GIBSON DUNN

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INDIA – LEGAL AND REGULATORY UPDATE (JUNE 2018)

To Our Clients and Friends:

The Indian Market

The Indian economy continues to be an attractive investment destination and one of the fastest growing major economies. After a brief period of uncertainty, following the introduction of a uniform goods and services tax and the announcement that certain banknotes would cease to be legal tender, the growth rate of the economy has begun to rebound, increasing to 7.7 percent in the first quarter of 2018, up from 6.3 percent in the previous quarter. In the World Bank's most recent Ease of Doing Business rankings, India climbed 30 spots to enter the top 100 countries.

This update provides a brief overview of certain key legal and regulatory developments in India between May 1, 2017 and June 28, 2018.

Key Legal and Regulatory Developments

Foreign Investment

1. *Compulsory Reporting of Foreign Investment*: The Reserve Bank of India ("**RBI**") has notified a one-time reporting requirement[1] for Indian entities having foreign investment. Each such entity must report its total foreign investment in a specified format (consisting of basic information such as the entity's main business activity) no later than July 12, 2018. Indian entities can submit their reports through RBI's website. Indian entities that do not comply with this requirement will be considered to be in violation of India's foreign exchange laws and will not be permitted to receive any additional foreign investment. This one-time filing requirement is a precursor to the implementation of a single master form that aims to integrate current foreign investment reporting structures by consolidating nine forms into a single form.

2. *Single Brand Retail*: The Government of India ("**Government**") has approved up to 100% foreign direct investment ("**FDI**") in single brand product retail trading ("**SBRT**") under the automatic route (i.e., without prior Government approval), subject to certain conditions.[2] Previously, FDI in SBRT entities exceeding 49% required the approval of the Government. The Government has also relaxed local sourcing conditions attached to such foreign investment. SBRT entities with more than 51% FDI continue to be subject to local sourcing requirements in India, unless the entity is engaged in retail trading of products that have 'cutting-edge' technology. All such SBRT entities are required to source 30% of the value of goods purchased from Indian sources. The Government has now relaxed this sourcing requirement by allowing such SBRT entities to count any purchases made for its global operations towards the 30% local sourcing

requirement for a period of five years from the year of opening its first store. The Government has clarified that this relaxation is limited to any increment in sourcing from India from the preceding financial year to the current one, measured in Indian Rupees. After this five year period, the threshold must be met directly by the FDI-receiving SBRT entity through its India operations, on an annual basis.

3. *Real Estate Broking Service*: The Government has clarified that real estate broking service does not qualify as real estate business and is therefore eligible to receive up to 100% FDI under the automatic route.[3]

4. *Introduction of the Standard Operating Procedure*: In mid-2017 the Government abolished the Foreign Investment Promotion Board - the Government body responsible for rendering decisions on FDI investments requiring Government approval. Instead, in order to streamline regulatory approvals, it has introduced the Standard Operating Procedure for Processing FDI Proposals ("**SOP**").[4] The Government has designated certain competent authorities who are to process an application for FDI in the sector assigned to them. For example, the Ministry of Civil Aviation is responsible for considering and approving FDI proposals in the civil aviation sector. Under the SOP, the competent authorities must adhere to time limits within which a decision must be given. Significantly, the SOP mandates a relevant competent authority to obtain the DIPP's concurrence before it rejects an application or imposes conditions on a proposed investment.

Mergers and Acquisitions

1. *Relaxation of Merger Notification Timelines*: Previously, parties to a transaction, regarded as a combination within the meaning of the [*Indian*] Competition Act, 2002 were required to notify the Competition Commission of India ("**CCI**") within 30 days of a triggering event, such as execution of transaction documents or approval of a merger or amalgamation by the board of directors of the combining parties. Now, the CCI has exempted parties to combinations from the 30 day notice requirement until June 2022.[5] This move will provide parties involved in a combination sufficient time to compile a comprehensive notification and will possibly lead to faster approvals by easing the burden on CCI's case teams.

2. *Rules for Listed Companies Involved in a Scheme*: The Securities and Exchange Board of India ("**SEBI**")'s listing rules requires listed companies involved in schemes of arrangement under the [*Indian*] Companies Act, 2013 ("**Companies Act**"), to file a draft version of the scheme with a stock exchange. This is in order to obtain a no objection/observation letter before the scheme can be filed with the National Company Law Tribunal. In March 2017, SEBI issued a revised framework for schemes proposed by listed companies in India. In January 2018, SEBI issued a circular[6] amending the 2017 framework. As a part of the 2018 amendments, SEBI clarified that a no objection/observation letter is not required to be obtained from a recognized stock exchange for a demerger/hive off of a division of a listed company into a wholly owned subsidiary, or a merger of a wholly owned subsidiary into its parent company. However, draft scheme documents will still need to be filed with the stock exchange for the purpose of information. The stock exchange will then disseminate the information on their website.

