Investing In...

India: Law & Practice
Rabindra Jhunjhunwala, Anshul Prakash, Anisha Chand and Abhishek Dadoo
Khaitan & Co

India: Trends & Developments
Rabindra Jhunjhunwala, Gautham Srinivas, Ritu Shaktawat and Abhishek Dadoo
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Contributed by:
Rabindra Jhunjhunwala, Anshul Prakash, Anisha Chand
and Abhishek Dadoo
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Contents

1. Legal System and Regulatory Framework p.3
   1.1 Legal System p.3
   1.2 Regulatory Framework for FDI p.3

2. Recent Developments and Market Trends p.3
   2.1 Foreign Direct Investment in the Current Climate p.3

3. Mergers and Acquisitions p.4
   3.1 Transaction Structures p.4
   3.2 Regulation of Domestic M&A Transactions p.4

4. Corporate Governance and Disclosure/Reporting p.4
   4.1 Corporate Governance Framework p.4
   4.2 Relationship between Companies and Minority Investors p.5
   4.3 Disclosure and Reporting Obligations p.5

5. Capital Markets p.5
   5.1 Capital Markets p.5
   5.2 Securities Regulation p.6
   5.3 Investment Funds p.6

6. Antitrust/Competition p.6
   6.1 Applicable Regulator and Process Overview p.6
   6.2 Criteria for Review p.7
   6.3 Remedies and Commitments p.7
   6.4 Enforcement p.7

7. Foreign Investment/National Security p.8
   7.1 Applicable Regulator and Process Overview p.8
   7.2 Criteria for Review p.8
   7.3 Remedies and Commitments p.8
   7.4 Enforcement p.9

8. Other Review/Approvals p.9
   8.1 Other Regimes p.9

9. Tax p.10
   9.1 Taxation of Business Activities p.10
   9.2 Withholding Taxes on Dividends, Interest, Etc p.11
   9.3 Tax Mitigation Strategies p.11
   9.4 Tax on Sale or Other Dispositions of FDI p.12
   9.5 Anti-evasion Regimes p.12

    10.2 Employee Compensation p.13
    10.3 Employment Protection p.13

11. Intellectual Property and Data Protection p.14
    11.1 Intellectual Property Considerations for Approval of FDI p.14
    11.2 Intellectual Property Protections p.14
    11.3 Data Protection and Privacy Considerations p.14

12. Miscellaneous p.14
    12.1 Other Significant Issues p.14
Indian Trends and Developments

Contributed by: Rabindra Jhunjhunwala, Gautham Srinivas, Ritu Shaktawat and Abhishek Dadoo
Khaitan & Co see p.22

India – Towards a Resilient Future

In a most positive development, green shoots in the Indian economy are now becoming visible following the devastating impact of the COVID-19 pandemic that adversely affected the world economy. During the first quarter of Fiscal 2021 (the Indian fiscal year being 1 April to 31 March), India’s Gross Domestic Product (GDP) tanked 24%, on account of disruptions caused by the restrictions and ceasing of economic activities during the nationwide lockdown announced by the government of India (GOI). However, we are witnessing a V-shaped recovery in the Indian economy, as the GDP recorded a quarter-on-quarter growth of 23% in the second quarter of Fiscal 2021.

As per the Finance Ministry’s Monthly Economic Review for November 2020, “The year-on-year GDP contraction of 7.5% in Q2 of 2020–21 underlies a quarter-on-quarter surge in GDP growth of 23%. This V-shaped recovery, evident at the halfway stage of 2020–21, reflects the resilience and robustness of the Indian economy. The fundamentals of the economy remain strong as gradual scaling back of lockdowns, along with the astute support of Atmanirbhar Bharat Mission has placed the economy firmly on the path of recovery. This is in alignment with economic recovery across the globe reflecting a worldwide pick-up in business and consumer confidence.”

