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ELP KNOWLEDGE SERIES

India Update

Part 1 of 2021

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FOREWORD

Dear Reader,

The Knowledge Series covers many developments over the recent past which will have an impact on companies doing business in/with India.

Select articles in this series are dedicated to regulatory changes announced in India's recent Union Budget - our article on India's tariff policies for instance, examines the Government's stance on tariffs and customs duties - which may force several companies to revisit their supply chain structures. We have also presented a detailed analysis of two important decisions by the Government – one is on goodwill not being considered as a depreciable asset and second is India expanding its regime of equalization levy to cover 'e-commerce supply'.

India's new labour law landscape, its subsequent implications and immediate compliance and action points for businesses is an important chapter in this update. Another chapter is dedicated to the enhanced fiduciary role of trustees of mutual funds as per the Third Schedule of the SEBI MF Regulations. Also discussed in our Knowledge Series are the issues of estate and succession planning (and all the complexities associated with it) and arbitrability of frauds in India.

On the ease of doing business and promoting domestic manufacturing front, we have included two articles. One is on India's long awaited Defence Acquisition Procedure which will ensure some degree of ease in doing business for an industry that was previously plagued by bureaucracy and red tape. The second article is on the widely discussed and promoted Production Linked Incentive (PLI) Scheme.

We hope you will find the information contained in the subsequent sections to be helpful. For any clarification or further information, please reach out to your point of contact at ELP or any member of our team who has contributed to this iteration of the 'India Update'.

Happy reading
Regards,
Team ELP

India's Customs Tariff Policy: Clear, Unambiguous and Truly Evolved

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'The two T's of cross border i.e. tension and trade, are best addressed with a clear policy. The good news is that Union Budget 2021 sets out India's tariff policy for cross border trade in clear and unambiguous terms.

The budget moves on customs tariffs, focused in letter and spirit on (a) safeguarding indigenous industry; (b) promoting value addition in certain sectors to be part of the global value chain; and (c) reducing cost of inputs and correcting the problem of inverted duty structure.

INCENTIVIZING IMPORTS

The first was carefully incentivizing raw material imports and blocking that of finished goods or ones that are indigenously manufactured in quantities that not just suffices domestic demand but also caters to the export market. Custom duties for industries, for example, chemicals, cut and polished stones, safety glasses and parts of signaling equipment, metal products such as screw, nuts where there is sufficient local capacity were hiked to discourage imports., etc.

To promote value addition in certain sectors, import duty has been freshly imposed or hiked, as the case may be. This has been done for goods such as solar inverters, parts of mobile phones, compressors for refrigerator/airconditioners. This aims to enable manufacturers to onshore majority value addition processes undertaken in course of the manufacturing.

CORRECTION OF DUTY RATES

The next measure involved correction of duty rates that either led to inverted duty structures or were causing an unwarranted increase in pricing of raw materials. Beneficiaries include sectors such as textiles, ferrous and non-ferrous metals, naptha, precious metals, etc. This has come as a huge relief to the importer communities as they have been advocating this cause with the Government for a long time.

It is indeed heartening to see that policy makers are not just hearing but also positively acting on representations.

With all the jubilation about tariff moves, an issue which initially created an enormous buzz was the new agri-infra development cess proposal. While it was feared that the cess would be inflatory, the actual picture is quite different. Although it is a new levy, the cess will not add a duty load on importers, since corresponding basic customs duty has been suitably adjusted in most cases. This is emphasized by the fact that several affected sectors, alcoholic beverages for example, have made it clear that this cess will not lead to increase in pricing of the final product.

Simply put, the undercurrent of these proposals, is that India has taken a definitive stand on its tariff policies. The policy has clearly challenged cheap imports, discouraged pseudo manufacturing such as assembling/ aggregation and encouraged exports from India.

In a bid to further showcase its intent on the tariff policy front, the Finance Minister indicated that lawmakers will now review as many as 400 old customs exemptions on stringent norms of requirement and anything which is not in sync with the Government's vision will be cancelled. This is unheard of; it's a painstaking job and it is being well done.

WHAT TO EXPECT

Expect more and more rationalization. The government is on the lookout for inefficiencies and would weed it out as soon as identified. For instance, several end-use based exemptions today warrant varying compliances. The government has taken up the mettle to standardize these compliances at the earliest.

Further, new exemptions would not come for an indefinite period. The same, if at all, would be notified for a purpose and with a life span of about two years. If one observes carefully, this roadmap suggests that the administration would act to help and support, but the beneficiary has to eventually stand and learn to manage on its own.

Finally, the peculiarity of this new explicit policy is that it makes room for adjustments immediately. Metal prices, steel in particular is exponentially rising and the Government has already cautioned domestic players. In a bid to ensure that costs of such items do not disrupt cost sheets of various other projects, infrastructure included, the government is taking head on measures. Illustratively, anti-dumping duty/countervailing duties on various steel products from China/ Indonesia, etc. are being temporarily suspended or revoked to balance out product prices and support projects and industry against inflation.

A few naysayers have denounced these policy measures. They may indeed be protectionist in their approach; however, they clearly lay out the long-term plan for achieving India's vision of being a global manufacturing hub. This also sends out a clear message to industries which have not been particularly impacted by these current tariff changes. Businesses should augment future plans to suit India's evolving policy towards localization as in time all industries will be similarly impacted. India is only aiming for a higher and meaningful value addition by onshoring of critical manufacturing processes. The trade constituents will have to be aligned accordingly.

This article has been printed in the Economic Times

Goodwill in M&A Lost Forever

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The Finance Bill 2021 has proposed that goodwill of a business or profession will not be considered as a depreciable asset. Depreciation would therefore, not be allowed on goodwill of a business or profession **in any situation**. Accordingly, goodwill of a business or profession has been excluded from the meaning of intangible assets under section 32 of the Income Tax Act, 1961 (**IT Act**) and corresponding changes under various other provisions are proposed to be amended.

Though a subject matter of litigation during assessments, it has been well settled by various judicial pronouncements, including the decision of Hon'ble Supreme Court in the case *of Smif Securities Limited [(2012) 348 ITR 302 (SC)]*, that goodwill is an asset that arises on account of consideration paid being in excess of fair value of assets and liabilities being acquired, irrespective of the fact whether consideration is discharged in cash or shares. The mode of acquisition of business may be via a merger, demerger or business purchase.

THE CASE OF INTANGIBLE ASSETS

Further there are a plethora of various judgements which have held that goodwill arising on a purchase of business is included under the definition of intangible asset and therefore is a depreciable asset in the hands of the buyer. As a matter of fact, this is one of the many reasons why a buyer generally prefers a business purchase as compared to a share purchase from a seller since the buyer would get enhanced depreciation on the value of assets that it has paid for.

The memorandum to the Finance Bill 2021 explains various provisions of the IT Act and the reasons as to why depreciation should not be allowed on goodwill. However, all such provisions pertain to a merger or a demerger situation where the depreciated asset block of the transferor company continues in the hands of the transferee company without any "step-up" in value. The logical reasoning behind this is the impact of mergers and demergers are tax neutral in the hands of transferor company and its shareholders and thus the transferee company should not avail depreciation on the asset value higher than the asset value that it inherits from the transferor company.

A DEBATABLE ISSUE

It is important to question the logic in disallowing depreciation on goodwill of a business or profession resulting from purchase of a business by a buyer from a seller for which the seller is being taxed on the capital gains – this being the difference between the consideration received and the tax value of net assets of its business. If the seller is being taxed for the consideration that it receives, then the buyer must also get the depreciation benefits on the assets that it has paid for. This certainly is not tax abuse or evasion that ought to be disallowed.

The proposal, in fact leads to a situation of double taxation where the seller is taxed but the buyer is not being allowed to depreciate the asset that it has paid for. Reasons to disallow allowability of depreciation on goodwill in all situations without making any distinction, including that of a business purchase is discriminatory and illogical.

Goodwill, by definition, is a residual asset, the value of which cannot be attributed to a specific tangible asset or intangible asset. But nonetheless, the buyer has paid value for this asset and there is no reason why depreciation benefit should be denied unless it has been abused by way of an internal restructuring which otherwise can be curbed under the provisions of General Anti Avoidance Rules. Further IND AS 103 also does not allow recognition of goodwill in a "common control business combinations".

THE SAVING GRACE

The saving grace is that consideration paid for acquisition of such goodwill will continue in the tax books as a non-depreciable asset, the cost of which will be available as a deduction in computing capital gains on any subsequent sale.
Further, what is proposed to be restricted is a depreciation claim on goodwill of a business or profession. However, if the buyer allocates the purchase price that it has paid for acquiring the business, into specific and identifiable assets, whether tangible or intangible, then depreciation on such allocated value of identified asset should be available to the buyer. The buyer may consider obtaining a business valuation or a purchase price allocation report from a registered valuer or a chartered engineer to support the allocation of purchase price to specific identifiable assets like brands, licenses, customer data, know-how, patents, copyrights, trademarks, etc. Such assets are covered under the definition of intangible assets and thus are entitled to depreciation.

