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India: Trends & Developments

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Trends and Developments

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Khaitan & Co

Khaitan & Co was founded in 1911 and is one of India's oldest and best-recognised full-service law firms. Its offices in Delhi-NCR, Mumbai, Bengaluru, Kolkata, Chennai, Pune, Ahmedabad and Singapore, and in international country-specific desks give it a strong pan-Indian and overseas presence. The private-client practice group at Khaitan & Co advises a range of national and international clients including large promoters, global Indian families, banks and financial institutions with respect to their private-client needs, trustees, family offices, and HNWIs. The highly ranked team at Khaitan & Co comprises professionals with the necessary expertise and experience in areas such as trusts, taxation, Wills and other testamentary instruments, obtaining probates, approvals from regulators, advice pertaining to corporate and securities laws and court-related dispute resolution. The team further draws upon its expertise in other areas of practice such as real estate and intellectual property.

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Investing In and Out of India, and Other Relevant Private Wealth Activities, in 2024

Introduction

The Indian private client practice landscape is undergoing significant transformations driven by economic growth, regulatory changes, globalisation, the political landscape, and evolving client expectations. Motivated by the need to boost India's footing as a global economy, the government has been undertaking sweeping changes to Indian laws. This has not only led to increased client sophistication and awareness but has also generated a need amongst the Indian private client practitioners to expand their horizons to meet the said expectations. The recent pandemic has also created an increased demand for succession planning and preparation of "Living Wills". Further, the expectation that the ruling government (which has now been re-elected for a third consecutive term) might reintroduce an inheritance tax and gift tax has led to an increased rush amongst Indians to safeguard their assets and create an effective succession plan which can insulate them from the advent of these ever-changing regulatory impositions. This comprehensive analysis explores key regulatory, tax and legal changes within India and abroad which are likely to shape the Indian private client practice in 2024.

Indian law and policy: critical developments and key regulatory movements

A uniform civil code

To date, the legal spheres of marriage, divorce, guardianship and succession have been governed by the personal and religious law applicable to an individual. Enshrined as a "directive principle" in the Indian Constitution, the introduction of a uniform civil code (UCC), to remove differences of personal laws has been a hotly debated issue. While claims of such introduction have been raised by the Centre every few years, even going so far as to set up a Legislative Committee to explore the viability of a UCC, the introduction has been contested by almost every community in India. Despite the debate, in 2024, the state of Uttarakhand became the first to introduce a UCC, applicable to the residents of their state, though the practical implementation of the UCC and the possible extension to the rest of the country is yet to be seen. Given that the current government has once again come into power, it is highly possible that a UCC will be introduced in other states as well.

Advance Medical Directives (AMDs) in India: a journey through legal reforms

In 2018, the Supreme Court of India (SC) had recognised passive euthanasia and laid down the framework for AMDs in India. The framework covered all aspects relating to the content, execution, and revocation of an AMD (2018 directions).

The AMD is a document limited to specifying the executor's (the person making the AMD) wishes with respect to their medical treatment in case of a terminal illness. The document must clearly specify circumstances under which medical treatment may be withdrawn. An AMD does not govern a person's financial aspects or investment decisions.

The 2018 directions were intended to be an interim measure until relevant parliamentary legislation was made. However, the 2018 directions were perceived to be complex and impractical considering the strict safeguards incorporated. To resolve the complexities, the SC in 2023 revised the directions and procedures required for the execution of an AMD (2023 directions).

The 2023 directions envisage the following key changes.

- Significantly reduced role of the "judicial magistrate first class" in execution and preservation of an AMD.
- Experience requirements for constituting the primary and secondary medical board relaxed.
- Timelines suggested for medical boards to provide their opinion on the condition of the patient.

The legal framework regarding AMDs is still complex and there is a lacking awareness regarding the judicial directions on the subject. There are instances where competent officials designated under the 2023 directions are yet to be appointed. Despite progress, practical challenges remain until a proper legislation is enacted on AMDs. In a recent first in the state of Goa, an AMD was registered by the senior-most presiding judge of the Bombay High Court at Goa. This is aimed to set an example for individuals who wish to have their AMD executed.

Recognition of surrogacy and Assisted Reproductive Technology (ART) laws and associated challenges

In India, it was only in 2021, that comprehensive laws on surrogacy and ART were enforced. The principal Indian surrogacy laws are the Surrogacy (Regulation) Act, 2021 (Surrogacy Act) and the Surrogacy (Regulation) Rules, 2022 (Surrogacy Rules). Further, the Assisted Reproductive Technology (Regulation) Act, 2021 (ART Act) was enforced in 2021.

