ECONOMIC LAWS PRACTICE
ADVOCATES & SOLICITORS

ELP KNOWLEDGE SERIES

India Update

Part 1 of 2019

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FOREWORD

Dear Reader,

We welcome you to the latest edition of ELP Knowledge Series, a quarterly round-up of critical legal and regulatory developments that can create potential compliance challenges and operational risk for businesses in India.

This iteration of 'India Update – Part 1 of 2019' examines the emerging landscape with respect to arbitrations in India and discusses taxation concerns pertaining to fair market value of acquired shares, emerging interplay between IBC and India's Income Tax Act, as well as increasing scrutiny of related party transactions.

Updated requirements for issue of capital and disclosure are analysed in detail, in addition to the latest press note on e-commerce sector, which has been widely debated in the business media. We also discuss the increasing relevance of Bureau of Indian Standards and certain key aspects of hotel acquisitions in the country.

We conclude by delving into the risk faced by nominee directors and concerns in the industry with respect to information exchange with competitors, which is looked at critically by the competition regulators globally.

Our continuing endeavour is to present a succinct summary to our readers on topics of relevance to them. We hope you will find this information helpful. For any clarification or further information, please connect with your point of contact at ELP or reach out to us at insights@elp-in.com.

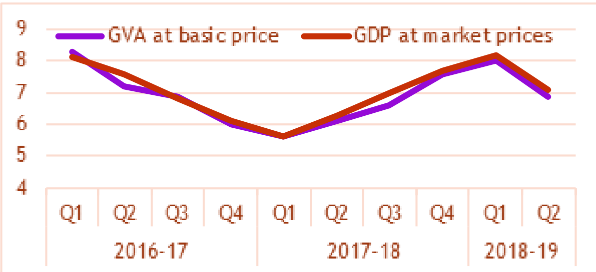
Regards,

Team ELP

INDIAN ECONOMY - A SNAPSHOT

ECONOMIC GROWTH

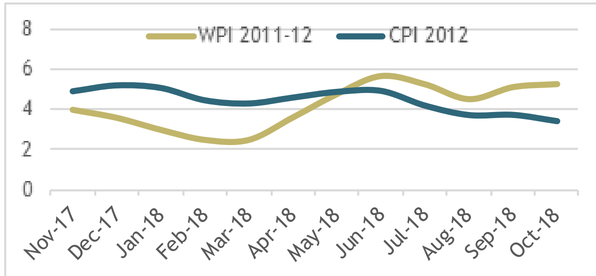
Quarterly Growth of GDP and GVA (%) at constant '11-12 prices



Source: Central Statistical Organisation (CSO)

INFLATION

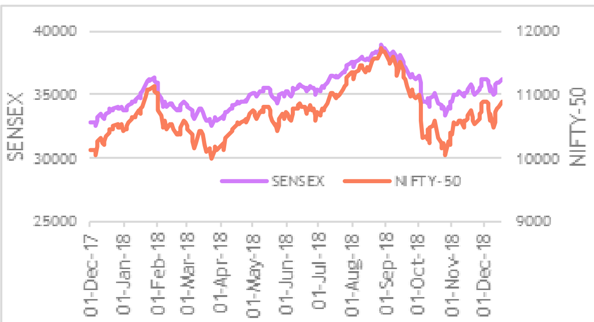
Inflation in WPI and CPI (%)



Source: Office of Economic Adviser- DIPP and CSO

SHARE MARKET

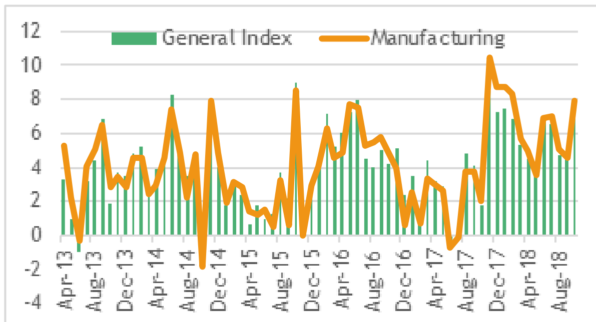
SENSEX and NIFTY-50



Source: BSE and NSE

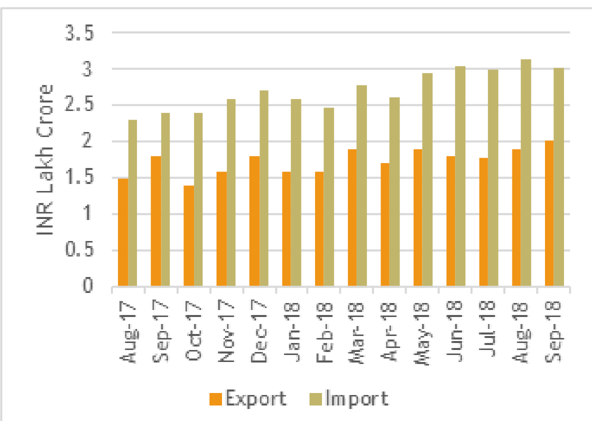
PRODUCTION GROWTH

Index of Industrial Production (IIP) growth in %



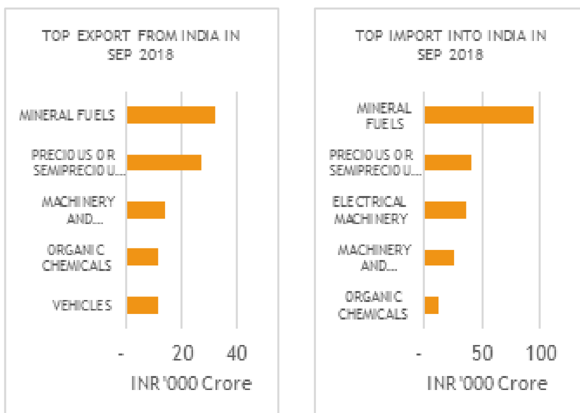
Source: CSO

EXTERNAL TRADE



Source: Ministry of Commerce

MAJOR GOODS TRADED



Source: Ministry of Commerce

Consolidated FDI Policy on E-Commerce

The Department of Industrial Policy and Promotion (**DIPP**) has issued Press Note 2 on 26 December 2018 (**Press Note**), which has amended the Consolidated FDI Policy issued on 28 August 2017 (**FDI Policy**) in relation to foreign direct investments in the e-commerce sector. The changes are material and may significantly impact the structure and business models of various e-commerce marketplaces (**E-commerce Marketplace**) which are owned by entities with foreign direct investments (**E-commerce Entity**).

EQUITY PARTICIPATION IN SELLER ENTITIES

The most significant change has been the addition of the stipulation that any entity shall not be permitted to sell its products on an E-commerce Marketplace run by an E-commerce Entity if:

- The E-commerce Entity or its group companies[1] have an "equity participation" in such entity; or
- The E-commerce Entity or its group companies have control over the inventory of such entity.

Our View: A number of e-commerce entities operating in India have made (or entities controlled by them have made) investments in entities (**First Level JV Entity**) that are owned and controlled by an Indian resident. The First Level JV Entities generally have subsidiary (**Second Level JV Entity**) in which it owns majority shareholding. In light of the guidelines on downstream investments, since the First Level JV Entity is owned and controlled by Indian residents, the entire investment in the Second Level JV Entity is deemed to be resident investment and there is no indirect FDI in the Second Level JV Entity. This enables the Second Level JV Entity to sell goods to the end consumer (i.e. B2C trading) without being subject to the restrictions on retail trading under the FDI Policy. Now, if an E-commerce Entity or its group companies have any "equity participation" in a company, such company shall not be permitted to sell goods on the E-commerce Marketplace.

The question is whether in the structure mentioned above, Second Level JV Entities would be deemed to have "equity participation" by E-commerce Entities or its group companies. This is particularly complicated by the usage of the term "equity participation" in Clause (v) of Paragraph 5.2.15.2.4 and the usage of the term "direct or indirect equity participation" in the Clause (ix) of Paragraph 5.2.15.2.4. The DIPP needs to clarify whether any existing structures are 'grandfathered' and shall be permitted to continue with their holding structures, since the Press Note does not state that it shall have a retrospective effect.

The DIPP also needs to clarify whether "equity participation" refers solely to equity investments or whether it includes investments using convertible instruments (such as compulsorily convertible preference capital or debentures) which is not uncommon in such structures.

APPLICABILITY OF 25% THRESHOLD NOW ON PROCUREMENT BY SELLER ENTITIES

Earlier, the FDI Policy stipulated that an E-commerce Entity shall not permit more than 25% of the sales value on a financial year basis from one seller or its group companies (Earlier Condition). The Earlier Condition has been omitted and the Press Note states that an E-commerce Entity shall be deemed to control the inventory of a seller (which is prohibited by the FDI Policy) if more than 25% of the purchases of such seller are from the E-Commerce Entity or its group companies (**New Condition**).

