PANORAMIC

JOINT VENTURES

India

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Joint Ventures

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Joint Ventures

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FORM

Types of joint venture
What are the key types of joint venture in your jurisdiction? Is the 'joint venture' recognised as a distinct legal concept?

Joint ventures in India can be broadly categorised as being either incorporated or unincorporated.

In the case of an incorporated joint venture, the joint venture is recognised as a distinct legal concept, which may take the form of a private limited company or public limited company incorporated under the Companies Act 2013, or a limited liability partnership under the Limited Liability Partnership Act, 2008. The same can be established by way of setting up a new entity or investing in an existing entity. The key benefits of an incorporated joint venture over an unincorporated joint venture are that it is a separate legal entity, accords limited liability to its shareholders and partners, possesses perpetual succession, has clear structures for accounting and governance, and has the ability to own assets in its name.

Unincorporated joint ventures in India can have different forms, the most common being unregistered partnerships, strategic alliances, contractual joint ventures and consortiums. These forms are contractual in nature and are used where the parties have mutual business interests and intend to collaborate with each other for a common commercial objective but prefer to remain loosely associated with the other parties.

Law stated - 31 August 2023

Common sectors
In what sectors are joint ventures most commonly used in your jurisdiction?

In India, joint ventures are used across sectors, whereby Indian parties collaborate with other Indian parties to form domestic joint ventures or where one of the parties is a foreign entity and a cross-border joint venture is formed. Often, two foreign parties will also collaborate to form a joint venture in India. Some joint ventures are regulation-driven (ie, in sectors in which the foreign direct investment policy of India limits the extent of foreign investment). Examples of such sectors are insurance, multi-brand retail trading, defence manufacturing and air transport services. Other commonly used joint ventures are commercially driven in sectors that require a high degree of technical skill and knowledge, are capital-intensive, or need strong local expertise, existing infrastructure or distribution networks. Some examples of such sectors are automotive, construction, infrastructure, oil and gas, drugs and pharmaceuticals, telecommunication, and hotels and tourism.

Most of the unincorporated and contractual joint ventures in India are used for executing limited-period infrastructure projects, especially the construction of roads and highways, bridges and tunnels, railways, etc.

Further, with the recent focus of the Indian government on increasing the indigenisation of complex technical processes and technologies and making India self-reliant, more and more technical collaborations are taking place between foreign entities and Indian entities in the form of joint venture companies or through various forms of technology transfer agreements.

Law stated - 31 August 2023

PARTIES

Rules for foreign parties
Are there rules that relate specifically to foreign joint venture parties?

The Indian government, through the Ministry of Commerce and Industry, Department for Promotion of Industry and Internal Trade, periodically issues policy guidelines relating to foreign investment in India – the Foreign Direct Investment Guideline (the FDI Guidelines). The FDI Guidelines broadly govern the sectoral caps for foreign investments, the mode through which foreign investment can flow into and out of India, the prescribed instruments that can be used, and the entry conditions attached thereto, if any. Such conditions may include norms for minimum capitalisation, lock-in periods, local sourcing, etc. Accordingly, investment by a foreign party in India for forming a joint venture can be done either through the 'automatic route' or the 'approval route' as mandated by the FDI Guidelines. Under the automatic route, neither the non-resident (foreign) acquirer or investor nor the Indian company require any approval from the government for the investment. Under the approval route, prior approval from the government is required. The requirement for following the approval route and the extent of acquisition of shares and control of the Indian investee company largely depends upon the business activities of the Indian company. In a few cases, it also depends on the source country of the investment flowing into India.

Investment by foreign parties in most sectors in India is permitted through the automatic route, such as manufacturing, e-commerce based on marketplace models, single brand retail trading with local sourcing requirements, cash and carry wholesale trading, airports (greenfield and brownfield), food processing, railway infrastructure, etc.

There are a few business sectors in which foreign investment is prohibited, such as lotteries, chit funds, real estate business, manufacturing of cigars and cigarettes and atomic energy.

Joint ventures that involve the inflow and outflow of foreign exchange are subject to a strict framework of regulations and guidelines prescribed under the Foreign Exchange Management Act 1999 (FEMA) administered by India's central bank, the Reserve Bank of India (RBI). Non-resident joint venture parties can hold equity instruments of the joint venture in the form of equity shares, compulsorily convertible debentures, preference shares and share warrants. The regulations issued under FEMA also prescribe the pricing and valuation guidelines for equity instruments. The price of shares issued by an Indian joint venture company to a non-resident joint venture party must not be less than the valuation of equity instruments done as per any internationally accepted pricing methodology for valuation on an arm's-length basis as a fair market price, duly certified by a chartered accountant or a merchant banker registered with India's market regulator, the Securities and Exchange Board of India (SEBI), or a practising cost accountant. If shares are transferred from a resident joint venture party to a non-resident joint venture party, the price of shares must be not less than the fair market price. If such shares are transferred by the non-resident joint venture party to the resident joint venture party, then the price of shares must not exceed the fair market price.

Law stated - 31 August 2023

Ultimate beneficial ownership

What requirements are there to disclose the ultimate beneficial ownership of a joint venture entity?

