

# DEFENCE



Sector & Laws in India

## INVESTMENT OPPORTUNITIES IN INDIAN DEFENCE SECTOR

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## INTRODUCTION

The Indian Defense sector has established its presence worldwide by a continuous progressive escalation and showing tremendous progress in infrastructural development in the area of nuclear and rocket technology. India is the largest importer of arms in the world with the amount going as high as 60% of its requirements. There is immense scope of holistic growth in this sector with an expected investment of INR 250 billion in 7-8 years and its 40% budget being spent on capital acquisitions.

The Indian Defence Sector consists of four main, professional uniformed services –

- **Indian Army** – It is the land based branch and the largest component amongst all the armed forces. While the de-jure and de-facto command lies with the President and the Minister of Defence, it is commanded by the Chief of Army Staff. It is organized into 7 commands with its headquarters at the Delhi Cantonment.
- **Indian Air Force** – It is the air arm of the armed forces and its primary responsibility is to secure the Indian airspace and conduct aerial warfare during conflict. While the President of India is the ex-officio commander, the Chief of Air Staff commands the Air Force. It is organized into 7 commands with its headquarters at Delhi.
- **Indian Navy** – It is the naval branch of the armed forces and while the President of India is the ex-officio commander-in-chief of the navy, it is commanded by the Chief of Naval Staff. It is headquartered at New Delhi and is divided into 3 commands.
- **Indian Coast Guard** – It protects India's maritime interests and enforces maritime law with jurisdiction over the territorial waters in the Contiguous and Exclusive Economic Zones. It is headquartered at

New Delhi and is headed by a Director General.

## REGULATORY FRAMEWORK

The prominent laws which govern the Defence sector are as follows –

### I. POLICIES

#### Defence Procurement Procedure 2013

This crucial policy dictates the steps that are to be followed in the process of arms procurement and governs the role of middlemen. It covers all capital acquisitions undertaken by the Ministry of Defence and the aforementioned four major defence services.

It does not govern the procurement procedures for DRDO (Defence Research and Development Organization), OFB (Ordinance Factory Board) and Defence Public Sector Undertakings (DPSUs).

The steps for defence procurement as listed in the policy are –

- **Request for Information (RFI)** – Document issued on the MoD website by SHQs (Service Headquarters) to manufacturers, vendors and Indian defence attaches posted abroad.
- **Services Qualitative Requirements (SQR)** – From the information collected through the RFI, the SQRs are prepared by SHQs, upon review, which lay down the user's requirements in a comprehensive and concrete manner, specifying the requirement of military grade, ruggedized and Commercially Off The Shelf (COTS) items.
- **Acceptance of Necessity (AON)** – SHQs prepare a Statement of Case that is sent to the DDP, DRDO and the finance and administrative departments of the Ministry of Defence for comments and placed before a Categorization Committee for approval.

- **Request for Proposals (RFP)** – Document to invite offers from vendors after full consideration of the requirements of the acquisition as per the Single Stage – Two Bid system wherein the technical and commercial offers are solicited together but in two different sealed envelopes.
- **Field Trials** – Conducted for validating ‘essential parameters’ by user service based on trial methodology as given in the RFP by constituting a trial team.
- **Commercial Negotiations** – Commence after Staff Evaluation Report has been accepted by the Director General (Acquisitions) through the composition of a Contract Negotiation Committee (CNC) that prepares a Comparative Statement of Tenders (CST).
- **Approval by Chief Financial Authority (CFA)** – After the CNC documents the process of selection of a vendor through its recommendation report, it is to be processed by Director/ Acquisition Manager for obtaining expenditure clearance and CFA approval
- **Award of contract** – After obtaining CFA approval, the contract is signed by the concerned Acquisition Manager of the acquisition wing and the date of signing is regarded as the date of contract for all purposes.

### Defence Agents

Defense Agents, are legally non-existent in the process of arms procurement since an ‘Integrity Pact’ is signed between the requisite government department and the bidders for all deals above Rs. 100 Crore wherein, the bidders promise not to engage middlemen and pay commissions, and the government explicitly promises not to indulge in illegal activities such as bribery.

However, the current Defense Minister has announced plans to regularize the role of middlemen amongst other major changes in the Defense Procurement Procedure 2015 which will be released by June, 2015.

