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Key Considerations

Joint Ventures In India

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Contents

Key Considerations - Joint Ventures In India

A joint venture does not have technical legal meaning and denotes any arrangement where two or more parties co-operate in order to run a business or achieve a commercial objective. We discuss here some of the most important issues that parties need to keep in mind while contemplating and negotiating a joint venture in India.

I. Types of Joint Ventures

Joint ventures by their very nature provide a lot of flexibility to the parties in terms of structuring.

Joint ventures can broadly be classified into two broad categories:

i. Incorporated joint ventures and

ii. Unincorporated joint ventures.

Incorporated joint ventures may be formed via two means. The joint venture parties may either incorporate a new corporate entity into which they may invest, or develop an existing corporate entity as the joint venture entity by investing into such entity. The corporate entity in such types of joint ventures functions as the special purpose vehicle to carry out the business objectives of the joint venture.

Unincorporated joint ventures are essentially business relationships between parties which are usually based on contracts executed between such parties. What qualifies such business relationships as an unincorporated joint venture is when such business relationship between two or more parties is in furtherance of a common purpose or action for a profitable venture, proceeds of which are to be shared in an agreed ratio. Such types of agreements are ideal where the parties do not intend to be bound by the formality and permanence of a corporate vehicle. Examples of such types of joint ventures are technology transfer agreements, joint co-operation and collaboration agreements. Unincorporated joint ventures may have significant tax issues if not structured properly as the Indian tax authorities may qualify such contractual arrangements as an "association of persons", a term not defined under the Income-tax Act 1961, and only interpreted in case laws. If a contractual arrangement qualifies as an “association of persons”, then the Indian tax authorities could tax such association of persons at the maximum marginal rate, which could be as high as 40% if any member of such “association of persons” is a non-resident.

There is no fixed rule as to which form of joint venture is best suited for the parties. This would essentially depend upon various factors such as (i) the business plans of the parties (ii) the amount of control and supervision a party wishes to retain, and (iii) regulatory considerations as foreign investments in a few sectors is still restricted and subject to certain conditionalities.

Some of the issues that we discuss in this paper are specifically relevant for incorporated joint ventures such as employment issues, most of the points that we discuss are universally applicable for both types of the joint ventures either directly or indirectly.

II. Corporate Governance

As corruption emerges as one of the significant threats to India’s democratic framework, it is a growing concern for corporations since it not only directly affects their ability to grow and compete but also creates issues for foreign partners. It has been seen if parties to a transaction do not weigh ethical standards in a stringent manner and if there is lack of good internal control systems, such issues may have ramifications (particularly for non-resident investors) in light of the Foreign Corrupt Practices Act, 1977, the UK Bribery Act, 2010 or in many cases, simply because of the internal polices of the non-resident investors. Given the significant tangible and intangible consequences of corruption, it becomes vital for corporations to tackle this phenomenon.

Grave consequences are faced due to corrupt or unethical practices coming into light, which are not only in the form of losing reputation, public and consumer faith but also in the form of heavy civil, criminal and penal sanctions which could even wipe out a business entirely, as seen in majority of cases. Indian corporations are beginning to take issues of corporate governance seriously. We have seen that foreign joint venture parties normally insist on stringent anti-corruption provisions in the documentation to be executed between the parties. FCPA diligences are becoming increasingly common and so are Indian service providers with specialism to conduct such diligence exercises. Here, sometimes Indian entities who may not be as sophisticated may not always understand the gravity or implications of such provisions. It is therefore important at a practical level to ensure that there is adequate training and exposure given to the relevant members of the joint venture in such anti corruption issues and best practices.

From a good governance perspective, we have seen parties adopt a variety of checks and balances such as incorporation of specialized committees (consisting of representatives of the joint venture partners and even independent advisors) to look into particular aspects of the business of the joint venture.

III. Funding for the Joint Venture

It is important that the joint venture parties discuss the financial requirements of the joint venture and how such requirements will be addressed. Indian banks are only allowed to have limited exposure to capital markets, and to that extent they bank funding for purchase of shares may not always be forthcoming.

From a foreign investor perspective, the JV could be funded in one of the following ways, either by way of equity or debt. If funded by way of equity, or instruments compulsorily convertible into common equity, such investment would qualify as Foreign Direct Investment, or "**FDI**". FDI in India is subject to sectoral caps and conditionalities, and also subject to pricing norms inasmuch as no non-resident can subscribe to or purchase Indian securities below the DCF[1] valuation and no non-resident can sell Indian securities above the DCF price. Further, any purchase or subscription to by a non-resident of Indian securities that are not in the nature of equity, or instruments compulsorily convertible into common equity, shall qualify as external commercial borrowings or "**ECB**", which are subject to stringent thresholds as set out below. Importantly, non-residents have recently been allowed to subscribe to shares of the Indian company against royalty or fees for technical services due to them, subject to compliance with the aforesaid pricing norms.

Foreign debt, or ECB, in India is subject to stringent conditions. For instance, ECB can only be received by an Indian company which is inter-alia engaged in manufacturing sector, or in hotels, hospitals, or software services. The maximum interest that can be paid on ECB is LIBOR + 500 basis points for a 5 year loan, and ECB can only be used for limited purposes such as capital expansion, and cannot be used for working capital, real estate or discharge of rupee loans.

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1. Discounted Free Cash Flow Method.

Most incorporated joint ventures will normally involve the granting of shares in the joint venture entity in consideration of the infusion of capital by the joint venture parties. Such infusion of capital may be take various forms such as:

- Milestone based infusion of capital where the parties clearly define concrete milestones which need to be achieved by the joint venture upon which specific funding would be provided. For instance there may be instances where a foreign joint venture partner would infuse a specific amount of capital upon the joint venture entity obtaining specific regulatory approvals.

- Shares may also be issued to a joint venture partner in consideration of lump sum technical know-how fee or royalty subject to sectoral guidelines and pricing regulations.