[1]The FDI Policy defines a "group company" as "two or more enterprises which, directly or indirectly, are in a position to:
(i) exercise twenty-six percent or more of voting rights in other enterprise; or
(ii) appoint more than fifty percent of members of board of directors in the other enterprise."

Our View: Sellers that predominantly procure products from an E-commerce Entity (or any of its group companies) may seek to comply with the New Condition by procuring products directly from other wholesalers, distributors or manufacturers. This may mean that each of such sellers may be required to build additional channels / relationships such that they comply with the New Condition. This may also place significant compliance burden for E-Commerce Entities as any non-compliance by sellers may lead to a contravention of the FDI Policy / Foreign Exchange Management Act, 1999 by E-commerce Entities. An unintended consequence of this rule could be that an Indian seller (without any foreign investment) that procures its products from the wholesale venture of any group entity of an E-commerce Entity will have to diversify its sourcing channels. This may impact their margins. Further, the Press Note does not clarify whether the 25% threshold is to be reckoned on the basis of transactions in a financial year or otherwise (though it is likely that it is to be reckoned on sales in a financial year, as had been specified in the Earlier Condition).

A view that is emerging amongst some market participants (which requires further analysis) is that since an E-commerce Entity cannot 'control' inventory, sale of products bearing private labels of E-commerce Entities will be prohibited on such E-commerce Marketplace. However, it is submitted that the facts in each case would have to be examined to determine whether an E-commerce Entity possesses 'control' over inventory and merely because a product shares a trademark with the E-Commerce Entity should not ipso facto mean that the E-Commerce Entity possesses control over inventory.

NO EXCLUSIVITY

An E-commerce Entity cannot require any seller to sell its products exclusively on its E-commerce Marketplace only.

MORE STIPULATIONS TO ENSURE LEVEL PLAYING FIELD FOR ALL SELLERS

The FDI Policy now stipulates that if an E-commerce Entity or any entity in which the E-commerce Entity has "direct or indirect equity participation" or is under common control, provides any services (including logistics, warehousing, payments, etc), such services should be provided to sellers in a fair and non-discriminatory manner. 'Cashback' offers to buyers are required to be given on a fair and non-discriminatory basis.

Our View: In spirit, an E-commerce Entity should endeavour to run the E-commerce Marketplace as a 'level playing field' by not favouring any particular sellers and undertaking transactions on an arm's' length basis. Once the Reserve Bank of India issues the appropriate notification to incorporate the provisions of the Press Note to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017, any breach by an E-commerce Entity of such condition could be proceeded against as a breach of the provisions of the Foreign Exchange Management Act, 1999, which is punishable by upto three times of the amount up to thrice the sum involved in such contravention with a further penalty which may extend to INR 5,000 for every day after the first day during which the contravention continues.

REPORT TO THE RESERVE BANK OF INDIA

E-commerce Entities are required to furnish a certificate along with the report of the statutory auditor to the effect that the E-Commerce Entity is in compliance with the provisions under the FDI Policy applicable to e-commerce sector.

Understanding potential risk For Nominee Directors in India

Buoyed by a vibrant economy and high returns, the private equity (PE) and venture capital (VC) space in India was on a rising track to record an all-time high investment of more than $33 billion in 2018. With an over 35% per cent more year-on-year increase, it remained a landmark year for the sector. Whether the foreign investor interest and PE investment tally of 2019 would outdo the highs of 2018 would not only depend on factors such as global economic trends, outcome of the upcoming national elections, but would also depend on the increasing scope of liability and stringent national and international regulatory pressure imposed by various government authorities and international organizations.

PROTECTING INVESTMENTS THROUGH AFFIRMATIVE RIGHTS – 'CONTROLLING DILEMMA' FOR NOMINEE DIRECTORS

For any PE investor, appointment of nominee director(s) on the board of the investee company remains one of the paramount ways of participating in the management and governance of such companies. For protecting the investment made, certain key matters pertaining to the operations of a company are listed down as affirmative vote matters in the contractual arrangements, the passing or approval of which remains conditional to receipt of affirmative vote from such nominee director. However, such an appointment also exposes the nominee directors to risks and poses several challenges.

The aspect of exercising 'indirect control', notably in respect of the power to determine the outcomes of a board meeting or shareholders meeting, has been discussed at vast length in various judicial precedents. Taking reference from the case of Century Tokyo Leasing Corporation/Tata Capital Financial Services Limited, the Competition Commission of India had held that affirmative rights relating to certain items would be considered 'control' for the purposes of the Companies Act, 2013 ("**Companies Act**"). These items include annual budget; annual business plan; exit and entry into lines of business; appointment of management and determination of their remuneration; or strategic business decisions.

However, a different view with respect to associating of veto rights to exercising of control has been taken in various cases, like in the case of Subhkam Ventures India Private Ltd. v. SEBI, where it was held that veto rights in favor of certain shareholders to veto certain actions proposed to be undertaken by the company (affirmative voting rights in the shareholders agreements) does not tantamount to 'control' and that the shareholders having such affirmative rights need not make an open offer under the Takeover Regulations to the other public shareholders of the target company.

Therefore, test of degree of control that veto right/affirmative right is able to grant to an investor is examined on the basis of facts and circumstances of each case. An indicative list of reserved matters has been provided in various judicial precedents and the test used to determine whether a particular matter falls within the protective or participative arena or is allowing a nominee non-executive director to exercise control, is based on whether the investor is in a position to influence major policy decisions of the investee company or not.

POTENTIAL LIABILITY UNDER VARIOUS LAWS IN INDIA

1. The duties of directors as codified under Section 166 of the Companies Act, 2013 do not distinguish between an executive and a non-executive director. And hence obligates a non-executive director almost on an equal footing as that of an executive director.

2. The term "officer in default" applies only to executive directors under the Companies Act, independent and non-executive directors (including nominee directors) can be held liable under section 149(12) of the Act if acts or omissions by the investee company:

- occur with the knowledge of such independent and non-executive directors, "attributable through board processes", and with the consent or connivance of such independent and non-executive directors; or
- where such independent and non-executive directors have "not acted diligently".

The affirmative voting rights provided to investor nominee directors under the provisions of an investment agreement and articles of association of an investee company can lead to a situation where non-executive directors would remain equally duty bound under section 166 of the Companies Act, 2013 while protecting the interests of the PE investor. It can be further argued that though a non-executive director, who is not involved in everyday operations of the investee company, can face a potential riskwhere upon grant of affirmative voting rights, knowledge can be attributed through board processes and lack of diligence is seen to be exercised in the decision-making process.

3. Any non-diligent exercise of veto made available to the nominee director can lead to significant consequences, including facing of liabilities and serious implications for non-compliance, such as penalties, forfeiture and in certain cases even arrest arising under various laws in India. Availability of such right and access to the information required in the process of decision making to exercise such veto right may also negate defences otherwise available to nominee directors against non-compliance by investee company, they sit on board of. In other words, the fact that a nominee director may not have any information or resources to be able to understand the business decisions, might not be enough to absolve him of the duties to understand the investee company's affairs and to apply his/her own mind to determine whether a particular transaction was in the investee company's interests.

4. PE investors also secure certain information rights under the investment agreements which bounds an investee company to provide such investors with company related information including financial statements, operations and management periodically. Most information rights also include the opportunity to visit the company's facilities, inspect the company's books and records and discuss matters with company officers. As a practical matter, an investee company while adhering to such provisions, shares or is made to share all such information with the nominee director himself. These rights bring in another layer of obligation on nominee directors to remain diligent while examining the information/documents and taking into consideration such information while exercising utmost diligence in reviewing the information can further outcast the shadow of liabilities under various laws in India.

5. Further with respect to other applicable laws, while it is difficult to provide any standard that would determine an individual's exposure to liability, it has generally been seen that 'only those persons are held liable for wrongdoing committed by a company, who were in charge of, and responsible for, the conduct of the business of the company at the time of commission of an offence'. Such liability may not always be foreseeable, and actions such as the violation of environment protection laws, dishonoring checks, offenses under the Income Tax Act of 1961 or Goods and Services Tax Act, 2016, violation of foreign exchange regulations, breach of securities regulations, non-payment of provident fund contributions, violation of the Shops and Establishments Act, or food adulteration, could result in liability that may not always be limited to the executive directors.

CONCLUSION

Securing affirmative voting and information rights in an investment agreement can be a double-edged sword for PE investors. Though it favorably provides an edge while securing the investment by guiding the operations in the desired manner, any inaccuracies in exercising such rights can also lead to risk of facing allegations and being charged for potential liabilities under various laws in India.

