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INDIA

Law and Practice

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1. Legal System and Regulatory Framework

1.1 Legal System

The Indian legal system is based on common law. The Indian Constitution has adopted a quasi-federal structure – one that is federal in nature (providing for separation of legislative powers between the union and the states) with unitary features (a unified judiciary).

In addition to judicial precedents and laws enacted by the Indian legislature, specialised regulatory authorities are empowered to issue regulations governing specific segments, for instance, the Reserve Bank of India (RBI) to regulate banking, financial and foreign exchange dealings; the Securities and Exchange Board of India (SEBI) to regulate the public securities market; and the Insurance Regulatory and Development Authority of India (IRDAI) to regulate the insurance industry.

The Indian judiciary has the Supreme Court as the apex authority and its decisions are binding on all other subordinate courts and tribunals. The high courts in each state (or union territory) are the principal civil courts in the state (or union territory), and oversee the functioning of the courts at the district level. Apart from these, various courts and quasi-judicial authorities have been set up to deal with specific subjects, such as the commercial courts, national company law tribunals (NCLT), consumer dispute forum, income tax appellate tribunals, etc.

1.2 Regulatory Framework for FDI

Foreign direct investment (FDI) in India is permitted through the following entry routes.

- Automatic route – foreign investments under this route do not require prior approval of the RBI, or the central government (through the administrative ministry/department concerned), as long as such investments are within the sectoral cap and meet specified conditions. For instance, 100% investment under the automatic route can be undertaken in entities engaged in manufacturing, agriculture, the service sector, industrial parks, etc.
- Approval route – investments under this route can only be undertaken upon receipt of prior approval by the RBI, or the department of the central government concerned, as the case may be. For instance, investment in brownfield pharma beyond 74% is subject to government approval (with investments up to 74% being under the automatic route).

In April 2020, as a protectionist measure in view of the COVID-19 pandemic, the Department for Promotion of Industry and Internal Trade (DPIIT) introduced certain changes to the Indian foreign exchange laws by issuing Press Note 3 (2020) (PN 3) placing any investment from any country sharing a land border with India under the approval route.

However, in certain sensitive sectors such as the lottery business, gambling, chit funds, real estate business, etc, foreign direct investment is completely prohibited.

The DPIIT is a department of the Ministry of Commerce and Industry, which administers and oversees the Indian foreign direct investment policy, and the RBI regulates foreign investment and foreign currency transactions in accordance with Indian foreign exchange laws.

2. Recent Developments and Market Trends

2.1 Foreign Direct Investment in the Current Climate

The Indian markets, despite the COVID-19 pandemic and its associated recession, have shown resilience and have managed to attract substantial foreign investment. In fact, India Inc witnessed some of its largest foreign investment transactions during the COVID-19 pandemic, with investments from Facebook, Google and many others in the Indian technology sector.

The government has continued to further its policies for improving ease of doing business in India and has introduced further relaxations in foreign investment norms in several sectors. In 2020, the government increased FDI limits in sectors such as defence (automatic up to 74%), insurance intermediaries (100% automatic), etc, subject to specified attendant conditions. In addition to the above, the government and regulators introduced various relief measures so investors could better deal with operational and compliance challenges caused by the pandemic. There has been a slew of labour reforms, updated SOPs for review of FDI proposals with clearer timelines, etc in order to attract foreign investment.

However, the COVID-19 pandemic has also caused the government to introduce protectionist measures against "opportunistic acquisitions/takeovers" from India's land bordering neighbouring countries. This is especially in view of the fact that most sectors fall under the 100% automatic route and do not require any scrutiny/review by the regulators. In view of the PN 3 restrictions, both primary and secondary acquisitions by non-resident entities from, or entities whose beneficial owners belong to, countries sharing land borders with India can be undertaken only with the prior approval of the government. The PN 3 does not specify the list of foreign countries that would be covered within its ambit, nor does it specify the beneficial ownership thresholds, and therefore much is left to the government's discretion in considering FDI proposals and allowing investments from land-bordering states.

It is expected that further sector-specific conditions may be relaxed to bolster the economy, especially in the manufacturing sector – with the intent of positioning India as a global, low-cost manufacturing centre.

Overall, the Indian government is expected to find a balance between safeguarding the national interest and implementing policies that will position India as an attractive FDI destination.

3. Mergers and Acquisitions

3.1 Transaction Structures

M&A transactions in India are most commonly implemented through securities acquisition structures – primary issuance, secondary sale or a combination of both, depending on the funding and liquidity requirements of the target business and exiting stakeholders. Other structures include tribunal-approved schemes of arrangement and contract-based selected business or asset acquisitions.

Though the basic structure for undertaking investment activities in private and public companies remains similar, each segment is subject to certain distinct regulations which independently govern important commercial aspects, including:

- quantum of acquisition: in a public listed company, an initial acquisition of 25% or more (and any subsequent acquisition of >5% in a financial year) would trigger a mandatory tender offer for a minimum 26% stake in the target no such restriction applies to a private company;
- pricing of securities: in a public listed company, the minimum price at which a foreign investor may acquire securities is linked to the historic volume-weighted average price of the stock (if frequently traded) or based on a valuation report by an independent valuer (if infrequently traded), based on parameters including book value, comparable trading multiples, etc; in a private company, the minimum price for foreign investment is linked to a valuation report done by an independent valuer as per any internationally accepted pricing methodology; and
- tenure of convertibles: in a public listed company, the maximum tenure for convertible securities (such as preference shares, debentures or warrants) is 18 months from its date of allotment; in a private company, such restrictions are not prescribed.

