

Private Client Wrap

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PRIVATE CLIENT WRAP: 2013 IN REVIEW

How did 2013 impact your personal wealth planning?

- Resident individuals surprised by a sudden reduction in outward remittance limits; acquisition of offshore immoveable property also disallowed
- Individuals with taxable income above INR 10 million face a 10% surcharge
- Beneficiaries of private trusts can initiate arbitration, says Bombay High Court
- A land ceiling bill appears to be in the pipeline
- Upper House of Parliament passes a landmark bill amending marriage laws; entitles the wife to a share in her husband's property upon divorce due to 'irretrievable breakdown of marriage'

Dear Reader,

As yet another year has drawn to a close, we can look back and ruminate, yet again, as to how it has been a mixed bag of happy and not-so-happy events. On the one hand, the Indian economy suffered its worst slowdown in over a decade and the rupee hit a lifetime low of 68.85 against the US dollar. The Indian legislature was at its least active in 2013 in the history of Indian independence, and several significant bills were kept pending on account of political standstill. On the other hand, positive changes have begun to come about due to an increasingly vocal cosmopolitan class, and its frustration at the inability of the government to keep pace with the country's aspirations. Idealism has formed the zeitgeist of the times, with anti-corruption, prevention of sexual harassment, corporate social responsibility and LGBT rights taking centre stage. It has often been said that India evolves in spite of its government and not because of it, and there is optimism that 2014 will bring about change.

2013 was chequered on the private client front as well, as the key legal highlights below will demonstrate. In December, Christie's generated USD 15 million in its maiden Indian auction in Mumbai, and it is anticipated that this auction, although small compared to Western standards, will herald the growth of the Indian art market in the coming years. India is the most vibrant luxury goods market as per a recent survey by Euromonitor and this is expected to influence other sectors as well. On the other hand, the broader dynamics will continue to be dictated by the legal regime – for example, the restriction on Indians remitting funds for immovable property purchases.

So, with the holiday season giving way to a new year, let's take a look back at key legal events of 2013 that affected personal wealth planning in order to equip ourselves better for what 2014 might bring.

1. RESTRICTION ON OUTWARD REMITTANCES

India still runs under a framework of exchange controls, and the Liberalised Remittance Scheme (LRS) restricts the purposes for and extent to which resident individuals can remit monies offshore. Although the LRS comes with a remittance cap, this cap has been progressively enhanced. Since 2007, individuals had enjoyed an upper limit of USD 200,000 per individual per year when in a sudden and unexpected move on 14 August 2013, the quantum was slashed to USD 75,000. The move seems to have been motivated by the poor show of the rupee against the dollar, and was accompanied by a disallowance on the use of outward remittances for acquisition of immovable property outside India (directly or indirectly). Meanwhile, Finance Act, 2013 also introduced a 1% withholding tax on payments made to resident Indians selling certain immovable property, if such sale price exceeds INR 5 million. Payments to non-resident sellers (including NRIs) would continue to have tax withheld at 20%.

The LRS amendment does not impact property which has been purchased prior to 14 August 2013 – due to the regulatory remittance limit, this was typically done by pooling of funds in an offshore vehicle and taking some leverage in the offshore vehicle, which was then serviced out of LRS funds. Existing owners can continue to service such loans but will not be able to take any new loans. With the rupee strengthening, it is hoped that the August changes were only a temporary measure and that 2014 leads to further liberalization of the LRS. Meanwhile, there has been a global focus on detailed disclosure and enhanced regulatory scrutiny. India has also introduced domestic measures and signed tax information exchange agreements to bolster its supervision of high value holdings and cross-border transactions, which is a trend expected to continue.

2. TAXING THE "SUPER-RICH"

In Budget 2013, the Indian Finance Minister announced the imposition of a surcharge (tax on tax) of 10% on individuals with an annual taxable income of INR 10 million taking the marginal tax rate to 33.99%. Although this surcharge was a temporary measure applicable only for FY 2013-14, the adoption of such a measure shows India's increasing alignment with global measures on the issue of taxing HNIs and UHNIs, which is also reiterated by certain proposals in the draft Direct Taxes Code Bill (DTC) slated to be introduced in 2014.

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The Indian Government was also showing a keen interest in re-introducing estate duty in Budget 2013 but it did not do so. The reason for repealing the earlier regime (1953-1985) was the skewed ratio of administrative costs to duty collected. Economists believe that this reason may no longer hold good in the face of increasing personal wealth and better collection machinery. While there has been no further update, and as the Government seems to have turned its attention more to strengthening tax administration and enforcement, HNIs have already begun to think of long term succession and wealth planning for their global assets.

3. ARBITRATION OF TRUST DISPUTES

Litigation in India is time consuming and expensive, and most parties prefer arbitration for dispute resolution. However, there is ambiguity as to the arbitrability of trust disputes, since the beneficiaries to a trust are not "parties" to the arbitration agreement. This creates issues since Indian private wealth structures are primarily focused on the use of trusts.