Foreign Direct Investment (FDI) inflow into India in the first six months of 2020–21 (ie, during the period the pandemic was at its worst in India) is quite encouraging, rising more than 10% year-on-year to reach USD40 billion. Foreign Portfolio Investment (FPI) inflows also reflect the same sentiment, reaching a historic high of USD8.5 billion in November, as per the Finance Ministry’s Monthly Economic Review for November 2020. Consequently, and on the back of continued contraction in imports, forex reserves continued to scale new heights to reach USD575 billion on 20 November 2020.

The Indian capital markets have also seen very high activity since the nationwide lockdown in March 2020. Both equity and debt capital markets have seen unprecedented activity. The equity capital market activity has been on overdrive this year (approximately USD35 billion in nine months of the calendar year 2020), surpassing performance in the calendar year 2007 (USD31.2 billion) with the majority of deal activity taking place in the first and second quarters of Fiscal 2021. India’s largest company by market capitalisation, Reliance Industries Limited, raised approximately USD 7 billion from its rights issue (India’s largest-ever ECM offering), while financial institutions, such as ICICI Bank Limited, Axis Bank Limited, HDFC Limited and Yes Bank Limited, collectively raised over USD7 billion through their share sales (source: Refinitiv – India’s Investment Banking Review).

Regulatory nimbleness to cope with the crisis and to facilitate ease of doing business

Crisis – a trigger for change

Often it takes a debilitating crisis to bring out a much-needed change in the way we do business. It is important that regulators also step in by transforming into enablers to usher in the changes, such as extensions of deadlines, relaxations in filings, temporary easing of rules, enabling the granting of a moratorium to borrowers, and other similar measures created space within which businesses could avail themselves of regulatory relief as they managed to stay afloat during the existential crisis. India also saw regulators ironing out regulatory overlaps to provide the industry with much-needed relief from filing and compliance requirements. For eg, the Ministry of Corporate Affairs and the Securities Exchange Board of India (SEBI) worked together to relax requirements for rights issue by listed companies, which helped many entities to raise funds during the nationwide lockdown period.

Regulatory extensions from compliance with regulations

The Reserve Bank of India (RBI) and SEBI undertook a slew of measures to enable Indian companies to cope with the effects of the COVID-19 pandemic. The measures were aimed at improving the functioning of Indian markets, providing essential relief to borrowers in times of distress caused by the COVID-19 pandemic, and easing the burden on borrowers by making working capital more accessible and mitigating the debt-servicing burden.

Some key measures adopted by the RBI included a reduction in the policy repo rate, a reduction in the reverse repo rate, relaxation from maintaining a 100% liquidity coverage ratio, and reducing the cash reserve ratio requirements of all banks, which released much-needed liquidity into the market. In respect of all term loans outstanding as of 1 March 2020, banks and financial institutions were allowed to offer moratoriums on the payment of installments. Similarly, lending institutions were allowed to offer deferment on the payment of interest on working capital.
facilities sanctioned as of 1 March 2020, recalculate drawing power by reducing margins, and re-evaluate the working capital cycle of borrowers.

SEBI too granted relaxations to relieve the compliance burden on listed companies during this period. It granted listed companies an extension for filing the quarterly and half-yearly financial results, and in conducting board and committee meetings. It also extended the time for filing returns, including secretarial compliance reports and corporate governance reports. It also relaxed the requirement for the publication of various advertisements in newspapers.

Taxpayers also breathed a sigh of relief as extensions in compliance timelines were announced, such as for filing of income tax returns and tax audit reports up to 31 December 2020 (from 31 October deadline for corporates).

Relaxations to enable entities to access critical working capital and growth capital
The RBI and SEBI announced multiple measures to enable entities to access critical working capital during the lockdown period and also to raise growth capital which would allow entities to bounce back. The measures announced by SEBI included relaxation from certain fundraising norms including an extension of validity of SEBI observations on public issues/rights issues by six months for observations expiring between 1 March 2020 and 30 September 2020. SEBI also allowed companies going for public issues on or before 31 December 2020 to increase or decrease the fresh issue size by up to 50% of the estimated issue size without the fresh filing of a draft offer document with SEBI.