For unincorporated joint ventures, it is important that the documentation set out the payment milestones, payment processes and trigger events for breach.

Illustration

Party A and Party B enter into a collaboration to manufacture and market certain products and share the revenue accrued on 50 – 50 basis. Party A is responsible for sales and collection and will remit Party B's share of the revenues to Party B after collection. The agreement should clearly state (i) whether the revenue share is to be done on a monthly/ quarterly/annual basis (ii) whether Party A has to provide any reporting to Party B with respect to collections (iii) whether Party A has audit rights on the books and accounts of Party B.

This is relevant not just for unincorporated joint ventures but also for incorporated joint ventures which involve agreements between the parties for the provision of various services and products.

IV. Competition Law Implications

Section 6 of the Competition Act, 2002 makes void any combination **which causes or is likely to cause an appreciable adverse effect on competition within India** and requires every acquirer to notify the Competition Commission of India ("**CCI**") of a combination and seek its approval prior to effectuating the same unless such combination has been specifically exempted (see ***Annexure A***).

The Competition Act requires that any acquisition of control, shares or voting rights or assets of an enterprise by a person that crosses the financial thresholds (see ***Annexure B***) prescribed under the said Act needs to be notified to the CCI. In the event of an existing company being converted into a joint venture either through acquisition of shares or through subscription of fresh shares a filing will need to be made with the CCI in the event that the prescribed thresholds are breached. However where a new joint venture entity is being set up, it would need to be seen whether such a new entity would be considered to be an 'enterprise' within the meaning of this provision.

Applicability of the De - Minimis Exemption

The Government of India has notified certain thresholds (Assets of 250 crores and Turnover of 750 crores), whereby all transactions which do not meet such thresholds need not be notified to the CCI. Therefore, if the joint venture partners were to setup a fresh joint venture , which has nil or negligible assets and no value attributable to its turnover at the time that the partners to the joint venture subscribe to the shares of such JV Co, it may be argued that such acquisition may not need to be notified.

V. Role of Regulators

Regulatory considerations play a very important role in any sort of joint venture, and regulatory due diligence is becoming increasingly common in cross border transactions.

Institutional bodies regulating capital flows include the Reserve Bank of India ("**RBI**"), the Securities

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2. enterprise" means a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or

   the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one

   or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

   Explanation.—For the purposes of this clause,—

   (a) "activity" includes profession or occupation;

   (b) "article" includes a new article and "service" includes a new service;

   (c) "unit" or "division", in relation to an enterprise, includes—

   i. a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods;

   ii. any branch or office established for the provision of any service;

and Exchange Board of India ("**SEBI**"), the Forward Markets Commission ("**FMC**"), the Insurance Regulatory and Development Authority ("**IRDA**"), and the Pension Fund Regulatory and Development Authority ("**PFRDA**"). Within the Government of India, the Ministry of Finance houses the Department of Revenue, the Department of Economic Affairs ("**DEA**") and the Department of Financial Services. The Department of Revenue hosts the Central Board of Direct Taxes ("**CBDT**"). DEA hosts the Capital Markets Division while the Department of Financial Services deals with banks, insurance and pension funds and their respective regulators. The Finance Minister heads the Foreign Investment Promotion Board ("**FIPB**") which approves foreign direct investment, on a case by case basis, into the country. The Ministry of Commerce and Ministry of Finance hosts the Department of Industrial Policy and Promotion ("**DIPP**") which is responsible for promulgating policy on foreign direct investment into the country. DIPP notifies the FDI Policy, which sets out all laws and regulations relevant to foreign direct investment in India.

The RBI is given primary authority to regulate capital flows through the Foreign Exchange Management Act ("**FEMA**"), 1999. Notably, Section 6 of FEMA authorizes the RBI to manage foreign exchange transactions and capital flows in consultation with the Ministry of Finance. The Banking Regulation Act, 1949, and the RBI Act, 1934 also provide the RBI with supporting authority to regulate capital flows. The RBI articulates policy with regard to capital account transactions through regulations, which must be placed before Parliament, notifications, which require publication in the official gazette, circulars and clarifications. The RBI also periodically publishes master circulars, compendiums of all communication by the RBI, on a variety of subjects related to capital flows such as foreign investment, ECB policy and trade credits.

Apart from financial regulators, sector specific regulators also pay an important role particularly in which in sectors which are regulated (both from a foreign investment perspective and from an industry regulation perspective). Examples of such regulated sectors are media and telecommunications. Sometimes joint ventures are mandated because of regulatory restrictions in foreign companies conducting business in India. For example, licenses for providing telecom services in India may only be obtained by Indian companies and foreign investment is such companies is restricted to 74% (with prior approval of the FIPB). It is often seen that the actual closing of a joint venture transaction (i.e. the point when investments actually take place) are made conditional on the successful procurement of various such key regulatory approvals.

Unfortunately, there is no informal consultation process that obligates the RBI, FIPB and the DIPP to give regulatory views on ambiguities in the law. Lack of ability to interact with the regulators happens to be one of the largest concerns for the foreign investors and it is crucial to seek legal advice on interpretation of the regulatory policies. Regulators are discretionary bodies and there is currently no appeal against the rejection of the RBI or the FIPB on matters of regulatory discretion. Delays in the consummation of the transaction on account of regulatory approval or failure of the joint venture entity to fulfill the conditions precedent can make the entire venture costlier than originally anticipated.

VI. Structuring and Tax Issues

Taxation of income in India is governed by the provisions of the Indian Income Tax Act, 1961 ("**ITA**"). Section 4 of the ITA referred to as the 'charging section' stipulates the basis of charge of income tax and lays down that 'total income' of any person is subject to income tax. Residents are taxable in India on their worldwide income, whereas non-residents are taxed only on Indian source income, i.e. income that is received or is deemed to be received or income that accrues or arises or is deemed to accrue or arise in India. The ITA contains provisions which discuss when income is deemed to have been received, accrued or arisen in India.

