

# Regulatory Hotline

January 21, 2014

## REGULATORY REGIME FORCING COS' 'EXTERNALISATION'

With Indian companies rapidly expanding their presence internationally, there has been an increased keenness in companies operating in high growth sectors to migrate their holding company structures from India to reputed offshore jurisdictions. For lack of a better word, let's refer this process of structuring/ restructuring as 'externalisation' as that term may fit the reference better than 'globalisation' or 'internationalisation', both of which have much wider imports.

There are several drivers for externalisation. First, it moves the businesses away from Indian tax and regulatory challenges into jurisdictions that may be more conducive from an operational standpoint and also substantially mitigates tax leakage and regulatory uncertainty. Unwritten prohibition on 'put options', retroactive **taxation** of indirect transfers, introduction of general anti-avoidance rules fraught with ambiguities, etc, are a few examples why Indian companies may want to avoid direct India exposure.

Second, from a fund raising perspective, it offers Indian companies to connect with an investor base that understands their business potential and thus values them higher than what they would have otherwise been valued at in domestic markets. **Infosys**, **Wipro**, Rediff, Satyam are classic examples of companies which preferred to tap the global capital markets (NYSE and **Nasdaq**) without going public in India.

Third, with the Indian currency oscillating to extremes, one of the biggest concerns for foreign investors is currency risk. By investing in dollars in the offshore holding company (OHC), foreign investors can be immune from the currency risk and benefit from the value appreciation of the Indian companies. Many foreign investors that invested in 2007 when the rupee was at around 42 to a dollar have suffered substantially with the rupee now being at 62 to a dollar.

Fourth, and this is more of a recent issue, with the coming of the new Companies Act, 2013, which provides for class-action suits, enhanced director liability, statutory minimum pricing norms (beyond exchange control restrictions), there will be keenness to flip the structure to an OHC and ring-fence potential liabilities under the Companies Act, 2013.

Lastly, such offshore jurisdictions also provide for great infrastructure and governmental policies that are discussed with businesses and are more closely aligned to growth of the businesses as against meeting revenue targets. With most clients offshore, there may be certain amount of snob value that may be associated with establishment in such offshore jurisdictions.

Indian tax and regulatory considerations play a very important role in externalisation. From a tax standpoint, flipping the ownership offshore may entail substantial tax leakage, and to that extent it is advisable if the flip is undertaken at early stages before the value is built up in the Indian asset. Another challenge from a tax perspective is the choice of jurisdiction for the holding company in light of the impending general anti -avoidance rules that may disregard the holding company structure if it is found lacking commercial substance. To protect the tax base from eroding, some of the developed countries like the US have anti-inversion tax rules which deter US companies from externalising outside the US.

From a regulatory standpoint, one of the challenges is to replicate the Indian ownership in the OHC, especially since swap of shares or transfer of shares for consideration other than cash requires regulatory approval, which may not be forthcoming if the regulator believes that the primary purpose of the OHC is to hold shares in the Indian company. Indian companies may be restricted from acquiring shares of the OHC on account of the OHC likely qualifying as a financial services company and Indian individuals may be restricted to acquire shares of the OHC under the new exchange control norms since OHC will not be an operating company. The extent of operations to be evidenced remains ambiguous. OHCs acquisition of Indian shares will also need to be carefully structured as the OHC will not be permitted to acquire Indian shares at below fair market value from an Indian tax and exchange control perspective.

India has recently allowed Indian companies to directly list on offshore markets, but the conditions that such listing can only be for 51% shares of the Indian company and that the proceeds of such issuance must be used overseas within 15 days may not allow the true potential of offshore listings to be unleashed. The utilisation of the direct listing regime remains to be seen as the Sebi is yet to come out with a circular setting out disclosures required for such listing.

However, considering the challenges faced by **India Inc**, the need to move away from India for growth seems inevitable in current times.

This article was published in The Economic Times dated January 15, 2014. The same can be accessed from

## Research Papers

### The Tour d'Horizon of Data Law Implications of Digital Twins

May 29, 2025

### Global Capability Centers

May 27, 2025

### Fintech

May 05, 2025

## Research Articles

### 2025 Watchlist: Life Sciences Sector India

April 04, 2025

### Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

### INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

## Audio

### CCI's Deal Value Test

February 22, 2025

### Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

### Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

## NDA Connect

Connect with us at events, conferences and seminars.

## NDA Hotline

Click here to view Hotline archives.

## Video

### Vyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX

April 01, 2025

the link.

– Ruchir Sinha & Nishchal Joshipura

You can direct your queries or comments to the authors

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.

Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business  
March 19, 2025

SIAC 2025 Rules: Key changes & Implications  
February 18, 2025