Generally, any investment in a public listed company would be subject to additional compliance and disclosure norms prescribed under securities regulations such as the takeover code, insider trading, and listing regulations.

In addition, there are several other criteria that come into play in structuring investment activities, including: prescribed foreign investment sectoral caps, minimum capitalisation norms (if applicable), taxation considerations (at the time of investment and exit), and the requirement for prior regulatory approvals (exchange control, antitrust, etc). Typically, transaction structures which require prior clearance by a regulator tend to have a longer runway to completion – a commercial risk to be adequately weighed in advance. As a general matter, it is not uncommon to see transactions structured in a manner that reduces regulatory scrutiny, and thus increases execution and completion efficiency.

In structuring deals, foreign investors may also consider:

- investing in Indian companies in a tranched manner by way of deferred consideration (with a maximum deferral period of 18 months);
- use of escrow mechanisms for a more secure funding structure; and
- use of options (call or put) to step up or step down investment, as long as the investor is not guaranteed any assured returns.

3.2 Regulation of Domestic M&A Transactions

M&A transactions in India may be subject to prior regulatory review or approval depending on various factors, such as size of investment, sector of operation of the target company, contractual rights of the investor, etc. Certain key regulatory reviews or approvals that may be triggered include antitrust approval (see **6. Antitrust/Competition**) and a SEBI review for transactions which trigger a mandatory tender offer.

Apart from the above, there are various sector-specific regulations which govern investment, conduct of business, etc in specific industries. For instance, separate regulations govern the pharmaceutical, banking/non-banking financial, and insurance industries, and specific regulatory approvals may be required for investment in companies operating in each space.

4. Corporate Governance and Disclosure/Reporting

4.1 Corporate Governance Framework

Corporate governance norms applicable to Indian businesses are enshrined primarily in Indian company law (for all companies) and securities regulations (for public listed companies). Sectoral regulators such as the RBI and IRDAI also prescribe corporate governance norms for entities falling under their regulatory ambit. These include, following specific criteria forthe composition of boards and their committees, qualifications of directors and independent directors, auditor responsibility, etc. The liability of directors is generally attached to the role they undertake on the board and may be considered "officer in default" for certain non-compliances; typically non-executive and independent directors have limited liabilities to the extent of their contribution in board matters.

A commonly used legal entity in India for private and public businesses is a limited liability company. Typically, foreign investors prefer investing in companies, as they offer a clear and tested structure for ownership, governance and economic rights.

Other legal forms include the incorporation of limited liability partnerships or the establishment of a limited presence in India through unincorporated entities, such as branch offices, liaison offices, project offices, etc. To establish such offices, a foreign investor would require prior permission, and be subject to specific conditions. Furthermore, such offices can only carry out certain limited functions.

4.2 Relationship between Companies and Minority Investors

Under Indian company law, certain rights are given to members of a company holding at least 10% of its share capital. These include requisitioning shareholder meetings, approaching the NCLT against oppression and mismanagement by persons in control, initiating class action suits against the company, etc. Shareholders holding more than 25% of the voting capital may also block matters requiring a special resolution (eg, amendment of constitutional documents, winding-up, mergers, etc). Furthermore, an increase in corporate governance standards has also contributed to the protection of minority interest. Moreover, related party transactions typically require approval from non-interested parties, thereby empowering minority shareholders in such aspects of decision-making.

Dissenting minority shareholders have also been given exit opportunities in certain circumstances, such as takeovers, or instances of variation of objects for which money is raised, merger of a listed company with an unlisted company, etc.

In the case of listed companies, minority shareholders have the right to nominate an individual as a small shareholder director on the board. Furthermore, to look into various aspects of the interest of shareholders, debenture holders and other security holders, listed companies are also required to formulate a stakeholders' relationship committee. Private companies with more than 1,000 security holders (shares, debentures, etc) are also required to formulate such a committee.

As an additional measure, SEBI has formulated the SEBI Complaints Redressal System (SCORES), which mandates all listed companies to redress the grievances of their shareholders raised on the SCORES platform and inform them about the steps taken within 30 days of receipt of the complaints.

4.3 Disclosure and Reporting Obligations

Indian foreign exchange laws mandate reporting of FDI inflows in prescribed formats and within specified timelines, irrespective of the investment size. In brief:

- FDI by way of primary issuance of securities is required to be reported by the Indian investee company within 30 days of the issuance of equity instruments, in Form FC-GPR; and
- FDI by way of secondary acquisition or transfer of securities is required to be reported by the resident transferor or transferee within 60 days of transfer of equity instruments or receipt/remittance of funds, whichever is earlier, in Form FC-TRS. However, as an exception, if such transfer is undertaken on the floor of an Indian stock exchange, then the reporting requirement falls on the foreign investor.

Investments in listed companies aggregating to 5% or more of the shares or voting rights (either by the foreign investor itself or through any entity acting in concert with the foreign investor) would trigger initial public disclosure obligations under Indian securities regulations. Thereafter, any change exceeding 2% of the shares or voting rights (by the foreign investor or persons acting in concert with it) would also be subject to public reporting obligations. Additionally, there may be pre-transaction approvals/post-transaction reporting required under the Indian insider trading regulations (applicable only if the investors qualify as designated persons of the listed company).

5. Capital Markets

5.1 Capital Markets

Indian capital markets play an important role in mobilising resources and channelling them towards economic development in the Indian scheme of things. Capital markets help the economy by mobilising investments that are either too risky for commercial banks or that require a long-term investment. While bank financing is the predominant source of funding, capital markets provide a sound alternative source of capital which is able to channel resources coherently and in accordance with the development needs of a growing economy.