For listed companies, SEBI announced multiple relaxations from procedural requirements for raising capital by way of a rights issue and follow-on public offering, conditions applicable for undertaking fast-track rights issues, including relaxing the eligibility requirements of average market capitalisation and minimum period of listing prior to undertaking the fast-track issue, and the minimum subscription requirement so that companies could raise capital faster from the market.

In order to enable companies to undertake issues, SEBI took a number of practical steps to relax procedural requirements so that companies could raise capital without being hindered by restrictions on movement during the lockdown. Some of the decisions taken included filing of an electronic version of the offer documents with SEBI and other regulators, sharing of the rights issue-related documents electronically with the shareholders, a procedure for inspection of material documents electronically, shareholders holding shares in physical form being allowed to submit a rights issue application electronically, providing optional (non-cash) third-party methods so that shareholders could easily apply and transfer funds to the companies in rights issues.

Similar to relaxations for rights issues, SEBI relaxed eligibility and procedural requirements to undertake further public issues (FPO). It relaxed the average market capitalisation of public shareholding from INR10 billion to INR5 billion. It also allowed companies which have been issued a show-cause notice under adjudication proceedings or against whom SEBI has initiated prosecution proceedings to undertake fast-track issues, provided the requisite information regarding such proceeding was adequately disclosed in the offer document, along with the potential adverse impact on the issuer. SEBI also reduced the minimum time gap between two qualified institutional placements (QIPs), a private placement offered to qualified institutional investors by listed companies, from six months to two weeks to enable companies to raise funds quickly.

SEBI also relaxed stringent fundraising norms for financially stressed companies enabling them to raise funds by way of preferential allotments, subject to stringent lock-in and use-of-proceeds requirements.

As a measure to increase liquidity in the hands of taxpayers, withholding tax rates on domestic payments were reduced by 25% and expeditious processing of tax refunds was announced.

Protection from opportunistic takeovers
The Department for Promotion of Industry and Internal Trade (DPIIT) introduced the Press Note 3 (2020) in April 2020 to prevent any opportunistic takeovers/acquisitions of Indian companies in the wake of the COVID-19 pandemic. Any investment from any entity in a country that shares a land border with India, or entities whose beneficial owners are based in such land-bordering countries, require government approval.

Relaxations under Indian insolvency laws
A series of amendments was introduced by GOI inter alia to the Insolvency and Bankruptcy Code 2016 (“the Code”) and the regulations framed under the Code, keeping pace with the regulatory changes and relaxations introduced under different legislations across different sectors of the economy to cope with the COVID-19 crisis.

- Suspension of initiation of Corporate Insolvency Resolution Process (CIRP) – GOI promulgated an Ordinance on 5 June 2020, inter alia to amend the Code such that no new applications under the Code could be filed for a period of six months from 25 March 2020. The ordinance was subsequently approved by parliament in September 2020 and the period was subsequently extended by a period of three months.
increased visibility and grants access to investor bases with a greater understanding of, and appetite for, niche businesses.

DEEPENING OF THE CORPORATE BOND MARKET FOR FOREIGN INVESTORS

Foreign participation in India’s debt market is regulated and is channelled through the FPI route, the Foreign Venture Capital Investment (FVCI) route, or the External Commercial Borrowing (ECB) route. Several measures have been undertaken to further liberalise/facilitate FPIs in debt instruments, including:

- increasing the limit for investment by an FPI in short-term (up to one year) corporate bonds and government securities, including treasury bills and State Development Loans (SDLs), from 20% to 30% of the total investment by that FPI in the respective category;
- exempting debt instruments issued by Asset Reconstruction Companies (ARC) or by entities under CIRP under the Code from the short-term investment limit;
- raising the limit for investment by FPIs in corporate bonds to 15% of outstanding stock with effect from 1 April 2020; introducing the Voluntary Retention Route (VRR) for FPI in debt, which provided investors with a new investment avenue, enabling long-term and stable FPIs into debt markets against commitment to retain a required minimum percentage of their investments in India for a period of their choice (minimum three years), in March 2019; and
- the introduction of the Fully Accessible Route (FAR) for investment by non-residents in securities issued by GOI.