IN CONCLUSION

To conclude, depreciation on goodwill is always an essential element in calculating post tax return of an acquisition proposal and would severely impact pay-back calculations of every M&A deal and the corresponding negotiations in the bid or offer price for an asset. With the advent of pre-pack solutions of stressed assets and InvITs leading to monetisation of infrastructure assets such as highways, airports, railway infrastructure etc. depreciation on goodwill would perform an important part in increasing the yield to the buyers. The government may reconsider allowing depreciation on goodwill arising on a business purchase and may, if necessary, reduce the depreciation rate for this asset class in line with international standards.

This article has been printed in Money Control

Snowballing Role of Trustees in Mutual Funds

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The Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 (**SEBI MF Regulations**) prescribe a three-tiered structure consisting of:

- Sponsors
- Trustees (Trustee Company or Individual Trustees)
- Asset management company (**AMC**)

SPONSORS

Under Regulation 2(x) of SEBI MF Regulations, a 'sponsor' is defined to mean any person who, acting alone or in combination with another body corporate, establishes a mutual fund and is akin to a promoter. In order to become a sponsor, one must be a 'fit and proper person.' Indeed Regulation 7 of the SEBI MF Regulations sets out several conditions for one to qualify as a 'sponsor', including a five-year track record, and profitability post interest deprecation and taxes, in three out of five years, including the fifth year. The sponsors typically become shareholders in the mutual fund company. In any event, if any one shareholder has more than 40% shareholding, he is deemed to be a sponsor. One might even query the continuous requirement of having a 'sponsor' once the trustee and AMC are appointed since the role of the sponsor, thereafter, is effectively minimal. There are several provisions which highlight a strict code for conflict of interest and under Regulation 25(20) of the SEBI MF Regulations, the sponsor (along with the AMC) remains liable for compensating the investor 'for any unfair treatment to any investor as a result of inappropriate valuation.'

TRUSTEES & AMC'S

The AMC manages the funds raised from the investors, and while they are regulated by the Securities and Exchange Board of India (**SEBI**), the trustees serve as an independent body to protect the interests of the investors and ensure compliance with the SEBI MF Regulations. One might even consider the trustee board as a first level regulator.

As the term 'Trustee' suggests, the trustee group has an enhanced fiduciary role to play; when compared to the AMC and its directors. Within the group of trustees, there is a further category of independent trustees, who have an additional fiduciary responsibility – largely pertaining to the dealings of AMC with the sponsor company and its related parties.

The Third Schedule of the SEBI MF Regulations stipulates that the trustees *'shall take into their custody, or under their control all the property of the schemes of the mutual fund and hold it in trust for all the unitholders.'* Indeed, the AMC must be 'appointed' by the trustees, as well as a custodian to hold the property of the Mutual Fund. The trustees are also mandated to ensure independent auditors for the mutual fund and AMC. Every declaration of dividend also needs to be approved by the trustees. The trustees are also charged with requirements to obtain consent of unitholders in certain instances.

As comes with any fiduciary office, there is an exposure to liability for failure to carry out the required functions. Recently, a first information report (**FIR**) was filed against Franklin Templeton India, its trustee company, and senior management, including the fund manager, for allegedly defrauding the 300,000 unitholders when it abruptly closed its debt schemes. While this matter remains, sub-judice, in another matter, the Calcutta High Court in the case of *ITC Limited v. J. P. Morgan Mutual Fund India Private Limited and Ors.* (**ITC Case**), allowed the trial against the directors of the trustee company, on the

ground that the plaint contained the necessary elements of the tort of negligence; namely a duty of care owed by the applicants/defendants, a breach of the duty by the applicants/defendants and the consequences of such breach (allegedly suffered by the plaintiff in the case). The suit is still pending before the Calcutta High Court but has prima facie found that the trustees owe duties towards the unit holders as per the SEBI MF Regulations.

In another matter arising out of the same facts involving Franklin Templeton India's trustee and its AMC, the Karnataka High Court while dealing with the primary question of requirement of obtaining the consent of unit holders for winding up of the scheme, noted that SEBI had failed to reply to the letter addressed to it by the trustees seeking permission and guidance of SEBI for the winding up of the mutual fund schemes. The High Court observed that this was perhaps the first case in the history where Regulation 39(2)(a) of the SEBI MF Regulations was invoked, that SEBI ought to have been cautious and ought to have played a very active role. As a watchdog, SEBI was expected to play a very proactive role by questioning the AMC, Trustees and Sponsor about the compliances with the provisions of the SEBI MF Regulations. It may be argued that if SEBI had responded to the clarification and guidance sought by SEBI that the trustees would have taken a guided winding up decision. While the matter is sub-judice as the trustees have moved the Supreme Court against the order of Karnataka High Court in relation to obtaining the approval of unit holders for winding-up of the scheme, it is interesting to note that due to absence of guidance from SEBI, the responsibility fell on trustees to address the issue of winding up of schemes under the SEBI MF Regulations.

HOW IS THE TRUSTEE TO DEAL WITH THESE RESPONSIBILITIES?

Recently, with a view to providing administrative assistance to the trustee in monitoring activities of the AMC, SEBI has (via a circular) directed trustees to appoint a dedicated officer who will assist the trustee and carry out the activities assigned to him by the trustee. Till date, that was not required. The circular also requires trustees to have standing arrangements with independent firms for special purpose audit and/or to seek legal advice in case of any requirement as identified and whenever considered necessary. These measures have been taken by SEBI to require trustees to efficiently oversee activities of AMCs which is a statutory obligation on them under the SEBI MF Regulations. The circular, originally scheduled to be effective from October 1, 2020, has now become effective from January 1, 2021.

The circular also clarified that appointment of an officer/having arrangement with firms, will not result in dilution of role of the trustees as the circular clearly specifies that notwithstanding the directions of SEBI in the circular, the trustees shall continue to be liable for discharge of various fiduciary responsibilities as cast upon them in the SEBI MF Regulations. So hitherto, the trustees had no option but to rely upon the resources of the AMC for several critical functions. This ability to appoint and retain assistance is very welcome for the trustees. Notwithstanding this, the trustees remain dependent on SEBI to truly enforce their powers.

On paper, trustees have power to appoint or dismiss the AMC, only with the approval of SEBI. Trustees are effectively the eyes and ears of SEBI and play a vital role in the governance structure of mutual funds in India. Keeping in view the extensive duties and obligations that have been cast on the trustees, trustees need to be more conscious of the decisions made by AMCs and evaluate its policies from time to time to ensure compliance with the SEBI MF Regulations.

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Equalization Levy: The Ambiguity Continues to Exist

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India has expanded its regime of equalization levy to cover 'e-commerce supply' by non-resident electronic commerce operators (**ECOs**) with operations related to India. In India's recently announced Union Budget, there are proposed amendments to provisions relating to Equalisation levy (**EL**) under the Income-tax Act, 1961 (IT Act) and the Finance Act, 2016 (FA16).

KEY DEFINITIONS

One of the most significant amendments proposed to clarify the scope of EL is introduction of definitions of the term 'online sale of goods' and 'online provision of services'. At present, the terms ECO and 'e-commerce supply' have been defined, and these terms, in turn, use the terms 'online sale of goods' and 'online provision of services', which are not defined. This earlier led to an ambiguity as regards the scope of EL. The new proposed definitions define 'online sale of goods' and 'online provision of services' to include one or more of the following activities taking place online:

- Acceptance of offer for sale; or
- Placing the purchase order; or
- Acceptance of the Purchase order; or
- Payment of consideration; or
- Supply of goods or provision of services, partly or wholly.

Hence, now, undertaking any one of these activities on a digital or electronic facility or platform owned, operated or managed by a non-resident may likely trigger the levy of EL. The proposed definitions may likely lead to covering within the ambit of EL various businesses which may traditionally not be understood to be e-commerce businesses.

THE RISK

The above issue is more worrisome especially since the term '*owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services*' used in the definition of the term ECO is yet to be clarified, and the possibility of the Revenue Department seeking to bring in even e-mail ordering within the definition of ECO cannot be ruled out. Hence, it is hoped that the legislature may bring more clarity to the same through further amendments/clarifications.

THE TERM 'CONSIDERATION'

EL is to be discharged by the ECO at the rate of 2% of the 'amount of consideration received or receivable by an *e-commerce operator*' from e-commerce supply or services made or provided or facilitated by it. However, the manner of determination of such 'consideration' is at present ambiguous and subject to interpretation. This leads to difficulties especially in determining the amount which should be taxed in respect of ECOs which merely facilitate a supply (market-place e-commerce).