Capital markets also offer attractive investment opportunities, with better returns than bank deposits, subject to risk profile, liquidity needs, and other factors for investors with domestic savings.

The capital markets in India comprise:

- the Gilt-edged market (market for government securities backed by the central bank, the RBI);
- financial intermediaries like mutual funds, venture capital companies, merchant bank entities, etc;
- development finance institutions; and
- the securities market (both primary and secondary).

5.2 Securities Regulation

SEBI regulates, promotes and directs developments in the Indian capital markets. The Indian securities market has grown extensively in terms of volumes, new products and financial services since SEBI was established in 1992. SEBI inter alia regulates the stock exchanges and any other securities markets; registers and regulates the working of capital market intermediaries like merchant bankers, brokers, portfolio managers, debenture trustees, rating agencies and so on; promotes and regulates self-regulatory organisations; monitors insider trading and fraudulent and unfair trade practices in securities markets; regulates primary and secondary markets, and regulates acquisitions and takeovers of listed entities.

Apart from being the market regulator, SEBI is also a quasi-judicial authority and has wide enforcement powers to deal with evolving challenges in the Indian capital markets. It has the power to impose a wide range of penalties, both monetary and substantive.

Foreign investors who intend to participate in the Indian capital markets are required to be registered with SEBI as foreign portfolio investors (FPI) through a local custodian. The Indian foreign portfolio investor regulations issued by SEBI govern the process to be followed for the registration of FPIs, eligibility criteria, categories of registration, key investment conditions and restrictions, etc. These regulations also provide a list of securities in which FPIs are permitted to invest. For example, FPIs are permitted to invest in debt securities when this is permitted by the RBI from time to time.

5.3 Investment Funds

Indian foreign exchange laws do not specifically subject investment funds to any additional regulatory review for the purpose of FDI.

6. Antitrust/Competition

6.1 Applicable Regulator and Process Overview

India has a mandatory and suspensory merger control regime. Certain acquisitions (of shares, voting rights, control or assets), mergers (including court-approved mergers), amalgamations, and demergers, are required to be notified to the Indian competition authority, the Competition Commission of India (CCI), if they exceed any of the eight asset/turnover-based financial thresholds prescribed under the Indian competition laws.

As such, the CCI is not the relevant authority nor does it have the statutory mandate to specifically review FDI. That said, the notification in Form I (ie, the shorter form) does seek information regarding any foreign investment in India as a result of a transaction (FDI, FPI, etc). However, the applicability of the merger control regime does not vary between transactions based on the involvement of foreign investment.

Exemptions

A transaction is required to be notified to the CCI, unless exempted under relevant provisions, notifications or merger control regulations, such as, share subscriptions, financing facilities or any acquisitions by foreign venture capital funds, institutional investors, or banks, pursuant to covenants of a loan or investment agreement. These only require a post-transaction intimation to the CCI and do not require pre-clearance.

Moreover, a transaction is not required to be notified to the CCI if the target either has assets less than INR3.5 billion (approximately USD49.44 million) in India, or a turnover of less than INR10 billion (approximately USD141.21 million) in India.

Additionally, Indian combination regulations list certain transactions which "need not normally be notified" to the CCI given that such categories of transactions are ordinarily not likely to cause an appreciable adverse effect on competition (AAEC) in India.

Certain sector-specific exemptions, applicable for a limited period, are also notified by the government of India from time to time. Currently, these exemptions include mergers of public scheduled banks, regional rural banks, as well as oil and gas public sector enterprises.

Process and Timelines

Once parties have signed the definitive documents for a transaction, a notification can be made to the CCI any time prior to closing. For acquisitions, the filing obligation is on the acquiring party alone, however, in the case of mergers/amalgamations, the merging parties need to file jointly.

The review and approval process can take up to 210 calendar days (computed in a manner specified under the Indian competition laws).

After a notification is filed, the CCI has 30 working days (excluding clock stops) to form a prima facie opinion (Phase I).

Clock stops include requests for additional information from the notifying parties, as well as third party stakeholder consultations for the likelihood of AAEC.

For "no issues" transactions, this typically translates to around 45 to 90 calendar days. However, if the CCI perceives any significant AAEC concerns, the CCI can open up an in-depth investigation (Phase II), which may lead to an increase in approval timelines. The Phase II investigation can take up to an additional 180 calendar days (excluding clock stops).

Standstill Obligations

Prior to approval or the lapse of 210 calendar days, taking any step towards full or part consummation of the transaction (eg, closing the foreign leg of the transaction, payment of part consideration, even if refundable, etc) is considered "gun-jumping". With reference to **6.4 Enforcement**, parties can be penalised for this by the CCI.

For abundant clarity, if a transaction does not meet the relevant triggers/requirements as set out below, the CCI does not have the jurisdiction to conduct a substantive competitive review.

6.2 Criteria for Review

The CCI conducts an extensive assessment of substantive overlaps between the businesses of transacting parties. Among other details, the notification requires identification of existing as well as potential horizontal, vertical and complementary overlaps or linkages among the parties (and their group entities).

The CCI's Substantive Test – AAEC

The CCI examines whether the transaction causes or is likely to cause an AAEC in any relevant market affecting India, by considering multiple prescribed factors.

Primarily, the CCI is required to assess the following:

- the individual and combined market shares of the transacting parties in the relevant market(s);
- the actual and potential state of competition in the markets – ie, the size and strength of existing competitors;
- incentive and ability to foreclose market competition;
- incentive and ability to increase prices/profit margins;
- the level of concentration and extent of vertical integration; and
- the degree of countervailing power.