A joint venture entity in India is required to disclose and report its ultimate beneficial ownership under various applicable laws and regulations, particularly under the Companies Act 2013 (the Companies Act) and the Prevention of Money Laundering Act 2002 (PMLA), as applicable. Further, India, as a member of the Financial Action Task Force (FATF), is mandated to achieve the FATF's objectives of combatting money laundering and terror funding. Specific rules, namely the Companies (Significant Beneficial Owners) Rules 2018 and its amendment in 2019, have been framed under the Companies Act to regulate significant beneficial ownership in an Indian company. The said rules envisage the principles of 'beneficial interest', 'significant beneficial owner' and 'significant influence' in the context of companies. Whether or not a party is a significant beneficial owner or exercises significant influence, directly or indirectly, in a company is determined by the degree of shareholding, voting rights, dividend entitlement, and power to participate in the financial and operating policy decisions of the company.

The significant beneficial owner could be a natural person, corporate entity, partnership, trust or pooled investment vehicle. Any party meeting the criteria of being a significant beneficial owner is required to make a declaration to the company to that effect in the prescribed form. The company must also take necessary measures to determine whether or not there is any individual who is a significant beneficial owner and, if so, identify him or her and cause such individual to make a declaration. The company must then report by making the necessary filings with the Registrar of Companies.

As per the PMLA, generally, banking and financial institutions are required to maintain records evidencing the identity of their clients, including joint venture companies in India, and the beneficial owners thereof. In turn, banking and financial institutions are required to report such information to the appropriate government authorities on the triggering of certain prescribed parameters. The joint ventures may be required to make relevant disclosures to the reporting entities. In addition, the SEBI and the RBI also have their own respective sets of disclosure and know-your-customer requirements for ultimate beneficial ownership of the Indian entities.

Law stated - 31 August 2023

SETTING UP AND OPERATING A JOINT VENTURE

Structure

Are there any particular drivers in your jurisdiction that will determine how a joint venture is structured?

The drivers for determining the structure of a joint venture are a combination of commercial considerations and regulatory requirements. The most common factors are:

- the proposed business activities of the joint venture company in India, such as manufacturing, project execution, services and trading;
- the intended time frame for the collaboration by the joint venture parties;
- the limitation of liability exposure to the joint venture parties, depending upon the nature of the business of the joint venture companies and the degree of risk associated therewith;
- the intended management structure and involvement by the joint venture parties in the management of the joint venture;
- the need for capital and flexibility for accessing financing options;
- the intended exit mechanisms from the joint venture and ease of exit for the joint venture parties;
- tax considerations; and
- regulatory requirements.

Based on the above considerations, if the parties intend to create a separate legal entity, have long-term operational objectives and require a formal structure with limited liability, incorporated joint ventures are preferred because of their corporate characteristics. Incorporated joint ventures are also preferred from a governance and accounting perspective. However, if the parties have a limited objective – for example, to execute a project – they may opt for an unincorporated structure in the form of a consortium, as this gives them flexibility at the time of conclusion of their objectives.

Law stated - 31 August 2023

Tax considerations

When establishing a joint venture, what tax considerations arise for the joint venture parties and the joint venture entity? How can tax charges be lawfully mitigated?

The primary tax considerations for a foreign joint venture party while establishing a joint venture in India and investing therein are income tax, dividend tax, withholding tax, capital gains tax and provisions of double taxation avoidance agreements signed between India and the investor's country. A joint venture is subject to corporate income tax on prescribed slabs for taxation calculated on the basis of its income. The joint venture parties themselves will be subject to income tax in the case of declaration of a dividend by the joint venture company in India. Capital gains tax is payable on the sale of shares of the joint venture. If any of the joint venture parties is a non-resident, withholding tax is applicable for any payments made to such a party by the Indian joint venture company.

As India is a signatory to double taxation avoidance agreements (DTAAs) with various countries, non-resident parties from such countries will be allowed to claim beneficial tax treatment, thereby lowering their tax liability. The DTAAs are typically in line with the United Nations model of double taxation avoidance agreements. However, DTAAs with a few countries – such as Singapore, Mauritius and Cyprus – offer a more preferential tax treatment for the investment received from such countries. However, limitation of benefits clauses in such DTAAs will restrict parties from claiming beneficial tax treatment if it is found that the affairs of the non-resident party are arranged with the primary purpose of claiming beneficial treatment under a DTAA or the parties are engaged in treaty shopping for tax avoidance.

Law stated - 31 August 2023

Asset contribution restriction

Are there any restrictions on the contribution of assets to a joint venture entity?

Generally, joint venture parties are allowed to contribute assets to the joint venture entity in India subject to compliance with valuation methods and prescribed accounting treatments for non-cash consideration. The Companies Act 2013 (the Companies Act) provides for the issuance of shares to the joint venture parties for consideration other than cash. In the case of a foreign joint venture party, there are certain additional regulations under the Foreign Exchange Management Act 1999 pertaining to pricing guidelines, and reporting and compliance requirements. Such regulations may vary depending on the nature and business of the joint venture entity, type of asset and the resident status of the joint venture party contributing the asset.

Law stated - 31 August 2023

Interaction between constitution and agreement

What is the interaction between the constitution of the joint venture entity and the agreement between the joint venture parties?