The Bombay High Court examined this point in an unreported case of Mr. Jayesh Dinesh Shah v. Kaydee Family Trust (March 6, 2013). The case revolved around a regular trust created by a settlor in favour of 6 beneficiaries, all of whom were minors at the point of time when the trust was created. The trust deed specifically included a clause for resolution of disputes by way of arbitration "*between the Trustees, or the Trustees and beneficiaries, or the beneficiaries inter-se*". The beneficiaries were not signatories to the trust. Three of the beneficiaries sued for appointment of an arbitrator with respect to a dispute against the trustee and the remaining beneficiaries. The Court had to consider whether beneficiaries, who were not signatories to the trust, could be bound by the obligations under the trust deed, particularly when they were minor without the capacity to enter into a contract. It was held that "*the definition of party' has to be interpreted harmoniously and the beneficiaries, who were referred in the said Trust Deed had to be construed as if the beneficiaries were also party to the arbitration agreement.*" There was a previous Delhi High Court judgment on this point in Ms. Chhaya Shriram v. Deepak C. Shriram, 150 (2008) DLT 673 (NULL), which ruled otherwise, and therefore this issue may not yet be at rest. An appeal against the Bombay High Court's decision has been preferred to the Supreme Court and is listed for hearing on 28 January 2014.

The permissibility of an arbitration by beneficiaries would necessarily depend on differences in local laws, such as arbitration laws or the jurisdiction's position on legal and equitable ownership. However, arbitration provisions are being included in trust deeds today, to allow for arbitration to be potentially initiated subject to developments in law at some later point in time.

4. POSSIBILITY OF A LAND CEILING BILL

The Draft National Land Reforms Policy was passed in July 2013, which contains some of the following suggestions:

- An upper limit of any person holding 10-15 acres of land;
- Removing exemptions on the above limit so far available to religious, educational and charitable institutions; and
- Having the above limit applicable not only on 'ownership' of land holdings but also on 'operational' land holdings to prevent concentration of large tracts of land through lease-in.

This is yet to attain the status of a law, and it may be difficult for this policy to attain political muster - many states have already expressed their criticism/ reservations against the land ceilings mandated by the draft policy. However, the implementation of these proposals could enable compulsory acquisition by the state governments of land held by individuals, companies or any other entity in excess of the prescribed ceiling. It is unclear at this point whether the ceiling limits applicable to an individual would be determined by clubbing land holdings of companies held by such an individual. There is also some apprehension around whether to hold land through trusts set up for the purpose. The new Companies Act which was passed in 2013 makes it possible to set up one person companies, which is being considered as a possible planning option.

5. HINDU FAMILY PROPERTY

Indian succession laws are religion specific, multi-layered and complex, and planning for the long term therefore involves some degree of complexity. As regards Hindu Undivided Families (HUFs), a common issue has been that of demonstrating whether property bequeathed is ancestral or self-acquired property. The Hindu Succession Act, 1956 permits a coparcener (family sub-group comprising lineal descendants of the ancestor) to dispose his/her undivided interest in HUF property under a will. In V.K. Surendra v. V. K. Thimmaiah ((2013) 10 SCC 211), the 'karta' of an HUF family (the father and oldest male member of that family) willed away certain property to one son. The son claimed this was self-acquired property and his siblings were not entitled to a share. The Supreme Court upheld the Karnataka High Court's decision that the Karta had no right to change the character of joint family property by transferring it under a will without the consent of other co-parceners. Further, a co-parcener who claims that a particular property is self-acquired property bears the burden of proof to establish that claim. It was held that if the transfer documents (by which the property was purchased) state that the property was self-acquired it is not sufficient evidence, particularly as it was not disputed that the loan acquired to purchase the property was re-paid out of ancestral property.

HUFs have caused some degree of confusion in the recent past on account of their being specific to the Indian context. Therefore, non-resident Indians who have been living outside the country for several years may find themselves to be in the position of a "Karta" or a manager of an HUF, who is akin to the trustee of a trust. Not only would succession laws limit their ability to bequeath such property under an international will, but the Karta status could create other issues for them in their home jurisdictions. For example, would the US FATCA disclosure requirements for a Karta of an HUF be similar to those for the trustee of a trust?

Another recent development in relation to ancestral property is that the Upper House of Parliament finally passed the Marriage Laws (Amendment) Bill, 2010. The version as passed introduces two landmark amendments to the matrimonial law regime under the Hindu Marriage Act, 1955 and the Special Marriage Act, 1954. These amendments: (i) introduce 'irretrievable breakdown of marriage' as a ground for divorce; and (ii) on this ground, also permit the wife to petition the court for a share in the husband's property as compensation. In a previous version of the Bill, this compensation was a 50% share in all property of the husband including ancestral immovable property. However, this has been modified. Under the draft as passed, the court will decide the quantum on a case-by-case

basis, although inherited property of the husband would be examined for determining the quantum. This provision seems to share similarities with the community property regime (joint spousal ownership of marital property) in several countries. However, unlike other countries, pre-nuptial and post-nuptial agreements (as a means to avoid the impact of community property law on divorce) may not be enforceable under Indian contract law. Here it is relevant to note that this Bill will lapse if the Lower House of Parliament does not pass it prior to the dissolution of the Lower House of Parliament in April or May 2014 in view of the impending national elections.

LOOKING AHEAD

January is named after the Roman god Janus, who is the two faced god presiding over transitions and the beginning and ending of conflict. This January, we look forward to 2014 and anticipate the changes that this new year and elections will bring. Forecasts say that there should be an upturn in the economy, and that there may be further innovation and advancement, as we have already seen with the explosive growth of Bitcoins as a new form of currency or the first Indian space mission to Mars (which was also the most cost effective of the four missions so far). However, there are very real macro-economic and other challenges to deal with in order to work towards overall development. It is impossible to predict the future. However, it is certainly possible to plan for difficult times on the basis of past experience, with the aim of being better in this year than we were in the previous year.

With that perspective, we look forward to welcoming the days ahead. We hope that you enjoyed this bird's eye view of 2013 and we wish your near and dear all the best for 2014.

The Private Client practice,

Nishith Desai Associates

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