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RECENT DEVELOPMENTS IN INDIAN LAW: IMPACT ON PRIVATE EQUITY TRANSACTIONS

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Abstract—Private equity investments have been growing rapidly in India. The growth may be attributed to the fact that companies which are funded by private equity funds often perform better compared to those which are not. Therefore, investments of such kind have gained importance, making it imperative to understand the legal framework that governs private equity fund and investments. Recently, the regulatory framework governing private equity funds and investments in India has seen notable changes. These changes have mostly found place in the Companies Act, 2013, securities laws enacted by the Securities and Exchange Board of India, the Income-Tax Act, 1961, and the Foreign Exchange Management Act, 1999. This article seeks to lay down the broad structure of the regulatory framework by tracing the legal developments in the legislations which govern private equity funds and their investments.

I. INTRODUCTION

Between 2010 and 2014, private equity (hereinafter "PE") and venture capital investments into India grew at a compounded annual rate of 20 *percent*.[1] The reasons for this are not hard to find. India presents a compelling growth opportunity backed by a stable political and legal framework, and is driven by a booming middle-class consumer story and a rapidly digitising and urbanising population.

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1 Aparna Sheth, Madhur Singhal & Pankaj Taneja, *Indian Private Equity Report 2015*, Bain & Company, Inc. and the Indian Private Equity & Venture Capital Association, http://bit.ly/1QkoZcS.

Recently, despite choppy macroeconomic seas and a global economic downturn, India has emerged as a leader amongst the 'emerging markets' of the world. With liberalisation having begun a quarter-century ago, and a possible second phase of progress and reform in the offing, India's vibrant economy presents particularly fertile ground for PE funds. PE funds have been bullish on India and continue to remain so (2015 saw a record inflow of an estimated USD 16.8 billion from PE funds).[2]

Empirical evidence has shown that in the Indian context, PE-funded companies perform strongly in comparison to their non-PE funded peers,[3] and that PE funds are now a significant source of finance for Indian companies.

Perhaps the most interesting aspect of PE funds' activity in India has been the re-working of the model traditionally employed by PE funds in the USA and Europe to adapt to the Indian regulatory and legal framework. As one commentator points out: *"While the traditional PE model has been successful in developed economies, PE firms quickly realised that transplanting this model to India would prove difficult due to various legal constraints. Accordingly, PE firms in India have developed an alternate model...and customised [it] for India's complex regulatory and governance environment."*[4] This adaptation and re-working of the traditional PE model points to the constraints in India's regulatory framework for PE funds.

Over the last decade and a half, the overarching theme on the regulatory front has been one of liberalisation and rationalisation, though not without setbacks. Changes in the legal framework, especially in taxation laws, have had a significant impact on investor sentiment in both public and private capital markets. This paper seeks to provide a high-level overview of the recent changes in law that impact PE activity and deal structuring in India.

A brief summary of the legal framework governing PE investments into Indian companies is in order before we look into notable changes in this framework. Broadly, the Companies Act, 2013 (hereinafter "2013 Act"), securities laws enacted by the Securities and Exchange Board of India (hereinafter "SEBI"), and the Income-Tax Act, 1961 (hereinafter "ITA") are the relevant laws that impact PE funds. Further, since the Indian Rupee is not fully convertible on the capital account, investments by non-residents (a majority of PE funds are non-residents) are governed by the Foreign Exchange Management Act, 1999 (hereinafter "FEMA").

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2 *Indian Private Equity Trend Report 2016*, Venture Intelligence,http://bit.ly/28SjUqS.

3 Vivek Pandit, ToshanTamhane, & Rohit Kapur, *Indian Private Equity: Route to Resurgence*, McKinsey & Company (June 2015), http://bit.ly/28UTvK3.

4 Afra Afsharipour, *The Indian Private Equity Model,* NSE Working Paper WP/8/2013 2 (2013).

II. RECENT DEVELOPMENTS

A. Companies Act

The 2013 Act, which came into force over 2014, was enacted to carry out a much-needed overhaul of India's previous company legislation (hereinafter "1956 Act"), and improve corporate governance standards. While the 1956 Act drew a strong distinction between private companies (these were lightly regulated in view of the fact that they were partnership-like, closely-held entities) and public companies (which had a broader shareholder base and thus merited greater regulation), the 2013 Act blurred this distinction and subjected private companies to a heavy compliance burden.