## II. ACTS

### A. The Army Act, 1950; The Air Force Act, 1950

These two legislations govern the affairs of the Indian Army and Air Force and have been similarly drafted. They enlist:

- powers of various ranks of officers subject to the Acts;
- the qualifications for enrolment and procedures for appointment and attestation;
- Conditions of service including termination, retirement from services, the immunities etc.
- offences punishable under the Acts and the punishment for offences committed while on duty and under certain other conditions, to be meted out during court martial;
- Penal deductions from salaries and other emoluments under certain circumstances;
- Procedure pertaining to arrest and other pre-trial procedures and those for a court- martial;
- Provisions regarding confirmation and revision of sentences and related to execution of sentences;
- Procedure regarding pardon and remission of sentences.

### B. The Navy Act, 1957

This legislation governs the affairs the Indian Navy and gives detailed provisions with respect to –

- Power of the Central Government to maintain naval forces and provisions regarding enrolment and appointment of officers;
- Conditions of service and entitlement to various service privileges and pay/pension;
- Articles of war including various offences and the corresponding punishment;
- Procedure regarding arrest and other pre-trial procedure, conducting court-

martial, awarding sentences and remission of the same;

- Procedure related to execution of sentences and judicial review of proceedings;
- Procedure related to disposal of property of deceased and missing persons.

### **C. The Coast Guard Act, 1978**

This Act regulates the affairs of the Coast Guard in order to ensure the security of India's maritime zones and the national interest in those zones and related matters.

It provides the law pertaining to constitution, conditions of service and the duties of the Coast Guard. Similar to the above listed Acts, this legislation also contains elaborate procedures regarding pre-trial and trial by the Coast Guard Courts. It also contains provisions regarding awarding of sentences, their execution and remission, pardon and judicial review of proceedings.

### **D. The Armed Forces Tribunal Act, 2007**

Having had their origin from military legislations formulated during the British rule, the Army Act 1950, the Air Force Act 1950 and the Navy Act 1957 did not have any provisions for appeal from the orders of a court martial.

The same was commented upon by the Hon'ble Supreme Court in the landmark case of Lt. Col. Priti Pal Singh Bedi v. Union of India. As a result of this, the Armed Forces Tribunal Act 2007 was passed which contains provisions regarding -

- the establishment of the Armed Forces Tribunal and its branches, having original and appellate jurisdiction regarding disputes and complaints with respect to commission, appointment, conditions of service and orders, findings and sentences of court martial;
- Powers and authority of the Tribunal and the procedure to be followed by it.

Moreover, it stipulates that its members are not bound to abide by the Code of Civil Procedure 1908 but must strictly adhere to the principles of natural justice while making decisions.

### **E. The Armed Forces Special Powers Act, 1958**

Modeled on legislations enacted by the British government during the Quit India Movement and the Partition riots, this Act grants wide ranging 'special powers' to officers of the Armed Forces in 'disturbed areas' and has been the subject of continuing controversy ever since.

It is applicable in all the North Eastern states and Jammu & Kashmir. The Act contains only 6 sections that give the following powers to members of the Armed Forces -

- After giving due warning, fire upon such person or use any other force on a person disturbing law and order, even if it causes death;
- Destroy any arms dump, hide-outs, prepared or fortified position or shelter or training camp from which armed attacks are made by the armed volunteers or armed gangs or absconders wanted for any offence.
- To arrest without warrant anyone who has committed cognizable offences or is reasonably suspected of having done so and may use force if needed for the arrest.
- To enter and search any premise in order to make such arrests, or to recover any person wrongfully restrained or any arms, ammunition or explosive substances and seize it
- To Stop and search any vehicle or vessel reasonably suspected to be carrying such person or weapons
- Any person arrested and taken into custody under this Act shall be made over to the officer in charge of the nearest police station with the least possible delay, together with a report of the circumstances occasioning the arrest

- Army officers have legal immunity for their actions. There can be no prosecution, suit or any other legal proceeding against anyone acting under that law. Nor is the government's judgment on why an area is found to be disturbed subject to judicial review.
- Protection of persons acting in good faith under this Act from prosecution, suit or other legal proceedings, except with the sanction of the Central Government, in exercise of the powers conferred by this Act.

#### **F. Civil Defence Act, 1968**

This is an Act that provides for civil defence and connected issues. It gives powers to the Central Government to make rules and provides for the constitution of Civil Defence Corps in times of hostile attacks and after a 2009 amendment, during disasters (natural or man-made). It is to be read along with the Civil Defence Regulations, 1968.

