Quest for growth

Destination India 2012

Overview of Tax & Regulatory framework in India

pwc

Foreword

India's economic growth hasn't been very exciting over the past year. The GDP growth for the first quarter of 2012 has been the lowest in the last nine years. The rupee has hit a new low of 56.52 against the US dollar. The manufacturing sector has been hit the most. The core sector growth has slowed down to 2.2%. India's growth is at the bottom of the BRIC group. Apart from these, a spate of amendments have been made in the Indian tax law concerning taxation of non-resident investors. A number of the amendments have been retrospective, going as far back as 1962. The Goods and Services Tax roll-out seems to be far away. Several questions are being raised. Is the India growth story over? Is India moving to a deceleration mode?

We believe the recent developments are not cyclical. They are more systemic. They need to be addressed by progressive, investor-friendly policies of the Government in critical areas. The poor performance can be addressed by taking steps to boost the manufacturing sector, clearing critical projects faster and managing the high interest regime. Overall, the Indian economic outlook still continues to be more certain and optimistic as compared with other global economies. India continues to be the land of opportunities for investors in the medium- to long-term. In 2011, India witnessed the second highest growth in FDI inflows in the world. After recording a negative growth in FY 2009-10 and FY 2010-11, there has been a trend reversal in foreign inflows. During FY 2011-12, FDI inflows into India recorded a strong growth of 88% at US$ 36.5 billion. Sectors with high growth potential include energy, infrastructure, manufacturing, pharma, heavy industries, construction, transportation, telecom, IT, etc. The Government continues to evaluate liberalisation of the policy regime for multi-brand retail trading, domestic civil aviation and reforms in the financial sector. All of these are expected to further increase investments into the country. At times, the sentiments might get a bit anxious. However, overall, foreign investors have expressed optimism on the India growth story and continue to invest.

Having a federal structure in India implies that investors will have to deal with both, the state as well as federal level laws. Knowing Indian rules and regulations is extremely critical as they change and evolve quickly. Various departments in the ministries have an open-window policy which gives clarity to investors while doing business in India. Rules and regulations related to foreign currency have become quite liberal. However, India continues to have a high corporate tax rate coupled with enormous litigation on transfer pricing. On the flipside, advance pricing agreements are now possible under the Indian tax regime. Measures like these are an assurance that going forward, we will have a stable tax regime in few areas at least.

Destination India helps potential investors set up business in India. Its focus is on tax policy, tax incentives, exchange control and the FDI policy. The publication has been compiled by our inbound investment advisory specialists in India, drawing on their extensive knowledge and experience of the typical issues faced by first-time investors in the country.

We can advise and assist you on your specific requirements.

July 2012

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01 Overview

Introduction

India is one of the oldest civilizations in the world with a kaleidoscopic variety and rich cultural heritage. A region of historic trade routes, it has been identified with its commercial wealth for much of its long history.

India implemented its Constitution in 1950 that provided for a parliamentary system of Government with three independent branches: the executive, the legislature and the judiciary. The country has a federal structure with elected Governments in its 28 States and seven union territories.

It is the world's largest democracy with a trillion dollar economy.

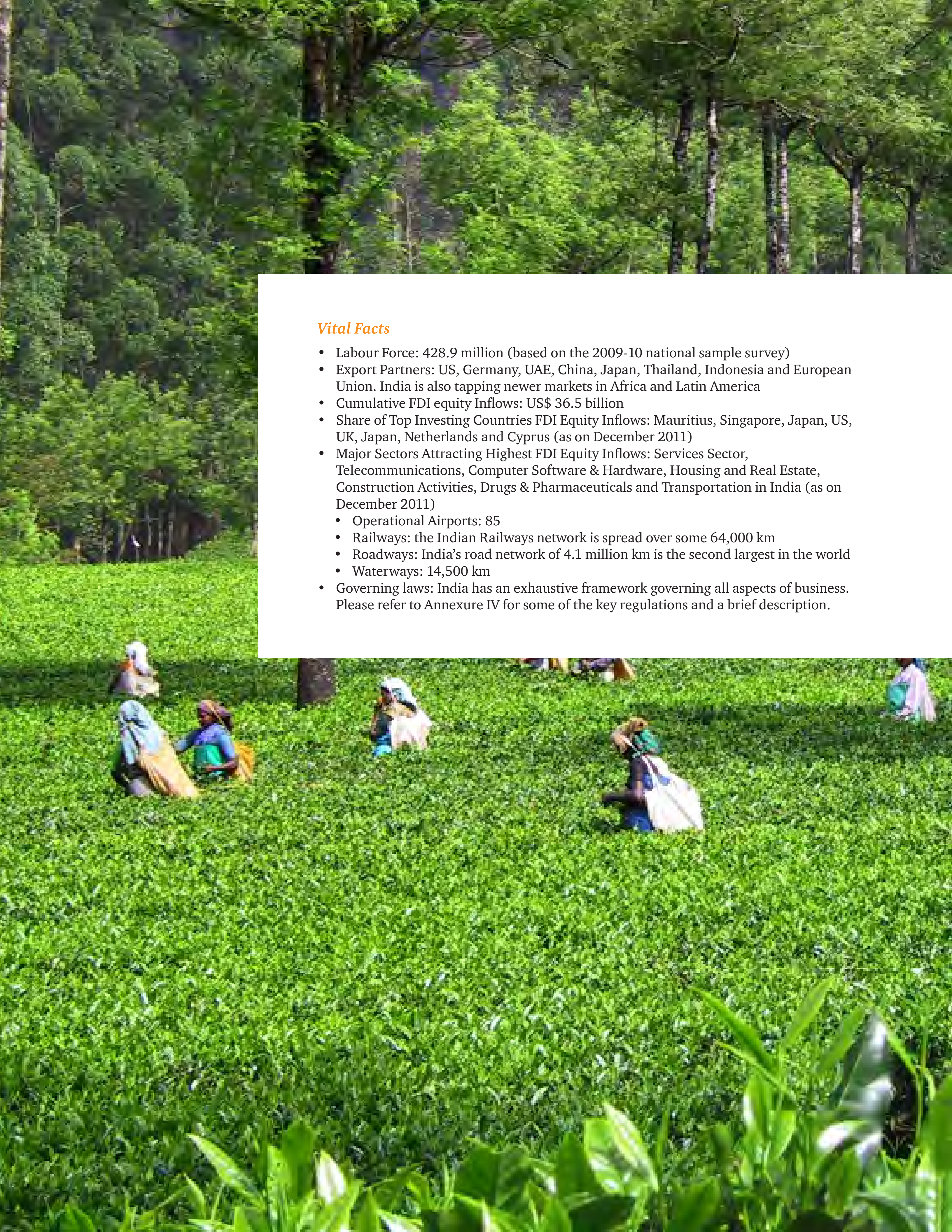
Economic Overview

According to the Economic Survey 2011-12, the Indian economy is estimated to grow at 6.9 per cent in 2011-12 and is expected to be around 7.6 per cent in the next fiscal year. The growth has been broad based with a rebound in the agriculture sector which is expected to grow around 2.5 per cent.

The Index of Industrial Production (IIP) registered a robust growth of 6.8 per cent in January 2012. Output of the manufacturing sector (which constitutes over 75 per cent of the index) grew by 8.5 per cent while that of Mining sector and electricity sector increased by 2.7 per cent and 3.2 per cent respectively. Industrial production expanded by 4 per cent over April 2011-January 2012.

Key highlights:

- India remains among the fastest growing economies of the world.
- Cumulative exports recorded during 2011-12 (April-January) stood at US$ 242.8 billion, registering a growth of 23.5 per cent
- Imports in 2011-12 (April-January) at US$ 391.5 billion registered a growth of 29.4 per cent
- Forex reserves stood at US$ 292.6 billion at end January 2012
- Services sector grew by 9.4 per cent, its share in gross domestic product (GDP) goes up to 59 per cent
- Industrial growth is estimated to be 3.9 per cent, expected to improve as economic recovery resumes
- Foreign trade performance to remain a key driver of growth
- Central spending on social services went up to 18.47 per cent this fiscal from 13.38 per cent in 2006-07
- Net capital flows stood at US$ 41.1 billion in the first half of 2011-12 remained higher as compared to US$ 38.9 billion in the first half of 2010-11
- India's external debt stock stood at US$ 326.6 billion at end September 2011



Vital Facts

- Labour Force: 428.9 million (based on the 2009-10 national sample survey)
- Export Partners: US, Germany, UAE, China, Japan, Thailand, Indonesia and European Union. India is also tapping newer markets in Africa and Latin America
- Cumulative FDI equity Inflows: US$ 36.5 billion
- Share of Top Investing Countries FDI Equity Inflows: Mauritius, Singapore, Japan, US, UK, Japan, Netherlands and Cyprus (as on December 2011)
- Major Sectors Attracting Highest FDI Equity Inflows: Services Sector, Telecommunications, Computer Software & Hardware, Housing and Real Estate, Construction Activities, Drugs & Pharmaceuticals and Transportation in India (as on December 2011)
  - Operational Airports: 85
  - Railways: the Indian Railways network is spread over some 64,000 km
  - Roadways: India's road network of 4.1 million km is the second largest in the world
  - Waterways: 14,500 km
- Governing laws: India has an exhaustive framework governing all aspects of business. Please refer to Annexure IV for some of the key regulations and a brief description.

02 Foreign Investment in India

Foreign collaboration in India

The Indian Government embarked on liberalising the regulatory framework, with specific reference to foreign investment, through the Statement on Industrial Policy of 1991. Since then, the Indian regulatory environment for foreign investment has been consistently eased to make it investor-friendly.

Under the current FDI framework, foreign investment is permitted by all categories of investors (other than citizens or entities of Pakistan) and in all sectors, except the following:

- Atomic energy and railways
- Lotteries, gambling and betting
- Agriculture (excluding floriculture, horticulture, seed development, animal husbandry, pisciculture, aquaculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors)
- Plantations (excluding tea plantations)
- Retail trading (other than single brand retail)
- Real estate (except construction development projects)
- Chit funds, nidhi companies, or trading in transferable development rights
- Manufacturing of cigars, cheroots, cigarillos and cigarettes, and tobacco and tobacco substitutes

Apart from these prohibited sectors, foreign investments can be made in other sectors under:

- Approval route, i.e., by the Government through the Foreign Investment Promotion Board (FIPB) under the Ministry of Finance
- Automatic route, i.e., no prior approvals, under delegated powers exercised by the Reserve Bank of India (RBI)

Approval route

A prior approval from the FIPB is required in cases of foreign investment where the project does not qualify for automatic route.

The following cases will fall under the approval route:

- Specified sectors which require FIPB approval for FDI or for FDI beyond a prescribed sectoral cap
- Investments other than equity shares and compulsorily and mandatorily convertible debentures or preference shares
- Investment for considerations other than cash [except for capitalisation of an external commercial borrowing (ECB) due for repayment and interest on such ECB, as well as technology royalties due for payment]
- Investments by citizens and companies of Bangladesh
- Investments in warrants and partly paid shares
- Investment in entities other than a company engaged only in downstream investment activities for holding purposes or which does not have any operations or any downstream investments. Additionally, such an Indian holding company, which fulfils the criteria prescribed under the Core Investment Companies (CICs) guidelines issued by the RBI, will have to comply with the norms prescribed therein

The decision of the FIPB is normally conveyed within four to six weeks from the date of submission of an application. A proposal for foreign investment is decided on a case-to-case basis on the merits of the case and according to the prescribed sectoral policy. Generally, preference is given to projects in high priority industries and the infrastructure sector, those with export potential, large-scale employment opportunities, links with the agro sector, social relevance, or those relating to the infusion of capital and induction of technology.

Foreign investment proposals under the FIPB route involving a total foreign equity inflow of more than 12 billion INR must be placed before the Cabinet Committee of External Affairs (CCEA) for its further consideration.

No prior approval from the FIPB or the CCEA is required for bringing in additional investment into the same entity in a case where such entity had earlier obtained FIPB/ CCEA approval and subsequently either the activity/sector has been placed under automatic route or sectoral caps have been removed or increased (provided that such additional investment along with initial/original investment is within the current sectoral caps).

Automatic route

Generally, except the cases mentioned above, all other cases of foreign investment would fall under the automatic route and does not require prior approval of the FIPB.

Computation of foreign investment

The Indian Government had issued guidelines to calculate total FDI in an Indian company where sectoral caps apply. As per this policy, the total FDI in an Indian company will comprise the following:

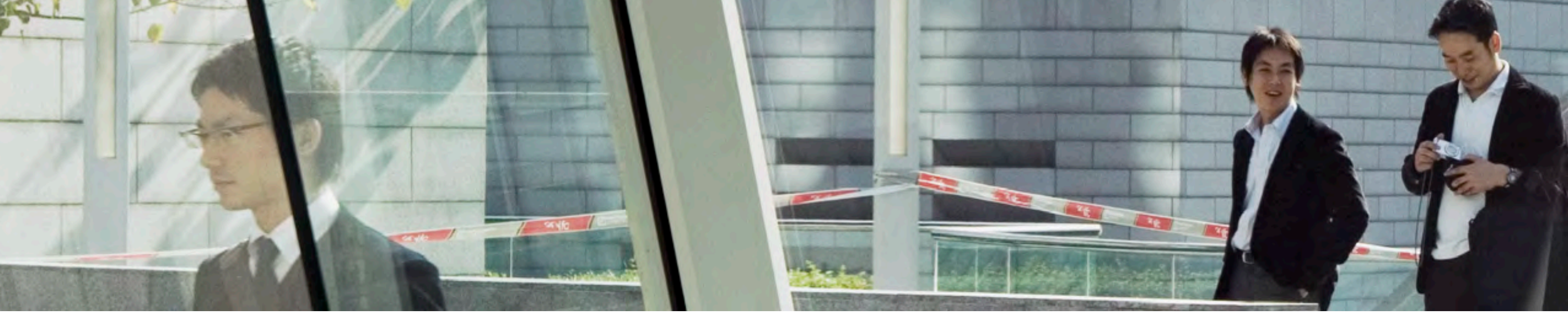
- Direct investment by a foreign investor is fully counted towards the foreign investment limits
- Indirect foreign investments through an Indian company 'owned' or 'controlled' by non-residents. Here 'owned' means more than 50% shareholding and 'control' means the right to appoint majority directors of the company

Further, for the computation of indirect foreign investment, 'foreign investment' will include all types of foreign investments, i.e., FDI, investment by FIIs (holding as on March 31), NRIs, ADRs, GDRs, foreign currency convertible bonds (FCCB) and convertible preference shares, convertible currency debentures regardless of whether the said investments have been made under schedule 1, 2, 3 and 6 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations.

Broadly, the principle emerging under this policy aspect is that in case an Indian company is owned and controlled beneficially by resident Indian citizens (RICs), any downsream investment made by such an Indian company will be considered as domestic investment and not counted towards foreign investment caps.

Foreign venture capital permitted to acquire securities under private arrangement

Foreign venture capital investors (FVCIs) can now invest in eligible securities (equity, equity linked instruments, debt, debt instruments, debentures of an IVCU or VCF, units of schemes or funds set up by a VCF) by private arrangement or purchase from a third party.



Foreign investment by qualified foreign investors

Qualified foreign investors (i.e., specified non- resident investors other than SEBI registered FIIs and SEBI registered FVCIs) are allowed to purchase rupee denominated units of equity schemes of domestic mutual funds (MFs) issued by the SEBI registered as domestic MFs on repatriation basis.

They are also permitted to acquire non-convertible debentures or bonds issued by NBFCs categorised as 'infrastructure finance companies'(IFCs). Further, QFIs from FATF compliant jurisdictions have also been permitted to invest with an individual cap of 5% and 10% in aggregate through SEBI registered depository participants (DPs), recognised brokers in equity shares of listed Indian companies or equity shares of Indian companies offered to public in India.

FDI in limited liability partnerships

FDI upto 100% is permitted with prior Government approval in limited liability partnerships engaged in sectors or activities currently eligible for 100% FDI under automatic route. They do not have any sectoral or other FDI-linked conditions. Some of the conditions, subject to which FDI in LLP would be permitted, are as follows:

- Only cash contribution will be permissible for FDI in LLPs
- Downstream investment by LLPs is not permitted
- LLP cannot raise foreign currency loans
- FIIs and FVCIs cannot invest in LLPs

Investment through share acquisition

Stock acquisitions may be made of an existing Indian company. This company can be either privately held or listed on a stock exchange. Stock acquisition is permitted after a resolution to this effect has been passed by the board of directors of the Indian company whose shares are being acquired. The acquisition will need to comply with FDI guidelines.

Prior FIPB approval is required in all cases where either the 'control' or 'ownership' of the Indian company, engaged in a sector where FDI caps apply, is transferred to or acquired by a non-resident entity.

Acquisition by way of share swap is also permitted with prior FIPB approval and subject to valuation guidelines.

Moreover, prior approval of the RBI has recently been dispensed with in the following cases of stock acquisitions:

- Acquisition of an existing equity by non-residents from residents where the share price falls outside the prescribed valuation norms but complies with the pricing prescribed under SEBI regulations or guidelines
- Acquisition of equity by residents from non-residents under the following cases:
  - Where prior FIPB approval is required
  - Where prescribed pricing guidelines are not met but complies with SEBI pricing guidelines
  - Where the transfer involves financial services sector activities

Valuation norms

The proposed share price to be issued or transferred from a resident to a non-resident must be determined according to the following guidelines:

- In the case of a listed company, the price may not be less than the price at which a preferential allotment of shares can be made under the SEBI guidelines. Further, in a rights issue, the prices are to be determined by the company
- In the case of an unlisted company, the issue or transfer of shares is required to be at a price arrived at by a SEBI registered category -I - merchant banker or a chartered accountant as per the discounted free cash flow method. Further, in the case of a rights issue, the price may not be less than the price at which an offer on a right basis is made to the resident shareholders

In relation to a transfer of shares from a non-resident to resident, the pricing of shares is to be determined as follows:

- In the case of a listed company, the price may not be more than the minimum price at which the transfer of shares can be made from a resident to a non-resident;
- In the case of an unlisted company, the price of shares may not be more than the minimum price at which the transfer of shares can be made from a resident to a non-resident

Investment by foreign institutional investors

A registered foreign institutional investor (FII) may, through the SEBI, apply to the RBI for permission to purchase the shares and convertible debentures of an Indian company under the portfolio investment scheme.

