aibi.org.in/Sebipr/Press_Release.pdf).



## 6. Capital Markets in India

## E. Overseas Listing of Indian Companies

Indian Companies are permitted to list instruments linked to their securities on stock exchanges outside India. This may be achieved through the issue of depository receipts – known commonly as ‘American Depository Receipts’ (“**ADR**”) or ‘Global Depository Receipts’ (“**GDR**”) depending on the location where the Company chooses to list.

An ADR is a stock that trades in the United States but represents a specified number of shares in a foreign corporation. ADRs are bought and sold on American markets just like regular stocks, and are issued / sponsored in the U.S. by a bank or brokerage. A GDR is similar to an ADR but is issued and traded on stock exchanges in countries other than the United States.

The ‘Depository Receipts Scheme, 2014’ (“**DR Scheme 2014**”)<sup>5</sup> effective December 15, 2014 was notified by the Central Government for investments under ADR/ GDR.

The salient features of the DR Scheme 2014 are:

- The securities in which a person resident outside India is allowed to invest under Regulation 5 of FEMA shall be eligible securities for issue of Depository Receipts in terms of DR Scheme 2014;
- A person will be eligible to issue or transfer eligible securities to a foreign depository for the purpose of issuance of depository receipts as provided in DR Scheme 2014;
- The aggregate of eligible securities which may be issued or transferred to foreign depositories, along with eligible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such eligible securities under the extant FEMA regulations, as amended from time to time;
- The eligible securities shall not be issued to a foreign depository for the purpose of issuing depository receipts at a price less than the price applicable to a corresponding mode of issue
- of such securities to domestic investors under FEMA;
- It is to be noted that if the issuance of the depository receipts adds to the capital of a company, the issue of shares and utilization of the proceeds shall have to comply with the relevant conditions laid down in the regulations framed and directions issued under FEMA;
- The domestic custodian shall report the issue / transfer of sponsored / unsponsored depository receipts as per DR Scheme 2014 in ‘Form DRR’ as given in annex within 30 days of close of the issue / program.

Earlier, the law allowed issue of GDR only against underlying asset being equity shares. Now, GDRs can be issued against all types of securities whether listed or unlisted. The conversion of GDR to shares and the transfer of GDR outside India between two non-residents are specifically exempted from tax. Apart from these, all other transactions pertaining to GDRs are taxed. Although a special tax regime has been framed, there is disparity as compared to certain concessional tax treatment that is available under normal provisions of the ITA.

However, through the Finance Act, 2015, the Government clarified that a new depository regime has been put in place, but that the tax benefits would only apply to cases valid under the old regime. This means that non-residents trading in certain DRs could be subject to the same taxes as those imposed on people trading in shares of unlisted companies here, besides creating tax ambiguities when such DRs are converted to shares. This was

5 Available at: <https://www.rbi.org.in/scripts/NotificationUser.aspx?id=9507&Mode=0>.

## 6. Capital Markets in India

done as the Government intended that tax benefits under the domestic law should be provided only in respect of sponsored issuances of GDRs by Indian listed companies.

Owing to the evolution of the capital markets globally and the corresponding growth of capital markets in India, SEBI constituted a high-level committee, to prepare a report on direct listing of equity shares of an Indian company on overseas stock exchanges. Based upon recommendations made in the report submitted by the high-level committee, the Companies (Amendment) Act, 2020 was introduced to include provisions for overseas direct listing on foreign stock exchanges by Indian companies.

Section 23 of the Companies Act, was amended to provide for “Private Placement and Public Offer” by Indian companies. However, the amendment requires such issue of shares to be carried out only in certain “permissible foreign jurisdictions”. As per the SEBI report, such permissible foreign jurisdictions may include a jurisdiction, which has treaty obligations to share information and cooperate with the Indian authorities in the event of any investigation. This amendment has been a welcome change as it enables Indian companies to benefit from accessing capital from diverse avenues and from a larger pool of investors.

## F. Listing of Foreign Companies in India

Similar to the ability of Indian Companies to raise capital abroad, foreign Companies are permitted to raise money on Indian capital markets by issuing ‘Indian Depository Receipts’ (“IDRs”). However, a foreign company intending to issue IDRs must meet the following eligibility requirements to list in India:

1. **Mandatory Listing in Home Country:** The Company must be listed in its home country;
2. **No Prohibition:** The Company must not be prohibited from issuing securities by any regulatory body;
3. **Net-worth and Capitalization Ceilings:** The Company should have a pre-issue paid up capital and free reserves of at least USD 50 million with a minimum capitalization of USD 100 million in its home country, during the last 3 years immediately preceding the issue;
4. **Compliance Track Record:** the company fulfills such other eligibility criteria as may be laid down by the SEBI from time to time in this behalf;
5. **Trading Track Record:** The Company is required to have a continuous trading record or history on a stock exchange in its home country for at least 3 years immediately preceding the issue; and
6. **Profit Track Record:** The Company should have a track record of distributable profits for at least three out of immediately preceding five years.

A foreign Company must then comply with the provisions of the following statutes, rules and regulations after listing:

- The Companies Act;
- The ICDR Regulations; and
- The Companies (Issue of Indian Depository Receipts) Rules, 2004.

## 6. Capital Markets in India

## G. Small and Medium Listing Enterprises (SME)

In order to facilitate capital raising by SME's and to provide an exit option for angel investors, Venture Capital ("VC") and Private Equity ("PE") funds, SEBI has allowed SME's to list their securities without an IPO and permit trading of specified securities on Institutional Trading Platform ("ITP") in SME Exchanges. SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013 govern the process of listing of SMEs without undertaking an IPO.

A SME being a public company should satisfy the following requirements to be eligible to list on the ITP:

- whose promoter, group company or director does not appear in the wilful defaulters list of RBI as maintained by Credit Information Bureau (India) Limited ("CIBIL");
- there is no winding up petition admitted against the company in a competent court;
- neither the company nor its group companies and subsidiaries have been referred to the Board for Industrial and Financial Reconstruction ("BIFR") within a period of 5 years prior to the date of application for listing;
- no regulatory action has been taken against it, its promoter or director, by SEBI, RBI, IRDA or MCA within a period of 5 years prior to the date of application for listing;
- company has at least 1 full year's audited financial statements, for the immediately preceding financial year at the time of making listing application;
- company has been in existence for not more than 10 years and its revenues have not exceeded INR 1 billion in any of the previous financial years;
- whose paid up capital has not exceeded INR 250 million in any of the previous financial years;

The following additional conditions should be satisfied by the company:

1. at least 1 AIF, venture capital fund ("VCF") or other category of investors / lenders approved by SEBI has invested a minimum amount of INR 5 million in equity shares of the company, or
2. at least 1 angel investor / group which fulfills specified criteria has invested a minimum amount of INR 5 million in the equity shares of the company, or
3. company has received finance from a scheduled bank for its project financing or working capital requirements and a period of 3 years has elapsed from the date of such financing and the funds so received have been fully utilized, or
4. a registered merchant banker has exercised due diligence and has invested not less than INR 5 million in equity shares of the company which shall be locked in for a period of 3 years from the date of listing, or
5. a QIB has invested not less than INR 5 million in the equity shares of the company which shall be locked in for a period of 3 years from the date of listing, or
6. a specialized international multilateral agency or domestic agency or a public financial institution as defined under Section 2(72) of the Companies Act has invested in the equity capital of the company.

## 6. Capital Markets in India

### H. Issue and Listing of Depository Receipts

In reference to Section 41 of the Companies Act and Companies (Issue of Global Depository Receipts) Rules, 2014 ('GDR Rules'), the Depository Receipts Scheme, 2014 ('DR Scheme'), Reserve Bank of India ('RBI') notification dated December 15, 2014, Central Government notification dated September 18, 2019 and Central Government notification dated October 07, 2019; only a Company incorporated in India and listed on a recognized stock exchange may issue permissible securities or their holder may transfer permissible Securities, for the purpose of issue of Depository Receipts ('DRs'), subject to compliance with some requirements:

1. Listed Company is in compliance with the requirements prescribed under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and any amendments thereof (the Eligibility).
2. Listed company shall be eligible to issue permissible securities, for the purpose of issue of DRs, if:
  - a) the Listed Company, any of its promoters, promoter group or directors or selling shareholders are not debarred from accessing the capital market by SEBI;
  - b) any of the promoters or directors of the Listed Company is a promoter or director of any other company which is not debarred from accessing the capital market by SEBI;
  - c) the listed company or any of its promoters or directors is not a willful defaulter;
  - d) any of its promoters or directors is not a fugitive economic offender.
3. Existing holders shall be eligible to transfer permissible securities, for the purpose of issue of DRs, if:
  - a) the Listed Company or the holder transferring permissible securities are not debarred from accessing the capital market by SEBI;
  - b) the Listed Company or the holder transferring permissible securities is not a willful defaulter;
  - c) the holder transferring permissible securities or any of the promoters or directors of the Listed Company are not a fugitive economic offender.

### I. Capital Raising

The company may also raise capital only through private placements and rights issue. Such companies shall not make an IPO while being listed on the ITP.

### J. Promoter's Contribution and Lock-in

The promoters are required to contribute for listing not less than 20% of the post-listing share capital of the company for listing on ITP. Such shares shall be subject to a lock-in for a period of 3 years from date of listing.

# Tax Considerations in Structuring Investments

Any person investing or doing business in India has to consider various direct (income) and indirect (consumption) taxes which are levied and collected by the central government and the applicable state governments. Below, we provide indicative lists of taxation heads in India.

## A. Corporate tax

Income tax in India is levied under the ITA. Resident companies are generally taxed at approximately 34% including surcharge and cess<sup>1</sup> (if net income is above INR 4 bn) However, in case of domestic companies having total turnover not exceeding INR 4 billion, the applicable tax rate has been reduced to 25% (effective maximum rate being 29.12%).<sup>2</sup> This has been done in order to encourage medium and small enterprises to shift to company structures, and make the taxation regime more viable for them.

As yet a further step towards this goal, and to promote growth of the domestic sectors and investment into India the Taxation Laws (Amendment) Act, 2019 (**2019 Amendment**) was passed by both houses of the Parliament.

As per the 2019 Amendment, effective from April 1, 2019, domestic companies may choose to be taxed at an effective rate of 25.17% (including surcharge and cess) under the newly introduced Section 115BAA of the ITA subject to certain conditions such as: (i) total income being computed without claiming certain specified deductions and exemptions under the ITA (**Deductions**); (ii) the company not being allowed to set off any current or carried forward losses or depreciation if such losses are attributable to the Deductions; and (iii) the company claiming depreciation in the manner prescribed under the ITA barring any claim of additional depreciation under Section 32(1)(iia). Once exercised, the option to be taxed under this provision cannot be withdrawn and will continue to apply for subsequent assessment years etc.

The 2019 Amendment has also introduced Section 115BAB to the ITA, as per which new manufacturing companies set up on or after October 1, 2019 and that start manufacturing on or prior to March 31, 2023, may avail an effective tax rate of 17.16% (including surcharge and cess) subject to meeting certain prescribed conditions, which are largely similar to the conditions applicable for availing Section 115BAA.

Non-resident companies are taxed at a rate of about 42% including surcharge and cess (if net income is in the range of INR 10 million – 100 million) and approximately 44% including surcharge and cess (if net income exceeds INR 100 million). While residents are taxed on their worldwide income, non-residents are only taxed on income arising to them from sources in India. A company is said to be resident in India if it is incorporated in India or has its POEM in India. Minimum alternate tax (**MAT**) at the rate of 15% (excluding surcharge and education cess) is also payable on the book profits of a company, if the company's income due to exemptions is less than 15% of its book profits. Importantly, no MAT shall be applicable in case of companies opting to be taxed under Section 115BAA / 115BAB, and provisions for MAT credit do not apply to such companies.

1 If the total income such Indian companies (availing the above-mentioned tax regimes) is (i) between INR 10 mn to INR 100 mn, the applicable surcharge is 7% of the taxable amount; and (ii) if the total income exceeds INR 100 mn, the applicable surcharge is 12% of the taxable amount.

2 This is in respect of FY 2019-20 where the specified turnover threshold is for FY 2017-18. With every Budget, the turnover threshold and the relevant FY is likely to change for the 25% tax rate.

## 7. Tax Considerations in Structuring Investments

With respect to ‘eligible start-ups’ meeting certain specified criteria, a 100% tax holiday for any 3 consecutive assessment years out of a block of 7 years beginning from the year in which such start-up was set up has been provided for.<sup>3</sup>

### Dividends and Share Buy-Back

Dividends distributed by Indian companies were previously subject to a dividend distribution tax (“DDT”) at an effective rate of 20.55% payable by the company. However, the Finance Act, 2020 abolished the DDT with effect from April 01, 2020 and reverted to a classical system of taxation of dividend / distributed income in the hands of shareholders / unit holders respectively, at the applicable marginal tax rate. Therefore, on payment of dividend there shall be a dividend withholding tax applicable on the company at the time of payment to the shareholders who can then take credit of the withheld amount while calculating his own taxes.

Further, the ITA provided that dividends declared by a domestic company and received by a ‘specified assessee’ in excess of INR 1 million, shall be chargeable to tax at the rate of 10% (on a gross basis) in the hands of the recipient (Section 115 BBDA). However, consistent with the abolition of DDT and reversion to a classical system for taxation of dividends, the Finance Act, 2020 has also put a sunset to the 10% tax on dividend income with effect from March 31, 2020; thereby deeming the provision to be redundant.

Further, to provide a level playing field to Indian shareholders of the non – resident companies, Finance Act, 2011 had introduced Section 115BBD which provided a 15% tax rate for dividends received by a domestic company from a foreign company in which the Indian company held at least 26% of the equity share capital (“**Specified Foreign Company**”). However, with abolishment of DDT, now dividend income is taxable in the hands of the shareholder only at the applicable rates. Hence, to provide parity in the tax treatment in case of dividends received by a domestic company from a Specified Foreign Company vis-a-vis dividend received from domestic companies, the Finance Act, 2022 has withdrawn the benefit of preferential tax rate under Section 115BBD with effect from April 1, 2023. Resultantly, dividends received from Specified Foreign Company shall now be taxed as per applicable tax slabs of the recipient.

Further, a domestic company would also be taxed at the rate of 21.63% (including surcharge and cess) on gains arising to shareholders from distributions made in the course of buy-back or redemption of shares if the buy-back is in accordance with companies laws in force. The buy-back of shares is exempt from taxation at the hands of the investors (i.e., the shareholders). Earlier, the buy-back tax was only applicable in case of unlisted companies. By virtue of Finance Act, 2019, buy-back tax was extended to listed companies with effect from July 5, 2019. However, the 2019 Amendment exempted from buy-back tax listed companies which made a public announcement of their buy-back plans prior to July 5, 2019.

The distribution tax is payable on the difference between consideration paid by such Indian company for the purchase of its own shares and the amount that was received by the Indian company at the time of issue of such shares, determined in the manner prescribed. The mechanism for determining the amount received by the Indian company in respect of issuance of shares, were notified by the CBDT in Rule 40BB of the Income Tax Rule, (1962), with effect from June 01, 2016.

<sup>3</sup> Section 80-IAC, Income Tax Act, 1961.

## 7. Tax Considerations in Structuring Investments

### Capital Gains

Tax on capital gains depends on the period of holding of a capital asset. In general, short term gains may arise if the asset is held for a period lesser than 3 years, and long term gains may arise if the asset is held for a period more than 3 years.

Gains from alienation of listed shares which are held for a period of more than 12 months are categorized as long term. Gains from alienation of unlisted shares and immovable property (being land or buildings or both) are treated as long term only when held for more than 24 months.

Long term capital gains earned by a non-resident on sale of unlisted securities may be taxed at the rate of 10%<sup>4</sup> (provided no benefit of indexation has been availed of) or 20% (if benefit of indexation has been availed) depending on certain considerations. Long term gains on sale of listed securities on a stock exchange used to be exempt and only subject to a securities transaction tax (“STT”). However, the Finance Act, 2018 removed this exemption and introduced a levy of 10% tax (Section 112A) on LTCG arising (on or after April 01, 2018) from the transfer of listed equity shares, units of an equity oriented mutual fund, or units of a business trust where such gains exceed INR 100,000. Short term capital gains arising from sale of listed securities (being listed equity shares or unit of an equity oriented mutual fund on the floor of the recognized stock exchange), where STT has been paid, are taxed at the rate of 15% (for both, resident and non-resident unit holders), while such gains arising to a from the sale of other listed securities are to be taxed as per the ordinary corporate tax rates applicable to the taxpayer (i.e., 40% in the case of non-resident). On the other hand, STCG from the sale of unlisted securities is taxed as per the tax rates generally applicable to the taxpayer.

Lastly, the Finance Act of 2022, in or to provide a level playing field, has capped the surcharge on tax on long term capital gains arising on transfer of any type of assets at 15%. In respect of shares of a private company, the maximum effective long-term capital gains tax rate on sale of shares for resident Indian will reduce from 28.496% to 23.92% (including surcharge and cess) and for non-residents from 14.248% to 11.96% (including surcharge and cess).

### Investments by FPIs

The RBI has notified certain caps on investments made by FPIs in the debt market.<sup>5</sup> The same were revised with effect from April 2018<sup>6</sup> (“**RBI 2018 Amendment**”) and was subsequently further relaxed by the RBI in July 2022<sup>7</sup> (“**RBI 2022 Amendment**”). Post the RBI 2018 Amendment, all future investment by FPIs in the debt market in India will be required to be made with a minimum residual maturity of one year. Moreover, the RBI 2022 Amendment brought in further clarity by stipulating that FPIs were allowed to invest in commercial papers and non-convertible debentures with an original maturity of up to one year, and during the period between July 08, 2022 and October 31, 2022 (both dates included) these investments would be exempted from the limit on short-term investments till maturity or sale of such investments.

<sup>4</sup> All tax rates mentioned in this section are exclusive of applicable surcharge and cess.

<sup>5</sup> A.P.(DIR Series) Circular No. 71, available at <http://rbi.org.in/scripts/NotificationUser.aspx?Id=9543&Mode=0>.

<sup>6</sup> A.P. (DIR Series) Circular No. 24 available at <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11266&Mode=0>.

<sup>7</sup> <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12355&Mode=0>.



## 7. Tax Considerations in Structuring Investments

Accordingly, all future investments within the limit for investment in corporate bonds, including the limits vacated when the current investment by an FPI runs off either through sale or redemption, are required to be made in corporate bonds with a minimum residual maturity of one year.

Further, FPI investments in corporate bonds were made subject to the following requirements:

- a) Investments including those by related FPIs should not exceed 50% of any issue of a corporate bond.
- b) No FPI shall have an exposure of more than 20% of its corporate bond portfolio to a single corporate (including exposure to entities related to the corporate).
- c) Moreover, the RBI 2022 Amendment stipulates that short-term investments by an FPI in government securities and corporate bonds shall not exceed 30% of the total investment of that FPI in any category. However, the RBI has clarified that investments by FPIs in government securities and corporate bonds made between July 08, 2022 and October 31, 2022 (both dates included) shall be exempted from the limit on short-term investments till maturity or sale of such investments.

However, the RBI in order to encourage a wider spectrum of investors to access the Indian corporate debt market, withdrew the 20% exposure limit in February 2019.<sup>8,9</sup> FPIs are also prevented from investing in partly paid instruments. Furthermore, FPIs are not be allowed to invest incrementally in short maturity liquid / money market mutual fund schemes. There are, however, no lock-in periods and FPIs are free to sell the securities (including those that are presently held with less than one year residual maturity) to domestic investors.<sup>10</sup> Recently, the SEBI permitted FPIs to invest in exchange traded commodities derivatives in India.<sup>11</sup>

In addition, Section 194LD of the ITA provides that interest payable to FPIs in respect of rupee denominated bonds and government securities shall be subject to a withholding tax rate of 5%. This beneficial provision has a sunset period, which by virtue of the Finance Act, 2020 was extended to interest payable before July 1, 2023. With a view to increase depth in the bond market, the transfer of rupee denominated bonds from one non-resident to another has also been exempted from capital gains tax.<sup>12</sup>

Further, Section 196D of the ITA provides that where any sum is payable to an FPI in the nature of income received in respect of securities (other than units referred to in Section 115AB) or capital gains arising from the transfer of such securities, then tax should be withheld at the rate of 20%. As the rate of withholding is specifically set out under Section 196D, a more beneficial tax rate provided under the relevant tax treaty cannot be applied. However, the Finance Act of 2021 amend this provisions to provide that tax treaty rate will be applicable to FPIs, if the FPI furnishes the tax residency certificate required under Section 90(4) or 90A(4) of the ITA.

### Indirect Transfer Provisions

India has introduced a rule to tax non-residents on the transfer of foreign securities the value of which are substantially (directly or indirectly) derived from assets situated in India. As per the ITA, shares or interests of a non-resident company are deemed to derive their value substantially from assets (tangible or intangible) located in India, if:

8 A.P. (DIR Series) Circular No.19 <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11475&Mode=0>.

9 A.P. (DIR Series) Circular No. 24 available at <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11266&Mode=0>.

10 See Sixth Bi-Monthly Monetary Policy Statement 2014-15, available at [https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/01\\_MPO09022015.pdf](https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/01_MPO09022015.pdf).

11 [https://www.sebi.gov.in/media/press-releases/jun-2022/sebi-board-meeting\\_60354.html](https://www.sebi.gov.in/media/press-releases/jun-2022/sebi-board-meeting_60354.html).

12 Section 47(viiaa), Income Tax Act, 1961.



## 7. Tax Considerations in Structuring Investments

- a) the value of the Indian assets exceeds INR 100 million; and
- b) the Indian assets represent at least 50% of the value of all the assets owned by the non-resident company.

To provide some comfort to investors, the Finance Minister in the 2014-15 budget had clarified that all cases arising from the indirect transfer rule would hence forth be scrutinized by a high level Government body. Finance Act of 2017 had built on this platform and exempted investors (direct / indirect) in Category I (sovereign funds) and Category II (broad-based funds) FPIs from the application of the indirect transfer tax provisions.<sup>13</sup> On September 23, 2019, the SEBI notified the SEBI (Foreign Portfolio Investors) Regulations, 2019 in supersession of the SEBI (Foreign Portfolio Investors) Regulations, 2014. Amongst other things, the new FPI regulations has replaced three categories with two where some entities from category III have been moved to Category II. Consequently, the Finance Act of 2020 modified the Second Proviso to Explanation 5 of Section 9(i)(i) to state that the exemption from the indirect transfer provisions continued to apply to those FPIs registered as Category I and II FPIs prior to the appeal SEBI(FPI) Regulations 2014; and introduced a Third Proviso to offer the same exemption to Category I FPIs registered under the new SEBI(FPI) Regulations 2019.

Further, the CBDT has clarified that indirect transfer tax provisions would not apply in respect of gains arising to a non-resident on account of redemption or buyback of shares or interest held indirectly in specified funds if (i) such income accrues from or in consequence of transfer of shares or securities held in India by the specified funds and (ii) such income is chargeable to tax in India. The CBDT further provided that this benefit would be applicable only in cases where the redemption or buyback proceeds arising to the non-resident does not exceed the pro-rata share of the non-resident in the total consideration realized from the transfer of shares or securities in India. Further, non-residents investing directly into the specified funds continue to be taxed as per the ITA.<sup>14</sup>

## Interests, Royalties & Fees for Technical Services

Interest earned by a non-resident may be taxed at a rate between 5 % to around 40% (exclusive of applicable surcharge and cess) depending on the nature of the debt instrument.

Royalties and fees for technical services earned by a non-resident would be subject to withholding tax at the rate of 10% and 2%<sup>15</sup> respectively (on a gross basis and exclusive of surcharge and cess).

These rates are subject to available relief under an applicable tax treaty. The scope of 'royalties' and 'fees for technical services' under Indian domestic law is much wider than what is contemplated under most tax treaties signed by India.

<sup>13</sup> Section 9(i)(i) Explanation 5, Second Proviso.

<sup>14</sup> CBDT, Circular No.28 of 2017, available at [https://www.incometaxindia.gov.in/communications/circular/circular28\\_2017.pdf](https://www.incometaxindia.gov.in/communications/circular/circular28_2017.pdf).

<sup>15</sup> In certain cases, withholding tax on royalties is also 2%.

## 7. Tax Considerations in Structuring Investments

### Withholding Taxes

Tax would have to be withheld at the applicable rate on all payments made to a non-resident, which are taxable in India. The obligation to withhold tax applies to both residents and non-residents. Withholding tax obligations also arise with respect to specific payments made to residents. Failure to withhold tax could result in interest and penal consequences.

### Wealth Tax

Pursuant to the notification of the Finance Act, 2015, the government has abolished wealth tax as the tax was proving to be a low-yield high-cost revenue measure.

### Personal Income Tax

Individuals are taxed on a progressive basis, with a maximum marginal effective rate of tax of around 40%. An individual may be treated as a resident if he resides in India for a period of at least 182 days in a specific year or 60 days in the year and 365 days in the 4 preceding years. A separate category of persons is considered to be 'resident but not ordinarily resident', with tax consequences similar to that of a non-resident. The surcharge for individuals ranges between 10% (in case the total income is below INR 5 mn – excluding income by way of dividends or capital gains) to 37% (in case the total income exceeds INR 50 mn – excluding income by way of dividends or capital gains). Further, the maximum surcharge on capital gains income chargeable under certain provisions (i.e., Section 111A, Section 112A, and Section 115AD) is restricted to 15%. From FY 2022-2023, the maximum rate of surcharge on tax payable on dividend income or long term capital gains income shall be capped at 15%. Health and Education Cess is levied at the rate of 4% on the amount of income-tax plus surcharge. India currently does not impose any estate or death taxes. Although there is no specific gift tax, certain gifts are taxable within the framework of income tax.

The Finance Act of 2021 reduced the statute of limitation for re-opening tax assessments in normal cases to three years (from the relevant AY), in order to limit prolonged uncertainty of tax proceedings. In the case of search, requisition or survey where AO has evidence to believe income has escaped assessments (exceeding INR 5mn) can be issued up till ten AYs from the relevant AY. The Finance Act of 2021 did away with the Authority Of Advanced Ruling (AAR), and replaced it with the Board for Advanced Ruling (BAR).

### Taxation of VDAs

The Finance Act, of 2022, for the purposes of taxing the transfer of crypto-assets, has introduced an elaborate regime for the taxation of 'virtual digital assets' ("VDA"), which has been defined broadly to include any information or code or number or token generated through cryptographic means or otherwise, that can be transferred, stored or traded electronically. As such, all kinds of crypto-assets (including non-fungible tokens) should fall within the definition of VDAs. The Finance Act of 2022 has introduced a blanket 30% tax on the transfer of all kinds of crypto-assets, and has disallowed taxpayers from setting off any losses or expenditure incurred for such

## 7. Tax Considerations in Structuring Investments

transfer (other than the original cost of acquisition). Additionally, a withholding tax at the rate of 1% at the time of payment or credit has also been introduced upon the payor of consideration (which shall be applicable on both parties in the case of a VDA-VDA exchange).

### Sovereign Wealth Funds and Pension Funds

In order to promote investment by certain Sovereign Wealth Funds & Pension Funds (“SWFs & PFs”), which are in the form of long term stable capital, the Finance Act, of 2020 (“FA, 2020”) exempted income of an SWF & PF that is in the nature of dividend, interest or long-term capital gains arising from an investment made by it in India in infrastructure facilities as defined under the under Section 80-IA (4) of the ITA. The aforesaid income is exempt when it is made in a company or enterprise carrying on the business of developing, or operating and maintaining, or developing, operating and maintaining any infrastructure facility. The benefit of the provision is also allowed if the SWFs & PFs made investment through Infrastructure Investment Trusts / Real Estate Investment Trust (“InvITs / REITs”) and AIFs.

#### Eligible Investors

Specified persons are eligible to avail benefits under this provision. In this context, while wholly owned subsidiaries of Abu Dhabi Investment Authority (“ADIA”), resident in UAE and making investments out of funds owned by the Government of UAE are deemed to be ‘specified person’, other SWFs are required to fulfil the following conditions to qualify for the exemption:

1. The SWF should be wholly owned and controlled, directly or indirectly, by the Government of a foreign country;
2. The SWF should be set up and regulated under the law of such foreign country;
3. The SWF’s earnings should be credited either to the account of the Government of that foreign country or to any other account designated by that Government so that no portion of the earnings inures any benefit to any private person;
4. The SWF’s assets should vest in the Government of such foreign country upon dissolution;
5. The SWF should not undertake any commercial activity whether within or outside India;
6. The SWF specified by the Government, by notification in the Official Gazette, for this purpose.

#### Time Frame for Exemption

It is important to note that as per Section 10(23FE) of the ITA, this exemption for ‘specified person’s is available for investments made between April 1, 2020, to March 31, 2024; and held for a minimum of at least three years.

#### Types of Investments

The investment may be in the form of debt or equity. Further, such investments will only be eligible for exemption in case where it is made in a company or enterprise carrying on the business of developing, operating or maintaining any infrastructure facility (as defined in explanation to Section 80-IA(4)(i) of the ITA) or as may be otherwise notified. Specifically roads, highway projects (including housing or other activities being an integral part of such highway project), water supply projects, ports, airports etc. are covered.

## 7. Tax Considerations in Structuring Investments

**Further, in order to address certain concerns on the practicality and conditionality of availing benefits, which were raised by the funds industry in 2020, the Finance Act of 2021 introduced a number of amendments:**

- Investment in AIFs: The Finance Act of 2021 (i) relaxed the condition of AIFs investing 100 percent into infrastructure facility to not less than 50 percent; and (ii) to allow AIFs to invest in InvITs. Therefore, exemption would be allowed even if the AIF into which the SWF / PF invests till such time that the AIF has invested atleast 50 percent into an infrastructure facility or in an InvIT.
- Extension of exemption to SWFs & PFs investing through a holding company: The Finance Act of 2021 extended the exemption available to SWFs & PFs in cases where the investment into infrastructure facility is made by such SWFs & PFs through a holding company. In order to avail the benefit, following are the conditions that are to be fulfilled: (i) the holding company should be a domestic Indian company; (ii) it should be set up and registered on or after April 1, 2021; (iii) 75 percent or more of its investment has been made in one or more infrastructure companies.
- Proportionate exemption in tax: Considering the above rationalisation wherein AIFs, holding company and the NBFC – IDC / IFCs do not need to invest 100 percent into infrastructure facilities, a proportionate exemption has been allowed to the SWFs & PFs investing through such entities.
- Loan or borrowings by SWFs & PFs: The Finance Act of 2021 allowed SWFs & PFs to take loans and borrowings provided that they are not used for the purpose of making investment in India. It is also proposed to provide that the condition regarding no benefit to private person and assets going to Government on dissolution would not apply to any payment made to creditor or depositor for loan taken or borrowing which have been used for purposes other than for making investment in India.
- Commercial activity: Previously, SWFs & PFs were not allowed to undertake any commercial activity whether within or outside India. The Finance Act of 2021 removed this condition and replaced it with a condition that SWFs / PFs shall not participate in day to day operations of the investee companies. It has been further clarified that appointing director and executive director for monitoring the investment would not amount to participation in day to day operations. Further, the term “investee” has been defined to mean a business trust or a company or an enterprise or an entity or a category I or II AIF or an InvIT or a domestic company or an NBFC – IFC / IDC, in which the SWF or PF, as the case may be, has made the investment, directly or indirectly, under the provisions of the ITA.