The term 'consideration received or receivable from ecommerce supply or services consideration' has now been proposed to be defined to include:

- *'consideration for sale of goods irrespective of whether the e-commerce operator owns the goods;*
- *consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator'.*

In terms of this newly proposed definition, there is an attempt to link the term 'consideration' to the value of underlying supply of goods and services facilitated through e-commerce, irrespective of whether such goods/services are owned/provided by the ECO. This indicates that the intent of the law is to levy EL on the entirety of consideration

which is paid by the person located in India and not just the amounts which are finally earned (received) by the ECO.

ILLUSTRATION

For example, in an online accommodation aggregator model (bookings of room made outside India by a person located in India), while the ECO collects the entirety of accommodation amount (charged by the hotel) from the customer, it retains only a fixed percentage thereof (as its income/consideration) while remitting the remainder to the accommodation service provider. In such a case, based on the present provisions, a view could be taken that only the amount which is retained by the ECO is the consideration received / receivable by it qua that supply. However, the proposed definition for the term 'consideration' would not permit such a view. The online accommodation market-place will post the amendment, be required to pay an EL of 2% on the entirety of the amounts collected by it, including the amounts which will subsequently be remitted to the service provider. Hence, presuming the ECO retains 10% of the amounts collected by it, in effect an EL of 20% will be charged on the actual consideration earned by it.

REPURCUSSIONS

While the above appears to have resulted in an administrative ease, the potential repercussions on the global tax policy seem to not have been duly considered. From another perspective, in case the ECO seeks to share the burden of the EL with the actual service provider, it would effectively lead to India taxing the income arising from renting of immoveable property, which is neither located in India nor is such income earned by a person resident in India. The fact that a credit of the EL may not be available in the ECO/ supplier's jurisdiction, further compounds the issue and will likely lead to double taxation.

OVERLAP BETWEEN EL AND ROYALTY/ FTS

By way of parallel proposals to amend Section 10(50) of the IT Act and Section 163 of FA16, it appears that the issue of an overlap between EL and royalty or fees for technical services (**FTS**) is addressed. On the First, it is proposed, that exemption under section 10(50) will not apply for royalty or fees for technical services which is taxable under the IT Act read with Double Taxation Avoidance Agreement (**DTAA**). Second, a proviso has been proposed to be added to Section 163 of the FA16 to clarify that any income which is taxable as royalty or FTS under the IT Act is excluded from the scope of EL. This will hopefully fix a loophole which could have led to double taxation.

CHANGE OF DATE

Section 10 of the IT Act deals with 'incomes not included in total income'. Section 10(50) excludes 'specified services' under FA 16 and 'income from any e-commerce supply or services', which would be leviable to EL, from the scope of 'income' under IT Act. However, perhaps on account of a legislative oversight, such exclusion covers only 'e-commerce supply or services made on or after the 1st day of April, 2021' even while the levy was effective from 1st April, 2020, thereby leading to a potential double taxation. An amendment has now been proposed to rectify this date to 1st day of April 2020'. This is a welcome step to remedy the legislative oversight in this regard.

CONCLUSION

The proposals addressing overlap between EL and royalty/FTS and rectifying date under Section 10(50) are steps in the right direction, providing much needed clarification in these areas. However, the proposed definitions of 'online sale of goods', 'online provision of services' and 'consideration', while definitely clarifying the position in law, will have significant ramifications, requiring businesses to carry out a holistic review of their operations to be sensitive of the additional tax costs.

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Transgenerational Wealth – Estate & Succession Planning

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Succession planning is not a one-time transactional approach of passing on assets to the next generation in a tax efficient manner. It is often confused with inheritance (estate) tax planning or forming a generation skipping trust to transfer wealth from a grantor directly to the grantors' grandchildren.

Succession planning seeks to achieve:

- Protection of family wealth from unforeseen events, disputes and contingencies;
- Alignment of economic interest & management control of various businesses and streamline shareholding & voting rights;
- Segregation of business assets, financial assets, realty assets, lifestyle maintenance corpus and philanthropy corpus;
- Ownership/control of assets is transferred to successive generations as desired;
- Continuity of business with flexibility for future exits;
- Effective flow of income to current and future generations for maintenance of lifestyle especially for disabled or incapacitated members, education, special occasions, new businesses or charity.

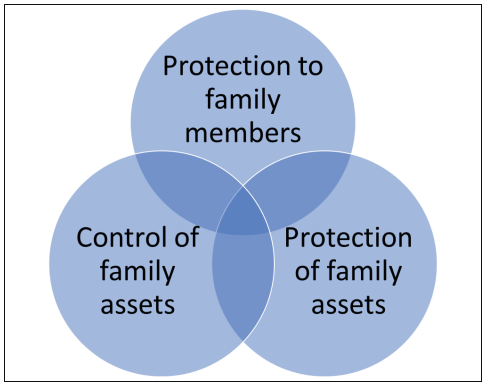
Family, ownership and business are the three important but interdependent dimensions in succession planning. Balancing family complexity, owners/shareholders returns and competitive business landscape requires a carefully orchestrated multi-year succession process.

SUCCESSION PLANNING METHODS

Various succession planning methods that have been time tested.

Shareholders agreement is one such tool that ensures that family co-owners are 'joined to the hip'. It sets out the rules of ownership viz exercise of voting rights, inter-se transfer of shares, valuation methodology, retirement, dispute resolution etc.

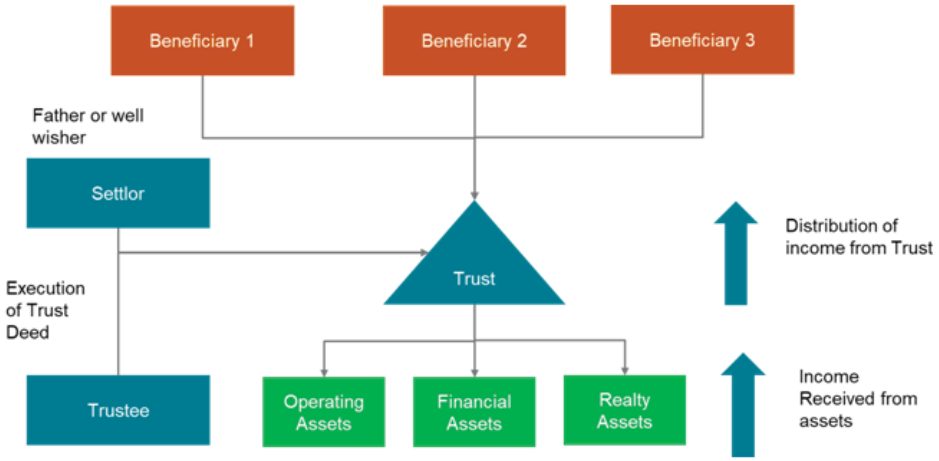
Private family trusts are often suggested for transfer of intergenerational wealth. Benefits of private family trusts is represented below:



Though trust laws in India are dated, the trust structure offers ease in separation of ownership and control from the economics attached to that asset, maximum flexibility in determining method of future distribution, increased confidentiality and avoidance of probate procedures. The patriarch of the family can decide which assets are to be transitioned to the next generation, migrate those assets into the trust, retain control of them as a trustee and distribute annual income or accumulations in a trust to the desired beneficiaries. A trust is not a legal entity but a fiduciary relationship defined by the settlor between a trustee and the beneficiaries. This relationship is codified by the settlor in a document called trust deed. There are no set rules for a trust deed and therefore drafting of it can be as simple or complex as the settlor can envisage. The trust deed governs the administration of the trust, sequence of trustees, management philosophy of the underlying assets, distribution

distribution rules of the trust funds to the beneficiaries amongst other features. A trust can be for a definite period or structured for perpetuity.

Typical constituents of a private family trust are:



IMPORTANT CONSIDERATIONS

With frequent amendments to the Indian tax rules, the tax rules applicable to a private family trust are quite complex. The tax consequences must be evaluated at the time of settlement of assets into a trust, income earned on these assets by the trust and ultimate distributions from the trust funds to the beneficiary. Taxation of trusts would fundamentally depend on whether it is characterized as a revocable or an irrevocable trust, discretionary or a non-discretionary (specific) trust. It could get further complicated if the trust deed is drafted as specific for corpus and discretionary for income. In additional the regulatory implications also must be considered while migrating assets into a trust.

If the assets under question are shares of listed companies, then SEBI Takeover Code would also apply and needs to be evaluated whether there is de-facto change in control. If there are immovable properties then state specific stamp duty implications must be considered. The situs of management and control of a trust would be deemed to be in India if the trustee is a resident of India. Thus a private family trust domiciled in a foreign jurisdiction must never have a trustee that is a resident of India, else the income of that trust would be taxable in India. Conversely, RBI permission would be required if a distribution from an Indian trust is envisaged to a foreign resident. It may not be possible for an Indian trust to own a foreign asset under trust, whereas a foreign trust can own an Indian asset if structured properly. Further there are reporting obligations on the individuals in India if he owns any foreign asset or is a trustee or a beneficiary of a foreign trust. Thus, each family would have their own situations and complexities that need to be dealt with individualistically and unconventionally while drafting the trust deed and there are no "one size fits all" solutions.