FIIs are permitted by the RBI to purchase the shares or convertible debentures of an Indian company through registered brokers on recognised stock exchanges in India. They are also permitted to purchase the shares or convertible debentures of an Indian company through private placement or arrangement. The total holding by each FII and SEBI approved sub-account of FII cannot exceed 10% of the total paid-up equity capital or 10% of the paid-up value of each series of convertible debentures issued by an Indian company. Further, the total holdings of all FIIs or sub-accounts of FIIs added together cannot exceed 24% of the paid-up equity capital or the paid-up value of each series of convertible debentures. The limit of 24% may be increased to the specified sectoral cap or statutory ceiling, as applicable, by the Indian company concerned by passing a board of directors resolution followed by the permission of the shareholders through a special resolution to that effect and prior intimation to RBI.

FIIs can now invest in the primary issues of non-convertible debentures (NCDs) or bonds only if the listing of such bonds or NCDs is committed to be done within 15 days of such investment. However, FIIs can also subscribe to unlisted bonds or NCDs in case the issuing company is an infrastructure company.

Pledge of shares

Promoters of an Indian company can pledge their shares to secure a loan obtained under ECB. However, this can happen only if the banker is satisfied that certain conditions with respect to the loan agreement are met, the loan registration number is obtained, and other specified conditions are satisfied. A non-resident shareholder in an Indian company can also pledge his stake in the company in favor of the AD to secure a credit facility extended to such company. The pledge may also be made in favor of an overseas bank to secure credit facilities extended to non-resident promoters or shareholders of the resident Indian company whose shares are pledged, provided, inter alia, such loaned funds are utilised for overseas business purposes.

Technology transfer

Payments of royalties, lump sum fees for the transfer of technology and payments for use of trademark or brand names can be freely made under the automatic route

Foreign direct investment in India

India ranks among the most attractive destinations for FDI in the world. Indian markets have potential and offer prospects of high profitability and a favorable regulatory regime to entice investors. A summary of FDI for key sectors is as follows:

Advertising industry

FDI upto 100% is permitted under the automatic route.

Film industry

FDI upto 100% is permitted under the automatic route in the film industry, including film financing, production, distribution, exhibition, marketing and associated activities related to the film industry.

Agriculture and allied activities

FDI or NRI investment is not permitted in agriculture and allied activities, except under the following activities:

- FDI up to 100% on the automatic route is permitted in floriculture, horticulture, development of seeds, animal husbandry, pisciculture, aquaculture, cultivation of vegetables and mushrooms under controlled conditions and services related to agro and allied sectors. Certain conditions apply for companies dealing with development of transgenic seeds and vegetables
- In the tea sector (including tea plantations), FDI up to 100% is allowed with the prior approval of the FIPB and subject to the following conditions:
    - Compulsory disinvestment of 26% equity in favour of an Indian partner or the Indian public within five years
    - Prior approval of the state Government is required for any change in land use
- FDI upto 100% under automatic route is permitted for coffee and rubber processing and warehousing

Alcohol: Distillation and brewing

FDI is permitted up to 100% under the automatic route, subject to obtaining an industrial licence.

Asset reconstruction companies

FDI up to 49% is permitted with prior FIPB approval in an asset reconstruction company (ARC) registered with the RBI. If any individual investment exceeds 10% of the equity, the investor may not hold any controlling interest in the ARC. Investments by FIIs are not allowed. However, SEBI registered FIIs can invest in security receipts (SRs) issued by RBI registered ARCs.

Banking

- Public sector banks: FDI and portfolio investment of up to 20% allowed under the approval route
- Private sector banks: Here, FDI up to 74% is allowed (up to 49% under the automatic route, and beyond that up to 74% under the approval route). Voting rights per shareholder are restricted to 10%. While the Cabinet has approved an amendment to the Banking Regulation Act increasing voting rights from 10 to 26%, a notification by the RBI giving effect to the amendment is still awaited. Please note that within the permissible FDI ceiling, there are separate limits for FII or NRI investment under the portfolio investment scheme. A foreign bank may operate in India through only one of three channels:
    - a branch or branches
    - a wholly-owned subsidiary
    - a subsidiary with aggregate foreign investment of up to a maximum of 74% in a private bank

Broadcasting

- Terrestrial broadcasting FM (FM radio): Foreign investment, including NRIs, persons of Indian origin (PIOs) and portfolio investments, is permitted up to 26% under the approval route;
- Cable network: Foreign investment, including FDI, NRI, PIO and portfolio investments, is permitted up to 49% under the approval route
- Direct-to-home: Foreign investment, including FDI, NRI, PIO and portfolio investments, is permitted up to 49% under the approval route. Within the 49% foreign equity, the FDI component should not exceed 20%;
- Headend-in-the-sky broadcasting services: A total of direct and indirect foreign investment, including FDI and portfolio investments, is permitted up to 74%. FDI up to 49% is permitted under the automatic route. Investment beyond 49% requires FIPB approval
- Uplinking hubs: Foreign investment, including FDI and FII, is permitted up to 49% under the approval route
- Uplinking TV channels: Foreign investment, including FDI and FII, up to 26% is permitted under the approval route for the uplinking of a news and current affairs TV channel. Hundred per cent FDI is permitted under the approval route for uplinking a non-news or current affairs TV channel

The above sub-sectors will also be subject to compliance with terms and conditions as may be prescribed by the Ministry of Information and Broadcasting. In addition, in these sub-sectors where FDI is limited to 49%, the Indian company will need to comply with the single largest Indian shareholder condition

Cigarettes

FDI is prohibited in the manufacture of cigars, cheroots, cigarillos and cigarettes, and tobacco and tobacco substitutes.

Civil aviation and airports

- FDI up to 49% is permitted for scheduled air transport services and domestic scheduled passenger airlines under the automatic route. NRI investment is permitted up to 100% under the automatic route. However, no direct or indirect equity participation by foreign airlines is allowed
- For non-scheduled air transport services, non-scheduled airlines and cargo airlines, FDI is permitted up to 74% (up to 49% under the automatic route and beyond that with FIPB approval). NRI investment is permitted up to 100% under the automatic route
- Hundred per cent FDI is permitted under the automatic route for maintenance and repair organisations, flying training institutes and technical training institutions
- FDI up to 74% and NRI investment up to 100% is permitted under the automatic route for ground-handling services subject to sectoral regulations and security clearances. FDI up to 49% is permitted under the automatic route and between 49 and 74% under the approval route
- FDI up to 100% is permitted under the automatic route for helicopter and sea-plane services. However, approval from the Directorate General of Civil Aviation will be required
- Foreign airlines can participate in the equity of companies operating cargo airlines, helicopter services and seaplane services

Coal and lignite

- FDI is permitted up to 100% under the automatic route in coal and lignite mining for the captive consumption by power projects, iron and steel, cement units and other eligible activities, subject to the provisions of the Coal Mines (Nationalisation Act), 1973
- A company setting up coal processing plants is allowed FDI up to 100% subject to the condition that it will not perform coal mining and will supply the washed or sized coal to parties supplying raw coal or coal processing plants instead of selling it in the open market

Commodity exchanges

Composite foreign investment (FDI plus FII) up to 49% is permitted with prior FIPB approval. However, FIIs are permitted to invest upto 23% without Government approval and restricted to secondary market purchases. FDI investment is capped at 26%. No foreign investor or entity including those acting in concert may hold more than 5% equity.

Credit Information Companies

Foreign investment (FDI plus FII) in Credit Information Companies is permitted up to 49%, subject to the following:

- Prior approval of the Indian Government and regulatory clearance from the RBI is required
- Investment by registered FIIs is permitted up to 24% (within the overall limit of 49%) only in listed Credit Information Companies, subject to conditions
- Foreign investment is subject to the Credit Information Companies (Regulation) Act, 2005

Courier services

FDI up to 100% is permitted under the approval route for courier services excluding the distribution of letters.

Defence

FDI, including NRI investments, in this sector, is permitted up to 26% subject to prior Government approval and compliance with security and licensing requirements and guidelines issued by the Ministry of Defence.

The single largest Indian shareholder is to hold at least 51%.

According to guidelines for the production of arms and ammunition, the management of the applicant company or partnership should be in Indian hands, and the majority of the board as well as the chief executive should be resident Indians. Further, there is a three-year lock-in period for the transfer of equity from one foreign investor to another.

Hazardous chemicals

Hundred per cent FDI is allowed under the automatic route, subject to an industrial licence under the Industries (Development & Regulation) Act 1951.

Hotels and tourism related industry

Hundred per cent foreign investment is allowed under the automatic route.

Industrial explosives

Hundred per cent FDI is allowed under the automatic route subject to obtaining the industrial licence under the Industries (Development and Regulation) Act 1951 and regulations under the Explosives Act 1898.

Insurance

FDI in the insurance sector is permitted up to 26% under the automatic route subject to obtaining a licence from the Insurance Regulatory and Development Authority.

Lottery business, gambling and betting

FDI or foreign technical collaboration in any form is prohibited in the lottery business, gambling and betting.

Micro and small enterprises (MSE)

Hundred per cent FDI is permitted in an MSE for the manufacture of items reserved under the small-scale sector, subject to compliance with the appropriate sectoral policy.

However, any industrial undertaking, with or without FDI, which is not an MSE and is engaged in manufacturing items reserved for the MSE sector (presently 20 items), will require FIPB approval where foreign investment is more than 24%. Such an undertaking will also require an

industrial licence under the Industries (Development and Regulation) Act 1951. This licence prescribes an export of a minimum of 50% of the new or additional annual production of the MSE reserved items to be achieved within a maximum of three years.

Mass rapid transport system

FDI up to 100% is allowed under the automatic route in mass rapid transport systems, including the associated commercial development of real estate, in all metropolitan cities.

Mining

- FDI is allowed up to 100% under the automatic route for activities such as the exploration and mining of metals and non-metal ores, including gold and silver, minerals, diamonds and precious stones
- FDI up to 100% is permitted with prior Government approval for the mining and mineral separation of titanium-bearing minerals and ores, its value addition and integrated activities, subject to sectoral regulations and the conditions of the Mines and Minerals (Development and Regulation) Act, 1957

Non-banking financial services

FDI in this sector is permitted under the automatic route, subject to compliance with the guidelines issued by the RBI.

Hundred per cent foreign investment is only allowed in the following 18 activities under the automatic route subject to the minimum capitalisation norms indicated below:

- Merchant banking
- Underwriting
- Portfolio management services
- Investment advisory services
- Financial consultancy
- Stock broking
- Asset management
- Venture capital
- Custodial services
- Factoring
- Credit rating agencies
- Leasing and finance - This would cover only finance lease
- Housing finance
- Forex broking
- Credit card business
- Money changing business
- Micro credit
- Rural credit

Minimum Capitalisation Norms (Foreign Equity): Fund-Based Activities

For non-banking financial companies (NBFCs), the minimum capitalisation norm has been fixed at US$ 0.5 million.

% FDI	*Minimum capitalisation*
Foreign capital up to 51%	USD 0.5 million to be bought upfront
Foreign capital > 51% and up to 75%	USD 5 million to be bought upfront
Foreign capital > 75%	USD 7.5 million to be bought upfront and the balance of USD 42.5 million in 24 months

Minimum Capitalisation Norms (Foreign Equity): Non-Fund-Based Activities

For Non- banking financial companies (NBFCS) the minimum capitalisation norm has been fixed at US$ 0.5 million

The following activities are classified as non-fund-based activities:

- Investment advisory services
- Financial consultancy
- Forex broking
- Money changing
- Credit rating

Hundred per cent foreign owned NBFCs with a minimum capitalisation of US$ 50 million are permitted to set up step-down subsidiaries for specific NBFC activities without restriction on the number of operating subsidiaries and without bringing in additional capital.

JV operating NBFCs with FDI up to 75% are permitted to set up subsidiaries to undertake other NBFC activities, subject to compliance with applicable minimum capitalisation norms by the subsidiaries.

Further, share premium received by non-resident investors will also be counted for computing minimum capitalisation.

A non-fund based NBFC is prohibited from setting up subsidiary for any other activity. Neither can it participate in the equity of an NBFC holding or operating company.

Petroleum

Other than refining

Hundred per cent FDI is permitted under the automatic route for the following, subject to the existing policy and regulatory framework in the petroleum sector:

- Oil exploration
- Petroleum product pipelines
- Petroleum products marketing
- Laying of natural gas and LNG pipelines
- LNG re-gassification infrastructure
- Market studies and formulation and investment financing in the petroleum sector.

Refining

In the case of PSUs, FDI is permitted upto 49% with prior FIPB approval. In the case of private Indian companies, FDI up to 100% is permitted under the automatic route.

Ports and harbours

Up to 100% FDI is allowed through the automatic route for the leasing of existing assets of ports, construction and maintenance of assets, leasing of equipment for port handling and leasing of floating crafts and captive facilities for port-based industries.

Power

FDI up to 100% is permitted in the power sector under the automatic route for projects relating to the generation, transmission, distribution and trading of power, other than the generation, transmission and distribution of electricity in atomic reactor power plants.

Print media

- Publication of newspapers, periodicals and Indian editions of foreign magazines in news and current affairs Foreign investment, including FDI, NRI, PIO and FII investment, is permitted up to 26%
- Publishing and printing of scientific and technical magazines, speciality journals and Periodicals FDI is permitted up to 100%
- Publication of facsimile editions of foreign newspapers. FDI up to 100% is permitted, provided it is by the owner of the original newspapers whose facsimile edition is proposed to be published in India

These sub-sectors need to comply with terms and conditions as may be prescribed by Ministry of Information and Broadcasting. In addition, in the above sub-sectors where FDI is limited to 49%, the Indian company needs to comply with the single largest Indian shareholder condition.

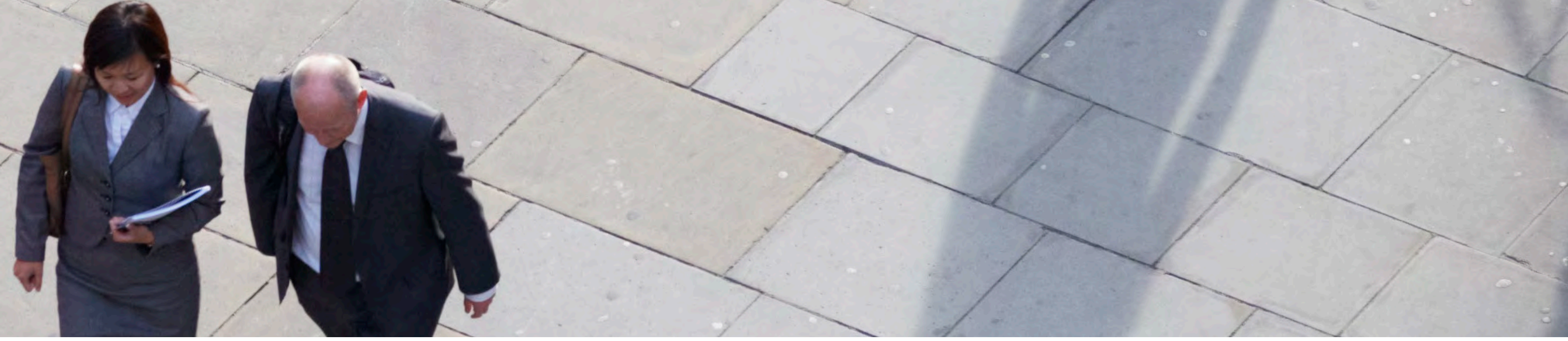
Construction development projects

FDI up to 100% under the automatic route is permitted in the following:

- Construction-development projects (including but not restricted to housing, commercial premises, resorts, educational institutions, recreational facilities, city and regional level infrastructure, and townships) subject to certain conditions such as:
  - Minimum area to be developed
  - Minimum capitalisation of US$ 10 million for a wholly-owned subsidiary and US$ 5 million for a JV with an Indian partner
  - Original investment i.e. the entire amount brought in as FDI with a minimum three-year lock-in from the date of receipt of each FDI installment or from the date of completion of minimum capitalisation, whichever is later

Investment by NRIs is not subject to the conditions as are applicable in the case of construction development projects.

Investment in SEZs, hotels, hospitals, industrial parks (satisfying prescribed conditions), the education sector and old-age homes is also exempt from the above requirement.



Industrial parks

FDI up to 100% is permitted under the automatic route subject to the fulfilment of prescribed conditions.

As per the recent change 'basic and applied R&D on bio-technology, pharmaceutical sciences, life sciences', has also been included within the meaning of industrial activity.

Satellites: Establishment operations

FDI up to 74% is permitted with prior FIPB approval subject to sectoral guidelines of the Department of Space, Indian Space Research Organisation.

Security agencies in the private sector

Under the Private Security Agencies (Regulation) Act, 2005, a security agency licensee should fulfil the following conditions:

- Be a firm registered in India
- Not have a foreign director or partner
- Be restricted to a maximum of 49% under the approval route

Stock exchanges, depositories, corporations

Foreign investment up to 49% (FDI cap at 26% and FII at 23%) is permitted with prior approval from FIPB. FIIs are allowed only through purchases in the secondary market.

Pharmaceuticals

Hundred per cent FDI is permitted in existing pharmaceutical companies with prior FIPB approval. With respect to greenfield investments, 100% FDI is permitted under the automatic route sector.

Telecommunications

FDI up to 74% is allowed for the following activities (subjected to prescribed conditions):

- Basic, cellular, unified access services, long-distance, V-sat, public mobile, radio trunk services, global mobile personal communication services
- Internet service providers with gateways
- ISPs not providing gateways
- Radio paging
- End-to-end bandwidth

FDI up to 100% is allowed for the following activities:

- Infrastructure provider providing dark fibre, right of way, duct space, power (IP Category 1)
- Email
- Voicemail

Trading

Hundred per cent FDI is permitted under the automatic route for trading companies engaged in the following activities:

- Cash-and-carry wholesale trading and wholesale trading subject to operational guidelines
- Trading for exports
- E-commerce: These companies engage only in B2B e-commerce and not in retail trading, implying that the existing restrictions on FDI in domestic trading are applicable to e-commerce as well

Hundred per cent FDI is permitted with prior Government approval for the test marketing of items for which a company has approval for manufacture, provided the test marketing facility is for two years and the investment for setting up the manufacturing facility commences with the test marketing activity.