One of the most significant regulatory developments that we expect in Fiscal 2021 is the establishment of a framework for the overseas direct listing of Indian companies. At present, GOI has, pursuant to a recent amendment to the (Indian) Companies Act, included an enabling provision allowing for public companies in India to be listed overseas. We anticipate further changes to Indian law to facilitate overseas listing, including through the introduction of a separate regulatory framework. Once this is operational, significant interest in listing overseas is expected from Indian companies, particularly start-ups and technology companies, since this offers, among others, the benefits of increased visibility and grants access to investor bases with a greater understanding of, and appetite for, niche businesses.

Streamlining of regulations to simplify fundraising and compliance requirements

SEBI has initiated steps to streamline various regulations to ease the compliance burden on companies and remove any inconsistencies that may have cropped up over the years. These include the issuance of consultation/discussion papers on SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and the review of the regulatory framework for corporate bonds and debenture trustees in February 2020, the e-voting facility provided by listed entities, the guarantees provided by a listed company, relaxation with respect to QIP issues, Amendment to SEBI (Delisting of Equity Shares) Regulations, 2009 for schemes of arrangement, Review of SEBI (LODR) Regulations, 2015, Review of Minimum Public Offer for large issuers in terms of Securities Contracts (Regulation) Rules, 1957, and re-classification of promoter/promoter group entities, to name a few. SEBI...
has been proactive in deliberating with all stakeholders to usher in changes that the market has been expecting, which will go a long way in achieving the GOI plan for ease of doing business.

Introduction of IBC helped to improve corporate debt market outlook
Over the last few years, the corporate debt market has emerged as an alternative to the banking sector for raising debt funds, especially since the banking sector started reporting high levels of non-performing assets. However, the corporate debt market received significant shocks in the Fiscals 2019 and 2020 when some of the large financial sector entities, like Infrastructure Leasing and Financial Services Limited (IL&FS), Reliance Capital Limited, and Dewan Housing and Finance Limited (DHFL), defaulted on their debts.

In such a scenario the Code and the Prudential Framework for Resolution of Stressed Assets issued by the RBI have instilled much-needed confidence in the ability of the system to resolve stressed asset cases in a time-bound manner and ensure redeployment of credit. As the Indian economy tries to recover from the aftermath of the pandemic it will need a competent debt market to support much-needed liquidity requirements. The Code will play an important role in ensuring that the system supports a quick resolution of delinquencies and redeployment of much-needed growth capital.

Relaxed tax regime to foster the manufacturing and service sector
India has recently rolled out a concessional corporate tax regime reducing the corporate tax rates to extremely competitive levels vis-à-vis the country’s manufacturing/exporting country counterparts.

With the objective of encouraging the setting up of new manufacturing entities and in furtherance of the “Make in India” movement, tax concessions focusing on the manufacturing sector were introduced. An Indian company incorporated on or after 1 October 2019 which commences manufacturing or production on or before 31 March 2023 (including generation of electricity) can now opt for a concessional tax rate of 15% (excluding surcharge and cess), subject to certain conditions such as inability to claim certain deductions/incentives, limits on the value of its second-hand machinery, nature of business, etc.

Besides new manufacturing companies, every company can now opt for a lower tax rate of 22% regardless of the sector and whether the company is new or existing, subject to certain conditions. The headline corporate tax rate in India is and has been 30% which, after including additional levies in the form of the surcharge and education cess, results in a maximum effective tax rate of approximately 35%. The recent corporate tax rate cuts have been one of the landmark tax concessions of recent times resulting in a maximum effective tax rate of approximately 17% for new manufacturing companies and 25% for other companies. Several existing companies have opted for this regime, and entities in the manufacturing space have been exploring this incentive with respect to their expansion plans.