Green Channel (Automatic Approval Route)

Acquisitions, mergers and amalgamations (including foreign-to-foreign transactions) where there is no (i) horizontal, (ii) vertical or (iii) complementary overlaps (in any of the plausible alternative relevant markets) can be notified to the CCI through the "green channel". Upon filing a green channel notification and on receipt of acknowledgement of the filing from the CCI, the transaction is deemed to be approved by the CCI.

6.3 Remedies and Commitments

When reviewing a notified transaction, the CCI may:

- clear the transaction unconditionally;
- clear the transaction with structural modifications (eg, divestments, etc) or behavioural commitments (ie, remedies such as non-exclusivity conditions, etc); or
- reject the transaction if it believes no modifications or remedies can address the AAEC concerns.

The CCI can accept modifications or remedies to alleviate AAEC concerns in Phase I (if proposed by the parties), or it can order them in Phase II, on a case-to-case basis.

Whenever the CCI approves a transaction with remedies, it can appoint an independent monitoring agency (ie, an accounting firm, management consultants, or any other professional firm) to oversee implementation of the remedies.

6.4 Enforcement

As stated in **6.3 Remedies and Commitments**, the CCI has the power to reject or block a transaction. However, to date, no transaction has been blocked by the CCI.

Appeals

The National Company Law Appellate Tribunal (NCLAT) is the first appellate authority. Parties have a right to appeal all final decisions of the CCI (as specified under the Competition Act) before the NCLAT within 60 calendar days. This includes decisions pertaining to:

- blocked/rejected transactions;
- any penalties imposed by the CCI;
- appeals against any Phase II commitments/modifications ordered by the CCI that the parties cannot adhere to.

Appeals from NCLAT go before the Supreme Court of India, the final appellate authority.

Consequences of Non-notification and/or Gun-Jumping

The CCI can initiate an enquiry into a transaction which was not notified to it for a period of up to one year from the date of completion of the transaction. Reportable transactions that have not been notified to the CCI are not automatically void, but are voidable.

For non-notification (and/or for gun-jumping), the CCI can also impose a fine of up to 1% of the combined assets or turnover of the parties to the transaction, whichever is higher. So far, the highest penalty imposed in this regard is INR100 million (approximately USD1.41 million).

7. Foreign Investment/National Security

7.1 Applicable Regulator and Process Overview

The DPIIT is the nodal authority for review and approval of FDI proposals in sectors falling under the approval route, along with the concerned departments/ministries notified by the Indian government. Proposals seeking FDI in sectors falling under the approval route, or activities requiring prior government approval must be submitted electronically through the Foreign Investment Facilitation Portal (FIFP).

To this extent, the DPIIT has issued Standard Operating Procedures (SOPs) for the processing, reviewing and approval of FDI proposals by relevant government ministries. In terms of the SOPs, such proposals are required to be disposed of within a period of eight to ten weeks from the date of submission. This includes the time taken by the concerned ministries in reviewing the application and seeking any clarifications from the investor. The DPIIT has been granted an additional period of two weeks to reconsider proposals that have been rejected or where it has been proposed that additional conditions should be imposed.

Approvals may be forthcoming where the foreign investor is complying with the attendant conditionalities prescribed in the FDI policy for investment in the relevant sectors. For most sectors, the FDI policy itself specifies these conditions or commitments. Needless to say, investment in regulated sectors also requires compliance with domestic laws and the regulations governing such sectors (eg, banking, non-banking, insurance, etc).

Investment in sectors under the automatic route does not require any prior approvals, provided that all the attendant conditionalities for the investments have been met.

7.2 Criteria for Review

As per the SOP, a foreign investment approval application submitted through the FIFP is required to contain, among other things:

- a summary of the proposed foreign investment;
- audited financial statements of the investee and investor entities for the last financial year;
- a signed copy of the JV agreement/shareholders' agreement/technology transfer, etc;
- details of ownership and control of the investee and investor entities;
- details of the significant beneficial owners of the investee and investor entities;
- foreign inward remittance certificates in case of post-facto approvals; and
- a valuation certificate approved by a chartered accountant and a certificate of statutory auditors.

Upon receipt of the proposal, the DPIIT assigns the same to the concerned ministries/departments for the processing/reviewing of such proposal. Proposals for investment in sensitive sectors, such as defence, civil aviation, broadcasting, etc, or proposals arising out of PN 3 are also forwarded to the Ministry of Home Affairs for a security clearance. Furthermore, in cases where the proposal involves total foreign equity inflow of more than INR50 billion, the proposal is also referred to the Cabinet Committee on Economic Affairs.

Proposals which have value propositions (eg, industry expertise, employment opportunities, boost to domestic manufacturing, etc) are likely to be considered more favourably. The concerned ministries/departments are required to consider the proposal in line with the exchange control norms, sectoral requirements, etc.

The concerned ministry/department is required to seek the DPIIT's concurrence in cases of rejection of proposals, or where additional conditions are proposed to be imposed for approval of the proposal.

The conditionalities associated with a particular sector are specified in the FDI policy itself and are agnostic to the manner of investment (whether joint venture, partnership, non-controlling interest). One would, of course, have to bear in mind the level of foreign investment permissible in a particular sector, and model the FDI proposals accordingly.

7.3 Remedies and Commitments

Typically, on submission of the FDI proposals, the concerned ministry/department may seek certain clarifications on the proposed investment and future business plans of the investor. As such, in reviewing such proposals, and at its sole discretion, the concerned ministry in consultation with the DPIIT may seek additional commitments from the investor. Certain commitments, such as confirmation that the parties have not entered into a non-compete arrangement, may be required for investment proposals in the pharmaceutical sector.