(a) Private Placement

Given that Indian company law does not permit private companies to offer their securities to the public at large, capital raising by private limited companies takes place through the issuance of securities to a select number of pre-determined persons in what is known as a 'private placement'. Since investments by PE funds usually involve a private placement, the mechanics of private placement is critical to smooth deal-making.

Under the 1956 Act, private companies could offer securities to a maximum of 49 persons through a private placement. Crucially, the private placement process under the 1956 Act was minimally regulated and hence, the process of issuing securities to PE funds to secure financing was, from a corporate compliance perspective, relatively straightforward.

The 2013 Act upended this situation by regulating private placements quite heavily by requiring that a long list of disclosures be made to persons proposing to subscribe to the private placement of a company's securities, and prescribing numerous other corporate secretarial actions for a private placement. Further, a company issuing securities in a private placement must also obtain a valuation report upon which the price of the securities being offered is to be based. This over regulation of private placements is misplaced in the context of PE investments – sophisticated investors such as PE funds do not require extensive disclosures from a company offering its securities, and there exists no rationale to regulate the financing activities of private companies since there is no offer being made to the public.

The rigours of a private placement under the 2013 Act have led companies to raise capital by disguising their private placements as 'rights issues' (i.e., shares are offered by a company to its existing shareholders in a rights issue, and such shareholders will then renounce the right to subscribe to the shares in favour of an investor, upon which the company will allot the shares to the investor). While this results in a smoother issuance process, it carries a degree of regulatory risk as it perhaps goes against the legislative intent. While amendments to the 2013 Act's private placement process are on the anvil, these amendments do not address the issues raised above.

(b) Directors' Liability

The 1956 Act did not explicitly set out a director's fiduciary duties – these duties arose from well-understood common law rules. The 2013 Act (in response to recent corporate governance scandals) has codified the duties of directors of a company, and significantly expanded the liabilities that directors of a company could be exposed to. Notably, in the event of any corporate wrongdoing, non-executive directors who do not take part in a company's day-to-day activities could be exposed to liabilities because such directors could be deemed to have knowledge of such company's acts.

Since a seat on the board of a portfolio company is a standard deal term in PE deals, PE funds have taken note of the very real possibility that the nominee directors they place on the boards of their portfolio companies are exposed to liabilities due to the 2013 Act's strong director liability regime.

As a result, more and more PE funds require "directors' & officers' liability insurance" policies to be taken out by their portfolio companies, and also insist upon indemnification for any liability attaching to their nominee directors. Another route PE funds might take to address this issue is to forgo a board seat as a director, and instead nominate a 'board observer' to exercise oversight over portfolio companies. While the intent behind increasing the scope of directors' liabilities is praiseworthy, the 2013 Act has regulated with a heavy hand - judicial guidance on the extent of directors' liabilities is awaited, and in the meantime, PE funds must strategise to mitigate this risk.

(c) Compulsorily Convertible Debentures

Compulsorily convertible debentures (hereinafter "CCDs") have been a popular instrument for PE funds investing in India. Indian company law seeks to protect a company's creditors by categorising certain sums due from a company as 'deposits', and prescribing onerous compliances thereon. Under the 1956 Act, CCDs could avoid being categorised as 'deposits' if (i) they were convertible into equity, or (ii) they were secured by immovable property. However, under the 2013 Act, to avoid categorisation as a 'deposit', CCDs must (i) convert into equity within 5 years, or (ii) be secured by a first charge or a charge ranking *pari passu* with the first charge on assets of the issuing company. The 2013 Act thus introduces difficulties into structuring a PE investment employing CCDs because it imposes a cap on the conversion period of CCDs, or alternately requires portfolio companies to provide significant security against CCDs - something that they may be neither willing to, nor capable of, doing.

B. Exchange Control

Under FEMA, the Reserve Bank of India (hereinafter "RBI") regulates foreign investment into Indian entities. Foreign investment can be made into India, *inter alia*, through the foreign direct investment (hereinafter "FDI") route, or through entities registered with the SEBI as foreign portfolio investors (hereinafter "FPIs") or foreign venture capital investors (hereinafter "FVCIs"). Under FEMA, the RBI regulates, *inter alia*, the price at which PE funds enter into and exit Indian companies, the extent to which foreign investors can invest in Indian companies engaged in certain sectors, and the types of entities foreign investment can flow into.