### Eligibility Condition for PF

The Finance Act of 2021 also provided an additional exemption to PFs. Under the previous provisions, a PF could take benefit of the exemption, inter-alia, if it was not liable to tax in its home jurisdiction. The Finance Act of 2021 clarified this position and stated that if the PF is liable to tax but exemption from taxation for all its income has been provided by the foreign country under whose laws it is created or established, then such PF shall also be eligible for exemption under these provisions.

### Double Tax Avoidance Treaties

India has entered into more than 100 bilateral tax treaties<sup>16</sup> for avoidance of double taxation. A taxpayer may be taxed either under domestic law provisions (i.e. under the ITA) or the applicable tax treaty to the extent it is more beneficial. A non-resident claiming treaty relief would be required to file tax returns and furnish a tax residency

<sup>16</sup> Please also refer to the Chapter 3 for implications under the Black Money Act, 2015.

## 7. Tax Considerations in Structuring Investments

certificate issued by the tax authority in its home country. The tax treaties also provide avenues for exchange of information between countries and incorporate measures to curb fiscal evasion.

India is also a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (“MLI”), in furtherance of the OECD’s Base Erosion and Profit Shifting (“BEPS”) project. The MLI is to be applied alongside existing tax treaties, modifying their application in order to implement BEPS measures. Specifically, the provisions of the MLI require the mandatory amendment of bilateral tax treaties to allow for certain minimum standards to be met. Importantly, the minimum standards include the denial of treaty benefits, if obtaining such benefits was one of the purposes of a transaction resulting in the benefit.

From a business point of view, this will create difficulties for businesses, based on the manner of its subjective application. These provisions raise the level of uncertainty when it comes to structuring business operations, and their applicability alongside the recently introduced GAAR may reduce ease of doing business due to the ambiguity on whether both provisions could potentially be applied at the same time or to the same transaction.<sup>17</sup>

The MLI entered into force on July 1, 2018, following the deposit of the instrument of ratification by a fifth country. For each country ratifying the MLI after the 5th instrument of ratification is deposited, the MLI shall come into force on the first day of the month following the expiry of three months from the date of such deposit. Accordingly, following India’s deposit of instrument of ratification on June 25, 2019, the MLI entered into force for India on October 1, 2019. The MLI will enter into effect for Indian treaties depending on the date of entry into force of the MLI for the corresponding countries and the type of taxation, i.e. withholding or otherwise.

### Anti-Avoidance

A number of specific anti-avoidance rules apply to particular scenarios or arrangements. This includes elaborate transfer pricing regulations which tax related party transactions on an arm’s length basis.

India has also introduced under its domestic law the general anti avoidance rule (“GAAR”), which provides broad powers to the tax authorities to deny a tax benefit in the context of ‘impermissible avoidance arrangements’. The GAAR has come into effect from April 1, 2017 and provides for override of tax treaties signed by India.

Further, the CBDT has clarified that general and specific anti avoidance rules can co-exist and be applied as and when necessary as per the facts of the situation. Although the CBDT has noted that anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and therefore domestic anti-avoidance rules should be applied, it has also clarified that if avoidance is sufficiently addressed by Limitation of Benefits clauses in treaties, i.e. clauses which limit treaty benefits to those persons who meet certain conditions, GAAR would not apply.<sup>18</sup>

Investments made upto March 31, 2017 are grandfathered, and the GAAR applies prospectively, i.e. to investments made after April 1, 2017.

<sup>17</sup> Our research paper on India’s MLI positions and the impact of MLI on availing treaty benefits is available at [http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/indias-mli-positions-impact-on-availing-treaty-benefits.html?no\\_cache=1&-cHash=c5ac9466416fe9925a8d70e7eac1f12b](http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/indias-mli-positions-impact-on-availing-treaty-benefits.html?no_cache=1&-cHash=c5ac9466416fe9925a8d70e7eac1f12b).

<sup>18</sup> Central Board of Direct Taxes, Circular No. 07 of 2017, dated 27th January, 2017.

## 7. Tax Considerations in Structuring Investments

### Obtaining Certainty and Risk Mitigation

Foreign investors seeking certainty on the Indian tax implications of a specific transaction or structure may seek an advance ruling. The rulings are pronounced by the Authority for Advance Rulings which is chaired by a retired Supreme Court judge. The rulings are binding on the taxpayer and tax department, and may be sought in relation to proposed or completed transactions. Statutorily, rulings have to be provided within a period of 6 months, which is aimed at substantially reducing the overall time and costs of litigation. An advance ruling may also be sought in relation to GAAR cases.

For transfer pricing matters, companies may enter into advance pricing agreements (“APAs”) which may be unilateral, bilateral or multilateral. APAs provide certainty for a period up to 5 years and the Finance Act, 2014 has provided for a 4 year look back for application of APAs. In terms of risk mitigation, care also has to be taken while drafting documents and implementing structures along with a coordinated strategy for tax compliance.

## B. Structuring Investments

Investments into India are often structured through holding companies in various jurisdictions for number of strategic and tax reasons. For instance, US investors directly investing into India may face difficulties in claiming credit of Indian capital gains tax on securities against US taxes, due to the conflict in source rules between the US and India. In such a case, the risk of double taxation may be avoided by investing through an intermediary holding company.<sup>19</sup>

While selecting a holding company jurisdiction it is necessary to consider a range of factors including political and economic stability, investment protection, corporate and legal system, availability of high quality administrative and legal support, banking facilities, tax treaty network, reputation and costs.

Over the years, a major bulk of investments into India has come from countries such as Mauritius, Singapore and Netherlands, which are developed and established financial centers that have favorable tax treaties with India. Some of the advantages offered by these treaties are highlighted in the table below:

---

<sup>19</sup> [http://dipp.nic.in/English/Publications/FDI\\_Statis-tics/2015/FDI\\_FactSheet\\_OctoberNovemberDecember2015.pdf](http://dipp.nic.in/English/Publications/FDI_Statis-tics/2015/FDI_FactSheet_OctoberNovemberDecember2015.pdf).

## 7. Tax Considerations in Structuring Investments

	Mauritius	Cyprus	Singapore	The Netherlands
<b>Capital gains Tax on Sale of Indian Securities</b>	<p>No local tax in Mauritius on capital gains.</p> <p>Mauritius residents not taxed on gains resulting from the transfer of shares in an Indian company acquired prior to April 1, 2017</p> <p>With respect to Indian shares acquired post April 1, 2017 and alienated after March 31, 2019, Mauritius residents subject to capital gains tax in India at rates applicable under Indian domestic law.</p>	<p>Cypriot residents not taxed. No local tax in Cyprus on capital gains.</p> <p>With respect to taxability in India, Cyprus residents shall not be taxed on transfer of shares acquired prior to April 1, 2017. However, they shall be subject to tax in India on transfer of Indian shares acquired post April 1, 2017.</p>	<p>No local tax in Singapore on capital gains (unless characterized as business income).</p> <p>Singapore residents not taxed on gains resulting from the transfer of shares in an Indian company acquired prior to April 1, 2017..</p> <p>With respect to Indian shares acquired post April 1, 2017 and alienated after March 31, 2019, Singapore residents subject to capital gains tax in India at tax rates applicable under Indian domestic law.</p> <p>(Please refer to section on “Investing into India: Considerations from a Singapore – India Tax Perspective”)</p>	<p>Capital gains taxable in Netherlands except in case of gains derived from shareholding of at-least 5% and subject to specified conditions (Participation Exemption).Capital gains derived by a Dutch resident from transfer of Indian shares shall not be subject to tax in India, except if:</p> <p>(i) the Dutch resident owns at least 25% shares of the Indian company, and the shares derive their value principally from immovable property located in India; and</p> <p>(ii) the Indian shares being transferred form part of at-least 10% of the capital stock of the relevant Indian entity and transfer is to an Indian resident (except in case of such a transfer in course of a corporate organization, re-organization, amalgamation, division or other similar transaction and the buyer or seller owns at-least 10% of the capital of the other).</p>
<b>Tax on Dividends</b>	<p>Non-resident recipient is taxed at the rate of 5% of gross amount of dividends (if the recipient is a beneficial owner of 10% of the company paying dividends), otherwise at 15%, as per the treaty.</p>	<p>Non-resident recipient is taxed at the rate of 10% on gross basis (if the recipient is a beneficial owner of the dividends) of gross amount of dividends as per the DTAA.</p>	<p>Non-resident recipient is taxed at the rate of 10% of gross amount of dividends (if the recipient is a beneficial owner of 25% of the company paying dividends), otherwise at 15%, as per the treaty</p>	<p>Non-resident recipient is taxed at the rate of 10% of gross amount of dividends (if the recipient is a beneficial owner of the dividends) as per the DTAA. However, please note that Netherlands had issued a directive in 2012 stating that this rate should stand reduced to 5% (if the beneficial holding of the recipient is at least 10%) on account of the Most Favoured Nation (MFN) clause in the Protocol to the India Netherlands DTAA.</p> <p>Please note that the Delhi High Court has ruled in favour of the taxpayer and granted the reduced 5% withholding rate to tax dividends; however, the CBDT recently issued a circular on February 03,2022 to retrospectively clarify that the MFN clause is inoperative in this context. As such, it must be noted that is a litigious issue. You may read more about it in our analysis on the same.<sup>20</sup></p>
<b>Withholding Tax on Outbound Interest</b>	<p>7.5% (if the recipient is a beneficial owner of the interest).</p>	<p>10% (if the recipient is a beneficial owner of the interest)</p>	<p>15% of the gross interest (if the interest is paid on a loan granted by a bank carrying on a bona fide banking business or by a similar financial institution; otherwise 15%.</p>	<p>10% (if the recipient is a beneficial owner of the interest)</p>

20 <https://www.nishithdesai.com/SectionCategory/33/Tax-Hotline/12/53/TaxHotline/5290/1.html>.

7. Tax Considerations in Structuring Investments

	Mauritius	Cyprus	Singapore	The Netherlands
<b>Withholding Tax on Outbound Royalties and Fees for Technical Services</b>	15% (for royalties), 10% for FTS	10%	10%	10%
<b>Other Comments</b>	The Global Business License 2 Category (GBC2) is being phased out and replaced with a new regime known as Authorized Company.	Cyprus economic crisis and financial situation has to be taken into consideration. Cyprus had been 'blacklisted' by India due to issues relating to exchange of information.  However, the Indian Government has in December 2016 removed Cyprus as a blacklisted jurisdiction. <sup>21</sup>	There are specific limitations under Singapore corporate law (e.g. with respect to buyback of securities).	To consider anti-abuse rules introduced in connection with certain passive holding structures.

### C. Indirect Taxation

Prior to July 1, 2017, a series of central and state taxes were levied at various stages of the production and distribution process. These included central excise duty on manufacture, central sales tax on inter-state sale, sales tax / value added tax on intra-state sale, and service tax on the rendering of services. Moreover, credit for input taxes paid was not uniformly available across central and state levies thereby leading to a cascading of taxes. With the introduction of the Goods and Services Tax (“GST”), India now has unified indirect tax system.

GST has subsumed and broadly replaced the following taxes:

#### Central Indirect Taxes

- Central Excise Duty/Value Added Tax (CENVAT)
- Additional Excise Duty
- Additional Customs Duty (CVD)
- Excise Duty levied under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955
- Special Additional Duty of Customs
- Service Tax
- Central Surcharges and Cesses so far as they relate to supply of goods and services

#### State Indirect Taxes

- State VAT / Sales Tax
- Entertainment and Amusement Tax (except when levied by local bodies)
- Central Sales Tax (levied by Centre and collected by State)
- Luxury Tax
- Octroi and Entry Tax
- Purchase Tax
- Taxes on lottery, betting and gambling
- Taxes on advertisement
- State surcharges and Cesses so far as they relate to supply of goods and services

21 85 CBDT, Circular No. 15 of 2017, available at [https://www.incometaxindia.gov.in/communications/circular/circular15\\_2017.pdf](https://www.incometaxindia.gov.in/communications/circular/circular15_2017.pdf).



## 7. Tax Considerations in Structuring Investments

### Goods and Services Tax

The GST regime is comprised of three major pillars: the Central Goods and Services Tax Act, 2017 (“CGST Act”) which provides for the taxing powers of the Central Government, individual State / Union Territory Goods and Services Tax Acts (“SGST Act” and “UTGST Act” respectively) which provide for the taxing powers of each State / Union Territory, and the Integrated Goods and Services Tax Act, 2017 (“IGST Act”), which grants exclusive rights to the Centre to tax inter-state commerce.

Under the GST regime the “supply” of goods, or services, or both, is treated as the taxable event, with different taxes applying to inter-state supply and intra-state supply. Every inter-state supply of goods or services is liable to IGST under the IGST Act, while every intra-state supply of goods or services is liable to both CGST under the CGST Act, and SGST / UTGST under the applicable SGST Act / UTGST Act. Supply is treated as either inter-state, or intra-state, depending on the location of the supplier, and the “place of supply” determined in accordance with the provisions of the IGST Act.

GST is levied at the following rates nil, 5%, 12%, 18% and 28% depending on the rate schedule applicable to the supply in question. Most goods and services (such as electrical appliances, oil, etc.) are taxed at 18%. To prevent cascading of taxes, a uniform input tax credit system is available in respect of input supplies of goods or services used or intended to be used in the provision of output supplies of goods or services or both. GST is a consumption tax and is typically passed on to the consumer of the good / service as part of the price.

As a general rule, the import of goods or services or both into India qualifies as a taxable inter-state supply chargeable to IGST, while the export of goods or services or both from India is treated as a zero-rated supply not chargeable to tax under the GST regime.

### Value Added Tax

With the introduction of the GST in India, States’ power to levy VAT has been significantly curtailed. From July 1, 2017, VAT may be levied only on the sale within a State of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption. VAT is levied on the sale of goods within a particular state and rates may vary from 0% to 15%, although there may be further variations depending on the state. VAT is a state specific levy and most states in India have introduced specific legislations for VAT. Under the VAT regime, a system of tax credits on input goods procured by the dealer is also available, to avoid the cascading effect of taxes that was prevalent under the erstwhile sales tax regime.

### CENVAT

CENVAT is a duty of excise which is levied by the Central Government on all goods that are produced or manufactured in India, marketable, movable and covered by the excise legislation.

With the introduction of the GST in India, the scope of CENVAT has been significantly limited. From July 1, 2017, CENVAT may be levied only on the production or manufacture of petroleum crude, high speed diesel, motor spirit (commonly known as petrol), natural gas, aviation turbine fuel and alcoholic liquor for human consumption.

## 7. Tax Considerations in Structuring Investments

The peak duty rate was reduced from 16% to 14% and has further been reduced to 8% from 12.36%, although there are other rates ranging upwards, or based on an ad valorem / quantity rate. The rate of CENVAT varies depending on the product description. In order to avoid the cascading effect of excise duty and double taxation, a manufacturer of excisable goods may avail of credit of duty paid on certain inputs and capital goods barring certain inputs used in the specified manufacture of certain products in accordance with the CENVAT Credit Rules. The credit can be utilized towards the duty payable on removal of the final product. The CENVAT scheme also takes into account credits with respect to any service tax paid by the manufacturer on input services received.

### Customs Duty

Customs duty is a duty that is levied on goods that are imported into India and exported from India. Customs duty is levied by the Central Government. The Customs Act, 1962 (“Customs Act”) provides for the levy and collection of duty on imports and exports, import / export procedures, prohibitions on importation and exportation of goods, penalties, offences, etc. The rates at which customs duty is levied are specified in the Customs Tariff Act, 1975.

While export duties are levied occasionally to mop up excess profitability in international prices of goods in respect of which domestic prices may be low at the given time, levy of import duties is quite wide. Prior to the introduction of GST in India, import duties were generally categorized into basic customs duty, additional customs duties, countervailing duty, safeguard duty and anti-dumping duty. With the introduction of GST, the customs framework has been significantly revamped. Import of goods is now subject to IGST at the rate prescribed for inter-state supply of the goods concerned, in addition to basic customs duty, while most other duties have been abolished, or significantly curtailed. While the standard rate of customs duty for import of goods is 28.84% (including IGST and education cess), the actual rate may vary according to the product description.

### Equalization Levy

The Finance Act 2016 introduced a new kind of tax called the equalization levy (“EL”). The EL is a 6% tax on income in excess of INR 10 million earned by non-residents from the provision of online advertising revenues in India. The EL is intended to tax revenue streams which were previously not considered taxable in India on the basis of physical-presence based permanent establishment tests.

The chapter on the equalization levy exists as a separate code in itself (and not as part of the ITA) and outlines separate provisions governing charge of tax, collection and recovery, interest and penalties, appeal, etc. Failure to deduct EL may result in a disallowance of expenditure claimed by the person making payment to the non-resident.

With effect from April 1, 2020, the scope of the EL has been expanded to cover non-resident e-commerce operators making supplies in India or having a nexus with India by imposing a 2% EL on the amount of consideration received or receivable by an ‘e-commerce operator’ from ‘e-commerce supply or services’ made or provided or facilitated by or through it:

1. to a person resident in India; or
2. to a non-resident in the following circumstances:

## 7. Tax Considerations in Structuring Investments

- sale of advertisement, which targets a customer who is resident in India or a customer who accesses the advertisement through an IP address located in India; and
- sale of data, collected from a person who is resident in India or from a person who uses an IP address located in India; or
- to a person who buys goods or services or both supplied by the ‘e-commerce operator’ using an IP address located in India.

For this purpose, the term ‘e-commerce operator’ is defined to mean “*a non-resident who owns, operates or manages digital or electronic facility for online sale of goods or online provision of services or both*”. The expression ‘e-commerce supply or services’ is defined to mean:

1. online sale of goods owned by the e-commerce operator; or
2. online provision of services provided by the e-commerce operator; or
3. online sale of goods or provision of services or both, facilitated by the e-commerce operator; or
4. any combination of activities listed in (i), (ii) or (iii) above.

The expansive language used to define ‘e-commerce operator’ and ‘e-commerce supply or services’ could potentially cover all sorts of digital transactions into India, including transactions between non-resident entities that have at best a tenuous nexus with India.

The application of the expanded EL to non-resident e-commerce operators is subject to certain *de minimis* thresholds, including a turnover threshold of INR 20 million, which is significantly higher than the INR 100,000 threshold applicable under the existing rules. If the sales, turnover, or gross receipts of the e-commerce operator from the e-commerce supply or services made or provided or facilitated is less than INR 20 million in a given financial year, the expanded EL shall not be charged. In addition to this threshold, the EL shall also not be charged in cases where: (a) the e-commerce operator making or providing or facilitating e-commerce supply or service has a PE in India and such e-commerce supply or service is effectively connected with such PE; or (b) the e-commerce supply or service is subject to a 6% EL under existing rules.

The EL has been imposed in a manner such that it does not fall into the definition of income tax or GST. Hence, tax credits are likely to be unavailable under either Double Tax Avoidance Agreements or under domestic GST laws. Moreover, the combined impact of GST and the EL could range between 25%-38%. Nevertheless, it has been proposed to expand the scope of the EL to cover more online services within its ambit.

The Finance Act of 2021 further introduced certain clarifications into the provisions of the expanded EL, which were given retrospective effect from April 1, 2020, namely:

1. Payments which are taxable as royalty or fee for technical services are not subjected to EL /Expanded EL.
2. Online sale of goods and online provision of services has been defined very widely to include the following activities, the existence of any of which would attract the EL:
  - a) acceptance of offer for sale; or
  - b) placing of purchase order; or
  - c) acceptance of the purchase order; or
  - d) payment of consideration; or

## 7. Tax Considerations in Structuring Investments

- c) supply of goods or provision of services, partly or wholly.

Expanded EL has to be paid on a gross basis henceforth and not on a net basis, which was possible earlier. For online platforms which perform the role of marketplaces or facilitators, this would mean that the EL would be applicable on the entire sum received by them (despite the goods/services provided not being theirs).

## D. TDS Obligations on E-Commerce Operators

Section 194-O of the ITA proposes to impose new withholding obligations on “e-commerce operators” from 1st April, 2020. The details of the Section are below.

- E-commerce operators are persons who own, operate or manage digital or electronic facility or platform for electronic commerce.
- E-commerce is the supply of goods or services or both, including digital products, over digital or electronic network.
- Services include fees for technical services and professional services.
- E-commerce participant means a person resident in India selling goods or providing services or both, including digital products, through digital or electronic facility or platform for electronic commerce.

The above is applicable to all platform owners e-commerce operators. In such a context, the e-commerce operator is required to withhold 1% of the gross amount of services or goods supplied through the platform. However, it is important to note that the obligation exists only in relation to Indian resident supplier of goods or services through the platform and not with respect to any goods or services facilitated by the platform from non-resident service providers or sellers.

## Human Resources

The labour sector in India is highly heterogeneous and segmented. Unlike other countries, where the economic growth has resulted in a shift from agriculture to industries, India has witnessed a shift from the agriculture and industrial sectors to the services sector. The services sector in India started to grow in the mid-1980s but accelerated in the 1990s when India initiated a series of economic reforms. Reforms in the services sector were part of the overall reform process, which led to privatization and streamlining of the approval procedures, among others. Existing studies show that liberalization and reforms have been some of the important factors contributing to the growth of the services sector in India. The rapid growth of the Indian economy in response to the improvement in the services sector is clear cut evidence of the cumulative growth of human capital in India.

Ease of doing business being the key for promotion of manufacturing and creating jobs, in 2020 the government took the bold move to consolidate, codify and reform 29 national level labour laws into 4 labour codes. The multiplicity of labour laws and overlapping provisions created significant bottlenecks and an unfavourable atmosphere for business growth. Hence, the government focused on amending the existing laws to make it less onerous and set the stage for the creation of an investment friendly environment. India has enacted four new codes on employment conditions, social security and occupational health, safety and working conditions: Industrial Relations Code, 2020; Code on Social Security, 2020; Occupational Safety, Health and Working Conditions Code, 2020; and Code on Wages, 2019. The codes consolidate, subsume and replace 29 national-level labour laws. The codes, however, are yet to be made effective. In furtherance of the labour codes, majority of the Indian states have introduced draft rules on at least 1 of the 4 labour codes.<sup>1</sup> Comments are currently being sought on the draft rules put forth by several states post which the same shall be finalized and notified.

In a move to make it easier for employers to comply with certain labour laws, the government has been making consistent efforts to reduce the compliance burden on employers. For example, number of registers that employers are required to maintain under nine national level labour laws were recently reduced from 56 to 5. Employers have also been permitted to maintain registers in electronic form so long as the integrity, serial numbers, and contents of the columns of the consolidated registers are not modified. Similarly, the number of forms and returns that employers are required to file under three national level labour laws has been reduced from 36 to 12 – thereby eliminating redundancies and duplication. In addition, several administrative and e-governance initiatives have been undertaken to generate employment and facilitate ease of doing business. These include launching an online platform for registration under five national level labour laws and providing an online facility for registration of establishments for the purpose of making social security and insurance contributions.

The advent of the COVID-19 pandemic has also witnessed a shift towards flexible working environments. The Department of Commerce, (Indian) Ministry of Commerce and Industry, has now permitted entities operating within a special economic zone to allow up to 50% of their employees (including contractual employees) to work from home or any other location outside the special economic zone.<sup>2</sup> This is a significant departure from the previous construct of a traditional workplace which was prevalent in SEZs and has been introduced to further stimulate employee productivity and versatility in the operations of the entities operating out of SEZs.

1 Available at [https://www.business-standard.com/article/economy-policy/wait-for-labour-codes-continues-even-as-most-states-publish-draft-rules-122072000528\\_1.html](https://www.business-standard.com/article/economy-policy/wait-for-labour-codes-continues-even-as-most-states-publish-draft-rules-122072000528_1.html).

2 Available at <https://egazette.nic.in/WriteReadData/2022/237284.pdf>.

8. Human Resources

## A. Employment Legislations

Employment laws in India do not stem from any single legislation. There are 44 national legislations and close to 150 state level laws governing subjects ranging from conditions of employment to social security, health, safety, welfare, trade unions, industrial and labour disputes, etc. We have set out below an overview of the key employment laws in India, several of which are in the process of being consolidated and codified into the above-mentioned 4 labour codes.

Statute	Applicability
<p><b>Factories Act, 1948</b> ("Factories Act")</p>	<p>Factories Act<sup>3</sup> is one of the earliest welfare legislations, which embodies the law relating to regulation of labour in factories. The statute prescribes, inter alia, terms of health, safety, working hours, benefits, overtime and leave.</p> <p>The statute is enforced by state governments in accordance with the state specific rules framed under the Factories Act.</p>
<p><b>Shops and Commercial Establishments Acts</b> ("S&amp;E Acts")</p>	<p>S&amp;E Acts are state specific statutes which regulate conditions of work and employment in shops, commercial establishments, residential hotels, restaurants, eating houses, theatres, places of public amusement / entertainment and other establishments located within the state.</p> <p>These statutes prescribe the minimum conditions of service and benefits for employees, including work hours, rest intervals, overtime, overtime wages, holidays, leave, termination of service, employment of children, young persons and women and other rights and obligations of an employer and employee.</p>
<p><b>Industrial Employment (Standing Orders) Act, 1946</b> ("Standing Orders Act")</p>	<p>This statute applies to factories, railways, mines, quarries and oil fields, tramway or motor, omnibus services, docks, wharves and jetties, inland steam vessels, plantations and workshops, where 100<sup>4</sup> or more persons are employed. In certain states in India, the applicability of the Standing Orders Act<sup>5</sup> has been extended to shops and commercial establishments as well.</p> <p>The statute mandates every employer of an establishment to whom the law applies to lay down clear and precise terms and conditions of service which is to be certified by the concerned labour department and thereafter enacted.</p>
<p><b>Contract Labour (Regulation and Abolition) Act, 1970</b> ("CLRA")</p>	<p>CLRA<sup>6</sup> applies to:</p> <ul style="list-style-type: none"> <li>▪ all establishments employing 20<sup>7</sup> or more persons or that have employed 20 or more persons (50 in some states such as Maharashtra &amp; Haryana) on any day of the preceding 12 months.</li> <li>▪ contractors employing or have employed 20 or more workmen on any day of the preceding 12 months (50 in some states including Maharashtra &amp; Haryana).</li> </ul> <p>The statute does not govern establishments where work of a casual or intermittent nature is carried out. It regulates the conditions of employment of contract labour, the duties of a contractor and principal employer and provides for abolition of contract labour in certain circumstances.</p>

3 This law has been replaced by the Code on Safety, Health and Working Conditions, 2020, which is yet to be made effective.

4 Subject to state specific amendments.

5 This law has been replaced by the Code on Industrial Relations, 2020, which is yet to be made effective.

6 This law has been replaced by the Code on Safety, Health and Working Conditions, 2020, which is yet to be made effective.

7 Subject to state specific amendments.

8. Human Resources

Statute	Applicability
<p><b>Maternity Benefit Act, 1961</b> ("Maternity Benefit Act")</p>	<p>Maternity Benefit Act<sup>8</sup> is applicable to:</p> <ul style="list-style-type: none"> <li>▪ all shops and establishments in which 10 or more persons are employed; and</li> <li>▪ factories, mines, plantations and circus.</li> </ul> <p>It prescribes conditions of employment for women employees,<sup>9</sup> before and after childbirth and also provides for maternity benefits and other benefits including benefits for adopting and commissioning mothers.</p>
<p><b>Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013</b> ("POSH Act")</p>	<p>The POSH Act aims at providing women, protection against sexual harassment at workplace and prescribes detailed guidelines for employers and employees for the prevention and redressal of complaints of sexual harassment. The statute applies to the organized and unorganized sector including government bodies, private and public sector organisations, non-governmental organisations, organisations carrying on commercial, vocational, educational, entertainment, industrial, financial activities, hospitals and nursing homes, educational and sports institutions and stadiums used for training individuals. For the purpose of the statute, the term 'workplace' is also interpreted to include all places visited by an employee during the course of employment or for reasons arising out of employment. The statute also mandates employers to constitute an internal committee to investigate into complaints of sexual harassment occurring at workplace of an establishment employing 10 or more employees.</p>
<p><b>Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996</b> ("BOCW Act")</p>	<p>BOCW Act applies to establishments employing 10 or more building workers in any building/ construction work and regulates the conditions of employment and service of the workers and imposes obligations on the employer, with respect to health, safety and welfare of the construction workers.</p>
<p><b>Minimum Wages Act, 1948</b> ("Minimum Wages Act")</p>	<p>Minimum Wages Act<sup>10</sup> provides for the fixing and revising of minimum wages by the respective state governments.<sup>11</sup> State governments periodically prescribe and revise the minimum wage rates for both the organized and unorganized sectors.</p>
<p><b>Payment of Wages Act, 1936</b> ("Payment of Wages Act")</p>	<p>Payment of Wages Act<sup>12</sup> regulates conditions of payment of wages. The statute applies to all employees whose basic salary is less than INR 24,000 per month and who are engaged in factories, railways, tramways, motor transport services, docks, wharves, jetty, inland vessels, mines, quarries and oil fields, workshops, establishments involved in construction work and other establishments as notified by the appropriate state governments.</p>
<p><b>Equal Remuneration Act, 1976</b> ("Remuneration Act")</p>	<p>Remuneration Act<sup>13</sup> applies to all factories, mines, plantations, ports, railways companies and shops and establishments. The statute provides for the payment of equal remuneration to men and women workers for the same work / work of a similar nature and prohibits discrimination on grounds of sex against women, in matters of employment.</p>

8 This law has been replaced by the Code on Social Security, 2020, which is yet to be made effective.

9 One of the important labour law reform in recent times is the enhancement of maternity benefits under the Maternity Benefit Act.