Increasing reliance on utilization of forensic auditing and investigation techniques combined with advanced data analytics has helped various companies and their investors in resolving unwarranted disputes in courts of law and other forums in India. Forensic techniques such as data analytics can be very useful in detecting, monitoring or investigating potentially improper transactions, events or patterns of behavior related to misconduct, fraud and non-compliance issues. By way of illustration, a Forensic Audit is a comprehensive and systematic process involving a series of activities and tasks undertaken for establishing the accuracy and authenticity of the transactions under review. Increasing reliance on conducting of forensic investigation coupled with legal health review, has helped various global private equity investors in collecting and preserving evidence, conducting interviews and preparing strategies for pursuing civil and criminal remedies while maintaining legal privilege.

In order to avoid and mitigate any liability on the nominee directors arising out of a non–compliance or breach by the investee company under various laws in India and any other legislation enacted outside India having an impact on conducting business in India, such directors should consider adopting adequate measures to safeguard the interests of private equity investors and avoid any undue liability on themselves.

Information exchange between competitors – Concerns under India's Competition Act

Information exchange between competitors has been a cause for concern for competition and antitrust regulators globally. While the oft-parroted thumb rule is "do not talk to competitors," this is divorced from business realities and other practical considerations. There is clearly a need to strike a balance between the justifiable reasons for collation and exchange of information (for instance, for formulating broad industry strategies; and addressing issues that impact the industry at large) and information exchange aimed at colluding with a competitor. The line between the two often blurs, leading to the tough question of "what kind of exchange of information is permissible."

Does the Competition Act, 2002 ('Act') specifically prohibit exchange of information?

While the Act has no specific provision barring the exchange of information, Section 3(3), which prohibits certain agreements between competitors, would extend to exchange of information as well where the exchange of information:

- Directly or indirectly determines purchase or sale price
- Limits or control the production, supply, market of a good or provision of service
- Results in sharing of market or source of production
- Results in bid rigging

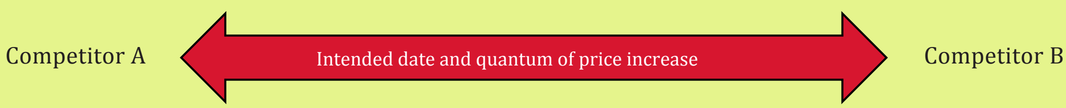
Such an exchange is presumed to be anti-competitive and is prohibited under the Act. However, the presumption is a rebuttable one. Further, in such cases, the intent of the parties is irrelevant, and a company cannot plead that it never intended to use the information exchanged for the purposes mentioned above.

When is exchange of information a concern?

Information exchange is a concern under the Act if it is of a nature that reduces the necessary degree of uncertainty (and competition) in the market between competitors and enables them to collude to fix prices, control supply, etc. As a simple rule, considering whether the information is commercially sensitive, such that a competitor should not know of it in a perfectly competitive market can help in assessing when information exchange can pose a problem.

Notably, even where the information in question is ultimately required to be shared with a government authority, that by itself will not be a justifiable reason for competitors to disseminate confidential information amongst themselves.

- **Information exchange that can lead to determination of price:**



In Re: Cartelization in respect of zinc carbon dry cell batteries market in India, the CCI found that certain manufacturers of zinc carbon dry cell batteries exchanged commercially sensitive information, such as date and quantum of price increase amongst themselves for the purpose of price-coordination.

- **Information exchange that can lead to limitation of supply and production of goods and services**

In Builders Manufacturer Association v. Cement Manufacturers Association and Ors, the CCI and the appellate tribunal found that the cement companies had decreased their supply in November 2010 followed by a price increase by some companies in January 2011, as they had shared sensitive information about price, production capacity, dispatch etc.

- **Information exchange that aids in bid rigging or collusive bidding when it comes to floated tenders**

The CCI in In Re Cartelization of Brushless DC Fans, found that the firms exchanged emails quoting same rates in the tender for fans.

What kind of exchanges among competitors can be reasonably justified under the Act?
As discussed above, information exchange between competitors is not per se a problem and not all exchange of information is barred.

Issues Impacting the Industry at large: Some information exchange might be permitted where it is to resolve issues that affect the sector. However, even in such cases only exchange of historic data, which is no longer competitive sensitive, will be permitted. Exchange of current or future information may not be permitted even in such situations.

Research & Development Venture: Exchange which is aimed at R&D is procompetitive in nature and generally permitted.

Due Diligence: Information exchange that takes place between two competitors during the due diligence process prior to a merger/acquisition is permissible, however subject to certain riders. Such information is generally shared only with legal counsels and subject to strict non-disclosure requirements. The report of such due diligence, if shared with the company, however, cannot contain any commercially sensitive information as described above.

What happens if a company is found to have exchanged information in contravention of the Act?

In case the information exchange amounts to cartelization, the CCI has the power to impose significant penalties, up to 10% of the average of the turnover for the last three years or 3 times of the profit for each year in continuation of a cartel, whichever is higher along with power to penalize individual officers found guilty of such exchange.

What can be done to mitigate risks?
The CCI has created a compliance manual which provides some understanding of information exchange and the possible ramifications of the same. The CCI's compliance manual can be accessed here. An indicative list of do's and don'ts for information exchanged are provided in the next section:

SUGGESTED DOs AND DON'Ts

DOs

- Companies must formulate a robust competition compliance program to educate their employees on how to conduct themselves in trade association meetings and with competitors.
- If pricing or other business sensitive information has to be shared with the government or government agencies, it must always be shared in sealed envelopes by the companies. In the event that a platform of an association is used, it must be ensured that the information is not exchanged amongst the member companies.

Some historic information may be exchanged through trade associations. Legal advice on what information is historic should be taken.

- Companies must document reasons for increase and decrease in price, change in supply or decrease in installed capacity or capacity utilization.
- Employees and companies should strive to maintain records of costing and decision regarding bid price and quantity.
- In case there are interactions with competitors in relation to legitimate tender processes, proper documentation to justify such interactions must be maintained.

DON'Ts

- Companies must NOT use trade association meetings as a platform to share pricing or other business-related sensitive information.
- Employees must NOT engage in informal communication with employees of competing companies regarding strategic information such as price, supply and production quantities.
- Employees must NOT exchange information with employees of competitors which would lead to control of production or supply in the market or result in imposition of any other restrictions on customer.
- Employees involved in the tendering process must NOT base their price bid and quantity on information received from competitors and must NOT have any discussions regarding the details of the bid being placed with the competitors.
- Employees, involved in a tendering process must not interact, especially through phone calls with competitors close to the submissions of bids.

The Arbitration And Conciliation (Amendment) Bill, 2018 : Promoting India as a hub for arbitration

The Arbitration and Conciliation (Amendment) Act, 2015 ('Amendment Act') substantially overhauled the earlier arbitration framework in India, in order to align it with global standards. Thereafter, in early 2017, a hi-level committee was constituted under the chairmanship of Hon'ble Justice B.N. Srikrishna, ('Committee') to review the institutional arbitration mechanism and address roadblocks experienced in the functioning of amended Arbitration and Conciliation Act, 1996 ('Arbitration Act'). Recently, on 10 August 2018, the Lok Sabha approved the Arbitration and Conciliation (Amendment) Bill, 2018 ('Bill') which was introduced based on the recommendations made by the Committee.

ANALYSIS OF THE KEY AMENDMENTS PROPOSED BY THE BILL

- **Designation of arbitral institutes by the Supreme Court (in case of an International Commercial Arbitration or ICA) or high courts (in case of arbitrations other than ICA) for appointing arbitrators and requirement for high courts (which do not have an arbitral institute within its jurisdiction) to maintain a panel of arbitrators:** This proposed change resonates with the decision of the apex court in Sun Pharmaceutical Industries Ltd., Mumbai v. M/s Falma Organics Ltd. Nigeria[2], in which the court directed Mumbai Centre for International Arbitration to appoint an arbitrator for an ICA.

- **Introduction of the Eighth schedule to the Arbitration Act, which lists the qualifications required to become an arbitrator:** While the amendment intends to provide a pool of qualified and experienced arbitrators, the water-tight qualifications mentioned in the Bill exclude the possibility of appointing overseas practitioners as arbitrators and limits the choice for appointing experts as arbitrators.

- **Deletion of provisions which (i) limit the court's role in appointing arbitrators to only examining the existence of the arbitration agreement and (ii) make the decision on appointment final and binding (with no appeal available from the same):** Whilst the deletion of the former provision may be misused by parties to argue all issues (e.g. existence of live claims or relevant qualifications of arbitrators etc.) at the time of appointment of arbitrators, it is a welcome change as it aligns section 11 with section 16 of the Arbitration Act which allows the arbitral tribunal (and not courts) to decide the question about the existence of an arbitration agreement. Further, it also does away with extensive arguments before courts on the existence of an arbitration agreement.