Even if there is a well-structured trust or other arrangements in place for a complex succession plan, a Will must be drafted to accommodate transfer of any residual asset that may be left behind in personal name to

the legal heirs or nominees as the case may be.

With the ballooning of liquid portion of wealth, financial management of a family corpus necessitates establishment of a family office. A family office can be formed as a corporate entity, LLP or a trust depending on tax and operational considerations. Large family offices could very well justify to be professionally managed considering the size of the corpus and the required expertise to invest in India as well as abroad and in different asset classes. Creation of family office is an integral part for continuity in succession planning.

To conclude succession planning is a complex and a continuous process. Success of any planning is as much dependent on family's preparedness as it is on proficient legal and tax advice. Families who have a unified sense of long-term vision, collaborative approach, robust governance tools are more likely to succeed in intergenerational wealth migration.

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Revisiting Arbitrability of Frauds in India

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In legalese, there exists a rather mundane and oft-quoted phrase – "*fraud vitiates everything*". While this phrase has generally stood the test of time in Indian courts, its pertinence, when arbitrating frauds, has had a truly eventful journey. A journey spanning six decades, two legislations and at least eight landmark Supreme Court (**SC**) judgements. Most recently, the SC has re-examined the issue with considerable brevity in *Vidya Drolia & Ors. v. Druga Trading Corporation*[1] (**Vidya Drolia**) and *N.N. Global Mercantile Pvt. Ltd. v. Indo Unique Flame Ltd. &Ors*[2] (**N.N. Global Mercantile**). In this article, the authors seek to analyze the conspectus of Indian precedents on arbitrability of fraud and ascertain whether *Vidya Drolia* and *N. N. Global Mercantile* are really the final pieces to this intriguing puzzle.

EARLY JUDICIAL DEVELOPMENTS

The first authoritative precedent on the subject was laid down in the context of the Arbitration Act, 1940 in *Abdul Kadir Samshuddin Bubere v. Madhav Prabharkar Oak*[3](***Abdul Kadir***) where 'serious allegations of fraud' were made against a party and the said party desired that the matter be tried in an open court. This was held by the SC as sufficient cause for the court to not make a reference to arbitration. However, the SC qualified this observation by holding that not every allegation imputing some kind of dishonesty would be enough for taking the matter out of the forum which the parties themselves had chosen i.e., arbitration. In *Abdul Kadir*, the Court therefore, opined that mere allegations would not be enough to induce the court to refuse to make a reference to arbitration. It was only in cases of allegations of fraud of a 'serious nature' that the court would refuse such reference.

The SC's judgment in *Abdul Kadir* continued to hold forth over the next five decades. Even after the advent of Arbitration and Conciliation Act 1996 (**the 1996 Act**), there was not any major judicial pronouncement by the SC until 2010 when, in *N. Radhakrishnan v. Maestro Engineers*[4] (***N. Radhakrishnan***), a Division Bench of the SC relying upon *Abdul Kadir* ruled that allegations of fraud and serious malpractices could only be settled in court through furtherance of detailed evidence by either party and as such could not be gone into by the arbitrator.

The embargo imposed by *N. Radhakrishnan* didn't sit well with the pro-arbitration agenda of the Arbitration and Conciliation Act,1996 (**1996 Act**). More so, because while reaching its findings in *N. Radhakrishnan,* the SC had failed to consider the following key aspects:

- Though *N. Radhakrishnan* referred to the case of *Hindustan Petroleum Corpn. Ltd. v. Pinkcity Midway Petroleums*[5] (***Hindustan Petroleum***), it did not deal with the ratio thereof. In fact, the ratio of *Hindustan Petroleum* ran counter to the findings in *N. Radhakrishnan*. After considering the language of Section 8 of the 1996 Act, *Hindustan Petroleum* had held that if there existed a clause for arbitration in an agreement between the parties, it would be mandatory for the civil court to refer the dispute to an arbitrator. Similar was also held in the case of *P. Anand Gajapathi Raju v. P.V.G. Raju*[6] (***P. Anand Gajapathi Raju***). However, the case of *P. Anand Gajapathi Raju* was not even considered in *N. Radhakrishnan.*

- The provisions contained in Section 16 of the 1996 Act were also not considered by the court. Section 16 expressly provides that a decision by the arbitral tribunal that the contract was null and void would not entail *ipso jure* the invalidity of the arbitration clause.

For the aforementioned reasons, the judgement in *N. Radhakrishnan* was held to be *per incuriam* in the subsequent SC decision in *Swiss Timing Ltd. v. Commonwealth Games Organising Committee* (***Swiss Timing***)[7].

[1] Vidya Drolia&Ors. v. Druga Trading Corporation 2020 SCC OnLine SC 1018.
[2] N.N. Global Mercantile Pvt. Ltd. v. Indo Unique Flame Ltd. &Ors. 2021 SCC OnLine SC 13.
[3] Abdul Kadir SamshuddinBubere v. Madhav Prabharkar Oak AIR 1962 SC 406.
[4] N. Radhakrishnan v. Maestro Engineers (2010) 1 SCC 72.

The judgement in *Swiss Timing* refused to affirm the contention that whenever a contract was said to be *void ab initio*, the courts exercising jurisdiction under Section 8 and Section 11 of the 1996 Act would be powerless to refer the disputes to arbitration. On the contrary, in a major departure from the prevailing standard set by *Abdul Kadir* and *N. Radhakrishnan*, *Swiss Timing* further held that arbitration ought not to be refused even in cases where the defence taken was that the contract was voidable, for instance, as provided under Section 17 of the Indian Contract Act, 1872 (**Contract Act**) for fraud. The court ought to decline reference to arbitration only where it reaches the conclusion that the contract is void on a bare reading, thereof without any requirement of further proof.

TESTING THE 'ARBITRABILITY' OF FRAUD

While the decision in *Swiss Timing* was a step in the right direction on the issue of arbitrability of fraud, it suffered from a malaise of a different kind and hence in *A. Ayyasamy v. A. Paramasivam* (***Ayyasamy***)[8], the same was impliedly over-ruled as being devoid of any precedential value. A necessary outcome of this was that the proposition of law laid down in *N. Radhakrishnan* stood revived. Nonetheless, the fact that *N. Radhakrishnan* did not set out the correct position of law was well accepted. In *Ayyasamy,* the SC cautioned against placing reliance on *N. Radhakrishnan*, and further clarified the law on arbitrability of fraud in the following manner:

- Mere allegation of fraud *simpliciter* is not a ground to nullify the effect of the arbitration agreement between the parties.
- It is only 'serious allegations of fraud' leading to a criminal offence or those with complicated allegations of fraud leading to such issues necessarily to be decided by the civil court by going through voluminous evidence, that arbitration can be side-tracked. Thus, fraud which vitiates the validity of the contract itself or the entire contract which contains the arbitration clause or the validity of the arbitration clause e.g., forgery/fabrication of documents in support of the plea of fraud would require the civil court's intervention.
- Where there are simple allegations of fraud touching upon the internal affairs of the party *inter se* and such allegations have no implication in the public domain, the arbitration clause need not be avoided and the parties can be relegated to arbitration.

The judgment in *Ayyasamy* was further clarified in the subsequent case of *Rashid Raza v. Sadaf Akhtar* (***Rashid Raza***)[9]. *Rashid Raza* ruled that to distinguish between 'serious allegations' and 'simple allegations' of fraud, the rule as laid down by *Ayyasamy* could be crystallized in the following two tests:[10]

- "Does the plea of fraud permeate the entire contract and above all, the agreement of arbitration, rendering it void?"
- "Whether the allegations of fraud touch upon the internal affairs of the parties *inter se* having no implication in the public domain?"

The ratio of *Swiss Timing*, *Ayyasamy* and *Rashid Raza* was then approved in *Avitel Post Studioz Ltd. & Ors. v. HSBC PI Holdings* ("***Avitel***")[11]. In *Avitel*, the SC held that post *Rashid Raza,* 'serious allegations of fraud' would arise only in two cases:[12]

- When the arbitration clause or agreement itself doesn't exist, as in, the party against whom breach is alleged claims that it cannot be said to have entered into the arbitration agreement.
- When allegations are made against the State or its instrumentalities of arbitrary, fraudulent, or *malafide* conduct thus necessitating the hearing of the case by a writ court and the questions raised in the dispute are not predominantly questions arising from the contract itself or breach thereof, but questions arising in the public law domain.