10 This law has been replaced by the Code on Wages, 2019, which is yet to be made effective.

11 Recently, there have been significant hikes in minimum wage rates in states such as Delhi and Karnataka.

12 This law has been replaced by the Code on Wages, 2019, which is yet to be made effective.

13 This law has been replaced by the Code on Wages, 2019, which is yet to be made effective.

8. Human Resources

Statute	Applicability
<b>Payment of Bonus Act, 1965</b> ("Bonus Act")	Bonus Act <sup>14</sup> applies to every factory and establishment in which 20 or more persons are employed on any day during an accounting year. It further provides for the payment of bonuses under certain defined circumstances, thereby enabling the employees to share the profits earned by the establishment. <sup>15</sup>
<b>The Payment of Gratuity Act, 1972</b> ("Gratuity Act")	The Gratuity Act <sup>16</sup> is applicable to every factory, mine, oil field, plantation, port, railway company, shop and commercial establishment where 10 or more persons are employed or were employed on any day of the preceding 12 months.  Employees are entitled to receive gratuity <sup>17</sup> upon cessation of employment, irrespective of the mode of cessation.  An employee is eligible to receive gratuity only in cases where he has completed a 'continuous service' of at least 5 years (interpreted to mean 4 years and 190 days) at the time of employment cessation.
<b>Employees' Provident Funds and Miscellaneous Provisions Act, 1952</b> ("EPF Act")	EPF Act <sup>18</sup> is one of India's most important social security legislations which provides for the institution of provident funds, pension fund and deposit-linked insurance fund for employees in factories and other prescribed establishments.  The statute envisages a contributory social security mechanism and applies to establishments having at least 20 employees. An employee whose basic salary is less than INR 15,000 per month, <sup>19</sup> or who has an existing provident fund membership based on previous employment arrangement is eligible for benefits under the EPF Act.
<b>Employees' State Insurance Act, 1948</b> ("ESI Act")	ESI Act <sup>20</sup> applies to all factories, industrial and commercial establishments, hotels, restaurants, cinemas and shops. Only employees drawing wages below INR 21,000 per month are eligible for benefits under this statute. The statute provides for benefits in cases of sickness, maternity and employment injury and certain other related matters.
<b>The Apprentices Act, 1961</b> ("Apprentices Act")	Apprentices Act provides for the regulation and control of training of technically qualified persons under defined conditions.
<b>The Rights of Persons with Disabilities Act, 2016</b> ("RPWDA")	The RPWDA prohibits workplace discrimination on grounds of disability and applies to both the private as well as public sector. Under the RPWDA, every employer is <i>inter alia</i> required to frame and publish an equal opportunity policy and identify posts/vacancies for disabled persons.

14 Id.

15 The Bonus Act was amended on Jan 01, 2016, inter alia revising the wage threshold for applicability of the statute from INR 10,000 to INR 21,000 per month.

16 This law has been replaced by the Code on Social Security, 2020, which is yet to be made effective.

17 Recently, the Government has doubled the gratuity limit to INR 20,00,000 from the previous limit of INR 10,00,000.

18 This law has been replaced by the Code on Social Security, 2020, which is yet to be made effective.

19 The wage ceiling for mandatory subscription under the EPF Act has been increased from INR 6,500 per month to INR 15,000 per month by way of the Employees' Provident Fund (Amendment) Scheme, 2014. The wage ceiling is not applicable to employees who fall within the category of 'international workers' as defined under the EPF Act. Further, the minimum pension payable under the Employees' Pension Scheme, 1995 has been fixed as INR 1,000.

20 This law has been replaced by the Code on Social Security, 2020, which is yet to be made effective.



8. Human Resources

Statute	Applicability
<p><b>Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959</b>                      (“EECNV ACT”)</p>	<p>EECNV Act is applicable to establishments in the public and private sector, having a minimum of 25 employees.</p> <p>The statute mandates the compulsory notification of vacancies (other than vacancies in unskilled categories, vacancies of temporary duration and vacancies proposed to be filled by promotion); to employment exchanges in order to ensure equal opportunity for all employment seekers.</p>
<p><b>Child and Adolescent Labour (Prohibition and Regulation) Act, 1986</b>                      (“Child Labour Act”)</p>	<p>Child Labour Act prohibits the engagement of children (below the age of 14) in certain employments (the Schedule to the Child Labour Act lays down prohibited occupations); and regulates the conditions of work of children and adolescents (aged between 14-18) years in certain other employments where they are not prohibited from working.</p>
<p><b>Industrial Disputes Act, 1947</b>                      (“ID Act”)</p>	<p>ID Act,<sup>21</sup> one of India’s most important labour legislations, prescribes and governs the mechanism of collective bargaining and dispute resolution between employers and employees. The statute contains provisions with respect to; inter alia, unfair labour practices, strikes, lock-outs, lay-offs, retrenchment, transfer of undertaking and closure of business.</p>
<p><b>Trade Unions Act, 1926</b>                      (“Trade Unions’ Act”)</p>	<p>Trade Unions Act,<sup>22</sup> one of India’s most important labour legislations, prescribes and governs the mechanism of collective bargaining and dispute resolution between employers and employees. The statute contains provisions with respect to; inter alia, unfair labour practices, strikes, lock-outs, lay-offs, retrenchment, transfer of undertaking and closure of business.</p>

*\* The list of employment laws is not exhaustive and does not reflect labour laws specific to certain industries and/or activities. The list also does not provide the details of compliances to be undertaken by the employer for each applicable labour law. Further, the applicability of each labour law (for the employer as well as its employees) needs to be determined based on various aspects including (i) the exact nature of activities/work performed, (ii) nature of establishment, (iii) number of employees, (iv) role and responsibilities of the employees, (v) salary / compensation, (vi) duration of employment, etc. For example, the ID Act, one of India’s most important laws governing industrial relations in India, applies only to individuals falling within the category of ‘workmen’ and specifically excludes persons who are employed in a managerial or administrative capacity, or a supervisor who draws a monthly salary exceeding INR 10,000.<sup>10 238</sup> There are also specific legislations governing terms and conditions of employment of individuals working in factories (Factories Act), commercial establishments (S & E Acts), mines (Mines Act, 1952), plantation workers (Plantations Labour Act, 1951), etc. Finally, it must be noted that under certain circumstances, Indian states have the right to amend the labour laws enacted by the central (federal) government and accordingly it is important to check for any state-specific amendments that may be relevant to a central (federal) labour law.*

## B. Employment Documentation

While there is no particular requirement under the central labour statutes to have written employment contracts, certain state specific S & E Acts such as the Karnataka Shops & Commercial Establishments Act, 1961, require an employer to issue an ‘appointment order’ to employees, within thirty days from the date of appointment. It is however recommended that the terms and conditions of employment, remuneration and

21 This law has been replaced by the Code on Industrial Relations, 2020, which is yet to be made effective.

22 This law has been replaced by the Code on Industrial Relations, 2020, which is yet to be made effective.

23 The salary threshold has been changed under the Code on Industrial Relations, 2020 to INR 15,000 per month.

## 8. Human Resources

benefits be clearly documented in order to ensure that the rights of both parties are adequately documented. Documents that are typically executed with an employee at the time of commencement of employment include (i) offer letter; (ii) employment agreement; (iii) non-disclosure and confidentiality agreement; (iv) Intellectual property and inventions assignment agreement; (v) training bonds, etc.

### Employment Agreements

In India, it is a general practice that employers issue offer letters to employees at the time of appointment. This document briefly outlines the terms and conditions of employment including probationary period, remuneration and other documents required to be produced at the time of joining. While many employers prefer to limit the employment documentation with an offer letter, it is recommended that employers execute detailed employment contracts outlining all terms and conditions of employment. While drafting the offer letter and employment agreements it is critical for employers to ensure that the applicable employment laws are being complied with.

Although there is no prescribed format for an employment contract, some of the commonly found and preferred clauses in such contracts include:

- Term of employment
- Designation, probation period, transfer etc.;
- Remuneration and benefits;
- Duties and responsibilities of the employee;
- Work location / remote work
- Conflict of interest;
- Confidentiality and non-disclosure;
- Intellectual property and assignment;
- Termination of employment
- Non-compete and non-solicitation obligations;
- Governing law and jurisdiction; and
- Dispute resolution

### Confidentiality & Non-Disclosure Agreement

A non-disclosure agreement (“**NDA**”) is an agreement in which one party agrees to give the second party confidential information about its business or products, and the second party agrees not to share this information with anyone else for a specified period of time. Some common clauses in NDA’s include:

- definition of ‘confidential information’ and exclusions thereof;
- term, if any, for keeping the information confidential.
- provisions regarding obligations on the use / disclosure of confidential information includes:

## 8. Human Resources

- use information only for restricted purposes;
- disclose it only to persons with a ‘need to know’ the information for specified purposes;
- adhere to a standard of care relating to confidential information;
- ensure that anyone to whom the information is disclosed further abides by the recipient’s obligations.

### Non-Compete & Non-Solicit Agreements

Employers may choose to enter into non-competition and non-solicitation agreements with their employees. Alternately, these obligations may be included in the employment agreement. While non-compete clauses during the term of employment are generally enforceable in India,<sup>24</sup> a post-termination non-compete clause is not enforceable since they are viewed to be in ‘restraint of trade or business’ under Section 27 of the Indian Contract Act, 1872 (“**Contract Act**”). Courts in India have time and again reiterated that a contract containing a clause restricting an employee’s right to seek employment and/or to do business in the same field beyond the term of employment is unenforceable, void and against public policy.<sup>25</sup> An employee cannot be confronted with a situation where he has to either work for the present employer or be forced to idleness. Though the stance of Indian courts on the question of restraint on trade is clear, such clauses are commonly included in the terms of employment for their deterrent effect. With respect to non-hire restrictions, courts have viewed the arrangement as an extension of a post-termination non-compete clause and therefore unenforceable.

The trend of incorporating restrictions on solicitation of employees, customers or clients during or after the term of employment has become common in recent times, especially with the increasing usage of social media and professional networking sites. A non-solicit clause is essentially a restriction on the employees from directly / indirectly soliciting or enticing an employee, customer or client to terminate his contract or relationship with the company or to accept any contract or other arrangement with any other person or organization. In determining the enforceability of a non-solicit clause, the courts have generally taken the view that such clauses shall be enforceable, unless it appears on the face of it to be unconscionable, excessively harsh or one-sided.<sup>26</sup>

### HR Policy / Employee Handbook

Except for certain labor laws that specifically require employers to frame certain policies (e.g. anti-sexual harassment policy as per the POSH Act) generally speaking, it is not mandatory for an employer to frame employee policies. However, it is recommended that all employers clearly set out the various policies and procedures applicable to employees and circulate such policies to employees periodically. Many subjects covered in a company’s employee handbook are governed by laws which may be specific to the state in which the workplace is located. Hence it is recommended that the employee handbook be drafted in accordance with the state specific applicable laws as well.

<sup>24</sup> Wipro Limited v. Beckman Coulter International S.A; 2006(3) ARBLR118(Delhi).

<sup>25</sup> Pepsi Foods Ltd. and Ors. v. Bharat Coca-Cola Holdings Pvt. Ltd. and Ors. 81(1991) DLT 122; Wipro Ltd. v. Beckman Coulter International S.A 2006(3) ARBLR118 (Delhi).

<sup>26</sup> Wipro Limited v. Beckman Coulter International S.A; 2006(3) ARBLR118(Delhi).

## 8. Human Resources

The general provisions incorporated in an employee handbook include (but not limited to):

- Employee benefits;
- Leave policies including paid leave, casual leave, sick leave, maternity leave (and other maternity benefits) etc.;
- Compensation policies;
- Code of conduct and behaviour policies;
- Anti-discrimination and sexual harassment policies;
- Immigration law policies;
- Complaint procedures and resolution of internal disputes;
- Internet, email and computer use policies;
- Conflict of interest policy;
- Equal opportunity policy;
- Privacy policy
- Anti-drugs, smoking and alcohol policy;
- Accident and emergency policies;
- Travel and expense policy;
- Whistleblower policy;
- Prohibition from insider trading.

## Stock Options

Employee stock option plans (“ESOPs”) are designed to give an employee participation in the equity of the company. ESOPs may be granted upon the joining of a company or thereafter, and shall continue to be an important tool for attracting and retaining talent. This is a popular strategy adopted by companies at large, who may not be able to afford larger or more competitive compensation packages. However, it is necessary that all companies comply with the necessary regulatory requirements under applicable laws in framing their stock option plans.

## C. Recruitment and Salary Benchmarking

Recruitment, or hiring, is a core process of the HR function in organizations. It is a series of steps: attracting and identifying the right talent, screening and interviewing, shortlisting, and finally selecting the candidate by making an offer of employment.

Organizations with huge growth plans and recruitment needs usually have a dedicated recruitment team catering to the talent needs. Few other corporates choose to outsource their hiring function. Organizations depend on advertisements, job boards, and social media channels to broadcast their hiring needs and attract talent from across industries. Investments are also being made in technology-driven platforms and tools to improve the efficiency and operating cost of the process.

## 8. Human Resources

Employers with a great brand value are able to attract qualified candidates, encouraging maximum possible number of job seekers to apply. This makes it possible to build a large pool of talented players in a tight job market and minimizes the time involved in finding candidates and filling roles for the present and future requirements of the company.

A well-planned and thoughtfully crafted recruitment process helps the hiring team filter the right candidates faster while staying focused on engaging the eligible candidates for maximum conversions. The recruitment process not only reflects the company's professionalism but also helps attract the right kind of candidates while saving the time and money spent on identifying, attracting, engaging, recruiting and retaining talent.

Every organization must have a good understanding of their competitive position in the market to be able to devise an effective talent strategy. Salary benchmarking, which is a comparator study of similar roles in the market and their overall compensation and other allowable benefits, can provide such an understanding to an organization. When pricing a new position, the first step is to document the key attributes of the positions to be priced—this is the job description.

Equally important is sourcing the data necessary to conduct an accurate market assessment and salary comparison. Compensation data comes in a variety of flavors, including survey data, HR-reported aggregate market data, and even employee-reported data, and it is imperative to align the type of data that is the best fit for the business — and for the position in consideration. When pricing for a highly specialized position or a hot-skill job in the market, there may be supplemental data sources required for reference to achieve an accurate assessment of the true price of the job.

This market intelligence data feeds directly into the organization's pay structures, making it possible to maintain externally competitive and internally equitable pay scales. Salary benchmarking is, therefore, an advantageous tool to craft a recruitment process that effectively attracts fresh talent and retains existing talent.

### D. Onboarding

Onboarding is the journey of systematic and purposeful conversion of a potential hire to a productive employee. Studies suggest that well-structured onboarding programs can enhance performance significantly and improve employee retention.

Employee onboarding is broadly defined as the process of familiarizing a new hire with the policies, the employee's role in the organization, and an understanding of the philosophy and the core values dictating the organizational culture. It also involves providing an environment in which the employee is made comfortable enough to interact freely with colleagues and establish social relationships in the workplace.

During the onboarding process, employees are thoroughly introduced to their department. They learn the culture and business objectives by participating in meetings and starter projects with co-workers. Managers plan and schedule regular check-in meetings with new employees so that they get comfortable talking to one another. Gradually, the new employees learn the specifics of the role and responsibilities, such as how to properly complete key tasks, who to go to with questions, how to get approval for work, and how to make suggestions.

An onboarding plan focuses on what matters most to each department with the goal of helping new employees make connections between company-wide goals and their day-to-day tasks. A sound onboarding program is all about setting a new hire up for success by providing the tools, resources, and guidance needed to perform the job well.

## 8. Human Resources

### Orientation

The onboarding process begins with an orientation, at which point the employee completes the necessary paperwork for labour law compliances. During orientation, the employee learns about the mission and vision and what the organization expects from them in terms of skills, communication style, and attitude. New hires are also provided with relevant guidance around safety, health, and conduct at the workplace. The benefits and entitlements provided by the organization are also shared as part of this process.

The orientation includes a guided tour of relevant areas of the business for necessary demonstrations, review of administrative procedures and procurement of laptops, mobiles, passwords, and affiliated resources. While an orientation agenda can be boiled down to a checklist of activities as enunciated above, onboarding is a more strategic plan.

## E. Employee Management

An employee management system encapsulates a systemic workflow of processes to enable and equip employees to be productive and stay engaged. Employees are assets in people-centric businesses so management of these assets is a task of tall order for all organizations to invest in.

### Clear Expectation-Setting

This is the very first step for all managers to invest in. Clear guidelines should be shared with employees in terms of the broader organizational goals and how individual contributions work toward them. It is important to set clarity on work hours, conditions, culture of the organization, protocols, etc. so as to ensure that employees are sure-footed in all endeavors.

### Open Communication Channels

Leaders need to foster a culture of open communication. This includes periodic updates on the organization's performance in the market, competitive position, and the vision held by organizational leaders. Fairness and transparency are key to any internal messaging to the staff. This will help build a shared understanding of the goals of the organization. However, one-way communication will continue to be limiting for employees; every staff member has an opinion and may like the opportunity to have his or her voice heard and be respected. A two-way communication channel is instrumental in building trust among employees.

### Employee Development

This factor is directly proportional to employee engagement. When organizations invest in employee growth and career development, employees generally express a sense of commitment for their roles. Employee development does not cease with skill-building initiatives only. It is also a function of counselling, mentoring, and performance feedback that individuals receive from managers from time to time. Employees feel empowered when assigned new tasks or a new role to develop skills on the job and are equipped with all the necessary resources for learning and growth.

## 8. Human Resources

### Reward and Recognition

Employees value genuine and specific recognition from managers, senior management, and coworkers. This recognition encourages confidence in job roles, which increases productivity and motivation in turn.

## F. Payroll

Payroll processing is a critical function impacting employees as it relates to the remuneration received at the end of a pay period. Payroll processing typically includes gathering employee time information for a selected time period, managing benefits and deductions, and distributing employee pay for that time period. Most companies use either a payroll software system or a third-party payroll processing service.

Payroll involves numerous activities among multiple teams so the payroll staff needs to be on top of their game every single day monitoring the employee count, changes to statutory policies, new deduction rules, and more. When it comes to payroll, paying employees is the number one task, but filing payroll taxes is an extremely important measure that must be accurate and on time, or an employer can incur expensive penalties. Establishing a solid payroll process helps employers avoid penalties for flouting statutory laws or policies (minimum wage, unpaid leave time, etc).

### Business Profile

Ensure the company has a valid, registered business number associated with the company's PAN and TAN. Payroll forms rely on registered numbers to send tax forms, payslips, and more.

### Location

It is important to define a policy for each region, including region-specific statutes applicable (professional tax, income tax, leave, etc).

### Leave Policy

Every employee is entitled to leave in various categories such as sick leave, casual leave, and annual or privilege leave, as per applicable laws. Setting a leave policy is of paramount importance to consider the carry forward and other implications when calculating paychecks.

### Attendance System

Biometric devices and timesheets help to gather employee attendance data for regular hours, shift hours, half-day permissions, and on-duty requests. Integration of biometric devices to capture attendance/shift data that syncs with payroll is an efficient way to capture inputs.

### Statutory Component

Adherence to Indian payroll laws is necessary to keep organizations compliant by alignment with statutory components including PF, LWF, ESI, PT, IT, etc.

## 8. Human Resources

### Payday

It is important to decide and communicate the payday and pay schedule so that employees can plan their finances accordingly. The wage period should be as per applicable laws.

### Employee Information

Details like designation, department, date of joining, salary components, reimbursements, etc. are all critical inputs at the start of a payroll cycle.

## G. Performance Management

Performance Management is a business discipline that exists to ensure that employee performance is aligned with organizational goals and that the employees are delivering on these goals. In practice, performance management is accumulation of practices consistently implemented to establish clear goals, offer consistent feedback, and help improve employee capabilities throughout the period.

Performance Management has a supplemental role in many organizational processes, such as:

### Goal Alignment

Helps employees to understand how their role and individual contributions fit into the bigger picture, leading to the overall achievement of the company's goals. This understanding keeps them focused and ensures that their work offers real value to the business.

### Employee Development

Performance management ensures that employees are continuously developing their skills and capabilities along with the changing needs of the business landscape. By constantly supplying employees with opportunities to grow, companies can build a strong workforce that is capable of achieving organizational goals.

### Retention and Growth

When there is significant time and effort invested to develop employees professionally, support to help them succeed with their goals, and consistent rewards for stellar performance, employees are more incentivized to stay with the company and to work harder. Consistent focus on employee performance also helps nurture leaders from within the organization. The natural outcome of this is business and revenue growth for the company.

## H. Offboarding

Employee offboarding is the series of steps that are initiated by organizations when an employee chooses to resign from the services of the organization or when his/her employment is terminated by the employer. Offboarding done right helps organizations send out goodwill ambassadors to the talent market, who will inspire new talent to join the organization.

An employee exit is a valuable opportunity to gain insights on the organizational practices, policies, leadership influence and impact, etc. Exiting employees are often open to sharing their honest opinion and feedback on their experience in the organization.



## 8. Human Resources

The most crucial aspect of a good employee offboarding process is to treat employees warmly, regardless of the reason behind departure. It is important to celebrate achievements and recognize the exiting employee's feel efforts. Proving exiting employees with a good letter of reference is a good gesture to acknowledge the individual's contributions.

### Handover

Employee offboarding has several aspects of handover. It is the manager's responsibility to ensure the exiting employee is able to perform a detailed handover of duties and responsibilities as well as a knowledge transfer to an assigned team member. There is also a handover of IT assets that the employee would be entitled to. It is critical to ensure all the documentation is complete prior to employee exit to ensure there is no scope of misuse of organizational resources or sensitive data in the custody of the exiting employee (such as email access, passwords, etc).

### Alumni Circle

Many organizations have also set up alumni circles, holding periodic meetings to make an open allowance to past employees to come forward and share updates. This is a great way to attract performers from the past to consider rejoining.

# Intellectual Property

With the advent of the knowledge and information technology era, intellectual capital has gained substantial importance. Consequently, Intellectual Property (“IP”) and the rights (“**Intellectual Property Rights**” or “**IPR**”) attached thereto have become precious commodities and are being fiercely protected. Keeping in line with the world, India also has well established statutory, administrative, and judicial frameworks for safeguarding IP and IPRs. It is pertinent to mention that India has complied with its obligations under the Agreement on Trade Related Intellectual Property Rights (“**TRIPS**”) by enacting the necessary statutes and amending its existing statutes.

Well-known international trademarks have been afforded protection in India in the past by the Indian courts despite the fact that these trademarks were not registered in India. Computer databases and software programs have been protected under the copyright laws in India, thereby allowing software companies to successfully curtail piracy through police and judicial intervention. Although trade secrets and know-how are not protected by any specific statutory law in India, they are protected under the common law and through contractual obligations.

## A. International Conventions and Treaties

India is a signatory to the following international conventions and treaties:

Convention	Date
<b>Berne Convention</b>	April 1, 1928 (Party to convention)
<b>Rome Convention for the Protection of Performers, Producers of Phonographs and Broadcasting Organization</b>	October 26, 1961 (Signature)
<b>Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms</b>	October 29, 1971 (Signature)
<b>Universal Copyright Convention</b>	January 7, 1988 (Ratification)
<b>Washington Treaty on Intellectual Property in Respect of Integrated Circuits</b>	May 25, 1990 (Signature)
<b>Paris Convention</b>	December 7, 1998 (Entry into force)
<b>Convention on Biological Diversity</b>	June 5, 1992 (Signature and ratification)
<b>Patent Cooperation Treaty</b>	December 7, 1998 (Entry into force)
<b>Budapest Treaty on the International Recognition of Microorganisms for the Purposes of Patent Procedure 1977</b>	December 17, 2001 (Party to treaty)
<b>Madrid Protocol</b>	July 8, 2013 (Member to treaty)

## 9. Intellectual Property

By virtue of membership to these multi-lateral conventions and treaties applications for the registration of trademarks, patents, and designs are accepted with the priority date claim; and copyright infringement suits can be instituted in India based on copyright created in the convention countries.

### B. Patents

Patent rights protect workable ideas or creations known as inventions. A patent is a statutory right to exclude others, from making, using, selling, and importing a patented product or process without the consent of the patentee, for a limited period of time. Such rights are granted in exchange of full disclosure of an inventor's invention.

The term "invention" is defined under Section 2(i)(j) of the Patents Act, 1970 ("**Patents Act**") as "a new product or process involving an inventive step and capable of industrial application." Thus, if the invention fulfills the requirements of novelty, non-obviousness (inventive step), and industrial application then it would be considered a patentable invention.

There are certain innovations that are specifically excluded from patentability even if they meet the criteria of an invention as defined under Section 2(i)(j) of the Patents Act. These inventions are listed in Section 3 and Section 4 of the Patents Act. India grants patent rights on a first-to-apply basis. The application can be made by either (i) the inventor or (ii) the assignee or legal representative of the inventor.

Any person who is resident of India cannot first file for a patent application outside India unless a specific permission has been obtained from the patent office. However, a person resident in India can file a patent application outside India after 6 weeks of date of filing the patent application in India. This rule does not apply in relation to an invention for which a patent application has first been filed in a country outside India by a person resident outside India.

The inventor, in order to obtain registration of a patent, has to file an electronic application with the Patent Office in the prescribed form along with the necessary documents as required. A patent application usually contains the following documents:

1. an Application Form in Form 1,
2. a Provisional or Complete Specification in Form 2,
3. a Declaration as to Inventorship in Form 5,
4. Abstracts,
5. Drawings, if any
6. Claims, and
7. a Power of Attorney in Form 26, if a patent agent is appointed.

## 9. Intellectual Property

Once the patent application has been filed, it gets published in the patent office journal. The patent application is examined by the patent office when a request for examination has been filed by the patent applicant. The patent office examines the patent application and issues an office action with procedural and substantive objections. As per the Patent (Amendment) Rules, 2016, an application for expedited examination may also be filed by the following types of applicants:

- a) a Patent Co-operation Treaty (“**PCT**”) applicant nominating the International Patent Office (“**IPO**”) as its International Searching Authority or as an International Preliminary Examining Authority in the corresponding international application; or
- b) a startup;
- c) a small entity;
- d) a female applicant or in case where more than one natural persons are applicants, at least one of the applicants is female;
- e) applicant for an application which pertains to a sector which is notified by the Central Government for expedited examination; and
- f) an applicant who is eligible to apply for expedited examination under an arrangement for processing a patent application pursuant to an agreement between Indian Patent Office and a foreign Patent Office.

A response to the office action has to be filed by the applicant and, subject to the satisfaction of the responses, the patent may be granted or refused by the patent office.

Patent rights are territorial in nature. Therefore, once a patent is granted, it gives the inventor the exclusive right to exclude third parties from making, using, selling in India, and importing to India, a patented product or process without the consent of the patentee. In the event someone uses a patented invention without the permission or consent of the patent owner, then the same would amount to patent infringement and the owner of the patent can approach the court of law for obtaining remedies not limited to injunctions, damages, etc. For infringement of a patent, only civil remedies are available.

In order to claim damages in a patent infringement suit, it is important to note that the product should be marked with the word “patent” or “patented” and should specify the patent number through which the patent protection is being claimed. Failure to do so can result in the defendant in the patent infringement suit claiming that he was not aware and had no reasonable grounds for believing that the patent existed.

Section 107A in the Patents Act, incorporates Bolar provision and provision for parallel imports. Bolar provision allows manufacturers to begin the research and development process in time to ensure that affordable equivalent generic medicines can be brought to market immediately upon the expiry of the patent without any threat of patent infringement by the patentee.

Under the parallel imports exception, a product, though patented in India, can be imported (without the consent of the patentee) from a person authorized to sell such a product, and such an act of importation would not amount to patent infringement. It is mandatory under the Indian patent law to file a statement (Form 27) as to the extent of commercial working in the Indian Territory of a patent granted by the Indian Patent Office.

The statement embodied in Form 27 of the Patents Rules, 2003 (“**Patent Rules**”) is required to be filed in respect of every financial year within 6 months of the end of each financial year (i.e. before September 30 of every year). Non-compliance with this requirement may invite penalty of imprisonment which may extend to 6 months, or with fine, or with both, as provided under Section 122(1) (b) of the Patents Act.

## 9. Intellectual Property

Upon an application made by any person interested, the Controller of Patents (“**Controller**”) may grant a compulsory license at any time after 3 years of the grant of a patent on the grounds that the reasonable requirements of the public with respect to the patented inventions have not been satisfied, or the patented invention is not available to the public at reasonably affordable prices, or the invention is not exploited commercially to the fullest extent within the territory of India.

### C. Copyrights

Copyright Act, 1957 (“**Copyright Act**”), supported by the Copyright Rules, 2013 (“**Copyright Rules**”), is the law governing copyright protection in India. Copyright Act provides that a copyright subsists in an original literary, dramatic, musical or artistic work, cinematograph films, and sound recordings.

A copyright grants protection to the author / owner of the work to certain works and prevents such works from being copied or reproduced without his/her consent. The rights granted under the Copyright Act to a creator include the right to stop or authorize any third party from reproducing the work, using the work for a public performance, make copies / recordings of the work, broadcast it in various forms and translate the work to other languages. The term of copyright in India is, in most cases, the lifetime of the creator plus 60 years thereafter.

Under Indian law, registration is not a prerequisite for acquiring a copyright in a work. A copyright in a work is vested when the work is created and given a material form, provided it is original. Unlike the US law, under Indian law, registration does not confer any special rights or privileges with respect to the registered copyrighted work. India is also a member to the Berne and Universal Copyright Convention, which protect copyrights beyond the territorial boundaries of a nation. Further, any work first published in any country which is a member of any of the above conventions is granted the same treatment as if it was first published in India.

As mandated by Section 19 of the Copyright Act, no assignment of copyright shall be valid unless such assignment is in writing and signed by the assignor and the assignee. Such assignment ought to identify:

- the work and the rights assigned,
- the territorial extent, and
- the duration of the assignment

Where, the territorial extent and the duration of the assignment has not been specified, it is deemed that the assignment extends to the territory of India and the duration of assignment is for a period of five years respectively. Further, Section 19 specifies that unless agreed otherwise, the rights assigned would be deemed to have lapsed in the event that the assignee does not exercise the rights granted by the assignor within one year.

The above conditions also apply to a license of copyright with one exception. While the assignment of copyright requires an agreement in writing signed by the assignor, the requirement for a signature has been done away with in cases of licensing of copyright. Therefore, a licensing agreement is required to be in writing but need not be “signed” by the licensor and/or the licensee.