Hundred per cent FDI is permitted with FIPB approval for single-brand product retailing, subject to the following conditions:

- Products to be sold should be of a single brand only
- Products should be sold under the same brand internationally
- Single-brand product retailing covers only products branded during manufacturing.
- The foreign investor should be the owner of the brand
- Where FDI is proposed to be beyond 51%, mandatory sourcing of at least 30% of the value of products sold will have to be done from Indian small industries, village and cottage industries, artisans and craftsmen. Small industries mean those that have a total investment in plant and machinery not exceeding US$ 1 million

Operational guidelines for wholesale trading

- Sales made by the wholesaler qualify as wholesale trading where the sales are made to the following eligible customers:
    - Entities holding sales tax or value added tax (VAT) registration, service tax or excise duty registration
    - Entities holding trade licences
    - Entities holding permits, licences, etc. for undertaking retail trade from Government authorities and local self Government bodies
    - Institutions with certificates of incorporation or registration as a society or registration as public trust for their own consumption
- Wholesale trading to group companies should not exceed 25% of the total turnover of the wholesale venture
- Full records indicating details such as name of entity, its licence, registration, permit number, amount of sale, etc should be maintained on daily basis

Venture capital fund and venture capital company

FVCIs are permitted to invest upto 100% under the automatic route in an Indian venture capital undertaking and may also set up a domestic asset management company to manage the fund.

A SEBI-registered FVCI can also invest in a domestic venture capital fund registered under the SEBI (Venture Capital Fund) Regulations, 1996.

However, if the entity undertaking venture capital fund activity is a trust registered under the Indian Trust Act, 1882, foreign investment will be permitted under the approval route.

FVCIs are permitted to invest in other companies subject to FDI regulations.

Entry options

A foreign company looking to set up operations in India, can consider the following options:

Operating as an Indian company

Wholly-owned subsidiary company

A foreign company can set up a wholly owned subsidiary company in India to carry out its activities. Such a subsidiary is treated as an Indian resident and an Indian company for all Indian regulations (including income tax, Foreign Exchange Management Act,1999 and the Companies Act), despite being 100% foreign-owned. At least two members, for a private limited company, and seven members, for a public limited company, are mandatory.

Activities of such a company will need to comply with the provisions of the FDI policy.

Joint venture with an Indian partner (equity participation)

Although a wholly owned subsidiary has proved to be the preferred option, foreign companies have also begun operations in India by forming strategic alliances with Indian partners. The trend is to choose a partner in the same area of activity or who brings synergy to the foreign investor's plans for India. Sometimes joint ventures are also necessitated due to restrictions on foreign ownership in certain sectors.

The foreign investment guidelines for investment in an Indian company have already been discussed above.

Limited liability partnership (LLP)

LLP is a new form of business structure in India. It combines the advantages of a company, such as being a separate legal entity having perpetual succession, with the benefits of organisational flexibility associated with a partnership. At least two partners are required to form an LLP and they have limited liability.

An LLP is comparatively easier to manage with less compliance levels as compared to a company form of organisation. Further, an LLP is not subject to mandatory requirements applicable to a company with regard to provision of depreciation and transfer to reserves prior to distribution of profits. As mentioned earlier, the FDI policy for LLPs has been notified making this a possible viable entity form for Indian business operations of foreign investors.

The operational guidelines with respect to compliances to be undertaken with respect to FDI in an LLP are likely to be notified soon by the RBI.

Operating as a foreign company

Liaison office

Setting up a liaison or representative office is a common practice for foreign companies seeking to enter the Indian market. The role of these offices is limited to collecting information about the market and providing information about the company and its products to prospective Indian customers. These offices act as listening and transmission posts and provide information between the foreign company and its Indian customers. A liaison office is not allowed to undertake anything other than liaison activities in India and cannot, therefore, earn any income in India, under the terms of approval granted by the RBI.

Project office

Foreign companies planning to execute specific projects in India can set up temporary project and site offices here for this purpose. The RBI has granted general permission to a foreign entity for setting up a project office in India, subject to the fulfilment of conditions. The foreign entity needs only to provide a report to the jurisdictional regional office of the RBI giving the particulars of the project or contract.

Branch office

Foreign companies engaged in manufacturing and trading activities abroad can set up branch offices in India for the following purposes, with the prior approval of the RBI:

- Export and import of goods
- Professional or consultancy services
- Research work in which the parent company is engaged, to promote technical or financial collaboration between Indian companies and the parent or overseas group company
- Representing the parent company in India and acting as a buying or selling agent in India
- IT and software development services in India
- Technical support for products supplied by the parent or group companies
- Acting as a foreign airline or shipping company

In general, manufacturing activity cannot be undertaken through a branch office. However, foreign companies can establish a branch office or unit for manufacturing in an SEZ subject to the fulfilment of certain conditions.

03 Funding Options in India

A foreign company which sets up a subsidiary in India can fund its Indian subsidiary via alternative options, which primarily consist of the following:

Equity capital

Regulatory approvals

Transfer to Reserve Rules

Corporate laws in India provide for a mandatory transfer of distributable profits to free reserves of the Indian company in the event of a dividend declaration. In the event that the Indian company declares dividends in excess of 20% of the paid-up capital, a minimum of 10% of distributable profits will need to be transferred to statutory free reserves.

Amounts transferred to statutory reserves can be ploughed back into the business of the company. These can be distributed to equity shareholders only on liquidation or in the case of inadequate profits (under the prescribed conditions).

Repatriation of capital

Equity funds can be repatriated only on liquidation or transfer of shares. Limited buy-back provisions are available under corporate laws. Capital reduction can be undertaken in certain circumstances with court approval. Sectors such as defence, construction and the development of real estate are subject to a minimum lock-in period before the capital can be repatriated.

External commercial borrowings (ECBs)

Indian companies (other than financial intermediaries) are allowed to raise ECBs from any internationally recognised source such as banks, financial institutions, capital markets, export credit agencies, suppliers of equipment, foreign collaborators and foreign equity holders.

ECBs can be raised from foreign equity holders holding the prescribed minimum level of equity in the Indian borrower company:

- ECB up to US$ 5 million: Minimum equity of 25% held directly by the lender
- ECB more than US$ 5 million: Minimum equity of 25% held directly by the lender and a debt-equity ratio not exceeding 4:1 (i.e. the total ECB (existing and proposed) should not exceed four times the direct foreign equity holding). Besides the paid-up capital, free reserves (including share premium) will also be considered for determining the total equity held by the foreign equity holder

ECB from an indirect foreign equity holder (holding a minimum of 51% equity) or from a group company under a common parent has also been recently permitted under the approval route, provided the total ECB liability does not exceed seven times the foreign equity held directly or indirectly by the lender

The prevailing ECB policy stipulates certain end-uses. For instance, ECBs can be availed only for the following:

- The import of capital goods, new projects, modernisation and expansion. This window can be availed only for projects in the real estate-industrial sector and the infrastructure sector:
  - Power
  - Telecommunications
  - Railways
  - Roads including bridges
  - Sea ports and airports
  - Industrial parks
  - Urban infrastructure (water supply, sanitation and sewage projects)
  - Mining, exploration and refining
  - Cold storage or cold room facility, including for farm-level pre-cooling, for preservation or storage of agricultural and allied produce, marine products and meat
- Overseas acquisition by Indian companies
- First stage acquisition of shares in the disinvestment process and in the public offer stage under the Government's disinvestment programme
- Companies engaged in Infrastructure sector have been permitted to raise ECB for the payment of Interest during construction (being capitalised) and are permitted to import capital goods by availing bridge finance by way of the supplier's or buyer's credit, subject to certain conditions. Also, such companies can utilise 25% of fresh ECB proceeds for the repayment of local rupee borrowings under the approval route subject to the fulfilment of prescribed conditions
- Payment for obtaining a licence or permit for 3G spectrum
- NBFCs exclusively involved in financing infrastructure projects can avail ECB subject to complying with the prudential standards prescribed by the RBI and the borrowing entities fully hedging their currency risk
- On-lending by infrastructure finance companies (IFCs) to the infrastructure sector is allowed under the approval route, provided the IFCs comply with prescribed conditions.
- Hotels, hospitals and software are permitted to avail ECBs under the automatic route. Other service sector units can approach the RBI for permission to raise ECB from foreign equity holders
- Borrowing companies in the power sector have also been allowed to use 40% of fresh ECB proceeds towards refinancing domestic rupee loans subject to approval from the RBI, provided 60% of the proceeds are utilised towards capex for Infrastructure projects.
- ECB has also been allowed for the maintenance and operation of toll systems for roads and highways
- ECB for working capital as a permissible end-use has been allowed for the civil aviation sector under the approval route, subject to the fulfilment of conditions

Apart from the specific end uses mentioned above, ECBs are not permitted for working capital, on-lending or investment in capital market or real estate.

Quantum restrictions on ECB

ECB can be availed for incurring rupee or foreign currency expenditure up to the following:

- US$ 750 million for borrowers in the infrastructure and industrial sectors under the automatic route
- US$ 200 million for borrowers in the service sector (IT, hotels and hospitals) under the automatic route
- US$ 10 million for lending to self-help groups or for micro-credit or for bonafide micro-finance activity including capacity building by NGOs engaged in micro-finance activities

ECBs are required to have the following prescribed minimum average maturities and all-in-cost ceilings:

Average maturity period	All-in-cost ceiling over six months LIBOR
Three years and up to five years	350 basis points
More than five years	500 basis points

The approval requirements for ECBs have been significantly liberalised. No prior approvals are required for ECBs complying with the prescribed minimum maturities, 'all-in-cost' ceilings and end-user requirements. All other ECBs require prior approval from the appropriate RBI committee.

Indian corporate bodies raising ECBs to meet foreign currency expenses can retain the funds abroad until the time of their utilisation. Pre-payments upto US$ 750 million can be made without approvals, subject to compliance with the minimum average maturity of the loan and in any case three years.

Preference shares

Indian companies can mobilise foreign investments through the issue of compulsorily convertible preference shares. The conversion formula or price needs to be determined upfront. The proposals are processed either through the automatic route or the FIPB route, as the case may be, depending on the sector in which the Indian company is engaged in. The following guidelines apply:

- Issue of preference shares is permissible only for a rupee-denominated instrument in accordance with the Indian Companies Act
- Only compulsorily and fully convertible preference shares are considered foreign direct equity for the purposes of sectoral caps on foreign equity. All other kinds of preference shares, optionally convertible or redeemable, fall outside the FDI cap and have to comply with ECB norms
- The dividend rate should not exceed the limit prescribed by the Ministry of Finance. It is currently fixed at 300 basis points above the State Bank of India's prime lending rate

Debentures

Debentures can be issued by Indian companies to raise funds. The debentures can carry an interest coupon rate. Such interest should typically be a tax-deductible expense for the Indian company. Where debentures are issued to a foreign investor, they need to comply with the FDI policy in case of compulsorily convertible debentures, and with the ECB guidelines where the debentures are non-convertible or optionally convertible. In case of compulsorily convertible debentures (CCDs), conversion formula or price has to be determined upfront.

Global depository receipts (GDRs), American depository receipts (ADRs) and Foreign Currency Convertible Bonds (FCCBs)

Foreign investment through GDRs, ADRs and FCCBs is also treated as FDI. Indian companies are permitted to raise capital in the international market through the issue of GDRs, ADRs and FCCBs, subject to restrictions.

The issue of ADRs or GDRs does not require any prior approval (either from the Ministry of Finance, FIPB or the RBI), except where the FDI after such issue will exceed the sectoral caps or policy requirements, in which case prior approval from FIPB is required. The issue of FCCBs up to US$ 500 million also does not require prior approval. Only companies listed on the stock exchange are allowed to raise capital through GDRs, ADRs and FCCBs. The end-use of FCCB proceeds has to comply with ECB norms. Any convertible instrument issued by a listed company has to be mandatorily convertible or redeemable within 18 months.

Foreign Currency Exchangeable Bonds (FCEBs)

In FY 2007-08, the Indian Government notified the Foreign Currency Exchangeable Bonds Scheme for the issue of FCEBs. The salient features of the scheme are as follows:

- FCEBs are bonds expressed in foreign currency, the principal and interest of which is payable in foreign currency
- An FCEB is issued by a company which is part of the promoter group of a listed company whose equity is offered and which is engaged in a sector eligible to receive FDI (offered company) and which holds shares in the offered company. The FCEB is subscribed to by a person resident outside India and is exchangeable into an equity share of the offered company on the basis of any equity related warrants attached to debt instruments
- The investment under the scheme is required to comply with the FDI policy as well as with the ECB policy requirements. The proceeds of FCEB:
    - are to be used in accordance with end uses prescribed under the ECB policy
    - are not permitted to be utilised for investments in the capital market or in real estate in India
    - can be invested by the issuing company overseas by way of direct investment, including in a JV or a wholly owned subsidiary (WOS), subject to existing guidelines on Indian direct investment in a JV or WOS abroad

04 Significant Exchange Control Regulations

Exchange control is regulated under the Foreign Exchange Management Act, 1999 (FEMA). Under the FEMA, foreign exchange transactions are divided into two broad categories: current account transactions and capital account transactions. Transactions that alter the assets or liabilities outside India of a person resident in India or, in India, of a person resident outside India, are classified as capital account transactions. All other transactions are considered current account transactions.

The Indian rupee is fully convertible for current account transactions, subject to a negative list of transactions which are either prohibited or which require prior approval.

An Indian company with foreign investment is treated equally with other locally incorporated companies. Similarly, a foreign-invested Indian company is also treated equally with other locally incorporated companies. Accordingly, the exchange control laws and regulations for residents apply to Indian companies with foreign investment.

Current account transactions

Foreign nationals or Indian citizens who are not permanently resident in India and have been deputed by a foreign company to its office, branch, subsidiary or JV in India are allowed to make recurring remittances abroad for family maintenance of up to 100% of their net salary. Further, up to 100% of the salary of a foreign national or Indian citizen deputed by a foreign company to its Indian office, branch, subsidiary or JV can be paid abroad by the foreign company, subject to the foreign national or Indian citizen paying applicable taxes in India.

Prior approval of the RBI is required for acquiring foreign currency for the following purposes:

- Holiday travel over US$ 10,000 per person p.a.
- Gift over US$ 5,000 or donation over US$ 10,000 per remitter or donor p.a.
- Business travel over US$ 25,000 per person per visit
- Foreign studies as per the estimate of the institution or US$ 100,000 per academic year, whichever is higher
- Consultancy services procured from abroad of over US$ 1,000,000 per project (US$ 10,000,000 in case of infrastructure projects)
- Reimbursement of pre-incorporation expenses over the higher of US$ 100,000 and 5% of investment brought into India

Certain specified remittances are prohibited:

- Remittances out of lottery winnings
- Remittance of income from racing, riding, etc. or any other hobby
- Remittance for the purchase of lottery tickets, banned or prescribed magazines, football pools, sweepstakes, etc.
- Payment of commission on exports made towards equity investments in joint ventures or wholly owned subsidiaries abroad of Indian companies
- Payment of commission on exports under the rupee state credit route
- Payment related to ’call back services’ of telephones

- Remittance of dividend by any company to which the requirement of dividend balancing is applicable
- Remittances of interest income of funds held in a non-resident special rupee (account) scheme

Capital account transactions

Capital account transactions can be undertaken only to the extent permitted. The RBI has prescribed a list of capital account transactions, which include the following:

- Investments overseas by residents
- Borrowing or lending in foreign exchange
- Export or import of currency
- Transfer or acquisition of immovable property in or outside India

Liberalised remittance scheme for resident individuals

Under the regulations of the Foreign Exchange Management Act, 1999, resident individuals are permitted to remit up to US$ 200,000 per financial year for any permitted current or capital account transaction, or a combination of both, subject to specified terms and conditions. This is in addition to a facility of foreign travel of up to US$ 25,000 per annum. All other transactions otherwise not permissible under FEMA and those in the nature of remittances for margins or margin calls to overseas exchanges or overseas counterparties, are not allowed under the scheme.

Miscellaneous

Repatriation of capital

Foreign capital invested in India is generally repatriable, along with capital appreciation, if any, after the payment of taxes due, provided the investment was on a repatriation basis.

Acquisition of immovable property in India

Generally, foreigners are not permitted to acquire immovable property except in certain cases, where the property is required for the business of the Indian branch, office or subsidiary of the foreign entity. NRIs or PIOs are permitted to acquire immovable properties (except agricultural land).

Royalties and technical know-how fees

As of 16 December 2009, payments of trademark or technology royalties have been freed from limits. For any payment relating to a period after 16 December 2009, Indian companies can make payment for trademark or technology royalties without any restrictions under the automatic route.

Dividends

Dividends are freely repatriable after the payment of dividend distribution tax by the Indian company declaring the dividend. RBI permission is not necessary for a dividend affecting a remittance, subject to specified compliance requirements.

Remittances by branch or project office

No prior approval is required for remitting profits earned by the Indian branches of foreign companies (other than banks) to their head offices outside India. Remittances of the winding-up proceeds of a branch office of a foreign company in India are permitted subject to the authorised dealer's approval. Remittances of winding-up proceeds of a project office of a foreign company in India are permitted under the automatic route subject to the fulfilment of the compliance requirements.

05 Direct Taxation in India

Corporate tax rates

The corporate tax rates are as follows:

Company	Where taxable income exceeds INR 10 million	Other cases
Domestic company	32.45%	30.9%
	(30% plus surcharge of 5% plus education cess of 3%)	(30% plus education cess of 3%)
Foreign company	42.02%	41.2%
	(40% plus surcharge of 2% and education cess of 3%)	(40% plus education cess of 3%)

Dividend distribution tax (DDT)

Dividend income is exempt in the hands of shareholders. However, DDT is levied on companies declaring dividends. The effective rate is 16.22% (15% plus 5% surcharge and education cess of 3%). The exemption from DDT to SEZ developers has also been withdrawn from 1 June 2011. In order to mitigate the cascading effect of DDT, any dividend received by a domestic company from its subsidiary during any financial year will be reduced from the dividend to be paid, distributed or declared by the domestic company for the computation of DDT, provided the subsidiary comapny has paid DDT which is payable under the provisions of Indian tax laws on such dividend

Minimum alternate tax (MAT)

To bring zero tax companies under the tax net, MAT at 18.5%, plus applicable surcharge and education cess, of profits is levied on companies whose tax payable under normal income-tax provisions is less than 18.5% of adjusted book profits. MAT is also applicable to SEZ developers and units with effect from FY 2011-12. The current effective rates are as follows:

The credit of tax paid under MAT provisions is allowed against the tax liability which arises in the subsequent 10 years under the normal provisions of the Income-tax Act. Unadjusted MAT credit can be carried forward till the 10th year, following the year in which the credit arises.