The judgment in *Avitel* also clarified another important aspect pertaining to the effect of

[5]Hindustan Petroleum Corpn. Ltd. v. Pinkcity Midway Petroleums (2003) 6 SCC 503.
[6]P. Anand Gajapathi Raju v. P.V.G. Raju (2000) 4 SCC 539.
[7]Swiss Timing Ltd. v. Commonwealth Games 2010 Organising Committee (2014) 6 SCC 677.
[8]A. Ayyasamy v. A. Paramasivam (2016) 10 SCC 386.
[9]Rashid Raza v. Sadaf Akhtar (2019) 8 SCC 710.
[10]*Ibid*
[11]Avitel Post Studioz Ltd. &Ors. v. HSBC PI Holdings (Mauritius) Ltd. 2020 SCC OnLine SC 656.
[12]*Ibid*

pending criminal proceedings arising out of fraud, on its arbitrability. Avitel held that if a civil dispute involved questions of fraud, misrepresentation, etc. which could be the subject matter of proceeding under Section 17 of the Contract Act, and/or the tort of deceit, the mere fact that criminal proceedings could be or were already instituted in respect of the same subject matter would not lead to the conclusion that the dispute was non-arbitrable.

THE CURRENT LEGAL POSITION

Pertinently, much like *Swiss Timing*, both *Ayyasamy* and *Avitel* cautioned against the use of *N. Radhakrishnan* as a binding precedent. Subsequently, in *Vidya Drolia*, a three-judge bench of the SC again considered its judgment in N. Radhakrishnan. In *Vidya Drolia*, the SC re-affirmed its findings in *Ayyasamy, Rashid Raza* and *Avitel* and over-ruled its judgment in *N. Radhakrishnan* by holding that allegations of fraud can be made the subject matter of arbitration when they relate to a civil dispute. However, fraud which vitiates the arbitration clause itself would render the dispute non-arbitrable.

The judgment in *Vidya Drolia* has recently been considered by a co-ordinate bench of the SC in *N. N. Global Mercantile*. In the said decision, while the SC has referred the findings in paragraph 92 of *Vidya Drolia*, which held 'existence' and 'validity' of an arbitration agreement as an intertwined concept, to the Constitution bench, it has re-affirmed *Vidya Drolia's* findings with respect to the arbitrability of fraud. *N.N. Global Mercantile* holds that all civil or commercial disputes, whether contractual or not, which can be adjudicated upon by a civil court, can also be adjudicated through arbitration unless such arbitral proceedings are expressly excluded by statute or by necessary implication. However, the criminal aspect of fraud viz. forgery or fabrication being essentially in the realm of public law, can only be adjudicated by a court. The SC has further clarified that the ground on which fraud was previously held to be non-arbitrable i.e., that the dispute would entail procuring voluminous evidence and would be thus, too complicated to be decided in arbitration is an 'archaic' and 'obsolete' view. On the contrary, the SC has observed that nowadays arbitral tribunals are required to regularly traverse through volumes of evidence.

ANALYSIS AND CONCLUSION

From *N. Radhakrishnan* to *N.N. Global Mercantile*, the courts have carefully filtered the prerequisites for referring a case to arbitration in disputes involving allegations of fraud. As on date, the decisions in *Ayyasamy, Rashid Raza, Avitel, Vidya Droliaand N.N. Global Mercantile* concurrently hold the field in this respect. These decisions have set forth different yet inter-linked tests on which arbitrability of fraud ought to be tested. In *Ayyasamy*, the SC opined that mere allegations of fraud *simpliciter* would not render a case non-arbitrable and it would be 'serious allegations of fraud', requiring consideration of voluminous evidence by the civil court which would be non-arbitrable. Relying on the *Ayyasamy* judgment, *Rashid Raza* gives 2 tests to determine 'serious allegations of fraud', the *first* of which deals with fraud permeating the contract entirely, especially the arbitration clause, and the *second* being determining whether fraud is restricted to internal affairs of the parties and has implications in the public domain. *Avitel* has further bucketed the tests laid down in *Rashid Raza* into cases where the arbitration clause/agreement itself does not exist and cases involving arbitrary, fraudulent, or mala fide conduct, which can be validly brought before writ courts. Both *Vidya Droliaand N.N. Global Mercantile* have now taken forward these principles by cumulatively upholding the dicta of *Ayyasamy, Rashid Raza* and *Avitel*, and by providing sanctity to arbitrating all allegations of fraud pertaining to civil disputes, until the arbitration clause itself is invalidated or allegations of fraud pertains to aspects of public law. However, *N.N. Global Mercantile* has further clarified that seeking adjudication of the disputes from a civil court and not by means of arbitration, for the sole reason that extensive evidence would require to be conducted, is no longer a permissible ground to side-track arbitrations.

As we move forward, issues of fraud would continue to be raised by Respondents wishing to avoid the arbitral process. Such cases would then have to be tested on the threshold of all the aforementioned principles. Though the principles presently governing arbitrability of frauds in India are undoubtedly sound, their effectiveness in deterring prospective Respondents willfully seeking to avoid arbitral proceedings, remains to be seen.

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India's New Labour Codes

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One of the last bastions to fall in the regulatory reform landscapes in India is the labour legislations. Some of them date back to 1926, and the law has certainly not kept up with the realities faced by Indian enterprise today.

Through 4 acts (hereinafter referred to as the '**Labour Codes**'), notified on August 2019 and September 2020, the Government of India has set the stage for a landmark reform in the Indian labour law landscape. 29 separate labour laws will make way for 4 new acts comprising a modern labour code which is designed to improve the working conditions and wages of labour and enhance the ease of doing business in the country.

As is the case in all such structural reforms, enterprises need to be informed, prepared and comply with the new Labour Codes that are targeted to be implemented from April 1, 2021.

In this article, we set out an overview of the code and what it means for businesses.

THE CODE ON WAGES, 2019

An Act to amend and consolidate the laws relating to wages and bonus and matters connected therewith or incidental thereto.

Key Highlights

- Definition of '**employee**' excludes an apprentice under the Act of 1961 and includes any person employed to do:
  - Any skilled, semi-skilled or unskilled,
  - Manual, operational, supervisory, managerial, administrative, technical or clerical work

  For hire or reward, whether the terms of employment be express or implied (The Chapter dealing with Payment of Wages is applicable to all 'employees').

- Definition of '**worker**' includes skilled, semi-skilled, unskilled, manual, operational, supervisory, managerial, administrative, technical or clerical and excludes an apprentice under the Act of 1961 and also those
  - Who are employed mainly in a managerial or administrative capacity oror administrative capacity or
  - Employed in a supervisory capacity drawing wage of exceeding fifteen thousand rupees per month

- **Wages**
  Sec 2(y) defines 'Wages' which was replicated in other codes:

  'Wages' means all remuneration whether by way of salaries, allowances or otherwise, expressed in terms of money or capable of being so expressed which would, if the terms of employment, express or implied, were fulfilled, be payable to a person employed in respect of his employment or of work done in such employment, and includes -
  - Basic pay;
  - Dearness allowance and
  - Retaining allowance, if any

  To see what wages do not include please **click here.**

- **National Floor Wage**
  A floor wage will be fixed by Central Government for different regions which will be the basis for the State Governments to fix the minimum wage. No State Government shall fix the minimum wage below the national floor wage

- While fixing the floor wage the Central Government will consult the Central Advisory Board and State Governments

- If any State Government is already paying more minimum wages, it cannot reduce it so as to bring it on par with national floor wage

THE CODE ON SOCIAL SECURITY, 2020

An Act to amend and consolidate the laws relating to social security with the goal to extend social security to all employees and workers either in the organized or unorganized or any other sectors and for matters connected therewith or incidental thereto.

Key Highlights

- **'Fixed term employment'**
  Fixed term employment was not defined under any earlier labour legislations. The Code defines it as engagement of an employee on the basis of a written contract of employment for a fixed period.

- **'Gig-worker'**
  means a person who performs work or participates in a work arrangement and earns from such activities outside of traditional employer-employee relationship.

- **'Home-based worker'**
  means a person engaged in, the production of goods or services for an employer in his home or other premises of his choice other than the workplace of the employer, for remuneration, irrespective of whether or not the employer provides the equipment, materials or other inputs.

- **'Platform worker'**
  means a person engaged in a work arrangement outside of a traditional employer-employee relationship in which organizations or individuals use an online platform to access other organizations or individuals to solve specific problems or to provide specific services or any such other activities which may be notified by the Central Government, in exchange for payment.

- **Social Security for Unorganized workers etc.**
  - The Central Government may frame the scheme for unorganized workers, gig workers and platform workers and the members of their families for providing benefits under Employees State Insurance
  - The Central Government shall frame and notify, from time to time, suitable welfare schemes for unorganized workers on life and disability cover; health and maternity benefits; old age protection; education; provident fund; employment injury benefit; housing; educational schemes for children; skill upgradation of workers; old age homes; funeral assistance etc.

- Similar provisions for gig workers and platform workers

- **Registration of gig workers etc.**
  Every unorganized worker, gig worker or platform worker shall be required to be registered to get covered under above welfare schemes

- **Provident Fund**
  - The contributions paid by the employer to the fund shall be 10% of the wages payable towards each of the employees (whether employed by him directly or by or through a contractor)
  - The employee's contribution shall be equal to the contribution payable by the employer in respect of him/her and may, if any employee so desires, be an amount exceeding 10% of the wages, subject to the condition that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under the Code
  - ***The Code reduces employers' contribution from 12% to 10% but there is a possibility to bring it back to 12%***

- **Employee State Insurance (ESIC)**
  - ESIC benefits will now also extend to all enterprises in hazardous industries, even if it employs only one worker
  - The Government reserves the power to defer or reduce employer's contribution, or employee's contribution, or both with respect to EPF and ESI for a period up to 3 months at a time as the case may be in the event of pandemic, endemic or national disaster.

