Overview of Tax & Regulatory framework in India: October 2013

Breaking Dawn on the Horizon

Destination India 2013

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Introduction

India has seen moderation in its growth rate from its previous peaks, but it still compares favourably with many other economies. The IMF forecasts that India's GDP growth rate will be behind China in 2014, but still better than the collective growth rate of emerging and developing economies and advanced economies respectively. The Prime Minister's Economic Advisory Committee also believes that India will register a growth rate of 5.3% in 2013-14.

The economy, however, is facing a few challenges at present. One among them is to maintain a healthy current account deficit. Exports have slowed with dampening demand in global markets, while import bills kept their momentum going, leading to a trade deficit.

The government has pulled the reforms trigger in the economy by moving towards reducing subsides on petroleum and diesel, attracting FDI in retail, aviation and broadcasting, passing the new Companies Act in the Parliament and setting up the Cabinet Committee on Investment, amongst the slew of measures this year.

Top investing countries and sectors (FDI equity inflows)

Country	Cumulative inflows (April 2000 – June 2013, Million USD)	Sectors	Projected GDP at PPP (2011 bn USD)
Mauritius*	74,765	Services sector	38,180
Singapore*	21,312	Construction development	22,248
UK	17,599	Telecommunications	12,866
Japan	14,750	Computer software and hardware	11,738
USA	11,436	Drugs and pharmaceuticals	11,318
Netherlands	9,373	Chemicals	8,993
Cyprus	6,993	Automobile	8,810
Germany	5,990	Power	7,954
France	3,672	Metallurgical	7,621
UAE	2,472	Hotel and tourism	6,732

Source: Department of Industrial Policy and Promotion, Government of India

**Both these countries are popular jurisdiction for establishing a holding company to route FDI into India.*

The long term prospects of India are strong. A PwC analysis[1] shows that India is not only one of the fastest growing economies of the world, but also the third largest in purchasing power parity (PPP) terms. The report further projects that India is going to maintain its third position in PPP terms through 2050.

India has gained importance at a global level

2030		2050	
Country	GDP at PPP (2011 bn USD)	Country	Projected GDP at PPP (2011 bn USD)
China	30,634	China	53,856
US	23,376	US	37,998
India	13,716	India	34,704
Japan	5,842	Brazil	8,825
Russia	5,308	Japan	8,065
Brazil	4,685	Russia	8,013
Germany	4,118	Mexico	7,409
Mexico	3,662	Indonesia	6,346
UK	3,499	Germany	5,822
France	3,427	France	5,714

Source: World in 2050 – The BRICS and beyond: prospects, challenges and opportunities, January 2013

India's emerging middle, a segment of population below the middle class, provides a large untapped market. In India, about 470 million people were in the Emerging Middle class in 2010 and they are expected to grow to 570 million people in 2021. This emerging middle class market in India is expected to constitute a trillion dollar market[2].

India's income distribution (Millions)

Household income / year (INR)		$* / day per capita	2010	2021 (Projection)
> 850, 000	Upper middle +	> $10	> $10	38,180
300,000 - 850, 000	Middle	$5 - $10	$5 - $10	22,248
150,000 - 300,000	Emerging middle	$1.7 - $5	$1.7 - $5	12,866
< 150,000	Low	< $1.7	< $1.7	11,738

Source: PwC Analysis, NCAER, CMI
**Purchasing Power Parity (PPP)*

1. *World in 2050 – The BRICS and beyond: prospects, challenges and opportunities, January 2013*
2. *Profitable growth strategies for the Global Emerging Middle – Learning from the 'Next 4 Billion' markets, PwC India, January 2012*

Chapter 2

Foreign investment in India

Foreign direct investment in to India

The Indian government had embarked on liberalising the regulatory framework, particularly foreign investment (FI), through the Statement on Industrial Policy of 1991. Since then, the regulatory environment in terms of foreign investment has been consistently eased to make it investor-friendly.

Under the current framework, FDI is permitted by all categories (of investors) and in all sectors except the following:

- Activities and sectors not open to private sector investment e.g. Atomic energy and Railway Transport [except mass rapid transport systems (MRTSs)]
- Lotteries, gambling and betting
- Agriculture (excluding floriculture, horticulture, apiculture, 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)
- Real estate business (except construction development projects) or construction of farmhouses
- Chit funds, nidhi companies or trading in transferable development rights
- Manufacturing of cigars, cheroots, cigarillos and cigarettes, tobacco and tobacco substitutes

FIs can be made in other sectors under the following:

- Approval route, i.e. by the government through the Foreign Investment Promotion Board (FIPB) under the Ministry of Finance or Department of Industrial Policy and Promotion (DIPP) under the Ministry of Commerce and Industry or both
- Automatic route, i.e. no prior approvals from regulatory authorities but only post facto intimations to RBI through Authorized Bankers

Approval route

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

The following cases will fall under this category:

- Specified sectors which require FIPB approval for FDI or for FDI beyond a prescribed sectoral cap (Refer page 5,6,8, and 9)
- Issue of shares for consideration other than cash i.e. issue of shares against import of capital goods/machinery / equipment and pre-operative/pre-incorporation expenses subject to compliance with certain stated conditions [except for capitalisation of an external commercial borrowing (ECB) due for repayment and interest on such an ECB, as well as technical knowhow fee or royalties due for payment]
- Investments by citizens and companies of Bangladesh or Pakistan
- Investments in warrants and partly paid shares
- Investment in an Indian company engaged only in downstream investment activities for holding purposes or which does not have any operations or any downstream investments. Additionally, a 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 or DIPP 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 further consideration.