Foreign investors may invest in India via an intermediate jurisdiction to mitigate tax leakage. Of the various double taxation avoidance agreements ("**DTAAs**") which India has entered into across the globe, some contain beneficial provisions with regard to capital gains tax and tax withholding on interest payments. Favourable legal and regulatory environment, coupled with a lower domestic tax regime in few of these jurisdictions, including Mauritius, Cyprus, Singapore and Netherlands, have made them, over the years, a popular choice for an intermediate jurisdiction for investment into India, we have explored the key considerations while choosing an intermediate jurisdiction in ***Annexure C.*** Since taxation on business income in most jurisdictions is higher, and repatriation of dividends from India is not tax effective,[3] returns to foreign investors from India are generally structured as capital gains or interest income, which can reduce the effective tax liability of foreign investor to 0% or 10% respectively, with the use of appropriate intermediate jurisdiction. Under the ITA, tax treaties override the provisions of ITA; however the taxpayer has the option to choose the application of the ITA if more favourable.

3. There is a dividend distribution tax ("**DDT**") of 15% (exclusive of surcharge and cess) payable by the Indian company on the dividend distributed to its shareholders; further, since DDT is a corporate level tax and not a tax in the hands of the shareholder, credit for DDT is usually not available.

In the context of a joint venture with foreign enterprises, if the Indian joint venture and the foreign shareholders qualify as "associated enterprises" (due to shareholding or dependence on the other or otherwise), then any transactions between them would be required to be conducted on an arm's length basis under the Indian transfer pricing regulations. The Indian domestic transfer pricing regime is relatively fairly relaxed. Further, certain typical Indian tax considerations would also be relevant such as where the shares of an Indian company are issues above the fair market value to an Indian resident, them the difference between the issue price and the fair market value would be considered as other income for the Indian company and would be taxable at the rate of 30% in the hands of the issuing company.

VII. Employees

The socialist economic pattern adopted in India has generally resulted in the formulation of a host of labour laws that are intended to protect the interests of employees (mainly the blue-collar workers). As a result, while interpreting and applying the various labour laws, the Indian courts tend to be liberal and in favour of employees. The applicability of some of the laws will depend on factors such as type of industry, number of employees in the organization, role / designation of the employees etc.

There are no specific laws governing the process of hiring of employees and there is no mandatory requirement to have a written employment contract. However, it is usually advisable to have a detailed employment contract, especially for employees working in the IT or knowledge industry sector and for those likely to generate any form of intellectual property. This type of contract can include provisions on duties and responsibilities, non-disclosure of confidential information, assignment of intellectual property, non-compete, non-solicitation and termination. It is also important to bear in mind that unlike many other jurisdictions in the world, Indian law does not permit an 'at-will' employment relationship. In cases where employees are to be transferred to the joint venture company, the manner of transfer - whether it be structured as resignation and rehire or transfer of the undertaking - becomes important, each having its own set of complications.

VIII. Non-Compete and Non-Solicit

In view of the rights guaranteed to Indian citizens under its Constitution, Indian contract law prohibits non-compete agreements wherein an individual is restrained from freely practicing any trade or profession. However, there are certain exceptions to such a restriction, especially in cases where there is a sale of goodwill, which may typically happens in an acquisition but is uncommon in a joint venture. Unlike non-compete clauses, the non-solicit clauses should however be generally enforceable as breach of such clauses is regarded as business interference; although in view of the high evidence requirements, there have not been any significant precedents. Practically, however, it may be difficult to prove that the employee was solicited or joined of his own volition; however, in most clauses the provision is worded in such a way that if any employee of the joint venture company joins either party, then such party employing him will be in default.

These provisions, particularly the non-compete clauses can sometimes be critical. For instance a lot of businesses in India are family run and there can be multiple entities carrying on similar business in the same group. Therefore, the non-resident joint venture partner may insist that the non-compete provisions should be extended to the affiliates of the Indian joint venture partner as well. There are no statutory non-compete provision in India that restrict non-residents from setting up competing ventures.

IX. Intellectual Property

Intellectual property is one of the primary considerations of a joint venture. This is because of a variety of reasons:

- when two parties get together to form a joint venture is the brand name to be formed and the ownership of the same;

- once a joint venture company is formed, the ownership and protection of intellectual property that the joint venture company creates is usually of prime significance;

- The contribution by a joint venture partners may also in the form of some sort of intellectual property to the joint venture company. For instance an invention or a patent for the invention or a design (in the case of a manufacturing JV), or a trademark or trade name or a business format / know-how / trade secret (e.g. Starbucks – Tata JV Coffee chain) or copyright (in the case of film production JVs).

As a result of the above, intellectual property based license / assignment agreements form the back bone for most joint ventures. We discuss below some of the main issues that arise in such cases.

i. Transfer of Intellectual Property

While transferring (licensing or assigning) an intellectual property right, issues may arise if the parties do not follow the necessary provisions of the law. For example, in the assignment of any copyright must confirm to certain parameters namely, it must be in writing, signed by both the parties, specifying the rights licensed, the royalty payable if any, the term of the licence and the territory for the rights.[4] Similarly, while transmitting trademarks, the licensor must ensure that the transmission does not create exclusive rights to use the mark in more than one person, with respect to using the trademark for the same types of goods and services or similar description of goods or services and such similarity should not be likely to create any confusion or deception.[5]

ii. Post-Term Use of Trademarks

Disputes involving post-term use of the licensor's mark by the joint venture are potential litigious issues once the licensor has exited the joint venture and the term of the license has expired. Often once the licensor has exited; it may be possible that the joint venture entity continue to use the trademark for reference purposes or as part of a corporate name. Careful drafting of the joint venture agreement and the trademark license agreement could minimize the risks arising from such litigation.

A signatory to the international conventions on intellectual property rights, India offers adequate protection to trademarks or brand names as well as copyright and designs of foreign collaborators. Enforcement mechanisms are becoming more reliable, which has previously been a bone of contention for foreign corporations.