- **Gratuity**
  - The completion of **continuous service of 5 years shall not be necessary** where the termination of the employment of any employee is due to- "***expiration of fixed term employment*** *or happening of any such event as may be notified by the Central Government*"
  - **Pro-rata Gratuity**
    In the case of an employee employed on **fixed term employment** or a **deceased employee**, the employer shall pay gratuity on **pro rata** basis

- As per the code, the gratuity is now to be calculated on 50% of the gross wages and not only on basic and DA as done earlier

- The maximum gratuity payable currently remains at **INR 20 lakhs**

Note: Since the wages are defined at 50%, any calculations (leave encashment, gratuity, PF etc.) under this Code may have to be at 50% instead of earlier calculations of only on basic and DA.

THE INDUSTRIAL RELATIONS CODE, 2020

An Act to consolidate and amend the laws relating to Trade Unions, conditions of employment in industrial establishments or undertaking, investigation and settlement of industrial disputes and for matters connected therewith or incidental thereto

Key Highlights

- **Fixed Term Employment**
  Engagement of a worker on the basis of a **written contract of employment** for a fixed period

- **The hours of work, wages, allowances and other benefits** provided to a fixed term employee shall not be less than that of a permanent worker doing the same work or work of similar nature. **He/she shall be eligible for gratuity if services are rendered under the contract for a period of 1 year.**

- **Standing Orders** are made applicable to industrial establishments employing 300 workers as against 50/100 at present. The employers are permitted to adopt Model Standing Orders of the Central Government as relevant to his establishment. No other certification under the Act is required.

- **Permission for lay-off, retrenchment, closure**
  The applicability under the earlier Chapter V-B has been increased to 300. In effect, the Code allows industrial establishments with up to 300 workers to lay off etc. without having to seek government's prior approval.

- **When over 50% of workers take concerted leave ('Mass Casual Leave'), it shall be considered as a strike**

- **Workers cannot go on strike without giving a notice of at least 60 days. Similar provisions for lock out.**

- **The Government proposes to set up a reskilling fund with the contributions of the employer equal to 15 days wages last drawn by the worker**

- **Negotiating Union/Council: The Code provides for negotiating union or negotiating council in every establishment wherever there is a registered trade union**

- **If majority of the negotiating council** reaches an agreement it will be construed as a binding settlement

THE OCCUPATIONAL SAFETY, HEALTH & WORKING CONDITIONS CODE, 2020

An Act to consolidate and amend the laws regulating the occupational safety, health and working conditions of the persons employed in an establishment and for matters connected therewith or incidental thereto

Key Highlights

- Applicable to **establishments** – any industry, trade, business, manufacturing or occupation with 10 or more workers

- Applicable to **contractor's establishment** employing 50 or more contract labourers. The definition of contractor includes **sub-contractor**

- Applicable to any establishment engaging 10 or more **inter-state migrant workers**. Employers shall cover them under social security and pay a lumpsum amount of fare for travel to his/her hometown every year

- Definition of '**Factory**': Increase innumber of employees for coverage from 20 to 40 without power and, 10 to 20 with power

- Definition of '**Industry':** Same as those laid down in the case of **Bangalore Water Supply – Triple test**

  Definition of '**Principal Employer**': In case of a factory, it is the **Occupier**. In case of other establishments, it is the authority which has ultimate control over the affairs of the establishment and where said affairs are

entrusted to a Manager or Managing director, such **Manager or Managing Director.**

- The Code defines '**Core-Activity of an establishment'**: 'Any activity for which the establishment is set up and includes any activity which is essential or necessary to such activity'.

- Employers are required to create safe working environment for female workforce. **Women** are permitted to work in all types of work, during the night shift with their **Consent.**

- Certain procedures are being **digitized.** These include: (a) Electronic registration (b) Electronic notice of commencement/cessation of operation (c) Option to electronically maintain register, issue wage slip and file returns (d) Web-based inspection scheme etc.

- Concept of "single" registration for establishments having 10+ employees

KEY ISSUES WITH THE CODES

- The new definition of '**wages**' will be likely to increase the **wage bill** significantly for some employers:

  - The employers need to re-look at some of the traditional salary components (allowances/benefits) under the new definition to ascertain whether each component is included / excluded from the definition of 'wages'.

  - The above may have an impact on the cost to be incurred by companies on components such **as provident fund, gratuity, leave encashment, overtime, statutory bonus etc.** Further with these changes, the net take home of the employee may also get **reduced. The cost to the company** may also increase to some extent.

  - If the exclusions allowed under the Code on Wages are less than 50% in a salary structure, the 'wage' under the definition could be higher.

- Employers need to have clarity on what amounts to '**sum paid to the employed person to defray special expenses**' under the definition of wages.

  - For instance, there is a possibility to exclude **uniform maintenance allowance** from the definition of 'wages' for entities having a company **policy** to wear uniform at workplace as per the demands of the business requirement.

- The review of Compensation/salary structures remain a highly **component specific exercise** and no hard and fast rules be applied unless the stipulated factors for respective components suggest the need for exclusion or are specifically excluded.

- **Under the Code on Social Security, 2020**, **gratuity** will have to be paid on the basis of the definition of wages for the entire tenure of employment of the employees (including the past period). This may result in a substantial increase in the cost to the company on account of the incremental base on which gratuity will be calculated.

- The **provisioning for gratuity**, including contributions to be made by the company, will have to be done accordingly, based on the actuarial valuation as per the terms of gratuity policy of the respective entity.

- Under the **OSHWC Code, 2020** an employee qualifying as a **'worker'**, is entitled to encash unutilized leave at the end of a calendar year:

- This will be an additional cost to the employer as under the current laws, workers are eligible to **encash**their unutilized leaves only upon **termination** of employment.

- Hence, employers, depending on role and profile of employees in various entities, need to **analyze** who qualifies as a '**worker'**, before determining applicability of this provision.

- There is no definition of Managerial/Supervisory personnel in the Codes. The employers may have to analyze and understand who would fall under the definition of '**worker**', '**supervisor'** and '**managerial'** basis earlier judicial pronouncements.

- The employers need to gear up for 100% compliance of the new Labour Codes without exception.

IMMEDIATE ACTION POINTS

- Set-up an **Internal Taskforce** (HR, Legal, Finance etc.) to review various aspects of the Labour Codes with Labour Law experts

- **Re structure the employment mix, if required to ensure compliance and efficiency**

- **Financial impact assessments** on various scenarios – The implications of the definition of 'wages'/Social Security/ Salary components/Fixed Term Employees/Consultants etc.

- Reviewing included/excluded components in the salary structure to understand the cost implications

- Incorporating Labour Code impacts within **2021 salary budgets**

- Focus on **full compliance**

Defence Acquisition Procedure 2020 – Key Takeaways

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The Ministry of Defence (MoD) has released the long-awaited Defence Acquisition Procedure Procedure 2020[13] (**DAP 2020**), which came into effect on October 1, 2020 to succeed the earlier version Defence Procurement Procedure 2016. The DAP 2020 governs the acquisition of capital defence equipment and has been introduced to further enhance the indigenous manufacturing of defence equipment. It also introduces several new ideas to balance the national priorities (such as timely procurements) and the challenges (such as budget allocation) that go along. Some of these aspects introduced in DAP 2020 are analyzed here below:

I Applicability of DAP 2020 to ongoing cases

DAP 2020 will be applicable to all the acquisition programs where RFP has not yet been issued (pre-Acceptance of Necessity (**AoN**) stage, AoN stage and Make and D&D cases). For cases where AoN has been accorded under earlier DPPs, the same will be aligned for RFP to be issued under DAP 2020. Only where the RFP has already been issued, will the acquisition procedure be progressed as per the provisions of the earlier DPP.

II Key Updates of DAP 2020

- **Change to 'Indian Vendor' definition**

  Through the recently revised FDI policy[14] , foreign investment into Indian defence companies is now permitted under the automatic route up to 74% for those companies seeking new industrial licenses. Companies not seeking any new industrial licenses or where the Government has previously given approval for FDI shall only be permitted foreign investment up to 49% under the automatic route. FDI beyond 49% will require Government approval for such companies and all foreign investment is subject to security clearance by the Ministry of Home Affairs and the Ministry of Defence.