#### **G. Assam Rifles Act, 2006**

This Act regulates the governance of the Assam Rifles, a paramilitary force known as Cachar Levy during the British rule and having fought in both the world wars.

It contains provisions regarding the constitution and conditions of service, service privileges, list of offences, pre trial and trial proceedings by Assam Rifles Courts, awarding and execution of sentences and confirmation or remission of the same.

#### **H. National Security Guard Act, 1986**

This Act provides for the constitution and regulation of the National Security Guard, a paramilitary force with the primary duty of combating terrorism and maintaining internal security. It also contains provisions similar to the above Acts regarding offences, punishments and trial by National Security Guard Courts.

#### **I. Sashastra Seema Bal Act, 2007**

This Act provides for the constitution and regulation of the Sashastra Seema Bal, another paramilitary force that ensures security of the borders of India and associated matters.

#### **J. Border Security Force Act, 1968**

This Act provides for the constitution and regulation of another paramilitary force in charge of guarding and ensuring the security of India's borders.

#### **K. Indo-Tibetan Border Police Act, 1992**

This Act regulates the constitution and affairs of another paramilitary force that professionally specializes in mountaineering and related activities to protect the borders of the country.

#### **L. Central Reserve Police Force Act, 1949**

This Act regulates the affairs and all matters related to this paramilitary force that assists States and Union Territories in maintaining law and order and containing insurgency.

#### **M. Central Industrial Security Force Act, 1968**

This Act provides for the constitution and regulation of an armed force that provides security to industrial establishments and undertakings owned by the Central Government and technical consultancy to the private sector.

It regulates the premier multi-skilled security agency which provides security cover to nuclear and space establishments, airports, seaports, power plants and even historical monuments.

#### **N. Territorial Army Act, 1948**

This Act provides for the constitution and regulation of a territorial army which is an organization of volunteers that receive military training for a few days in a year and

will be called upon to fight only in case of an emergency. It is the second line of defence after the Indian Army.

### III. SECTOR POLICY

As per the Consolidated FDI Policy 2015 released by the Ministry of Commerce & Industry on May 12, 2015, FDI upto **49%** is allowed through the **automatic route**.

A few more policies have been relaxed that are favorable to the investors:

- Portfolio investments by FPIs/FIIs/ are now permitted at upto 24% along with other investments entailing more flexibility as compared to such investments being barred before
- Prior approval of the Department of Defense Production (DoDP) to sell products to the government entities is not required anymore.
- Sale of items to any other entity is permitted with the condition of the Licensee requiring prior permission from the Department of Defense Production, Ministry of Defense.
- (For more information, see Ministry of Investment Policy and Promotion Circular Dated 12th May, 2015 at [http://dipp.nic.in/English/acts\\_rules/Pres\\_s\\_Notes/pn7\\_2014.pdf](http://dipp.nic.in/English/acts_rules/Pres_s_Notes/pn7_2014.pdf))

### REGULATORY BODIES

The Ministry of Defence (MoD) is responsible for managing, coordinating and supervising all agencies and functions of the armed forces and related to the defence sector.

It works in close association with the Ministry of Home Affairs (MHA) and the National Security Council (NSC).

#### 1. Ministry of Defence (MoD)

The four main services of the Indian Armed Forces are under the direct supervision of the Ministry of Defence.

The following are the main departments of the Ministry that deal with key tasks related to defence and security.

##### a) Department of Defence (DOD)

The DOD works to implement the policy of the government on all matters of defence and security and communicate them to various agencies for implementation.

##### b) Department of Defence Production (DDP)

The objective of the DPD is to develop a comprehensive production infrastructure by establishing production facilities for the indigenization and development of arms and ammunition, warships, submarines, missiles etc. It is also responsible for the import and export of defence equipment.

##### c) Department of Ex-serviceman Welfare (DESW)

This department is responsible for the implementation of pay, pension and other welfare schemes in place for ex-servicemen of the military and paramilitary and associated agencies.

##### d) Defence Research and Development Organisation (DRDO)

This department works towards enhancing self reliance in defence systems by undertaking design and development in areas of military technology and qualitative requirements as specified by the Army, Navy and Air Force.

## 2. Ministry of Home Affairs (MHA)

It is responsible for maintenance of internal security and domestic policy and consists of various departments, one of which monitors the paramilitary forces of the country.