The constitution documents (memorandum and articles of association) of a joint venture company, when registered, become binding on the company and the shareholders as if they had been signed by the company and by each shareholder. In the event that the agreement between the joint venture parties conflicts with the provisions of the constitution documents, the constitution documents supersede and take precedence over the joint venture agreements. Where any restriction is incorporated in the joint venture agreement, but not specified in the constitution documents, such restriction is not binding on either the company or the shareholders. This legal principle was upheld by the Supreme Court of India and reiterated through numerous judicial pronouncements over the years. However, the courts, in recent times, have been making a concerted effort to uphold the sanctity of joint venture agreements and treat them as valid, binding and enforceable between the parties, so long as such agreements are in accordance with the law and not in contradiction with the constitution documents of the company; the joint venture agreement should not be held unenforceable merely because its provisions are not incorporated in the constitution documents. This was observed by the Supreme Court of India in January 2012 in the matter of *Vodafone International Holdings BV v Union of India (UOI) and Ors.*

Nonetheless, to bolster the enforceability of such agreements between the joint venture parties, it is common practice and also recommended that the key provisions under such agreements are expressly incorporated in the constitution documents of the joint venture company. Further, it is pertinent to note that the Companies Act (section 58(2)) provides that any contract or arrangement between two or more persons in respect of the transfer of securities shall be enforceable as a contract. Therefore, a contract between shareholders and the company is binding on the company with respect to the transfer of securities in the event that the constitution documents are silent on the matter. Registration of the agreement is not mandatory; however, the requisite stamp duty is payable on the agreement between the joint venture parties.

Law stated - 31 August 2023

Party interaction

How may the joint venture parties interact with the joint venture entity? Are there any restrictions?

Generally, joint venture parties interact with the joint venture company by way of management participation or by exercising their rights as shareholders of the company. Management participation is done by nominating key managerial personnel or directors to the board of the joint venture company. Although the directors' primary responsibility is towards the company, the nominating shareholders exercise their control over the management of the company provided that such control does not result in an adverse effect on the company. As shareholders, the joint venture parties are statutorily entitled to have access and the right to inspect certain records of the company, such as the constitution documents, audited financial statements, statutory registers and minutes books of shareholders' meetings. The said statutory rights are limited in nature and do not give the shareholders a right to access day-to-day information about the affairs of the company. However, joint venture agreements between parties may provide for additional information and inspection rights to the shareholders, and the same may be incorporated in the constitution documents of the joint venture company to make it binding on the parties and the company.

Law stated - 31 August 2023

Exercising control

How may the joint venture parties exercise control over the joint venture entity's decision-making?

Joint venture parties may exercise their control in the joint venture company's decision-making at the board level and at the shareholder level. Certain decisions are made by the board and certain other decisions are made only with the approval of the shareholders (ie, the joint venture parties). The decision-making process and the rights of the board members and shareholders over decision-making are provided under the Companies Act. Generally, the said statutory rights prescribe decision-making by a majority of the votes at the board level. At the shareholders level, certain decisions need to be approved by an ordinary resolution (ie, by simple majority) and certain important matters are required to be approved by special resolution (ie, by approval of a three-quarters majority of the shareholders present and voting). However, the joint venture agreement between the parties and the constitution documents of the joint venture company may provide for stricter requirements for decision-making at the board level and at the shareholder level than prescribed under the Companies Act.

Accordingly, joint venture parties, especially minority investors, may exercise control over the decision-making of the joint venture company by way of having veto rights, creating a list of reserved matters or affirmative vote matters that can be passed only with the approval of the directors nominated by a specific investor, or requiring the affirmative vote of a specific shareholder at the shareholders' meeting. Further, the agreements and the constitution documents may also provide for special quorum requirements for meetings of the board or shareholders, ensuring representation of the minority investor. In the case of limited liability partnerships and unincorporated joint ventures, there is more flexibility for the joint venture parties to agree on the degree of control and the process to exercise such control.

Law stated - 31 August 2023

Governance issues

What are the most common governance issues that arise in connection with joint ventures? How are these dealt with?

The common governance issues in connection with joint ventures in India arise in relation to the management of the joint venture company, the conflicting business goals and interests of the joint venture parties, and differences of business culture. Issues such as the management of the joint venture company, improper or irresponsible functioning of the board and individual directors acting in the sole interest of their nominating shareholder, rather than the company itself, are of primary concern. Thus, conflicts between the duties of management and shareholders' interests in the company are significant from the perspective of corporate governance. Conflicting business goals and interests of the joint venture partners hinder the smooth functioning of the joint venture company. Such conflicts often result in deadlock situations in decision-making that prevent any further constructive action being taken by the company. Further, differences in business cultures, especially in the context of foreign joint venture parties, also pose a challenge for good corporate governance. Disagreements between the parties, especially with regard to business ethics, can be a matter of concern for joint venture parties, as this may have implications not only for the joint venture company but also for the foreign joint venture party in its home jurisdiction. Effective ways to deal with such governance issues are to establish robust mechanisms of internal control through formal policies and procedures, constituting committees at the board level with a variety of functions and responsibilities to oversee day-to-day operations, and adopting best corporate practices. The parties must also have effective procedures for the resolution of deadlock situations. There must also be proper alignment of the interests and goals of the joint venture parties prior to establishing the joint venture. An important way to tackle corruption-related governance issues is incorporating strict anti-corrupt practice clauses in the joint venture agreements between the parties. Such internal measures can be guided by the corporate governance framework of the Ministry of Corporate Affairs and the Securities and Exchange Board of India.