Where an entity has an earlier FIPB or CCEA approval for an activity/ sector or sectoral caps, additional foreign investment in such an entity does not require prior approval from the FIPB or the CCEA, where subsequent to the earlier approval:

- either the activity or the sector, had been placed under the automatic route; or
- sectoral caps had been removed or increased (provided that such additional investment along with the original investment is within the current sectoral caps)

Automatic route

Generally, except in the cases mentioned above, all other cases of foreign investment fall under the automatic route and do not require prior approval of the FIPB or DIPP.

Computation of FDI

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
- Indirect Foreign Investments (IFIs) through an Indian company owned or controlled by non-residents. Here 'owned' means more than 50% shareholding and 'control' means right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.

Further, for the computation of IFI, 'FI will include all types of investments, i.e., FDI, investment by FIIs (holding as on 31 March), NRIs, ADRs, GDRs, foreign currency convertible bonds (FCCBs),convertible preference shares and convertible currency debentures regardless of whether the said investments have been made under Schedule 1, 2, 3 or 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 downstream investment made will be considered as domestic investment and not counted towards foreign investment caps.

Further, any downstream investments made by an Indian company owned or controlled by non-residents would also be required to comply with sectoral caps and conditionalities. In this regard, RBI has issued circular incorporating the downstream investment policy guidelines issued by DIPP in 2009. Further, a statutory auditor would need to certify whether downstream investment is in compliance with the FDI Policy and FEMA provisions.

Foreign venture capital permitted to acquire securities under private arrangement

Foreign Venture Capital Investors (FVCIs) can 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 subject to compliance with certain conditions.

Foreign investment by qualified foreign investors

Qualified foreign investors (QFIs) are non- resident investors other than SEBI-registered FIIs and SEBI-registered FVCIs who meet the KYC requirements of SEBI.

QFIs from FATF compliant jurisdictions and resident in a country that is a signatory to IOSCO's MoU or a signatory of a bilateral MoU with SEBI have been permitted to invest in equity shares of listed Indian companies or equity shares of Indian companies offered to the public in India through SEBI-registered depository participants (DPs) or SEBI-registered brokers within an individual cap of 5 and 10% in aggregate of the paid-up capital of listed companies or both.

Further, QFIs can also purchase rupee denominated units of equity schemes of domestic mutual funds (MFs) on a repatriation basis and eligible corporate debt instruments, viz. listed non-convertible debentures (NCDs), listed bonds of Indian companies, listed units of MF debt schemes and 'to be listed' corporate bonds directly from the issuer or through a registered stockbroker on a recognised stock exchange in India. QFIs are also permitted to acquire non-convertible debentures or bonds issued by NBFCs categorised as infrastructure finance companies (IFCs).

FDI in limited liability partnerships

FDI up to 100% is permitted with prior government approval in limited liability partnerships engaged in sectors or activities currently eligible for 100% FDI under the automatic route. Such sectors/activities should 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 is permissible for FDI in LLPs.
- LLPs with FDI are not allowed to make downstream investments.
- LLP cannot raise ECB.
- FIIs and FVCIs cannot invest in LLPs.

Investment through share acquisition

Non resident investors can acquire shares of an existing Indian company subject to compliance with sectoral conditions. Stock acquisition is permitted after a resolution to this effect has been passed by the board of directors of the company whose shares are being acquired. The acquisition will need to comply with valuation guidelines prescribed by RBI or SEBI from time to time.

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 is subject to valuation guidelines.

Prior approval of the RBI is no longer required for the following cases of share acquisitions:

- Acquisition of existing equity by residents from non-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 non-residents from residents under the following cases:
  - Where the requisite approval of the FIPB has been obtained
  - Where prescribed pricing guidelines are not met but comply with SEBI pricing guidelines
  - Where the investee company is in the financial services sector

Valuation norms

Issue of shares to non-residents or transfers from resident to non-residents is subject to valuation guidelines as set out below:

- In case of transfer of shares from resident to non-resident, the consideration cannot be less than the amount determined as per discounted cash flow method in case of unlisted shares. However, if shares are listed, then the consideration price cannot be less than the price at which preferential allotment of shares can be made under SEBI guidelines.
- In relation to a transfer of shares of an Indian company (listed or unlisted) from a non-resident to resident, the price cannot exceed the above mentioned price
- Where non-residents (including NRIs) are making investments in an Indian company, by way of subscription to its Memorandum of Association, such investments may be made at face value subject to their eligibility to invest under the FDI scheme.