Companies Act

1. *Action Against Non-Compliant Companies*: Registrars of companies ("**RoC**") in various Indian states, acting on powers granted under the Companies Act, have initiated action against companies which have either not commenced operations or have not been carrying on business in the past two years. In September 2017, the Government announced that over 200,000 companies had been struck-off from the register of companies based on the powers described above.[7] Further, the director identification numbers for individuals serving as directors on the board of such companies were cancelled, resulting in their disqualification to serve on the board of any company for a period of five years. The striking-off was targeted at Indian companies that failed to fulfill regulatory and compliance requirements (such as filing annual returns) for three years.[8]

2. *Notification of Layering Rules*: The Government has notified a proviso to subsection 87[9] of Section 2 of the Companies Act along with the Companies (Restriction on Number of Layers) Rules, 2017 (the "**Layering Rules**").[10] The effect of these notifications is that an Indian company which is not a banking company, non-banking financial company, insurance company or a government company, is not allowed to have more than two layers of subsidiaries. For the purposes of computing the number of layers, Indian companies are not required to take into account one layer consisting of one or more wholly owned subsidiaries. Further, the Layering Rules do not prohibit Indian companies from acquiring companies incorporated outside India which have subsidiaries beyond two layers (as long as such a structure is permitted in accordance with the laws of the relevant country).

3. *Provisions of Companies Act Extended to all Foreign Companies*: India has enacted the Companies (Amendment) Act, 2017 in order to amend various sections of the Companies Act. The provisions of the amendment act are being brought into effect in a phased manner. Recently, the Government has notified a provision in the Companies (Amendment) Act, 2017[11] which extends the applicability of sections 380 to 386 and sections 392 and 393 of the Companies Act to all foreign companies which have a place of business in India or conduct any business activity in the country. Prior to this amendment, these provisions were only applicable to foreign companies where a minimum of fifty percent of the shares were held by Indian individuals or companies. These provisions of the Companies Act include a requirement to (a) furnish information and documents to the RoC, such as certified copies of constitutional documents, the company's balance sheet and profit and loss account; and (b) comply with the provisions governing issuance of debentures, preparation of annual returns and maintaining books of account.

4. *Notification of Cross Border Merger Rules*: The Government had notified Section 234 of the Companies Act and Rule 25A of the Companies (Compromises, Arrangements and Amalgamations) Rules 2016. Please refer to our regulatory update dated May 1, 2017 for further details. In this update, we had referred to the requirement of the RBI's prior permission in order to commence cross border merger procedures under the Companies Act. On March 20, 2018, the RBI issued the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 (the

"**Cross Border Merger Rules**").[12] The Cross Border Merger Rules provide for the RBI's deemed approval where the proposed cross-border merger is in accordance with the parameters specified by it. These parameters include, where the resultant company is an Indian company, a requirement that any borrowings or guarantees transferred to the resultant entity comply with RBI regulations on external commercial borrowings within a period of two years from the effectiveness of the merger. End-use restrictions under the existing RBI regulations do not have to be complied with. However, where the resultant company is an offshore company, the transfer of any borrowings in rupees to the resultant company requires the consent of the Indian lender and must be in compliance with Foreign Exchange Management Act, 1999 and regulations issued thereunder. In addition, repayment of onshore loans will need to be in accordance with the scheme approved by the National Company Law Tribunal. Currently, these provisions apply only to mergers and amalgamations, and not to demergers.

Labour Laws

1. *States Begin Implementing Model Labour Law*: In mid-2016, the Government introduced the Model Shops and Establishments (Regulation of Employment and Conditions of Service) Bill ("**S&E Bill**"). The S&E Bill, as is the case with other shops and establishments legislation in India, mandates working hours, public holidays and regulates the condition of workers employed in non-industrial establishments such as shops, restaurants and movie theatres. States in India can either adopt the S&E Bill in its entirety, superseding existing regulations, or choose to amend their existing enactments based on the S&E Bill. The S&E Bill seeks to update Indian laws, adapting them to current business requirement for non-industrial establishments. For example, the S&E Bill (a) enables establishments to remain open 365 days in a year, and (b) allows women to work night shifts, while containing provisions for employers to ensure safety of women workers. Registration provisions under the new legislation have also been eased. In late 2017, the State of Maharashtra notified a new shops and establishments statute based on the S&E Bill. Other states in India are expected to follow suit.