Law stated - 31 August 2023

Nominee directors

With an incorporated joint venture, what controls exist in your jurisdiction in relation to nominee directors? How should a nominee director balance the potentially conflicting interests of the joint venture company and the appointing shareholder?

Directors nominated by shareholders are vested with the power of oversight over the business operations of the company, are responsible for any cases of non-compliance, and are statutorily bound to act in the best interests of the company at all times and in good faith to promote the company's objectives. Directors are not supposed to act as representatives of shareholders on the board; they have a fiduciary duty towards the company itself. Nominated directors are obligated to avoid situations in which the interests of the company may be in conflict with the shareholders' interests. However, in practice, there are situations where such conflicts arise, particularly when a shareholder has business dealings with the joint venture company. To deal with situations of conflict, the Companies Act enables directors to excuse themselves from participating in meetings where such conflicted transactions or matters are proposed to be considered. Further, significant decisions may be reserved for approval by the shareholders taking away any decision-making powers of the directors, thereby avoiding any possible conflict at the board level. However, while deciding the items that may be reserved for decision-making at the shareholder level, it should be noted that some items can only be resolved at the board level.

Law stated - 31 August 2023

Competition law

What competition law considerations are engaged by the formation and operation of the joint venture? Is approval needed?

The Competition Act 2002 (the Competition Act), read with the Competition Commission of India (procedure in regard to the transaction of business relating to combinations) Regulations 2011, requires mandatory pre-notification of all acquisitions of shares, voting rights, assets or control and mergers and amalgamations (combinations) that cross prescribed thresholds to the Competition Commission of India for its approval prior to completion of the transaction. The thresholds for mandatory pre-notification are set out in terms of assets or turnover in India and abroad. These thresholds are:

- at the enterprise level, the parties to the combination jointly have:
    - in India, assets valued at more than 10 billion rupees or turnover of more than 30 billion rupees; or
    - in India or outside India, in aggregate, assets valued at more than US$500 million including at least 5 billion rupees in India, or turnover more than US$1,500 million including at least 15 billion rupees in India; or
- at the group level, the group acquirer to the combination jointly has:
    - in India, assets valued at more than 40 billion rupees or turnover of more than 120 billion rupees ; or
    -

in India or outside India, in aggregate, assets valued at more than US$2 billion, including at least 5 billion rupees in India or turnover of more than US$6 billion including at least 15 billion rupees in India.

A de minimis exemption, or a small target exemption, for a transaction is available and such transactions do not qualify as a combination under the Competition Act. Accordingly, enterprises that are a party to a combination where the value of assets being acquired, taken control of, merged or amalgamated is not more than 3.5 billion rupees in India, or where the turnover is not more than 10 billion rupees in India, are exempted from the pre-notification requirement under the Competition Act. The de minimis exemption is presently available until 28 March 2027. In general, the Competition Act prohibits combinations that cause, or are likely to cause, an appreciable adverse effect on competition within the relevant market in India. Any such combination is void.

Law stated - 31 August 2023

Provision of services

What are the key considerations in your jurisdiction in structuring the provision of services to the joint venture entity by joint venture parties?

A transaction for rendering services between the joint venture entity and joint venture parties is likely to qualify as a transaction between associated enterprises under the tax laws in India and, thus, would be required to be conducted on an arm's-length basis. The said transaction may also fall within the ambit of a related party transaction under the Companies Act, requiring compliance with the relevant provisions of that Act. The supply of services by the joint venture party to the joint venture entity would also be subject to goods and services tax, depending upon the rule of place of supply.

Therefore, subject to the above, a transaction for provision of services between the joint venture party and the joint venture entity is flexible to be structured based on the commercial consideration of the parties.

Law stated - 31 August 2023

Employment rights

What impact do statutory employment rights have in joint ventures?

India's legal framework for employment consists of various laws, codes and regulations formulated by the central and state governments. Such framework needs to be complied with in the case of employees of the joint venture entity, including employees seconded or transferred to the joint venture entity. For the purposes of applicability of employment laws, employees are broadly categorised as workmen and non-workmen. A workman is a person who is employed in any industry to do any manual, unskilled, technical, clerical or supervisory work and their employment is strictly governed by India's labour laws. Any person working in a managerial or administrative capacity falls under the category of non-workmen and their terms of service are primarily governed by employment agreements.

In the case of secondment, the secondee's employment will be governed by the employment laws applicable for the category in which the secondee falls.

It is not uncommon for foreign joint venture parties to send their employees on secondment to their Indian joint venture company. Generally, secondee employees possess high technical and managerial skills. Employment visa conditions for foreign secondees prescribe a minimum salary of US$25,000 per year as an annual floor limit (except for a few categories of employees, such as ethnic cooks, language teachers and translators). Further, the employment arrangement for secondees is generally structured in such a way that while the secondee maintains an employment relationship with the foreign joint venture party, the secondee also enters into an employment relationship with the joint venture entity. This is to mitigate the risk of creating a permanent establishment or place of business of the foreign joint venture party in India.