(a) Optionality Clauses & Other Instruments

PE funds have typically structured their investments into Indian companies with a bouquet of downside protection and exit mechanisms. One such mechanism is a 'put option' requiring the investee company or its promoters to buyback securities held by the PE fund in the event that an exit has not been delivered within a specified timeline. Previously, despite the lack of a clear rule in this regard, on an *ad hoc* basis, the RBI objected to instruments with put options in certain deals on the ground that such instruments were debt disguised as equity (in India debt and equity investments are regulated under two separate exchange control regimes). The ostensible reason why the RBI took this view is because instruments with a put option might allow foreign investors to exit from their investments with an assured return, thus insulating them from the risks associated with equity investments. Notwithstanding the lack of clarity over their enforceability, put options linked to a specified internal rate of return were a regular feature of Indian PE deal documentation, albeit clouded by regulatory uncertainty.

After prolonged uncertainty, in 2014 the RBI legalised 'put options', subject to certain conditions such as a lock-in period and restrictions on the pricing at the time of exit, with the guiding principle being that a foreign investor would not be allowed to exit with an assured return. The legalisation of put options brought in much needed clarity, but the RBI's stance against options allowing an assured return means that PE funds still do not have the flexibility to completely protect themselves against downside scenarios. Of late, however, there have been indications from the RBI that it is ready to allow foreign investors some flexibility and permit instruments that give an assured return as a downside protection.[5]

Another notable development is that in 2015, partly paid-up shares and warrants were made eligible instruments for FDI. Prior to 2015, only equity, compulsorily convertible preference shares or CCDs were eligible instruments for FDI, and the use of warrants or partly-paid up shares for FDI was subject to governmental approval. The conditions for the use of partly-paid up shares and warrants for making FDI are that (i) their pricing should be determined upfront, and (ii) 25 *percent* of the consideration amount should be received upfront, with the balance consideration to be remitted within 18 months. While the intent behind permitting warrants as an eligible instrument for FDI seems to be to permit more flexibility in the choice of instrument, in practice, the condition that 25 *percent* of the consideration be committed upfront is onerous, and defeats the very purpose of issuing warrants. Therefore, warrants continue to be an unattractive instrument for PE funds when investing in India.

(b) Changes to the FPI and FVCI regimes

A PE fund, by registering as an FPI or an FVCI with SEBI, could also invest in India through the FPI or FVCI route. Investing through the FPI route permits PE funds to trade in listed securities such as equities, while investing through the FVCI route permits PE funds to enter into and exit from Indian companies without having to comply with the pricing guidelines for entry and exit under FEMA. These attributes make the FPI route and the FVCI route attractive to PE funds.

(i) Changes to the FPI regime

Under the FDI regime, limits are imposed on the amount of foreign investment permitted in Indian companies engaged in certain specified sectors (referred to as 'sectoral caps'). Historically 'sub-limits' within such overall investment limits were prescribed for investments by FPIs in certain 'sensitive' sectors where the government was uncomfortable with the volatility caused by the FPIs' 'hot money'. For instance, while the overall limit on foreign investment in the defence sector was 49 *percent*, FPIs were permitted to invest only up to 24 *percent* in the sector. In 2015, the Indian government did away with the sub-limits for investments by FPIs and introduced composite caps for foreign investment in such sectors. Thus, in a move that is likely to bring greater capital inflow, FPIs are now permitted to invest in Indian companies up to the prescribed sectoral caps.

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5 For example, in 2015, the RBI permitted the Tata Group to purchase NTT DOCOMO, Inc.'s stake in their Indian joint venture at a pre-determined price that was higher than the permissible exit price under FEMA. Further, in his Sixth Bi-Monthly Monetary Policy Statement, 2014-15, the Governor of the RBI stated that the RBI proposed to "introduce greater flexibility in the pricing of instruments, including an assured return…through an embedded optionality clause."

Another significant development with regard to FPIs is the RBI's proposal to allow FPIs to invest in unlisted corporate bonds issued by Indian companies, a move aimed at deepening India's bond markets. Currently, FPIs are only allowed to invest in listed or to-be-listed corporate bonds, and in unlisted bonds of companies engaged in the infrastructure sector; PE funds made use of the FPI route to invest in Indian companies through structured debt instruments, especially in the real estate sector. One of the drawbacks of this route however, was that the investee company had to get its bonds listed within a specified time period, which may not be feasible for many companies. In the event the RBI decides to permit FPIs to invest in unlisted corporate bonds this drawback would be removed, and given the other developments in the tax and legal framework surrounding debt investments, we could see significant PE activity in the debt space going forward.