## 3. National Security Council (NSC)

The NSC is an apex body, headed by the Prime Minister with the National Security Advisor as its secretary. It is a 3 tiered body consisting of:

➤ The Strategic Policy Group – Chaired by the Cabinet Secretary, it includes Chiefs of the Armed Forces and the Intelligence Bureau (IB) and Research & Analysis Wing (R & AW) who make recommendations regarding matters of national security.

National Security Advisory Board – It consists of senior retired officials (civilian and military), academicians and distinguished members of society with expertise in matters of internal and external security, foreign affairs and defence and advises the government on the same.

Secretariat represented by a Joint Intelligence Committee – It analyses intelligence data from IB, R & AW and the directorates of military, naval and air intelligence.

## FOREIGN INVESTMENT IN DEFENSE SECTOR

- As per the Consolidated FDI Policy 2015 released by the Ministry of Commerce & Industry on May 12, 2015, FDI upto 49% is allowed through the automatic route. Proposals for FDI beyond 49% with proposed inflow in excess of Rs. 2000 Crores are to be approved by the **government** on a case-to-case basis.
- Investments by foreign portfolio investors/FIIs (through portfolio

investment) are permitted up to 24% under automatic route.

- The requirement of single largest Indian ownership of 51% of equity removed.
- A lock-in period of 3 years on equity transfer has been done-away with in FDI for defense.

## TAX INCENTIVES

**A.** The scope of exemption for granting full exemption from Basic Custom Duty (BCD) and Countervailing Duty (CVD) on goods imported for use in the manufacture of aircraft for the Ministry of Defense is being clarified to the effect that the exemption is available to all materials in any form and articles thereof, subject to the overall condition that they conform to aeronautical specifications accompanied with a certificate of conformance and/or a release note. Either of the following two deductions can be availed:

1. Investment allowance (additional depreciation) at the rate of 15% to manufacturing companies that invest more than INR 1 Billion in plants and machinery acquired and installed between 01.04.2013 to 31.03.2015 provided the aggregate amount of investment in the new plants and machinery during the said period exceeds INR 1 Billion.
2. In order to provide a further fillip to companies engaged in the manufacture of an article or thing, the said benefit of additional deduction of 15% of the cost of new plants and machinery, exceeding INR 250 Million, acquired and installed during any previous year until 31.3.2017.

## INVESTMENT OPPORTUNITIES

India is among the world's top ten countries in terms of defence expenditure and it is the third-largest importer of defence hardware. Indian defence procurements include strategic defence capabilities on land, sea and air. Capital outlay for defense has been increased by INR 50 Billion including a sum of INR 10 Billion for accelerating the development of the railway system in the border areas. INR 1 Billion is provided to set up a Technology Development Fund for defense. INR 22.5 Billion has been provided to strengthen and modernize border infrastructure in 2015.

Three main investment opportunities in India include:

1. Defense products manufacturing
2. Supply chain sourcing opportunity.
3. Defense offsets.

## BUDGET 2014-15 ON DEFENSE

The budget for 2014-2015 was increased by 12% setting it at 2.29 trillion INR (\$38.35 billion).

Among the defense services, the Army with an approximate budget of Rs. 1,18,231 Crore accounts for 53 per cent of the total interim defense budget, followed by the Air Force (Rs 54,262 Crore; 24 per cent), Navy (Rs 37,627 Crore; 17 per cent), the Defense Research and Development Organization (DRDO) (Rs 11,960 Crore, five per cent) and the Ordnance Factories (Rs 1,873 Crore; one per cent) Among the three armed forces, Army has the highest (19 per cent) increase in the budget.

While the Navy's budget has been increase by a modest 3.5 per cent, the Air Force's budget has been contracted by a 5.6 per cent. The DRDO on the other hand has got a 13 per cent hike in its budget.

The increase in permitted FDI from 26% to 49% also came into effect the by the 2014-15 budget. The capital acquisition growth in the army has increased by 56.83% as compared to the previous years.

## HOW INDIA JURIS CAN ASSIST

- Providing assistance in tackling legal issues, policies & regulatory framework of Defense sector.
- Provide periodic analysis of the FDI policy and Government schemes in Defense sector to suit the needs of the investors.
- Suggesting effective structures and roadmaps for entry into India.
- Assistance in incorporating companies, liaison offices and branch offices in India.
- Provide advice and facilitate successful Joint Ventures, MOUS, and Acquisitions etc.
- Advice on Taxation, Repatriation & remittance of money from India.
- Other assistances as may be required.

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