Once the FDI proposal is approved, the government may seek certain confirmations from the investor, which would typically include:

- compliance with the applicable pricing norms, reporting obligations, and submission of relevant documentation;
- compliance with anti-pollution standards; and
- compliance with downstream investment norms, etc.

7.4 Enforcement

Upon review of the FDI proposals, the concerned ministry in consultation with the DPIIT may reject the FDI proposal. For investments falling under the approval route, obtaining such approval from the competent authority is a prerequisite for undertaking such investment. While a revised proposal may be submitted for fresh consideration, there is no specific provision to appeal a rejection by the competent authorities.

The DPIIT can challenge any investment which falls foul of the Indian foreign exchange laws, and can require that action be taken against the defaulting party. However, the DPIIT may, based on the factual circumstances, either regularise the transaction post facto by requiring the parties to carry out compounding, or require the parties to unwind such transaction.

Violation of the Indian foreign exchange laws may attract a monetary penalty. It may also result in adjudication proceedings and/or enforcement proceedings being undertaken against the defaulting parties. Depending on the nature of the contravention, the parties may also undertake a voluntary compounding process by admitting a contravention, and paying the monetary penalty computed on a prescribed computational matrix.

8. Other Review/Approvals

8.1 Other Regimes

Factors such as nature of the investor, objective of the investment, mode of entry, sector of entry, etc, would result in different laws and regulations being applicable to a particular transaction. The following are some of the key considerations/requirements that a foreign investor should be mindful of when investing in India.

General Registration and Compliances

In cases of transactions concerning India-entry, regular business-related registrations become relevant. While some are common to all sectors, others are industry specific. Some of the common registrations for an establishment include tax registrations, bank accounts and operating licences (under the shops and establishment laws of the relevant jurisdiction in which the establishment is located).

Industry-specific licences from the sectoral regulators include:

- a licence from the Department of Telecommunications for telecom operating companies;
- a licence from the Insurance Regulatory Development Authority for insurance companies;
- registration with the RBI for banks and NBFCs; and
- registration with SEBI for mutual funds and venture capital funds, etc.

Investment in Public Companies

Foreign investors are not permitted to acquire shares of a public listed company through the FDI route, by way of acquisitions of shares on the floor of the stock exchange unless they are already in control of such public listed company. Typically, such investments can be undertaken by foreign investors either through the foreign portfolio route (which requires a separate registration with SEBI) or after such investor has acquired control of the public listed company.

Furthermore, any substantial acquisition of shares, voting rights, or control of a public listed company beyond certain specified thresholds triggers a mandatory tender offer, requiring the investor to provide an exit opportunity to the public shareholders.

Real Estate Transactions

Foreign investment is not permitted in the real estate business (ie, dealing in land and immovable property with a view to earning profit from them), construction of farmhouses, and trading in transferable development rights in India.

However, subject to specific conditions, foreign investment of up to 100% under the automatic route is permitted for construction or development projects, including development of townships, construction of residential or commercial premises, roads or bridges, hotels, resorts, hospitals, educational institutions, recreational facilities, etc.

Furthermore, foreign investors are not permitted to acquire immovable property in India, without the prior permission of the RBI, except for leasing immovable property for a period not exceeding five years. However, immovable property may also be acquired for carrying on the activities of a branch, office or other place of business (excluding a liaison office), other than for investors from certain specified jurisdictions.

E-commerce Activities

The FDI Policy classifies e-commerce activities into two segments, one is an inventory-based model (where the inventory of goods and services is owned by the e-commerce entity itself); and the other is a marketplace-based model (where the e-commerce entity only provides its platform to facilitate transactions between the buyer and the seller).

Under the automatic route, 100% FDI is permitted for investments in the marketplace model, subject to attendant conditionalities. However, foreign investment in inventory-based models is not permitted. Furthermore, 100% FDI under the automatic route is permitted for investments in e-commerce entities engaged in business-to-business e-commerce, but not in retail trading.

The Indian government has also introduced rules prescribing an elaborate framework for e-commerce entities and has brought them within the aegis of consumer protection laws to ensure the increased safety of consumers from unfair trade practices, price manipulations, false or misleading advertisements, etc. Given the robust consumer protection regime, compliance checks would be necessary before investing in e-commerce entities.

Single Brand Retail Trading

FDI in single brand retail trading (SBRT) has attracted immense interest from foreign investors. Over the course of years, the government has also been easing out the conditionalities for investment in SBRT. The most significant being relaxation in local sourcing norms, to enable foreign investors to manufacture and market their products in India's large consumer market. Under the automatic route, 100% FDI is permitted for investment in SBRT entities, subject to their compliance with the attendant conditionalities.

Pharmaceuticals and Medical Devices

India is highly positioned in the global pharmaceuticals sector and has seen a steady flow of foreign investment. Under the automatic route, 100% FDI is permitted for investment in the greenfield pharmaceuticals sector. 100% FDI is also permitted in brownfield pharmaceuticals, of which investment up to 74% is permitted under the automatic route, and any incremental investment requires government approval. Additionally, 100% FDI in the automatic route is also permitted for investment in medical devices (both greenfield and brownfield).

In addition to the above, investment in the pharmaceuticals sector requires compliance with the Indian Drugs and Cosmetics Act. As a generic medicine hub, India has also placed price control on drugs and medical devices.

Apart from the above, foreign investment in each sector comes with its own set of unique conditionalities, regulatory concerns, etc, that have to be considered at the time of investment. Sectors such as defence, insurance, financial services, banking, etc, have sectoral regulators which impose additional compliances and approval/registration requirements.