  However, in a first, MoD has restricted the foreign participation by introducing a definition of 'Indian Vendor' to reflect two additional conditions for Buy (Indian-IDDM), Make I, Make II, Development cum Production Partner (**DcPP**) in D&D acquisitions through DRDO/DPSUs/OFB and SP Model categories:

  - Ownership by Resident Indian Citizen(s): A company is considered as 'Owned' by resident Indian citizens if more than 50% of the capital in it is directly or beneficially owned by resident Indian citizens and /or Indian companies, which are ultimately owned and controlled by resident Indian citizens. Indirect foreign investment shall be accounted for in counting the 49% FDI.

  - Control by Resident Indian Citizen(s): 'Control' shall include the right to appoint majority of the directors or to control the management or policy decisions by virtue of their shareholding or management rights or shareholders agreements or voting agreements.

  This means that the maximum permitted FDI shall be 49% under the categories of Buy (Indian-IDDM), Make I, Make II, DcPP in D&D acquisitions through DRDO/DPSUs/OFB and SP Models. Further, no pyramiding of FDI shall be permitted in Indian holding companies or in Indian entities subscribing to shares or securities of the Applicant Company or the Strategic Partner.

- **Embargo on import of weapons/platforms**

  With a view to promote domestic and indigenous industry and also align the DAP with the Governments 'Make in India' initiative, the MoD has notified a list of 101 weapons/platforms banned for import. As a result, such weapons can only be procured under the Buy (Indian - IDDM), Buy (Indian), Buy and Make (Indian) (only if Buy quantities are zero) and Buy (Global - Manufacture in India) (only if Buy quantities are zero) categories of acquisition.

[13] Available at *https://www.mod.gov.in/defence-procurement-procedure*

[14] Press Note No. 4 (2020 series) issued by Department for Promotion of Industry and Internal Trade, Ministry of Commerce & Industry

With the changes to India's FDI policy and the change to the 'Indian Vendor' definition, companies owned and controlled by foreign OEMs will be eligible to participate either individually or in collaboration with Indian partners for procurement of weapons & platforms banned for import into India through the categories of Buy and Make (Indian) and Buy (Global – Manufacture in India).

- **Buy (Global – Manufacture in India)**

  A new category of procurement – Buy (Global – Manufacture in India) has been introduced in the DAP 2020, which replaces the previous 'Buy and Make' category. It involves outright purchase of equipment from foreign vendors followed by indigenous manufacture having a minimum of 50% indigenisation content. Indian vendors will also be permitted to participate, and acquisitions under this category can be carried out without any initial procurement of equipment in FF state.

  For all intents and purposes, the 'Buy and Make' category has just been rebranded to appear more attractive for foreign investors. The features of 'Buy (Global – Manufacture in India)' and 'Buy and Make' are similar in all aspects with the only point of difference being that payment of the manufactured portion must be made in INR under 'Buy (Global – Manufacture in India)'.

- **Leasing**

  Leasing has been introduced as another category for acquisition as it provides for a means to possess and operate the asset without owning the asset and is useful to substitute huge initial capital outlays with periodical rental payments. The DAP 2020 permits leasing of equipment in two categories – Lease (Indian), where the lessor is an Indian entity and is the owner of the asset, and Lease (Global). It could be an operating lease (dry or wet, depending on the kind of services required) or finance lease, with the MoD retaining the option of owning the asset for a nominal pre-determined consideration or returning it to the Lessor at the end of the lease. An elaborate procedure has been laid down for this category.

- **Revamped Offset Policy**

  In the revamped offset policy, to drive indigenisation, vendors who achieve a minimum 30% IC in 'Buy (Global)' categories, do not have to discharge their offset obligations. The new policy also exempts defence procurement through Inter-Governmental Agreements, Foreign Military Sales and ab initio Single Vendor cases from the offset obligation. This is in direct contrast to the previous policy however, the objective seems to bring technology through the FDI policy and other procurement categories since offsets have not yet shown the desired results over past decade of its existence[15] .

  The new Offset Policy has also done away with the concept of Offset Banking. However, existing banked offsets under the previous DPPs can still be utilised. The multipliers for discharge of offset obligations have also been amended (**click here to read**).

- **Changes in Standard Contract Document**

  The efficacy of the defence contracts will depend on the ability of the MoD personnel to amend the Standard Contract Document clauses according to the need in individual cases, which has always been a challenge. However, MoD through the Standard Contract Document in DAP 2020 has addressed a few of the key issues that plagued contract negotiations (on both sides) often in the past. Some of the new clauses include: (a) Monitoring of projects based on contractual milestones (b) Title and Risk of Loss (c) Denial Clause (d) Buyers Right to Optimisation of Life Cycle Support and System Enhancements (e) Extension of PVC and FERV Clause

III The Fine Print

- **Post Contract Management**

  Formalises the procedures after the signing of the contract. This entails management of pre-dispatch and joint-receipt inspections, change in the vendor's name, bank guarantees, payments, delivery schedule, liquidated damages, contract amendment, IC verification, buy-back, claims, arbitration, termination of contract, etc.

- **Impetus to MSMEs and start-ups**

  To boost defence manufacturing in MSMEs and start-ups, the Ministry of Defence has introduced 'Innovation' as a new acquisition category. This entails procurement of products designed and developed by MSMEs and start-ups through: (1) Innovations for Defence

[15] *https://thewire.in/government/defence-offset-policy-changes-dap-2020*

Excellence which provides grants to start-ups and MSMEs for technology development for defence and aerospace; (2) Defence Research and Development Organization's Technology Development Fund which supports defence projects by Indian MSMEs; and (3) research and development establishments.

- **Acquisition of ICT products and systems**
  A new chapter has been incorporated on the acquisition of Information and Communication Technology (ICT) systems, to provide a mechanism to acquire and up-grade ICT systems. This is vital to maintain tactical dominance in electronic warfare and cyber domain. These ICT systems include electronic warfare equipment, satellite-based communication systems, intelligence gathering equipment, satellite imaging and mapping, surveillance systems and other software intensive ICT programmes including AI projects and cyber systems.

- **Promotion of indigenous materials**
  The DAP 2020 promotes of use of high-end Military Materials and Special Alloys already available in the country and development/manufacture of such materials for future needs.

OUR COMMENTS

The DAP 2020 has cleared a lot of previously existing roadblocks in defence procurement and has endeavoured to ensure some degree of ease in doing business for an industry that was previously plagued by bureaucracy and red tape.

India is now slowly emerging as an exporter mainly due to the country's emphasis on 'Make in India', with India now exporting to about 42 countries worldwide including the US, Australia, Finland, France, Germany, Israel, South Africa and Sweden. In lieu of India's ever-improvingdefence sector, the Prime Minister has announced a target of exporting USD 5 billion worth of military hardware which is about INR 35,000 crores. The Indian Government has also announced plans to spend USD 130 billion on military modernization in the next 5 years. Changes to the FDI Policy and the DAP 2020 will provide the necessary impetus to the Foreign OEMs to include Indian companies into their global supply chain which is expected to further boost exports.

In a boost to the domestic manufacturing industry, the Government has banned 101 defence items for import into India, which it hopes will benefit not only the domestic market but exports as well. It has been hailed as a big step towards self-reliance in defence with the Government expecting contracts worth approximately INR 4 lakh crores to be placed upon the domestic industry within the next 6 to 7 years.

One of the key focus areas of the DAP 2020 was to implement 'Ease of Doing Business' with emphasis on simplification, delegation and making the procurement process industry friendly. Many of the complaints raised by the industry such as the unrealistic setting of General Service Qualitative Requirements (GSQRs) for weapons/ platforms being procured, drawn out procurement process, complex trial and testing procedures etc. have been addressed by the DAP 2020 through a number of new and revised chapters.

However, one must remember that DAP 2020, like earlier DPPs, is a compilation of procedures which facilitate acquisition but cannot enable it unless there is adequate financial backing for all the acquisition programs. With the current year's capital budget being just about INR 3,340 crore more than last year's allocation, and future allocations being uncertain, it will take more than just the DAP 2020 for India to become self-reliant in defence production.

Production Linked Incentive Scheme: Making India a Factory for the World

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The key focus of the Indian Government in recent years has been to strengthen domestic manufacturing, increase self-reliance and reduce import bills. To realize these objectives, Government has announced multiple fiscal and non-fiscal incentive schemes and measures, inviting Companies to invest and manufacture in India. One such scheme, that is widely discussed and promoted, is Production Linked Incentive (**PLI**) Scheme.