Tax incentives to boost investments in financial services and infrastructure sectors
Several tax incentives have been announced by GOI in the recent budgets with respect to the International Financial Services Centre/Gift City, including a 10-year tax holiday to units set up in a Gift City. Furthermore, to incentivise investment in the infrastructure sector, GOI has extended tax exemption to foreign pension funds and Sovereign Wealth Funds (SWF) with respect to the dividends, interest and long-term capital gains income of these funds if they, inter alia, invest in “eligible sectors”. The list of eligible sectors has been expanded to include sectors in the telecommunications, education and tourism spaces, amongst others. Walking the talk, GOI recently conferred the tax exemption on a UAE-based SWF. As per media reports, the application for exemption seems to have been processed and approved expeditiously, ie, in less than two months, and the efficacious handling of the process should encourage more applicants.

Tax efficiency marries profit extraction
Until recently, dividend income was exempt in the hands of the non-resident shareholders but the dividend-paying company was required to pay additional corporate tax in the form of Dividend Distribution Tax (DDT) at a rate of approximately 21%. The DDT regime had multiple downsides. It resulted in high tax cost on the extraction of profits, it was unclear whether DDT was subject to beneficial rates under tax treaties (tax on Indian companies and not the foreign shareholder), and it was generally not available as a credit against the tax payable by shareholders in their home jurisdictions (subject to applicable local laws).

As of 1 April 2020, the DDT regime has been abolished, shifting the tax benefits from the company to the shareholders. For non-residents, this effectively means that they should not only be able to benefit from the concessional rate of dividend taxation available under the applicable tax treaties, but also benefit from credit of tax paid on dividends in India.

Measures to protect India’s tax base and “substance”-based tax regime
E-commerce sector – a new levy on online supply and services
Businesses have expanded online amidst the pandemic. Not untouched by the tax reforms, effective 1 April 2020, the online
sale of goods and provision of services by non-residents attract an “equalisation levy” of 2%. Additionally, certain tax deduction-at-source provisions has also been introduced, requiring an online platform operator to deduct tax at source in relation to payments to domestic e-commerce participants offering goods/services through the platform. While the levy may open coffers for GOI, online platforms with insufficient margins to absorb the equalisation levy are grappling with these new tax provisions, which also result in a cash flow and additional compliance burden. These measures follow the 6% levy which was introduced in the year 2016 on payments to non-residents towards online advertising and related services. These measures make India one of the first countries to implement specific measures focusing on taxation of the digital economy.

Anti-abuse regime
The noose on aggressive tax planning and tax evasion has been tightened by the introduction of the domestic anti-avoidance rules and ratification of the OECD’s Multilateral Instrument (MLI), which introduces a substance test in the tax treaties covered by the MLI whereby if one of the drivers of a structure or transaction is treaty benefit, the same could be denied. The MLI also has a more comprehensive limitation of benefits clause which could, in future, be adopted by the signatories to the MLI. The focus on “substance over form” has been clearly highlighted and compliance with the law in letter and spirit will be an extremely important consideration in any form of tax structuring.

Fiscal 2021 – a year of opportunities
Sharp rebound from the COVID-19 pandemic-induced decline
India is witnessing a V-shaped economic recovery post the lifting of the nationwide lockdown. Decline of the Indian GDP has not been as substantial as projected earlier. India’s GDP growth rose to 7.5% year on year in the second quarter of Fiscal 2021, a sharp rebound from the lockdown-induced decline of 23.9% in the first quarter of Fiscal 2021 (source: Monthly Economic Review, Department of Economic Affairs, GOI). The performance of Indian industries and the service sector has been better than expected. A bountiful monsoon has brought cheer to the economy, with an expectation of a record agricultural output which would result in an increase in overall demand for goods and services, across sectors.

Indian markets have also recovered well post the lows of March 2020. According to SEBI, recovery in the market has been broad-based. While the large-cap and mid-cap indices have increased around 55%, the small-cap index has increased around 70% since the lows of March 2020. This recovery is not only in the heavy-weight stocks but across the board in the index. Around 40–50% of the constituents in each index category – large, mid and small-cap – outperformed the respective indices. More than 93% of the stocks on the NSE and more than 75% of the stocks on the BSE have yielded positive returns in this financial year as of 30 September 2020. Corporate earnings are set to improve after the COVID-19 shock. The corporate earnings results of 225 listed banking and financial sector companies in India (representing around 80% of all the listed banking and financial sector companies in terms of market capitalisation) reflected a robust rise in operating profits by 23.2% in the second quarter of Fiscal 2021, similar to profit levels in September 2018. Furthermore, provisioning on loans and advances grew only marginally, resulting in a sharp jump in net profits of 90.2% (source: Monthly Economic Review, Department of Economic Affairs, GOI).