X. Documentation

A joint venture because of its customized and flexible nature involves customized documentation. We discuss some of the important aspects of documentation in a joint venture.

4. Section 30 and 30A, Copyright Act, 1957.

5. Section 40, Trademarks Act, 1999.

i. Term Sheet or Memorandum of Understanding

In a joint venture scenario, it is quite common that while parties are still assessing each other's competencies or where the terms of the transaction may not be finalized immediately a brief description and broad outline of the terms (typically commercial arrangement) on which the joint venture is proposed to be undertaken are finalised prior to undertaking the transaction. This document is commonly known as a "term sheet" or a "memorandum of understanding". If the transaction necessitates a diligence, then entering into the joint venture can be subject to the favourable outcome of such diligence. More often than not Indian parties tend to treat a term sheet as sacrosanct and deviating from the terms once agreed becomes difficult. Appropriate legal advice ought to be taken prior to entering in a term sheet to ensure more fruitful discussions on legal documentation. It is also important to classify whether the term sheet is binding or non-binding.

Importantly, from a Competition Law perspective, the timing of entering into a binding exclusive term sheet / memorandum of understand is critical to determine the deadlines for making filings with the Competition Commission of India.

ii. Joint Venture Agreement

The Joint Venture Agreement ("**JVA**") governs the inter-se rights amongst the shareholders and lays down their rights and future obligations in terms of management, funding, branding etc. of the JV Co. The JVA can be structured either as a Share Subscription cum Shareholders Agreement or a Share Purchase cum Shareholders Agreement.

While operating a JV involves various intricacies including rights in Shareholders' meetings and Board appointment and voting rights, there are many other important considerations that must be taken into account. Many situations may arise in the course of business that may require changes in the shareholding patterns. Shareholders' rights including affirmative voting rights, deadlock resolution mechanism etc. into play, when the JV partners cannot decide on a particular course of action. Furthermore, various other exit options too may be considered. We discuss some important provisions which are typical in JVAs below.

1. Reserved Matters

Depending upon the shareholding of the parties, the list of reserved matters is one of the most highly debated clauses in a JVA. For a minority partner or a foreign joint venture partner these clauses are of particular importance since this clause ensures that the joint venture company cannot take any decision regarding certain specified issues without their approval. Any matter that is outside the scope of the normal day to day working of the company may be included in this list of reserved matters. Common reserved matters include (without limitation):

(a). The appointment and/or removal of senior management or the statutory auditors of the company;

(b). Changes in capital structure, mergers and acquisitions, creation of subsidiaries; and

(c). Large capital expenses, acquisitions of outside entities, entering into indebtedness.

2. Deadlock Resolution

Confronting and resolving a dead lock is one of the main concerns in a joint venture. A deadlock is usually faced where there are two parties having equal control of the joint venture company or equal rights to decide on a particular issue, are in dispute and neither party is willing to surrender control to the other. While there is no definite way of completely avoiding conflicts and deadlocks, one way of possibly minimizing a deadlock situation is to ensure a full documentation of the joint venture exercise, setting out detailed division of responsibilities for establishment, development and operation of the JV Co. This, accompanied with a detailed business plan where the commercial parameters are clearly set out, will definitely help in reducing the amount of conflict. In the event that the shareholders declare a situation of deadlock, it is imperative that the JV partners lay down the specific deadlock resolution mechanism since a situation of deadlock is typically a matter that is not a breach of any law or of a contract and thus is cannot be submitted to arbitration. We have observed the following ways in which deadlock are typically resolved:

a. Buy – Sell

In such cases, one party offers to buy the shares of the other party for certain consideration. The other party must either sell his shares or give a counter offer to buy the shares of the purchasing party at the same price. There are various variations to the above process, the most popular variations are those whereby instead of one party offering a price to the other party, both parties decide to make an offer to the other at any time only at a price equal to or higher than a price determined as per Fair Market Value ("**FMV**") or can decide to allow the price of sale to be determined as per the 'Russian Roulette' mechanism etc.

b. Put – Call

In the context of a JV Co, a put option is usually negotiated where there is a partner holding majority stake. A put option enables the right-holder to sell their shares to another party such that the other party must compulsorily purchase the shares offered. It is generally exercised as a downside exit or reduction in shareholding. A call option in JV documentation is usually negotiated by a party which has more than just a financial interest in the JV Co. A call option enables the right-holder to call upon another shareholder to compulsorily sell their shares to the right-holder. Often majority stake holders or promoters prefer to retain a call option so that in a downside, they can retain control of the JV Co by buying out other JV partners.

c. Independent Third Party Industry Expert

Parties typically decide on a list of certain technical matters which they shall refer to an independent third party industry expert in the event that the parties themselves cannot agree to a certain course of action. The decision of this third party industry expert shall be binding on all the parties.

d. Deadlock Resolution Committee

Deadlock Resolution Committee consists of representatives of all the shareholders along with certain industry experts who discuss and deliberate over deadlock issues, following which they decide by voting on the course of action to be adopted by the JV Co, which thereafter becomes binding on the JV Co.

iii. Ancillary Documents

Specifically in joint ventures, the chunk of the documentation in JVs may be in the related documents such as license / technology / services / management agreement(s) which determines the manner and form in which each party contributes towards the JV Co. Thus it is important that each of these documents work cohesively with each other. It is also important to set out the treatment of all these documents at the time of exit along with the ownership of rights created by virtue of these agreements.

XI. Dispute Resolution

Differences of opinion on the dispute resolution clause are normally not fatal for the deal. We have seen that arbitration is the preferred method of dispute resolution. However, we have seen instances in the past where Indian parties insist on conducting the arbitration in India in accordance with the Indian Arbitration Act, 1996 and the non-resident parties demand arbitration in a neutral jurisdiction with rules of any premier arbitral institution as the law of arbitration. While Indian parties are clearly motivated by the cost benefits, non-resident parties are skeptical about the fairness and efficacy of Indian proceedings.