- **30 days provided for deciding application for appointment of arbitrators:** The suggested reduction in the time period to dispose the applications from 60 days to 30 days will expedite proceedings.

[2] 2017 SCC OnLine SC 1200.

- **Establishment of the Arbitration Council of India ('ACI') as a body corporate:** The governing body for ACI is to consist of an eminent arbitration practitioner, an eminent academician, secretary to the Government of India in the Department of Legal Affairs and secretary to the Government of India in the Department of Expenditure, a representative from trade and commerce organisations chosen by the Central Government and a Chief Executive Officer (whose appointment and qualifications are to be decided by the Central Government). Contrary to the diverse composition suggested by Committee for ACI's governing body, the Bill envisages a governing body consisting (in majority) of nominees of the government. The Bill also omits to include an overseas arbitration practitioner, who could provide a view point/ perspective on global arbitration practices in India.

- **ACI is to (i) grade arbitral institutes and (ii) accredit arbitrators; additionally, ACI is to establish and maintain a depositary of awards made in India and overseas, formulate policies inter alia to grade arbitral institutes and for uniform professional standards in arbitration, and promote arbitration in India:** Whilst, the establishment of the ACI is a positive step towards reforming the arbitration culture in India and was introduced on the basis of the Committee's recommendations, given the noticeable variances between the Committee's suggestions and the provisions of the Bill, few concerns are brewing in the industry on the following aspects:
  - Disregarding the Committee's word of caution against establishing a regulator, in view of the functions to be performed by ACI, many apprehend that the Bill has infact created a regulator
  - ACI's independence and impartiality in performing its functions given that its governing body consists mostly of nominees of the government, who is one of the largest litigators in India.
  - Bill's failure to provide for voluntary grading of arbitral institutes
  - Bill's failure to provide for checks on ACI
  - Data privacy and confidentiality issues on awards sought to be stored with ACI

- **Exclusion of ICA from the timeline of 12 months (from completion of the pleadings) for making an award:** Given the exclusion of ICA from the statutory timeline for completing arbitrations, it remains to be seen whether ICA's seated in India will be expeditiously disposed, a practice which is still a work in progress.

- **Completion of statement of claim and defence within six months from the date the arbitrator or all the arbitrators, as the case may be, receive written notice of their appointment:** Though the proposed amendment is a positive step to expedite arbitration, there is uncertainty about its interpretation if parties wish to amend pleadings and/or file a rejoinder.

- **If parties have filed an application with courts for extending time to make an award and such application is pending disposal, arbitrator's mandate will continue (and not terminate automatically) until the application is disposed:** If implemented, this provision saves parties the unnecessary hassle of reappointing arbitrators to proceed with the arbitration if their application seeking extension is granted after 18 months.

- **Court to hear arbitrators before the arbitrator's fees is reduced in proceedings filed for extending time to make an award:** This provision has been welcomed all around – not only does it comply with the principles of natural justice, but also does away with an arbitrator's apprehension of being imposed with an unjustified fine and reduces the possibility of arbitrations being disposed hastily.

- **Immunity for arbitrators from legal action:** This amendment will preserve the integrity of proceedings and ensure the finality of awards which will encourage parties to opt for arbitration.

- **Replacement of 'furnishes proof' in section 34 of the Arbitration Act with 'establishes on the basis of the record of the arbitral tribunal' the grounds on which a party seeks to challenge the award:** Recently, the Supreme Court[3] held that 'ordinarily' no proof beyond the arbitrator's record is required to prove grounds on which an award is challenged. While the amendment is in consonance with the above ruling in spirit, it does not provide for the exceptions laid down by the Supreme Court i.e. (i) parties to file an affidavit for some matters which, though not a part of the tribunal's record, could be required to determine the issue and (ii) to allow, in 'absolutely necessary' circumstances, cross examination of the deponent. While post award circumstances which warrant evidence in challenge proceedings (e.g. knowledge of fraud played upon an innocent party) cannot be totally negated, it remains to be seen whether the proposed amendment (in its present form) absolutely bars additional evidence in challenge proceedings.

- **Addition of a non-obstante clause 'Notwithstanding anything contained in any other law' before the words 'An appeal shall lie' in sections 37 and 50 of the Arbitration Act, which relate to circumstances in which appeals may be filed in relation to domestic and foreign arbitrations:** In line with judicial precedents[4] the proposed amendment takes away a general right of appeal from parties and expressly restricts their right of appeal as available under the Arbitration Act.

- **Unless parties agree, the Amendment Act applies to arbitral and related court proceedings, which commenced on or after the date the Amendment Act came into force i.e. 23 October 2015:** Though the Bill attempts to clarify one of the primary bones of contention under the Amendment Act i.e. its applicability, it contradicts a ruling of the Supreme Court[5] which held that the amended section 36 (in relation to enforcement of an award made in India) of the Arbitration Act will apply to applications under section 34 (in relation to challenge to an award) of the Arbitration Act which were pending on the date of commencement of the Amendment Act. Interestingly, the Supreme Court has directed the legislature to reconsider the proposed amendment in light of its decision. Therefore, it remains to be seen whether the Bill will be amended to bring it in consonance with judicial precedents.

CONCLUSION

The Bill remains silent on few critical issues plaguing the Indian arbitration practice, such as clarifying whether two Indian parties can opt for a foreign seated arbitration and unilateral appointment of arbitrators. It has missed incorporating some (much needed) amendments suggested by the Committee such as introducing guidelines for costs in proceedings initiated in relation to Part II of the Arbitration Act and recognizing and enforcing awards of emergency arbitrators, who can be approached under various institutional arbitration rules for interim relief before the tribunal is appointed.

Nevertheless, the Bill is a tangible step in the right direction towards easing the conduct of business in India and efficacious resolution of commercial disputes. If enacted, the Bill will be a great stride towards projecting India as a hub for arbitration, especially for institutional arbitration.

[3] Emkaay Global Financial Services Limited v. Girdhar Sondhi, (2018) 9 SCC 49.

[4] Kandla Export Corporation & Anr. v. OCI Corporation & Anr., 2018 SCC OnLine SC 170.

[5] Board of Control for Cricket in India v. Kochi Cricket Private Limited and Ors., 2018 SCC OnLine SC 232.

SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 - Key amendments

The regulatory framework for fund raising via initial public offer, offer for sale, rights issue as well as preferential issue for listed companies was governed by the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations which came into force in 2009 ("ICDR 2009"). In June 2017, the Securities and Exchange Board of India ("SEBI") constituted the Issue of Capital & Disclosure Requirements Committee ("Committee") to amend the ICDR 2009. The objective of the Committee was to review the ICDR 2009 to:

- Simplify the language and complexities in the regulations
- Incorporate changes in market practices and regulatory environment
- To make the regulations more readable and easier to understand

The Committee recommended replacing the ICDR Regulations 2009 with the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("ICDR 2018") . ICDR 2018 was notified on September 11, 2018 and came into force from November 10, 2018. A broad overview of some of the key changes in ICDR 2018 is presented below:

KEY DEFINITIONS

- **Anchor Investor for SME Exchange:** The definition of anchor investor has been divided into two parts based on whether the public issue is on the main board or is on the SME exchange: whilst the minimum application requirement of INR 10 crores continues for public issue on the main board (same as in ICDR 2009), if the public issue is on the SME exchange, the minimum application requirement is kept as INR 2 crores for a 'qualified institutional investor' to be considered as an anchor investor.

- **Fugitive Economic Offender:** Given the recent instances of several high-profile promoters of Indian companies being accused of fraud and cheating and subsequently fleeing the country, a new definition of fugitive economic offender has been introduced which now includes any individual against whom a warrant for arrest in relation to a 'scheduled offence' has been issued by any court in India, who has either left India to avoid criminal prosecution or who being abroad, refuses to return to India to face criminal prosecution. An issuer is not eligible to make an initial public offering, rights issue, preferential issue, further public offer, qualified institutional placement or a bonus issue, if any of its promoters or directors is a fugitive economic offender.

- **Promoter:** Under ICDR 2018, the definition of promoter(s) has been aligned to that of the Companies Act, 2013:
  - Person(s) named as such in draft offer documents, offer documents or identified as such in the annual return under section 92 of the Companies Act, 2013
  - Person(s) who has 'control' over the affairs of the issuers, directly or indirectly, whether as a shareholder, director or otherwise
  - Person(s) in accordance with whose advice, directions or instructions the board of director of the issuer is accustomed to act; (person(s) acting in professional capacity are specifically excluded from this definition)
  - In addition to financial institutions, scheduled banks, foreign portfolio investor (other than Category III foreign portfolio investors) and mutual funds, venture capital fund, alternative investment funds, foreign venture capital investor, registered insurance companies will not be treated as a promoter merely by the fact that such entity holds 20% or more of the equity share capital of the issuer unless such entity satisfies the aforesaid requirements.