The Copyright Act grants ‘special rights’ to authors (under Section 57) and to performers (under Section 38B). The author/performer has the right to (a) claim authorship of the work/claim to be identified as the performer; and (b) restrain or claim damages with respect to any distortion, mutilation, modification, or other act in relation to the said work/performance if such distortion, mutilation, modification, or other act would be prejudicial to his honor or repute. These special rights can be exercised by the legal representatives of the author. A copyright

## 9. Intellectual Property

is infringed if a person without an appropriate consent does anything that the owner of the copyright has an exclusive right to do. However, there are certain exceptions to the above rule (e.g. fair dealing). The Copyright Act provides for both civil and criminal remedies for copyright infringement. In the event of infringement, the copyright owner is entitled to remedies by way of injunction, damages, and order for seizure and destruction of infringing articles.

The Copyright Act was amended in 2012 to establish a just framework for distribution of royalties to right owners through copyright societies. The primary function of a copyright society (also generally referred to as ‘collecting society’) is to administer the rights on behalf of its members and grant licenses for the commercial exploitation of these rights. Such a society collects the license fee or the royalty on behalf of its members, which is then conveyed to the members after making deductions for the expenses borne for collection and distribution. One registered copyright society in India is the Indian Performing Right Society Limited (IPRS).

Under the Copyright Act, authors of literary or musical works (i) incorporated in films; or (ii) sound recordings (which are not part of films) have the right to receive royalties equal to the royalties received by the assignee of such rights for exploitation of their works (other than communication to public of that film in cinema halls). These rights cannot be assigned or waived by the right holders (except in favor of legal heirs and copyright societies).

### D. Trademarks

Trademarks are protected both under statutory law and common law. The Trade Marks Act, 1999 (“**TM Act**”) along with the rules thereunder govern the law of trademarks in India.

Under the TM Act, the term ‘mark’ is defined to include ‘a device, brand, heading, label, ticket, name, signature, word, letter, numeral, shape of goods, packaging or, combination of colors, or any combination thereof.’ Thus, the list of instances of marks is inclusive and not exhaustive. Any mark capable of being ‘graphically represented’ and indicative of a trade connection with the proprietor is entitled to registration under the TM Act. This interpretation opens the scope of trademark protection to unconventional trademarks like sound marks.

India follows the NICE Classification of goods and services, which is incorporated in the Schedule to the Trade Marks Rules, 2017 (“**New Trade Mark Rules**”). Once the trademark is granted, it gives the proprietor of the registered trademark an exclusive right in relation to that trademark within the territorial jurisdiction of India.

9. Intellectual Property

The flowchart below describes the method of obtaining a trademark in India:

### Obtaining a Trademark in India

<b>Search before Application</b>	Carry out a search at the Trade Marks Registry, to find out if same or similar marks are either registered or are pending registration. This is advisable although not compulsory.
<b>Filing of the Application</b>	Under the TM Act, a single application with respect to multiple classes can be filed along with an affidavit at the time of filing (if there is prior usage of the mark being claimed by the applicant).
<b>Meeting the Official Objections</b>	The Trade Marks Registry sends the “Official Examination Report” asking for clarifications, if any, and also cites identical or deceptively similar marks already registered or pending registration. The applicant has to overcome the objections.
<b>Advertising of the Application</b>	The application is thereafter published in the “Trade Marks Journal,” which is a Government of India publication, published by the Trade Marks Registry.

In addition to trademarks, the following categories of marks can also be registered under the TM Act:

### Certification Marks

Certification marks are given for compliance with defined standards, but are not confined to any membership. Such marks are granted to anyone who can certify that the products involved meet certain established standards. The internationally accepted “ISO 9000” quality standard is an example of a widely recognized certification mark.

### Collective Marks

Collective marks can be owned by any association. The members of such associations will be allowed to use the collective mark to identify themselves with a level of quality and other requirements and standards set by the association. Examples of such associations would be those representing accountants, engineers or architects.

India’s Trade Mark Registry has begun to recognize “unconventional trademarks” and has extended trademark protection to a sound mark. On August 18, 2008, India’s first “sound mark” was granted to Sunnyvale, California based Internet firm Yahoo Inc.’s three note Yahoo yodel by the Delhi branch of the Trademark Registry.

## 9. Intellectual Property

### Internet Domain Names

Indian courts have been proactive in granting orders against the use of infringing domain names. Some of the cases in which injunctions against the use of conflicting domain names have been granted are: *www.yahoo.com vs. www.yahooindia.com* and *www.rediff.com vs. www.radiff.com*. In the *www.yahoo.com case*,<sup>1</sup> it has been held that “the domain name serves the same function as a trademark, and is not a mere address or like finding number on the internet, and therefore, it is entitled to equal protection as a trademark”.

### Assignment of Trademarks

A registered or unregistered trademark can be assigned or transmitted with or without the goodwill of the business concerned, and in respect of either or all of the goods or services in respect of which the trademark is registered. However, the assignment of trademarks (registered or unregistered) without goodwill requires the fulfillment of certain statutory procedures including publishing an advertisement of the proposed assignment in newspapers.

### Recognition of Foreign Well-Known Marks & Trans-Border Reputation

The New Trade Mark Rules provide applicants with the opportunity to apply for recognition of their marks as “Well-Known Trademarks” in India.

To apply, an applicant is required to file form TM – M and pay a fee of INR 100,000 for each trademark. The applicant is also mandatorily required to submit evidence/documents supporting the claim that the applied mark is a well-known one. The Trade Marks Registry has issued guidelines regarding the procedure to file for recognition of a trademark as a Well-Known Trademark (“**Guidelines**”) on May 22, 2017. The Guidelines state that an applicant may submit the following documents as evidence to support a claim for recognition of a mark as a well-known trademark, (i) any applications made or registrations obtained for the mark; (ii) duly corroborated copy of the annual sales turnover of the applicant’s business based on the mark; (iii) number of actual or potential customers of goods or services sold under the said mark; (iv) publicity and advertisements in relation to the said mark; and (v) evidence as to recognition of the mark is the relevant section of the public/consumers in India and abroad. As per the Guidelines, in addition to such evidence, an applicant is also required to submit the following documents, if available at the time of filing an application for recognition of a mark as a well-known trademark (i) copies of judgments of any court in India or the Registry wherein the said mark has been recognized as a well-known trademark; and (ii) details of successful enforcement of rights in relation to the said mark wherein the mark has been recognized as a well-known trademark by any court in India or the Trademarks Registry.

Prior to the notification of the New Trade Marks Rules, such recognition was provided via a court order/judgment, whereas now such recognition is proposed to be provided by registration of mark as a well-known mark. Further, infringement actions for a registered trademark along with the claims for passing off for an unregistered mark are recognized by Indian courts. The courts not only grant injunctions but also award damages or an order for account of profits. In addition to the civil remedies, the TM Act contains stringent criminal penalties.

<sup>1</sup> Yahoo!, Inc. vs Akash Arora & Anr., 1999 IAD Delhi 229.



## 9. Intellectual Property

### The Madrid Protocol

The Madrid System, administered by the International Bureau of World Intellectual Property Organization (“WIPO”), Geneva, permits the filing, registration and maintenance of trademark rights in more than one jurisdiction on a global basis. This system comprises two treaties; the Madrid Agreement concerning the International Registration of Marks, which was concluded in 1891 and came into force in 1892, and the Protocol relating to the Madrid Agreement, which came into operation on April 1, 1996. India acceded to the relevant treaties in 2005 and in 2007.

### E. Trade Secrets

Trade Secrets deals with rights on private knowledge that gives its owner a competitive business advantage. Confidential information and trade secrets are protected under common law and there are no statutes that specifically govern the protection of the same. In order to protect trade secrets and confidential information, watertight agreements should be agreed upon, and they should be supported by sound policies and procedures.

### F. Designs

Industrial designs in India are protected under the Designs Act, 2000 (“**Designs Act**”), which replaced the Designs Act, 1911. The Designs Act incorporates the minimum standards for the protection of industrial designs, in accordance with the TRIPS agreement. It also provides for the introduction of an international system of classification, as per the Locarno Classification. The Design Rules, 2001 (“**Design Rules**”), was amended on 30th December 2014, to incorporate official fees for filing a new design application and the category of applicant have been further divided into two main categories ‘natural person’ and ‘other than natural person’ and the fee will depend on the type of applicant. The category of ‘other than natural person’ is further divided into ‘small entity’ and ‘others except small entity’. An entity is considered to be an ‘small entity’ if the investment does not exceed the limit specified for medium enterprise in the Micro, Small and Medium Enterprises Development Act, 2006.

As per the Designs Act, “design” means only the features of shape, configuration, pattern, ornament or composition of lines or colors applied to any “article” whether in two dimensional or three dimensional or in both forms, by any industrial process or means, whether manual mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye.

The Designs Act provides for civil remedies in cases of infringement of copyright in a design, but does not provide for criminal actions. The civil remedies available in such cases are injunctions, damages, compensation, or delivery-up of the infringing articles.

A company in India needs to ensure that it fully leverages the intellectual property developed by it as this may often be the keystone of its valuation. Further, it needs to establish systems to ensure that such intellectual property is adequately recorded, registered, protected and enforced. It needs to conduct IPR audits to ensure that any intellectual property developed by the company is not going unnoticed or unprotected. The company also needs to ensure that its employees do not violate any third party’s intellectual property rights knowingly or unknowingly. A company must ensure that its intellectual property is not only protected in India, but also in the country where it carries on its business, where its products are exported, or where it anticipates competition.

# Privacy and Data Protection

There have been a plethora of developments in the privacy and data protection space in India. Globalization and technology have made cross border data flows ubiquitous and an essential phenomenon for global economic activity. India, the largest consumer of mobile data in the world, has woken up and acknowledged the importance of data, its uses and security. Taking the cue of global heavyweights and pushed against the wall, in light of multiple data breaches in recent times, the Government and judiciary have been taking a more pro-active stance on protecting consumer rights and balancing organizations' interest when it comes to the fight (and freedom) for data. Hence, navigating India's complex legal and regulatory framework also entails privacy and data implications to be considered by organizations looking to do business in India, either with or without a physical presence.

The Supreme Court in the landmark decision of *Justice K. S. Puttaswamy (Retd.) and Anr. v. Union of India And Ors.*<sup>1</sup> affirmed that a fundamental right to privacy exists under the Constitution that is enforceable against the State even though it was not explicitly worded. This decision overruled previous Supreme Court decisions where the court held that there was no fundamental right to privacy. Further, the Court also asked for a data protection law to be framed to protect individual's rights against privacy parties.

Data protection in India is currently governed by the Information Technology Act, 2000 (“**IT Act**”) and the Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011 (“**Data Protection Rules**”), issued thereunder together the “**Current Law**”. The Current Law as such applies only to data in electronic form and not otherwise (such as in physical paper form). In 2019, the Government of India had constituted<sup>2</sup> a committee headed by Kris Gopalakrishnan of Infosys to explore the governance of ‘non-personal data’. This committee has released two versions of a report on the implementation of a Non-Personal Data Governance Framework for public comments.

The Personal Data Protection Bill, 2021 (“**PDP Bill**”) which had been pending before Parliament since December 2019, was officially withdrawn in August, 2022 with the Government citing the need for a more comprehensive legal framework governing data protection and privacy.<sup>3</sup>

The Bureau of Indian Standards have also made available to the public its new standards for data privacy assurance i.e., the IS 17428 which was notified in the official Gazette on December 21, 2020.<sup>4</sup> The standard seeks to provide a privacy assurance framework for organizations to establish, implement, maintain and continually improve their data privacy management system. It comprises two parts – one being the prescriptive part where the requirements are to be mandatorily implemented by anyone applying the standard and the other part being the suggestive part with detailed best practices to aid in implementing the requirements of the prescriptive part.

We have elaborated on these aspects below.

1 Supreme Court, Writ Petition (Civil) No 494 Of 2012.

2 Constitution of Committee of Experts to deliberate on Data Governance Framework, September 13, 2019, available at <https://meity.gov.in/content/constitution-committee-experts-deliberate-data-governance-framework>.

3 Available at <https://www.thehindubusinessline.com/blexpainer/the-withdrawal-of-the-pdp-bill-and-the-road-ahead/article65747464.ece>.

4 See <https://egazette.nic.in/WriteReadData/2020/223869.pdf>.

## A. Current Framework

### General Data Protection Law

In India, data protection viz. private parties is currently governed by the IT Act and the Data Protection Rules. There are two categories of information covered under the IT Act, which need to be considered with respect to data protection:

- a) **Personal information (“PI”)** which is defined as any information that relates to a natural person, which, either directly or indirectly, in combination with other information available or likely to be available with a body corporate, and is capable of identifying such person; and
- b) **Sensitive personal data or information (“SPDI”)** which is defined to mean such personal information which consists of information relating to:
  - i. passwords;
  - ii. financial information such as bank account or credit card or debit card or other payment instrument details;
  - iii. physical, physiological and mental health condition;
  - iv. sexual orientation;
  - v. medical records and history;
  - vi. biometric information.<sup>5</sup>

### Applicability

The Data Protection Rules are applicable to a body corporate that is engaged in the collection, receiving, possessing, storing, dealing or handling of SPDI using an electronic medium and sets out compliances for protection of SPDI by such body corporate. Thus, the Data Protection Rules do not apply to (i) natural persons who collect SPDI, or (ii) to standalone PI, or (iii) to information purely in the physical domain.

Further, the Data Protection Rules are applicable only to body corporates located within India. Therefore, if SPDI of any individual is collected, received, processed, stored, dealt with and handled outside India, the Data Protection Rules may not be applicable. The IT Act, however, is applicable to an offence committed outside India, if the act involves a computer, computer system or computer network located in India. However, the local data protection laws of the relevant countries may also apply in relation to such data.

### Processing Data under a Contractual Obligation

The now withdrawn PDP Bill had introduced the concept of a ‘Data Fiduciary’ and a ‘Data Processor’ – wherein the Data Processor processes data on behalf of the Data Fiduciary and is subject to fewer compliance requirements as compared to the Data Fiduciary who remains primarily responsible. However, no such distinction existed in the Data Protection Rules.

<sup>5</sup> Further, as per Rule 3 of the Data Protection Rules, any information that is freely available or accessible in public domain or furnished under the Right to Information Act, 2005 or any other law for the time being in force will not be regarded as sensitive personal data or information for the purposes of the Data Protection Rules.

## 10. Privacy and Data Protection

However, the Department of Information Technology issued a Clarification on the Data Protection Rules in 2011 (“**2011 Clarification**”). It was clarified that:

The rules governing the collection and disclosure of SPDI,<sup>6</sup> will not apply to any body corporate providing services relating to collection, storage, dealing or handling of SPDI under a contractual obligation with any legal entity located within or outside India. The rules will, however apply to a body corporate, providing services to the provider of information under a contractual obligation directly with them. This clarification thus brought in a lower compliance requirement for ‘Data Processors’, as have come to be known under the withdrawn PDP Bill. This clarification was essentially introduced for the IT/Business Process Outsourcing (BPO) industry – where data is usually processed on the basis of contracts between the outsourcing entity and the entity who does the actual processing.

### Compliance Requirements

The existing compliance requirements for the body corporates (company, firm, sole proprietorship, or other association of individuals) who possess, or handle SPDI under the Data Protection Rules are as follows:

- i. Provide the individual with the option to either not provide the SPDI to the body corporate or to withdraw his/her consent (withdrawal of consent must be given in writing) given previously for the collection of SPDI.
- ii. Ensure that the SPDI is collected for a lawful purpose connected with the activity of the body corporate, and that the collection of the SPDI is considered necessary for the purpose.
- iii. Obtain specific consent of the individual, in writing (or any mode of electronic communication) regarding the purpose of use of the SPDI.
- iv. Provide a privacy policy for the handling of or dealing in SPDI and ensure that such privacy policy is available on its websites and for view by individual.
- v. Ensure that SPDI is not retained for longer than is required for the purpose for which the SPDI is collected.
- vi. Ensure that the SPDI is used for the purpose for which it has been collected.
- vii. Permit the individual to review the SPDI provided and have any inaccurate or deficient SPDI corrected or amended as feasible.
- viii. Ensure that a grievance officer is appointed, whose name and contact details are published on the website of the body corporate.
- ix. Ensure that to the extent any SPDI is transferred to any third party (within or outside of India), specific permission has been obtained for such transfer, and that the transferee provides the same level of data protection as adhered to by the transferor as required under the Indian data protection laws.
- x. Implement reasonable security practices and procedures such as the International Standard IS / ISO / IEC 27001, or any security practices and procedures that may be agreed to between the individual and the body corporate.
- xi. Maintain comprehensive documented security policies.

<sup>6</sup> Rules 5 and 6 in particular.

## 10. Privacy and Data Protection

### Penalties

#### Personal Information

Whilst there is no specific compliance set out in the IT Act or the Data Protection Rules with respect to PI, the IT Act provides for a penalty for offenders who, while providing services under a contract, have accessed PI, and with wrongful intent, discloses the PI, knowing that such disclosure would cause harm without authorization.<sup>7</sup>

This section prescribes a penalty of imprisonment up to three years and/ or a fine up to INR 500,000. Important points to be kept in mind are:

#### SDPI

As per the IT Act, where a body corporate, possessing, dealing or handling any SPDI is negligent in implementing security measures, and thereby causes wrongful loss or wrongful gain to any person, such body corporate shall be liable to pay damages by way of compensation to the affected person.<sup>8</sup> There is no cap prescribed under the IT Act on the compensation payable to the person so affected.

Since the IT Act has extra-territorial jurisdiction, the above penalties may be applicable to parties outside India, subject to meeting certain nexus requirements to India.<sup>9</sup>

### Industry Specific Regulations

#### Telecommunications Law

The *Indian Telegraph Act, 1885*<sup>10</sup> and the *Indian Telegraph Rules, 1951*<sup>11</sup> provide for certain directions issued by the Central/State Government for the interception of messages in situations of public emergencies, or in the interest of public safety. The Central/State Government may in specified instances, issue directions for such interception.

From a regulatory perspective, it would be pertinent to note certain obligations of telecom service providers (“TSP”) under the Unified License (“UL”)<sup>12</sup> issued to the TSP by the Department of Telecom (“DoT”). We have listed below some privacy specific requirements to be complied with under the UL:

- TSPs have to permit the government agencies to inspect ‘wired or wireless equipment, hardware/software, memories in semiconductor, magnetic or optical varieties’ etc.
- TSPs cannot employ ‘bulk encryption’ equipment in its network. However, it has to ensure the privacy of any message transmitted over the network and prevent unauthorized authorization of any message’. This condition extends to those third parties who render services to the TSP.
- TSPs are required to maintain Call Detail Record (CDR)/ IP Detail Record (IPDR) and Exchange Detail Record (EDR) with regard to communications exchanged over the TSP network. This data needs to be maintained for a period of one year.

7 Section 72A, IT Act.

8 Section 43A, IT Act.

9 Section 75, IT Act.

10 Section 5 of the Indian Telegraph Act, 1885.

11 Rule 419A of the Indian Telegraph Rules, 1951.

12 Available at [http://www.dot.gov.in/sites/default/files/2016\\_03\\_30%20UL-AS-1.pdf?download=1](http://www.dot.gov.in/sites/default/files/2016_03_30%20UL-AS-1.pdf?download=1).

## 10. Privacy and Data Protection

- The TSP is not permitted to export out of India, accounting information of Indian telecom users (with the exception of international roaming subscribers) or user information of Indian telecom users (with the exception of international roaming subscribers using Indian TSP's network while roaming and International Private Leased Circuit customers).
- TSPs have to maintain Call Detail Records/IP Detail Record for internet services rendered for a minimum period of one year. Parameters of IP Detail Records that need to be maintained as per the directions/instructions issued by the government to the telecom operators.
- TSPs have to maintain log-in/log-out details of all subscribers for services provided such as internet access, e-mail, Internet Telephony, IPTV etc. These logs are required to be maintained for a minimum period of one year.
- A penalty of up to INR 500,000,000 may be imposed by the government in the event of any security breaches on the TSPs networks which are caused due to inadequate precautions at the end of the TSP.

### Banking Laws

Apart from the IT Act and Data Protection Rules, banks and financial institutions in India are governed and regulated by various regulations and guidelines (“**Banking Laws**”) issued by the Reserve Bank of India (“**RBI**”), the apex bank in India. There is no specific definition of ‘sensitive data’ or its equivalent under the banking laws. However, different Banking Laws, based on their subject matter seek to protect such kind of information.

Further, certain Banking Laws impose obligations on banks, which include that when engaging third party vendors / service providers / consultants / sub-contractors, to contractually impose certain obligations on such third parties.

Some of the major laws in the BFSI sector which have privacy and security related provisions include the *Payment and Settlement Systems Act, 2007*, *RBI Circular on a Cyber Security Framework for Banks*,<sup>13</sup> *RBI Guidelines on Information Security, Electronic Banking, Technology Risk Management and Cyber Frauds*,<sup>14</sup> *RBI Report on Information Systems Security Guidelines for the Banking and Financial Sector*,<sup>15</sup> *RBI Guidelines on Managing Risks and Code of Conduct in Outsourcing of Financial Services by Banks*,<sup>16</sup> *RBI Master Circular – Know Your Customer (KYC) norms / Anti-Money Laundering (AML) standards/Combating Financing of Terrorism (CFT)/Obligation of banks and financial institutions under PMLA, 2002*,<sup>17</sup> *RBI's Master Circular on Customer Service in Banks, 2014*,<sup>18</sup> and *RBI's Master Circular on Credit Card Operations of Banks*.<sup>19</sup>

- Importantly, RBI released the *Storage of Payment System Data Directive, 2018*<sup>20</sup> in April 2018 which mandated the entire data relating to payment systems operated by system providers to be stored in a system only in India. This data should include the full end-to-end transaction details / information collected / carried / processed as part of the message / payment instruction. This Circular exempts data corresponding to the foreign leg of a transaction from this requirement. The deadline to comply with this mandate was on October 15, 2018. The RBI then released clarifications in the form of FAQs on the circular in June 2019.<sup>21</sup> The FAQs

13 Available at <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT41893F697BC1D57443BB76AFC7AB56272EB.PDF>.

14 Available at <https://rbidocs.rbi.org.in/rdocs/content/PDFs/GBS300411F.pdf>.

15 Available at <https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?ID=275>.

16 Available at <https://rbi.org.in/Scripts/NotificationUser.aspx?id=3148&Mode=0>.

17 Available at [https://rbi.org.in/scripts/BS\\_ViewMasCirculardetails.aspx?id=9848](https://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=9848).

18 Available at [https://www.rbi.org.in/scripts/bs\\_viewmascirculardetails.aspx?id=9008](https://www.rbi.org.in/scripts/bs_viewmascirculardetails.aspx?id=9008).

19 Available at [https://www.rbi.org.in/scripts/BS\\_ViewMasCirculardetails.aspx?id=7338](https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7338).

20 Available at <https://www.rbi.org.in/scripts/NotificationUser.aspx?id=11244&Mode=0>.

21 Available at <https://www.rbi.org.in/Scripts/FAQView.aspx?id=130>.

## 10. Privacy and Data Protection

clarified that the directive is applicable to all Payment System providers authorised / approved by the Reserve Bank of India (RBI) to set up and operate a payment system in India. It was also clarified that the end to end payments data is to be stored in India. The FAQs also addressed cross border data flows, where it clarified that for processing of payment transaction is done abroad, the data should be deleted from the systems abroad and brought back to India not later than the one business day or 24 hours from payment processing, whichever is earlier.

- The RBI has also established a renewed regulatory framework for storage of payment instrument data by stakeholders for processing recurring payments.<sup>22</sup> A customer's card data cannot be stored by any entity in the payment transaction / payment chain other than card issuers and card networks. However, the last 4 digits of the actual card number and card issuer's name can be stored for transaction tracking and reconciliation purposes. Merchants and payment aggregators are prohibited from storing customer's actual card data and are required to purge existing data from their systems by 30th June 2022.<sup>23</sup> As an alternative, the RBI has also prescribed workable solutions such as device-based tokenization and card-on-file tokenization as per prescribed framework. For recurring payments, merchants and payment aggregators have been working together with card issuers and card networks to implement these tokenization solutions to ensure continuity in online checkouts and payments as well as seamless recurring payments.<sup>24</sup>

### Capital Markets and Financial Services

The Capital Markets and Financial Services industry is primarily regulated in India by SEBI. SEBI came out with a framework for cyber security for some regulated entities called the *Cyber Security and Cyber Resilience framework of Stock Exchanges, Clearing Corporation and Depositories* (“**SEBI Circular**”).<sup>25</sup> The SEBI Circular is only applicable to Clearing Corporations, Depositories and Stock Exchanges (“**MIIs**”).

The SEBI Circular extensively covers the obligations of the MIIs as far as maintaining their IT infrastructure is concerned, such as the need to establish a Cyber Security and Cyber Resilience Policy, along with confidentiality and privacy requirements to be followed by MIIs.

### Insurance Regulations

The insurance regulator, the Insurance Regulatory and Development Authority of India (“**IRDAI**”) has in place a number of regulations and guidelines which contain provisions on data security. Examples are the ‘*Guidelines on Information and Cyber Security for Insurers*’ (“**Insurer Guidelines**”),<sup>26</sup> *IRDAI (Outsourcing of Activities by Indian Insurers) Regulations, 2017*,<sup>27</sup> *IRDAI (Maintenance of Insurance Records) Regulations, 2015*,<sup>28</sup> and the *IRDAI (Protection of Policyholders' Interests) Regulations, 2017*.<sup>29</sup>

22 Available at <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11668&Mode=0>.

23 Available at <https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12211&Mode=0>.

24 Available at <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12159&Mode=0>.

25 Available at [http://www.sebi.gov.in/sebi\\_data/attachdocs/1436179654531.pdf](http://www.sebi.gov.in/sebi_data/attachdocs/1436179654531.pdf).

26 Available at <https://www.irdai.gov.in/ADMINCMS/cms/Uploadedfiles/07.04.2017-Guidelines%20on%20Information%20and%20Cyber%20Security%20for%20insurers.pdf>.

27 Available at [https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral\\_Layout.aspx?page=PageNo3149&flag=1](https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3149&flag=1).

28 Available at [https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral\\_Layout.aspx?page=PageNo2604&flag=1](https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2604&flag=1).

29 Available at [https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral\\_Layout.aspx?page=PageNo3191&flag=1](https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3191&flag=1).



## 10. Privacy and Data Protection

The above guidelines and regulations broadly provide for the following:

- Policies to be framed by the Insurer for information security;
- Requirement to establish an Information Security Committee and its duties;
- Requirement to appoint a Chief Information Security Officer and his duties;
- Information Security Risk Management;
- Data Security;
- Platform, Application and Infrastructure Security; and
- Cyber Security.

Via the Insurer Guidelines, the IRDAI has recognized the immense growth in the information technology space, the varied applications of these developments on the insurance sector and the critical need to protect sensitive customer data, especially health data. Further, the *IRDAI (Maintenance of Insurance Records) Regulations, 2015* contain a data localization requirement – where records pertaining to all the policies issued and all claims made in India, are to be stored in data centers located and maintained only in India.

### Healthcare Regulations

The Ministry of Health and Welfare released a draft bill for *Digital Information Security in Healthcare Act* (“**DISHA**”). The main purpose of DISHA is to: (i) establish a National eHealth Authority to regulate the e-Health records and digital health information across India, and Health Information Exchanges; (ii) standardize and regulate the process related to collection, storing, transmission and use of digital health data; (iii) and to ensure reliability, data privacy, confidentiality and security of digital health data.

More recently, a National Digital Health Mission (“**NDHM**”) was announced by the Central Government and the MOHFW published a blueprint<sup>30</sup> in late 2019 recommending the creation of a National Digital Health Ecosystem (“**Ecosystem**”) which allows for interoperability of digital health systems at the patient, hospital, and ancillary healthcare provider level.

On April 23, 2022, the Ministry of Health and Family Welfare released a draft Health Data Management Policy<sup>31</sup> to govern data under in the proposed Ecosystem,<sup>32</sup> which allows for interoperability of digital health systems at the patient, hospital, and ancillary healthcare provider level. The draft Health Data Management Policy also recognizes stakeholders such as data fiduciaries (similar to data controllers under GDPR). It establishes compliances requirements for these stakeholders while recognising individual rights.

30 Available at <https://nha.gov.in/home/ndhb>.

31 Available at [https://abdm.gov.in/assets/uploads/consultation\\_papersDocs/Draft\\_HDM\\_Policy\\_April2022.pdf](https://abdm.gov.in/assets/uploads/consultation_papersDocs/Draft_HDM_Policy_April2022.pdf).

32 <https://economictimes.indiatimes.com/tech/technology/budget-2022-23-fm-announces-open-platform-for-national-digital-health-ecosystem-under-abdm/articleshow/89272174.cms>.



## B. Recent Focus on Non-Personal Data Governance

The Ministry of Electronics and Information Technology, Government of India (“**MeitY**”) constituted a committee (“**NPD Committee**”) to explore the governance of non-personal data (“**NPD**”). The terms of reference of the NPD Committee were to: (a) study various issues relating to non-personal data; and (b) to make specific suggestions for considerations of the Central Government on the regulation of non-personal data. Currently, processing of NPD is not regulated under law.

On July 12, 2020, the NPD Committee released their interim report<sup>33</sup> on the Non-Personal Data Governance Framework for public comments. The report called for a separate NPD governance framework to be put into place. However, the report was not a well-articulated document in terms of definitions, proposed provisions and the purpose sought to be achieved by the framework.

Subsequently, on January 4, 2021, the NPD Committee released a revised version of their interim report clarifying certain aspects. The revised report, amongst other things, details the types of NPD that may be collected, delves into public and private rights that may subsist in such data, as well as provides for a detailed data sharing mechanism that exempts transfers between private entities. The report provides separate guidelines for ‘Data Businesses’,<sup>34</sup> or data collecting entities that meet certain thresholds, calls for the separate treatment of certain ‘High Value Datasets’,<sup>35</sup> and also calls for the creation of a separate regulator that would function independently. The NPD Committee issued its final report in September 2021. However, since the submission of the final report by the NPD Committee, the MeitY hasn’t published the report in the public domain, neither has it indicated its intention to action the recommendations of the NPD Committee.

More recently in 2022, the MeitY released the draft National Data Governance Framework Policy (“**NDGFP**”) which is primarily targeted at creating an Open Data Platform consisting of NPD generated and maintained by the Government, and facilitating intra-Government data sharing.<sup>36</sup> For the purposes of administering the framework, the NDGFP proposes to establish the Indian Data Management Office (**IDMO**) under the aegis of the MeitY. The NDGFP does not allude to any mandatory data sharing requirements for private entities, although it urges private entities to voluntarily participate in the framework. The NDGFP is currently pending finalization and release by the MeitY.<sup>37</sup>

33 Available at [https://static.mygov.in/rest/s3fs-public/mygov\\_159453381955063671.pdf](https://static.mygov.in/rest/s3fs-public/mygov_159453381955063671.pdf).