9. Tax

9.1 Taxation of Business Activities

The Income Tax Act, 1961 ("IT Act") imposes separate headline tax rates for domestic and foreign companies earning income from India.

The effective tax rate is a combination of factors such as the nature of the entity, its residential status, the nature of business undertaken, the turnover/gross receipts and the applicable surcharge and cess rates.

A summary of certain tax rates is set out below.

- Indian companies – 25% (subject to turnover); or 30%. Surcharge on tax: 7%/12% if income exceeds INR10 million or INR100 million, respectively. A reduced tax rate of 22% (plus 10% surcharge) is available to domestic companies; and 15% (plus 10% surcharge) is available to newly set-up domestic manufacturing companies, in each case subject to applicable conditions.
- Foreign companies – 40%. Surcharge on tax: 2%/5% if total income exceeds INR10 million or INR100 million respectively.
- Minimum Alternate Tax (MAT) – 15% of adjusted accounting profits, except companies which opt for 22%/15% rates mentioned above.
- Indian partnership firms (general/limited liability partnership) – 30% (plus surcharge of 12% on income over INR10 million).
- Foreign partnership firms (general or limited) and limited liability companies (LLCs) – treatment as a partnership firm/corporation/association of persons for Indian tax is a fact-based determination depending on the features of each entity, and the tax rates specified above are applicable accordingly.
- Cess – 4% health and education cess on tax and surcharge payable in all cases.

9.2 Withholding Taxes on Dividends, Interest, Etc

All payments made to non-residents which are chargeable to tax in India are subject to withholding tax at the rates mentioned under the IT Act, subject to a lower rate under a tax treaty. The domestic law rates are:

Interest payments: 20% on foreign currency debt, or 40%/30% depending on whether the foreign investor is a corporation, firm or association, etc. A 5% concessional tax rate applies in certain cases. Rates to be increased by applicable surcharge and cess.

Dividends: Prior to 1 April 2020, dividends received from Indian companies were tax-free in the hands of foreign shareholders and Indian companies paid a Dividend Distribution Tax (DDT). Effective from 1 April 2020, the DDT regime has been abolished. Dividends are now chargeable in the hands of non-resident shareholders at a rate of 20%, plus the applicable surcharge and cess.

Tax rates are subject to beneficial rates under the applicable tax treaty. The requirement of a minimum shareholding in a company to claim beneficial treaty rates varies across treaties.

The legitimacy of treaty shopping has been a controversial issue under Indian tax jurisprudence. The OECD's Multilateral Instrument (MLI) and the recent introduction of domestic anti-abuse rules would lead to close examination of the "principal purpose" of an arrangement and commercial substance in structures.

In the context of dividend and interest income, tax treaties generally require that the recipient is the "beneficial owner" of the income. In some treaties, there is a "limitation of benefits" clause limiting the treaty benefit to those satisfying the motive test.

9.3 Tax Mitigation Strategies

Tax Neutral Structuring

Mergers and demergers are "tax neutral", subject to conditions. Unlike other modes of business transfer, mergers and demergers allow the transferee entity to carry forward and set off the unutilised tax losses of the target business. Depreciation may also be claimed on goodwill created in a merger, resulting in a tax benefit to the merged entity (this is a litigious position). This form of business transfer or combination is preferred for internal group restructuring as well as where the target business needs to be hived off to unlock its value for potential investors.

A transfer of assets between a holding company and its wholly owned subsidiary is also not taxable under the IT Act, subject to conditions. This also negates the requirement to comply with valuations; however, the transferee cannot benefit from a cost step-up with respect to the assets acquired in this manner.

Leveraged Buyout Acquisitions

Leveraged buyout structures are used to acquire shares/businesses of Indian companies. The acquiring entity is debt financed and the debt is used to purchase shares of the Indian target. The investment is often combined with a merger of the target entity with the acquiring entity and thereafter, the target entity discharges the acquiring entity's debt. This provides buyer access to the funds of the target entity and also creates an interest shield for the target entity.

Intellectual Property Migration

The migration of Intellectual Property (IP), developed and owned by an Indian entity, to an appropriate offshore vehicle is generally evaluated when the IP is expected to attain significant value in the future and/or attract investment from investors who may prefer to invest in an offshore vehicle. This ensures that the income from exploitation of the IP is not earned by an Indian entity and, therefore, is outside the Indian tax net. Tax considerations include valuations, control and management, commercial considerations, etc.

Funding and Returns

Funding through a debt instrument often trumps an equity infusion. This allows interest deductibility for the payer (subject to thin capitalisation rules), beneficial rates on interest and potential capital gains tax exemption on sale of the instrument under tax treaties, and the option to convert a hybrid debt instrument into equity (eg, compulsorily convertible debentures).

Investing at an Offshore Level

To stay away from the Indian tax net, in certain cases, investments are made at an offshore level which owns the Indian target/business, as opposed to a direct investment in an Indian entity. The seller may be subject to tax in India at the time of exit (where the offshore holding entity derives "substantial value" from India); however, this too is subject to tax treaties, which could provide an exemption.

Structuring Transfer of Assets/Business

A share transfer versus a business transfer is commonly evaluated from a tax-structuring perspective. Generally, a share transfer proves beneficial for a foreign investor. Tax outflow on the sale of shares by a non-resident is lower versus sale of a business/asset by a domestic company. Furthermore, extraction of the domestic company's income earned from an asset/business transfer is subject to dividend-related tax costs.

While structuring opportunities are available, it is pertinent to note that, in practice, any tax structuring strategy could be exposed to closer scrutiny by tax authorities in India. Accordingly, any structuring move must be backed by commercial substance, robust documentation and valuations, etc.