(ii) Changes to the FVCI regime

PE funds investing through the FVCI route can avail of certain relaxations and exemptions: *inter alia,* investments through the FVCI route can be made using equity-linked instruments and FVCIs can benefit from relaxations under certain securities laws. However, FVCIs were permitted to invest only in nine sectors (hereinafter "Permitted Sectors").[6] Recently, the RBI has permitted FVCIs to invest outside the Permitted Sectors, provided the investee entity meets certain criteria,[7] and has also permitted FVCIs to invest in companies engaged in the infrastructure sector. While these amendments appear to be geared toward attracting early-stage risk capital, the liberalisation of the FVCI route once again increases the attractiveness of the FVCI route for PE funds.

(iii) Escrow/Deferred Payment

PE deal terms often involve an escrow or deferred payment arrangement in order to accommodate indemnity for representations and warranties, or in order to provide for earn-outs to existing management/promoters. Until very recently, any deferred payment arrangement required RBI approval, and escrow arrangements lasting for more than 6 months required RBI approval.

The RBI has now liberalised these conditions: buyers are permitted to defer payment of up to 25 *percent* of the total consideration for a period of 18 months

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[6] The nine sectors are: biotechnology, IT related hardware and software development, nanotechnology, seed research and development, research and development of new chemical entities in pharmaceutical sector, dairy industry, poultry industry, production of bio-fuels, and hotel-cum-convention centres with seating capacity of more than 3,000.

[7] The investee entity must be (i) less than 5 years old, (ii) its annual turnover must never have exceeded INR 250 million, and (iii) it must be working towards innovation, development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property.

from the date of the definitive documents, and escrow arrangements are permitted on similar terms; any deferred payment or escrow beyond the abovementioned limits still requires RBI approval. However, while the extant rules did not prescribe any limits on the amounts or period of indemnification by sellers in share purchase transactions, the RBI has now clarified that in transactions involving a deferred payment, any indemnification provided by sellers must comply with the abovementioned limits, or otherwise be cleared by the RBI. The above amendment is a welcome change as it provides PE funds with greater flexibility when structuring transactions involving a deferred payment or escrow element – importantly, the need to seek the RBI's approval can be obviated in certain circumstances.

(iv) Investments into AIFs

Alternative Investment Funds (hereinafter "AIFs") are onshore fund vehicles regulated by SEBI, and in the four years since AIFs were introduced, the vehicle has seen a significant amount of success. While AIFs may be organised as companies, trusts or limited liability partnerships, for certain tax reasons that are elaborated upon below, AIFs are usually structured as trusts. However, FEMA did not specifically permit foreign investments into trust vehicles, and this caused significant uncertainty amongst both the sponsors of PE funds and investors in PE funds (referred to as 'limited partners' or "LPs" in industry parlance). Further, there was lack of clarity regarding whether investments by AIFs that pooled foreign capital would be considered downstream foreign investment.

In 2015, the RBI clarified this issue by expressly allowing foreign investment into AIFs without having to obtain RBI approval, and further clarified that investments by AIFs would not be considered downstream foreign investment so long as neither the sponsor nor the investment manager of the AIF is owned or controlled by non-residents. This is a highly positive development that will be a huge boost for the Indian AIF industry because it will enable them to raise funds from foreign LPs easily.

C. Taxation

India has, over the years, gained a reputation for having an unpredictable tax environment. The situation is still very much one where PE funds often do not have clear visibility on tax outcomes. Below, some of the recent tax developments that impact PE funds are briefly described.

(a) Amendment of the Indo-Mauritian DTAA

Undoubtedly the most significant development in tax law impacting PE funds is the recent amendment of the Indo-Mauritian Double Taxation Avoidance

Agreement (hereinafter "Indo-Mauritian DTAA"). PE funds have historically invested in India through intermediate holding vehicles based in Mauritius to take the benefits of the Indo-Mauritian DTAA, and thus eliminate tax leakages in India. The amendment to the Indo-Mauritian DTAA now restores India's right to tax capital gains on the sale of shares made by Mauritius-based PE funds – therefore, investing through Mauritius will no longer shield PE funds from having to pay tax in India.