34 The NPD Committee report defines a ‘Data Business’ as any organization (Government or private organization) that collects, processes, stores, or otherwise manages data.

35 The NPD Committee report defines a ‘High-value Dataset’ as a dataset that is a public-good and benefits the community at large.

36 Available at URL: [https://www.meity.gov.in/writereaddata/files/National%20Data%20Governance%20Framework%20Policy\\_26%20May%202022.pdf](https://www.meity.gov.in/writereaddata/files/National%20Data%20Governance%20Framework%20Policy_26%20May%202022.pdf).

37 MeitY, “National Data Governance Framework Policy”, Press Release, PIB, July 27, 2022, available at URL: <https://pib.gov.in/PressReleasePage.aspx?PRID=1845318#:~:text=The%20Draft%20National%20Data%20Governance,Research%20and%20Innovation%20eco%2Dsystem>.

# Environmental Laws

The tremendous growth of the Indian economy has burdened its finite natural resources. To prevent indiscriminate exploitation of natural resources, the Government regulates the development of industrial projects / activities through environmental approvals and compliances. The approvals may be required at the Central or State level, depending on the type of activity undertaken by the entity. Most of the compliances are mandatory in nature and consequences of non-compliance could result in criminal liability along with a monetary penalty. In 2016, the Ministry of Environment, Forest and Climate Change (“**MoEFCC**”) re-categorized industries in India into red, orange, green and white based on the Pollution Index which is a function of the emissions (air pollutants), effluents (water pollutants), hazardous waste generated and consumption of resources.<sup>1</sup> The industries which fall under the ‘White Category’ (such as scientific, mathematical instrument manufacturing and solar power generation through photovoltaic cell) are non-polluting industries and such industries will not require environmental clearance and consent from the Government.<sup>2</sup> In addition, with the aim of bringing uniformity and clarity to the terms and conditions for environment clearances, the MoEFCC has released standard environment clearances for 25 industrial sectors such as oil and gas transportation, pharmaceuticals and chemical industries, iron and steel plants, etc.<sup>3</sup>

Various environmental legislations including State specific legislations may be applicable, depending on the type of industrial activity undertaken depending on the State in which the entity operates or proposes to operate from. Primarily, however, it is the Environment (Protection) Act, 1986 (“**EPA**”), the Water (Prevention and Control of Pollution) Act, 1974 (“**Water Act**”) and the Air (Prevention and Control of Pollution) Act, 1981 (“**Air Act**”) are the key legislations which have been enacted with respect to conservation and protection of the environment.

The MoEFCC recently put forth a consultation paper<sup>4</sup> on proposed amendments to the EPA, Water Act, Air Act and the Public Liability Insurance Act, 1991 (“**PLI**”) which seek to rehaul the penalty mechanism under the aforementioned acts. The consultation paper seeks to decriminalize penalties under the EPA, Water Act, Air Act and PLI by replacing imprisonment with higher penalties. Moreover, the consultation paper advocates for the appointment of “Adjudicating Officers” under each of the above-mentioned acts, who will determine the quantum of penalty for contravention of any provision under the act. However, the consultation paper is yet to be finalized and there is no clarity on whether the above-mentioned proposals will be enacted into law.

## A. Environment (Protection) Act, 1986

EPA is an umbrella legislation enabling the government to control, prevent and abate environmental pollution. It lays down standards of discharge of environmental pollutants through various rules and notifications particularly in the areas of controlling chemical and hazardous waste management, noise pollution, coastal development, amongst others.

1 Available at <http://pib.nic.in/newsite/PrintRelease.aspx?relid=137373>.

2 To view the full list of industries under the red, orange, green and white categories, please visit <http://pib.nic.in/newsite/PrintRelease.aspx?relid=137373>.

3 The official memorandum was released on August 9, 2018 and can be viewed here: <http://environmentclearance.nic.in/View.aspx?rid=30>.

4 Available at <http://www.oecd.org/environment/outreach/37838061.pdf>.

## 11. Environmental Laws

Any industry which causes ‘injury to the environment’ comes within the purview of the EPA. The EPA has defined “environment” to include water, air and land and the inter-relationship which exists among and between water, air and land, and human beings, other living creatures, plants, micro-organism and property.

Various notifications and rules have been laid down under the EPA, some of which have been discussed below:

### Environmental Impact Assessment (“EIA”) Notification

The EIA Notification has made it mandatory to obtain prior Environmental Clearance (“EC”) for a wide range of developmental projects, from mining, power plants, cement plants, storage facilities of hazardous substances to construction projects and townships. Such projects would require submission of an application which would include an EIA Report. The application would undergo scrutiny at four stages – Screening, Scoping, Public Consultation and Appraisal. EC may be granted subject to certain terms and conditions. After having obtained the EC, the project management is mandated to comply with certain post clearance reporting in respect of the terms and conditions of the EC.

### Coastal Regulation Zone (“CRZ”) Notification

The CRZ Notification classifies the coast into various categories depending on the ecological sensitiveness and prohibits the establishment of new industries and the expansion of existing industries, except for activities that require direct water access and foreshore facilities. Projects within the CRZ also require prior EC and post clearance reporting.

### Hazardous Substances

In the aftermath of the Bhopal Gas tragedy, the Government has laid special emphasis on the handling of hazardous substances by industries. The EPA has defined “hazardous substance” to mean “any substance or preparation which, by reason of its chemical or physico-chemical properties or handling, is liable to cause harm to human beings, other living creatures, plants, micro-organism, property or the environment.” The broad and open definition would bring within its ambit a wide array of manufacturing activities.

Various rules have been formulated for handling and management of hazardous substances under the EPA. Moreover, industries which deal with hazardous substances further require compliance with the PLI, which provides for strict liability in case of an accident.

## B. Air & Water Act

The Air Act & the Water Act respectively vest regulatory authority in the common Central and State Pollution Control Boards (“PCB”). The PCBs are mandated to issue and revoke consents to operate, require self-monitoring and reporting, conduct sampling, inspect facilities, require corrective action and prescribe compliance schedules.

The Water Act prohibits the discharge of sewage or trade effluents into a stream, well or sewer by any industry, operation or process without the approval of the State PCB.

## 11. Environmental Laws

The Air Act empowers the State PCBs to notify standards of emission of air pollutants by industrial plants and automobiles. The State PCBs have also been authorized to designate areas as ‘pollution control areas’.

Industries are required to obtain the ‘consent to establish’ (“**CtE**”) before the construction of a new project from the State PCB. After construction and upon inspection by the PCB, the operator is required to obtain ‘consent to operate’ (“**CtO**”) to commence operations. CtO is typically given for a period of 5 or 10 years depending on the industry category and the CtO will need to be renewed periodically. An industry which is non-polluting will still be required to obtain consent if it falls within a designated ‘pollution control area’.

The State PCBs, with the approval of the Central PCBs, have the authority to impose fines for the violation of the Rules. Maharashtra is one of the very few states which have implemented the provisions to impose penalties for unauthorized storage of hazardous waste.<sup>5</sup>

### C. Municipal Authorities

Land and Water are State subjects under the Constitution. Therefore, environmental regulations of Municipal Corporations on these aspects might vary depending on the state in which the industry seeks to establish itself.

### D. Litigation & Penalty

The Supreme Court of India has held the right to enjoyment of pollution free air and water as part of Right to Life, enshrined under Article 21 of the Constitution, which guarantees protection of life and personal liberty. Therefore, any citizen may approach the Supreme Court or a High Court directly, through a Public Interest Litigation (“**PIL**”), on the violation of Article 21. The Supreme Court has relaxed the standing and procedural requirements for filing a PIL and a citizen can enforce environmental laws through a simple letter addressed to the court.

The National Green Tribunal has been established in 2010 for effective and expeditious disposal of cases relating to environment protection and conservation. It has a dedicated jurisdiction on environmental matters and is mandated to dispose applications within 6 months of filing.

---

<sup>5</sup> Available at <http://www.oecd.org/environment/outreach/37838061.pdf>.

11. Environmental Laws

The citizens are empowered to bring legal claims under each of the three laws discussed above. Contravention of the provisions of the EPA, Air Act or the Water Act may lead to imprisonment, or fine or both.

Objective	Notification / Rules under the EPA
Environment Impact Assessment	Environment Impact Assessment (EIA) Notification, 2006
Regulations on Development along the Coast	Costal Regulation Zone (CRZ) Notification, 2011 <sup>6</sup>
Noise Pollution	Noise Pollution (Regulation and Control) Rules, 2000
Chemical Management	<ul style="list-style-type: none"> <li>▪ Manufacture Storage and Import of Hazardous Chemicals Rules, 1989</li> <li>▪ Chemical Accidents (Emergency Planning, Preparedness and Response) Rules, 1996</li> <li>▪ Manufacture, Use, Import, Export and Storage of Hazardous Micro Organisms, Genetically Engineered Organisms or Cells Rules, 1989</li> </ul>
Waste Management	<ul style="list-style-type: none"> <li>▪ Hazardous and Other Wastes (Management and Transboundary Movement) Rules, 2016</li> <li>▪ Bio-Medical Waste Management Rules, 2016</li> <li>▪ Municipal Solid Wastes (Management &amp; Handling) Rules, 2000</li> <li>▪ E-waste (Management) Rules, 2016</li> </ul>

6 116 In April 2018, the Government released the Draft Coastal Regulation Zone Notification, 2018 which proposes to reduce coastal regulation zones. Available at <https://pib.gov.in/newsite/PrintRelease.aspx?relid=186875>.

# Dispute Resolution in India

As is the practice world-wide, India also prescribes to judicial, quasi-judicial as well as other alternate dispute resolution methods. Besides courts, in certain cases, other forums such as tribunals and administrative bodies are also approached for resolution of disputes. Arbitration is now a well settled mode for resolving commercial disputes in India.

## A. Judicial Forums – Courts and Tribunals

The Supreme Court of India is the apex judicial authority in India. The Supreme Court generally receives appeals from the High Courts that occupy the tier below it. Beneath the High Courts are the subordinate civil and criminal courts that are classified based on whether they are located in rural or urban areas and by the value of disputes such courts have jurisdiction to adjudicate upon.

Certain important areas of law have dedicated tribunals to facilitate the speedy dissemination of justice by individuals qualified in the specific fields. These include the National Company Law Tribunal, the Income Tax Appellate Tribunal, the Labour Appellate Tribunal, the Copyright Board, Securities Appellate Tribunal, the Competition Commission of India, the National Green Tribunal amongst others.

The Commercial Courts Act, 2015 (“**Commercial Courts Act**”) provides for establishment of Commercial Courts by notification by the State Government, in consultation with the concerned High Court. For territories where the High Court itself is vested with the original jurisdiction i.e. where particular suits may directly be filed before the High Court, the Chief Justice of such High Court may constitute a Commercial Division within such High Court. These specially notified courts are at the same level as High Courts in terms of hierarchy. Once the Commercial Division/Commercial Court is established, the Chief Justice of the High Court would be required to constitute the Commercial Appellate Division. As per the Commercial Courts Act, ‘Commercial Disputes’ of a ‘Specified Value’ are to be heard by such Special Courts.

The Commercial Division and Commercial Appellate Division of High Courts (Amendment) Act, 2018 (“**Commercial Courts Amendment Act**”) has been passed which seeks to: (a) reduce the minimum value of a dispute for pecuniary jurisdiction and introduces Commercial Courts even in jurisdictions where the concerned High courts have ordinary original civil Jurisdiction, (b) introduce Commercial Appellate Courts, and (c) splits Commercial courts in two types – (i) District Judge Level; & (ii) Below District Judge Level. The Commercial Courts Amendment Act has also brought about a change to the name of Commercial Courts Act. Prior to the amendment, it was called the Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Act, 2015, by virtue of the Commercial Courts Amendment Act, the name has been changed the name to the “Commercial Courts Act, 2015”.

Finally with the introduction of the Insolvency and Bankruptcy Code, 2016 (“**Code**”) there is a marked change in the regime involving resolution of insolvencies and commercial matters. The Code has seen several amendments. Any apparent loopholes are being plugged at the earliest and the law is evolving rapidly. Certain government bodies and government companies also have in-house dispute redressal systems where certain disputes may be referred for adjudication.

## B. Jurisdiction of Courts

Jurisdiction may be defined as the power or authority of a court to hear and determine a cause, to adjudicate and exercise any judicial power in relation to it. The jurisdiction of a court, tribunal or authority may depend upon fulfillment of certain conditions or upon the existence of a particular fact. If such a condition is satisfied, only then does the authority or Court, as the case may be, have the jurisdiction to entertain and try the matter. Jurisdiction of the courts may be classified under the following categories:

### Territorial Jurisdiction

Every court has its own local or territorial limits beyond which it cannot exercise its jurisdiction. The legislature fixes these limits.

### Pecuniary Jurisdiction

The Code of Civil Procedure, 1908 (“CPC”) provides that a court will have jurisdiction only over those suits the amount or value of the subject matter of which does not exceed the pecuniary limits of its jurisdiction. Some courts have unlimited pecuniary jurisdiction i.e. High Courts and District Courts in certain states have no pecuniary limitations.

### Jurisdiction as to Subject Matter

Different courts have been empowered to decide different types of suits. Certain courts are precluded from entertaining certain suits. For example, the Presidency Small Causes Courts have no jurisdiction to try suits for specific performance of contract or partition of immovable property. Similarly, matters pertaining to the laws relating to tenancy are assigned to the Presidency Small Causes Court and therefore, no other Court would have jurisdiction to entertain and try such matters.

### Original and Appellate Jurisdiction

The jurisdiction of a court may be classified as original and/or appellate. In the exercise of original jurisdiction, a court acts as the court of first instance and in exercise of its appellate jurisdiction, the court entertains and decides appeals from orders or judgments of the lower courts. Munsiff's Courts, Courts of Civil Judge and Small Cause Courts possess original jurisdiction only, while District Courts and High Courts have original as well as appellate jurisdictions, subject to certain exceptions.

In addition to the above, the High Courts and the Supreme Court also have writ jurisdiction by virtue of Articles 32, 226 and 227 of the Constitution.

## 12. Dispute Resolution in India

Indian courts generally have jurisdiction over a specific suit in the following circumstances:

- Where the whole or part of the cause of action (the facts on account of which a person gets a right to file a suit for a relief) arose in the territorial jurisdiction of the court.
- Where the defendant resides or carries on business for gain within the territorial jurisdiction of the court.
- Where the subject matter of the suit is an immovable property (real property and items permanently affixed thereto), where such immovable property is situated within the jurisdiction of the court.

### C. Law on Interim Relief

Due to heavy case load and other factors, legal proceedings initiated before Indian courts can often take inordinate amounts of time before final resolution. Thus, it is common for the plaintiff to apply for urgent interim reliefs such as an injunction requiring the opposite party to maintain status quo, freezing orders, deposit of security amount etc. Interim orders are those orders which are passed by the court during the pendency of a suit or proceeding and which do not determine finally the substantive rights and liabilities of the parties in respect of the subject matter of the suit or proceeding. Interim orders are necessary to deal with and protect rights of the parties in the interval between the commencement of the proceedings and final adjudication. Hence, interim proceedings play a crucial role in the conduct of litigation between the parties.

Injunctions are a popular form of interim relief. The grant of injunction is a discretionary remedy and in the exercise of judicial discretion, in granting or refusing to grant, the court will take into consideration the following guidelines:

#### Prima Facie Case

The applicant must make out a prima facie case for succeeding in the case and in support of the right claimed by him. Further, the applicant should be a bona fide litigant i.e. there must exist a strong case for trial before the court which requires investigation and a decision on merits and facts. There must exist a strong probability of the applicant being entitled to the relief claimed by him.

#### Irreparable Injury

The applicant must further satisfy the court that if the injunction, as prayed, is not granted he/she will suffer irreparable injury such that no monetary damages at a later stage could repair the injury done, and that there is no other remedy open to him by which he can be protected from the consequences of apprehended injury.



## 12. Dispute Resolution in India

### Balance of Convenience

In addition to the above two conditions, the court must also be satisfied that the balance of convenience must be in favour of the applicant. In order to determine the same, the court needs to look into factors such as:

- whether it could cause greater inconvenience to the applicant if the injunction was not granted.
- whether the party seeking injunction could be adequately compensated by awarding damages and the defendant would be in a financial position to pay the applicant.

### D. Specific Relief

The Specific Relief Act, 1963 (“**Specific Relief Act**”) provides for specific relief for the purpose of enforcing individual civil rights and not for the mere purpose of enforcing civil law. Under the Specific Relief Act, courts are mandated to grant specific relief unless the relief is expressly barred under the limited grounds provided in the statute.

Specific performance is an order of the court which requires a party to perform a specific act in accordance with the concerned contract.

While specific performance can be in the form of any type of forced action, it is usually used to complete a previously established transaction, thus, being the most effective remedy in protecting the expectation interest of the innocent party to a contract. The aggrieved party may approach a Court for specific performance of a contract. The Court will direct the party in breach to fulfill his part of obligations as per the contract capable of being specifically performed.

The Specific Relief Act was amended and received Presidential assent on August 1, 2018 (“**Specific Relief Amendment Act**”). The Specific Relief Amendment Act has altered the nature of specific relief from an exceptional rule to a general rule which will certainly ensure contractual enforcement.

Some salient features of the Specific Relief Amendment Act are below:

- Courts must now grant specific performance of a contract when claimed by a party unless such remedy is barred under the limited grounds contained in the statute.
- If a contract is broken due to non-performance of a promise by a party, the party suffering the breach has the option of substituting performance through a third party or through its own agency.
- A suit filed under the Specific Relief Amendment Act must be disposed of by the court within 12 months. Such period can be extended by 6 months after recording written reasons by the court.
- No injunction can be granted by the court in relation to an infrastructure project if such injunction would cause delay or impediment in the progress or completion of the infrastructure project.

## 12. Dispute Resolution in India

### E. Law on Damages

Under Indian law, parties can choose to opt for the remedy of specific performance or damages upon a breach of contract. The goal of damages in tort actions is to make the injured party whole through the remedy of money to compensate for tangible and intangible losses caused by the tort. The remedy of damages for breach of contract is laid down in Sections 73 and 74 of the Contract Act. Section 73 states that where a contract is broken, the party suffering from the breach of contract is entitled to receive compensation from the party who has broken the contract. However, no compensation is payable for any remote or indirect loss or damage.

Section 74 deals with liquidated damages and provides for the measure of damages in two classes: (i) where the contract names a sum to be paid in case of breach; and (ii) where the contract contains any other stipulation by way of penalty. In both classes, the measure of damages is, as per Section 74, reasonable compensation not exceeding the amount or penalty stipulated for.

### F. Dispute Resolution by Arbitration

Due to the huge pendency of cases in courts in India, there was a dire need for effective means of alternative dispute resolution. India's first arbitration enactment was the Arbitration Act, 1940 which was complimented by the Arbitration (Protocol and Convention) Act of 1937 and the Foreign Awards Act of 1961. Arbitration under these laws were not effective and led to further litigation as a result of the rampant challenge of arbitral awards. The legislature enacted the current Arbitration & Conciliation Act, 1996 (the "**A&C Act 1996**") to make both, domestic and international arbitration, more effective in India. The A&C Act, 1996 is based on the UNCITRAL Model Law (as recommended by the U.N. General Assembly) and facilitates International Commercial Arbitration as well as domestic arbitration and conciliation. As the name of the A&C Act 1996 suggests, it also covers conciliation.

Under the A&C Act, 1996, an arbitral award can be challenged only on limited grounds and in the manner prescribed. India is party to the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards.

In furtherance to measures taken by the Indian government in support of the 'ease of doing business in India', and after two aborted attempts in 2001 and 2010 to amend the arbitration law, on October 23, 2015, the President of India promulgated the Arbitration and Conciliation (Amendment) Ordinance, 2015 ("**Arbitration Ordinance 2015**"). The Arbitration Ordinance 2015 incorporated the essence of major rulings passed in the last two decades, as well as most of the recommendations of 246th Law Commission Report and have clarified the major controversies that arose in the recent years.

Thereafter, on December 17, 2015 and December 23, 2015 respectively, the Arbitration and Conciliation (Amendment) Bill, 2015 ("**Arbitration Bill 2015**") was passed by the Lok Sabha and Rajya Sabha respectively, with minor additions to the amendments introduced by the Arbitration Ordinance 2015. On December 31, 2015,

The President of India signed the Arbitration Bill 2015 and thereafter, the gazette notification was made on January 1, 2016. Accordingly, the Arbitration and Conciliation (Amendment) Act, 2015 ("**Arbitration Amendment Act 2015**") amends the A&C Act 1996 and came into effect from October 23, 2015.

## 12. Dispute Resolution in India

The Arbitration Amendment Act 2015 is applicable prospectively to the arbitral proceedings commenced after October 23, 2015. Some salient features of the Arbitration Amendment Act 2015 are as below:

- Provides strict timelines for completion of the arbitral proceedings and arbitration related court proceedings.
- Lays down the mechanism for fast track arbitration (to be completed within 180 days).
- Introduced certain amendments to the existing provisions with regard to the process of appointment of an arbitrator and clarified the grounds of challenge of an arbitrator for lack of independence and impartiality.
- Provides for an avenue for seeking interim relief and assistance from Indian courts in foreign-seated arbitrations.
- Introduction of the ‘cost follow the event’ regime to bring it in line with international standards.
- The process of enforcement and execution under the A&C Act 1996 has also been streamlined so that challenge petitions do not operate as an automatic stay on the execution process.

The Arbitration and Conciliation (Amendment) Act, 2019 (“**Arbitration Amendment Act 2019**”) had been introduced.

The Arbitration Amendment Act 2019 brings about several key changes to the arbitration landscape in India:

- The Arbitration Amendment Act 2019 seeks to establish the Arbitration Council of India (“ACI”), which can exercise powers such as grading arbitral institutions, recognising professional institutes that provide accreditation to arbitrators, issuing recommendations and guidelines for arbitral institutions, and taking steps to make India a centre of domestic and international arbitrations.
- Further, Arbitration Amendment Act 2019 amends the Arbitration Amendment Act 2015 by providing the Supreme Court and the High Court with the ability to designate the arbitral institutions which have been accredited by the ACI with the power to appoint arbitrators.
- The Arbitration Amendment Act 2015 had introduced a time-limit of 12 months (extendable to 18 months with the consent of parties) for the completion of arbitration proceedings from the date the arbitral tribunal enters upon reference. The Arbitration Amendment Act 2019 amends the start date of this time limit to the date on which statement of claim and defence are completed.
- The Arbitration Amendment Act 2019 also excludes ‘international commercial arbitration’ from this time-limit to complete arbitration proceedings.
- The Arbitration Amendment Act 2019 introduces express provisions on confidentiality of arbitration proceedings and immunity of arbitrators.
- The Arbitration Amendment Act 2019 further prescribes minimum qualifications for a person to be accredited/act as an arbitrator under the Eighth Schedule.
- Importantly, the Arbitration Amendment Act 2019 also clarifies the scope of applicability of the Arbitration Amendment Act 2015. Arbitration Amendment Act 2019 provides that Arbitration Amendment Act 2015, entered into force on 23 October 2015, is applicable only to arbitral proceedings which commenced on or after 23 October 2015 and to such court proceedings which emanate from such arbitral proceedings.

On August 30, 2019, the Central Government notified Sections 1, 4–9, 11–13, 15 of the Arbitration Amendment Act 2019. The notified amendments include amendments relating to the timeline for arbitration, confidentiality and applicability of the 2015 Amendments. However, it must be noted that the provisions pertaining to the ACI have not been notified yet.

## 12. Dispute Resolution in India

Recently, the Arbitration and Conciliation (Amendment) Act, 2021<sup>1</sup> was introduced whereby all grounds and principles inserted by the Arbitration Amendment Act 2015 have been retained with the addition of the proviso to Section 34(3), which states that an unconditional stay on the enforcement of the award would be granted pending disposal of the challenge if the court is prima facie satisfied that the arbitration agreement or the making of the award was induced by fraud or corruption. This has been given retrospective effect and shall apply to all court proceedings emanating from arbitral proceedings, irrespective of whether such arbitral proceedings commenced from October 23, 2015 or not.

Broadly, the A&C Act 1996 covers the following recognized forms of arbitration:

### Ad-hoc Arbitration

Ad-hoc arbitration is where no institution administers the arbitration. The parties agree to appoint the arbitrators and either set out the rules which will govern the arbitration or leave it to the arbitrators to frame the rules. Ad-hoc arbitration is quite common in domestic arbitration in India and continues to be popular.

In cross border transactions it is quite common for parties to spend time negotiating the arbitration clause, since the Indian party would be more comfortable with ad-hoc arbitration whereas foreign parties tend to be more comfortable with institutional arbitration. However, with ad-hoc arbitrations turning out to be a lengthy and costly process, the preference now seems to be towards institutional arbitration as the process for dispute resolution.

### Institutional Arbitration

As stated above, institutional arbitration refers to arbitrations administered by an arbitral institution. Institutions such as the International Court of Arbitration attached to the International Chamber of Commerce in Paris (“ICC”), the London Court of International Arbitration (“LCIA”) and the American Arbitration Association (“AAA”) are well known world over and often selected as institutions by parties from various countries. Within Asia, greater role is played by institutions such as the Singapore International Arbitration Centre (“SIAC”), the Hong Kong International Arbitration Centre (“HKIAC”) and China International Economic and Trade Arbitration Commission (“CIETAC”). The Dubai International Arbitration Centre is also evolving into a good center for arbitration.

While Indian institutions such as the Indian Council of Arbitration attached to the Federation of Indian Chambers of Commerce and Industry (“FICCI”), the International Centre for Alternative Dispute Resolution under the Ministry of Law & Justice (“ICADR”), the Court of Arbitration attached to the Indian Merchants’ Chamber (“IMC”), Mumbai Centre for International Arbitration (“MCIA”), Nani Palkhiwala Arbitration Centre (“NPAC”) and the Delhi High Court Arbitration Centre are in the process of spreading awareness and encouraging institutional arbitration, it would still take time for them to achieve the popularity enjoyed by international institutions.

---

<sup>1</sup> <https://egazette.nic.in/WriteReadData/2021/225832.pdf>.

## 12. Dispute Resolution in India

The Arbitration Amendment Act 2019 was introduced with a view to strengthen institutional arbitration in India. It seeks to establish the Arbitration Council of India (ACI), which would exercise powers such as grading arbitral institutions, recognising professional institutes that provide accreditation to arbitrators, issuing recommendations and guidelines for arbitral institutions, and taking steps to make India a centre of domestic and international arbitrations. However, it must be noted that the provisions pertaining to the ACI have not been notified yet.

### Statutory Arbitration

Statutory arbitration refers to scenarios where the law mandates arbitration. In such cases, the parties have no option but to abide by the law of the land. It is apparent that statutory arbitration differs from the above types of arbitration because (i) the consent of parties is not required; (ii) arbitration is the compulsory mode of dispute resolution; and (iii) it is binding on the Parties as the law of the land. Sections 24, 31 and 32 of the Defence of India Act, 1971, Section 43(c) of The Indian Trusts Act, 1882 and Section 7B of the Indian Telegraph Act, 1885 are certain statutory provisions which deal with statutory arbitration.

### Foreign Arbitration

When arbitration proceedings are seated in a place outside India, such a proceeding is termed as a Foreign Arbitration. The seminal judgment of the Supreme Court of India in *Bharat Aluminum Co. v. Kaiser Aluminum Technical Service, Inc.*<sup>2</sup> (“**BALCO Judgment**”), had altered the landscape of arbitration in India and has overturned the law laid down in *Bhatia International vs. Bulk Trading*.<sup>3</sup> The BALCO Judgment, held that provisions of Part I of A&C Act 1996 are not applicable to foreign awards and foreign seated arbitrations where the arbitration agreement was entered into on or after September 6, 2012. This has considerably reduced the level of interference by Indian courts in foreign arbitrations.

Awards passed in such foreign seated arbitrations would not be subject to challenge under Section 34 of the A&C Act in India. Another consequence of the judgment was that parties to a foreign seated arbitration cannot seek interim reliefs in aid of arbitration from the Indian courts. However, by the Arbitration Amendment Act 2015, the position has been partially reversed and even in a foreign seated arbitration, parties can apply for interim reliefs before Indian Courts, unless they specifically opt out of such a recourse under their contract.

## G. Enforcement of Foreign Arbitral Awards

Foreign Award is defined in Section 44 and Section 53 of the A&C Act, 1996. India is a signatory to the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (“**New York Convention**”) as well the Convention on the Execution of Foreign Awards, 1923 (“**Geneva Convention**”). Thus, if a party receives a binding award from another country which is a signatory to the New York Convention or the Geneva Convention and the award is made in a territory which has been notified as a convention country by India, the award would then be enforceable in India.

<sup>2</sup> 117 (2012) 9 SCC 552.

<sup>3</sup> (2002) 4 SCC 105.

12. Dispute Resolution in India

Reciprocity is only in relation to the place where the award is made and does not bear any real relation to the nationality of the parties or whether the nations to which each of the parties belong have signed or ratified the Conventions.