Law stated - 31 August 2023

Intellectual property rights

How are intellectual property rights generally dealt with on the creation, operation and termination of a joint venture in your jurisdiction?

Intellectual property (IP) rights are generally licensed by the joint venture parties to the joint venture entity, if required. In some instances, the IP is also assigned to the joint venture entity. The terms and conditions of such licensing arrangements and assignments can be commercially decided by the parties. At present, there is no restriction on the payment of royalties by the Indian joint venture company to the foreign joint venture IP owners. The joint venture parties may retain ownership rights on their background IP and license the same to the joint venture entity.

Typically, on termination of the joint venture, the implications for the IP rights – including for transferred IP, developed IP or foreground IP – are dealt with in the joint venture agreement itself and the parties may agree on various options, such as a buyout of the IP from the joint venture, obtaining a licence for use or a sale of the foreground IP to a third party and distribution of the proceeds.

Law stated - 31 August 2023

FUNDING THE JOINT VENTURE

Typical funding

How are joint ventures generally funded in your jurisdiction? Are there any particular requirements relating to funding and security packages?

Incorporated joint venture entities in India (ie, companies and limited liability partnerships (LLPs)), are generally funded through the infusion of capital by the joint venture partners or by debt. The capital in the company is infused by way of equity instruments or debentures and preference shares compulsorily convertible into equity shares. Debt funding generally includes loans from the joint venture partners, loans from banks and financial institutions by way of term loans, working capital loans or project financing.

The Indian joint venture entity is also eligible to avail itself of loans from its foreign joint venture partners or foreign banks and financial institutions (ie, external commercial borrowings (ECB)), subject to compliance with the conditions prescribed for the same, such as an all-in cost ceiling per annum, minimum average maturity period and end use of the loan proceedings. The Indian authorised dealer bank of the joint venture entity is permitted to allow the creation of a charge on immovable assets, movable assets, financial securities and issue of corporate or personal guarantees in favour of the overseas lender to secure the ECB to be raised by the Indian joint venture.

Typically, the joint venture agreement envisages the funding options to be availed by the joint venture entity and the priority of exploring or availing such options.

Law stated - 31 August 2023

Capital injection restrictions

Are there any legal or regulatory restrictions on the injection of capital into, or the distribution of profits or the extraction of cash by other means from, the joint venture entity?

The injection of capital by a foreign joint venture partner to the joint venture entity is regulated by the Ministry of Commerce and Industry, Department for Promotion of Industry and Internal Trade's Foreign Direct Investment Guidelines in terms of sectoral caps for the investment by a foreign party, pricing guidelines of security instruments to be issued, lock-in periods (if applicable), etc.

Distribution of profits or extraction of cash from the joint venture entity is typically achieved by way of declaration of dividends out of the eligible profit of the joint venture entity or out of any remaining undistributed profits for any previous financial years. Interim dividends can also be declared during any financial year out of the eligible surplus. Dividends are freely repatriable to non-resident joint venture parties. The joint venture partner is also eligible for payments if the joint venture partner provides any services or intellectual property to the joint venture entity.

Further, the joint venture partner may also be paid cash if the joint venture entity exercises a buyback of shares or undergoes capital reduction.

Law stated - 31 August 2023

Tax considerations

What tax considerations should be taken into account in the operation of the joint venture?

During its operation, the joint venture entity is subject to corporate income tax in India. The tax rate for a joint venture incorporated as a company varies between 25 per cent to 30 per cent of its taxable income, plus applicable surcharges based on its annual turnover. Presently, a beneficial tax rate of 22 per cent, plus applicable surcharges, has been provided for companies that do not claim any deductions or incentives and that have not claimed set-off of loss and unabsorbed depreciation carried forward from any earlier years. Further, a concessional tax rate of 15 per cent, plus applicable cess, has been introduced for newly set up domestic manufacturing companies from the tax year 2019–2020 and for domestic companies engaged in the business of generation of electricity from the tax year 2020–2021, provided the company was incorporated on or after 1 October 2019 and has commenced, or will commence, manufacturing or production on or before 31 March 2024 and meets other prescribed conditions.

If the joint venture is incorporated as a limited liability partnership (LLP), the profits earned are liable to income tax at the flat rate of 30 per cent, plus applicable surcharges. However, if the tax payable by the company or the LLP is less than 18.5 per cent (excluding surcharges and cess) of the book profits of the company or LLP, then companies and LLPs are liable to pay minimum alternate tax at the rate of 18.5 per cent, plus applicable cess, on their adjusted book profits.

An unincorporated joint venture may be determined as an association of persons (AOP) and, in such a case, the AOP is treated as a separate entity for the purpose of tax assessment, distinct from its constituting members.