These changes have a significant impact, given that ICDR 2018 and other SEBI regulations cast obligations on persons who are 'promoters' of a company. It remains to be seen how SEBI interprets the above definition in the context of shareholders having rights to veto certain operational matters of an issuer/company.

- **Promoter Group:** ICDR 2009 contemplated promoter group to include a body corporate where a promoter held 10% or more of the equity share capital. ICDR 2018 has increased this threshold to 20% or more of the equity share capital in light of the challenges faced by issuers with respect to nature of confirmations that are to be provided by the promoter group and the materiality of the information. Additionally, where a promoter is a body corporate, if a group of individuals or companies (or a combination thereof) are 'acting in concert' hold 20% or more of the equity share capital of another body corporate ("Another Body Corporate") and such group also holds 20% or more of the equity share capital of the issuer and are also 'acting in concert' such Another Body Corporate will be considered as a promoter group.

INITIAL PUBLIC OFFER

- **Eligibility Criteria:** The ICDR 2018 has clarified that the eligibility criteria to make an IPO such as the net tangible asset requirement, operating profit requirement and the net profit requirement is to be calculated on a restated and consolidated basis. Under ICDR 2009, one of the conditions for an initial public offer (on the main board) required the issuer to have a minimum average pre-tax operating profit of INR 15 crores during the three most profitable years out of the immediately preceding five years. ICDR 2018 has modified this condition requiring the issuer to have operating profit of at least INR 15 crore during the preceding three years (or twelve months each) with operating profit in each of these three years.

- **Shortfall in Minimum Promoter Contribution:** ICDR 2009 contemplated that if the minimum promoter's contribution fell below 20% of the post issue paid up share capital, non-promoters i.e. only alternate investment funds could contribute to meet the short fall subject to maximum of 10% of the post issue paid up share capital without being identified as the promoters. ICDR 2018 has expanded this to include foreign venture capital investors, scheduled commercial banks, public financial institutions, or registered insurance companies. Such contributions are subject to a lock-in of 3 years from the date of commercial production or date of allotment in the initial public offer, whichever is later.

- **Non-Promoter Lock-in:** ICDR 2018 exempts equity shares held by an employee stock option trust or transferred to the employees by an employee stock option trust pursuant to exercise of options as per the stock option plan or scheme; however, such shares will be locked in as per the SEBI (Share Based Employee Benefits) Regulations 2014. ICDR 2009 did not provide for such an exception which would therefore result in issuers having to accelerate the vesting of shares and allotment of shares to ex-employees prior to filing of the draft offer document.

- **Pledge of Promoters' Locked-in Shares:** ICDR 2009 allowed promoters to pledge their locked-in shares only to scheduled commercial banks or public financial institutions for the loans granted by such banks/institutions subject to certain conditions. ICDR 2018 has expanded this to include non-banking finance companies ("NBFCs") and housing finance companies in addition to the aforesaid banks and institutions. Given that such NBFCs are an important source of financing for issuers, the amendment provides flexibility in creating security over shares held by the issuer.

- **Time period to disclose the price band:** ICDR 2009 required that the issuer announce the price band at least five days prior to opening of the issue. Given that the volatility in the global markets has a direct impact on market sentiments and market prices of the listed peer group companies, the ICDR 2018 aims to reduce market exposure and introduces flexibility by requiring that issuers disclose the price band at least two days prior to the opening of the issue.

PREFERENTIAL ISSUE

- **Eligibility of Seller of Shares to Participate in Preferential Issue:** ICDR 2009 debarred persons from participating in a preferential issue if such persons had sold equity shares held in the issuer in the six months period preceding the preferential issue. ICDR 2018 exempts promoters from the aforesaid ineligibility if the sale is an inter-se transfer among promoters and entities forming part of the promoter group which qualifies under regulation 10(1)(a) of the SEBI (Substantial Acquisition of Shares and Takeover Regulations) 2011 or the sale by the promoters/promoter group is due to invocation of pledge by a scheduled commercial bank, public financial institution, systematically important NBFC, mutual fund or insurance company.

- **Valuation of Specified Securities for non-cash consideration:** ICDR 2009 required a valuation certificate to be issued by an independent valuer and submitted to the stock exchanges if the preferential issue of the specified securities was being done to promoters/promoter group for non-cash consideration.

  ICDR 2018 extends the above requirement to a preferential issue of the specified securities to any person for non-cash consideration.

QUALIFIED INSTITUTIONAL PLACEMENT (QIP)

- **Minimum Public Shareholding:** The ICDR 2018 has done away with the institutional placement programme contemplated under ICDR 2009. However, some of the provisions applicable to the institutional placement programme are now reflected in the provisions applicable to QIPs. ICDR 2018 permits an issuer to undertake a QIP for achieving minimum public shareholding within a year from listing either by way of a fresh issue or a secondary sale by promoters or promoter group.

Key income-tax concerns surrounding the Insolvency and Bankruptcy Code, 2016

IBC (Insolvency and Bankruptcy Code)was a key legislation introduced to tackle the problem of burgeoning NPAs of financial institutions. Though this has proved instrumental in addressing the corporate insolvency situation in the country, several crucial issues have emerged under IBC framework, including the potential issues under India's Income-tax Act, 1961 ('IT Act') on M&A/transactions under IBC. To reduce the income-tax impact on the transactions under IBC, the Finance Act, 2018 introduced some key amendments to the IT Act, relating to companies under IBC. A snapshot is provided below:

KEY AMENDMENTS TO THE IT ACT

- **Carry-forward of losses:** As a general rule, under the IT Act, a company is not eligible to carry-forward its accumulated losses of earlier years where there is a (more than 50%) change in the ownership of the company. However, companies under the IBC have huge accumulated losses and further, the resolution plan usually involves substantial change (which generally exceeds 50%) in the ownership of these companies under the IBC. In order to provide relief to companies under IBC, an exception has been introduced in the provisions of IT Act to exempt the change in shareholding effectuated through an approved resolution plan under IBC.

- **Relief from Minimum Alternate Tax ('MAT'):** As per the IT Act, companies can avail a deduction of either brought forward losses or unabsorbed depreciation against their book profits while computing MAT. In order to grant relief to companies under IBC, the provisions governing MAT have been amended to provide for aggregate deduction of brought forward losses and unabsorbed depreciation against the book profits for companies for whom an application for resolution process has been admitted by the Adjudicating Authority under IBC.

STILL SIGNIFICANT GROUND TO COVER

These amendments, while being timely and welcome, are not enough to resolve all the income-tax issues impacting IBC transactions since there is no blanket exemption provided to such transactions. Some of the key income-tax issues still impacting IBC transactions are:

1) **Remission of trading liability**
Under IBC, operational creditors as well as creditors providing working capital loans may take a haircut. As per section 41 of the IT Act, any such haircut (i.e. remission of any trading liability) is chargeable to income-tax under normal provisions. In addition, there may be MAT implications as well on such haircut.

2) **Write-back of loans**
- Waiver of interest and even the principal (in some cases) runs the risk of taxation. However, based on judicial precedents, it may be possible to argue that waiver of loans availed on capital account may not be liable to tax under the normal provisions of IT Act.
- Currently, any haircut taken by creditors risks a MAT levy at the rate of approx. 20%, subject to set-off of accumulated losses. Thus, a potential bidder, in the absence of any exemption from MAT provisions, is required to factor in this tax cost and, accordingly, lower his or her bid. This translates to a substantial reduction in bid amounts.

3) **Reduction of capital**
- Capital reduction is one of the common modes adopted by a company under the purview of IBC, in order to reorganize its capital structure. As per section 2(22)(d) of the IT Act, any distribution by a company to its shareholders, on the reduction of its capital, to the extent of accumulated profits, whether capitalized or not, would be treated as deemed dividend.

Accordingly, the company is liable to deposit the Dividend Distribution Tax ('DDT') (approximately @20%) within 14 days of distribution of such proceeds. Any failure in depositing DDT within 14 days, will lead to levy of interest and penalty.

- Further, it is equally important to evaluate the taxability of such distribution for shareholders. The matter has been settled by the Apex Court's ruling in the case of G. Narasimhan (236 ITR 327), wherein it has been held that the amount distributed by a company on capital reduction has two components: distribution attributable to accumulated profits and distribution attributable to capital. Any distribution over and above the accumulated profits is chargeable to capital gains tax for shareholders.
- Additionally, the provisions of section 50CA of the IT Act may also be triggered. As per section 50CA, where the sales consideration on transfer of shares is less than its Fair Market Value ('FMV'), the FMV is deemed to be the sales consideration. Accordingly, when the payout to the shareholders exceeds accumulated profits and the payout price of the shares is less than the FMV of the shares, provisions of section 50CA may be triggered and such FMV is deemed to be the sales consideration for computing capital gains for the shareholders.
- In a case where no consideration is paid for capital reduction, applicability of section 56(2)(x) of the IT Act on capital reduction is litigative.