Company	Where taxable income exceeds INR 10 million	Other cases
Domestic company	20.01%	19.05%
Foreign company	19.44%	19.05%

MAT provisions (which were applicable only to companies) were extended to limited liability partnerships (LLPs) w.e.f financial year 2011-12 in the modified form of alternate minimum tax (AMT). The AMT provisions have now been further extended to all other assessees w.e.f financial year 2012-13. AMT will be applicable at the rate of 18.5% on the adjusted total income (as per income-tax provisions) rather than the adjusted book profits as is the case for companies. Like companies ALP credit will be available to LLPs and other assessees for the period of 10 years.

In the case of an individual, or a Hindu undivided family (HUF) or an association of persons or a body of individuals or an artificial judicial person, AMT is not payable if the adjusted total income of such a person does not exceed INR 2 million.

Particulars	***Tax rates****	
	Resident	***Non-resident***
a. Short-term capital assets1 (other than mentioned in (b))	Normal corporate or individual tax rates	Normal corporate or individual tax rates
b. Short-term capital assets-listed equity shares and units of equity-oriented funds which have been charged to securities transaction tax (STT)	15%	15%
c. Long-term capital assets-listed equity shares in a company or unit of an equity-oriented fund which have been charged to STT	Exempt	Exempt
d. Long-term capital assets-listed securities (other than (c))	10%	10%
e. Other long-term capital assets2	20%	20%
Long –term capital gains arising to a non-resident (not being a company) or a foreign company – from transfer of unlisted securities	NA	10% (No indexation and currency fluctuation benefit)

** An applicable surcharge and education cess will also be levied on the above tax rates.*

1 A short-term capital asset is one held for a period of not more than 36 months (not more than 12 months in the case of shares, listed securities, units of mutual funds and zero coupon bonds).

2 Indexation of cost of acquisition and improvement of a long-term capital asset of any nature (other than debentures or bond other than capital indexed bonds issued by the Government) is available to residents. However, the benefit of indexation will not be available to non-residents on long-term capital assets being shares or debentures of an Indian company acquired in foreign currency. Securities, including equity shares in a company or unit of an equity-oriented fund, which have not been charged to STT, may be taxed @ 10% (plus applicable surcharge and education cess) without giving any indexation benefit at the option of the taxpayer.

Computation of general total income -following are the key features for computation:

- All income that accrue/arise or is deemed to accrue/arise or is received/deemed to be received in India is taxable in the hands of a non-resident taxpayer subject to the benefit of double taxation avoidance agreement (DTAA) with the taxpayer's country of residence
- Taxable income is computed for a uniform accounting year, i.e., the fiscal year from 1 April to 31 March
- The taxable income is called 'total income', computed after adding certain disallowances, such as loss on sale of assets and miscellaneous expenditure written off and the reduction of certain allowances or benefits from the profits

Depreciation

Depreciation is allowed separately at the following rates for computing taxable income:

In the case of a new asset, depreciation for the whole year is allowed only if the asset is put to use for 180 days or more during the fiscal year. Otherwise, depreciation is allowed at only half the prescribed rate.

Factory building	10%
Furniture and fittings	10%
Plant and machinery (general)	15%
Computers (including software)	60%
Motorcars, other than those used in a business of running them on hire	15%
Intangible assets (such as know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of a similar nature)	25%
Windmill	15%

For certain priority items, such as energy saving devices and pollution control equipment, depreciation is allowed at higher rates.

In addition, 20% depreciation on the actual cost of a new plant or machinery acquired and installed after 31 March 2005 is allowed to a taxpayer engaged in the manufacture or production of any product or generation or distribution of power in the year in which such a new plant or machinery is acquired and installed.

Undertakings engaged in the generation and/or distribution of power have the option of claiming tax depreciation at the above rates or on a straight-line basis at rates prescribed in the Income-tax Rules, 1962. The rates vary from 1.95 to 33.40%.

Taxation of know-how fees in the hands of foreign companies

Under the domestic tax law, royalties or technical fees payable to non-residents with a permanent establishment in India are taxed on a net basis. In contrast, they are taxed on a gross basis in the case of non-residents without a permanent establishment in the country. The following concessional tax rates apply if the agreement relates to a matter included in industrial policy or if it has been approved by the Government of India:

- For contracts entered on or after 1 June 2005-10%
- For contracts entered into after 31 May 1997 but 20% before 1 June 2005
- For contracts entered into on or before 31 May 1997-30%

Surcharge and education cess, as applicable, will also be levied. If applicable DTAA provides for a beneficial rate than the same would become applicable.

Taxation of dividends received from overseas group companies

From FY 2011-12, dividends received by Indian companies from specified foreign companies will be taxed at a concessional rate of 15%. However, no expenditure will be deductible while computing this dividend income. 'Specified foreign company' refers to a company in which the Indian company holds 26% or more in nominal value of the equity share capital.

Double tax avoidance agreements (DTAAs)

The DTAAs override the Indian Income-tax Act provisions to the extent that they are more beneficial to the assessee.

Note: Concessional tax rates applicable under certain double tax avoidance conventions that India has signed with various countries are provided in tabular form under Annexure 2.

In order to promote mutual economic relations, trade and investment, relief is granted on income chargeable to tax, both under the Income-tax Act of India and the domestic tax laws in the other country.

Tax information exchange agreements (TIEAs)

Recently, India entered into TIEAs, with Bermuda, Isle of Man, British Virgin Islands, Bahamas, Cayman Islands among others. The objective is to promote international cooperation on tax matters through the exchange of information. These agreements facilitate information sharing including exchange of banking and ownership information. However, the nature of tax-related information that can be shared under a TIEA varies from agreement to agreement.

Transactions with persons located in notified territories

Anti-avoidance measures have been introduced (from 1 June 2011) in order to discourage transactions with the persons located in countries that do not effectively exchange information with India. These measures enable the Indian Government to designate any country or jurisdiction not exchanging information with India as a 'notified jurisdictional area'. Transactions between any taxpayer and a party located in a notified jurisdictional area would be deemed as transactions between 'associated enterprises'. Transfer pricing regulations will apply accordingly. Transactions with those located in these jurisdictions would have the following additional implications:

- No deduction would be allowed on payments made to any financial institution unless an authorisation is issued to the income-tax authorities to seek relevant information from the financial institution
- No deduction would be allowed for any expenditure or allowance unless the taxpayer maintains the prescribed documents or provides the prescribed information to the tax authorities
- Receipts from a person located in the notified jurisdictions, will become taxable income for the taxpayer unless he or she is able to explain the source of this money in the hands of the payer or in the hands of the beneficial owner
- Payments made to a person in a notified jurisdictional area will be liable for withholding of tax at a higher rate

Advance rulings

To facilitate full planning and to avoid future disputes under the Income-tax Act, a non-resident can approach the Authority for Advance Rulings to determine aspects of any proposed or current transaction.

An advance ruling can also be sought by a resident to determine the tax liability of a non-resident with whom a transaction has been undertaken or is proposed.

Certain notified residents can also apply to the Authority to seek a ruling concerning the computation of total income.

Such an advance ruling would be binding on the person seeking it in relation to the transaction and the income-tax department cannot disregard the ruling unless there is some change in the facts or law affecting it.

General Anti Avoidance Rule (GAAR)

GAAR provisions have been recently introduced under the Indian tax laws empowering the tax department to declare an 'arrangement' entered into by an assessee to be an 'impermissible avoidance agreement' (IAA). The resulting consequence could be denial of tax benefit either under the provisions of the Act or under DTAA. Any step in or part of any arrangement can also be declared as an IAA. These provisions will become effective from financial year 2013-14 i.e. 1 April 2013 onwards.

An IAA is defined as an arrangement whose main purpose or one of whose main purposes is to obtain a 'tax benefit'. For a transaction to be declared as an IAA, at least one of the following conditions should be satisfied:

- The arrangement creates rights and obligations between parties that are not normally on arm's length
- It results directly or indirectly in any misuse or abuse of the provisions of the Act
- It lacks commercial substance
- The means or manner employed is not ordinary for bonafide purposes

Any arrangement is deemed to lack commercial substance if the substance or effect of the arrangement is inconsistent with the form of its individual steps or parts. The arrangement is deemed to lack commercial substance inter alia under the following situations as well:-

- It involves round-trip financing
- It involves an accommodating party
- It involves elements that set off or cancel each other
- It involves transaction conducted through one or more persons such that its value, location, source, ownership or control of funds is disguised

Once an agreement is declared as an IAA, the consequence could be denial of tax benefit either under the provisions of the Act or under the DTAA. Such a denial could be in any manner including disregarding, combining or recharacterising a step, disregarding or treating an accommodating party or any other party as one person, piercing a corporate veil, treating equity as debt, treating capital as revenue and vice-versa, etc.

Payment of royalty

The expression 'royalty' is defined as consideration received or receivable for transfer of all or any right in respect of certain property or information. However there were following controversies with regard to meaning, characterisation, scope and taxability of royalty:

- Whether consideration for use of computer software is royalty or not
- Whether the right, property or information has to be used directly by the payer or is to be located in India or control or possession of it has to be with the payer
- The meaning of the term process, etc.

In order to remove the above controversies, the definition of royalty provided under the domestic tax laws has been ammended/clarified retrospecively wef. 01 June 1976

It has been clarified that the consideration for use or right to use of computer software is 'royalty' and that transfer of all or any rights in respect of any right, property or information includes transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such a right is transferred.

It has also been clarified that royalty includes consideration for any right, property or information, whether or not the following conditions apply:

- The possession or control of such right, property or information is with the payer
- Such right, property or information is used directly by the payer
- The location of such right, property or information is in India

Further, it has also been clarified that the term 'process' includes transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such a process is secret.

Tax residency certificate (TRC)

Due to recent amendments under the domestic tax law, in order to obtain tax treaty benefit it will now be necessary for a non-resident assessee to furnish a certificate (containing prescribed particulars) of his/her being a resident of that country, obtained from the concerned Government.

Meaning of term not defined under the DTAA or domestic tax law

It has been recently provided that in case any term used in DTAA is not defined either under the DTAA or domestic tax law and a meaning is assigned to it by issue of a notification by the Central Government and such notification is bring into force, then the meaning of such term will become applicable to DTAA from the date on which such DTAA has come into force.

Tax return by persons holding assets outside India

Any resident who is otherwise not required to furnish a return of income, will now be required to furnish a return before the specified due date, if he/she has any asset located outside India including any financial interest in any entity, or as signing authority in any account located outside India.

Wealth tax

Wealth tax is charged on net wealth as on 31 March every year (referred to as the valuation date). It is charged both on individuals as well as companies at the rate of 1% of the amount by which the 'net wealth' exceeds INR 3 million. The term 'net wealth' broadly represents the excess value of certain assets over the debts concerned. Assets include guest houses and residences, motorcars, jewellery, bullion, utensils of gold and silver, yachts, boats, aircraft, urban land and cash. A debt is an obligation to pay a certain sum of money incurred in relation to those assets included in 'net wealth'.

Direct Taxes Code (DTC)

On 30 August 2010 the Government placed before the Parliament the Direct Taxes Code Bill, 2010. The Bill is modelled on the draft Direct Taxes Code (originally released in August 2009), changes proposed in the revised discussion paper (released in June 2010) and further suggestions and comments made by stakeholders. The DTC is proposed to be effective from 1 April 2013.

Note: The salient features of the Bill are summarised in Annexure III.

Gift tax

There is no gift tax liability in India. Any sum of money exceeding or immovable property whose stamp duty value exceeds or any immovable property whose fair market value exceeds INR 50,000 received without consideration by an individual from any person will be subject to tax as 'income from other sources'. This will not apply to any sum of money received from the following:

- Relative (spouse, brother, sister, brother or sister of the spouse or any lineal ascendants or descendants)
- On the occasion of marriage of the individual
- Under a will or by way of inheritance
- In the death expectation of the donor

Tax incentive scheme

Special economic zone (SEZ) scheme

The SEZ Policy was introduced by the Government in 2000 to provide an internationally competitive and conducive environment for exports. The SEZ Act, 2005 along with the associated Rules, provides the framework for all important legal and regulatory aspects of development as well as for units operating in SEZs.

SEZs are duty-free enclaves considered to be outside the customs territory of India for the purposes of carrying out their authorised activities.

SEZ developers are entitled to 100% tax holidays (of profits and gains derived from the business of developing the SEZ) for 10 consecutive years out of 15 beginning from the year in which the SEZ is notified by the Government. Exemption from DDT has been discontinued with effect from 1 June 2011 and exemption from MAT has been discontinued from FY 2011-12. Expenditure undertaken by a developer on account of the development of SEZ is also exempt from duties of customs, excise and central sales tax.

A unit set up in an approved SEZ enjoys a 100% tax holiday for five years and 50% for the next 10 years (in the last five years subject to certain additional conditions) out of profits derived from actual exports of goods and services. The tax holiday period commences from *the year in which the SEZ unit begins to manufacture or produce or provide services.*

Note: Annexure I sets out the salient features and benefits of the SEZ.

Setting up of industrial parks

Under the Industrial Park Scheme 2008 notified by the CBDT, the industrial park developers are eligible for 100% tax deduction provided for 10 consecutive years out of 15 after the commencement of operations of such units.

Some of the conditions to be fulfilled to avail the benefit of an industrial park are as follows:

- The date of commencement of the industrial park should be before 31 March 2011
- The area allocated or to be allocated to industrial units shall not be less than 90% of the allocable area
- There should be a minimum of thirty industrial units located in an industrial park
- For the purpose of computing the minimum number of industrial units all units of a person and his or her associated enterprises to be treated as a single unit
- The minimum constructed floor area should not be less than 50,000 square metres
- No industrial unit, along with the units of an associated enterprise, should occupy more than 25% of the allocable area
- The industrial park should be owned by only one undertaking
- Industrial units should undertake only manufacturing activity as defined in the National Classification, 2004, code issued by the Central Statistical Organisation, Department of Statistics

Industrial parks enterprises or undertakings in specified states

Income-tax holidays and exemptions from CENVAT are available for units set up in industrial parks in the states of Uttranchal, Himachal Pradesh and the North East states, subject to certain conditions. These are summarised in the table below:

State	Incentives	Validity period	Eligible units
• Uttaranchal & Himachal Pradesh	100% income-tax holiday for first five years, next five years -30% (25% if the assessee is not a company) 100% exemption from CENVAT	10 years	• Units engaged in specified activities that have began manufacturing or commence operations or undertake substantial expansion from 7 January 2003 up to 31 March 2012. • New units that have commenced commercial production or existing units undertaking more than 25% expansion in installed capacity on or after 7 January 2003 but before 31 March 2010
• ***North***- Eastern States (including Sikkim)	• 100% income-tax holiday • Concessional rate of duty payable on 10 years, value addition during manufacture or refund of duty in cash, subject to conditions	10 years	• Units that begin manufacturing any eligible article or thing • Undertake substantial expansion • Carry out prescribed eligible business from 1 April 2007 to 31 March 2017 • New industrial and existing units before 1 April which have undertaken substantial expansion by refund of duty paid in cash, subject to increase in investment by 25% or more • Units who have and will commence production between 1 April 2007 and 31 March 2017

Tax holiday for infrastructure, power and natural gas network

Undertakings engaged in the prescribed infrastructure projects are eligible for tax deduction of profits from the following businesses:

- 100% tax deduction for 10 consecutive years out of 20 for undertakings engaged in developing, operating and maintaining infrastructure facilities such as roads, bridges, rail systems, highway projects, water supply projects, water treatment systems, irrigation projects, sanitation and sewage systems or solid waste management systems
- 100% tax deduction for 10 cosecutive years out of 15 for undertakings involved in developing, operating and maintaining ports, airports, inland waterways or inland ports
- 100% tax deduction for 10 cosecutive years out of 15 for the following undertakings:
    - Set up in any part of India for the generation and/or distribution of power and begin to generate power upto 31 March 2013
    - Start transmission or distribution by laying a network of new transmission or distribution lines upto 31 March 2013
    - Undertake substantial renovation and modernisation of the existing network of transmission or distribution lines upto 31 March 2013

Seven year tax holiday available to entities engaged in the production of mineral oil will not be available for blocks licenced under contracts awarded after 31 March 2011.

Deduction on investments for specified businesses

Tax incentives provided by allowing 100% deduction on any capital expenditure (other than on land, goodwill and financial instrument) is available to the following types of businesses:

- Setting up and operating a cold chain facility on or after 1 April 2009
- Setting up and operating a warehousing facility for storage of agricultural produce on or after 1 April 2009
- Laying and operating a cross-country natural gas or crude or petroleum oil pipeline for distribution, including storage facilities being an integral part of such network commencing operations on or after 1 April 2007
- Building and operating, anywhere in India, a two-star hotel or above category commencing operations on or after 1 April 2010
- Building and operating, anywhere in India, a hospital with at least 100 beds commencing operations on or after 1 April 2010
- Developing and building a housing project under a scheme for slum redevelopment or rehabilitation commencing operations on or after 1 April 2010
- Developing and building a housing project under a notified scheme of affordable housing framed by the central or a state Government commencing operations on or after 1 April 2011

- Fertiliser production in a new plant or in a newly installed capacity in an existing plant commencing operations on or after 1 April 2011
- Setting up and operating an inland container depot or a container freight station notified or approved under the customs act 1962, on or after 1 April 2012
- Bee-keeping and production of honey and bees wax on or after 1 April 2012
- Setting up and operating a warehouse facility for storage of sugar on or after 1 April 2012

In case of certain specified businesses commencing operations on or after 1 April 2012 such as cold chain facility, warehousing for agricultural produce, hospital with at least 100 beds, notified affordable housing project and production of fertiliser, the deduction is 150% of capital expenditure incurred on or after 1 April 2012.

Tax holiday for other facilities

Food processing units

A 100% tax holiday for the first five years and a deduction of 30% (25% if the assessee is not a company) of profits for the subsequent five years are available to undertakings engaged in the business of processing, preservation and packaging of fruits and vegetables or in the integrated business of handling storage and transportation of food grains, starting operations on or after 1 April 2001.

Further, this is available to additional industries such as processing, preserving and packaging of meat and meat products or poultry, marine and dairy products, that has began operations on or before 1 April 2009.

Scientific research and development

If certain conditions are met, a deduction is available on twice the amount of scientific research expenditure incurred on an approved in-house research and development facility by a company engaged in the business of bio-technology or any business of manufacture or production of any article or thing except specified articles. Currently, this weighted deduction is available until FY 2016-17.

From FY 2011-12, any sum paid to a national laboratory or a university or an Indian Institute of Technology or an approved scientific research programme also qualifies for a weighted deduction of 200% as against the earlier 175%.