Also, choice of the neutral jurisdiction is also debated. Here a few things need to be kept in mind. According to recent judgement of the Indian Supreme Court if the parties opt for international arbitration with venue and seat outside of India, then Indian courts will be barred from getting involved in such arbitration proceedings, which was hitherto the largest concern of the foreign investors as involvement of Indian courts in arbitration process could substantially the litigation process by many years, our analysis of the aforesaid judgment is attached as ***Annexure D.*** However, as a consequence of the judgment, if the parties have opted for international arbitration, approaching Indian courts for interim reliefs may not be permissible, which could be a sore point sometime as it may be necessary to approach the local Indian courts for urgent interim reliefs.

XII. Exit

While discussing the incorporation and initiation of a joint venture it is equally important to discuss what happens if the joint venture fails or if one partner wishes to exit. There are various ways in which a joint venture may terminate.

i. Natural expiry in cases where the joint venture was established for a specific purpose;

ii. Mutual consent;

iii. IPO;

iv. Deadlock;

v. Breach;

vi. Transfer of shares by one partner to the other partner or to a third party.

It is important that the parties contemplate various exit/ termination scenarios upfront and include detailed provisions with respect to the consequences of exit/ termination in the joint venture documentation. Some of the typical issues which arise when a party exits the joint venture or when the joint venture terminates are:

i. In case of breach, should the non-defaulting partner buy out the defaulting partner;

ii. In case a partner wishes to sell her shares to a third party, what are the rights of the remaining partner;

iii. Should the corporate entity forming the joint venture be wound up;

iv. What happens to the intellectual property brought in by a the exiting partner – should the joint venture be given rights to continue using it.

Annexure A

Type of Combination	For parties in India	For parties world-wide (including in India)	For the Group in India	For the Group world-wide including in India)
Acquisition, Mergers and Amalgamations	**Assets**- INR 15 billion (approx. USD 333 million*); or **Turnover**- INR 45 billion (approx. USD 1 billion*);	**Assets**- USD 750 million; or **Turnover**- USD 2.25 billion; including in India at least **Assets**- INR 7.5 billion (USD approx. 167 million*); or Turnover- INR 22.5 billion (approx. USD 500 million*);	**Assets**- INR 60 billion (approx. USD 1.3 billion*); or **Turnover**- INR 180 billion (approx. USD 4 billion*);	**Assets-** USD 3 billion; or **Turnover**- USD 9 billion; including in India at least **Assets**- INR 7.5 billion (approx. USD 167 million*); or **Turnover**- INR 22.5 billion (approx. USD 500 million*);

** For reference USD 1 = INR 45*

Annexure B

The list of transactions that are exempt are as listed below:

- An acquisition of shares or voting rights, solely as an investment or in the ordinary course of business in so far as the total shares or voting rights held by the acquirer directly or indirectly, does not entitle the acquirer to hold twenty five per cent (25%) or more of the total shares or voting rights of the company, not leading to acquisition of control of the enterprise whose shares or voting rights are being acquired.

- An acquisition of shares or voting rights, where the acquirer, prior to acquisition, has fifty percent (50%) or more shares or voting rights in the enterprise whose shares or voting rights are being acquired, except in the cases where the transaction results in transfer from joint control to sole control.

- An acquisition of assets, not directly related to the business activity of the party acquiring the asset or made solely as an investment or in the ordinary course of business, not leading to control of the enterprise whose assets are being acquired (other than an acquisition of assets which represents a substantial business operation).

- An acquisition of stock –in-trade, raw materials, stores and spares in the ordinary course of business.

- An acquisition of control or shares or voting rights or assets by one person or enterprise of another person or enterprise within the same group.

- A merger or amalgamation involving a holding company and its subsidiary wholly owned by enterprises belonging to the same group and/or mergers or amalgamations involving subsidiaries wholly owned by enterprises belonging to the same group.

- An acquisition of current assets in the ordinary course of business.

- A combination taking place entirely outside India with insignificant local nexus and effect on markets in India.

Annexure C

Income Stream	Tax Treatment		
	Mauritius	Singapore	Cyprus
Sale of shares	Income from the sale of shares of an Indian Company by a Mauritius Company is only taxable in Mauritius. Mauritius levies no capital gains tax. Hence, there will be no tax incidence.	Income from the sale of shares of an Indian Company by a Singapore Company is only taxable in Singapore. There is no capital gains implication in Singapore if the income is characterized as capital gains. To avail the capital gains exemption, the entity claiming the tax benefit must have incurred an annual expenditure of 200,000 Singapore dollars in Singapore, on operations, in the immediately preceding 24 months prior to the date the gains arise (LOB). However, Singapore tax authorities may construe capital gains to be in the nature of business income unless (a) the Singapore Company holds 20 % of the ordinary shares in the Indian Co. and (b) the shares are held for a continuous period of 24 months.	As per the India-Cyprus tax treaty, income from the sale of shares of an Indian Company by a Cyprus entity is only taxable in Cyprus. Thus, Cyprus tax residents are exempt from capital gains tax in India. There is no capital gains tax in Cyprus. Hence, no tax incidence.