4) Conversion of debt into equity

- Any structuring measure such as conversion of debt into equity would have to be taken after taking into consideration the share valuation rules, Transfer Pricing provisions and ECB regulations as the same could have income-tax implications for both, the buyer as well as the seller. Under the IT Act, there are deeming provisions such as section 50C, 50CA, section 56(2)(x) etc. which would come into play. Accordingly, conversion of debt into equity below FMV may result into income-tax implications for the lender or company or both depending upon the exact fact pattern.
- Companies under insolvency resolution process may convert their existing outstanding debt into equity which may necessitate fair valuation of such debt instrument and the difference between its carrying value and the fair value may need to be recognized as gain/loss in profit or loss account. Accordingly, such differential when credited to the P&L account is subject to MAT for the company.

5) Issue / transfer of shares less than FMV

In case shares are received for a consideration lower than the prescribed fair market value, the difference is taxed as income of the recipient of the shares as income from other sources under Section 56(2)(x) of the IT Act. Thus, issue of equity shares at prices lower than their fair market value to lenders/new investors under a resolution plan may result in tax implications for the recipients of shares.

Relief proved	Issues still impounding
- Companies under IBC can carry-forward and set-off brought forward losses - Brought forward losses and unabsorbed depreciation, both, can be adjusted against book profits under MAT - As per a recent Apex Court ruling, IBC overrides IT Act	- Haircut on operational credit and loan may attract liability under normal provisions as well as MAT - Issue or conversion of any securities not in-line with FMV under IT Act may have income-tax impact - Reduction of capital / buy-back / any distribution to shareholders has income-tax hurdles

CONCLUSION

IBC is widely considered as one of the most effective reforms for resolving India's predicament on overwhelming NPAs in the corporate sector. However, pathbreaking ideas and reforms always come with their own set of challenges. As the IBC process gains more momentum, it would be imperative for the Government to recognize and address emerging issues to ensure its continuing effectiveness.

Emerging trends in acquisition of hotels

Investment in the hospitality sector in India has attracted sustained interest from domestic and foreign investors over last few years. Of late, institutional investors have also committed significant capital to this sector and created a large portfolio of hotels, often through acquisitions of operating hotels. Similarly, many of the global hotel management companies now own or have invested in hotels in India.

Acquirers typically rely on both equity and debt funding for such transactions. This article highlights investment options/avenues and associated risks for the hospitality sector investment transactions in India.

FOREIGN EQUITY

While FDI is permissible up to 100% of equity in a hotel-owning company or a limited liability partnership, hotel investments are considered as 'investments in construction development projects' under the FDI policy issued by the Government of India and, as such, are subject to the conditions applicable to all construction development projects. However, hotel projects are entitled to certain relaxations as compared to other construction development projects.

Point to note: Foreign investors would need to bear in mind the pricing guidelines which restrict them from acquiring equity securities in Indian companies at a price lower than the fair value. Additionally, exit by way of transfer of equity securities to a resident would need to be at a value not more than the fair value of such securities. These restrictions also apply to what is known as downstream investments, that is, investments by an Indian entity owned or controlled by non-residents into another Indian entity.

DOMESTIC EQUITY

There are no specific provisions applicable to investments through equity by domestic investors in hotel assets. The provisions of the Companies Act, 2013 ("Companies Act") relating to subscription of purchase of equity securities are however to be complied with.

Point to note: Equity transactions involving acquisition of listed Indian entities may trigger open offer provisions under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 issued by the Securities and Exchange Board of India ("SEBI"). Even if the open offer provisions are not triggered, certain disclosure requirements may apply for acquisitions. Compliance of the aforesaid laws would also have to be ensured in cases of infusion of foreign equity.

DEBT FINANCING

RBI's recent inclusion of hotels under the definition of "infrastructure sector" has provided a significant boost, considering a liberalized approach for financing is applicable to infrastructure sector. This allows the hotel industry to access longer tenure debt and cheaper facilities and also provides lenders with a less stringent approach qua provisioning of the facilities to this sector.

Hotels also have access to foreign debt through external commercial borrowings ("ECB"), under the automatic route, as regulated by the RBI. In certain situations, ECBs along with relevant hedging facilities may allow for access to funds cheaper than rupee debt for borrowers. Corporates are also increasingly analyzing structures around bond issuances as a means of raising debt – rupee bonds, also known as "masala bonds" are becoming popular, given their ability to rest the currency risk with the lender and/or investor, instead of passing this on to the issuer.

Point to note: Financial institutions are undertaking specific scrutiny to better understand and create specific structures for the hotel industry. It usually makes better commercial sense to approach a financial institution that has a clear understanding of the hotel industry, rather than only availing of a simple corporate credit facility.

REAL ESTATE INVESTMENT TRUSTS ("REITS") AND INFRASTRUCTURE INVESTMENT TRUSTS ("INVITS")

To encourage investments in the real estate and infrastructure sectors, SEBI introduced REITs and InvITs as alternate investment structures to be set up as registered trusts under the regulations framed by SEBI.

Point to note: Whilst REITs and InvITs offer an alternate method of accessing the market and pooling together funding from retail investors, there has been no real progress in the actual establishment or listing of REITs and InvITs. SEBI has brought in several amendments in order to address the concerns that have kept developers away from this method. However, issues such as tax treatment, stamp duty and high thresholds for investment in already developed projects are still unresolved.

UNDERSTANDING TYPICAL RISKS IN HOTEL ACQUISITIONS

Although no transaction is exactly like the other, investors should be aware of the following risks that are typical of hotel acquisitions and investment transactions in India:

Leveraged Assets: Given the high costs of acquisition of real estate and ballooning construction costs, hotel properties are often heavily leveraged. More often than not, there are long-standing payment defaults leading to institutional lenders designating their debt as 'non-performing assets'. This, then restricts the promoters from transferring securities or ceding control by way of further investments in the owner.

Land Title: Given the multiplicity of land laws, the historical nature of land holdings, and devolution of small scattered holdings in the name of individuals without adequate paper trails, the acquirer of, or investor in, any business that relies on any real estate asset, should employ adequate time and resources to ascertaining the quality of the title of land.

Third Party Consents: Third party consents from lenders and lessors may be required in case of acquisition of substantial shareholding or control over an owning entity. Additionally, consents from various authorities for hotel operations may need to be examined to verify whether there are any operations may need to be examined to verify whether there are any requirements to obtain consents or intimations to the relevant authorities.

Diligence Issues: As under any other acquisition, the acquirer undertakes diligence of the target. Such diligence may throw up issues for the acquirer to consider while making its decision to purchase or invest. These issues could lead to a reduction in the asking price or obligations on the target and promoters to 'clean house' or mitigate their effects. However, communication of information by persons associated with the company to acquirers and their advisors would need to be seen through the lens of insider trading regulations in India. The scope of due diligence of listed entities is usually more limited than as may be desired by the acquirer.

Competition: Certain large transactions would trigger the combination provisions of the Competition Act, 2002. Any acquisition of control, shares, voting rights or assets and any mergers and amalgamations which cross the specified jurisdictional thresholds are to be reported to the Competition Commission of India (CCI). The jurisdictional thresholds in India adopt the 'size of parties' test and transactions which meet any one of the specified thresholds are to be notified to the CCI as the Competition Act, 2002 adopts a suspensory regime.

CONCLUSION

The last three years have witnessed the hospitality sector seeing consistent growth. To be sure, increase in occupancies, the increase in average room rates and the fact that demand has outpaced supply in many markets in India, has been a welcome relief for the industry. However, the flip side is that India is still not viewed as a very favorable investment destination on account of several risks (mentioned above) - developmental risk being key. In order to promote more greenfield ventures vis-à-vis investments in operational assets, it is important to bring down interest rates and increase debt tenure for the hospitality sector. State governments will also need to work cohesively with industry on the labyrinth of licensing requirements. A single window approval would perhaps benefit the sector to a large extent. Ultimately, industry will necessarily have to work closely with the Government to take India's hospitality sector to its next level of evolution.

Acquisition of Shares – A perspective on tax considerations while determining fair market value

TAXABLE INCOME ON THE ACQUISITION OF SHARES: DEPENDENT ON FAIR MARKET VALUE

Under the provisions of the Income-tax Act, 1961, the sale of shares of an unlisted Indian company above the fair market value of the shares can result in "income" in the hands of the seller and consequently result in income-tax liability. Similarly, if the purchaser of shares of an unlisted Indian company pays a price lower than the fair market value of the shares purchased, the purchaser may become liable to pay income tax.