A weighted deduction is available of 125% any sum paid for scientific research to a domestic company, if such a company fulfils the following conditions:

- Has scientific research and development as its main objective
- Is approved by the prescribed authority, in the prescribed manner
- Fulfils other conditions as may be prescribed

Hotels and convention centres

A five-year 100% tax holiday commencing from the initial year (subject to certain conditions) is provided on profit derived from the business of hotels (two, three and four-stars) and convention centres located in specified areas. This will be available provided the construction is completed and operations are started during 1 April 2007 to 31 July 2010.

Besides, a five-year tax holiday is available on profits derived from the business of new two-star, three-star and four-star category hotels located in specified districts having a world heritage site. Also, the hotel should start functioning between 1 April 2008 and 31 March 2013.

Hospitals

A five-year tax holiday is available on profits derived from operating and maintaining hospitals located anywhere in India (other than the excluded area), subject to the fulfilment of certain conditions. The hospital should start functioning between 1 April 2008 and 31 March 2013.

06 International Assignments in India

There is no separate tax regime for foreign nationals working in India. Taxation of an individual in India depends upon his or her residential status for the relevant tax year, which in turn depends upon the number of days that he or she was physically present in India. In India, the financial year (tax year) runs from 1 April of the year to 31 March of the succeeding year.

Under the domestic tax law, a person is considered to be a resident of India if one of the following conditions is satisfied:

- He or she is present in India for a period of 182 days or more in the relevant financial year (also referred to as the '182 days rule')
- He or she is present in India for 60 days in the relevant tax year and 365 days or more in the preceding four financial years (also referred to as the '60 days rule')

However it has been provided that where a citizen of India leaves India for the purposes of taking up employment outside India or an Indian citizen or person of Indian origin, being outside India, comes on a visit to India, then only the 182 days rule will apply.

In case, an individual satisfies neither of the conditions listed above, he or she qualifies as a non-resident (NR) for that financial year.

A resident individual is treated as resident but not ordinarily resident (RNOR) of India if he or she satisfies any one of the following conditions:

- NR in 9 out of 10 years preceding the relevant financial year
- Physically present in India for 729 days or less during the 7 years preceding the relevant financial year

In case, an individual does not satisfy the conditions listed above, he or she would qualify as resident and ordinarily resident (ROR) for that financial year.

In determining the physical presence of an individual in India, it is not essential that the stay in India should be continuous or at the same place. Further, both the date of arrival and departure are considered as days in India for determining the duration of stay of the individual in India.

If a foreign individual qualifies as a tax resident of both India and his home country, then the conditions provided under the tie breaker test of the relevant DTAA would have to be seen in order to determine the tax residential status of foreign individual.

Scope of taxation

Under the domestic tax laws, the scope of taxation for each category of residential status is as under:

- ROR: Worldwide income of the individual is liable to tax in India for the relevant tax year
- RNOR: Income received in India, income accruing or arising from a source in India, income derived from a business controlled from India, or income from a profession set up in India is liable to tax in India
- NR: Income received in India or income accruing or arising from a source in India is liable to tax in India

Taxation of employment income

Employment income for services rendered in India is taxable in India, irrespective of the place where the income is received. Taxable income includes all amounts, received in cash or in kind, arising from an office of employment. It need not necessarily be the employer who makes the payment or provides the benefit. Apart from salary, fees, bonuses and commissions, some of the most common remuneration items are allowances, reimbursement of personal expenses, education payment and perquisites or benefits provided by the employer either free of cost or at concessional rates. All such payments are included, whether paid directly to the employee or on his or her behalf.

Housing benefits provided by an employer are generally taxed at 15% of the salary or the actual rent paid for the accommodation, whichever is less. Hotel accommodation is taxable at 24% of salary or the actual amount paid, whichever is less. Cost of meals and laundry expenses are fully taxable. The value of any specified security or sweat equity shares allotted or transferred directly or indirectly by the employer or former employer, free of cost or at a concessional rate, and the amount of any contribution to an approved superannuation fund by the employer, to the extent it exceeds 1,00,000 INR, are taxable as perquisites in the hands of employee. Car and driver facilities provided by the employer are also taxable as perquisites at concessional value.

There are a number of issues relating to the taxation of employment income, which depends on the facts and circumstances of each case, and on the views taken by the tax authorities. Therefore, it is advisable to seek professional advice on the remuneration package as a whole to minimize Indian tax incidence.

Tax withholding

In respect of employment income, the employer will be required to withhold tax on the earnings from salary at applicable rates and hand over the same to the Government's treasury within seven days from the end of the month during which salary is paid (except for March wherein the time line is extended to 30 April). This is applicable even if the employer is not resident in India.

Double taxation agreements

Where an individual is treated as a tax resident of another country, he or she may qualify for relief from Indian tax under a double taxation agreement between that country and India. Most current agreements lay down various tests to determine in which of the two countries an individual is resident for treaty purposes. Most agreements contain clauses, which exempt a resident of one country from tax on employment income in India if he or she is present in India for less than 183 days in a tax year, and if some other conditions regarding the salary charge back and payment of salary by a non resident etc. are satisfied (short stay exemption).

Where the individual is coming from a non-treaty country, short stay exemption is available under the domestic tax law, provided the individual's stay in India during the tax year does not exceed 90 days and certain other conditions are met.

Tax rates

Taxes are levied at progressive rates in India. Rates applicable for financial year 2012-13 are as follows:

Taxable income over (INR)	***Not over (INR)***	***Tax on column 1 (INR)***	***Percentage of tax on excess (%)***
0	200,000	-	0%
2,00,001	500,000	-	10%
5,00,001	10,00,000	30,000	20%
10,00,001		130,000	30%

Resident senior citizens (aged 60 years or more) having income up to INR 2,50,000 do not have to pay income tax. For very senior citizens (aged 80 years and above) the basic exemption limit is INR 5,00,000.

Further, in addition to the above, an education cess @3% of the tax will be levied.

Tax registration

An individual needs to apply for and obtain the tax registration called permanent account number (PAN). PAN is required to file the tax return and also needs to be reported in the tax withholding returns or certificates.

Tax-return filing

At the end of each year, a tax return has to be filed with the income tax authorities in the prescribed form. The due date for filing of return is 31 July of the relevant assessment year. However, a belated return can be filed before the expiry of one year from the end of relevant assessment year. It is mandatory to file the return electronically if the total income exceeds INR 10,00,000 or where the individual qualifies as ROR and has foreign assets or has signing authority in any accounts located outside India.

Other matters

Some other considerations which are relevant for the foreign nationals are listed below:

Visa

A foreign national coming to India must hold a valid passport and visa. Visa is issued by the Indian consulates or high commissions situated in the respective country, depending upon the purpose and duration of visit. A foreign national is not permitted to take up employment in India unless he or she holds an employment visa. Employment visa is issued to highly skilled and/or professionals provided they are drawing a salary exceeding the prescribed limit and is generally issued for a period of two to three years. Extension of visa can be done in India.

Foreign nationals coming for business meetings or to set up joint ventures require a business visa. Business visa is not convertible into employment visa within India.

Registration with Foreigners Regional Registration Officer (FRRO)

A foreign national visiting India who either has a valid employment visa or intends to stay for more than 180 days must register within 14 days of arrival with the Foreigners Regional Registration Officer (FRRO). On submission of prescribed documents to the FRRO a residential permit is issued to the foreign national.

Payment of salaries outside India

The current exchange control regulations permit a foreign national who is an employee of foreign company and is on secondment or deputation to a subsidiary in India to maintain a foreign currency account in a bank outside India and receive the entire salary outside India, provided tax on the salary has been paid in India.

Social security in India

In October 2008, the Government introduced the mandatory social security norms for foreign nationals who qualify to be international workers. A foreign national qualifies to be an international worker, if he or she is coming to India to work for an establishment in India to which the Indian social security regulations apply. International workers coming from a country with which India has a social security agreement (SSA or totalisation agreement) on a reciprocity basis and who are contributing to the home country social security, either as a citizen or resident and enjoying the status of 'detached worker' for the period and terms as specified in the relevant SSA, will qualify to be 'excluded employees' and accordingly will be exempt from the Indian social security requirements.

India has, so far, signed SSAs with eleven countries. However, only the SSAs signed with Belgium, Germany, Switzerland, Luxembourg, Netherlands, Denmark, Korea and France have been notified and made operational thus far.

Every international worker has to contribute 12% of his or her salary, comprising mainly basic wages, dearness allowance, retaining allowance (but excluding bonus, house rent allowance, etc.) to the Employee's Provident Fund. The employer is required to make a matching contribution (i.e. 12% of the salary) and deposit both the employer's and employee's contributions along with an administrative charge of approx 1.1% of salary with the Indian social security authorities by the 20th day of the following month. Out of the employer's contribution of 12%, an amount equal to 8.33% of salary is allocated to the pension fund of the international worker.

An international worker can withdraw the accumulations to the Employee's Provident Fund on retirement from services in the establishment after attaining 58 years of age; or on retirement on account of permanent and total incapacity to work due to bodily or mental infirmity, as certified by the prescribed medical officer or registered practitioner; or on suffering from notified diseases provided in the scheme; or as per the provisions specified in the relevant SSA under which the international worker is covered.

International workers covered under an SSA will be eligible for withdrawal or exportability of pension, as per the provisions of the relevant SSA. However, International workerss from countries with which India does not have an SSA can withdraw the pension only after rendering services for 10 years with covered establishments.

For a more detailed analysis and further information, please refer our publications titled ‘Assignments in India’ and ‘Indian social security for cross-border assignments’.

Foreign nationals who are being sent to India on secondment by their foreign employers, for services to be rendered in India, must ensure that a proper secondment structure is in place. The following considerations should be kept in mind:

- Place of delivery of the salary
- Charging back the salary to the Indian entity, if is to be paid outside India
- Current exchange control regulations for delivering salary
- Corporate tax implications (permanent establishment exposure)
- Withholding tax
- Transfer pricing regulations
- Service tax implications

07 Indirect Taxation in India

Customs duty

Customs duty is levied by the central Government on goods that are imported into and exported from India, though the list of goods on which export duty is levied is very limited . The rate of customs duty applicable to a product to be imported or exported depends on its classification under the Customs Tariff Act, 1985 (CTA).

The customs tariff is aligned with the internationally recognised Harmonised Commodity Description and Coding System of Tariff Nomenclature (HSN) provided by the World Customs Organisation.

Customs duty is levied on the transaction value of the imported or exported goods. While the general principles adopted for the valuation of goods in India are in conformity with the World Trade Organisation agreement on customs valuation, the central Government has established independent Customs Valuation Rules applicable to the export and import of goods.

India does not have one uniform element of customs duty, and the customs duty applicable to any product is composed of a number of components. The types of customs duties applicable are as follows:

- BCD is the basic component of customs duty levied at the effective rate notified under the First Schedule to the CTA and applied to the landed value of the goods (i.e. the CIF value of the goods plus landing charges at 1%)

The peak rate of basic customs duty (BCD) is currently set at 10% for all goods other than agricultural and other specified products. However, the Government of India has the power to exempt specific goods, wholly or in part, from the levy of custom duties. In addition, preferential or concessional rates of duty are available under the various bilateral and multilateral trade agreements that India has entered into with other countries.

- The countervailing duty (CVD) is equivalent to, and is charged in lieu of, the excise duty applicable on like goods manufactured in India. CVD is calculated on the landed value of the goods and the applicable BCD. However, the CVD on specific consumer goods intended for retail sale is calculated on the basis of the maximum retail price (MRP) printed on their packs after allowing specified abatements. The general rate of excise duty is currently 12% and consequently so is the rate of CVD
- Education cess (EC) at 2% and secondary and higher education cess (SHEC) at 1% are also levied on the aggregate customs duties
- Goods attracting customs duties at bound rates under international commitments (for example, the IT Agreement and Indo-US Textile Agreement) have been exempt from these cesses
- Additional duty of customs (ADC) at 4% is charged in addition to the above duties on imports subject to certain exceptions

ADC is calculated on the aggregate of the assessable value of the imported goods, the total customs duties (i.e. BCD and CVD) and the applicable EC and SHEC.

BCD, EC and SHEC levied on the aggregate customs duties are a cost on any import transaction. The duty incidence arising on account of all other components may be set off or refunded subject to prescribed conditions. Where goods are imported for the purposes of manufacture, the Indian manufacturer may take credit for the CVD and ADC paid at the time of import to set it off against the output excise duty . In the case of service providers, CVD credit is available to set off against the output service tax. Similarly, the central Government allows a refund for the ADC paid on goods imported for the purpose of trading in India, subject to fulfilment of the conditions prescribed under the governing notifications and circulars issued in this regard.

CENVAT (excise duty)

Central value added tax (CENVAT), commonly referred to as excise duty, is a tax levied by the central Government on the manufacture or production of movable and marketable goods in India.

The rate of excise duty levied on the goods depends on the classification of the goods under the excise tariff, which is primarily based on the HSN classification adopted so as to achieve conformity with the customs tariff. The standard rate of excise duty for non-petroleum products is 12%. In addition, EC at 2% and SHEC at 1% are applicable on aggregate excise duties. Thus, the effective rate of excise duty is 12.36%.

The excise duty on most consumer goods intended for retail sale is chargeable on the basis of the MRP printed on the goods packaging. However, abatements are admissible at rates ranging from 15 to 55% of the MRP for the purposes of charging excise duty. Goods other than those covered by an MRP-based assessment are generally chargeable to duty on the transaction value of the goods sold to an independent buyer. In addition, the central Government has the power to fix tariff values for charging ad valorem duties on goods.

The excise duty is a modified form of value added tax (VAT) which allows manufacturers to claim credit on the excise duty paid on locally sourced goods and the CVD and ADC paid on imported goods. The credit can be utilised for the payment of excise duty on the clearance of dutiable final products manufactured in India. In the light of the integration of the Goods and Services Tax (GST) initiated in 2004, manufacturers of dutiable final products can also claim credit of the service taxes paid on input services used in or in relation to the manufacture of final products and clearances of final products up to the place of removal. In addition, credit is admissible on the following input services:

- Advertisement or sales promotion services
- Services in relation to procurement of inputs
- Activities relating to accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking and credit rating

The CENVAT credit rules exclude certain services from the ambit of input services.

Service tax

Service tax is levied on specified taxable services identified under chapter 5 of the Finance Act, 1994 (the Act). At present approximately 120 services are classified as taxable under the Act. The existing rate of service tax is 12%. In addition, EC of 2% and SHEC of 1% of the service tax is levied on taxable services. Thus, the effective rate of service tax is 12.36%.

The onus of paying service tax lies on the provider of the services. However, for specified services, such as transport of goods by road and sponsorship services, the service tax liability rests with the recipient of the services.

Further, the Union Budget 2012-13 has introduced shared liability in discharging service tax in the following cases:

- Hiring of motor vehicles to carry passengers
- Supply of manpower
- Works contract

Taxable services provided by service providers located outside India to a recipient in India are subject to service tax under the Services (Provided from Outside India and Received in India) Rules, 2006. Under these rules, the service recipient is required to register and pay the tax in accordance with the relevant provisions of law.

The current threshold limit for service tax exemption for small service providers is INR 10 lakh. The threshold limit for obtaining service tax registration is INR 9 lakh. All those liable to pay service tax on eligible taxable services received or provided by them are required to obtain service tax registration from the jurisdictional Service Tax Commissioner. According to the Service Tax Rules, 1994, the service provider or service recipients, liable to pay service tax, who receive services in more than one premises or office and who have a centralised billing or accounting system, can opt for centralised registration by making an application to the Commissioner of Central Excise within whose jurisdiction the premises or office from where the centralised billing or accounting is performed is located.

Service tax was earlier charged on the gross value of the services rendered. The central Government has introduced the Service Tax (Determination of Value) Rules, 2006, which contain the valuation methodology under specified circumstances.

In light of the integration of goods and services tax, a service provider can avail credit of excise duties paid on capital goods and inputs used for providing output services, along with the service taxes paid on input services, subject to the fulfilment of certain prescribed conditions.

Further, the central Government, under the Export of Service Rules, 2005 (Export Rules), has declared that no service tax is chargeable on the export of services. The benefit of exemption from service tax would be available on exported services, subject to the fulfilment of the conditions prescribed under the Export Rules.

As an alternative, the service provider can also discharge the service tax on exports and claim a rebate of the service tax paid. In addition to the rebate of tax paid on the exported services, rebate or refund provisions have been established with regard to the service tax paid on input services and excise duty paid on input goods used in providing the exported services.

The central Government has also introduced the Point of Taxation Rules, 2011, which envisages the point in time when a service shall be deemed to have been provided, thereby creating a deeming fiction for imposing the tax even prior to receipt of consideration for the services rendered.

These rules prescribe accounting of services tax on accrual basis as against the earlier system of cash basis. Further, the central Government has proposed to introduce taxation system based on a negative list, which is to be implemented from a date to be notified after the Finance Act, 2012. Subsequently, service tax will be levied on all services provided or agreed to be provided in a taxable territory, except the following:

- Services in the negative list
- Services specifically exempted by notification

In this regard, the Government has issued the draft Place of Provision of Services Rules, 2012, which provide for determination of the place of consumption of the services.

Sales tax

The sale of movable goods in India is chargeable to tax at the central or state level. The Indian regulatory framework has granted power to state legislatures to levy tax on goods sold within that state. Such sales are, therefore, chargeable to VAT at the rates notified under the VAT laws of the relevant state.

All goods sold in the course of interstate trade are subject to central sales tax (CST).

Where goods are bought and sold by registered dealers for trading or for use as inputs in the manufacture of other goods or specified activities (such as mining or telecommunication networks), the rate of sales tax is 2%, provided Form C is issued by the purchasing dealer. In the absence of Form C, the applicable rate would be the rate of VAT on such goods in the originating state.

CST is sought to be phased out on the introduction of GST in India, which is expected to be introduced in about two years. In the interim, CST will continue to coexist with state-level VAT.

Inter-state procurement on which CST is charged in the originating state is not eligible for input tax credit in the destination state.

VAT

State-level sales tax was replaced by VAT with effect from 1 April 2005 in most Indian states. At present, all the Indian states have transitioned to the VAT regime.

Under this regime, the VAT paid on goods purchased within the state is eligible for VAT credit. The input VAT credit can be utilised against the VAT or CST payable on the sale of goods. This ensures that the cascading effect of taxes is avoided and that only the value addition is taxed.

