

OPERATING IN INDIA - CONSIDERATIONS FOR IN-HOUSE COUNSEL

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M&A In India: Key Statistics

- Between April 2021 to June 2021, foreign direct investment (FDI) into India was US\$22.53 billion.
- Despite the COVID-19 pandemic, the FDI inflow between April 2020 to March 2021 was higher at US\$59 billion as compared to the period between April 2019 to March 2020 (US\$50 billion).
- Since 2013, India has seen a steady year-on-year percentage increase in FDI investments.
- Gujarat, Maharashtra and Karnataka are the top 3 states attracting FDI in India. Services sector and Computer software and hardware sector continue to attract the highest FDI.
- The United States is the top investing country after Mauritius and Singapore, which are used as intermediary jurisdictions.
- Deal activity (public and private) remains strong.



Cultural Issues

- Most businesses are traditional, family-run businesses and not professionally managed.
- Hierarchically arranged business structures. Decision-making is at the top level.
- Meetings are more informal and timelines may not always be met. Timelines are treated as indicative. Communication issues - tendency to say “yes” in order to be polite.
- Low compliance level especially corporate and employment records.
- Convincing points for buy-out
 - Often family-owned enterprises and successful start-ups expect a premium;
 - Offer key employment positions to the individual JV partners post buy-out; and
 - Absence of successor or lack of interest, skills in successors.
- Convincing points for exit
 - Bargain/hair-cut on the rate of return; and
 - Preferably sell stake to a non-resident (no valuation requirements and less regulatory implications).



Key Laws For A Foreign-Owned Business

- The Foreign Exchange Management Act, 1999 and the rules and regulations thereunder.
- The Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 and the Consolidated Foreign Direct Investment Policy.
- The Companies Act, 2013.
- The Insolvency and Bankruptcy Code, 2016.
- The Securities and Exchange Board of India's regulations.
- The Competition Act, 2002.
- The Indian Contract Act, 1872.
- Laws on anti-corruption, intellectual property, employment and data privacy.
- The Income-tax Act, 1961 and Double Taxation Avoidance Agreements.



Entry Into India

- The types of entities that can be established by foreign companies are
 - Liaison/Representative office
 - ✓ Place of business to act as a channel of communications, represent the parent company in India and promote technical/financial collaborations.
 - ✓ Cannot undertake commercial, trading or industrial activities and cannot generate income.
 - ✓ Must maintain itself out of inward remittances received from outside India.
 - Branch office
 - ✓ Place of business to render professional/consultancy services, render services in information technology and software development and carry out research.
 - ✓ Cannot conduct manufacturing business.
 - ✓ Restrictions on acquisition of immoveable property.



Entry Into India (Contd.)

- Project office
 - ✓ For a specified duration and to complete a specific project in India.
 - ✓ Restrictions on modes of funding of the project.
- Private limited company
 - ✓ Governed by the Companies Act, 2013 and its rules.
 - ✓ Liability can be limited by shares or guarantee.
 - ✓ Separate legal entity having perpetual succession.
- Limited liability partnerships
 - ✓ Governed by the Limited Liability Partnership Act, 2008 and its rules.
 - ✓ Hybrid entity. Members have limited liability akin to a company but enjoy freedom to mutually agree to terms of existence akin to a partnership.
 - ✓ Separate legal entity having perpetual succession.



Press Note 3 Of 2020

- Introduced in April 2020, Press note 3 mandates foreign investors from a country which shares a land border with India to take prior approval of the Indian government for FDI into India.
- Aimed at regulating investments from China and may also cover investments from entities based in Hong Kong and Taiwan.
- Further capitalization of existing investments also hit for Chinese subsidiaries in need of funds.
- Multi-jurisdictional transactions may also require approval if they result in an indirect investment in an Indian company.
- *De minimis* threshold for beneficial ownership of, or indirect investment by, an entity or a citizen of a border sharing country has not been prescribed.
- Ambiguity for FDI which is ultimately held by overseas listed companies or investment funds as it is difficult to identify beneficial ownership in the absence of a threshold.
- Unlike the CFIUS in the United States or the measures adopted by the European Union and the United Kingdom, Press note 3 is sector agnostic.



Foreign Investment - Regulated Sectors

- Key sectors in which FDI is prohibited: Lottery business, including government/private lottery, online lotteries; gambling and betting, including casinos; trading in Transferable Development Rights; real estate business or construction of farmhouses; manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes; and atomic energy and railway transport.
- Key sectors in which FDI is subject to sectoral caps or other conditions
 - Defence - Up to 74% under the automatic route, above 74% under the government route if it is likely to result in access to modern or state of the art technology.
 - Multi-brand retail trading - Up to 51% under the government route.
 - Single-brand retail trading - Up to 100% under the automatic route.
 - Pharmaceuticals - Up to 100% for greenfield and 74% for brownfield under the automatic route; above 74% for brownfield under the government route.
 - Insurance - Up to 74% under the automatic route.