While the amendment does grandfather investments made prior to April 1, 2017, and provides for certain tax benefits to investors that satisfy a 'limitation-of-benefits' clause for a two year period thereon, PE funds will need to re-think their India-focused investment structures. Notably, the amendments to the Indo-Mauritian DTAA would not capture capital gains made on the sale of CCDs, or on the sale of derivatives and other securities, and therefore, capital gains on the sale of these instruments will still be exempt from tax in India.

The amendments to the Indo-Mauritian DTAA indicate that the Indian government has taken a strong stand against tax planning practices. Despite industry forecasts that the amendment to the Indo-Mauritian DTAA will deter foreign investors, the recent rationalisation of domestic long term capital gains tax rate downward to 10 *percent* means that PE funds may now decide to price this tax into their investments.

An equally important effect of the amendment to the Indo-Mauritian DTAA is the consequent amendment of the double taxation avoidance agreement between India and Singapore (hereinafter "India-Singapore DTAA"). The reason for this is that the protocol to the India-Singapore DTAA provides that in the event the Indo-Mauritian DTAA is amended such that Mauritius can no longer tax capital gains earned by Mauritian companies from the sale of an Indian company's shares, Singapore would also lose the right to tax capital gains earned by Singaporean companies from the sale of an Indian company's shares under the India-Singapore DTAA. Therefore, India (not Singapore) can now tax the capital gains earned by Singaporean residents from the sale of shares of an Indian company. In recent times, Singapore has emerged as a popular destination from which to invest into India and many PE investors have chosen to invest into India through Singapore domiciled funds. It is possible that with the amendment to the India-Singapore DTAA described above, Singapore will also lose its appeal as a jurisdiction in which to domicile India-focused PE funds.

Mauritius and Singapore apart, PE funds have also employed the Netherlands and Cyprus as intermediate holding company jurisdictions when investing into India. However, press reports suggest that in line with the Indian government's stance against tax treaty abuse, India is in the process of renegotiating its treaties with Cyprus and the Netherlands.

(b) Characterisation of Income

The income earned by PE funds from the sale of securities is usually characterised as 'capital gains', as opposed to 'business income' (capital gains are taxed at lower rates than business income). However, the criteria employed by tax authorities when characterising income as 'capital gains' or 'business income' are quite subjective, and this has been a continuous source of uncertainty for PE funds. After protracted litigation on this point, the Indian tax authorities recently issued a series of circulars providing objective criteria to guide tax officers when characterising income (hereinafter "Tax Circulars"). The Tax Circulars sought to give taxpayers certainty regarding the characterisation of their income from the sale of shares.

As per the Tax Circulars, income earned from the sale of listed shares will be characterised as capital gains if such shares are held for 12 months prior to their sale. Income earned from the sale of unlisted shares will be characterised as capital gains, regardless of the period of holding prior to sale – however, there are caveats: tax officers have the discretion to treat income earned from the sale of a private company's shares as 'business income' (i) where the genuineness of the transaction is questionable, (ii) where a question pertaining to lifting the corporate veil arises, and most troublingly (iii) where there is a transfer of the control and management of the underlying business along with the shares.

The Tax Circulars may thus have the opposite of their intended effect – by giving tax officers the leeway to challenge income characterisation on highly nebulous grounds such as 'genuineness', or whether the corporate veil can be lifted, the Tax Circulars merely open the door for further controversy on this point. The Tax Circulars have the effect of causing massive uncertainty for PE funds looking to do 'control' deals; it is another matter that the meaning of the term 'control' is itself highly unclear.

(c) Pass-through status for AIFs

Originally under the ITA, only venture capital funds registered under the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 (hereinafter "VCF Regulations") and investments in companies operating in the Permitted Sectors were accorded with 'pass-through' status, i.e., there would be no taxation at the fund level, and LPs' gains from the fund's exits would be taxed as though the LPs had invested directly into portfolio companies. This position was amended when the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (hereinafter "AIF Regulations")[8] came into force and 'pass-through' status was granted to all

[8] While the VCF Regulations catered to all kinds of investment funds investing in unlisted Indian companies, the AIF Regulations had categorised investment funds into several sub-categories

investment funds registered as 'venture capital funds' under Category I of the AIF Regulations, irrespective of the sector in which their portfolio companies operated in. While this took away the sector specific investment requirement for venture capital funds, none of the other sub-categories of AIFs (such as private equity funds or infrastructure funds) were granted 'pass-through' status and such funds had to rely on a certain structuring mechanism involving a degree of tax ambiguity for attaining 'pass-through status'.