Currently, there is no VAT on goods imported into India. Exports are zero rated. This means that while exports are not charged to VAT, the purchaser of inputs used in the manufacture of export goods or goods purchased for exports can claim a refund of the VAT charged on the goods.

State VAT is charged at varying rates of 1%, 4 % 5% and 20%. Goods other than those notified to be covered under the above rates are charged at a general rate ranging from 12.5% to 15%.

Turnover thresholds have been prescribed so as to keep small traders out of the ambit of VAT. A tax under a composition scheme, at a lower rate, may be levied on such small traders in lieu of VAT.

The following conditions also apply to VAT:

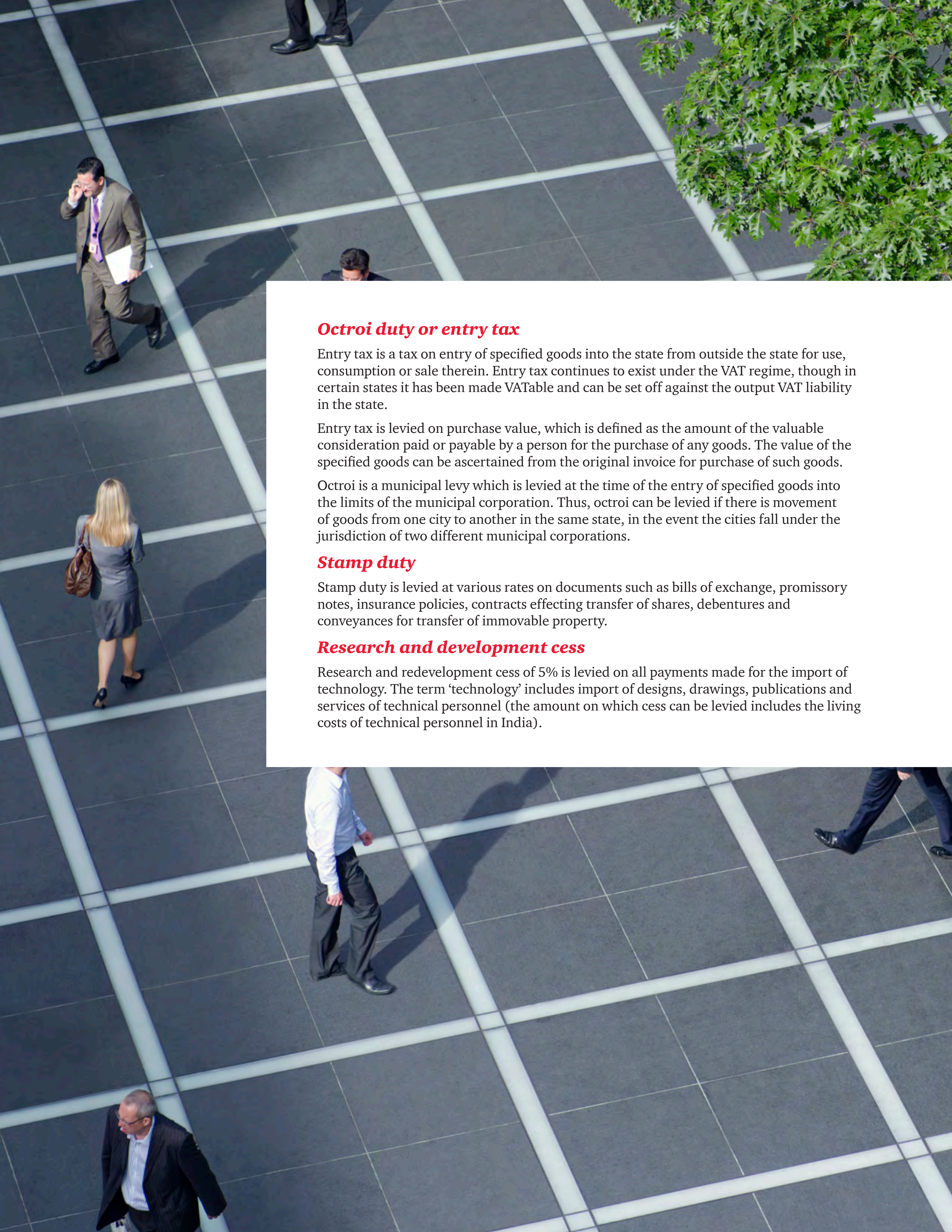
- VAT registered dealers need to issue serially numbered invoices with prescribed particulars
- Most states require VAT returns to be filed monthly or quarterly
- A comprehensive self-assessment of VAT has been introduced
- Turnover taxes, surcharges, additional surcharges and the special additional tax have been abolished in most states
- Entry taxes continue to exist, but have been made VATable, except where they are paid in lieu of octroi

In 2006, the central Government took a major step towards the transition to a national integrated GST. Implementation of GST will be a historical reform in India as it will subsume CVD, excise duties, service tax, CST, state VAT and some other state levies.

At present, a dual-rate GST model is envisaged whereby the tax rate will be converged to one standardised rate of 16% on goods and services within three years of implementation.

Under the proposed dual GST model, a central GST as well as a state GST will be levied on the taxable value of a transaction of supply of goods and services. Both the centre and the state will legislate, levy and administer the central GST and the state GST, respectively.

A reform like GST is obvious to attract a lot of deliberation and discussion at all stages of planning and implementation and, as such, is a time-consuming exercise. Implementation of GST also entails constitutional amendments as to the rights and powers of the central and state Governments to levy different taxes.



Octroi duty or entry tax

Entry tax is a tax on entry of specified goods into the state from outside the state for use, consumption or sale therein. Entry tax continues to exist under the VAT regime, though in certain states it has been made VATable and can be set off against the output VAT liability in the state.

Entry tax is levied on purchase value, which is defined as the amount of the valuable consideration paid or payable by a person for the purchase of any goods. The value of the specified goods can be ascertained from the original invoice for purchase of such goods.

Octroi is a municipal levy which is levied at the time of the entry of specified goods into the limits of the municipal corporation. Thus, octroi can be levied if there is movement of goods from one city to another in the same state, in the event the cities fall under the jurisdiction of two different municipal corporations.

Stamp duty

Stamp duty is levied at various rates on documents such as bills of exchange, promissory notes, insurance policies, contracts effecting transfer of shares, debentures and conveyances for transfer of immovable property.

Research and development cess

Research and redevelopment cess of 5% is levied on all payments made for the import of technology. The term 'technology' includes import of designs, drawings, publications and services of technical personnel (the amount on which cess can be levied includes the living costs of technical personnel in India).

08 Mergers and acquisitions

India has witnessed an increase in M&A and outbound activity in recent years, owing to its dominant participation in the global economy. This is subject to the interplay of various tax and regulatory legislations, ranging from direct and indirect taxation, securities laws, company law, foreign exchange control regulations, competition law and stamp duty law.

Part I: Indian M&A

The Indian regulatory framework broadly facilitates the following modes of acquisition and reorganisation:

- Share acquisition
- Asset acquisition: Assets (itemised sale) or business (slump sale)
- Amalgamations and demergers

1 Share acquisition

1.1 Sale of shares

Transfer of shares in Indian companies is taxable in India as capital gains, subject to benefits under applicable Double Tax Avoidance Agreement (DTAA), if any.

- Listed shares:
  - Long-term capital gains (LTCG) i.e., shares held for a period of more than 12 months, are exempt from tax if sale is on a stock exchange
  - Short-term capital gains (STCG) are taxed at 16.22% for residents and 15.76% for non-residents
- Unlisted shares:
  - LTCG: Tax at 10.5% for non-residents; tax at 21.63% for residents
  - STCG: Tax at 32.45% for resident companies; tax at 42% for non-resident companies

Transfer of shares or interest in a foreign company is taxable in India, if such a company derives value substantially from assets located in India or if it results in transfer of rights in relation to management or control of an Indian company.

Repatriation of funds

Apart from payment towards various services provided by the parent company, funds can also be repatriated through distribution of dividend, repurchase (buy-back) of shares or capital reduction by the company.

- Dividend
  - It attracts dividend distribution tax (DDT) of 16.22% and is payable by the company paying the dividend. Dividend is exempt from tax in the hands of shareholders
  - There is no withholding tax on dividend payments on which DDT has been paid by the company
  - Companies distributing dividend have to comply with the transfer to reserve rules under the Companies Act
  - Repurchase (buy-back) of shares is taxable as capital gains, subject to benefits under the applicable tax treaty, if any
- ***Capital reduction***
  - Requires the approval of the high court
  - Taxable as deemed dividend to the extent of accumulated profits of the company
  - Balance amount taxable as capital gains (similar to repurchase of shares)

1.2 Acquisition of shares

- Acquisition of shares of a listed company requires compliance with the Takeover Code. An open offer is required for the acquisition of 25% or more stake in a listed company.
- Transfer of shares is subject to stamp duty at 0.25% of the value of shares transferred and is generally borne by the buyer. However, no stamp duty is payable if shares are held in an electronic form
- Funding costs: The interest cost on loan for the acquisition of shares is not tax-deductible as dividend income is exempt from tax in the hands of the shareholders

Withholding tax

- The buyer (including non-residents) has to withhold actual capital gains tax liability of non-residents from sale consideration payable to a non-resident.
- No withholding of tax is required in case of acquisition of shares from Indian residents

Debt or equity requirements

- Indian companies can be funded by a mix of debt, equity and convertible instruments
- There are no prescribed debt-equity ratios or thin capitalisation rules under taxation law. Also, debt or equity amounts are generally driven by commercial considerations

Note: GAAR provisions to be introduced from FY 2013-14. Refer Part II for details

Preservation of tax losses

- No impact on carrying forward tax losses on transfer of shares of a listed company
- Transfer of shares of non-listed companies beyond 49%, to disentitle the company from carrying forward previous years' business loss
- No impact of transfer of shares on carrying forward unabsorbed depreciation allowance

2 Asset or business acquisition

2.1 Sale of assets

- Computation of gains is made with respect of each asset and this is taxable as short-term or long-term capital gains, depending on the period of holding of assets. Sale of depreciable assets always results in short-term capital gains
- Capital gains are determined by reducing the acquisition cost of assets from sales consideration. In case of long-term capital gains, the acquisition cost is indexed based on cost inflation index
- The cost of acquisition of self-generated intangible assets is generally taken as 'nil'.
- Sale consideration for transfer of immovable property cannot be less than the stamp duty valuation
- The non-compete fee is charged to tax as business income.
- The seller is liable to charge VAT or sales tax on the transfer of movable property at specified rates
- Transfer of business undertaking with its assets and liabilities for a lump-sum consideration is referred as slump sale and is taxed differently
- Capital gains are determined by reducing the net worth of business undertaking from sales consideration. Net worth is the book value of assets (tax written down value to be considered for tax depreciable assets) less liabilities transferred
- Capital gains are taxable as long-term capital gains in case the business undertaking is held for more than three years. No indexation benefit is available in case of slump sale of undertaking
- Slump sale is typically not subject to VAT or sales tax

2.2 Purchase of asset

- In case of a slump sale, lump-sum purchase consideration is allocated to various assets based on a valuation report;
- Purchase of assets such as building, plant and specified intangible assets for use in business entitles to depreciation benefits. Goodwill, if not represented by specified intangible assets, is not eligible for depreciation
- The buyer is liable for stamp duty on the transfer of immovable property at the rate applicable in the concerned state

Funding costs

- Interest on loan taken for the acquisition of assets is generally tax-deductible. However, there are some exceptions to this rule

3. Amalgamations and de-mergers

Amalgamations or de-mergers of companies are exempt from the levy of capital gains tax in the hands of the transferor company as well as its shareholders, subject to the fulfilment of specified conditions.

3.1 Amalgamation

An amalgamation refers to the merger of one or more companies into another through a court process.

Conditions to be satisfied to claim tax exemption are as follows:

- Transfer of all assets and liabilities
- Shareholders holding at least 75% of shares (in value) in amalgamating company to become shareholders in the amalgamated company

3.2 De-mergers

A de-merger refers to the transfer of an undertaking or a part thereof, from one company into another through a court process.

Conditions to be satisfied to claim tax exemption are as follows:

- Transfer of all assets and liabilities of the undertaking
- Consideration for demerger settled through the issue of shares to the shareholders of the de-merged company on a proportionate basis
- Shareholders holding at least 75% of shares (in value) in demerged company to become shareholders in the resulting company

3.3 Carrying forward accumulated loss and unabsorbed depreciation

Amalgamation

- Accumulated loss or unabsorbed depreciation of an amalgamating company running an industrial undertaking, ship, hotel, banking, aircraft (restricted to public sector companies) to be carried forward by the amalgamated company
- Specified conditions laid down like continuance of business, holding of assets, etc.

De-merger

- Accumulated loss or unabsorbed depreciation directly related to the undertaking being demerged is transferrable
- Proportionate common losses are also transferable

3.4 Other matters

- Amalgamations and de-mergers normally attract stamp duty (potentially significant) at rates varying from state to state
- Stock exchange (for listed companies), high court and other regulatory clearances are required for amalgamations or de-mergers

Part II: Inbound investments

- Generally, acquisitions in India are made through a tax efficient jurisdiction such as Mauritius, Singapore, Netherlands or Cyprus to optimise tax on repatriation of funds and exit. However, tax authorities have been questioning the use of such jurisdictions in absence of commercial substance
- The Indian Government has proposed to introduce General Anti Avoidance Rules (GAAR) from FY 2013-14. GAAR empowers tax authorities to disregard transactions which have been entered into – for obtaining tax benefit and lack commercial substance

Part III: Outbound investments

- Regulation of overseas direct investment
  - Outbound investment from India to invest in a joint venture or a wholly owned subsidiary abroad is allowed under automatic route for bonafide business purposes subject to 400% of the net worth of the Indian investor
- Tax on overseas investments
  - Considering the tax regime of target countries coupled with nascent foreign tax credit regulations, it becomes imperative that investments are structured to optimise overseas tax efficiencies
  - Essential tax considerations for the Indian outbound investor are offshore capital gains optimisation, foreign tax reduction and optimisation of Indian tax credits on repatriation of funds to India
  - Dividend received from overseas companies (in which an Indian company holds 26% or more of the equity share capital) is taxable at 16.22% in hands of the Indian company for FY 2012-13 on gross basis
  - Currently, India has no controlled foreign corporation (CFC) rules and there is no India tax on foreign profits that remain with offshore subsidiaries.
  - The Government has proposed to introduce CFC regulations in the proposed Direct Tax Code
- Outbound structuring
  - It is important to have a robust outbound structure which is flexible, optimises global tax cost, has the ability to bring in new investors and repatriate or deploy funds in a tax efficient way.

09 Transfer Pricing in India

Introduction

A separate code on transfer pricing (TP) under sections 92 to 92F of the Indian Income Tax Act, 1961 (the Act) covers intra-group transactions and is applicable from 1 April 2001. The basic intent of these TP provisions is to avoid shifting of profits from India to offshore jurisdictions. Since the introduction of the code, transfer pricing has become an important international tax issue affecting multinational enterprises operating in India. Broadly based on the Organisation for Economic Cooperation and Development (OECD) guidelines, these regulations describe the various transfer pricing methods and impose extensive annual transfer pricing documentation requirements.

Transfer pricing legislation

Statutory rules and regulations

The Indian transfer pricing code provides that the price of any international transactions between associated enterprises (AEs) is to be computed with regard to the arm's length principle. Effective from Financial Year (FY) 2012-13, the TP provisions have been extended to specified domestic transactions as well.

However, the TP legislation is not applicable in a scenario where the computation of the arm's length price (ALP) has the effect of reducing the income chargeable to tax or increase the losses in India. This is aligned with the legislative intent to protect the tax base of India.

Type of transactions covered

The term 'international transaction' to mean a transaction between two or more AEs involving the sale, purchase or lease of tangible or intangible property, provision of services, cost-sharing arrangements, various modes of capital (debt) financing, guarantees, business restructuring or reorganisation transactions or any other transaction having a bearing on the profits, income, losses or assets of such enterprises. The AEs could be either two non-residents or a resident and a non-resident. A permanent establishment (PE) of a foreign enterprise also qualifies as an AE. Accordingly, transactions between a foreign enterprise and its Indian PE are within the ambit of the code.

Associated enterprises

The relationship of AEs covers direct/indirect participation in the management, control or capital of an enterprise by another enterprise. It also covers situations in which the same person (directly/indirectly) participates in the management, control or capital of both the enterprises.

Based on the following parameters, two enterprises would be deemed as AEs:

- Direct/indirect holding of 26% or more voting power in an enterprise by the other enterprise or in both the enterprises by the same person
- Advancing of a loan, by an enterprise, that constitutes 51% or more of the total book value of the assets of the borrowing enterprise
- Guarantee by an enterprise for 10% or more of total borrowings of the other enterprise
- Appointment by an enterprise of more than 50% of the board of directors or one or more executive directors of the other enterprise or the appointment of specified directorships of both enterprises by the same person
- Dependence of an enterprise (in carrying on its business) on the intellectual property licensed to it by the other enterprise
- Purchase of 90% or more of raw material required by an enterprise from the other enterprise or from any person specified by such other enterprise at prices and conditions influenced by the latter
- Sale of goods or articles manufactured by an enterprise to other enterprise or to a person specified by such other enterprise at prices and conditions influenced by the latter
- Existence of any prescribed relationship of mutual interest (none prescribed till date)

Further, a transaction between an enterprise and a third party may be deemed to be a transaction between AEs if there exists a prior agreement in relation to such transaction between the third party and the AE or if the terms of such transaction are determined in substance between the third party and the AE.

Specified domestic transactions (SDT)

From FY 2012-13, the TP provisions have extended their scope to 'specified domestic transactions'. The following domestic transactions have been specified for this purpose:

- Payment to related parties[1]
- Transactions of tax holiday undertakings[2] with other undertakings of the taxpayer

This provision is applicable only if the aggregate value of such transaction exceeds INR 50 million in the relevant tax year.

Arm's length principle and pricing methodologies

The following methods have been prescribed for the determination of the ALP:

- Comparable uncontrolled price (CUP) method
- Resale price method (RPM)
- Cost plus method (CPM)
- Profit split method (PSM)
- Transactional net margin method (TNMM)
- Such other methods as may be prescribed[3]

No particular method has been accorded a preference over the other. The most appropriate method for a particular transaction would need to be determined according to the nature and class of the transaction or associated persons and dependent on functions performed by such persons as well as other relevant factors.

The legislation requires a taxpayer to determine an ALP for international transactions. In case where more than one ALP is determined by applying the most appropriate transfer pricing method, the arithmetic mean (average) of such prices shall be the ALP of the international transaction. Accordingly, the Indian legislation does not recognise the concept of arm's length range but requires the determination of a single ALP.