There are about 48 countries (listed below) which have been notified by the Central Government as reciprocating convention countries, with the most recent addition being Mauritius:

<b>Australia</b>	<b>Ecuador</b>	<b>Malaysia</b>	<b>Spain</b>
<b>Austria</b>	<b>Federal Republic of Germany</b>	<b>Mexico</b>	<b>Sweden</b>
<b>Belgium</b>	<b>Finland</b>	<b>Morocco</b>	<b>Switzerland</b>
<b>Botswana</b>	<b>France</b>	<b>Nigeria</b>	<b>Syrian Arab Republic</b>
<b>Bulgaria</b>	<b>German Democratic Republic</b>	<b>Norway</b>	<b>Thailand</b>
<b>Central African Republic</b>	<b>Ghana</b>	<b>Philippines</b>	<b>The Arab Republic of Egypt</b>
<b>Chile</b>	<b>Greece</b>	<b>Poland</b>	<b>The Netherlands</b>
<b>China (including Hong Kong and Macau)</b>	<b>Hungary</b>	<b>Republic of Korea</b>	<b>Trinidad and Tobago</b>
<b>Cuba</b>	<b>Italy</b>	<b>Romania</b>	<b>Tunisia</b>
<b>Cuba</b>	<b>Japan</b>	<b>Russia</b>	<b>United Kingdom</b>
<b>Czechoslovak Socialist Republic</b>	<b>Kuwait</b>	<b>San Marino</b>	<b>United Republic of Tanzania</b>
<b>Denmark</b>	<b>Mauritius, Malagasy Republic</b>	<b>Singapore</b>	<b>United States of America</b>

Section 48 of the A&C Act, 1996 deals with the conditions to be met for the enforcement of foreign awards made in countries party to the New York Convention. It stipulates that the only cases where enforcement can be refused are when one party is able to show that:

- the parties were under some incapacity as per the applicable law or that the agreement was not valid under the law of the country where
- the award was made or the law which the parties have elected;
- that the party against whom the award has been made was not given adequate notice of appointment of arbitrators, arbitration proceedings or was otherwise unable to present his case;
- the award addresses issues outside the scope of the arbitration agreement, and if separable, any issue which is within the ambit of the agreement would remain to be enforceable;
- the composition of the tribunal or the procedure were not in accordance with the agreement of the parties or if there was no such agreement with the law of the country where the arbitration took place; and lastly, the award has been set aside or suspended by a competent authority in the country in which it was made or has otherwise not yet become binding on the parties.
- Additionally, enforcement may also be refused if the subject matter of the award is not capable of settlement by arbitration under the laws of India or if the enforcement of the award would be contrary to the public policy of India. In this context, the term ‘public policy’ is to be given a narrow meaning. The Supreme Court, in the landmark judgment of *Shri Lal Mahal Ltd. v. Progetto Grano Spa*,<sup>4</sup> has stated that enforcement of a foreign award would be refused on the grounds of public policy only if it is contrary to (i) fundamental policy of Indian law, (ii) the interests of India, or (iii) justice or morality.

4 2013(8) SCALE 489.

## 12. Dispute Resolution in India

The Arbitration Amendment Act 2015 has clarified that a foreign award would be in conflict with the public policy of India only if:

- i. the making of the award was induced or affected by fraud or corruption or was in violation of obligations of confidentiality or admissibility of evidence; or
- ii. it is in contravention with the fundamental policy of Indian law; or
- iii. it is in conflict with the most basic notions of morality or justice.

Recently, in the case of *Vijay Karia & Ors. v. Prysmian Cavi E Sistemi SRL*,<sup>5</sup> the Supreme Court held that any rectifiable breach under the Foreign Exchange Management Act, 1999 (“**FEMA**”) cannot be said to be a violation of the fundamental policy of Indian law. It held that the Reserve Bank of India could step in and direct the parties to comply with the provisions of the FEMA or even condone the breach. However, the arbitral award would not be non-enforceable as the award would not become void on this count.

The Arbitration Amendment 2015 further clarifies that the test as to whether there is a contravention with the fundamental policy of Indian law will not entail a review on the merits of the dispute.

Most of the protections afforded to awards which are made in countries that are party to the New York Convention are also applicable to those made in countries party to the Geneva Convention. The A&C Act also provides one appeal from any decision where a court has refused to enforce an award, and while no provision for second appeal has been provided, a party retains the right to approach the Supreme Court.

### Practitioner Tip: Arbitration

#### Seat of Arbitration

Recent judgments of the Supreme Court<sup>6</sup> have clarified the importance and the significance of the seat of arbitration.

In India seated arbitration, when parties have chosen a seat of arbitration, or if the arbitral tribunal has determined a seat, such a determination automatically confers jurisdiction on the courts at such seat of arbitration for the purposes of interim orders and challenges to an award.

If a seat has not been determined, unless there are any contrary indications, the designation of a ‘venue’ in an arbitration clause can indicate the ‘seat’ of the arbitration.

Thus, it is of utmost importance to determine the ‘seat of arbitration’ while drafting an arbitration clause.

#### Stay on Enforcement – Fraud and Corruption

The 2020 Ordinance has introduced a retrospective amendment to the A&C Act 1996. The amended regime provides that if there is a prima facie finding by the Court that the arbitration agreement or contract which is the basis of the award, or the making of the award was induced or effected by fraud or corruption, then there will be an unconditional stay on the enforcement of an India seated arbitration award until the challenge to the award is determined.

<sup>5</sup> *Vijay Karia & Ors. v. Prysmian Cavi E Sistemi SRL*, 2020 SCC OnLine SC 177.

<sup>6</sup> *BGS SGS SOMA JV v. NHPC Ltd.*, Civil Appeal No. 9307 OF 2019.



## H. Enforcement of Foreign Judgments in India

The definition of ‘judgment’ as given in Section 2(9) of the CPC is inapplicable to ‘foreign judgment’. A foreign judgment must be understood to mean an adjudication by a foreign court upon a matter before it and not the reasons for the order made by it. The foreign Court must be competent to try the suit, not only with respect to pecuniary limits of its jurisdiction and the subject matter of the suit, but also with reference to its territorial jurisdiction. In addition, the competency of the jurisdiction of the foreign court is not to be judged by the territorial law of the foreign state, but rather, by the rule of Private International Law.

A foreign judgment may be enforced by filing a suit upon judgment under Section 13 of CPC or if the judgment is rendered by a court in a “reciprocating territory”, by proceedings in execution under Section 44A of the CPC. Judgments of specified courts in reciprocating countries can be enforced directly by execution proceedings as if these foreign judgments are decrees of the Indian courts. Foreign judgments of non-reciprocating countries can be enforced in India only by filing a suit based on the judgment. A foreign judgment is usually recognized by Indian courts unless it is proved that:

- it was pronounced by a court which did not have jurisdiction over the matter;
- it was not given on the merits of the case;
- it appeared on the face of the proceeding to be founded on an incorrect view of international law or a refusal to recognize Indian law (where applicable);
- principles of natural justice were ignored by the foreign court;
- the judgment <sup>Foreign</sup> was obtained by fraud; or
- the judgment sustained a claim founded on a breach of Indian law.

The jurisdiction of foreign courts is decided by applying rules of conflict of laws. Even if the court did not have jurisdiction over the defendant, its judgment can be enforced if the defendant has appeared before the foreign court and not disputed its jurisdiction. While a decision of a foreign court must be based on the merits of a case (i.e. not a summary decision/judgment in default), the mere fact that it was ex-parte (in the absence of a party) does not preclude enforcement. The test is whether it was passed as a mere formality or penalty or whether it was based on a consideration of the truth and of the parties’ claim and defence. For applying the third exception, the mistake or incorrectness must be apparent on the face of the proceedings. Merely because a particular judgment does not conform to Indian law when it is under no obligation to take cognizance of the same does not preclude enforcement. The term ‘natural justice’ in the fourth exception to enforcement refers to the procedure rather than to the merits of the case. There must be something which is repugnant to natural justice in the procedure prior to the judgment. The fifth exception of a judgment being obtained by fraud applies as much to domestic judgments as to foreign judgments. The last exception for instance would ensure that a judgment regarding a gambling debt cannot be enforced in India.

Where any judgment from a ‘reciprocating’ territory is in question, a party may directly apply for execution under Section 44A. A judgment from a non-reciprocating country cannot be enforced under this section. A party approaching the Indian court must supply a certified copy of the decree together with a certificate from the foreign court stating the extent to which the decree has been satisfied or adjusted, this being treated as conclusive proof of the satisfaction or adjustment. Execution of the foreign judgment is then treated as if it was passed by a District Court in India. However, the parties may still challenge the enforcement under the provisions of Section 13 of the CPC.



## 12. Dispute Resolution in India

The courts may refuse execution of a foreign judgment in India on the grounds mentioned above. Further the claims may be barred under limitation. The Supreme Court has recently held that the limitation law of the country where the decree was rendered would be applied even in the country where the decree is sought to be executed.

### I. An Overview of Insolvency and Bankruptcy

The Insolvency and Bankruptcy Code, 2016, (“**Bankruptcy Code/Code**”), which came into effect on December 15, 2016, is a welcome overhaul of the erstwhile fragmented and time-consuming bankruptcy regime in India. The Bankruptcy Code is a comprehensive insolvency legislation as it consolidates the existing laws relating to insolvency of companies, limited liability entities (including limited liability partnerships), unlimited liability partnerships, and individuals into a single legislation. Some of its most noteworthy features are discussed below.

#### Time-Bound Resolution

The Code created time-bound processes for insolvency resolution – as per its provisions, every insolvency resolution process must be concluded within 180 days of commencement of the insolvency resolution process, which was extendable by another 90 days in case of delay. However, the Insolvency and Bankruptcy (Amendment) Act, 2019, which was notified on August 16, 2019, has amended this timeline. The insolvency resolution process must now be completed within 330 days of its commencement, including the time taken in legal proceedings in relation to such resolution process. Pending insolvency resolution processes which have not been completed within the period of 330 days must be completed within a period of 90 days from the commencement of the Insolvency and Bankruptcy (Amendment) Act, 2019. The time-bound nature of the resolution process marks the onset of a monumental change in the corporate insolvency regime, and has renewed faith amongst investors, both nationally and internationally. The Insolvency and Bankruptcy Code (Amendment) Bill, 2021 (“IBC Bill”) was passed which introduces an alternate insolvency resolution process for micro, small, and medium enterprises called the pre-packaged insolvency resolution process (“PIRP”).

Unlike a corporate insolvency resolution process, PIRP may be initiated only by debtors. The IBC Bill provides an overview of the application and procedure for PIRP and stipulates that a resolution plan must be approved by the committee (holding at least 66% of the voting shares) within 90 days from the commencement date of PIRP.

#### Streamlined Processes

The resolution processes are conducted by licensed Insolvency Resolution Professionals (“**IRPs**”); and the specialised National Company Law Tribunal adjudicates insolvency resolution for corporate entities. The Code establishes a specialised Insolvency and Bankruptcy Board of India which is responsible for the regulation of various aspects of insolvency and bankruptcy, including issuing and formulating regulations, and regulation of insolvency professionals. Specific Information Utilities have been established which collect, collate and disseminate financial information related to debtors.

## 12. Dispute Resolution in India

### Regulatory & Legislative Impetus

The central government, central banking institute, and the central securities exchange regulator in India have added teeth to the Code by ensuring that its implementation is smooth and efficient. With their inputs, the Code is not merely an amendment to a statute – but an overhaul of the entire framework.

It is evident that the Government is leaving no stone unturned in its aim to improve the ease of doing business in India. The legislature, RBI, SEBI, and the judiciary have presented a unified front, unprecedented in India so far. Any apparent loopholes are being plugged at the earliest and the law is evolving rapidly.

# Trade with India

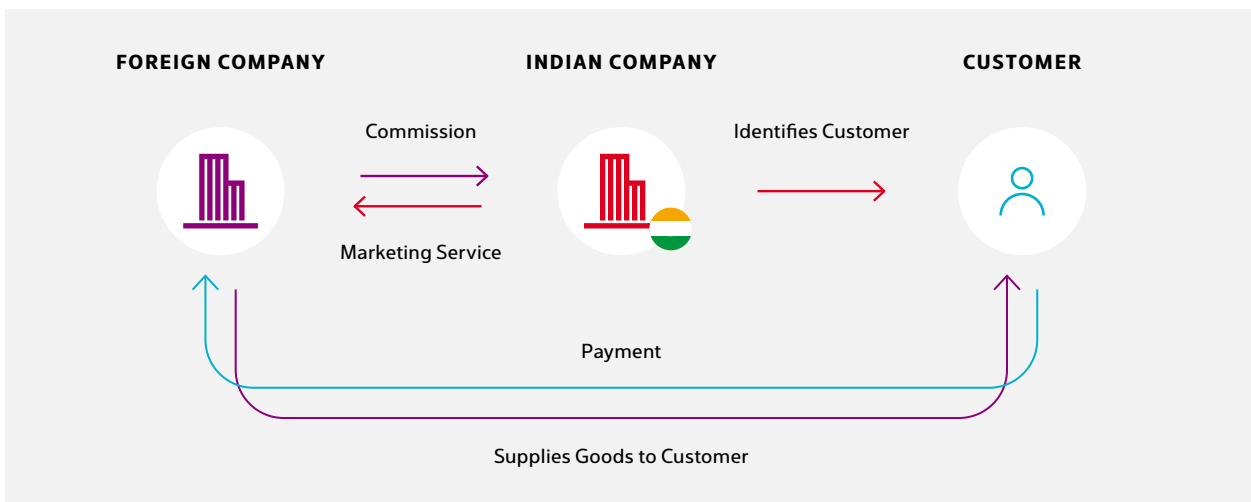
While some may wish to do business in India, many manufacturers and service providers are interested in doing business with India. With a potential market of over 1 billion people, India is a lucrative export destination.

## A. Trade Models

There are many ways in which one can trade with India. While setting up an operation in India and trading through it, is one option, there are numerous ways of trading with India without actually setting up operations. Some of these are discussed below.

### Marketing

Under this non-exclusive arrangement, a foreign company engages an Indian company to render marketing services on behalf of the foreign company. In the event a customer is identified, the Indian company informs the foreign company and the foreign company directly enters into an agreement and provides the goods to such customer. A commission is paid to the Indian company for the marketing services provided. All obligations to import the goods in India shall vest with the customer. Further, the Indian company does not have the right to conclude any agreements on behalf of the foreign company. A diagrammatic representation of the structure is contained below:

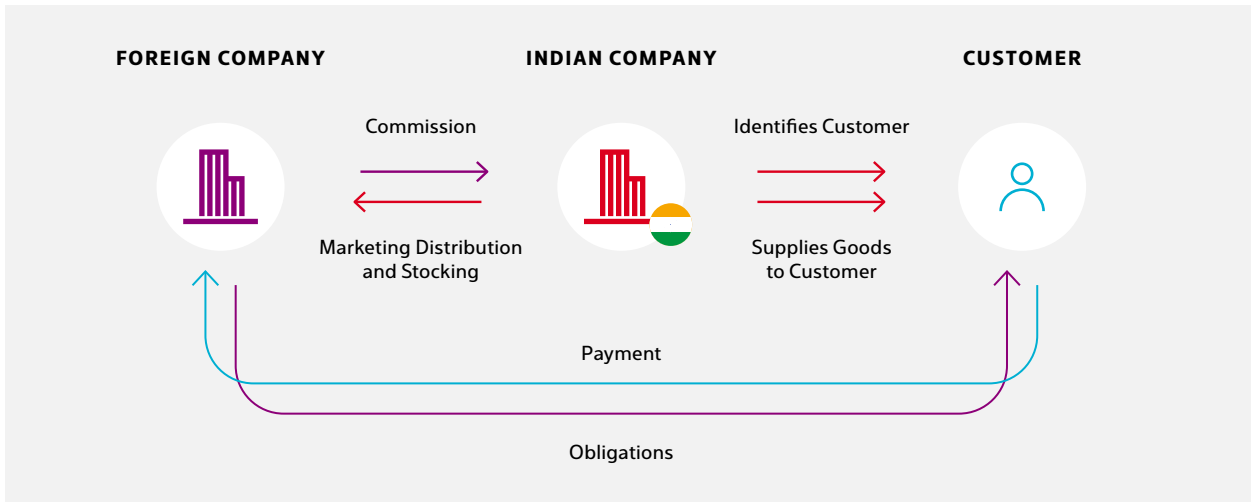


### Marketing and Distribution

Under this arrangement, a foreign company engages an Indian company for rendering marketing and distribution services on behalf of the foreign company. Under such an arrangement the goods are already stocked with the Indian company and in the event a customer is identified, the Indian company supplies the goods to the customer. All rights and obligations, including payment obligations flow between the foreign company and

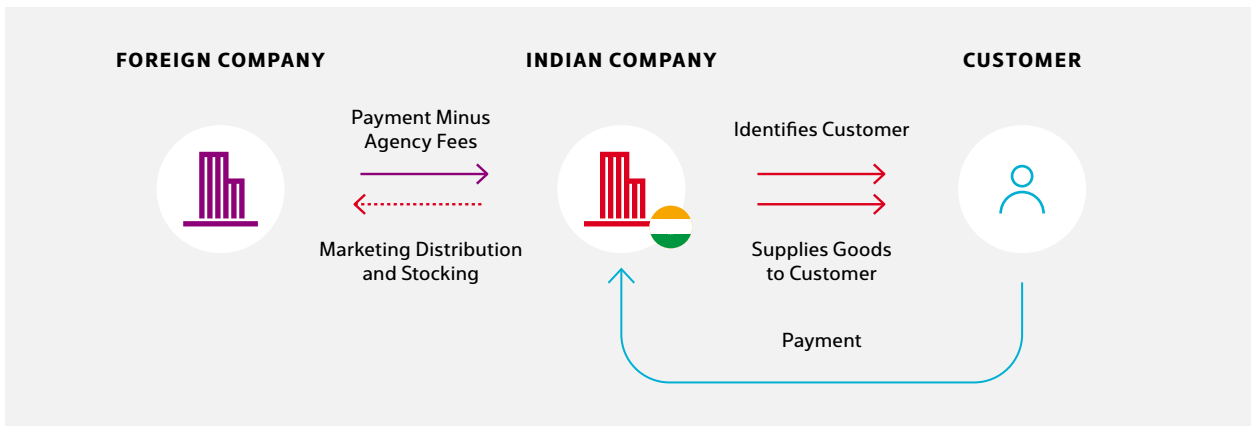
13. Trade with India

the customer. A commission is paid to the Indian company for marketing, distribution and stocking of goods. A diagrammatic representation of the structure is contained below:



Agency

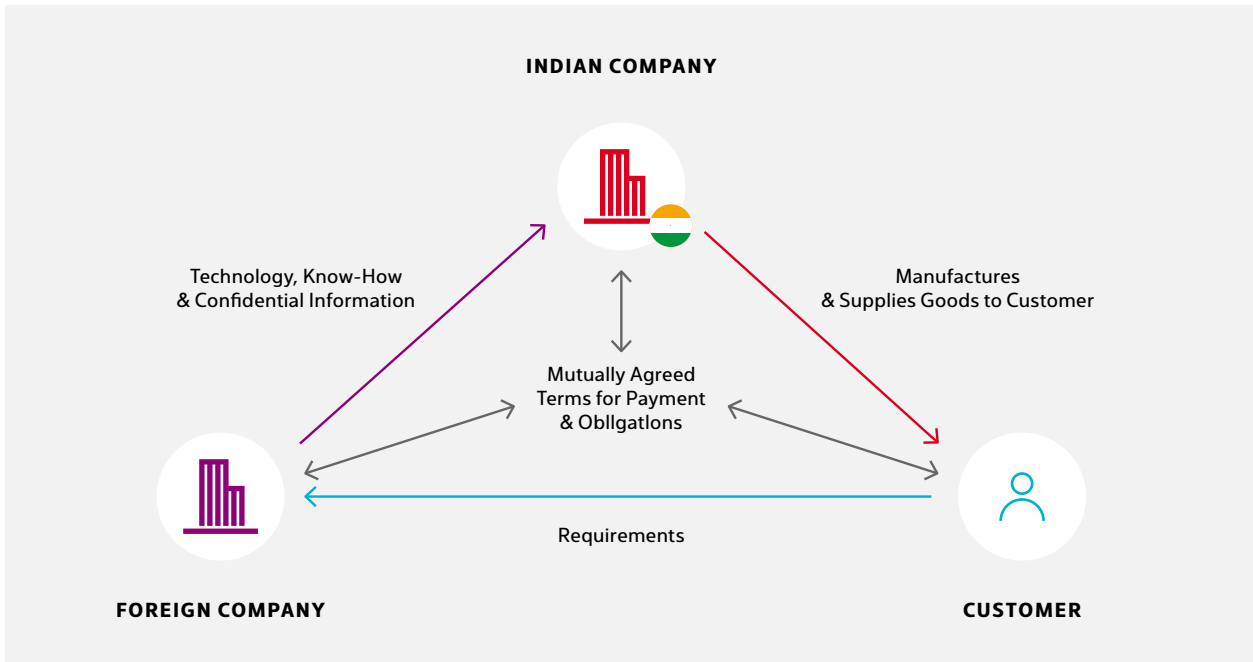
Under this arrangement, the foreign company appoints an Indian company to act as its agent in India. As the agent, the Indian company markets, stocks and distributes the goods and retains a part of the consideration paid by the customer as an agency fee. This structure is described in the diagram below:



Teaming Agreements (Joint Development)

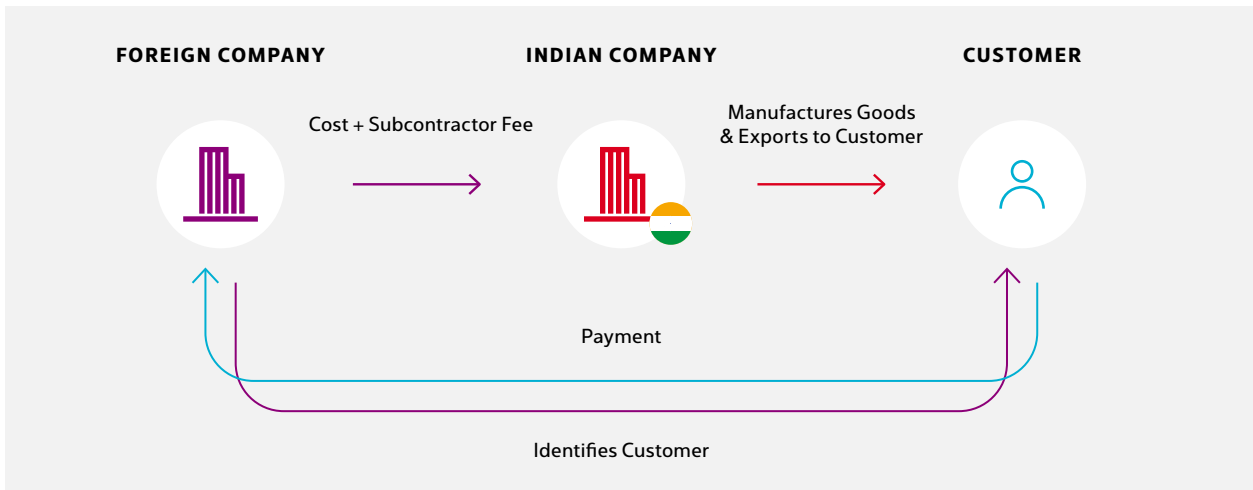
Under this arrangement, a foreign company and an Indian company team up for the development of products for an identified customer. In such situations the foreign company provides its technology, know-how and confidential information to the Indian company which in turn undertakes the manufacturing of the products in India and supplies the same to the customer. The rights and obligations, including payment obligations are mutually agreed between the foreign company, Indian company and the customer. A diagrammatic representation of the structure is contained below:

13. Trade with India



Subcontractor

Under this arrangement, a foreign company engages an Indian company to manufacture certain goods. The goods manufactured by the Indian company are in turn exported to the customers of the foreign company. Although all such exports would be done by the Indian company, the same shall be undertaken on behalf of the foreign company. The foreign company pays the Indian company on a cost-to-cost basis, along with a percentage as commission. The customers pay the foreign company for the goods received. A diagrammatic representation of the structure is contained below:



## B. Implications Under Tax Laws

Some of the above models of doing business with India may lead to the foreign company having a permanent establishment (“PE”) for the purposes of taxation laws. A PE connotes projection of a foreign enterprise into the territory of the taxing state in a substantial and enduring form. In certain circumstances, a foreign entity could be said to have a PE in India if it has a fixed place of business (such as an office or branch), if it is engaged in construction / installation activity in India, deputed employees to provide services in India or conducts business in India through agency arrangements etc. In general, the income of a foreign entity which arises in India and is attributable to the PE may be taxable in India. Consequently, the income of a foreign entity could possibly be taxed in India and in another jurisdiction. Foreign entities may avail tax benefits contained in treaties and agreements that India has entered into with governments of various jurisdictions to avoid such double taxation of income.

The business models discussed above could in certain cases result in the foreign entity having a PE in India on account of the mode of operations and scope of activities undertaken in India. Therefore, it is essential for foreign companies engaging in trade with Indian parties to carefully structure their agreements and operations to avoid any adverse tax exposure in India.

## C. Customs Duty

The primary tax relevant to the import of goods into a country is customs duty. Customs duties are levied whenever there is trafficking of goods through an Indian customs barrier i.e. levied both for the export and import of goods. Export duties are competitively fixed so as to give advantage to the exporters. Consequently a large share of customs revenue is contributed by import duty. Customs duty primarily has a ‘Basic Customs Duty’ for all goods imported into India and the rates of duty for classes of goods are mentioned in the Customs Tariff Act, 1975 (the “**Tariff Act**”), which is based on the internationally accepted Harmonized System of Nomenclature. The general rules of interpretation with respect to tariff are mentioned in the Tariff Act. The rates are applied to the transaction value of goods (for transactions between unrelated parties) as provided under the Customs Act or by notification in the official gazette.

A further duty, known as Additional Customs Duty or the Countervailing Duty (“**CVD**”) is imposed to countervail the appreciation of end price due to the excise duty imposed on similar goods produced indigenously. To bring the price of the imported goods to the level of locally produced goods which have already suffered a duty for manufacture in India (excise duty), the CVD is imposed at the same rate as excise duty on indigenous goods.

In addition to the above, there are also Additional Duties in lieu of State and local taxes which are also imposed as a countervailing duty against sales tax and value added tax imposed by States. Further, the Central Government, if satisfied that circumstances exist which render it necessary to take immediate action to provide for the protection of the interests of any industry, from a sudden upsurge in the import of goods of a particular class or classes, may provide for a Safeguard Duty. Safeguard Duty is levied on such goods as a temporary measure and the intention for the same is protection of a particular industry from the sudden rise in import.

Under Section 9A of the Tariff Act, the Central Government can impose an Antidumping Duty on imported articles, if it is exported to India at a value less than the normal value of that article in other jurisdictions. Such duty is not to exceed the margin of dumping with respect to that article. The law in India with respect to anti-dumping is based on the ‘Agreement on Anti-Dumping’ pursuant to Article VI of the General Agreement on Tariffs and Trade, 1994.

## D. Special Schemes

In light of the liberalization of foreign trade and investment into India, the Indian Government has implemented various special schemes under the Foreign Trade Policy (“FTP”) to incentivize investments into specific sectors or areas. The imports and exports in India are governed by the Foreign Trade (Development and Regulation) Act, 1992. The Central Government has set up the Directorate General of Foreign Trade under the Act which is responsible for formulating and executing the FTP. The current FTP was notified in 2015 and covers the period from 2015-2020. However, the same has been recently extended till March 31, 2023.<sup>1</sup>

To encourage exports, the FTP enlists various schemes, such as- Export Oriented Units (“EOU”), Electronics Hardware Technology Parks (“EHTP”), Software Technology Parks (“STP”), Bio-Technology Parks (“BTP”) and Special Economic Zones (“SEZ”). 100% FDI in EOUs and SEZs are permitted through automatic route. Units registered under STP/ EHTP Scheme of the government of India is permitted to have foreign equity participation up to 100% under automatic route without any prior regulatory approvals.

We have highlighted two schemes here:

### EOU Scheme

EOUs are governed by the provisions of Chapter 6 of the FTP which have also been made applicable to STPs, EHTPs and BTPs. Hence the scheme is for EOU / STP / EHTP / BTP and is referred in common parlance as the EOU Scheme. Projects undertaking to export their entire production of goods and services may be set up under the EOU Scheme for manufacture of goods, including repair, remaking, reconditioning, re-engineering and rendering of services. Trading units are not covered under the scheme.

To be considered for establishment as an EOU, projects must have a minimum investment of INR 10 million in building, plant and machinery. EOUs are allowed duty-free import of capital goods, raw materials, components, consumables, intermediates, spares and packing materials, etc. required for the manufacture of the product. These items can also be procured from within India free from all internal taxes.

New and second hand capital goods and spares, required for the unit, can be imported without a license. For services, including software units, sale in the domestic tariff area in any mode, including online data communication, is permissible up to 50% of value of exports and/or 50% of foreign exchange earned, where payment for such services is received in free foreign exchange.

Some of the other salient features under the EOU Scheme are:

- EOUs shall be permitted to retain 100% of export earnings in exchange earners foreign currency (“EEFC”) accounts.
- Export loans from banks are available at special concessional rates.
- Exemption from service tax in proportion to their exported goods and services.
- Central excise duty is not payable on exported products and a refund can be claimed of any customs or excise duty paid on raw materials used in the manufacture of the exported goods.

1 Available at: <https://pib.gov.in/PressReleaseFramePage.aspx?PRID=1862335#:~:text=In%20view%20of%20this%2C%20it,%2C%20w.e.f.%20October%201st%2C%202022.>

### 13. Trade with India

- Import facilities have been liberalized and are worked out on the basis of the import content of the free on board (FOB) value of goods to be exported.
- There are several state level incentives such as infrastructure, waiver of sales tax, reduction of stamp duty etc. that are made available to EOUs.

## SEZ Scheme

The SEZ Scheme was first introduced through the Export Import (EXIM) Policy in April, 2000 to provide an internationally competitive and hassle-free environment for exports. The Special Economic Zones Act, 2005 has been enacted to provide for the establishment, development and management of the SEZ for the promotion of exports. Units may be set up in SEZs for manufacture, reconditioning and repair or for service activity. All the import / export operations of the SEZ units will be on self certification basis. The units in the Zone have to be a net foreign exchange earner but they shall not be subjected to any predetermined value addition or minimum export performance requirements.

Some of the distinguishing features and facilities of an SEZ are:

- SEZ is a designated duty free enclave and is to be treated as foreign territory for trade operations and duties & tariffs.
- No license requirement for import.
- 100% service tax exemption and from securities transaction tax.
- 100% exemption from customs duty on import of capital goods, raw materials, consumables, spares, etc. However, any goods removed from the SEZ into a domestic tariff area will be subject to customs duty.
- 100% exemption from Central excise duty on procurement of capital goods, raw materials, consumables, spares, etc from the domestic market.
- Supplies from domestic tariff area to SEZ units are treated as exports.
- 100% tax exemption for a block of 5 years, 50% tax exemptions for a further 5 years and upto 50% of the export profit reinvested in the business for the next five years. These benefits are subject to a sunset clause which will become effective from 1 April 2020.<sup>2</sup> However, SEZ units and developers which were earlier exempted from liability to the minimum alternate tax (“MAT”) at the rate of 18.5% are subject to MAT.
- Earlier, SEZs were exempt from the levy of taxes on the sale or purchase of goods other than newspapers under the Central Sales Tax Act, 1956. Under the GST regime, the same benefits have been extended and SEZs are zero rated (i.e., exempt) from GST.<sup>3</sup>

<sup>2</sup> Available at: <http://sezindia.nic.in/cms/facilities-and-incentives.php>.