The funds industry made numerous representations to the Indian government requesting that 'pass-through' status under the ITA be extended to all sub-categories of AIFs, and in 2015, the Indian government amended the ITA to grant 'pass-through' status to all AIFs other than hedge funds.

This was a highly sought-after, and very positive, development but again was not without a few drawbacks. For instance, the 'pass-through' status offered to onshore PE funds would only be applicable for income characterised as 'capital gains', and not for income characterised as 'business income' (as noted above, income characterisation is itself a highly vexed issue).

(d) Onshore Fund Managers

Historically, PE funds have preferred to base their fund management entities offshore for the fear of being exposed to the tax risk of having a permanent establishment in India, or being regarded as an Indian tax resident. Apart from the impact on fund structuring, this has led to the Indian fund management industry moving offshore to reduce tax risks. Recently, there have been two developments that impact PE fund managers.

The first is the introduction of a "substance-over-form" test for corporate residency based on the 'place of effective management' (hereinafter "PoEM") of an entity into the ITA in 2015. While the PoEM test is yet to come into force (it will become effective from April 1, 2017), its wide scope means that offshore PE funds having onshore investment advisory entities could be dragged into the Indian tax net, because tax authorities will regard them as being effectively managed from India. As with other pain points within the ITA, the issue once again is the lack of clarity that the PoEM test causes, and thus, the PoEM test could now further incentivise PE funds to base their investment advisory entities offshore. That said, Indian tax authorities have published a draft guidance which states that the existence of onshore support functions that are preparatory and auxiliary in character will not be conclusive evidence that an offshore company's

under three broad categories: (i) Category I encompassing, venture capital funds, infrastructure funds, SME funds, etc., (ii) Category II encompassing private equity funds, and (iii) Category III encompassing hedge funds.

PoEM is in India – possibly opening up a safe harbour for PE funds to base their fund managers onshore.

This brings us to the second recent fund manager-related development in Indian tax law. In 2015, the Indian government sought to encourage offshore funds to move their fund managers into India by providing that an offshore fund by virtue of having onshore fund managers alone would not be subject to taxation in India. The PE industry was, however, largely dissatisfied with the amendment since the conditions to qualify for the above safe harbour were onerous. While the Indian government recently tried to rationalise these qualifying conditions, the funds industry continues to perceive them as onerous.

The net effect is that for the near term, it appears that PE funds will continue to base their fund managers offshore.

(e) General Anti-Avoidance Rules

The general anti-avoidance rules (hereinafter "GAAR") were inserted into the ITA in 2012, and will come into force from April 1, 2017. The GAAR represent by far the most significant tax concern for PE funds. While the courts in India have generally restricted tax authorities' discretion to 'look-through' tax planning structures and required tax authorities to use a "form-over-substance" approach, under the provisions of the GAAR, tax authorities have extensive discretion to disregard or invalidate an arrangement entered into with the main objective of tax avoidance. This could have a significant impact on PE funds that have structured their investments into India through tax friendly jurisdictions, as tax authorities could invoke the GAAR to invalidate such tax planning arrangements, unless PE funds are able to demonstrate adequate commercial rationale and substance in their arrangements.

Currently, there is considerable debate regarding whether the GAAR will apply to structures that qualify under treaty based anti-abuse provisions such as 'limitation-of-benefit' clauses, and given that India is in the process of amending its relevant tax treaties, guidance is awaited from the Indian government and tax authorities regarding the exact scope of the GAAR's applicability. The introduction of the GAAR may require the PE funds to re-look at their existing structures and ensure their robustness, so as to withstand scrutiny under the GAAR.

(f) Foreign Account Tax Compliance Act

In 2015, India entered into agreements with the United States to implement a United States legislation known as the Foreign Account Tax Compliance Act (hereinafter "FATCA"), and inserted certain provisions of FATCA into rules made under the ITA. FATCA is aimed at collecting tax information regarding the

United States' citizens. As such, FATCA imposes heavy reporting and compliance obligations upon resident Indian entities having direct or indirect investment by the residents of the United States. In particular, it impacts onshore PE funds that have resident American LPs, or LPs that are beneficially owned by resident American entities. Due to FATCA's incorporation into the ITA, onshore PE funds could be obligated to perform due diligence and collect data regarding their LPs, and to make reports to the Indian tax authorities.