While the above legislation is welcome, there are several issues that stem from the same.

- The ART Act is only procedural in nature and lacks substance.
- Only married couples (having medical indication necessitating gestational surrogacy) and ever-married single women (widowed or divorced) can seek surrogacy after satisfying the plethora of conditions prescribed. This has led to exclusion of several communities from availing the option of surrogacy and has led to challenges on the constitutional validity of the Surrogacy Act.
- Earlier, as per the Surrogacy Rules, a couple undergoing surrogacy was required to have both gamete (a reproductive cell comprising a single set of dissimilar chromosomes – half of the genetic material required to create an organism) from the intending couple without the assistance of a donor. In February 2024, an amendment was made to the Surrogacy Rules through which the use of donor gamete was allowed. However, this is only permitted in situations where either the husband or the wife suffers from a medical condition necessitating the use of a donor gamete.

Even though the above-mentioned legislation has been instrumental in determining the law on surrogacy and ART services, it will be interesting to see whether the exclusions envisaged under the laws will stand the test of constitutional validity, and it is believed that landmark judgments from the constitutional courts will be necessary to settle the position of law.

Nominee rights under the Companies Act: the SC's clarification

The SC has in the case of Shakti Yezdani and Anr. v Jayanand Jayant Salgaonkar and Ors., conclusively resolved the conundrum in relation to the rights of a nominee vis-à-vis legal heirs over the devolution of securities.

The SC, on its careful perusal of the relevant provisions of the Companies Act, 1956 (and pari materia provisions under the Companies Act, 2013) ("Companies Act") regarding nomination by a security holder, declared that the provisions of the Companies Act do not override testamentary and intestate succession laws, thereby clarifying that the rights of a legal heir would prevail over that of a nominee in the case of shares and securities governed by the Companies Act. The interpretation of the SC was based on the consistent views taken by the lower courts while interpreting the provisions of nominations under different statutes.

Debate on reintroduction of estate duty

The potential reintroduction of estate duty has become a hotly debated topic in India and has remained a contentious issue throughout the last decade. Due to this, high-net-worth individuals (HNWIs) are seeking advice from practitioners on ways to counter the impact of the potential reintroduction of estate duty in India.

Setting up of irrevocable private trusts is being seen as the popular choice amongst Indians. The transfer of assets to a well-structured trust removes assets from an individual's estate while the individual may retain control and benefit from the said assets to a certain extent. The key is structuring the trust comprehensively to also address other succession objectives such as mitigating family disputes, protection from business liabilities or matrimonial discord. However, the exact nature of the law (if and when reintroduced) remains uncertain, and there is always a possibility that estate duty may also be imposed on trusts and hence any structuring carried out at this stage with a view to safeguard assets against estate duty will need to be revisited.

The estate duty regime was enforced in India through the Estate Duty Act, 1953, with the goal of reducing economic inequality. However, the high administrative costs for its enforcement made it unviable and led to its repeal in 1985. Anticipation of its return is fuelled further by the fact that income and wealth inequality in India at present is at the highest level. It is believed that the top 1% of the population of India has control over 40% of the wealth of the country. However, there is no clear visibility on whether the tax will be re-introduced any time soon.

Impact and potential of revamped overseas investments framework

In 2022, the government of India in consultation with the Reserve Bank of India (RBI), with a view to liberalise global investments from India, revamped the overseas investments framework (New OI Framework). The New OI Framework deals with overseas investment by persons resident in India in equity, debt and immovable properties and overhauls the previous legal framework applicable to such investments. A recent amendment in the New OI Framework has opened further opportunities by enabling overseas investment in funds that are indirectly regulated (by virtue of the fund manager being regulated) instead of being directly regulated by the financial regulator of the host country.

The New OI Framework, even though landmark in nature, is believed to have fallen short in addressing some ambiguities.

- Round-tripping – "round-tripping" (an Indian entity investing in a foreign entity which in turn holds an investment in an Indian entity) was previously prohibited. The New OI Framework relaxes the said constraints whereby it is now provided that "no person resident in India shall make a financial com-