Further, distribution of profits in the form of dividends by a joint venture company and payment of interest, royalties and fees for technical services by the joint venture company to the foreign joint venture party are subject to applicable withholding tax (tax deducted at source), as prescribed under the Indian Income Tax Act 1961 and the applicable double taxation avoidance agreements (DTAAs). For most countries, the rates of withholding tax vary from 10 per cent to 20 per cent depending upon the nature of payment by the joint venture entity and the applicable DTAA based on the country of the joint venture party. Shares of profits from LLPs are exempt from tax in the hands of the joint venture partners of the LLP. There is no group taxation regime in India and each entity in the group is required to be assessed separately for tax purposes and to pay tax on its own taxable income.

Law stated - 31 August 2023

Accounting and reporting issues

Are there any noteworthy accounting or reporting issues for the joint venture parties regarding their investment in the joint venture?

All incorporated joint venture entities, as part of their annual filing, are required to file their annual accounts and annual returns with the Registrar of Companies (ROC) within 30 days and 60 days, respectively, from the conclusion of their annual general meeting. The items to be filed include the balance sheets, profit and loss accounts, and financial statements. The books of accounts must be maintained and prepared in accordance with the Indian Accounting Standards, as prescribed by the Companies Act 2013, and must include, inter alia, disclosures on interests in other entities and related party transactions. Where the joint venture entity and the non-resident joint venture party are construed as associated enterprises, an additional reporting-related compliance requirement is applicable under the transfer pricing regulations in India. In addition, if any of the joint venture parties is a non-resident, then any investment made by such non-resident joint venture party in the joint venture must be reported to the Reserve Bank of India within 30 days of allotment of the shares by the joint venture. The joint venture is also required to disclose significant beneficial ownership through necessary filings with the ROC.

Law stated - 31 August 2023

DEADLOCK, EXIT AND TERMINATION

Deadlock provisions
What deadlock provisions are commonly included in joint venture agreements in your jurisdiction?

The common deadlock resolution provisions in joint venture agreements in India are divided into several steps and follow an escalation matrix. First, the deadlock is referred to the senior officers of the joint venture parties for a commercially reasonable resolution in good faith and on an amicable basis, within a prescribed time frame. If the deadlock is not resolved within this time frame, the parties may have an option to exercise their exit rights, such as put and call options and drag-along and tag-along rights, as may be provided in their joint venture agreement. Additionally, the parties are also given the right to resolve their deadlock through the dispute resolution mechanisms agreed upon in the joint venture agreements. The sequence of exercising the aforesaid rights for the purpose of resolving the deadlocks depends upon the choice of the joint venture party to achieve a particular commercial objective or intention to continue association with the other joint venture party.

Law stated - 31 August 2023

Exit provisions
What exit provisions are commonly included? Does the law restrict any forms of mandatory transfer provision or any basis of calculation?

The most common exit provisions in a joint venture agreement are optionality clauses (ie, put and call options). Such options enable the party exercising such rights to purchase the shares of the other party or sell their shares to the other party. Such clauses are recognised under Indian law and various regulators generally permit such clauses in joint venture agreements.

Drag-along and tag-along provisions are generally present in joint ventures, especially with minority joint venture parties. If the intention is for an outright sale of the joint venture and exit of all parties, the majority joint venture party may be given an option of exercising their drag-along rights to compel the minority joint venture to sell their shares. Contrastingly, tag-along rights enable the minority joint venture party to sell their shares to an incoming party if the majority joint venture party proceeds to sell their shares to that incoming party. Pre-emption rights, such as right of first refusal or right of first offer, are also commonly used by joint venture parties, enabling the non-selling joint venture party to retain control of the joint venture.

In relation to mandatory transfer provisions on account of default or material breach by a joint venture party, the provisions must be properly structured in the joint venture agreements, as the provisions for a reduced price for the defaulting party's shares may be unenforceable if the reduced price does not meet the pricing guidelines under the Foreign Exchange Management Act 1999 (FEMA) for the non-resident defaulting joint venture party.

Further, the provision for exiting the joint venture with assured returns by a non-resident joint venture party holding equity instruments of the joint venture entity with an optionality clause would not be enforceable as per the provisions of the FEMA. Thus, the exit provisions, especially the mandatory transfer provisions, need to be well advised.

Law stated - 31 August 2023

Tax considerations following termination
What are the tax considerations on termination of the joint venture?

In the event of termination of the joint venture and transfer of shares of the joint venture parties pursuant to their exit, the profits arising out of the transfer of shares by the joint venture parties are subject to capital gains tax. Capital gains are classified as either short-term capital gains (equity shares held for less than 12 months) or long-term capital gains (equity shares held for more than 12 months). Tax on long-term capital gains is calculated at 20 per cent for resident joint venture parties and generally at the rate of 10 per cent for non-resident joint venture parties. Tax on short-term capital gains is calculated at the prevailing tax bracket for the parties, which is determined on the basis of the total taxable income of the party.

On winding up of the joint venture, any accumulated profits can be distributed as dividends immediately prior to liquidation and any remaining assets and cash of the company can also be distributed. The dividends declared will be subject to taxation in the hands of the joint venture party. The remaining assets and cash of the company that are distributed shall be taxed as capital gains after adjusting the amounts declared as dividends.

Law stated - 31 August 2023

DISPUTES

Choice of law and resolution methods
In your jurisdiction, are there constraints on the choice of law or the method of dispute resolution provided for in joint venture agreements?