D. Distressed Deals

One of the major talking points of the last year has been the massive build-up of non-performing loans on the books of major Indian banks. This is indicative of a larger issue: corporate India has a significant debt problem, and this presents a compelling opportunity for PE funds.

Interest in this opportunity has been bolstered by numerous legal developments that seem to be coming together at the right time. For one, the Indian government is rapidly moving toward improving the country's debt recovery and corporate resolution laws and infrastructure. Perhaps the stand-out reform in this area is the recently enacted Insolvency and Bankruptcy Code, 2015 (hereinafter "Insolvency Code"). The Insolvency Code, and other recently proposed amendments to debt recovery legislations, consolidate the legal regime for insolvency and provide for a framework in which bondholders can speedily recover debts or turnaround companies.

Another key reform that dovetails with the Insolvency Code is the framework laid down by the RBI (wearing its banking regulator hat) for banks to take control of defaulting corporate borrowers. Known as the Strategic Debt Restructuring (hereinafter "SDR") scheme, this framework permits banks to convert their debt into equity, take control of borrowers, and remove their extant managements when defaults by borrowers cross certain thresholds. Subsequently, the SDR requires banks to exit such defaulting borrowers *via* a stake sale. This presents an opportunity for PE funds to acquire companies at attractive valuations from banks that are anxious to get bad debt off their books, and turn them around. Given the fact that the SDR scheme has seen considerable use till date, the industry expects significant distressed 'Mergers & Acquisitions' (hereinafter "M&A") activity.

The government has also made efforts to attract investment into asset reconstruction companies (hereinafter "ARCs"). ARCs are specialised vehicles set up under a statutory framework to securitize loans originated from banks – however, they have not seen much success since their inception due to a lack of capital. The government has now proposed to allow a sponsor to hold the entire capital of an ARC, has also allowed foreign investment up to 100 *percent* in ARCs under the automatic route, and has similarly allowed FPIs to invest in 100 *per cent* of the security receipts issued by ARCs. These measures should hopefully help ARCs attract some much needed capital. There are already serious indications of interest from several PE funds around the world on the heels of this development. In sum, these developments promise highly exciting times for PE funds engaged in the distressed, turnaround and special situations spaces.

E. Antitrust

India's antitrust regulator, the Competition Commission of India (hereinafter "CCI") has taken on an increasing importance for PE funds. Rules made under the Competition Act, 2002 (hereinafter "Competition Act") regulate M&A activity (hereinafter "Combination Rules") by putting in place a 'suspensory' merger control regime which requires acquirers to notify the CCI prior to closing a transaction, in the event the transaction meets certain prescribed financial thresholds (hereinafter "Thresholds"). Notifying the CCI and obtaining its approval stretches deal timelines and inflates transaction costs. Relevant developments in this space have been with regard to the exemptions from having to notify deals for the CCI's approval.

While the Combination Regulations do provide for certain exemptions from notifying the CCI, the CCI's decisional practice over 2015 tended towards narrowing down of these exemptions, such that PE deals which cross the Thresholds would usually require notification to the CCI. In 2016, the CCI amended the Combination Regulations to virtually shut down exemptions available to PE funds in this regard. While PE funds acquiring up to 25 *percent* in companies (without acquiring any control) were previously exempted from the notifying requirement, this threshold has now been brought down to 10 *percent*.

On the other hand, the Ministry of Corporate Affairs (hereinafter "MCA") has recently doubled the financial amounts on which the Thresholds are based and extended the life of certain other exemptions available from the requirement to notify transactions to the CCI. Currently, transactions involving a target company with either assets of the value of not more INR 3.5 billion in India or turnover of not more than INR 10 billion in India would be exempt from the requirement to obtain prior approval from the CCI.

F. Dispute Resolution

The slow dispute resolution mechanism in India has been a pain point for foreign investors. Over the past year, the Indian government has made a demonstrable effort to improve dispute resolution mechanisms in India. Below are some notable developments in this regard.