mitment in a foreign entity that has invested or invests in India, at the time of making such financial commitment or at any time thereafter, either directly or indirectly, resulting in a structure with more than two layers of subsidiaries". However, the method of determining layers of subsidiaries lacks clarity leading to ambiguity in interpreting whether the subsidiaries commence at the foreign entity or at the Indian entity level.
- Bona fide business activity – under the New OI Framework, "bona fide business activity" has been defined as any business activity permitted under the laws of both India and the host country. However, within India, variations as to permissibility of activities exist across different states. For instance, online gaming and the sale of liquor are legal only in certain states. In such instances, it is unclear whether foreign investments may be made into businesses engaged in the above-mentioned activities.
- Liberalised Remittance Scheme (LRS) investments and unlisted debt – it is not uncommon for Indian HNWIs to park/invest a certain portion of their wealth abroad by making outward remittances under the LRS. As per a recent report of the RBI, LRS remittances surged to a new high in the financial year (FY) 2023–2024. However, the New OI Framework restrains individuals from parking idle funds abroad beyond a period of six months and requires such funds to be repatriated back to India. This has also led to issues where some foreign banks have a minimum balance requirement. Further, under the LRS, investment into unlisted debt is prohibited raising concerns as to whether investments made into foreign fixed deposits would be treated as "unlisted debt".

"Family offices" – talk of the town: Family Investment Funds (FIFs) in the International Financial Services Center (IFSC) at Gujarat International Finance Tec-City (GIFT)

In India, HNWIs have historically been known to invest in various offshore jurisdictions largely to safeguard their wealth from the Indian tax system. While individual remittances are one avenue, larger offshore investments by HNWIs are generally managed and controlled through overseas family offices. Due to India's robust taxation system and strict foreign exchange controls, setting up an Indian family office which enabled investment diversification has proved difficult and relatively disadvantageous to the rich.

However, with the introduction of FIFs in GIFT IFSC, the government has recognised the wealth drain and has demonstrated its intent to formalise a family office structure whilst providing a tax efficient regime. FIFs are regulated through the International Financial Services Centres Authority (Fund Management) Regulations, 2022 ("FM Regulations"). A FIF is an investment fund pooling contributions made by a single family. The initially restrictive definition of a "single family" (individual lineal descendants of a common ancestor, including their spouses and children) has now been broadened encompassing entities, including trusts where the family maintains control and holds significant economic interest (directly or indirectly).

The revised definition of "single family" has far reaching favourable implications:

- allowing HNWIs to utilise funds parked in existing structures without having to liquidate;
- restricting individuals with a limit of USD250,000 under the LRS – however, overseas portfolio investment (OPI) from

listed and unlisted entities is allowed up to an amount equivalent to 50% of the net worth of that particular entity; and
- while trusts are used by Indian HNWIs as succession planning tools, LRS investments by trusts are specifically prohibited – by including trusts in the definition, HNWIs are now provided with avenues to mobilise the said structures as family offices.

All FIFs set up in GIFT IFSC will be treated as non-resident for foreign exchange purposes and, hence, not be curtailed by the Indian exchange control regulations in making offshore investments.

In addition, the following incentives, among others, are provided to FIFs making it an attractive proposition similar to the incentives provided in favourable overseas jurisdictions.

- They are exempted from satisfying net worth criteria prescribed under the FM Regulations and are only required to maintain a minimum corpus of USD10 million within three years from obtaining a certificate of registration.
- Ten-year tax holiday on business profits earned by any unit in GIFT IFSC.
- Capital gains earned by FIFs set up as trusts or LLPs are taxed only at one level exempting distributions to family members.

This is primarily aimed at incentivising families that have migrated their business and assets overseas, to return to and generate wealth in India whilst having the status and benefits available to a non-resident. In a recent development, the IFSC Authority granted its in-principle approval to two family offices to set up FIFs. Many more applications seeking approval are pending and in due course, Indian families will be able to explore global investment opportunities through FIFs.

Current trends in India

Establishment of private trusts in anticipation of a divorce/separation

Matrimonial disputes at present are at an all-time high in India, with a report of the United Nations suggesting that the number of divorcees have doubled in the past two decades in India. Due to the rising matrimonial disputes, it is now a common practice to establish private trusts to mitigate financial impact. This trend is more commonly witnessed amongst affluent families having significant joint family assets. The intent of establishing such trusts is to insulate the family estate from claims arising from the matrimonial dispute. Trusts are preferred in India because the law in relation to pre-nuptial agreements is grey and a typical pre-nuptial agreement lacks legal recognition.

Generally, an irrevocable discretionary trust is created with independent professional trustees; and family members including future descendants are named as beneficiaries. Transferring assets into a well-structured trust removes the assets from personal net worth calculations during divorce settlements and in the event of a divorce, the female spouse does not have any rights over the trust assets.

Typically, under an asset protection trust, spouses are either entirely excluded from trust benefits or removed from the list of beneficiaries upon the occurrence of specified events, such as the initiation of divorce proceedings. Such trusts would require that the family member who is facing any claims does not have direct control/ownership over the trust's operations or assets.