<sup>3</sup> Available at: <http://eicbma.com/gst2017/gst-notification-no-64-2017-customs-06072017.pdf>.



### 13. Trade with India

The government through an amendment to the SEZ Rules in August 2013 has provided for significant relaxations in area requirements of SEZ, extending duty exemption benefits on upgradation of structures in SEZ area, reducing the minimum land area requirement for both multi brand and sector specific SEZs by half and providing for an exit from the SEZ scheme at the option of the SEZ unit. SEZ Rules will also be amended shortly by the government to bring the rules in conformity with the GST Act. As per the recent amendment to the SEZ Rules, 2006, the setting up of units by Multilateral or Unilateral or International agencies has been permitted in International Financial Services Centre.<sup>4</sup>

A scheme to establish Free Trade and Warehousing Zones (FTWZs) was introduced in the 2004–09 Foreign Trade Policy to create trade-related infrastructure to facilitate the import and export of goods and services, with the freedom to carry out trade transactions in free currency. The Foreign Trade Policy 2015-20 sets out provisions governing the same.<sup>5</sup> An FTWZ is a special type of SEZ, with an emphasis on trading and warehousing, and is regulated by the provisions of the SEZ Act and Rules. It is aimed at making India a global trading hub. FDI is permitted up to 100% in the development and establishment of the zones and their infrastructural facilities. Each zone would have minimum outlay of INR 10 billion and a 500,000 sq. m built-up area. Units in the FTWZs would qualify for all other benefits as applicable to SEZ units. The country's first FTWZ was launched in Panvel, Mumbai in 2010.

---

4 Available at: <http://sezindia.nic.in/upload/uploadfiles/files/Amemdment%20Rule%202006.pdf>.

5 Available at: <http://dgftcom.nic.in/exim/2000/policy/chap-7A.htm>.

## Sector-Specific Regulations

All major sector in India have some sector-specific regulations. Here we give examples of two sectors, healthcare and education. You can access several sector-specific research papers outlining key regulations at our knowledge site.<sup>1</sup>

### A. Healthcare Sector

The Indian pharmaceutical and medical device industry is one of the fastest growing markets in India and has reached newer heights in the wake of the COVID-19 pandemic. India's domestic pharmaceutical market turnover reached USD 42 billion in 2021 from 20.03 billion in 2019.<sup>2</sup> The medical device sector is counted among the top 20 global medical devices market and is poised to grow to USD 50 billion by 2025 as per some industry estimates.<sup>3</sup> The growth of the Indian pharmaceutical and medical device industry in recent years is attributable to the increasing governmental focus to make India a hub for manufacturing drugs and medical devices. In pursuance, the Government has introduced various production linked-incentives and is also working towards revamping the regulatory landscape to be robust and predictable. These factors coupled with the COVID-19 pandemic has catalysed the ease of doing business in India.

The industry is primarily regulated under the Drugs and Cosmetics Act, 1940 (“**D&C Act**”) which governs marketing approvals, manufacture, import and sale of drugs and medical devices. Various rules framed under the D&C Act regulate drugs and biologicals (Drugs and Cosmetics Rules, 1945), clinical trials (New Drugs and Clinical Trial Rules, 2019) and medical devices (Medical Device Rules, 2017). Over the years, India's apex drug regulator – the Central Drugs Standard Control Organisation – has put in place comprehensive processes to streamline regulatory processes. In addition to the D&C Act, India has regulations specifically regulating the advertising and pricing of drugs and medical devices as well.

In the healthcare sector, digital health is flourishing. In 2020, the Indian Government launched the Ayushman Bharath Digital Mission to put in place various measures both in the infrastructure and policy space to encourage the use of digital health tools. Some noteworthy regulatory and policy developments include issuing guidelines to regulate telemedicine (the Telemedicine Practice Guidelines, 2020), releasing a policy framework for the creation of a National Health ID (the National Digital Health framework) and launching the Unified Health Interface Initiative. The Government Budget of 2021 was colossal to the sector in terms of the greater emphasis placed on healthcare than in previous years. India's healthcare budget had increased by 137% from 2020 (in part to fund the Government's response to COVID-19). The Government Budget 2022 further increased the healthcare budget by 16.5% from 2021. The Government is also actively expanding its policy initiatives including the AtmaNirbhar Swasth Bharat Yojana and the Ayushman Bharat Pradhan Mantri Jan Arogya Yojana to develop capacities of primary, secondary, and tertiary care health systems, strengthen existing national institutions, and create new institutions, and to create a public health insurance scheme.

In the coming years, we expect this sector to grow by leaps and bounds and for India to climb higher in its position as a global leader in the pharmaceutical and healthcare sector.

1 Available at: <https://www.nishithdesai.com/SectionArticle/33/Research-and-Articles/57/ResearchatNDA.html>.

2 Available at: <https://www.statista.com/statistics/1037947/india-pharmaceutical-market-annual-turnover/#:~:text=India's%20domestic%20pharmaceutical%20industry's%20annual,billion%20U.S.%20dollars%20in%202021.>

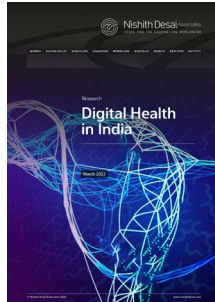
3 Available at: <https://www.investindia.gov.in/sector/medical-devices>.

## 14. Sector-Specific Regulations

Our detailed research papers on the legal and regulatory framework governing various sub-sectors within the broad healthcare sector, such as the pharmaceutical, medical device and healthcare services industries in India can be accessed here:



August 2022  
**Clinical Trials in India**  
 Legal and Regulatory Framework



March 2022  
**Digital Health in India**



February 2022  
**The Indian Pharmaceutical Industry**  
 Regulatory, Legal and Tax Overview



February 2022  
**Medical Device Industry in India**  
 Regulatory, Legal and Tax Issues



October 2020  
**Telemedicine in India**  
 The Future of Medical Practice?



May 2020  
**Investment in Healthcare**  
 Legal, Regulatory and Tax Overview

## B. Education Sector

The Indian education sector is undergoing a paradigm shift. The National Education Policy, 2020 (“**NEP**”) is reformist and foresighted, and the Government has taken numerous steps, including issuing regulations, towards achieving the vision of the NEP.

The education sector in India can be broadly categorized as follows:

- Pre-school
- Primary to Secondary school or K-12
- Higher education
- Vocational/skill-based training

#### 14. Sector-Specific Regulations

The NEP, once implemented at a large scale in letter and spirit, could have groundbreaking impact on the future of education in India. There is not only an emphasis on holistic and multidisciplinary learning, but also on technological integration. A greater emphasis is also rightly placed on Early Childhood Care and Education.

The past few years have seen immense private sector involvement in K-12 sector. Ranging from low-cost schools, to premier schools, the private sector has played a pivotal role in improving the quality of education and enrollments at the school level. The current 10+2 framework at the school level is soon set to be replaced with a 5+3+3+4 structure to promote better overall learning and well-being. The recent growth of EdTech in India has also enhanced teaching and learning, resulting in more student engagement even outside of school. The goal of the government is to achieve 100% Gross Enrolment Ratio in preschool through secondary school by 2030.<sup>4</sup>

There has been a noticeable shift in higher education as well. There has been increasing adaptability towards skill learning for better job prospects, in addition to traditional university education. The regime on online education had been drastically changed in 2021, where regulations now provide legal recognition to online degree programmes in India. In addition, autonomy has been given to several universities across the country to improve enrollments. The government has also issued guidelines for transforming higher education institutions into multidisciplinary universities with focus on research, liberal arts, skill based, employment oriented new-age learning.<sup>5</sup>

Higher education is to be made more flexible, with students having the choice to pursue subjects from various disciplines. Further, the NEP seeks to (i) establish 'light but tight' regulation through a single regulator for higher education; (ii) support online education and open and distance learning; and (iii) increase collaboration between Indian and foreign universities in academics and research.

The recent regulations on online education, collaboration between Indian and foreign higher educational institutions, and academic bank of credits, among others, have opened up avenues for numerous players in the sector, both domestic and foreign. Collaborations with foreign institutions, EdTech platforms and the like have received a boost, and these regulations could prove to be crucial for realizing the potential of EdTech in India.

Investment in education has also been on the rise. The India Brand Equity Foundation estimates that India's education system is the largest in the world, with a population of 500 million between the age group of 5-24.<sup>6</sup> Because of the sheer size of the sector, and the progressive regulations, several well-known private equity and venture capital funds are showing interest in education sector resulting in rise in deal making in the industry. In addition to traditional investment structures, impact investment in the education space has also gained popularity, with investor interests being balanced with societal good.

---

4 Paragraph 1.1, NEP.

5 Available at: [https://www.ugc.ac.in/pdfnews/5599305\\_Guidelines-for-Transforming-Higher-Education-Institutions-into-Multidisciplinary-Institutions.pdf](https://www.ugc.ac.in/pdfnews/5599305_Guidelines-for-Transforming-Higher-Education-Institutions-into-Multidisciplinary-Institutions.pdf).

6 Available at: <https://www.ibef.org/industry/education-sector-india>.

## 14. Sector-Specific Regulations

Our detailed research papers on various aspects of the education sector can be accessed here:



June 2022

### Higher Education

Opportunities for Foreign Educational Institutions in India

Strategic, Legal and Tax Issues



June 2022

### EdTech: From IT to AI

A legal Perspective



February 2020

### Investment in Education



April 2019

### Impact Investment: Innovation for India's Education Sector

Strategic, Legal and Tax Issues

## C. Research Papers

Our industry insights have also resulted in us writing a number of original Research Papers and Articles in various burgeoning and relevant areas of the law. The same can be accessible [here](#).

## Conclusion

Historically, India has had a poor track record with its growth rate subsisting through much of the period from independence until 1991. There were several obstacles hindering successful establishment of businesses in India such as the arduous system of securing prior licences and permits for production of goods imposed restrictions on internal production. Moreover, many industrial sectors were housed in unwieldy and unproductive public sector undertakings, which effectively had a monopoly in their respective sectors. Bureaucracy was rampant and the polity highly corrupt; even the private sector was largely subject to their whims and vagaries resulting in a lack of efficacy in business operations. This overarching lack of stability made India a non-conducive environment for fostering business development and growth.

India's import policies, despite the recent relaxations, continue to remain unfriendly with very high import duties charged on many imported goods. Moreover, India's tax and corporate laws are intrinsically complex and ever-evolving.

Following the liberalization of India's economy in 1991, a broad sweep of reforms were introduced to its financial and trade policies. These changes have resulted in a positive impact on its sizable Indian populace. Liberalization had already provided the much needed proverbial shot in the arm for the entrepreneurial spirit of India's people and it found a new lease of life after years of being stifled. For instance, the IT/ITES sector is one of the few that has seen the introduction of a large number of friendly policies which have enabled the sector to grow by leaps and bounds in the last two decades and give rise to brands like Infosys, Tata Consultancy Services and Wipro that have achieved global recognition.

While corruption still exists, the continued enhancement and expansion of digitization and computerization of numerous public bodies has led to an increased level of efficiency and institutions such as the RBI and SEBI becoming increasingly proactive in dealing with foreign investment into India. Furthermore, certain state governments have taken dynamic steps to improve efficiency in public offices such as the RoC. While the level of caution exercised by the state governments may seem to be draconian; it has tremendously aided India in avoiding any major internal impact of the financial crisis.

Modi government's policies of smart cities, Digital India, single window policy has given the correct signals to all. Also the Government's mantra of "ease of doing business" has brought about many reforms which will work towards changing the perception about doing business in India. The testimony of which is an ever improving rank of India in the annual World Bank's ease of doing business report. More and more ministries are moving towards online access for granting licenses/ approvals/ registrations/ reporting etc. and single window clearance.

To conclude, whilst it is apparent that India still has a long way to go, it has already positioned itself and continues to enhance its attractiveness as a desired destination for investment and trade. Whilst its expanding levels of intellectual capital and digital infrastructure are likely to make it a global hub for services, high levels of domestic consumption coupled with significant cost competitiveness, along with a global demand of shift in supply chain outside of China, makes India an ever attractive destination for investments in services and manufacturing.

# Investing into India: Considerations from a Mauritius – India Tax Perspective

## A. Mauritius – India Relations: Background

India and Mauritius have shared close economic, political and cultural ties for more than a century. There has been close cooperation between the two countries on various issues including trade, investment, education, security and defense.

Bilateral investment between the two countries has continued to strengthen the ties between the two nations. As of March 2016, the cumulative FDI inflows from Mauritius to India was around USD 96 Billion amounting to 33% of the total FDI inflows, making it India's largest source of FDI.<sup>1</sup> Several global funds and strategic investors have invested into India from Mauritius due to various commercial, strategic and tax related advantages offered by the country. Mauritius has also emerged as an important gateway for investments into Africa.

India is also Mauritius's most important trading partner and the largest exporter of goods and services into Mauritius. The combined trade between the two countries stood at USD 1.9 Billion.<sup>2</sup>

- The major bilateral agreements between the two nations cover several areas not just restricted to finance, trade and commerce but also include intelligence, cultural ties, environmental protection etc. Some of the key bilateral treaties and institutional agreements between India and Mauritius include: The Double Taxation Avoidance Agreement, 1982 as amended by the Protocol in 2016
- Bilateral Investment Promotion and Protection Agreement, 1998
- MoU on Cooperation in Biotechnology, 2002
- MoU on Cooperation in the Field of Environment, 2005
- MoU Concerning Cooperation in the Exchange of Finance Intelligence Related to Money Laundering & Financing of Terrorism, 2008
- Supply Contract for the Coastal Radar Surveillance System, 2009
- MoU on Science and Technology Cooperation, 2012
- MoU on Textiles, 2012
- MoU on cooperation in MSME Sector (2013)
- MoU on Cooperation in Ocean Economy (2015)
- MoU in the field of Traditional Systems of Medicine (2015)

1 Fact Sheet on FDI, as accessible at [https://dpiit.gov.in/sites/default/files/FDI\\_FactSheet\\_JanuaryFebruaryMarch2016.pdf](https://dpiit.gov.in/sites/default/files/FDI_FactSheet_JanuaryFebruaryMarch2016.pdf).

2 Release by the Ministry of External Affairs on India-Mauritius Relations, as accessible at [http://www.mea.gov.in/Portal/ForeignRelation/Mauritius\\_08\\_01\\_2016.pdf](http://www.mea.gov.in/Portal/ForeignRelation/Mauritius_08_01_2016.pdf).



## B. Mauritius – India Tax Treaty: Special Considerations

### Residence and Entitlement to Treaty Relief

A person is considered a resident of Mauritius for relief under the tax treaty, as long as it is liable to tax in Mauritius by reason of domicile, residence or place of management. The Indian tax authorities issued a Circular (789 of 2000) stating that a tax residency certificate (“TRC”) issued by the Mauritius tax authorities constitutes sufficient proof of residence in Mauritius and entitlement to treaty relief. This Circular was upheld by the Indian Supreme Court in the landmark Mauritius Case (*Union of India v. Azadi Bachao Aandolan*<sup>3</sup>) where it was held that in the absence of a ‘limitation of benefits’ or anti-abuse clause within the treaty, there was nothing illegal about ‘treaty shopping’ and legitimate tax planning using low tax jurisdictions. The Supreme Court affirmed the time tested principle laid down by the UK House of Lords in the case of *Duke of Westminster*<sup>4</sup> where it was held “every man is entitled, if he can, to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be”. Therefore, based on this judgment and Circular, any Mauritius based investor holding a valid TRC should be entitled to treaty relief.

The Supreme Court in *Vodafone International Holdings*<sup>5</sup> was also of the view that that treaty benefits cannot be denied to an entity resident in Mauritius having a valid TRC, especially in the absence of a limitation of benefits clause within the treaty.

A number of cases have confirmed treaty benefits for Mauritius based investors including:

*Dynamic India Fund I*,<sup>6</sup> *DDIT v. Saraswati Holdings Corporation*,<sup>7</sup> *E\*Trade*,<sup>8</sup> *D.B. Zwirn Mauritius Trading*,<sup>9</sup> *In re, Ardex Investments Mauritius Ltd.*,<sup>10</sup> *In re, SmithKline Beecham Port Louis Ltd.*,<sup>11</sup> *DLJMB Mauritius Co.*,<sup>12</sup> *Moody’s Analytics Inc.*<sup>13</sup>

Very recently, *the Punjab & Haryana High Court in Serco BPO (P) Ltd. v. AAR*<sup>14</sup> and *the Authority for Advance Rulings in In re, Dow AgroSciences Agricultural Products Ltd.*<sup>15</sup> have also upheld treaty benefits for Mauritius based investors.

In 2013, Government also issued a press release clarifying that the Circular is still valid and that, at that moment, a TRC obtained by a Mauritius company should not be questioned for proof of residence. India and Mauritius signed a Protocol, which significantly amended the provisions of the tax treaty between the two countries. The Protocol amended the prevailing residence based tax regime under the tax treaty and gave India a source based right to tax capital gains which arise from alienation of shares of an Indian resident company acquired on or after April 1, 2017 by a Mauritius tax resident.

3 [2003] 263 ITR 706 (SC).

4 (1936) 19 TC 490, [1936] AC 1.

5 [2012] 341 ITR 1.

6 AAR 1016/2010 dated 18th July, 2012.

7 [2009] 111 TTJ 334.

8 [2010] 324 ITR 1 (AAR).

9 [2011] 333 ITR 32 (AAR).

10 [2012] 340 ITR 272 (AAR).

11 [2012] 348 ITR 556 (AAR).

12 [1997] 228 ITR 268.

13 [2012] 348 ITR 205.

14 WP (C) No. 11307 of 2014 (O&M).

15 AAR No. 1123 of 2011.



## 16. Investing into India: Considerations from a Mauritius – India Tax Perspective

However, the Protocol provided for grandfathering of investments and the revised position only became applicable to investments made on or after April 1, 2017. Importantly, the Protocol introduced a limitation of benefits provision which was a prerequisite for a reduced rate of tax (50% of domestic tax rate) on capital gains arising during a two year transition period from April 1, 2017 to March 31, 2019. As per the limitation of benefits clause in the amended treaty (contained in Article 27A of the amended tax treaty), a Mauritius resident shall be entitled to the benefit of such reduced tax rate on sale of shares of an Indian company only if the following criteria are satisfied:

- Purpose not to be primarily tax driven (Article
- 27A(1) of the amended treaty): The affairs of the Mauritius resident are not arranged with the primary purpose of taking benefit of the reduced tax rate.
- The Mauritius resident is not a shell or conduit
- (Article 27A(2) of the amended treaty): A shell / conduit entity is one with negligible or nil business operations or with no real and continuous business activities carried out in Mauritius.
- As per Article 27A(4) of the amended treaty, a Mauritius resident is deemed not to be a shell or conduit if its expenditure on operations in Mauritius is at least Mauritius Rupees 1.5 million in the twelve months immediately preceding the date the relevant capital gains arise.

As described, with the amendment to the tax treaty, especially the introduction of the limitation of benefits provision, residence alone is not sufficient for entitlement to treaty benefits, particularly with regard to investment in shares of an Indian company.

## PE Risks

Mauritius companies having a PE in India should be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the Mauritius – India context.

A PE of a Mauritius based entity may be constituted in India if such entity has a ‘fixed place of business’ in India through which a part or the whole of its business here is carried on. Such fixed place may be constituted through a branch, an office, factory, workshop, warehouses, constructions or place of effective management in India. A PE may also be constituted if a Mauritius resident has a building, construction or assembly project in India for a period exceeding 9 months. In *GIL Mauritius Holdings Ltd. v. ADIT*<sup>16</sup> the Delhi Tribunal held that presence in India for installation of a pipeline may not per se be a PE but should give rise to a PE only if it extends for a period beyond 9 months.

The Protocol provided for a new inclusion falling within the ambit of PE. Consequent thereto, the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only where activities of that nature continue (for the same or connected project) for a period or periods aggregating more than 90 days within any 12-month period also falls within the definition of PE.

A PE may be constituted if a Mauritius entity has a dependent agent in India concluding contracts or maintaining a stock of goods in India for making deliveries on behalf of the foreign enterprise.

<sup>16</sup> [2012] 348 ITR 491 (Del).

## 16. Investing into India: Considerations from a Mauritius – India Tax Perspective

The Mumbai tribunal in *DDIT v. B4U International Holdings Limited*<sup>17</sup> held that an Indian entity that did not have the power to conclude contracts on behalf of a Mauritius enterprise should not be treated as a dependent agent. It also held that even if there is a PE, as long as the Indian entity was compensated at arm's length, no further profits should be attributed to the Mauritius based taxpayer.<sup>18</sup> The decision of the Mumbai tribunal has been affirmed by the Bombay High Court.<sup>19</sup>

## Taxation of Royalty and FTS

Under the India-Mauritius treaty the maximum Indian tax rate on cross-border royalties is 15%. A withholding tax rate of 10% is applicable under Indian domestic law.<sup>20</sup> Royalty is defined to mean consideration for the right to use any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience. The definition of royalty is more restricted than under Indian domestic law.

Prior to the Protocol, the treaty did not have a specific provision dealing with fees for technical services. Such income was treated as business profits taxable in India only if the Mauritius enterprise carried on business in India through a fixed base or PE.<sup>21</sup> However, the Protocol amended the treaty by inserting Article 12A to provide for taxation of fees for technical services. As per the amended treaty, FTS arising in India to a Mauritius resident is taxable in India, subject to a maximum tax rate of 10% of the gross amount paid as FTS. The tax rate, as well as applicable withholding tax rate, for FTS under Indian domestic law is also 10%.

FTS is defined to mean payments as consideration for managerial or technical or consultancy services, including the provision of services of technical or other personnel. However, business profits and fees for independent services (typically covering professional services or other independent activities of a similar character) and fees for dependent services (typically connected to contracts of employment) are excluded from the purview of FTS contemplated under Article 12A. To such extent therefore, the definition of FTS under the amended treaty is more restricted than under Indian domestic law.

## Taxation of Interest

Prior to the amendment of the India-Mauritius treaty by the Protocol, there was no relief for withholding tax on interest under the treaty and the domestic rates applied. The domestic withholding tax rate on interest ranges between 5% (introduced for certain specific bonds) to around 40%.

In terms of the amended treaty, there is a lower withholding tax rate of 7.5% for interest payment made by an Indian resident to a Mauritius resident. This rate is nil in case the interest is being paid to a bank resident in Mauritius, carrying on bona fide banking business.

<sup>17</sup> [2012] 18 ITR 62 (Mumbai).

<sup>18</sup> Based on the decision in *DIT International Taxation Mumbai Vs M/S Morgan Stanley & Co.* [2007] 292 ITR 416.

<sup>19</sup> ITA Nos. 1274, 1557, 1599 & 1621 of 2013.

<sup>20</sup> In any case, following amendments to the ITA by the Finance Act, 2015, the withholding tax rate applicable in case of royalty and fees for technical services ("FTS") has been reduced to 10% from the earlier 25%.

<sup>21</sup> *Spice Telecom v. ITO*, (2008) 113 TJJ Bang. 502.

## Taxation of Capital Gains

Prior to amendment of the tax treaty by the Protocol, capital gains (whether long term or short term) earned by a Mauritius resident from the transfer of securities in India was not subject to tax in India. Under Indian domestic law, capital gains tax range from around 10% to 40% depending on the period of holding, the nature of the security involved and the status of the investor. Gains from the transfer of listed securities which are held for a period of more than 12 months are categorized as long term capital gains.

Gains arising from the transfer of unlisted securities should be treated as long term only when such securities have been held for more than 36 months, except for unlisted shares, in which case the period of holding is reduced to 24 months. If the holding period of such securities is less than 36 months or 24 months (in case of unlisted shares), then the gains arising upon their transfer shall be in the nature of short term gains.<sup>22</sup>

The relief from capital gains tax previously provided a significant advantage for Mauritius based funds and other investors. It was particularly beneficial for US investors investing via Mauritius as they were able to avoid double taxation of capital gains income which potentially arise because of conflict in source rules (for capital gains tax) under US and Indian domestic law.

From the Supreme Court decisions in *Azadi Bachao Andolan and Vodafone International Holdings* to the various advance rulings referred to above, Courts have generally held that a Mauritius resident holding a TRC should not be taxable on gains earned from transfer of Indian securities. There has been some challenge from revenue authorities on entitlement to relief on the basis that the Mauritius entity was not the real beneficial owner of the Indian investment.<sup>23</sup>

However, all of the aforementioned decisions were made with regard to the India-Mauritius treaty prior to its amendment by the Protocol. As discussed above, the Protocol amended the residence based tax regime under the tax treaty and gave India a source based right to tax capital gains which arose from alienation of shares of an Indian resident company acquired on or after April 1, 2017 by a Mauritius tax resident. However, the Protocol provided for grandfathering of investments and the revised position became applicable to investments made on or after April 1, 2017. Further, with respect to shares acquired on or after April 1, 2017, capital gains arising during a two year transition period from April 1, 2017 to March 31, 2019 is chargeable at a reduced rate of tax (50% of domestic tax rate) subject to the fulfillment of criteria pertaining to limitation of benefits as discussed.

It is noteworthy that the Protocol only changed the regime with respect to capital gains arising from the sale of shares, and the tax regime prevalent under the treaty prior to its amendment remains the same for other capital assets even after the amendment of the treaty.

The Protocol to the Indo-Mauritius treaty has therefore significantly altered the position in relation to taxation of capital gains.

One may also note that in the case of *Re: Castleton Investments*,<sup>24</sup> it was held that although the Mauritius investor may not be liable to capital gains tax, the gains may still be subjected to minimum alternate tax at the rate of 18.5%. However, following the recommendations of the Committee on Direct Tax Matters chaired by Justice AP Shah, the government issued a Press Release<sup>25</sup> clarifying that MAT should not be applicable to Foreign Portfolio

22 The period of holding for unlisted shares from 36 months to 24 months is the result of a recent amendment to the ITA by the Finance Act, 2016.

23 *Aditya Birla Nuvo Ltd. v. DDIT*, [2011] 242 CTR 561.

24 [2010] 324 ITR 1 (AAR).

25 As accessible at <http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/390/Press-Release-Applicability-of-Minimum-Alternate-Tax-24-09-2015.pdf>.

## 16. Investing into India: Considerations from a Mauritius – India Tax Perspective

Investors as well as foreign companies, provided that the latter category are resident in a country having a treaty with India and do not have a permanent establishment in India within the definition of the term in the relevant treaty. On the basis of the Press Release, the Supreme Court disposed<sup>26</sup> the appeal filed by Castleton in terms thereof. The Finance Act, 2016 further amended (applicable with retrospective effect from April 1, 2001) the ITA clarifying that the MAT provisions shall not be applicable to foreign companies meeting the conditions mentioned above. Consequently, MAT is not applicable on foreign companies investing into India through Mauritius.

### Exchange of Information and Assistance in the Collection of Taxes

The Protocol amended the India-Mauritius treaty to strengthen the exchange of information framework in line with internationally prescribed norms. The amended treaty clarifies that information cannot be declined solely because the information is held by a bank, financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person. However, there are safeguards in relation to supply of information which disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which is contrary to public policy.

Mauritius has also become a signatory to the Convention on Mutual Administrative Assistance and has made a commitment to early implementation of the new global standard for the purposes of automatic exchange of information (the Common Reporting Standard (CRS) developed by the OECD).

Further, the Protocol introduced Article 26A to the treaty, which provides that India and Mauritius shall lend assistance to each other in the collection of revenue claims. It allows for Mauritius authorities to enforce and collect taxes of Indian revenue claims, as if such claims were its own, upon a request from Indian revenue authorities.

### Mauritius – India Bilateral Investment Promotion and Protection Agreement

Bilateral investment promotion and protection agreements (BIPAs) are agreements between two States for the reciprocal encouragement, promotion and protection of investments in each other's territories by individuals and companies situated in either State.

The India-Mauritius BIPA is comprehensive and provides several reliefs to investors from Mauritius including fair and equitable treatment, protection against expropriation, repatriability of capital, an efficient dispute resolution framework and other rights and reliefs. Taking advantage of the BIPA is an important strategic reason for investors to invest from Mauritius. It should be noted that India does not have a BIPA with the US and hence, typically US investors investing from Mauritius seek to take advantage of the India-Mauritius BIPA.

---

<sup>26</sup> CA Nos. 4559 & 4560 of 2013.

# Investing into India: Considerations from a Singapore – India Tax Perspective

## A. Singapore – India Relations: Background

Building on their centuries-old historical and cultural linkages, Singapore and India have, over the years, developed a very strong strategic partnership, which covers a whole gamut of areas of cooperation including trade, tourism, security and defence. Singapore is an important partner for India, owing to its strategic location, stable government, competitive work-force and a pro-business environment. It is ranked #1 in World Bank's ease of doing business index. Singapore has a mature and developed financial market with an important stock exchange to facilitate the raising of capital and improve stock liquidity. Singapore also has good connectivity to the rest of Asia, Europe and the United States, thereby making it very convenient for prospective clients to invest there. Several multinational corporations including Indian companies are actively considering setting up regional or international headquarters in Singapore.

Singapore has always been an important strategic trading post, giving India trade access to the Malay Archipelago and the Far East. For India, Singapore has also played an important role with respect to India's "Look East" Policy for expanding its economic, cultural and strategic ties in Southeast Asia.

FDI of around USD 44.88 billion has been received from Singapore from April 2000 to March 2016, making it the second largest investor in India after Mauritius accounting for 16% of total FDI received by India.<sup>1</sup> The investments from India to Singapore have been equally forthcoming.<sup>2</sup> Singapore has become a preferred centre of operations for Indian companies active in the Asia Pacific region. Thanks to its enabling environment, access to low cost finance, strong air connectivity, availability of skilled resources and the presence of a large Indian community, Singapore has emerged as a key offshore logistics and financial hub for many Indian corporate/houses.

In 2005, India and Singapore signed the Comprehensive Economic Cooperation Agreement ("CECA") to promote trade, economic development and partnerships which integrates agreements on trade in goods and services, investment protection, and economic cooperation in fields like education, intellectual property and science & technology. The CECA eliminated tariff barriers, double taxation, duplicate processes and regulations and provided unhindered access and collaboration between the financial institutions of Singapore and India.

1 [https://dpiit.gov.in/sites/default/files/FDI\\_FactSheet\\_JanuaryFebruaryMarch2016.pdf](https://dpiit.gov.in/sites/default/files/FDI_FactSheet_JanuaryFebruaryMarch2016.pdf).