Foreign Investment - Other conditions

- Up to 100% FDI is permitted under the automatic route in sectors not specifically listed.
- Investments to comply with fair market value requirements - Any internationally accepted pricing methodology will work. Reporting requirements must also be complied with.
- Downstream investments by an Indian entity having FDI are also permitted subject to compliance with prescribed conditions.
- Issue of shares by an Indian company to non-residents for non-cash consideration is regulated.
- 18/25 Rule on Deferred Consideration and Indemnity
 - Effective May 20, 2016, caps have been imposed on deferred consideration and indemnity pay outs in a cross-border share sale transaction.
 - Approval of the Reserve Bank of India is needed if: (i) consideration amount deferred or escrowed exceeds 25% or a period of 18 months from the date of the transfer agreement; or (ii) Seller's indemnity exceeds 25% of the total consideration or a period of 18 months from the date of payment of the full consideration.



Investment Strategies

	Asset Purchase	Slump Sale	Share Purchase
Mode	Itemized purchase of assets for an agreed price	Transfer of undertaking for a lump sum consideration without values assigned to any individual asset	Purchase of equity shares by an agreement
Stamp Duty	Depends on value of assets transferred and place where assets are located	Depends on value attributed to each asset in the business and place where business is located	0.015% of the purchase price of the shares <u>plus</u> additional stamp duty on the share purchase agreement at the applicable rate in the State of execution
GST	Applicable	Not Applicable	Not Applicable
Successor Liability	Can be ring-fenced	Can be ring-fenced	Cannot be ring-fenced



Key Investment Considerations

- Non-solicitation clauses: Enforceable during the term of the contract. Clauses on non-solicitation of clients/customers may not be enforced post-termination but other non-solicitation clauses are generally enforceable even after termination.
- Non-compete clauses: Non-compete clauses are generally enforceable during the term of the contract but may not be enforced post-termination.
- Confidentiality: Indian courts have consistently granted injunctions to protect confidential information on the principles of equity and common law.
- Damages: Actual damages are awarded and consequential damages are not awarded. Liquidated damages are also awarded. Liability can be limited except in the case of a fundamental breach of a contract.
- Data privacy: No specific legislation. Focus is to protect individual's sensitive personal data or information exchanged in electronic form. No protection for data received in a verbal or written form or data of juridical persons. Proposal to enact a new Personal Data Protection Bill.
- Enforcement: Foreign arbitral awards are more easily enforceable than foreign judgments. Contracts to provide for interim relief from a competent court in India pending arbitration proceedings.



Key Tax Considerations

- Manufacturing companies incorporated after October 1, 2019 are taxed at 15%. Existing manufacturing companies are now taxed at 22%. Claiming exemptions is not permitted.
- The applicable tax rate for limited liability partnerships is 31.20% which may increase to 33.38% or 34.94% after including the surcharge.
- Asset purchase: Capital gains tax based upon the nature and location of the assets transferred, the holding period and the cost of acquisition for the seller.
- Slump Sale: Special provision for computation of capital gains tax under Section 50B of the Income-tax Act, 1961.
- Share Purchase: Incidence of capital gains tax depending on the holding period. Foreign companies can explore beneficial provisions under the relevant DTAA.
- Tax Treaty Pointers: Changes in India's tax treaties with Mauritius and Singapore. Investments made after April 1, 2019 are subject to the normal rate of tax. Alternative tax structuring jurisdictions include the Netherlands for equity investments and Mauritius for debt/interest income.
- Indirect Transfers: Tax may be attracted at an India level if on the specified date: (i) the value of assets located in India exceeds INR100 million; and (ii) represents at least 50% of the value of all assets owned by the entity whose shares are being transferred.



Key Employment Considerations

- Includes Central laws and State-specific legislations - not consolidated in one statute.
- Contracts are extremely important in the case of employees engaged in managerial and supervisory roles as India's employment laws usually do not provide for mandatory and statutory benefits/ pay-outs for such employees.
- Mandatory requirements on leave, holidays, facilities to be provided by employer, maternity benefits, policy of prevention of sexual harassment.
- Categories of employees - Workmen; non-workmen; consultants; and contract labourers.
- Contracts lay down extensive confidentiality obligations. Provisions on assignment of intellectual property critical for tech deals.



Key Intellectual Property Law Considerations

- Any patent or copyright created by an employee/independent contractor belongs to the employee/independent contractor.
- Deed of assignment for patents must be executed in writing, be registered with the Patents Registry and must specify the nature of interest in the patent that is being assigned.
- Deed of assignment for copyrights must be executed in writing but need not be registered with the Copyright Board.
- Trademarks need not be mandatorily registered in India.
- Deed of assignment for a registered trademark must be registered with the Trademark Registry.



Anti-Bribery Compliance

- The Prevention of Corruption Act, 1988 (POCA) is the key legislation on anti corruption.
- Unlike the Foreign Corrupt Practices Act, 1977 (FCPA) which has extra-territorial jurisdiction, POCA only confers jurisdiction in India.
- Corruption is penalized in the context of public servants.
- Unlike FCPA which criminalizes giving a bribe, POCA criminalizes giving and accepting a bribe. It is applicable to:
 - A person who takes a bribe and who is a public servant;
 - A person who gives the bribe to a public servant; and
 - Any middlemen who influences a public servant to take a bribe (either by a payment or otherwise).



Thank You



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