Shift in global sentiment to reduce dependence on a single country for imports
Due to COVID-19 there has been a considerable shift in the global outlook to reduce dependence on a single country for raw materials and finished goods. Nations across the globe are reconsidering trade ties and their dependence on made-in-China goods and raw materials. Companies planning to relocate are focusing on countries that have an attractive long-term investment climate in terms of ease of doing business, cost of manufacturing, quality of institutions and governance standards, availability of transport and logistics, and availability of a large domestic market. India scores high in all of the above parameters and this is reflected in the increasing interest from international companies looking to invest there. This interest is largely from Asia, led by Japan, Korea and Thailand, but includes Europe and the USA. GOI has also facilitated the migration by announcing the Production Linked Incentive Scheme for 10 sectors worth INR2 lakh crore and approximately USD27 billion, which aims to give companies incentives on incremental sales from products manufactured in domestic units. Furthermore, India has an advantage of favourable demographic dividends. India’s working-age population (between 15 and 64 years of age) outgrew its dependant population in Fiscal 2018. This demographic advantage is expected to continue for the next two to three decades. GOI has been focusing on the sustained availability of a trained quality workforce so that India can benefit from the demographic dividend. In addition, over the last few years, India has undertaken multiple reforms in labour market regulations and has worked towards increasing the participation of women in the workforce and increasing worker mobility across India.

Turning a new corner, India is likely to bounce back with an impressive 8.8% growth rate in Fiscal 2021, regaining the position of the fastest-growing emerging economy, surpassing China’s projected growth rate of 8.2% as per the International Monetary Fund in its latest “World Economic Outlook” October 2020. Overall, robust fundamentals, coupled with decisive monetary and regulatory support from the government, are poised to make India an attractive foreign investment destination.
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.

Authors

Rabindra Jhunjhunwala is a partner and a senior member in the corporate law practice. He started with the firm in its Kolkata office in 1990 and co-founded the Mumbai office in 2001. He heads the firm’s IBA, France desk and Germany desk initiatives. He also sits as an officer on the IBA Corporate and M&A Committee. His practice spans a range of areas, including domestic and cross-border M&A, PE investment and transaction documentation work, and he regularly advises clients on all aspects of foreign investments (both inbound and outbound) and regulatory approvals. He has advised several multinationals and Indian companies on complex and big-ticket M&A transactions.

Gautham Srinivas is a partner in the securities, capital markets and corporate practice group. Gautham has advised clients on private equity investments and other areas of corporate law. He has represented issuers, investment banks, and selling shareholders on various initial public offerings (IPOs), qualified institutions placements (QIPs), rights offerings, high-yield debt offerings, and global depository receipts (GDR) offering, among others, both Regulation S and 144A deals. He has extensive experience in drafting offer documents and providing securities law advisory, and he has advised clients on corporate law matters, including listed companies regarding their investments.

Ritu Shaktawat is a partner in the direct tax practice group. Ritu has advised clients in the areas of corporate taxation and international taxation, including bilateral tax treaties and transfer pricing. She focuses on matters involving transaction tax advisory, structuring and documentation of domestic, cross-border and global M&A deals having an India leg; complex interpretational issues pertaining to income characterisation and permanent establishment (Indian taxable presence of foreign entities) aspects; taxation of EPC contracts; taxability of the ever-evolving e-commerce business models; funds taxation; and general anti-avoidance rules and place of effective management, which are relatively new issues that are becoming critical across jurisdictions.

Abhishek Dadoo is a partner in the public M&A practice group. He routinely advises financial and strategic investors on listed company transactions and has been involved in friendly as well as hostile acquisitions in the listed space. Abhishek actively contributes on topics relating to public M&A, takeover and insider trading regulations, including engagement with regulators.