Choice of governing law in an agreement between parties is recognised and accepted by Indian courts. It is common for international commercial contracts, such as joint venture agreements, made between foreign parties and Indian entities to be governed by a foreign law. Generally, the law of the foreign party's jurisdiction or of a neutral jurisdiction is chosen. However, agreements between two Indian parties are necessarily governed by Indian laws.

While the principle of choice of governing law is recognised, such governing law may not have judicial notice by the courts and will, therefore, need to be proved as a fact if the dispute is to be adjudicated by Indian courts. Indian evidence law requires that if a dispute is adjudicated before an Indian court and the subject matter of such a dispute is governed by a foreign law, the party relying on the foreign law will be required to plead and prove such foreign law as if it were a fact to the proceedings. The choice of law must also be bona fide and should not be opposed to public policy.

With regard to dispute resolution mechanisms, arbitration is the most common mechanism for dispute resolution in joint venture agreements. Such arbitration may be seated in a foreign jurisdiction. Courts in India also recognise the right of parties to assign their dispute resolution mechanisms to courts in foreign jurisdictions if such courts ordinarily have jurisdiction over the subject matter of the dispute. However, generally, if arbitration is an agreed dispute resolution mechanism in the agreement, the parties cannot approach a court for resolution of their disputes.

Law stated - 31 August 2023

Mandatorily applicable local law

What mandatory provisions of local law will apply irrespective of the choice of governing law?

There are certain mandatory provisions of local Indian laws that apply to joint ventures, regardless of the parties' choice of governing law. Such mandatory provisions are of the laws applicable to the management and governance of the joint venture entity, such as company law, taxation law, foreign exchange law, competition law, criminal law and employment laws. Matters that are purely contractual in nature can be chosen to be governed by the law agreed upon by the parties.

Law stated - 31 August 2023

Remedy restrictions

Are there any restrictions on the remedies a tribunal can grant that would have a bearing on the arbitration of joint venture disputes? Are there any restrictions on the arbitration of shareholder claims?

While most commercial disputes and breaches of contract in the context of a joint venture can be referred to and settled by arbitration, there are various disputes in the context of a joint venture that cannot be referred to arbitration. Such disputes include those between the joint venture parties with regard to management and administration of the joint venture entity, particularly relating to the subject matter of company law or disputes arising from a violation of certain statutory provisions, where statutory remedies are sought (such as winding up, insolvency or remedies for oppression and mismanagement of the joint venture entity). Such matters are subject to the exclusive jurisdiction of the National Company Law Tribunal (NCLT) or courts.

Law stated - 31 August 2023

Minority investor protection

Are there any statutory protections for minority investors that would apply to joint ventures?

The Companies Act 2013 (the Companies Act) provides various legal protections and rights to minority shareholders of a joint venture company. In the event of oppression and mismanagement of the joint venture company, the Companies Act gives the right to shareholders to approach the NCLT if such shareholders represent no fewer than 100 members of the company or not less than one-tenth of the total number of its shareholders, whichever is less, or hold not less than one-tenth of the issued share capital of the company. Class action suits can also be initiated by a prescribed number of shareholders on behalf of the other shareholders. The Companies Act also provides for various mechanisms for minority shareholders if they wish to exit the company on the triggering of certain events.

From a management perspective, the Companies Act requires various items to be passed by a special resolution (ie, by a three-quarters majority of the shareholders present and voting). Thus, a minority shareholder that has more than a quarter of the shareholding of the company also has the power to control the passing of such special resolutions. At sboard level, certain matters can be decided only with the unanimous approval of all the directors present and voting in the board meeting. Such matters primarily include decisions on investments, or giving loans, guarantees or securities by the joint venture company.

Regardless of the choice of governing law of the parties to their joint venture agreement, the aforementioned rights are always available to the minority shareholders of the joint venture company.

Law stated - 31 August 2023

Liabilities
How can joint venture parties have liabilities to each other beyond what is expressly agreed in the joint venture agreement?

The liabilities of joint venture parties towards each other are typically governed by the joint venture agreement between them. However, in some instances, courts have recognised the fiduciary duties of one joint venture party to the other party, similar to a partnership, depending upon the terms of the joint venture agreement.

In relation to the liabilities of joint venture parties towards third-party claims, the nature and extent of liabilities depend upon the structure of the joint venture. In the case of incorporated joint ventures, generally, joint venture parties are not liable towards third parties for the acts of the joint venture entity, except in certain instances where the separate legal identity of the joint venture was compromised by the joint venture parties for their own gain and the corporate veil is lifted because it is determined that fraudulent and dishonest use was made of the joint venture entity by the persons who are in control of the joint venture entity.

Law stated - 31 August 2023

Disclosure of evidence
Are there any particular issues that can arise in joint venture disputes in your jurisdiction concerning disclosure of evidence?

In the context of disclosure of evidence, the general rule is that a party intending to rely upon a document is bound to produce the same document before the arbitrator or court, share a copy of the same with the opposite party and make the original document available for inspection.

Further, a party to the dispute is permitted to obtain materials and documents from the other party by way of discovery. Any party may approach the court or the arbitration tribunal for an order directing the other party to make discovery of documents relating to the subject matter of the dispute.