Family businesses: succession planning and business continuity

In India, reports suggest that family businesses (FBs) account for nearly 70% of the gross domestic product. Although multiple studies have indicated that generally FBs have witnessed growth over the years, FBs are increasingly encountering challenges in relation to ensuring seamless transition to future generations.

Unique to India is the Hindu law on joint family properties and businesses. Simply put, a joint family business is one which is owned and carried out by a joint Hindu family, ie, between various family branches or where joint family funds have been used to set up and grow the business. The lack of clarity regarding the delineation of source of funds and ownership, coupled with the lack of codification of Hindu law, has created a legal lacuna within which members of the larger family, who have not actively contributed to the creation or growth of the business, are laying claim over the business assets. Further, there is growing conflict on who within the family will control the business with younger generations having a difference of opinion on the running of a FB.

Claims are usually levied stating that the origin of funds was borne out of an ancestral pool of funds, leading to the business being a joint family business, even if not reflected in its current ownership. These claims result in an FB and its members being embroiled in litigation, leading to erosion of wealth, reputation and, more importantly, legacy. This also serves as a repellent for financial investors who do not wish to tangle with a familial dispute.

Ownership and management of FBs require alignment in vision of multiple generations and robust succession planning to ensure business continuity and growth. Indian promoter families have adopted a proactive approach towards business succession planning – not only with ownership but also with management succession.

These issues have created awareness amongst families that it might be easier to separate the FB which will ultimately help in keeping the family together, and this approach has resulted in the structuring and execution of large-scale family settlements, family separations and family constitutions.

Cross-border wealth planning: strategies for Indian HNWIs

Protecting wealth: Indian HNWIs and the proposed UK non-domicile tax reforms

The newly elected UK government has confirmed the abolishment of the current tax regime for non-UK domiciled individuals ("non-doms") and its replacement with a residency-based regime from April 2025. The current tax regime provides flexibility to non-doms to safeguard their global income and gains from being taxed in the UK so long as they are not remitted into the UK. This regime will be abolished, with some amendments to the original proposal such as not introducing a 50% reduction in taxable foreign income for individuals who lose access to the current beneficial remittance basis of taxation in the first year of implementation of the new regime.

In addition, it is also intended that changes are made to the current inheritance tax (IHT) from 6 April 2025. All non-UK assets held in "excluded property trusts" (non-UK assets held in trusts that were settled by non-UK domiciled individuals) will be liable for IHT. For UK residents of more than ten years, their UK and non-UK assets will be liable for IHT. However, if the settlor has

been non-resident in the UK for more than ten years, non-UK assets should not be liable for IHT, dependent upon the so-called "ten-year tail".

Hence, the heavily employed strategies by Indian HNWIs with a UK nexus such as the use of a domicile opinion and statement are undergoing re-evaluation. The reforms in the UK tax regime for non-doms have led to rising concerns amongst non-resident Indians, recent migrants to the UK, and people who are planning to shift base to the UK. However, it should be noted that this is for the purpose of UK residents paying appropriate tax rather than successfully avoiding such fundamental obligation. Furthermore, it should be emphasised that non-UK assets for non-UK residents of at least ten years will not be liable for IHT.

Impending reductions in the US estate duty exemptions drive surge in trust set-ups

In the US, the temporarily increased federal lifetime gift and estate tax exemption limits (USD13.61 million in FY 2024) are proposed to be significantly reduced from 1 January 2026 onwards. The exemption limit is proposed to be reduced to around USD7 million. Estates exceeding the exemption limit could be taxed at rates of up to 40%.

To mitigate the effects of reduced gift and estate tax exemption limits, Indian HNWIs with a US nexus are proactively planning and consulting with their legal advisers to establish trust structures which would shield their estate from the US estate tax. There is also a significant increase in lifetime gifts being made to the non-US family members.

This has given rise to significantly unique trust structures which meet the estate planning objectives, both from an Indian as well as US legal and tax perspective.

Looking ahead: key takeaways for 2024

India remains a compelling jurisdiction for private-client advisers and consultants due to its massive economy, reform-oriented government policies, joint Hindu family businesses, growing per capita income and a comprehensive exchange control framework. With the government and judicial focus shifting to the sphere of succession, marriage, surrogacy, and divorce, the private-client practice outlook for 2024 in India looks intricate, exciting, and consistently captivating.

All eyes are now on the next set of reforms that will be introduced by the ruling government which seems entirely focused on bringing about regulatory reforms which will largely affect the private-client practice, be it socio-economic reforms focused on the poor such as a UCC, or legislative reforms such as "estate duty" which will focus on the rich.

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