Start–ups

1. *Issue of Convertible Notes by Start-ups*: The Government had eased funding for start-ups in India in January 2016. Please refer to our regulatory update dated May 18, 2016, for an overview of this initiative. In January 2017, the RBI had permitted start-ups to receive foreign investment through the issue of convertible notes.[13] The revised FDI Policy issued in 2017 now incorporates these provisions. The provisions allow for an investment of INR 2,500,000 (approx. USD 36,700) or more to be made in a single tranche. These notes are repayable at the option of the holder, and convertible within a five year period. The issuance of the notes is subject to entry route, sectoral caps, conditions, pricing guidelines and other requirements that are prescribed for the sector by the RBI.[14]

Capital Gains Tax

1. *Charging of Long Term Capital Gains Tax*: An important amendment to Indian tax laws introduced by the Finance Act, 2018[15] is the levy of tax at the rate of 10% on capital gains made on the sale of certain securities (including listed equity shares) held at least for a year. The tax is levied if the total amount of capital gains exceeds INR 100,000 (approx. USD 1,448). This amendment came into effect on April 1, 2018. However, all gains made on existing holdings until January 31, 2018 are exempt from the tax. In all such 'grandfathering' cases, the cost of acquisition of a security is deemed to be the higher of the actual cost of acquisition and the fair market value of the security as on January 31, 2018. Where the consideration received on transfer of the security is lower than the fair market value as on January 31, 2018, the cost of acquisition is deemed to be the higher of the actual cost of acquisition and the consideration received for the transfer.[16]

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[1] RBI Notification on Reporting in Single Master Form dated June 7, 2018. Available at https://rbidocs.rbi.org.in/rdocs/Notification/PDFs/NT194481067EB1B554402821A8C2AB7A52009.PDF

[2] Press Note No. 1 (2018 Series) dated January 23, 2018, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, Government of India.

[3] *Id*.

[4] Standard Operating Procedure dated June 29, 2017. Available at http://www.fifp.gov.in/Forms/SOP.pdf

[5] MCA Notification dated June 29, 2017. Available at http://www.cci.gov.in/sites/default/files/notification/S.O.%202039%20%28E%29%20-%2029th%20June%202017.pdf

[6] SEBI Circular dated January 3, 2018. Available at https://www.sebi.gov.in/legal/circulars/jan-2018/circular-on-schemes-of-arrangement-by-listed-entities-and-ii-relaxation-under-sub-rule-7-of-rule-19-of-the-securities-contracts-regulation-rules-1957-_37265.html.

[7] Press Information Bureau, Government of India, Ministry of Finance, "Department of Financial Services advises all Banks to take immediate steps to put restrictions on bank accounts of over two lakh 'struck off' companies", http://pib.nic.in/newsite/PrintRelease.aspx?relid=170546 (September 5, 2017).

[8] Live Mint, "Govt blocks bank accounts of 200,000 dormant firms", http://www.livemint.com/Companies/oTcu9b66rZQnvFw6mgSCGK/Black-money-Bank-accounts-of-209-lakh-companies-frozen.html (September 6, 2017).

[9] MCA Notification vide S.O. No. 3086(E) dated September 20, 2017.

[10] Notification No. G.S.R. 1176(E) dated September 20, 2017. Available at http://www.mca.gov.in/Ministry/pdf/CompaniesRestrictionOnNumberofLayersRule_22092017.pdf

[11] MCA Notification dated February 9, 2018. Available at http://www.mca.gov.in/Ministry/pdf/Commencementnotification_12022018.pdf

[12] FEMA Notification dated March 20, 2018. Available at https://rbidocs.rbi.org.in/rdocs/notification/PDFs/CBM28031838E18A1D866A47F8A20201D6518E468E.pdf

[13] RBI Notification of changes to RBI regulations dated January 10, 2017. Available at https://rbi.org.in/scripts/NotificationUser.aspx?Id=10825&Mode=0

[14] Consolidated FDI Policy Circular of 2017. Available at http://dipp.nic.in/sites/default/files/CFPC_2017_FINAL_RELEASED_28.8.17.pdf

[15] Section 33 of the Finance Act, 2018. Available at http://egazette.nic.in/writereaddata/2018/184302.pdf

[16] CBDT Notification No. F. No. 370149/20/2018-TPL. Available at https://www.incometaxindia.gov.in/news/faq-on-ltcg.pdf

Gibson Dunn lawyers are available to assist in addressing any questions you may have regarding the issues discussed above. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the Aerospace and Related Technologies industry group, or any of the following:

Washington, D.C.
Karen L. Manos - Co-Chair (+1 202-955-8536, kmanos@gibsondunn.com)
Lindsay M. Paulin (+1 202-887-3701, lpaulin@gibsondunn.com)
Erin N. Rankin (+1 202-955-8246, erankin@gibsondunn.com)