2 See @ <https://www.hcsingapore.gov.in> › Bilateral Relations › India – Singapore Relations.

## 17. Investing into India: Considerations from a Singapore – India Tax Perspective

A number of bilateral agreements and institutional arrangements have been executed between Singapore and India. Listed below are some of the key agreements:

- Establishment of Diplomatic Relations (1965);
- Bilateral Air Services Agreement (1968);
- Defence Cooperation Agreement (2003);
- India and Singapore are poised to see enhanced economic cooperation as well as an increase in trade and investment flows.

## B. Singapore – India Tax Treaty: Special Considerations

### Residency of Partnerships and Hybrid Entities

Tax treaty relief may only be claimed by persons who are residents in accordance with the taxation laws of India or Singapore, as the case may be. Singapore based LLPs may face difficulties in claiming treaty relief in view of the Schellenberg Wittmer<sup>3</sup> case wherein a Swiss general partnership was held not to be entitled to treaty benefits since it is a fiscally transparent entity in Switzerland and does not qualify as a resident of Switzerland under the tax treaty. Further, Swiss resident partners of the partnership could also not take advantage of the treaty since they were not direct recipients of the income. Similarly, under Singapore law, a partnership or an LLP is a fiscally transparent entity and may not be able to claim treaty reliefs in India since it would not qualify as a Singapore resident under the tax treaty. The treaty in this regard needs to be revised.

### PE Risks

Singapore residents having a PE in India would be taxed to the extent of income attributable to such PE. It is necessary to take into account specific PE related tax exposure in the Singapore India context.

A PE may be constituted if a Singapore based enterprise has a fixed base, office, branch, factory, workshop, etc. in India. The enterprise is deemed to have a PE in India if it has an installation or structure which is used for the extraction or exploitation of natural resources in India and such installation or structure is used for more than 120 days in a fiscal year. A construction PE may be constituted if the work carried on at a building or construction site, installation or assembly project or supervisory activities in connection therewith continue for a period of more than 183 days in a fiscal year. A Singapore enterprise shall also be deemed to have a PE in India if it provides services or facilities in relation to exploration, exploitation or extraction of mineral oils in India for a period of more than 183 days in a fiscal year.

The India –Singapore Double Taxation Avoidance Agreement (“India- Singapore DTAA”) is also one of the few tax treaties signed by India which have a service PE clause. A service PE may be constituted if a Singapore enterprise provides services through its employees who spend more than 90 days in India in any fiscal year (or 30 days if the services are provided to a related enterprise).

3 [2012] 210 TAXMAN 319 (AAR).

## 17. Investing into India: Considerations from a Singapore – India Tax Perspective

A dependent agent in India of the Singapore enterprise would be treated as a PE if the agent negotiates and concludes contracts, maintains a stock of goods for delivery or habitually secures orders wholly or almost wholly on behalf of the Singapore enterprise.

The Delhi High Court in *Rolls Royce Singapore Pvt. Ltd. v. ADIT*<sup>4</sup> held that a sales agent in India providing services to a Singapore company would be treated as giving rise to a dependent agent PE in India. The Court noted that the Indian entity was prohibited from promoting products of competitors, and that the Singapore company exercised extensive control over the Indian entity whose activities were wholly or almost wholly devoted to the Singapore company. However, the Court also accepted the established principle that if the agent (PE) is compensated at arm's length, there can be no further attribution of taxable income. In *WSA Shipping (Bombay) Pvt Ltd. v. ADIT*<sup>5</sup> the Mumbai Tribunal held that an Indian service provider which acted on behalf of a Singapore company could not be treated as an agency PE in India since the Indian entity was an independent agent that provided services to multiple clients.

## Exemption for Capital Gains Tax on Sale of Shares

Prior to the amendment to the capital gains tax provisions of the India-Singapore Tax Treaty, gains arising to a Singapore resident from the sale of shares of an Indian company would be taxable only in Singapore, whereas Singapore did not impose a capital gains tax. Hence, the transaction would be tax exempt in both countries.

However, the India-Singapore treaty was significantly amended by way of the Third Protocol in March, 2017. The Third Protocol to the India-Singapore Treaty provides that gains arising to a Singapore resident from disposal of shares in an Indian company shall be taxable in India.

The Third Protocol also provided for grandfathering of investments made by a Singapore resident prior to April 01, 2017 and the revised position became applicable to investments made on or after April 1, 2017. Further, with respect to shares acquired on or after April 1, 2017, capital gains arising during a two year transition period from April 1, 2017 to March 31, 2019 is chargeable at a reduced rate of tax (50% of domestic tax rate) subject to the fulfillment of criteria pertaining to limitation of benefits as discussed.

In order to claim the benefits under the tax treaty for grandfathered investments prior to April 01, 2017, and during the interim period between April 01, 2017, March 31, 2019, the Third Protocol also introduced an anti avoidance clause in the form of a limitation of benefit (“**LoB**”) clause.

As per the LoB clause (contained in Article 3 of the Third Protocol, and inserted as new Article 24A of the DTAA), a Singapore resident would be entitled to the capital gains tax exemption on sale of shares of an Indian company only if the following criteria were satisfied:

- Purpose not to be primarily tax driven (Article 3.1 of India- Singapore DTAA protocol): The affairs of the Singapore enterprise were not arranged with the primary purpose of taking benefit of the capital gains tax relief.
- The Singapore resident was not a shell or conduit (Article 3.2-3.4 of India- Singapore DTAA protocol): A shell / conduit entity is one with negligible or nil business operations or with no real and continuous business activities carried out in Singapore.

4 [2012] 347 ITR 192 (Delhi).

5 [2012] 53 SOT 306 (Mum).



## 17. Investing into India: Considerations from a Singapore – India Tax Perspective

A Singapore resident is deemed not to be a shell or conduit if its annual operational expenditure in Singapore was at least SGD 200,000 per year in the two years preceding the transfer of shares giving rise to capital gains.

As such, the India- Singapore DTAA Third Protocol serves as a broad anti-avoidance provision within the treaty itself. A Singapore entity would not be entitled to the capital gains tax relief if its affairs were arranged with the primary purpose of taking benefit of such relief. If this was the case, the benefit would be denied even if the Singapore entity incurred an annual operational expenditure of SGD 200,000.

## Taxation of Royalty and FTS

Interest, royalties and FTS arising in India and paid to a Singapore resident may be taxed in Singapore. However, if the Singapore resident is the beneficial owner of the royalties or FTS, the tax so charged shall not exceed 10% of the gross amount that is paid. The domestic withholding tax rate on royalty and FTS paid to non-residents is also 10% on a gross basis (excluding applicable surcharge and cess).

Royalties is defined to mean consideration for the right to use any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information or for the use of, or the right to use, any industrial, commercial or scientific equipment, other than payments derived by an enterprise from (i) the incidental lease of ships or aircraft used in such transportation; or (ii) the use, maintenance or rental or containers (including trailers and related equipment for the transport of containers) in connection with such transportation. The definition of royalty is more restricted than under Indian domestic law which has been subject to certain retroactive amendments in 2012.

The Mumbai Tribunal in *Standard Chartered Bank v. DCIT*<sup>6</sup> held that payment for data processing services provided by a Singapore based company cannot be treated as taxable royalty income since the Indian client did not have possession or control over the mainframe computer in Singapore and could only transmit the data and receive back processed information from the server. This case may be contrasted with *In Re: Cargo Community Network Pte. Ltd.*<sup>7</sup> where it was held that payment to a Singapore based service provider for access to an internet based air cargo portal would be characterized as taxable royalty payments.

The scope of FTS in the Singapore treaty is more restrictive than most treaties signed by India. FTS refers to payments of any amount in consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel if such services:

- a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment is in the nature of royalties; or
- b) make available technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the services to apply the technology contained therein; or
- c) consist of the development and transfer of a technical plan or technical design, but excludes any service that does not enable the person acquiring the service to apply the technology contained therein.

<sup>6</sup> 2011 TPI 728 (ITAT-Mumbai).

<sup>7</sup> [2007] 289 ITR 355 (AAR).



---

**17. Investing into India: Considerations from a Singapore – India Tax Perspective**

The case of *Bharati AXA General Insurance Co.Ltd. v. Director of Income Tax*<sup>8</sup> dealt with the taxability of payments made by an Indian entity for support services provided by a Singapore company, which included strategic advice, marketing support, IT services, choosing re-insurance partners, review of actuarial methodologies, etc. in line with the global practices.

The Authority of Advance Ruling (AAR) held that such payments are not FTS as the services do not “make available” any technical knowledge, know-how or skill to the Indian company. However, in *Organisation Development Pte. Ltd. v. DDIT*,<sup>9</sup> the Chennai Tribunal held that payments made to a Singapore based service provider for license to a specialized software to enable management based on ‘balanced score card’ techniques and transfer of knowledge and skill would be treated as fees for technical services subject to withholding tax in India.

## Exchange of Information

The Singapore India tax treaty was amended in 2011 to strengthen the exchange of information framework in line with internationally prescribed norms.

The amended treaty clarifies that information cannot be declined solely because the information is held by a bank, financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person. However, there are safeguards in relation to supply of information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

Singapore has also become a signatory to the Convention on Mutual Administrative Assistance and has made a commitment to early implementation of the new global standard for automatic exchange of information purposes (the Common Reporting Standard (CRS) developed by the OECD).

---

8 (2010) 326 ITR 477 (AAR).

9 [2012] 50 SOT 421 (Chen).

# Investing into India: Considerations from a USA – India Tax Perspective

## A. US – India Relations: Background

The inception of market-oriented reforms in India has marked a new phase in the relationship between India and the United States of America (“US”). With the impending shifting of political and economic polarity in the globe to the Asian region, economic and strategic alliances between India and the US are stronger than ever before. Accelerating trade and exchange in technology and investment coupled with improved collaboration in the fields of energy, national security and environmental protection have laid down the foundations in this growing relationship.

India’s flourishing market comprising of a highly educated and skilled populous has resulted in several US companies investing in the country. As per data collected by the DIPP, cumulative FDI into India from the US from April, 2000 to December 2015 amounts to around USD 17 billion which would approximately be 6.2% of total FDI inflows into India. Moreover, the progressive rationalization of the investment regime in India has resulted in more comfort for US players to set up shop in India. Currently, India has become a market that is indispensable to the business plans of any multi-national corporation based in the US.

India’s trade relations with the US have seen substantial improvement in the past decade as well. As reported by the Indian embassy in the US, bilateral trade between the two nations has as of 2015 was close to USD 66 billion, representing more than a 400% increase post-liberalization in India.

In lieu of the continuing co-operation and strong diplomatic and economic relations between the two nations, a number of bilateral agreements and institutional arrangements have been executed between India and US. Listed below are some of the key agreements:

- India-US Double Taxation Avoidance Agreement (“**India-US DTAA**”)
- India-US Agreement to Improve International Tax Compliance and to Implement Foreign Account Tax Compliance Act (“**FATCA**”)
- US-India Civil Nuclear Agreement
- U.S.-India Science and Technology Cooperation Agreement
- Agreement for Cooperation on Joint Clean Energy Research And Development Center (“**JCERDC**”)
- New Framework for India-US Defence Relationship

Going forward, with strengthening dialogue and a constant exchange of synergies in the form of diplomatic visits, the relations between India and the US are accelerating at an exponential pace.

## B. US – India DTAA: Special Considerations

### Residency of Companies

The India US DTAA does not provide any tie-breaker rules in situations where a company is treated as a tax resident of both India and the US under their respective domestic laws. Tax residence in a particular jurisdiction generally attracts taxation of the worldwide income of the individual / entity concerned in that jurisdiction. Therefore, the OECD model convention has tie-breaker rules to determine residence of individuals and entities in situation where individuals/ entities qualify as a resident of both jurisdictions (between which the tax treaty is entered into).

The absence of tie-breaker rules in the India-US DTAA in relation to companies becomes important in light of the amendment introduced in 2015 in India with respect to criteria for determination of tax residence of companies incorporated outside India. Prior to this amendment, i.e., up to financial year 2014-15, a company incorporated outside India qualified as an Indian tax resident in a financial year (April 1 to March 31) only if the entire control and management of its affairs was located in India during that financial year. From financial year 2015-16 onwards, a foreign company qualifies as tax resident in India if its POEM in the relevant financial year is in India.

Under US domestic law, all companies incorporated in the US are treated as US tax resident. Therefore, if a US company has its POEM in India, its worldwide income could be taxable in both in India and in the US without any credit being available in either country for taxes paid in the other country. This issue becomes aggravated by the concern around how existence of POEM is proposed to be determined by Indian tax authorities. In December 2015, the government issued draft guidelines in relation to determination of POEM; and issued the final guidelines (i.e., Guiding Principles for Determination of POEM of a Company) in 2017.

### Residency of Partnerships and Trusts.

The India-US DTAA is an example of how a special provision is provided for in a DTAA to deal with availability of treaty benefits to partnerships and trusts. Under Article 3(e) of the India-US DTAA, partnerships, trusts and estates are specifically included in the definition of the term 'person'. Further, under Article 4 of that India-US DTAA, it is provided that for such entities, the term 'resident of a contracting State' applies only to the extent that the income derived by such entity is subject to tax in that State as the income of a resident, either in its own hands or in the hands of its partners or beneficiaries. In this regard, the technical explanation of the India-US DTAA on Article 4 provides that under US law, a partnership is never taxed and a trust and estate are often not taxed. Under the provision, income received by such an entity will be treated only to the extent such income is subject to tax in the US as income of a US resident. Thus, treaty benefits would only be given to such US entities only as far as income received by them is taxable either at the entity or the partner/beneficiary level in the US.

In *General Electric Pension Trust, In re*,<sup>1</sup> the Authority for Advance Rulings while analyzing this held that a pension trust established under US laws was not entitled to benefits of the India-US DTAA since it was exempt from tax liability in the US.

---

1 (2006) 280 ITR 425 (AAR).

## Capital Gains

Article 13 of the India-US DTAA provides that each country may tax capital gains in accordance with the provisions of its own domestic law. While general international tax jurisprudence suggests that a DTAA must allocate taxability to one of the states involved in cases where there is a risk of double taxation, the India-US DTAA specifically opts for domestic law taxability presumably on the basis that differing rules for taxation of capital gains would not create a conflict.

The capital gains tax regime in India works in such a way that all Indian tax residents are taxable on their worldwide income, including income in the nature of capital gains arising from disposal of a foreign asset. However, all non-residents are taxed in India only on India-sourced income i.e. capital gains arising from the disposal of an Indian asset. Similarly, in the US, all US citizens and resident aliens for tax purposes are taxed on their worldwide income in form of capital gains (irrespective of situs of disposed asset). However, non-residents are not taxed in the US for disposal of all US-sourced assets. There is no US capital gains tax on a non-resident selling US securities. Thus, in a case where a US citizen disposes of his/ her Indian assets, he/she is liable to be taxed both in India (as the asset is India sourced) and in the US (since he/she is a US citizen) as there are no allocation rules provided for the same in the *India-US DTAA*. In *Trinity Corporation v. CIT*,<sup>2</sup> the Authority for Advance Rulings held that the capital gains from the sale of shares in an Indian company by a US resident shareholder to a US resident company were taxable in India as the shares of the Indian company had to be regarded as a capital asset situated in India. Although Article 25 of the India-US DTAA provides for tax credit from the state of residence in case of double taxation, the availability of such credit in this case is not assured.

### Credit Rules: Double Taxation of the Same Income?

Article 25 of the India-US DTAA provides that the US shall allow its residents or citizens to claim a tax credit in the US on income tax paid in India by or on behalf of such residents or citizens. However, the provision also provides that the determination of the source of income for purposes of credit is subject to domestic laws of the US as applicable for the purpose of limiting foreign tax credit. According to the US Internal Revenue Code (“IRC”), in order to claim a tax credit for taxes paid in another country, the income must be ‘foreign sourced’. However, the IRC also provides that all income earned by a US citizen or resident from disposal of assets (irrespective of situs) would be US sourced.

This means that the sale of assets, even in a foreign country by a US person would be treated as US sourced and therefore, foreign tax credit may not be available in such cases. Therefore, since the India-US DTAA does not provide specific allocations in the case of capital gains, there is a risk that a US citizen is subject to tax in both nations in respect of disposal of Indian assets. This uncertainty is the major reason why a large chunk of the investment into India by US entities comes through holding companies set-up in Mauritius. Though the Mauritius route has been under the scanner for quite a few years, courts and ITAT tribunals have consistently upheld relief under the India-Mauritius tax treaty, with the most recent ruling being that of the Authority for Advance Rulings in the case of *Dow AgroSciences Agricultural Products Limited*.<sup>3</sup>

Moreover, complications arise in case of credit claimed in relation to dividends as well since Article 25 is subject to limitations contained in the IRC. In India, dividend distribution tax is payable at the company’s level on

2 [2007]165TAXMAN272(AAR).

3 AAR No. 1123 of 2011. Order dated 11th January, 2016.

## 18. Investing into India: Considerations from a USA – India Tax Perspective

distribution and is exempt in the hands of the shareholder. However, the IRC taxes resident shareholders for dividends received by them. The IRC provides that foreign tax credit is generally available only in a case where tax is paid on the same income by the same taxpayer in a foreign country. Although the Indian company is to pay tax on the same distribution, since the tax is paid at the company level and since dividends received is exempt in the hands of the shareholder in India, claiming a tax credit for the shareholder becomes difficult. Thus, US credit rules consider only 'juridical double taxation' where the same entity is doubly taxed on account of the same income as opposed to 'economic double taxation' where the same income is doubly taxed in the hands of different entities. Such situations have created tax leakage.

However, Article 25 of the India-US DTAA also provides that if a US company owns at least 10% of the voting stock of its subsidiary in India, the US would grant underlying tax credit for tax paid in India for distributions made by the Indian company in the form of dividends. Thus, tax credit would be available in the US in cases where the shareholder is a US company and the holding in the Indian company is at least 10%. Nonetheless, the specific inclusion of underlying credit only for US company shareholders of Indian companies, owning at least 10% of the Indian company's shares might suggest that tax credit may not be available to any US shareholder which is not a company.

### PE Issues

The concept of a PE is commonplace in almost all DTAA's. In general, business profits of an enterprise earning income are taxable only in its state of residence unless it earns such income through a PE in the source state. Thus, a US entity earning business profits from India would be taxed in India for the same only if such profits are earned through a PE in India. As per Article 5 of the India-US DTAA, a PE can be anything from a fixed place of business, a dependent agent in India entering into contracts or securing orders on behalf of the US entity or a service PE. Although all US DTAA's contain the PE clause, the service PE clause is found in very few DTAA's. The service PE clause is borrowed from the UN Model Convention and creates a PE when a US entity deposes its employees to India to perform services on its behalf.

In general, a service PE is only created when the deputed employees spend a particular time period in the other State performing services on behalf of the foreign entity. The India-US DTAA has provided for a time period of 90 days to be spent in India for a US entity to create a service PE through deputation of employees performing services in India. However, the service PE provision in the India-US DTAA has carved out a different rule when a US entity deposes employees to an associated enterprise or related party. In such a case, irrespective of time spent, a service PE would be created if employees are deputed to the Indian entity to perform services on behalf of the foreign entity.<sup>4</sup>

The Hon'ble Supreme Court of India in *DIT v. Morgan Stanley & Co*<sup>5</sup> has elaborated on the scope of this provision. The Court held that in case of stewardship activities performed by employees of the US entity in India, since the activities could not be considered as provision of services by or on behalf of the US entity, there would be no service PE implications. With respect to employees of the US entity who were deputed to the Indian related party, a service PE was held to exist since the employees continued to be on the rolls of the US entity and the employees had a lien on their employment. Once a PE is created in India, taxation of business profits is determined as per rules contained in Article 7 of the India-US DTAA. Although the authorized OECD approach

<sup>4</sup> A similar provision can be found in India's DTAA's with Canada and Australia as well.

<sup>5</sup> [2007] 162 TAXMAN 165 (SC).

## 18. Investing into India: Considerations from a USA – India Tax Perspective

suggests that the source state must have the right to tax only those profits as are directly attributable to a PE in India, the India-US DTAA borrows the limited force of attraction rule as contained in the UN Model Convention. Thus, apart from profits directly attributable to the Indian PE, the US entity would also be taxed for profits from sales in India of similar goods as sold through the PE or profits from business activities in India similar to those undertaken through the PE.

### Fee for Included Services

As per Article 12 of the India-US DTAA, 'fees for included services' means payments made to any person in consideration for the rendering of any technical or consultancy services if such services are incidental to the application or enjoyment of the right, property or information in relation to royalty payments or 'makes available' technical knowledge, experience, skill, know-how, or processes etc. Further, the India-US DTAA lays down a 15% withholding tax on such payments falling under this provision. This provision is generally not contained in most other US DTAs and this provision is found mostly only in Indian DTAs.

The Memorandum of Understanding annexed to the India-US DTAA explains the concept of the expression 'make available' used in Article 12 and clarifies that other than in cases where royalty payments are involved, Article 12 only covers services where there is transfer of some technology, knowledge or skill whereby the recipient is able to independently apply the same.

Thus, in cases where technical services are provided by US entities in India, payments for the same will not be subject to withholding tax under the India-US DTAA unless if such criteria are satisfied. The Karnataka High Court in the case of *CIT v. De Beers India Minerals (P.) Ltd.*<sup>6</sup> and the Delhi High Court in *CIT v. Guy Carpenter & Co Ltd.*<sup>222</sup> have upheld this principle.

### Limitation on Benefits

As is the general norm for US DTAs, the India-US DTAA also contains a limitation on benefits clause. In this regard, Article 24 of the India-US DTAA provides for a limitation on benefits clause. As with its other treaties, the US has ensured that under the India-US DTAA, only 'qualified residents' of either treaty state are entitled to benefits of the treaty. With respect to corporate entities, the provision is intended to ensure that only companies that are resident in either state that fulfill substantial substance requirements and strong business activities in such state may be entitled to treaty benefits.

In this regard, Article 24 lays down a two-fold ownership/base-erosion test for claiming treaty benefits by which more than 50% of each class of an entity's shares must be owned, directly or indirectly, by individual residents who are subject to tax in either state, or by the government or government bodies of either state and the entity's gross income must not be used in substantial part, directly or indirectly, to meet liabilities in form of deductible payments to persons, other than persons who are residents of either State, government or government bodies of either state or US citizens. However, benefits under the India-US DTAA may be claimed if the entity is engaged in active trade or business in respect of which the concerned income has been earned or if a principal class of its shares are actively traded in a recognized stock exchange in either state.

<sup>6</sup> (2012) 346 ITR 467 (Kar.), 222. (2012) 346 ITR 504 (Del.).

## FATCA

India and the US entered into an agreement in July 2015 for implementation of the US the FATCA. FATCA is a broad set of rules to increase tax compliance by 'US persons' (essentially US citizens, US green card holders and US residents) with financial assets held outside the US. FATCA subjects virtually any entity, even if: (i) remotely / indirectly invested in the US market; or (ii) financial institution dealing with US citizens / green-card holders; or (iii) subsidiary of a US person, to strict due diligence and reporting compliances with the US Internal Revenue Services. FATCA legislation defines financial institutions in such a way, that it includes banks, custodians, brokers, certain types of insurance & companies, mutual funds, hedge funds, private equity funds, trust companies, etc. If a financial institution outside the US does not comply with due diligence and reporting obligations prescribed, investment income/ sale consideration receivable in relation to sale of US investments would be liable to withholding tax at 30% in the hands of the payee. The financial institution would have to claim refund to avail benefits of the India-US tax treaty, if applicable.

Under the India-US agreement for implementation of FATCA, both governments have agreed to exchange information annually on an automatic basis with respect to reportable accounts held by financial institutions in their respective jurisdictions. Consequently, the Indian government has introduced rules regarding reporting obligations of Indian financial institutions.

## Mutual Agreement Procedure and Transfer Pricing

The India-US tax treaty has clauses similar to the OECD model convention for Mutual Agreement Procedure for resolution of situations where taxpayers considers that actions of India and US tax authorities result or would result in taxation which is not in accordance with the provisions of tax treaty. For effective resolution of such disputes and to boost investment sentiments among MNCs, in January 2015, the Central Board of Direct Taxes signed a Framework Agreement with the Revenue Authorities of USA. The framework agreement seeks to resolve about 200 past transfer pricing disputes between the two countries in the Information Technology (Software Development) Services and Information Technology enabled Services segments. More than 100 cases had been resolved as of January 2016.

Prior to resolution of disputes under the Framework Agreement the US bilateral Advance Pricing Agreement ("APA") programme was closed to India. The success of the Framework Agreement in short period of one year has led to the US Revenue Authorities opening up their bilateral APA programme to India. The USA is expected to begin accepting bilateral APA applications shortly.

Unilateral APA programmes allow taxpayers to enter into an agreement with tax authorities in advance regarding the appropriate arms' length price/ method for computation thereof. This helps reduce potential transfer pricing disputes. It may be noted that transfer pricing applies subjective tests for computation of arms' length price for cross-border transactions between associated enterprises. Consequently, disputes arising from transfer pricing adjustments forms a significant component of income tax disputes in India. Bilateral APAs are those where both countries involved agree on a common arms' length price in relation to identified transactions between associated enterprises. This becomes important for multi national companies as differences in arms' length price arrived at by two/ more jurisdictions involved could lead to double taxation.





## About NDA

At Nishith Desai Associates, we have earned the reputation of being Asia's most Innovative Law Firm—and the go-to specialists for companies around the world, looking to conduct businesses in India and for Indian companies considering business expansion abroad. In fact, we have conceptualized and created a state-of-the-art Blue Sky Thinking and Research Campus, Imaginarium Aligunjan, an international institution dedicated to designing a premeditated future with an embedded strategic foresight capability.

We are a research and strategy driven international firm with offices in Mumbai, Palo Alto (Silicon Valley), Bangalore, Singapore, New Delhi, Munich, and New York. Our team comprises of specialists who provide strategic advice on legal, regulatory, and tax related matters in an integrated manner basis key insights carefully culled from the allied industries.

As an active participant in shaping India's regulatory environment, we at NDA, have the expertise and more importantly—the VISION—to navigate its complexities. Our ongoing endeavors in conducting and facilitating original research in emerging areas of law has helped us develop unparalleled proficiency to anticipate legal obstacles, mitigate potential risks and identify new opportunities for our clients on a global scale. Simply put, for conglomerates looking to conduct business in the subcontinent, NDA takes the uncertainty out of new frontiers.

As a firm of doyens, we pride ourselves in working with select clients within select verticals on complex matters. Our forte lies in providing innovative and strategic advice in futuristic areas of law such as those relating to Blockchain and virtual currencies, Internet of Things (IOT), Aviation, Artificial Intelligence, Privatization of Outer Space, Drones, Robotics, Virtual Reality, Ed-Tech, Med-Tech and Medical Devices and Nanotechnology with our key clientele comprising of marquee Fortune 500 corporations.

The firm has been consistently ranked as one of the Most Innovative Law Firms, across the globe. In fact, NDA has been the proud recipient of the Financial Times–RSG award 4 times in a row, (2014-2017) as the Most Innovative Indian Law Firm.

We are a trust based, non-hierarchical, democratic organization that leverages research and knowledge to deliver extraordinary value to our clients. Datum, our unique employer proposition has been developed into a global case study, aptly titled 'Management by Trust in a Democratic Enterprise,' published by John Wiley & Sons, USA.

## Research@NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our "Hotlines". These Hotlines provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our NDA Labs dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction. We regularly write extensive research papers and disseminate them through our website. Our ThinkTank discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

As we continue to grow through our research-based approach, we now have established an exclusive four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. Imaginarium AliGunjan is a platform for creative thinking; an apolitical eco-system that connects multi-disciplinary threads of ideas, innovation and imagination. Designed to inspire 'blue sky' thinking, research, exploration and synthesis, reflections and communication, it aims to bring in wholeness—that leads to answers to the biggest challenges of our time and beyond. It seeks to be a bridge that connects the futuristic advancements of diverse disciplines. It offers a space, both virtually and literally, for integration and synthesis of knowhow and innovation from various streams and serves as a dais to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research publications. Please feel free to contact us at [research@nishithdesai.com](mailto:research@nishithdesai.com).

## Recent Research Papers

Extensive knowledge gained through our original research is a source of our expertise.



September 2022

### Ahead of the Game

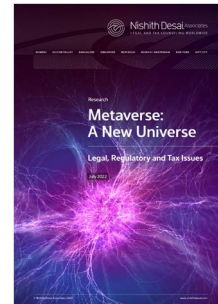
Legal, Regulatory and Tax Issues in India's Gaming Industry



August 2022

### M&A Lab

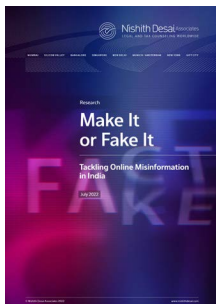
HDFC-HDFC Bank:  
Merger of Giant HDFC Twins!



July 2022

### Metaverse: A New Universe

Legal, Regulatory and Tax Issues



July 2022

### Make It or Fake It

Tackling Online Misinformation in India



June 2022

### Mergers & Acquisitions

An India Legal, Regulatory and Tax Perspective



April 2022

### Private Equity and Private Debt Investments in India

Regulatory, Legal and Tax Overview

For more research papers [click here](#).

**MUMBAI**

93 B, Mittal Court, Nariman Point  
Mumbai 400 021, India

Tel +91 22 6669 5000

**SILICON VALLEY**

220 S California Ave., Suite 201  
Palo Alto, California 94306, USA

Tel +1 650 325 7100

**BANGALORE**

Prestige Loka, G01, 7/1 Brunton Rd  
Bangalore 560 025, India

Tel +91 80 6693 5000

**SINGAPORE**

Level 24, CapitaGreen  
138 Market St  
Singapore 048 946

Tel +65 6550 9855

**NEW DELHI**

13-H, Hansalaya Building, 15  
Barakhamba Road, Connaught Place  
New Delhi 110 001, India

Tel +91 11 4906 5000

**MUNICH / AMSTERDAM**

Maximilianstraße 13  
80539 Munich, Germany

Tel +49 89 203 006 268

**NEW YORK**

1185 6th Avenue, Suite 326  
New York, NY 10036, USA

Tel +1 212 464 7050

**GIFT CITY**

408, 4th Floor, Pragya Towers  
GIFT City, Gandhinagar  
Gujarat 382 355, India

**Doing Business in India**

The Guide for US Businesses and Organizations Entering and Expanding into India