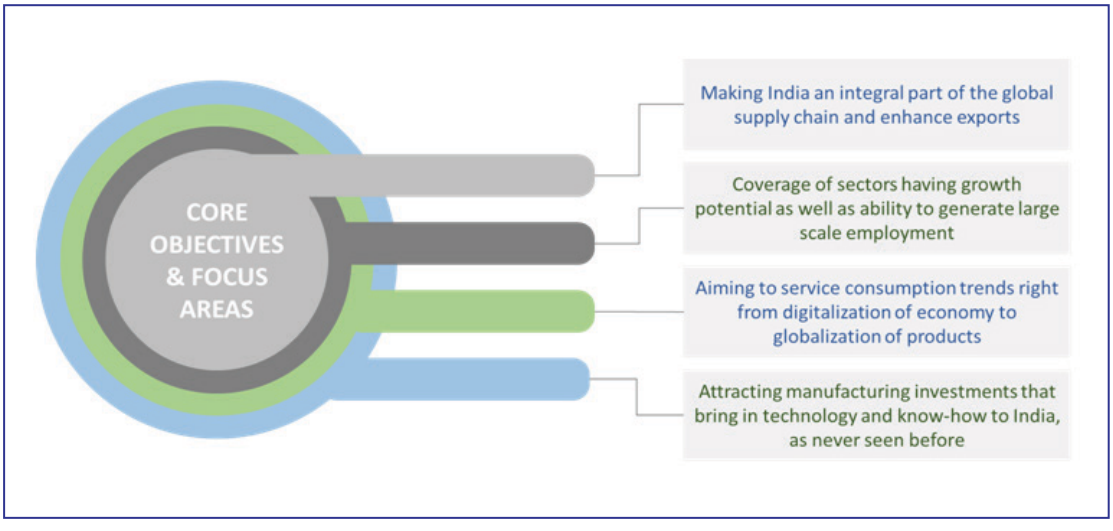
Through the PLI Scheme, the Government intends to promote its flagship Make-In-India program and also align with the Atmanirbhar Bharat campaign.

The scheme was first launched in April 2020, for the Large-Scale Electronics Manufacturing sector, and ever since has been extended to as many as 13 Target Sectors (10 being recent additions). Several large Indian & foreign businesses are already in the fray to avail these incentives given that the eligibility is restricted. Although the overall objectives & contours of the scheme are defined at the central government level, the fine mechanics of the scheme i.e. the implementation policy is notified by the nominated GOI Ministry or department under aegis of Ministry of Commerce.

2021 Union Budget allocation for PLI scheme at INR 1.97 Lakh Crores

WHAT'S IN STORE?

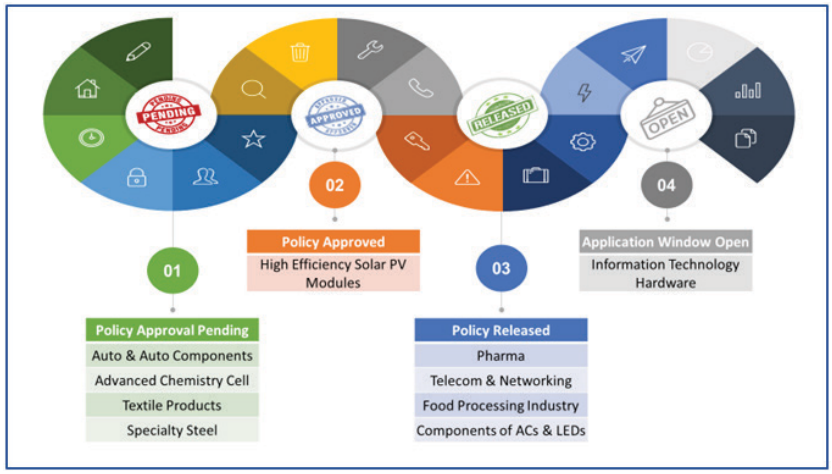
- Incentive of 4% to 6% on incremental sales (outliers existent). Additional incentives for globalizing brands, in the form of branding and marketing support
- Eligibility basis fulfilment of investment and incremental turnover threshold as per sector specific schemes
- Total incentives capped for each applicant. Possible increase in scenarios, where other applicants are not able to fulfil thresholds



BENEFICIARIES

Basis the parameters laid out, several beneficiaries of the PLI scheme have been identified. It is important to note that the implementation stage, i.e. policy formulation & subsequent action through nominated ministry/ department, currently varies.

Sector Policy Framing Status & Application Window



Note: Application window for (1) Mobile & Electronic Components (2) KSM, Drug Intermediates & API & (3) Medical Devices sector(s) is already closed.

The nominated ministry/ department details are as under

	Product	Nominated Agency
	IT Hardware	Ministry of Electronics & IT
	Pharma	Department of Pharmaceuticals
	Telecom & Networking	Department of Telecommunication
	Food Processing Industry	Ministry of Food Processing
	Components of ACs & LEDs	Department of Promotion of Industryand Internal Trade
	High Efficiency Solar PV Modules	Ministry of New & Renewable Energy
	Auto & Auto Components	Department of Heavy Industries
	Textile Products	Ministry of Textiles
	Advanced Chemistry Cell	Department of Pharmaceuticals
	Specialty Steel	Ministry of Steel

MODALITIES

Each PLI Scheme specifies conditions and qualifying criterion for eligibility. Qualifying parameters across notified PLI Schemes are similar, : with threshold criteria differing in each Scheme. Key parameters are as follows:

Eligible Person

- Inclusion for entitiy engaged in manufacture of goods falling within Target Sector
- Scheme may provide inclusion or exclusion for domestic and foreign company
- Benefits to contract manufacturers, as defined in FDI Policy Circular of 2017, in certain Policies
- Maximum number of beneficiaries under Scheme & manner of selection specified in Scheme

Eligible Product

- Benefits restricted to notified goods falling within Target Sector. List of eligible products specified in Scheme
- Only manufacturing activity is covered and trading activity is expressly excluded. What constitutes as manufacture is defined
- Eligible product can be manufactured either in existing or new manufacturing facility

Scheme Period

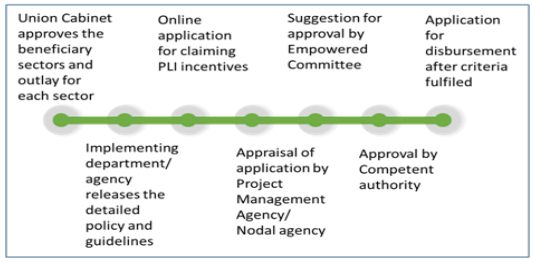
- Incentives are eligible for 4 - 6 years (exceptions exist)
- Scheme Period excludes time allowed for making application
- Scheme may provide for re-opening for fresh applications during Scheme Period

Investment Criteria

- Condition of prescribed incremental investment over Base Year. - both cumulative and annual thresholds specified
- Base Year is defined in Policy for determinig incremental investment
- Separate thresholds prescribed for each Scheme
- Qualifying 'investment' expenditure is specified - Land and building cost is excluded

Sales Criteria

- Condition of prescribed incremental turnover over Base Year
- Base Year is defined in Policy for determinig incremental turnover
- Separate thresholds for different products. **Currently Notified Policies does not include export sales as qualifying criteria**
- Credit notes and discounts to be excluded from sales



In addition to above, a periodic review of eligible companies will be undertaken by an Empowered Committee (EC) through the Scheme period, with respect to investments, employment generation, production, and value addition requirement under the Scheme. EC is empowered to revise incentive rates, ceilings, target segments and eligibility criteria during the tenure of the Scheme.

Interestingly, non-fulfilment of investment or sale criteria in a specific year does not impact eligibility in other years.

> Any person investing in manufacturing in India should undertake a detailed review of PLI Scheme from a coverage and eligibility perspective. Time bound evaluation & decision making to opt for the scheme is of essence.
>
> PLI is a welcome support to the economy, especially in pandemic times. Corporates should align the plan for expansion/ diversification/ backward integration in view of the eligibility for the Scheme.
>
> Comprehensive preparation of the application inter-alia building up a convincing 'company cum product profile' is key to secure benefits under the scheme. These efforts shall go a long way to address various scoring criterion too.

INTERESTING FACTS

Benefits under PLI Scheme are mutually exclusive from benefits available under other Schemes of Government. An entity can thus be a beneficiary under (2) or more schemes of the Central or State Government

WAY FORWARD

- Evaluate coverage and eligibility under the Scheme for the investment pipeline. Non-coverage of specific products may warrant making suitable representation before relevant authority.
- Applications under PLI Scheme are to be undertaken within time bound manner. Thus, timely tracking of new releases and seeking clarifications is essential to file an application within timeline.
- Strict criterion for eligibility & scoring, warrants garnering information on past experiences and preparing a robust application.
- Additionally, the application should ensure that Applicant's interest is protected from future potential interpretational or other issues.
- While Government has until now identified (13) Target Sectors, the Indian market has demonstrated potential in other sectors, which can evolve into global champions. Non-Target sector can make a case for inclusion within PLI Scheme through representation before relevant forum.

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Today, ELP has an extensive client base across multiple industry sectors with clients from Fortune 500 Companies, Public Sector Undertakings, Multi Nationals, Indian Corporate power houses and even start-ups. We work closely with leading global law firms in the UK, USA, Middle East and Asia Pacific region, giving us the ability to provide real-time support on cross-border concerns.

We actively seek to build, and nurture long-term relationships and our clients value us for providing practical, implementable and enforceable advice. Each project team is helmed by experienced professionals and partners with extensive domain knowledge and expertise, ably supported by some immensely talented and youthful professionals.

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