As mentioned above, the Indian provisions require the computation of an 'arm's length price' based on 'arithmetic mean' of comparable results . Further the law provides flexibility in ALP by allowing variance of around 5% of the transaction value. However for FY 2011-12 the Central Government has removed 5% and would notify the variance percentage but for the FY 2012-13 and onwards the variance percentage has been capped at 3%.

1. Covers expenditure incurred towards a related party. Related party defined to include a party which has 20% or more voting power in the other party.
2. Transactions covered in sections 80A, 80-IA(8) and 80-IA(10) and Chapter VI-A and section 10AA of the Act.
3. The CBDT has for FY 2011-12 onwards notified 'other method'. It has been described as any method which takes into account the price which has been charged or paid or would have been charged or paid for same or similar uncontrolled transaction, with or between non-AEs, under similar circumstances.

It is also to be noted that prior FY 2009 - 2010, the flexibility of 5% was allowed around ALP and not the transaction value. The law as it stood before FY 2009-2010, resulted in tax controversy on availability of the benefit of 5% as a standard deduction in computing the ALP. Therefore, the Finance Act 2012 has further clarified that the law had never intended to allow any standard deduction for computing the arm's length price.

Safe harbour provisions

Effective from April 2009, the Central Board of Direct Taxes (CBDT) has been empowered to formulate safe harbour rules. These rules will specify the circumstances in which the tax authorities will accept the ALP as declared by a taxpayer, without detailed analysis. The basic intention behind the introduction of these rules is to reduce the tax litigation in determining the transfer prices of international transactions. Till date, no safe harbour rules have been issued by the CBDT.

Advance pricing agreements

Recently the provisions relating to advance pricing agreement (APA) has been introduced which are effective from 1 July 2012.

An APA is an agreement between the taxpayer and the tax authorities for the upfront determination of the arm's length price/pricing methodology (which is acceptable to the Revenue) of a related party transaction. Essentially, the taxpayers seek an APA to determine the arm's length price of a transaction upfront, thereby ascertaining their tax liability (from the transaction) and consequently mitigating tax litigation at a later stage.

The CBDT, with the approval of the Central Government, has been empowered to enter into an APA with any taxpayer, who is undertaking international transactions, to determine the ALP or specify the manner in which ALP shall be determined. The APA so entered shall be binding on the taxpayer and the tax authorities with respect to the transaction covered under the agreement. Such agreement shall be valid for a period not exceeding five years. The CBDT is yet to frame detailed rules/guidelines for APA.

Documentation and report requirements

Documentation requirements

Taxpayers are annually required to maintain a set of extensive information and documents related to international transactions undertaken with AEs. As mentioned above, the transfer pricing provisions are applicable to specified domestic transactions as well, therefore, the taxpayer is also required to maintain the prescribed documentation in respect of such transaction (Effective from FY 2012-13).

The code prescribes detailed information and documentation that the taxpayer has to maintain to demonstrate that the price complies with the arm's length principle. All such information or documents should be contemporaneous and in place by the due date for filing the return of income (i.e. 30 November following the close of relevant tax year). The prescribed documents must be maintained for a period of nine years from the end of the relevant tax year and should be updated annually on an ongoing basis.

Taxpayers having aggregate value of international transactions below INR 10 million are relieved from maintaining the prescribed documentation. However, even in these cases, it is imperative that documentation is adequate to substantiate the ALP of international transactions.

The documentation requirements are also applicable to the foreign companies having income taxable in India.

Accountant's report

It is mandatory for all taxpayers, to obtain an independent accountant's report with respect to all international transactions between AEs. The report has to be furnished by the due date of the tax return filing (i.e. on or before 30 November for corporates having international transactions). Effective from FY 2012-13, SDT are also required to be reported in the accountant's report (in Form 3CEB) along with the international transactions entered into with the AEs. The report requires the accountant to give an opinion on the proper maintenance of prescribed documents and information by the taxpayer. Additionally, the accountant is required to certify the 'true and correct' nature of an extensive list of prescribed particulars in Form 3 CEB.

Burden of proof

The burden of proving the arm's length nature of a transaction primarily lies with the taxpayer. During audit proceedings, if the tax authorities, on the basis of material, information or documents in their possession, are of the opinion that the ALP was not applied to the transaction or the taxpayer did not maintain/produce adequate and correct documents/information/data, the tax officer may readjust or recompute the price used in the transaction after giving the opportunity of being heard to the tax payer.

Penalties

The following penalties have been prescribed for default in compliance with the provisions of the transfer pricing code:

Particulars	***Penalty***
Failure to maintain the prescribed information/document	2% of transaction value
Maintains or furnishes any incorrect, information/ documents[4]	2% of transaction value
Failure to report any international transaction which is required to be reported[5]	1 lakh plus 2% of transaction value
Adjustment to taxpayer's income	100% to 300% of the total tax adjustment amount

Effective from 1 April 2013, all the above penalty provisions will also be attracted to the SDTs

4. Effective from 1 July 2012, as amended by Finance Act 2012
5. Effective from 1 July 2012, as amended by Finance Act 2012

Special Economic Zones in India

Annexure I

Special economic zones in India

"The objectives of SEZs include making available goods and services free of taxes and duties supported by integrated infrastructure for export production, quick approval mechanisms, and a package of incentives to attract foreign and domestic investments for promoting exports."

Ministry of Commerce and Industry, Government of India

An SEZ is a specifically delineated, duty-free area notified as such by the Ministry of Commerce and Industry under the Special Economic Zones Act, 2005 (SEZ Act). The zone is considered to be outside the customs territory of India for the purposes of carrying out authorised activities. An SEZ is deemed to be a port, ICD, land station and land customs station under the provision of the Customs Act, 1962.

The SEZ Act, 2005 and SEZ Rules, 2006, which came into force with effect from 10 February 2006 govern the development of SEZs. The SEZ Act provides the umbrella legal framework for all important legal and regulatory aspects of SEZ development as well as for units operating in these SEZs. An important salient feature of the SEZ Act is that it has an overriding effect over other laws.

The scope of the SEZ Act includes the following:

- Establishment of SEZs and units
- Fiscal regime for developers and units
- Requirements, obligations and entitlements
- Single-window clearance mechanism
- Granting of licence to industrial undertakings to be established in an SEZ
- Establishment of administrative authority for SEZs set up by the Government of India
- Special courts and single enforcement agency to ensure speedy trials

According to the Ministry of Commerce and Industry, SEZs can be set up by private developers, central or state Governments, or jointly by any two or more of the above on contiguous, vacant land.

Fiscal benefits to the developer or co-developer

Income tax incentives

- Hundred per cent tax deduction for 10 years out of 15 years, beginning with the year in which the SEZ is notified by the Government
- Exemption from dividend distribution tax discontinued with effect from 1 June 2011
- Exemption from minimum alternate tax discontinued from FY 2011-12. Accordingly, the SEZ developer or co-developer will henceforth be required to pay MAT.

Indirect tax incentives

- Exemption from customs duty on import of capital goods and raw material into the SEZ for authorized operations
- Exemption from excise duty on local procurement of capital goods and raw materials
- Exemption from CST on inter-state purchases subject to submission of statutory declaration Form I
- Exemption from payment of service tax on the input services wholly consumed in the SEZ unit for authorised operations and refund mechanism for service tax paid wholly or partially consumed outside the SEZ for authorised operations.

In addition, goods sold from DTA units to the SEZ unit will attain the status of physical exports. In light of this, the sale of goods to an SEZ unit will be regarded as exports and the DTA unit will be eligible for export benefits:

- Exemption from ADC in lieu of sales tax or VAT on goods supplied to an SEZ unit
- Exemption from VAT as per VAT legislation
- Exemption from payment of stamp duty as per state Government policy

Who should set up an SEZ unit

Export-oriented entrepreneurs, manufacturers and service providers (including IT and ITeS providers, BPOs, contract manufacturers, etc.) have huge growth potential in Indian SEZs. Electronic hardware, software manufacturers and telecom equipment manufacturers/suppliers can also set up units in SEZs for supply to the domestic market.

FDI policy

Hundred per cent FDI is permitted under the automatic route for SEZ development. For units in SEZs, the FDI policy of the Government of India will apply. Approval to units proposing to avail FDI is granted by the Board of Approvals, Ministry of Commerce and Industry in line with the FDI policy. No separate approval is required from FIPB.

No minimum export obligation

- There is no obligation on units to export goods or services from an SEZ unit
- However, SEZ units have to be positive net foreign exchange earners at the end of five years calculated cumulatively
- There is no limit on DTA sales provided full import duty is paid
- The supply of IT hardware, software and telecom equipment to domestic markets, as well as the supply of goods and services to other SEZ, EOU and STPI units are counted towards export earnings

Fiscal benefits to an SEZ unit

- Fifteen-year graded income-tax deduction on export profits beginning with the year in which the unit begins to manufacture, produce or provide services: Hundred per cent for the initial five years, fifty percent for the next five years and up to fifty percent for the remaining five years, equivalent to profits ploughed back for re-investment
- Tax deduction only for physical exports
- Exemption from MAT has been discontinued with effect from FY 2011-12. Accordingly, SEZ units will henceforth be required to pay MAT.
- Same indirect tax benefits as the SEZ developer
- Exemption from electricity duty
- Exemption from payment of stamp duty (as per state Government policy)

Liberal exchange controls norms

- Hundred per cent export earnings maintainable in foreign exchange in special foreign currency account with minimal restrictions on business payments outside India
- Unlimited period for export realisation
- Branches of foreign companies in SEZ eligible for manufacturing activities

Offshore banking units

An offshore banking unit is a branch of a bank in India located in the SEZ with the permission of the RBI. Offshore banking units provide cheaper finance at international rates to units in SEZs. Banks setting up offshore banking units in SEZs are entitled to tax deduction (beginning with the year in which they obtain requisite approvals) of hundred percent for the first five years and fifty percent for the next five years. A similar deduction is available to units of an International financial services centre.

Free trade and warehousing zone (FTWZ)

This is a special category of the SEZ governed by the SEZ Act, 2005 and SEZ Rules, 2006, mainly for trading, warehousing and other related activities.

- To be used as 'international trading hubs'
- Deemed to be a foreign territory
- A key link in logistic and global supply chains, servicing both India and the globe
- Fiscal benefits such as customs duty deferment: Imported goods can be stored for five years without payment of customs duty, interest or penalty
- Administrative benefits such as reduction in customs clearance time, transportation facility, etc.
- Support facilities such as banking and information system for cargo tracking
- High quality infrastructure

How to set up an FTWZ

Trading unit

A company can become a trading unit in an FTWZ for the purposes of trading and warehousing and other authorised operations.

Service unit

A company can avail the services of a third party which is a unit in an FTWZ for trading and warehousing and other authorised operations. Trading entities, importers and exporters, 3PLs, CHAs, freight forwarders, shipping lines, manufacturers, etc. can become units in an FTWZ. Units are required to execute a bond-cum-legal undertaking for import and warehousing of goods inside the FTWZ.

Activities permitted in an FTWZ

The following activities are permitted in a FTWZ:

- The unit can carry FTWZ to DTA and DTA to FTWZ transactions
- A unit in an FTWZ can hold goods on account of a foreign or a DTA supplier and buyer
- Warehousing can be undertaken on behalf of foreign or domestic clients
- Trading, with or without labeling, can be carried out
- Packaging and repacking without any processing can be carried out
- Re-sale, re-invoice or re-export of goods can be carried out
- Other value optimisation services can be carried out

Obligations of an FTWZ unit

- All transactions are required to be done in only convertible foreign currency
- A unit has to be a positive net foreign exchange earner over five years. A unit has to comply with the NFE requirement as stipulated in the SEZ Rules. There is no obligation on clients of service units
- The value on FOC imports are to be taken as foreign outflow
- The following are counted toward the inflow of foreign exchange earnings
  - Supplies need to be made to bonded warehouses where payment is received in foreign exchange
  - Goods need to be supplied against free foreign exchange

Tax incentives

- Customs duty is exempt when goods are imported into the FTWZ for authorised operations. Customs duty becomes payable at the time of clearance of goods into DTA [customs duty payable on quantity cleared into DTA and not on the full quantity received into FTWZ]. Therefore, the customs duty can be deferred by importing the goods into FTWZ
- Inbound taxable services as well as those performed inside the FTWZ for use in authorised operations are exempt from service tax. Similarly, taxable services in relation to the transportation of goods from port to FTWZ or from one FTWZ to another is also exempt
- No central excise duty is leviable inside the FTWZ
- Goods procured from the DTA for authorised operations are exempt from the levy of tax under central sales tax
- Stamp duty is exempt on any instrument executed in connection with the carrying out of the purposes of the FTWZ
- Trading profit earned on the re-export of imported goods from the FTWZ is exempt from income tax similar to the SEZ unit

Tax Rates under Double Taxation Avoidance Agreements

Annexure II

Tax rates under double taxation avoidance agreements

Name of the country	***Interest***	***Dividend***	***Royalty (refer to note l & m)***	***Fee for technical services (refer to note l & m)***
Austria	10%	10%	10%	10%
Armenia	10%	10%	10%	10%
Australia	15%	15%	10% (b); 15% in other cases	10% (b); 15% in other cases
Albania	Government press release dated 29 January 2009			
Bangladesh	10%	10% (c); 15% in other cases	10%	No specific provision (e)
Belarus	10%	10% (i); 15% in other cases	15%	15%
Belgium	10%(k); 15% in other cases	15%	10%(f)	10%(f)
Botswana	10%	7.5% (i); in other cases 10%	10%	10%
Brazil	15%	15%	25% if royalty arises from trademarks; 15% in other cases	No specific provision (e)
Bulgaria	15%	15%	15% if royalty relates to copyrights of literary, artistic or scientific work; 20% in other cases	20%
Canada	15%	15% (c); in other cases 25%	10% (b); in other cases 15%	10% (b); in other cases 15%
Cyprus	10%	10% (c); in other cases 15%	15% (including fee for included services) (q)	10% (for technical fees) (q)
Croatia	Union cabinet approved the signing of tax treaty on 19 January 2006. The treaty is yet to be notified.	10%	10%	10%
Denmark	10% (k); 15% in other cases	15% (i); 25% in other cases	20%	20%
Ethiopia (refer note r)	10%	7.5%	10%	10%
Finland	10%	10%	10%	10%
Germany	10%	10%	10%	10%
Greece	14%	14%	14%	14%
Georgia	10%	10%	10%	10%
Hungary	10% (f)	10% (f)	10% (f)	10% (f)
Iceland	10%	10%	10%	10%

Name of the country	*Interest*	*Dividend*	*Royalty (refer to note l & m)*	*Fee for technical services (refer to note l & m)*
Indonesia	10%	10% (i); 15% in other cases	15%	No specific provision (e)
Ireland	10%	10%	10%	10%
Israel	10%	10%	10%	10%
Italy (refer to note o)	15%	15% (c); in other cases 25%	20%	20%
Japan	10%	10%	10%	10%
Jordan	10%	10%	20%	20%
Kazakhstan	10%	10%	10%	10%
Kenya	15%	15%	20%	17.5% (for managerial, technical, professional or consultancy fees)
Kuwait	10%	10%	10%	10%
Republic of Korea	10% (n); 15% in other cases	15% (d); 20% in other cases	15%	15%
Kyrgyz Republic	10%	10%	15%	15%
Latvia	Government press release dated 18 September 2008			
Libya Arab Jamahriya	14%	14%	14%	No specific provision (e)
Grand Duchy of Luxembourg	10%	10%	10%	10%
Malaysia	10%	10%	10%	10%
Malta	10%	10% (i); in other cases 15%	15% including fee for included services (q)	10% on fee for technical, managerial and consultancy services (q)
Mauritius	14%	5% (c); in other cases 15%	15%	No specific provision (e)
Mexico	10%	10%	10%	10%
Mongolia	15%	15%	15%	15%
Montenegro	10%	5% (i); in other cases 15%	10%	10%
Morocco	10%	10%	10%	10%
Mozambique	10%	7.5%	10%	No specific provision (e)
Myanmar	10%	5%	10%	No specific provision (e)
Namibia	10%	10%	10%	10%
Nepal	10% (n); in other cases 15%	10% (c); in other cases 15%	15%	No specific provision (e)
Netherlands	10% (f)	10% (f)	10% (f)	10% (f)
New Zealand	10%	15%	10%	10%
Norway	15%	15% (i); in other cases 25%	10% (f)	10% (f)
Oman	10%	10% (c); in other cases 12.5%	15%	15%
Philippines	10% (n); in other cases 15%	15% (c); in other cases 20%	15%	No specific provision (e)
Poland	15%	15%	22.50%	22.50%

Name of the country	*Interest*	*Dividend*	*Royalty (refer to note l & m)*	*Fee for technical services (refer to note l & m)*
Qatar	10%	5% (c); in other cases 10%	10%	10%
Portugal	10%	10% (i); 15% in other cases	10%	10%
Romania	15%	15% (i); in other cases 20%	22.50%	22.50%
Russian Federation	10%	10%	10%	10%
Saudi Arabia	10%	5%	10%	No specific provision (e)
Serbia	10%	5% (i), in other cases 15%	10%	10%
Singapore	10%(k);in other cases 15%	10%(i); in other cases 15%	10%	10%
South Africa	10%	10%	10%	10%
Sudan	10%	10%	10%	10%
Slovenia	10%	5%(c); in other cases 15%	10%	10%
Switzerland	10%	10%	10%	10%
Syrian Arab Republic	10%	5% (c), in other cases 10%	10%	No specific provision, (e)
Taipei	10%	12.5%	10%	10%
Tajikistan	10%	5% (i), in other cases 10%	10%	No specific provision, (e)
Tanzania (p)	12.5%	10%(c); in other cases 15%	20%	20% On management and professional fees
Thailand	10%(n),in other cases 25%	15%(c)(h); 20%(i) or (h)	15%	No specific provision (e)
Trinidad and Tobago	10%	10%	10%	10%
Turkey	10%(k); in other cases 15%	15%	15%	15%
Turkmenistan	10%	10%	10%	10%
Uganda	10%	10%	10%	10%
Ukraine	10%	10%(i); in other cases 15%	10%	10%
United Arab Emirates	5%(k); in other cases 12.5%	10%	10%	No specific provision (e)
United Arab Republic (Egypt)	No specific provision (e)	No specific provision (e)	No specific provision (e)	No specific provision (e)
United Kingdom	10%(n); in other cases 15%	15%	10%(b); in other cases 15%	10%(b); in other cases 15%
United States of America	10%(k); in other cases 15%	15%(c); in other cases 25%	10%(b); in other cases 15%	10%(b); in other cases 15%
United Mexican States	10%	10%	10%	10%
Uruguay	PIB (Ministry of Finance) release dated 8 September 2011. Treaty yet to be notified	15% (i); in other cases 20%	22.50%	22.50%
Vietnam	10%	10%	10%	10%
Zambia	10%	5% (j); in other cases 15%	10%	10% on managerial and Consultancy fees

Notes:

a The treaty tax rates on dividends are not relevant in case of dividend paid by an Indian company, because under the current Indian tax legislation, dividend distribution by such companies is exempt from income tax in the hands of the recipient.

b This is applicable for use of industrial, scientific or commercial equipment.

c This is applicable if the beneficial owner is a company which holds at least 10% of the capital of the company paying the dividend.

d This is applicable if the beneficial owner is a company which owns 20% of the capital of the company paying the dividend.

e In the absence of a specific provision, it may be treated as business profits under respective treaties.

f The 'Most Favoured Nation' clause is applicable. The protocol to the treaty limits the scope and rate of taxation to that specified in similar articles in the treaties signed subsequently by India with other OECD nations.

g In most of the treaties the interest attributable to financing of exports, imports and loans granted by specified institutions is subject to nil or lower withholding tax rates.

h This is applicable if the company paying the dividend is engaged in an industrial undertaking.

i This is applicable is if the beneficial owner is a company which holds at least 25% of the shares of the company paying the dividend.

j This is applicable if the recipient is a company owning at least 25% of the capital during the period of six months before date of payment.

k This is applicable if paid on a loan granted by a bank or financial institution.

l The tax rate under domestic tax laws is 20% plus surcharge @ 2%; since education cess of 3% is levied, the effective tax rate is 21.012% (applicable for payments under the agreements entered prior to 1 June 2005 but after 31 May 1997).

m The prescribed tax rate for royalty and fees for technical services under domestic tax laws is 10% (plus surcharge @ 2% and education cess of 3%, so the effective tax rate is 10.506%). The rate would apply for payments under the agreement entered on or after 1 June 2005.

n This is applicable if interest is received by a bank or financial institution.

o The protocol amending the DTAA with Italy (January 2006) stipulates the rate of 10% for Dividend, Interest, Royalty and Fee for Technical Services

p As per a Government Press Release, under an agreement signed on 27 May 2011 the maximum rate of tax to be charged in the country of source will not exceed a two-tier 5% or 10% in the case of dividends and 10% in the case of interest and royalties. This is yet to be notified.

q There is a separate clause for technical fees and fee for included services under the treaty.

r As per a Government press release, an agreement was signed on 25 May 2011, but it is yet to be notified.