However, there are instances where a party can claim privilege. In such instances, the documents can be treated as protected from production. Such privilege is available for attorney–client communication, where the production of documents is contrary to the public policy of India or where the production of documents may incriminate the party.

Law stated - 31 August 2023

MARKET OVERVIEW

Jurisdictional advantages
What advantages does your jurisdiction offer for parties wishing to set up and operate joint ventures?

India continues to be an attractive investment destination for foreign parties wishing to set up and operate their businesses. The most attractive factors that make India a destination of choice for foreign investments are that India is a large developing economy and a large consumption base, with a young workforce and recently introduced structural tax reforms. The legal and regulatory framework has been made investor-friendly, especially from the perspective of a foreign investor. The compliance regime has also been streamlined and various structural changes have been made, such as streamlined insolvency law, and proposed codes for labour and employment laws.

From a taxation perspective, India has entered into double taxation avoidance agreements with many countries, thereby enabling foreign parties to benefit from lower taxation compared to domestic tax rates. Foreign exchange control laws are also constantly being liberalised to further boost foreign investment; the limits for foreign investment in most sectors is 100 per cent without any government approval. India also has bilateral investment treaties with many countries to offer favourable conditions and treaty-based protection to the foreign investors and investments.

The government of India is developing various industrial corridors to promote manufacturing in various sectors.

The impartiality of courts in India, and the recognition and enforceability of foreign judgments and foreign arbitral awards also provide incentives to foreign parties.

Law stated - 31 August 2023

Requirements and restrictions
Are there any particular requirements or restrictions relating to joint ventures in your jurisdiction that could deter international investors?

Despite moves to streamline and liberalise the regulatory framework in India, certain compliance requirements remain, especially in sectors that are highly regulated, which may deter foreign investors. In relation to foreign investment, while most sectors have been liberalised, restrictions, caps and conditions on foreign investment remain in certain sectors that may deter foreign investors. Some examples of such restrictions include local sourcing requirements for the retail sector, minimum lock-in periods for investments in some sectors and the inability to exercise certain shoot-out exit clauses.

Further, at present, foreign direct investment into India and the formation of a joint venture with an entity from any country that shares a land border with India, such as China (including Hong Kong), Nepal, Pakistan, Bhutan, etc, require prior permission from the Indian government. This process involves multiple layers of security clearance due to national security concerns.

Law stated - 31 August 2023

UPDATE AND TRENDS

Key developments of the past year

What are the current trends affecting joint ventures in your jurisdiction? What recent developments in legislation and case law have had an impact on joint ventures?

The government of India continues to introduce various schemes, policies and reforms to boost economic activity resulting in foreign investment.

Continued trends in the liberalisation of various sectors and the proposed privatisation of certain public sector undertakings have a direct bearing on the possibility of joint venture activity in India. The flagship Make in India scheme and an emphasis on making India self-reliant has given a further push to localisation and domestic production.

As a result, a trend is emerging towards localisation of industry in India for the domestic market as well as the global supply chain – leading to an increasing trend in setting up joint ventures in India.

With regard to recent legislative advancements, the Digital Personal Data Protection Act, 2023 (the DPDP Act), which has become a law after receiving Presidential assent on 11 August 2023, holds the objective of safeguarding the personal data of a person. It establishes a system of checks and balances for the handling of such personal data. While the DPDP Act holds the status of a 'statute', its provisions have not come into effect thus far. The provisions of the DPDP Act will come into effect on a date that the central government may announce in the Official Gazette.

Notably, the DPDP Act pertains exclusively to personal data that is collected in digital form or non-digital data that is digitised subsequently. The Act is also applicable to digital personal data that is processed outside of India, provided such processing is linked to activities related to the offering of goods or services to data principals (data subjects) within India.

Joint ventures often involve the sharing of resources, information, and personal data between different entities. The DPDP Act's regulations could potentially be relevant to joint ventures during various stages of their existence, and thus, joint ventures should be watchful in processing and utilising their data at every such stage. These stages include the pre-establishment of the joint venture entity (such as the sharing of data for conducting due diligence), operating the joint venture entity (such as using the customer data for analytics purposes), and exiting the joint venture entity (such as ascertaining which joint venture partner can lawfully retain the data after the joint venture comes to an end). In these contexts, the provisions of the DPDP Act would be relevant in outlining how data protection measures should be observed and managed by the parties involved in the joint venture. This implies that the guidelines under the DPDP Act could be considered and followed by joint ventures to ensure the appropriate handling of personal data throughout their lifecycle, from inception to operation to the eventual conclusion of the joint venture.

Further, the High Court of Delhi, in March 2023, in the matter of*ITD Cementation India Limited v/s SSJV ZVS Joint Venture & Ors.* passed a significant judgment on the issue of lifting the corporate veil on joint ventures in India. The court held that, in such a case, all the joint venture partners are jointly and severally liable to third parties. This ruling has established two main principles: first, joint venture partners can be held vicariously liable for the actions of the joint venture entity, even if it is a separate legal entity; and second, joint ventures are akin to partnerships and must therefore also comply with the principles of partnership laws. The said ruling of the High Court of Delhi provides clearer guidelines to foreign parties contemplating forming joint ventures in India regarding their potential liabilities emanating from their joint ventures in India.

Law stated - 31 August 2023