Income Stream	Tax Treatment		
	Mauritius	Singapore	Cyprus
Buyback	Tax shall be payable by the Indian company at the rate of 20% on the total consideration it pays to buy back the shares minus the amount at which the shares were issued by the Indian company..	Tax shall be payable by the Indian company at the rate of 20% on the total consideration it pays to buy back the shares minus the amount at which the shares were issued by the Indian company.	Tax shall be payable by the Indian company at the rate of 20% on the total consideration it pays to buy back the shares minus the amount at which the shares were issued by the Indian company.
Dividend	Dividend Distribution Tax shall be payable by the Indian Company prior to distribution of profits at the rate of 15%*. Dividend Income received by the Mauritius Company shall be taxable as business income in Mauritius at the rate of 15%. However, the Mauritius Company should be eligible to avail deemed foreign tax credit of 80% or underlying tax credits, which will reduce the effective tax incidence to 0%-3%.	Any dividend distributed by a company in India is subject to dividend distribution tax @15%. The dividend received by the Singapore Company should be exempt from tax in Singapore.	Any dividend distributed by a Company in India is subject to dividend distribution tax @15%. The dividend received by the Cyprus Company should be exempt from tax.
Interest	Interest income would be subject to 40% withholding tax for Indian rupee borrowing (including CCDs).	Subject to a 15% withholding tax in India. Further, interest income should be characterized as business	Interest income earned by a Cyprus company from an Indian company shall be taxable in Cyprus, though

Income Stream	Tax Treatment		
	Mauritius	Singapore	Cyprus
	In case of ECB, the withholding rate is 5%.	income in Singapore and be subject to tax @17%. However, due to tax credit available in Singapore, the effective tax rate in Singapore is likely to be 2%. In case of ECB, withholding rate will be 5% in India. LOB provision may not be complied with to avail treaty benefits for interest income.	a withholding tax of 10 % is payable in India. Further, as the local tax rate on such income in Cyprus is 10% and Cyprus gives tax credit for the taxes paid in India, no tax is payable in Cyprus. Hence, interest income attracts a net tax incidence of 10%. In case of ECB, the withholding rate will be 5% in India.

Herein below are some of the key pros and cons of each intermediate jurisdiction mentioned above:

I. Mauritius

Advantages	Disadvantages
• Minimal business income tax in Mauritius • No tax implication for the sale of shares of the Indian Company by the Mauritius entity. • No exchange control or thin capitalization requirements and therefore provides flexibility with funding to the Mauritius entity. • nvestments from Mauritius into India are protected under the India- Mauritius Bilateral Investment Treaty. • More corporate operational flexibility than Singapore for any potential restructuring exercise • Most preferred for investment into India.	• In case of debt investments, interest income received by the Mauritius entity from the Indian Company would be subject to a high tax incidence. • India-Mauritius tax treaty may be re-negotiated to introduce a LoB provision.

II. Singapore

Advantages	Disadvantages
• Singapore does not have thin capitalization rules and hence there is flexibility with respect to funding. • No tax implication for the sale of shares of an Indian Company by a Singapore Company or the buyback of the Singapore entity's share by the Indian Company. • Singapore entity may have the option to get listed on the Singapore Exchange (SGX) which is a vibrant market for Indian real estate assets. • LOB clause should provide adequate protection against the GAAR to transactions involving Singapore as it will aid and provide a strong base to prove that a particular arrangement is not an impermissible avoidance arrangement by satisfying the indicative parameters laid down by the Finance Ministry early this year while accepting some of the recommendations of the Shome Committee	• Less corporate restructuring flexibility as against Mauritius and Cyprus in terms of buy back, cross border mergers etc. • Issues surrounding characterization of capital gains as business income continue to exist – Whether Rule 220 can be applied to CCDs? • The Singapore entity is required to incur an annual operating expense of 200,000 Singapore Dollars for at least 2 years preceding the date when the gains arise in order to avail the treaty benefits. • Investments from Singapore into India may not be adequately protected as there is no Bilateral Investment Treaty between India and Singapore. However, the India Singapore Comprehensive Co-operation Agreement inter-alia provides protection against expropriation of investments.

III. Cyprus

Advantages	Disadvantages
• There is no exchange control restriction or thin capitalization rules under the local laws of Cyprus and thus there exists flexibility with respect to funding. • The interest income received by the Cyprus entity from an Indian entity is subject to lesser	• Cyprus not seen as favorably as Singapore by the revenue authorities and may be subject to scrutiny. • In the past we have seen the Cyprus tax authorities deeming income at arms length rate and thereby taxing such deemed income

Advantages	Disadvantages
tax incidence as compared to Mauritius or Singapore. • Investment from Cyprus into India are protected under the India-Cyprus Bilateral Investment Treaty. • Benefits of European Union ("**EU**") Directives available particularly when investors are from EU	at 10% even when no interest was accrued / paid to the Cyprus entity.

Annexure D

Bhatia International and Venture Global Overruled, But Pro-Spectively![6]

The Constitutional Bench of the Supreme Court ("**Court**") on September 6, 2012 in its decision in *Bharat Aluminum Co. ("**Appellant**") v Kaiser Aluminum Technical Service,* Inc.*("**Respondent**"),* after laudable consideration of jurisprudence laid down by various Indian & foreign judgments and writings of renowned international commercial arbitration authors, ruled that findings by the Court in its judgment in *Bhatia International v Bulk Trading S.A & Anr*[7] ("**Bhatia International**") and *Venture Global Engineering v Satyam Computer Services Ltd and Anr*[8] ("**Venture Global**") were incorrect. It concluded that Part I of the Arbitration and Conciliation Act, 19963[9] ("**Act**") had no application to arbitrations which were seated outside India, irrespective of the fact whether parties chose to apply the Act or not. Hence getting Indian law in line, with the well settled principle recognized internationally that "the seat of arbitration is intended to be its center of gravity". But this welcome overruling by the Court of its previous decisions will provide no relief to the parties who have executed their arbitration agreements prior to the current judgment as the Court, right at the end of its judgment, directed that the overruling was merely prospective and the laws laid down therein apply only to arbitration agreements made after September 6, 2012.

I. Brief Facts

The appeal filed by *Bharat Aluminum Co.* before the Division Bench was placed for hearing before a three Judge Bench as one of the judges in the Division Bench found that judgment in *Bhatia International* and *Venture Global* was unsound and the other judge disagreed with that observation. Subsequently it was directed to be placed before the Constitution Bench on January 10, 2012 along with other similar matters.

6. Nishith Desai Associates - Dispute Resolution Hotline dated September 7, 2012, available at http://www.nishithdesai.com/New_Hotline/Dispute/Dispute Resolution Hotline_Sep0712.htm

7. 2004 (2) SCC 105.

8. 2008 (4) SCC 190.