Direct Taxes Code

Annexure III

Direct Taxes Code (DTC)

On 12 August 2009, the Indian Government released the draft DTC for public debate. The objective is to moderate the tax rates and simplify tax laws. All direct taxes including wealth and income tax will be brought under one code. Public and stakeholder feedback on the proposals outlined in the draft were analysed by the Government, and suggestions for amendments received from public, business associations and other bodies were taken into account. In June 2010, a revised discussion paper addressing the major issues was released and further, feedbacks were received. The DTC Bill, 2010, which addressed the issues and concerns raised by various stakeholders, was tabled in Parliament on 30 August 2010. The Bill was then referred to a Standing Committee on Finance, which prepared a report providing its recommendations after collating the representations made by stakeholders with the response of the Ministry of Finance. The report was released in March 2012. The response of the Ministry and the recommendations of the Committee provide clarity and are indicative of the approach that can be expected in the final version of the DTC to be released.

A summary of significant proposals of the DTC follows:

Commencement

The DTC is proposed to be effective from 1 April 2013. This gives time to companies to understand the provisions, engage in a dialogue with the Indian Government and, more importantly, restructure their operations as they switch over to taxation under the DTC. Also, this gives time to the Government to adapt its systems to accept and audit additional new compliance requirements imposed on taxpayers.

Tax rates

- Tax rates for individuals are proposed to be revised as follows:

New income slab (INR)	*Tax Rate*
Up to 200,000**	Nil
200,001– 500,000	10%
500,001 – 1,000,000	20%
Above 1,000,000	30%

** *In the case of resident senior citizens, INR 200,000 may be read as INR 250,000 and INR 200,001 as INR 250,001.*

- Partnership firms, associations of persons and bodies of individuals will be taxed separately as an 'unincorporated body' at a maximum marginal rate of 30% without any threshold exemption limit
- Tax rate for companies (both domestic and foreign) is proposed at 30%
- Domestic companies will continue to be liable to dividend distribution tax at 15%
- Foreign companies will be subject to branch profits tax of 15%

Minimum alternative tax (MAT)

- MAT is proposed to be levied on book profits at 20%
- MAT credit will be available for set-off against normal tax liability for up to 15 consecutive financial years immediately succeeding the year in which the credit becomes available

Wealth tax

The DTC proposes to levy wealth tax at 1% of net wealth over INR 1 crore. All taxpayers except non-profit organisations are liable to wealth tax. New categories of assets introduced for levying wealth tax are archaeological collections, drawings, paintings, sculptures or any other work of art, watch with a value in excess of INR 50,000 and equity or preference shares held in controlled foreign companies (CFC).

International taxation

- Transportation charges paid to a non-resident by a resident are taxable as also transportation charges paid by non-residents to non-residents if they are in respect of carriage to or from a place in India
- Income arising from transfer of shares of a foreign company is sought to be taxed in India if assets in India (held directly or indirectly by the company) represent at least 50% of the fair market value of all the assets owned by the foreign company. The 50% test is to be applied at any time during the 12 months prior to the transfer
- The presumptive taxation scheme is continued with no change in the rates except in the case of non-residents engaged in
    - The business of providing services or supplying plant and machinery in connection with prospecting for or extraction or production of mineral oil or natural gas, wherein the rate will be increased from 10% to 14%;
    - The operation of ships, wherein the rate will be increased from 7.5% to 10%; and
    - The operation of aircraft, wherein the rate will be increased from 5% to 7%
- Definition of royalty has been expanded and withholding tax rate has been increased from 10% to 20%, both for royalty as well as fees for technical services
- Head office expenditure would be allowed to the extent of 0.5% of total turnover or gross receipts of business in India

Residency rules

Companies having a place of effective management in India at any time in the year will be considered residents in India.

The place of effective management is defined to mean the following:

- A place where board of directors (BoD) or executive directors, as the case may be, make their decisions, or
- In a case where the BoD routinely approves commercial and strategic decisions made by the executive directors or officers, the place where such executive directors or officers perform their functions

Separately, the following CFC provisions are proposed to be introduced as an anti-avoidance measure. CFC provisions introduced with a view to tax passive income earned by a foreign company directly or indirectly controlled by a resident in India.

- CFC means a foreign company which satisfy the following conditions:
  - The foreign company is controlled by resident taxpayers- Control define to mean one or more persons resident in India, individually or collectively, directly or indirectly, hold shares carrying not less than 50% of the voting power or capital of the company
  - Such foreign entity is a resident of a country with a lower level of taxation, i.e. the amount of tax payable in the foreign country is less than 50% of the corresponding tax payable under the DTC
- The net profit earned by the CFC will be attributed (and not only the passive income) to the resident taxpayer based on the percentage holding and for the period such percentages are held
- CFC provisions will not be applicable in case the foreign company is listed on a stock exchange or is engaged in 'active trade or business' (subject to certain conditions) or if the specified income does not exceed INR 2.5 million
- Where 50% or more of the income of an offshore entity is derived from the sale of goods or services to controlled corporations, it will not be considered as having engaged in active trade or business
- The underlying foreign tax credit mechanism is not provided

Treaty provisions vis-à-vis domestic tax law

- The provisions of the DTC or the double tax avoidance agreement, whichever is more beneficial to the taxpayer shall apply, except in the following circumstances:
  - When General Anti-Avoidance Rules (GAAR) provisions are invoked
  - When CFC provisions are invoked
  - When branch profit tax is levied

Branch profit tax

- The concept of branch profits tax is proposed to be introduced. Profits of Indian branches of foreign companies will be additionally subjected to branch profits tax at 15%. Branch profits tax is proposed to be levied on income attributable directly or indirectly to a permanent establishment (PE) or immovable property situated in India. PE is defined in the same way as in the treaties and includes one day service PE, equipment PE and insurance agent PE.

Applicable tax rates for non-residents

- Royalty and fee for technical services rates is proposed to be increased to 20% on gross basis
- Capital gains are to be taxable at 30%
- Corporate tax rate would be 30%

Definitions of key terms to be enlarged

- Fees for technical services will include consideration for development and transfer of design, drawing, plan or similar services
- Royalty will include the consideration for use or right to use ship or aircraft and live coverage of any event
- Specified income will be deemed to accrue in India even if payments are made outside India, services are being rendered outside India, or even if income has otherwise not accrued in India

Domestic taxation

Corporate tax

DTC proposes the corporate tax rate to be 30% and also provides for unlimited carry-forward of business losses. In an attempt to rationalise and simplify tax computation, the DTC proposes amendments in the basis of computation of business income from the current 'business profits with specified adjustments' to an 'income-expense model' prevalent in certain developed and other Association of Southeast Asian Nations (ASEAN) countries. Largely, DTC also maintains a status quo on dividend distribution tax (DDT) levy at 15% on the dividend declared or distributed.

Computation

- Business income will be computed based on the income-expense model:

Gross earnings	XXX
Less: Business expenditure	
Operating expenditure (includes all expenditure laid out for the purposes of the business)	XXX
Permitted finance charges (includes interest charges, finance charges, etc.	XXX
Capital allowances (includes depreciation, deferred revenue expenditure, etc.)	XXX
Taxable income from business	XXX

- Business assets will be distinguished from investment assets. Business assets will be further classified as business trading assets and business capital assets
- 200% weighted deduction for in-house scientific R&D expenditure will be extended to all industries
- The remaining value of the block of business capital assets where all assets cease to exist will continue to be eligible for depreciation
- In the case of a finance lease, the lessee would be eligible to claim capital allowance

Dividend distribution tax

DDT rate will be maintained at 15%.

Exemptions, deductions and new schemes

- Profit-based tax incentives are sought to be discontinued and expenditure or investment-based incentive scheme will be introduced and will apply to the following businesses:
  - Generation, transmission or distribution of power
  - Developing or operating and maintaining Infrastructure facility (as defined)
  - Operating and maintaining a hospital in specified areas
  - Processing, preservation and packaging of fruits and vegetables
  - Laying and operating cross country natural gas or crude or petroleum, pipeline distribution network including storage facilities
  - Setting-up and operating a cold chain facility
  - Setting-up and operating agricultural warehouse facility
  - Building and operating anywhere in India new hotel of two star or above category on or after 1 April 2010
  - Building and operating anywhere in India a new hospital with at least 100 beds on or after 1 April 2010

- Developing and building a housing project under notified schemes of slum redevelopment or rehabilitation commencing on or after 1 April 2010
- Exploration and production of mineral oil or natural gas
- Developing a SEZ and to a unit established in a SEZ

• Export based incentives or profit-based incentives are proposed to be discontinued without affecting the tax payers currently enjoying such incentives, which will be grandfathered. Tax holiday is proposed for infrastructure companies grandfathered for projects eligible until 31 March 2012. Also a tax holiday for SEZ developers grandfathered for projects notified until 31 March 2012. Tax benefits will be allowed to SEZ units starting operations before 31 March 2014

Capital Gains

- A paradigm shift in taxation of capital gains is proposed under the DTC. All capital gains would be considered as income from ordinary sources and be taxable at normal rates of tax, removing the benefits of lower rates. However, fair market value substitution date is shifted to 1 April 2000. Cost of acquisition is deemed to be nil for all self-generated assets and where cost of assets cannot be determined
- Transfer of business capital assets will be taxed under the head business income. STT would continue and no capital gains tax would be levied on the sale of equity shares of a company or unit of an equity oriented fund held for more than one year if STT is paid on the transfer
- Capital gains tax would be payable only on 50% of the gains in case equity shares of a company or unit of an equity oriented fund are held for a period up to one year, if STT is paid on the transfer. The cost of acquisition of assets acquired on retirement from unincorporated body would be prescribed

Mergers and acquisitions

- Full value of consideration in case of transfer of land and building has been specified to be the stamp duty value in all cases, as against the provisions of the Income-tax Act whereby a revenue officer can refer the matter to a valuation officer to determine the value of the land and building
- The Income-tax Act states that exemption on holding company to subsidiary transfers shall be withdrawn and the exempted gain will be taxed in the year of transfer of original asset if the conditions of exemption were violated. The DTC seeks to tax such exempted gain in the year in which the conditions are violated. Hence, the rigours of revising past years returns has been done away with
- The DTC narrows the definition of business reorganisation to include only reorganisation between 'residents'

- The DTC specifically provides for the issue of equity shares to shareholders of the demerged company, as against the Income-tax Act which does not specify the nature of shares
- The DTC provides for a liberalised regime for carry forward of loss, as compared to the Income-tax Act
- The DTC provides for carrying forward the losses of the demerged unit upon satisfaction of the business-continuity test. The Income-tax Act does not contain such a condition
- In case of succession of a sole proprietorship, or a partnership firm, by a company, the DTC provides for the carry forward of losses, subject to fulfilment of prescribed conditions. This was not facilitated under the Income-tax Act
- New provisions have been introduced in the DTC which expressly provide for the taxation of income for payments received in case of the retirement of a participant, being a member of an unincorporated body

Slump sale

Profit on slump sale will be liable to tax under the head capital gains.

Individual tax: Residency rules and taxability

The separate category of resident but not ordinarily resident is proposed to be done away with. Resident individuals would enjoy exemption on income sourced outside India for two consecutive financial years i.e. in the financial year in which the individual becomes a resident and in the immediately succeeding financial year if the individual was a non-resident for nine years immediately preceding the financial year in which he or she becomes a resident.

Financial institutional investors (FIIs)

- Income earned by FIIs would be taxed as capital gains
- Payments made to FIIs as a consideration for sale of listed securities shall not be subject to withholding tax

Mutual funds

- Distribution tax of 5% would be levied on distribution of income by an equity-oriented mutual fund. Such income will be exempt in the hands of the investors
- Income distributed by funds other than equity-oriented mutual fund will be taxable in the hands of the investors and shall not subject to levy of distribution tax

Banking companies

The deduction for amounts credited to provision for bad and doubtful debts account would be restricted to 1% of aggregate average advances computed in the prescribed manner, subject to fulfilment of prescribed conditions.

Insurance companies

- Profits of life insurance business shall be the profits determined in shareholders' account (subject to certain specified adjustments) and shall be taxable at 30% (as against 12.5% earlier)
- Profits of other insurance business shall be the profits disclosed in annual accounts, subject to certain prescribed adjustments
- Insurance or reinsurance premium received by a non-resident entity for covering risk in India shall be taxable at the rate of 20%
- Tax rate of 5 % has been proposed on the amount of income distributed by a life insurance company to the policyholders of an 'approved equity oriented life insurance scheme'. This tax seems to be targeted towards ULIP products

Trust taxation

- Trust taxation provisions have been simplified. Differential and complex tax regime for determinate and indeterminate trusts is proposed to be removed
- Provisions relating to taxation of business income of trust at maximum marginal rate have been dropped

Venture capital funds (VCF) and venture capital company (VCC)

- The DTC retains the existing tax regime applicable to VCF and VCC, i.e. only in respect of the investments of VCF or VCC in the venture capital undertaking. The venture capital undertaking is permitted to carry on business in nine specified sectors as well as in any other business as may be prescribed later
- The income of VCF or VCC would be exempt and taxable in the hands of the investor in the VCF or VCC in the manner in which it was received

Governing laws
Annexure IV

Governing laws

India has an exhaustive legal framework governing all aspects of business. The key regulations and a description of each are as follows:

Arbitration & Reconciliation Act, 1996	Relates to alternate redressal of disputes
Central Excise Act, 1944	Governs duty levied on the manufacture or production of goods in India
Central Sales Tax, 1956	Governs the levy of tax on all inter-state sales in India
Companies Act, 1956	Governs all corporate bodies in India
Competition Act, 2002	Ensures free and fair competition in the Indian market
Consumer Protection Act, 1986	Protects consumers from unscrupulous traders and manufacturers
Customs Act, 1962	Deals with import and export regulations
Customs Tariff Act, 1975	Creates a uniform commodity classification code based on the globally adopted harmonised system of nomenclature for use in all international trade- related transactions
Direct Taxes Code Bill, 2010	Aims to moderate tax rates and simplify tax laws. All direct taxes including wealth tax and income tax will be brought under one bill.
Environment Protection Act, 1986	Provides a framework for obtaining environmental clearances Act, 1986
Factories Act, 1948	Regulates labour in factories
Foreign Exchange Management Act, 1999	Regulates foreign exchange transactions including India inbound investments as well as outbound investments
Indian Contract Act, 1872	Codifies the way contracts are entered into, executed and implemented. It also codifies the effects of breach of contract
Income Tax Act, 1961	Governs direct taxes on the income of all persons, both corporate and non-corporate, as well as residents and non-residents
Industrial Disputes Act & Workmen Compensation Act, 1951	Covers labour laws relating to disputes
Industrial (Development Regulation) Act,1951	Provides for the development and regulation of certain industries
Information Technology Act,1999	Governs e-commerce transactions
Limited Liability Partnership Act, 2008	Establishes a new form of entity which combines the organisational flexibility of partnership with the advantages of limited liability. It provides operational flexibility for such enterprises by sparing them detailed legal and procedural requirements intended for large companies
Prevention of Money Laundering Act, 2002	Prevents money laundering and provides for the confiscation of property derived from, or involved in, money laundering
Patents Act, Copyright Act, Trade Marks Act, Design Act	Protects intellectual property rights
Right to Information Act, 2005	Sets out the right of every citizen to access information under the control of public Act, the authorities and promotes transparency and accountability in the work of public authorities
Securities and Exchange Board of India Act, 1992	Relates to the protection of investor interest in securities and regulation of the securities market. It puts in place securitisation and asset foreclosure laws, creating a legal framework for establishment of asset reconstruction companies.
Special Economic Zones Act, 2005	Governs the establishment, development and management of the special economic zones (SEZs) to promote exports. It provides for fiscal and economic incentives for developers of SEZ units.

Notes

Notes

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