Recently, several unlisted Indian companies that have received investments and investors in such companies have received notices from the Income-tax department questioning the valuation at which deals have been concluded. The Income-tax department has claimed that analogous to a share sale transaction, subscription to shares of an Indian company will render the premium paid above fair market value, towards subscription to equity shares of the unlisted Indian company, liable to tax at the hands of the Indian company in case of issue of shares above fair market value (under Section 56(2)(viib) of the Income-tax Act, 1961, unless it falls within the prescribed exemptions). Similarly, the discount below fair market value will be liable to tax at the hands of the investor in case of issue of shares below the fair market value (under Section 56(2)(x) of the Income-tax Act, 1961).

EXEMPTIONS FROM SECTION 56 (2) (VIIB) OF THE INCOME-TAX ACT, 1961

The exemptions from Section 56(2)(viib) of the Income-tax Act, 1961 include :

- An Indian unlisted company receiving share application money from non-resident applicants
- A "start-up" company registered with the Department of Industrial Policy and Promotion, that has obtained approval of the Inter-Ministerial Board of Certification, receiving investment in accordance with the stipulations provided in such approval
- The consideration for issue of shares is received by a venture capital undertaking from a venture capital company or a venture capital fund
- The consideration for issue of shares is received by an Indian company from a class or classes of persons that are exempt pursuant to notification by the Central Government

It is important to note that the above should not apply to situations or affect transactions where there is neither any increase nor decrease in the wealth of a shareholder (or of the issuing company), such as on account of issuance of bonus shares, or for a pro-rata rights issue[6].

METHODOLOGY FOR VALUATION OF FAIR MARKET VALUE OF SHARES

Rule 11U read with Rule 11UA of the Income-tax Rules, 1962, provides the methodology to be adopted in order to determine the fair market value of the shares of an unlisted company under the Income-tax Act, 1961.

For an unlisted Indian company, the fair market value is the higher of (i) the fair market value determined under Rule 11UA(2) of the Income-tax Rules, 1962 (i.e. either by the net asset value method, or the discounted cash flow method), and (ii) the fair market value as determined by the assessee, which is substantiated by the assessee to the satisfaction of the Income-tax Assessing Officer.

According to judicial precedent[7], the valuation of shares carried out in compliance of Rule 11UA(2) of the Income-tax Rules, 1962, should not be subjected to scrutiny of the Income-tax Assessing Officer. Consequently, the onus to justify the genuineness of the valuation is on the assessee only if valuation is done other by the methodology prescribed under Rule 11UA(2). Further, since the assessee has the right to determine the methodology adopted to determine the fair market value of the shares, the Assessing Officer cannot reject the method of valuation adopted unless the taxpayer fails to substantiate the valuation with data and evidence[8].

CONCLUSION

The reasoning for bringing about taxation on share premium was mainly to discourage companies from bringing in undisclosed money of the promoters and directors by issuance of shares at a high premium. Though the intent behind this move, no doubt is a good one, it resulted in creating ambiguity and moreover, led to litigation. Through this article we have attempted to highlight that if the assessee has adopted a methodology other than what is prescribed under Rule 11UA(2), there is a risk of scrutiny of such valuation. During such scrutiny, if the assessee is unable to substantiate the valuation to the satisfaction of the Assessing Officer, there may be a risk of tax litigation.

[6] Sudhir Menon HUF v. Assistant Commissioner of Income-tax – 21(2), Bandra, Mumbai ([2014] 45 taxmann.com 176 (Mumbai - Trib.))

[7] Rameshwaram Strong Glass Private Limited v. Income-tax Officer, Ward-2(1), Ajmer (96 taxmann.com 542)

[8] Agro Portfolio Private Limited v. Income-tax Officer, Ward-1(4), New Delhi (ITA No. 2189/Del/2018)

A perspective on Bureau of Indian Standards

Standardization of products and processes is a touchstone today for the globalized world. It indicates the existence of accepted product standards and a claim that the manufactured/produced product and its underlying process adheres to the prescribed standards. International Standards Organization ("ISO"), with a membership of 162 countries, publishes guidelines which form the backbone for standards issued by national standards bodies in their respective domestic jurisdictions.

STANDARDIZATION: THE INDIA PERSPECTIVE

The Bureau of Indian Standards ("BIS"), previously known as the Indian Standards Institute ("ISI"), is India's statutory national standards body, established under the Bureau of Indian Standards Act, 1986. Consequently, the new Bureau of Indian Standards Act, 2016 ("BIS Act") was enacted with the objective of revamping the erstwhile regime of standardization and to bring it at par with global norms (the standards published by BIS are aligned to ISO standards).Its main functions include formulation of standards, product certification, compulsory registration with respect to specified products, certification for foreign manufacturers and hall marking.

Under the framework of the BIS Act, the government is empowered to notify goods or articles which are required to have minimum standards prescribed by the BIS and have an 'ISI' certificate mark. Apart from this, other businesses may also adopt standards published by the BIS voluntarily. Presently, mandatory certification is prescribed in respect of 136 products wherein issues like public interest, public health and safety, security, infrastructure requirements, mass consumption are involved.

BENEFITS OF ISI CERTIFICATION

The BIS certificate is widely accepted as a proof for a product to be safe and qualitative & thus adds to the value, goodwill and acceptability of the product on the global canvass.

- Ensures identification of counterfeit products in the market and is synonymous to trust and safety
- Assumes significance as ISI mark products are a must for government procurements
- Gives an edge to the products in the foreign market and supports procurement of similar licenses/ certifications in other jurisdictions
- In case of products under compulsory list, non-ISI products are banned from selling in the market

TYPES OF CERTIFICATION

Compulsory Registration Scheme (CRS)	Product Certification Scheme (PCS)	Foreign Manufactures Certificate Scheme (FMCS)
- Compulsory registration for manufacture, storage, import, sale or distribution in India for specified products; - Products to be properly tested and registered under BIS to ensure public health and safety; - For products notified by the Ministry of Electronics & Information Technology (Government of India) in relation to Electronics & IT Goods; and - For products notified by the Ministry of New and Renewal Energy- products such as - Solar Photovoltaic, Systems, Devices and Components Goods.	- Applicable on domestic manufacturers and provides third party assurance of the quality, safety, condition and reliability of the product; and - Provides third party guarantee of quality, safety and reliability of products and adds to its value and goodwill.	- Provides certification to foreign manufacturers having a factory location outside India in relation to the products imported into India; and - Applicable for grant of license for all the products except Electronic & IT Goods notified by the Ministry of Electronics & Information Technology.

APPLICATION PROCEDURE

It should be noted that compliance to the BIS standards is mandatory not only for Indian businesses but also for foreign manufacturers supplying underlying products into India. Any contravention in the said context may attract consequences ranging from monetary penalties (minimum INR 1 Lakh which may extend up to 5 times the value of goods involved) to even imprisonment in exceptional cases.

As regards the application for obtaining the certification, it is a long-drawn process entailing submission of numerous documents with great detailing ranging from documents substantiating the kind, nature and quality of raw material to the machinery involved in its manufacturing. Further, the procedure also extends even to the qualification of the personnel involved in overall quality control and management of its production. Experts from the BIS also visit the manufacturing facility to undertake recce of the production process and quality control procedures so adopted. Random checks and surveillance are carried out regularly for ensuring adherence to the standards.

Recent additions to the PCS and FMCS mandatory certification list	Recent additions to the CRS List
- Steel Products like Indented wire for Pre-stressed concrete, Un-coated stress relieved strand for Pre-stressed concrete, - Fusion bonded epoxy coated reinforcing bars, etc. - Chemicals & Fertilizers, viz., Caustic Soda - Kitchen Appliances like, food mixture, centrifugal juicer - Domestic Water Heaters for use with LPG	- Crystalline Silicon Terrestrial Photovoltaic (PV) modules (Si wafer based) - Thin-Film Terrestrial Photovoltaic (PV) Modules (a-Si, CiGs and CdTe) - PV Module (Si wafer and Thin film) - Power converters for use in photovoltaic power system - Utility –Interconnected Photovoltaic inverters - Storage battery

SIGNIFICANT PRACTICAL LEARNING AS REGARDS FMCS

Pre-filing of Application

- **Appointment of Authorized Indian Representative (AIR)**
  - Must be an Indian Resident
  - Agreement with AIR must be signed beforehand
  - Is entrusted with overall responsibility and could therefore be personally liable (imprisonment / financial penalty) for non-compliance of the BIS Act and / or Rules
- **Test Report/ Equipment List**
  - Must be in prescribed format
  - Any advance technological testing / report/ usage of equipment may not suffice if does not strictly meet the prescribed standards