9. Relevant provisions attached here.

II. Relevant Issues Dealt by the Court

The Court was unable to support the conclusions recorded by it in its previous decisions in Bhatia International and Venture Global. It concluded that the Act has adopted the territorial principle unequivocally accepted by the UNCITRAL Model Law, thereby limiting the applicability of Part I to arbitrations, which take place in India. It further stated that the territoriality principle of the Act precludes Part I from being applicable to a foreign seated arbitration, **even if the agreement purports to provide that the Arbitration proceedings will be governed by the Act (emphasis supplied).**

i. Interpretation of Section 2(2) of the Act.

The pertinent issue for consideration before the Court was whether absence of the word *"only"* in Section 2(2) makes Part I of the Act applicable to all arbitrations, including arbitrations seated outside India. The previous judgments including Bhatia International and Venture Global clearly held that Part I would apply to all arbitrations including those held out of India, unless the parties by agreement, express or implied, exclude all or any of its provisions.

The primary contention put forth by the Appellant was that absence of the word *"only"* in Section 2(2) of the Act permits applicability of Part I of the Act to arbitrations held outside India, there being a conscious deviation from Article 1(2) of UNCITRAL Model Law. Further, restricting the applicability of this provision would lead to conflict with the rest of the provisions of the Act.

The Court following the principles of literal interpretation and in regard of the legislative intention held that applicability of Part I of the Act is limited only to arbitrations held in India and omission of the word *"only"* from Section 2(2) has no relevance. It further observed that the present wording of the Act does not deviate from the territoriality principle as accepted under Model Law and absence of *"only"* in the said provision does not change the content/intention of the legislation. It was observed that it is not permissible for the court while construing a provision to reconstruct the provision. The Court cannot produce a new jacket, while ironing out the creases of the old one.

ii. No Conflict With Section 2(4) and 2(5) of the Act

The Court dealt with the aspect whether the above interpretation of Section 2(2) of the Act would be in conflict with Sections 2(4) & 2(5). The Appellant contended that the language of Sections 2(4) & 2(5) makes Part I applicable to every arbitration, *whether in India or outside.*

The Court categorically held that there exists no conflict among the said provisions as Section 2(4) is applicable to *"every arbitration under any other enactment for the time being in force"* **covered by Part I (emphasis supplied)** and for the purposes of this section *"enactment"* would mean only an Act made by the Indian Parliament. Section 2(5) is merely an extension to Section 2(4) to deal with all proceedings in relation to arbitration with the exception of statutory or compulsory arbitrations in case of inconsistency and "all arbitrations" includes only those to which Part I is applicable. Thus, by virtue of the above provisions, Part I of the Act applies to all arbitrations held in India in accordance with the provisions of any Indian enactments unless inconsistent with the provisions of the Act.

iii. Award Under Section 2(7) of the Act is a "Domestic Award"

The scheme of the Act indicates that Part I applies to domestic arbitrations as well as international arbitrations conducted in India. International Commercial Arbitration included within Part I contemplate arbitrations between two foreign parties under foreign law with seat in India. Therefore, domestic awards made within Part I of the Act includes within its scope both, award rendered in an international arbitration held in India as well as arbitration between two domestic parties and not awards rendered in arbitration held outside India.

The object of Section 2(7) is to differentiate between domestic and foreign awards as covered under Part II of the Act. There is no overlapping between the two parts of the Act as the latter deals only with arbitrations held outside India, thereby categorizing them as foreign awards. The Court held that Act being based on the territoriality principle excludes applicability of Part I to foreign seated arbitrations even if the agreement is governed by the provisions of the Act.

iv. Party Autonomy

The Act permits the parties to decide the place of arbitration. The Court interpreting Section 20 of the Act pertaining to place/seat of arbitration has clarified that if seat of arbitration is India, parties are free to choose any place or venue within India for conducting the arbitration proceedings. However, the said provision is to be read with Section 2(2) of the Act to understand the applicability of principle of territoriality. In the absence of parties failing to specify law governing arbitration proceedings, the same would be governed as per the law of the country in which arbitration is held, having the closest connection with the proceedings.

The Court has distinguished the concept of *"seat"* and *"venue"* and explained their significance in arbitration proceedings. The distinction between seat and venue of arbitration assumes significance when foreign seat is assigned, with the Act as the curial law governing the arbitration proceedings. In such scenario, Part I would be inapplicable to the extent inconsistent with arbitration law of the seat.

Further, elaborating on the issue of choice of substantive law, the Court interpreting Section 28 of the Act held that arbitrations under Part I of the Act not being international commercial arbitration would be compulsorily governed by the Indian substantive law, to prevent domestic parties from resorting to arbitration with foreign governing law, whereas no such compulsion prevails in case of international commercial arbitration as defined under Section 2(1) (f) of the Act. The very objective of the Section is to segregate domestic and international arbitrations and convey the legislative intention of not providing extra-territorial applicability to Part I of the Act.

v. Application of Part II of the Act

The Court held that there is no overlapping of the provisions of Part I and Part II of the Act and Part II is not merely supplementary. There is complete segregation between both the parts as Part I deals with all four phases of arbitration-commencement, conduct, challenge and recognition and enforcement whereas Part II pertains only to recognition and enforcement of foreign awards. Further, the Court held that regulation of conduct of arbitration and challenge would be done by the Courts of the country in which arbitration is conducted, thereby application of Part I provisions to foreign awards would defeat the very object of the Act. Elaborating on the said issue, the Court has also clarified that approaching judicial authority under the non-obstante clause in Section 45 of the Act, does not make Part I applicable to foreign arbitrations held outside India.

vi. Enforcement of Foreign Award Under Section 48(1) & (2) Though Being Under Part II –Construed as Falling Under Part I

No provision for annulment of foreign award is provided under the Act. Section 34 pertaining to challenge of awards being included within Part I clearly reflects the legislative intention to restrict its scope to domestic awards. Section 48 of the Act recognizes that Courts of two nations are competent to annul or suspend an award including the country in *"which the award was made"* and *"under the law of which the award was made".* Enforcement of foreign award in India would be refused only if the said award is set aside by Courts of either of the countries as specified above. The Appellant contended that Courts in both the countries have concurrent jurisdiction to annul the award.