9.4 Tax on Sale or Other Dispositions of FDI

Capital gain derived by a foreign investor from the disposition of FDI is generally taxable in India. Although there is no general exemption, capital gain is taxable at special rates which depend on the period of holding and the nature of the investment. Long-term gains are taxable at 10% or 20%; while short-term gains are taxable as ordinary income (15% for listed shares traded on a recognised stock exchange in India). There are differing time thresholds for determining whether gains are long term or short term.

The taxability of capital gains under domestic law is subject to beneficial provisions under tax treaties.

The legal position in India on fiscally transparent entities being allowed benefits under tax treaties continues to remain under debate. In view of this, tax-transparent investors such as limited partnerships evaluate investing through a drop-down corporate vehicle eligible to claim treaty benefits.

9.5 Anti-evasion Regimes

Indian tax law has both specific as well as general anti-avoidance rules in the IT Act.

Specific Anti-avoidance Rules

Some of these provisions are discussed below:

Minimum fair value pricing requirement

A deeming fiction under the IT Act triggers tax in the hands of the buyer and the seller when transactions for certain assets (eg, immovable property, securities) are undertaken at a discount to fair value – (i) the discount is deemed as ordinary income in the hands of the recipient; and (ii) fair value is deemed as the minimum sale consideration for calculation of the seller's capital gains tax liability (subject to certain exceptions).

Issuance of shares at premium-to-fair value

If a closely held company issues shares to a resident at a price which exceeds the fair value of the shares, the premium-to-fair value is deemed as ordinary income of the entity issuing the shares (even where non-residents invest at a premium, the tax authorities investigate aspects such as the credit-worthiness of the investor, source of funds, etc, under a general provision applicable to all taxpayers).

Transfer pricing rules

These are comprehensive and apply to related party/deemed related party transactions requiring them to satisfy the "arm's length" principle, and there are prescribed compliances.

Thin capitalisation rules

The IT Act has rules which cap interest deduction to Indian companies at 30% of EBITDA on cross-border intra-group debt (including debt guaranteed by an associated enterprise, expressly or impliedly).

Corporate tax residency

A foreign company effectively controlled and managed from India could be deemed as an Indian tax resident, resulting in its global income being subjected to Indian tax.

General Anti-avoidance Rules (GAAR)

Effective from 1 April 2017, GAAR have been included in the IT Act to combat aggressive tax planning and tax avoidance. Under GAAR, the revenue authorities have wide powers to, inter alia, deny tax treaty benefits, treat debt as equity and vice versa, re-characterise any arrangement or a step thereof, look through a corporate structure, and levy tax based on the "substance", ignoring the "form" of an arrangement or a transaction. Arrangements or transactions, the "main purpose" of which is to obtain a tax benefit, will be caught under GAAR if they meet any of the "tainted elements" criteria prescribed under the test.

India does not have specific "anti-hybrid" rules; however, given the wide scope of GAAR, hybrid arrangements may be evaluated from a "substance" perspective under GAAR.

The MLI took effect from 1 April 2020 for the first set of tax treaties between India and several countries across the globe. With the introduction of the "principal purpose test" amongst other measures, India took yet another step towards curbing tax-avoidance strategies.

10. Employment and Labour

10.1 Employment and Labour Framework

Overview of Indian Labour Law Regime

The Indian Constitution provides for a federal structure wherein the central as well as state governments are empowered to enact suitable legislations to regulate and protect the interests of employees. While there are over 50 national laws and many more at the state level for different types of industry and the nature of the work undertaken by them, the principal labour legislations that regulate employees' conditions of employment are those relating to industrial disputes, factory laws, and state-specific shops and establishment laws. Further, there are certain social security legislations relating to employee provident funds and employee insurance laws.

Works Committee and Collective Bargaining Agreements in India

Works committee

There is no statutory requirement to have a workers' representative on the board of an Indian company. However, industrial disputes laws provide for the constitution of a works committee composed of both workers' and employers' representatives to settle worker-related disputes and any other issues related to conditions of service.

Labour unions in India

Previously, labour unionisation was largely restricted to the traditional sectors such as the manufacturing industry, where labour unions have helped blue-collar employees with lower employment security successfully negotiate higher wages, job security and other demands. However, in the recent past, large-scale lay-offs by IT/ITeS companies, long working hours, automation and digitisation have led predominantly white-collar employees to organise themselves into trade unions. The Indian trade union laws set out the mechanism for registration of trade unions. Once the trade union is recognised, refusal by an employer to bargain collectively in good faith is regarded as an unfair labour practice.

Note for Foreign Investors

Labour unionisation and its associated risks may seem a deterrent to foreign investors as the involvement of trade unions is likely to curb the flexibility of employers in terms of dealing with employee issues. Save as mentioned herein, there are no particular labour laws that would hamper/prove disadvantageous to foreign investors that are considering investing in India.

10.2 Employee Compensation

Employee Compensation Framework

Primarily, India follows a cash-based payment of wages system. However, in addition to salary payments, certain companies also incentivise their employees by formulating and adopting employee stock option plans to give their employees a stake in the business. There are legislations prescribing minimum wages for various categories of employees in the organised sector and prohibiting unauthorised deductions from their wages. Employees are also entitled to certain statutory benefits such as a provident fund, pension, employee's state insurance, gratuity (end-of-service benefit) and statutory bonus, depending on the quantum of their monthly wages.

Employee Compensation in an Investment Transaction

Share sale

In a share sale scenario, the acquisition of shares by a buyer will not result in any change in employer and/or employee compensation structures – only the shareholding pattern and/or management structure of the entity will change. Therefore, the investment will have no impact on the employee compensation structure.