(a) Amendment of the Arbitration & Conciliation Act, 1996

Defects in the drafting of the Arbitration and Conciliation Act, 1996 (hereinafter "Arbitration Act"), coupled with considerable judicial divergence over the interpretation of its provisions, had prevented arbitration in India from becoming truly effectual. This was compounded by uncertainty over the scope of a challenge to a foreign arbitral award in Indian courts and the permissible degree of interference or assistance by an Indian court during the pendency of such arbitrations. In 2015, the government amended the Arbitration Act to clearly delineate the limits on Indian courts' powers to review foreign seated arbitral awards. Other amendments to the Arbitration Act now clarify that parties to an agreement may choose to allow Indian courts limited powers to grant interim reliefs with regard to a foreign seated arbitration, and that such interim relief may be obtained from High Courts in India.

These amendments, coupled with the increasingly pro-arbitration approach taken by Indian courts, has given comfort to PE funds regarding foreign seated arbitrations with Indian parties that would need to be enforced through Indian courts. However, it should be noted that the concept of 'seat of arbitration' has neither been defined nor clarified by the amendments to the Arbitration Act and therefore, arbitration clauses in deal documentation need to be crafted carefully to avoid grey areas in their interpretation.

(b) National Company Law Tribunal

Under the 1956 Act, numerous issues related to companies were litigated before, or carried out through a statutorily established tribunal called the Company Law Board (hereinafter "CLB"). However, the CLB's jurisdiction was limited with regard to the matters it could hear, and other courts/tribunals also dealt with company matters in a fragmented manner. The 2013 Act has replaced the CLB with the National Company Law Tribunal (hereinafter "NCLT"). While the NCLT had a turbulent gestation (it survived two constitutional challenges), it represents a new kind of company disputes forum: the NCLT will hear all matters related to companies (including amalgamations, class action suits, and liquidations), and appeals from the NCLT will go to an appellate body and then to the Supreme Court of India. The NCLT will also have qualified technical members and benches across the country. Importantly, the jurisdiction of the NCLT ousts the jurisdiction of other civil courts in India. The introduction of the NCLT has the potential to be a watershed moment for Indian corporate litigation – it could result in a streamlined and effective forum in which company matters could be litigated.

G. Anti-Corruption Laws

An area of increasing concerns for PE funds and LPs is the threat of enforcement actions under the United States' Foreign Corrupt Practices Act of 1977 (hereinafter "FCPA"), and the United Kingdom's Bribery Act, 2010. These laws essentially expose PE funds to liabilities in the event that their associates in foreign countries engage in corrupt practices.

The FCPA prohibits American entities, as well as their officers and employees, from directly or indirectly bribing a 'foreign official' to obtain an improper business advantage. The United States' Department of Justice has in recent times been very actively pursuing cases under the FCPA against large corporations and has also been levying astronomical fines. For sponsors of India-focused funds, this means that illegal payments made by their portfolio companies in India could cause significant legal and reputational damage to the sponsor itself. Given that corruption has been a high-profile issue in India of late, PE funds must be aware of the significant levels of risks posed by the Anti-Corruption Laws when acquiring interests in Indian companies.

To mitigate this risk, PE funds must consider performing a thorough due diligence of portfolio companies for any history of corrupt practices - in certain situations, a forensic audit by experts may be called for. From a documentation perspective, obtaining adequate cover through taking representations and warranties as to corrupt practices from promoters is necessary, but PE funds must also consider a strong covenant package obliging portfolio companies to eschew corrupt practices, conduct periodic reviews, and inform investors regarding any actual or suspected corrupt activities by the company's officers.

III. CONCLUSION

A quarter of a century has passed since India historically opened up its economy, and we still face regular tinkering and tweaking to our commercial laws that govern business deals and PE transactions. While the commitment to progressively liberalising the economy has continued unabated irrespective of the party in power at the Centre, India has drawn much criticism over the years over the slow pace of its reforms, and has drawn even more criticism over the speed of regulatory action. In light of this unique mix of transformational opportunity coupled with regulatory fluidity, the role of the Indian transactional lawyer has assumed tremendous importance. Today, a PE deal lawyer has to grapple with a frequently changing regulatory and tax environment, and protect his or her clients from any adverse fall-outs arising from such shifting sands. It is important, therefore, to constantly re-visit known doctrines and customary market positions on various legal issues while structuring a PE deal in India.

However, the constantly changing framework does not necessarily always present problems. Often, it presents new opportunities and new ways of deal-structuring as well. Very often, a known and well understood door closes, only for another to open in its place—most often with the astute efforts and brilliance of the Indian transactional lawyering community, which itself has evolved into a professional, battle-wisened bunch that is ready to take on new challenges!