During Physical Visit by the BIS Scientists

- **Preparation before Visit**
  - Separate Lab must be earmarked for carrying out relevant tests
  - Prescribed documentation (including process flow charts and test reports) to be kept ready
  - Basic hygiene of the factory premises to be ensured
- **During the Visit**
  - Feasibility of taking two suitable samples for carrying out prescribed tests before the Officers
  - One sample should be kept in the factory till the grant of License
- **Post the Visit**
  - Suitable sample should be sent to India for carrying out tests at BIS Lab / authorized lab
  - This may delay the overall period of obtaining license, thus requires effective planning

Post Grant of Certification

- **Submission of Indemnity Bond, BIS Agreement and the Performance Bank Guarantee**
  - Certain jurisdictions bar manufacturers from exporting goods directly. This may give rise to exploring the possibility of ensuring joint responsibility obligation of manufacturer and exporter vis-a-vis the BIS, in order to safeguard the financial interest of the manufacturer in wake of any contravention by the exporter
- **Payment of minimum marking fee in advance**
  - Actual marking fee needs to be calculated at the end of financial year basis actual production on which BIS mark is used against which the advance fee would be adjusted
- **Compliance of relevant BIS standards throughout the manufacturing process**

IMPORTANCE OF BIS ADHERENCE FOR BUSINESSES

The significance of standardization is growing by the day – this is vividly evident from factors such as (a) large-scale opportunities present across the globe for products; (b) significance of quality and reliability of products assumes among the consumer in general; and (c) intention of the Government becoming visible from ever-expanding list of products for compulsory certifications.

It is not only to safeguard themselves from imposition of heavy fines and penalties for not meeting the prescribed standards, it is also for the long-term vision and strategy of the businesses and its sustainable market standing that they ought to obtain certification for their products before penetrating into newer markets and uncharted territories. For businesses the challenge therefore today is not so much as to the adherence to the relevant laws as it is to be mindful of what laws are applicable to its products/services in the first place.

With the world witnessing ever increasing non-tariff barriers to trade and with the phenomenal pace with which technology is advancing, need for standardization of products is important today more than ever to maintain competitiveness in an international marketplace. Consequently, the role of national standards bodies has become all the more vital. In view of the intensity of the current regulated business environment, it is of paramount importance for businesses to gain a comprehensive knowledge of relevant Indian regulations mandating compliances including the BIS Certification.

Customs law and enforcement – Focus on related party transactions

While customs duties form a significant component of the government's overall tax receipts, they have demonstrated a decreasing trajectory over last few years, owing primarily to factors such as reduced tariff rates (from India's WTO commitments and in support of manufacturing activities in the country) and increasing coverage of trade volumes under FTAs/RTAs. Faced with the rising complexities in business practices and cross-border arrangements/ transactions between entities of Multi-National Enterprises (MNEs), customs authorities are increasingly focusing on audit and investigations to ensure optimal compliance shore up tax receipts. This note provides an overview of the customs audit and investigation scenario in the country.

REGULATORY AND ENFORCEMENT STRUCTURE

The enforcement powers under the Customs Act are conferred upon the "Officers of Customs" which are the officers as notified by the Central Government. The regulatory and enforcement structure of customs department consists of jurisdictional assessment authorities, directorate of revenue intelligence ('DRI') authorities, and, special valuation branch ('SVB'). Broad functions of each of these authorities is set out below:

- **Jurisdictional assessment authorities:** These authorities monitor the import/export transactions, undertake regular assessment process, issue show cause notices and undertake adjudication proceedings. The primary source of selection of transaction for examination by such authorities is the risk management system (RMS). In case of related party transactions, the jurisdictional authorities would generally refer the matters to the SVB.
- **SVB:** SVB or GATT Valuation Cell has been constituted to examine in detail and determine the issues pertaining to valuation of imports between related persons. In case of related party transactions, there is a presumption in law that the relationship has influenced the price and there is a higher onus on the importer to establish before the SVB authorities, based on relevant details/ documents, that the declared import price should be accepted under the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 ('Valuation Rules'). While the proceedings are pending before the SVB authorities, all the imports made between the concerned related parties would remain provisional. Accordingly, it is important that the SVB proceedings are concluded in a time bound manner. In this regard, in 2016, the Government had issued certain circulars to streamline the proceedings before SVB authorities by removing inherent inefficiencies and removing associated transaction costs.
- **DRI:** DRI is the enforcement authority under the Ministry of Finance and its primary focus is on investigation of cases where there is evasion of customs duties. Related party transactions, especially in relation to under-valuation or payment of royalties, license fees, etc. remain the focus of cases investigated by the DRI. In terms of its charter of functions, there is sharing of intelligence and information between the DRI and other tax authorities (Service tax, Excise and Income-tax authorities) other enforcement / regulatory agencies such as the Enforcement Directorate ('ED').

The Customs authorities have wide powers in the course of investigation in relation to undertaking search and seizure, calling details/documents and summoning persons for giving evidence. It is important for companies to understand its rights and responsibilities in relation to investigation, and, participate carefully in any investigation proceedings.

SELECTION AND SCRUTINY PROCESS

Customs department has moved towards an automated system for screening and clearance of imports as a measure towards trade facilitation and for effective identification of duty risks related to imports. There is Electronic Data Interchange (EDI) system at all major locations for electronically transacting customs' clearance documents. Risk Management System (RMS) is implemented at customs locations where EDI is operational.

With the automated system for scrutiny and higher level of sharing of information between different tax and regulatory authorities, the customs authorities have moved from a micro level assessment of independent bill of entry to a macro level understanding / scrutiny of business practices to examine implications under Customs law.

RELATED PARTY TRANSACTIONS – KEY ISSUES

In relation to cross-border arrangements/transactions, following are generally seen to be the areas which are often scrutinized by the customs authorities:

Whether related persons

In the definition of related person, in addition to certain objective criteria (such as any person who directly/indirectly owns, controls, or holds 5% or more outstanding voting stocks/shares or both), there are certain subjective criteria prescribed in relation to 'direct or indirect control' exercised over the other. In other words, the definition emphasizes on operational control. Accordingly, even independent distributors who have to follow policies of foreign suppliers/manufacturers and have to follow the pricing policy of the foreign supplier, are treated as 'related' by customs authorities. Consequently, the declared import price is rejected by the Customs authorities, and the onus shifts on the importer to establish the basis of import price as per the Valuation Rules.

Free supplies

Often, between related persons there are transactions where the goods are supplied by the foreign affiliate entity on free of cost basis, requiring the related importer to declare import value for payment of customs duties. Such situations would be where the foreign supplier is sending goods/samples for testing purposes, prototypes are supplied for demonstration purposes, or, goods are supplied for being given to customers under warranty. In such cases, value adopted for transfer pricing, cost plus mark-up basis and other such commercial and legally justifiable basis can be adopted for valuation under customs.

Payment of technical know-how fees, royalties and license fees

At times, related parties enter into agreements for payment of royalties, license fees, transfer of technical know-how etc. Rule 10 provides for certain costs and services to be loaded to the transaction value, where they constitute as condition of sale. There are several judicial decisions to determine whether the payments are to be considered as condition of sale. Usually, where without such payment the transaction of import of goods would not have been possible, and, where there is cross fall breach clause in relation to grant of intellectual property rights, and, the supply of goods, the payment would be a condition of sale and would form part of the assessable value of goods imported. In demonstration between the Customs authorities that the cost incurred is not a condition of sale, following factors are relevant to be considered:

- Whether the price of imported goods is deflated
- Whether royalty payment is correlated to manufacturing operations in India and not to imports
- Whether the imports can be made from independent third party
- Whether importer purchases from independent foreign party
- Degree of indigenous procurements

AMP expenses borne by Indian subsidiary/distributor

Rule 10 (1) (d) provides that 'the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues, directly or indirectly, to the seller' shall be included in the assessable value. Accordingly, the customs authorities include in the transaction value, the advertising, marketing and promotion (AMP) expenses incurred by the subsidiary / distributor to the extent it can be said that such expenses have accrued benefit to foreign supplier.

This issue has been closely examined by the transfer pricing authorities as also the Customs authorities. The Delhi Tribunal, in **Reebok India Company** has held that advertising expenses are includible in the assessable value of imported goods as the AMP expenses were towards promotion of Reebok brand as a whole and not only in respect of imported goods. The Mumbai Tribunal, in the case of **Samsonite South Asia Pvt. Ltd** has held that advertising expenses incurred by the importer towards cost sharing of advertising expenses incurred at the group level are not to be included in the import price as there was no nexus between expenses incurred and imports made.

CONCLUSION

Related party transactions have a presumption of ill-intent and tax evasion, stemming from legacy and practical business realities. In such instances, it is vital to be aware of the potential areas that can expose a company to scrutiny from customs authorities, and to plan ahead in terms of proper documentation, approvals and responses. This helps in speedy, time-bound resolution of investigations and ensures business continuity.

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