Asset/business sale

Indian labour laws do not provide for automatic transfer of employees pursuant to an asset/business sale. In the case of an asset/business sale (including associated employees), consent of the employees must be obtained for transfer of their employment to the buyer. Furthermore, if the buyer does not offer: (i) continuity of service along with credit for the period of service rendered by the employee to the seller; and (ii) no less favourable terms of employment than the terms enjoyed with the seller, then all employees who qualify as "workmen" (ie, non-managerial employees of both genders) under Indian industrial disputes laws will be entitled to statutory notice of one month (or salary in lieu thereof) and retrenchment compensation (at a rate of 15 days' salary for each completed year of service with the seller).

Therefore, in the case of an asset/business sale, the buyer will be required to ensure that the aggregate compensation of the transferring employees is unaffected/no less favourable than what the employees were previously provided by the seller. Employee rights (such as the right to retrenchment compensation and gratuity based on the period of continuous service rendered) will continue to remain the same, including any special rights accorded to employees pursuant to a collective bargaining agreement.

10.3 Employment Protection

In relation to employees' rights in the event of an acquisition, refer to **10.2 Employee Compensation**.

As regards consultation with trade unions, there are no statutory consultation or information requirements in relation to transfer of employees pursuant to an asset/business sale. However, subject to any specific terms of a collective bargaining agreement in force, in order to avoid any conflict with the employees, it would be advisable to have discussions with the employees' trade union of the particular establishment before initiation of an acquisition or any other investment transaction.

11. Intellectual Property and Data Protection

11.1 Intellectual Property Considerations for Approval of FDI

FDI by companies relating to pharmaceutical or other sensitive sectors under the approval route are typically screened by the government. This is generally to ascertain the holding or ownership structure of the IP and what value such investment would bring to India.

11.2 Intellectual Property Protections

India is an emerging jurisdiction in terms of providing a strong IP protection regime. India has robust statutory regulation for most forms of IP and this is complemented by the evolution of rich jurisprudence. The Indian courts have been adopting a liberal and out-of-the-box approach to strongly meet the newer and challenging forms of infringements and counter such infringements.

Considering that the regime is constantly evolving in all aspects, especially from an innovation and enforcement perspective, certain areas do require improvement, such as the software and pharmaceuticals sectors.

The Indian patents law excludes inventions relating to mathematical or business method or a computer program, per se, or algorithms from patentability. The term "per se" has led to considerable confusion and interpretation issues leading to the assumption that a computer program is not patentable. However, in a recent judicial precedent, the IP tribunal granted a patent to an invention relating to "method and device for accessing information sources and services of the web", stating that the invention makes a significant technical contribution to the state of the art and has a critical technical effect.

Similarly, Indian patent laws restrict the granting of a patent for the mere discovery of a new form of a known substance, unless there is enhancement of the known efficacy of that substance. While this is not restricted to pharmaceutical patents, it has been primarily applied in cases of pharmaceutical patents. The Supreme Court of India in a landmark decision has clarified that the efficacy required under Indian patent laws for pharmaceutical patents is therapeutic efficacy and applicants are required to prove therapeutic efficacy by way of cogent scientific proof. Consequently, the companies applying in this field need to be mindful of such patent law requirements while drafting patent specifications.

Furthermore, unlike the USA, where the concept of damages as a whole is much more profound and ingrained in the judiciary with respect to IP violations, India has a long way to go in relation to the granting of quantum of damages. Certain courts in India have in recent times become quite progressive in granting a substantial amount of damages, however. For instance, a court awarded costs of approximately USD677,000 in a trade mark infringement matter last year.

11.3 Data Protection and Privacy Considerations

Presently, aspects relating to "data privacy" and "data protection" are largely governed, on a sector-neutral basis, by the Information Technology Act 2000 (the "Technology Act") and the rules thereunder. In addition, various sectoral regulators, such as the RBI, have issued regulations which impose data-related obligations in the sectors governed by these regulators, such as banking, telecommunications and insurance.

The Technology Act, read with the allied rules concerning sensitive personal data, provides for the protection of personal information designated as sensitive personal data or information, such as passwords and medical records.

Extraterritorial Jurisdiction

The Technology Act is applicable to offences outside of India as well, irrespective of the nationality of the offender, provided that the offence involves a computer, computer system or computer network located in India.

Enforcement and Penalties

Contravention of provisions dealing with the protection of sensitive personal data or information, which results in wrongful loss or wrongful gain to any person, may result in the breaching entity being held liable to pay damages to the person so affected. The quantum of such compensation is uncapped and is to be decided by the court on a case-by-case basis.

In terms of enforcement, complaints about offences under such provisions have not frequently been made to the competent adjudicatory authorities.

12. Miscellaneous

12.1 Other Significant Issues

All key significant issues on the subject have already been addressed above.

Khaitan & Co was founded in 1911 and is among India's oldest and most prestigious full-service law firms. It is also one of the largest, with over 700 professionals and 152 partners and directors. The firm's teams, comprising a powerful mix of experienced senior lawyers and dynamic rising stars in Indian law, offer customised and pragmatic solutions that are best suited to their clients' specific requirements. The firm acts as a trusted adviser to leading business houses, multinational corporations, financial institutions, governments, and international law firms. From mergers and acquisitions to intellectual property, banking to taxation, capital markets to dispute resolution, and emerging areas like white-collar crime, data privacy and competition law, the firm has strong capabilities and deep industry knowledge across practices. With offices in New Delhi, Noida, Mumbai, Bengaluru and Kolkata, the firm also has capabilities in overseas markets via its country-specific desks and robust working relationships with top international law firms across jurisdictions.

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