The Court has clarified that the expression *"under the law of which the award was made"* refers to the procedural law/curial law of the country and has no reference to the substantive law of the contract between the parties. Rejecting the contrary views upheld in its previous judgments annulling foreign award on the basis of law governing the dispute, the Court held that awards passed in arbitrations conducted outside India cannot be annulled under the provisions of the Act.

vii. Applicability of Section 9 to Foreign Seated Arbitrations

The major contention of the Appellant for applicability of Section 9 relief to foreign awards was not to leave any party remediless and correct interpretation being adopted in *Bhatia International.* The applicability of Part I was extended only to the extent of granting interim reliefs and not annulment as the same would invite extra-territorial operations.

Section 9 of the Act acts in aid of the arbitration proceedings and provides interim reliefs before or during arbitration or at any time after the making of award but prior to the enforcement of the award under Section 36 of the Act. The Court held that Section 36 being applicable only to domestic awards, pertains only to arbitrations with Indian seat, thereby Section 9 cannot be made applicable to arbitrations held outside India in contravention of the territoriality principle established under Section 2(2) of the Act. It was further clarified that if parties voluntarily chose a foreign seat, it would be implied that consequences of such choice would be known to them and non-applicability of Section 9 would not render them remediless.

viii. No Relief for Awards Passed in Non-Convention Countries

Awards passed in non-convention countries are not included within the ambit of the Act. The Court held that non-inclusion of the same does not amount to a lacunae as the legislative intention needs to be understood from the language and aspects not included therein cannot be incorporated vide interpretation. The ability to remove such defects is vested only with the Parliament and in its absence; applicability of the Act is limited to awards passed under the Act and in convention countries.

ix. Maintainability of Suits for Interim Reliefs

Existence of cause of action is the basis to maintainability of suits under the Code of Civil Procedure, 1908 ("**Code**"). Pendency of arbitration proceedings does not constitute sufficient ground for maintainability of a suit for interim relief. The Court has specified that no suit on the merits of the arbitration would be maintainable as the same would be subject to Sections 8 and 45 of the Act and relief if any would be purely to safeguard the property in dispute before the Arbitrator. No substantive reliefs on the merits of the arbitration could be claimed in the suit and in the event of a valid cause of action; no such suit would be maintainable. The relief claimed would be subject to future award that may be passed and contingent cause of action would not suffice to get proper reliefs. No provision of the Code or the Act vests powers to grant interim relief in suits in the absence of existence of a substantive suit, in pending arbitrations held outside India.

III. Analysis

Due to the limited application of the present judgment to arbitration agreements executed post September 6, 2012, the Appellants in the present appeal are effectively on the losing side as their arbitration agreements were executed prior to the said period and hence the present judgment is not applicable to them. The judgment has several positive and negative elements that need to be considered:

i. Positives

The judgment has clarified several legal anomalies which had tarnished the image of Indian arbitration laws and judicial system. It has remedied the primary concern which foreign parties faced while arbitrating against an Indian party i.e. ensuring minimum interference by local courts in arbitrations seated outside India.

The judgment by further clarifying that no annulment proceedings would lie in India against an award made outside India has got the Indian arbitration law at par with other international jurisdictions. It has eased the difficulties the foreign investors/ players have been facing in enforcing foreign awards in India against Indian parties.

ii. Negatives

The judgment while overruling *Bhatia International* failed to appreciate an important observation which was made by the Court in allowing the applicability of Section 9 of the Act to arbitrations seated outside India. The Court in *Bhatia International* had observed that one important reason for allowing the applicability of Section 9 of the Act to arbitrations seated outside India was that interim orders from foreign courts and arbitration tribunals are not enforceable in India and such a situation would leave foreign parties remediless. The Court by not considering this issue has made it very difficult for foreign parties to now seek meaningful and enforceable interim reliefs against Indian parties in arbitration seated outside India.

The judgment also failed to address the issue as to whether two domestic parties could choose a foreign seat thereby excluding the applicability of Part I of the Act. The said issue has been debated extensively in other jurisdictions and also raised by the Appellant herein. The Court inspite of clarifying that Indian substantive law would be applicable compulsorily to all domestic arbitrations and Indian parties where seat of arbitration is India cannot circumvent the application substantive Indian law has failed to discuss the scenario wherein domestic parties opt for a foreign seat.

The biggest negative one can draw from this judgment is its implied adoption of the doctrine of prospective overruling. The Court has made its ruling applicable only to the **arbitration agreements executed (emphasis supplied)** post the present judgment i.e. post September 6, 2012. Though the doctrine of prospective overruling is recognized in India the application of the same in the present situation would lead to more confusion. By pegging the applicability of the present judgment to the execution of an arbitration agreement the court has opened a Pandora's Box of questions. For example: If an arbitration agreement in executed in August, 2012 and the disputes under the same arise in July, 2016 the parties under that agreement would be bound by the rules laid down by *Bhatia International and Venture Global* leading to two sets of jurisprudence running parallel in India. Infact, for the parties, who challenged the law laid down by *Bhatia International* and have been successful in their challenge, will be still subject to the said law laid down by Bhatia International for adjudication of their disputes pending before the date of this judgment. This is quite an anomaly that has been created.

The Court could have achieved its objective of avoiding confusion due to overruling of *Bhatia International* and *Venture Global* by restricting the applicability of the Court's decision only to the cases arising in future and prohibiting its applicability to the cases which have attained finality. This would be a more appropriate application of the doctrine of prospective overruling.

IV. Steps Ahead

In light of the prospective applicability of the present judgment it is advisable that parties revise their arbitration agreements and re-execute them, if they wish to bring them under the umbrella of the new law.

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