In relation to a transfer of shares of an Indian company (listed or unlisted) from a non-resident to resident, the price may not be more than the minimum price at which the transfer of shares can be made.

Investment by foreign institutional investors (FIIs)

A registered 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 concerned Indian company by passing a board of directors' resolution, followed by the permission of the shareholders through a special resolution to that effect and immediate intimation to the RBI.

FIIs can now invest in the primary issues of NCDs or bonds only if their listing is committed to be done within 15 days of such an investment. FIIs can also subscribe to unlisted bonds or NCDs in case the issuing company is an infrastructure company.

FDI in major sectors in India

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

Agriculture and allied activities

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

- FDI up to 100% under automatic route is permitted in floriculture, horticulture, development and production of seeds and planting material, 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 tea sector (including tea plantations), FDI up to 100% is permitted under the approval route
- FDI up to 100% is permitted under automatic route for coffee and rubber processing and warehousing

Asset reconstruction companies (ARC)

Foreign investment by way of FDI and FII is permitted up to 100% (upto 49% under automatic route and beyond 49% with prior FIPB approval) in an ARC registered with the RBI. While FIIs can invest in ARCs, total shareholding of an individual FII shall not exceed 10% of the paid-up capital. Further, SEBI registered FIIs can invest in security receipts (SRs) issued by RBI registered ARCs up to 74% of each tranche of scheme of SRs. All investments in ARCs will be subject to provisions of section 3(3)(f) of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI).

Banking

- ***Public sector banks:*** FDI and portfolio investment is restricted to 20% with a prior FIPB approval
- ***Private sector banks:*** FDI up to 74% allowed (up to 49% under the automatic route, and beyond 49% and up to 74% under the FIPB approval route). Voting rights per shareholder are restricted to 26%. 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 only through one of the following three channels:
  - a branch or branches
  - a wholly-owned subsidiary
  - a subsidiary with an aggregate FI of maximum 74%

Broadcasting

- Teleports (setting-up of uplinking hubs or teleports), direct-to-home, cable networks [Multi System Operators (MSOs) operating at a national, state or district level and undertaking upgradation of networks towards digitalisation and addressability], mobile TV and headend-in-the-sky(HITS) broadcasting services: FDI is permitted up to 74% (up to 49% under automatic route and beyond 49% and up to 74% under approval route).
- Cable network [other MSOs not undertaking upgradation of networks towards digitalisation and addressability and local cable operators (LCOs)]: FI is permitted up to 49% under the automatic route.
- Terrestrial broadcasting FM (FM radio): FDI is permitted up to 26% under the approval route.
- Uplinking TV channels: FDI up to 26% is permitted under the approval route for the uplinking of a news and current affairs TV channel. 100% FDI is permitted under the approval route for uplinking a non-news or current affairs TV channel.
- Downlinking of TV channels: 100% FDI is permitted with prior Government approval

FI as specified above, in addition to FDI, includes FII, NRI, FCCBs, ADRs, GDRs and convertible preference shares held by foreign entities.

FDI in broadcasting sector will also be subject to compliance with terms and conditions 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 condition that the largest Indian shareholder will hold at least 51% of the share capital of the company.

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.
- 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.

- Foreign airlines have been permitted to invest in the capital of Indian companies operating scheduled and non-scheduled air transport services to the limit of 49% of their paid-up capital, subject to specified conditions.
- 100% FDI is permitted under the automatic route for maintenance and repair organisations, flying training institutes and technical training institutions.
- FDI up to 74% is permitted 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. However, NRI investment upto 100% is permitted under the automatic route.
- FDI up to 100% is permitted under the automatic route for helicopter and sea-plane services.
- Foreign airlines can participate in the equity of companies operating cargo airlines, helicopter services and seaplane services.
- 100% FDI is permitted under the automatic route for greenfield investments in airports. With respect to existing airports, FDI up to 100% is permitted, up to 74% under the automatic route and up to 100% with prior FIPB approval.

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 FDI up to 100% is permitted under the automatic route subject to the condition that it will not conduct 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 (CFI) (FDI plus FII) up to 49% is permitted with prior FIPB approval. However, FIIs are permitted to invest up to 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.

The Union Cabinet has approved the proposal to permit FI in this sector under the automatic route However, an official press note implementing the decision is awaited.

Credit information companies

CFI in credit information companies is permitted up to 49%, subject to the following conditions:

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

The Union Cabinet has approved the proposal to permit FI (FDI+FII) up to 74% in this sector under the automatic route[4].

Courier services

FDI up to 100% is permitted under the automatic route in companies undertaking courier business.

Defence

FDI in this sector is permitted up to 26% subject to prior FIPB approval and compliance with security and licensing requirements and guidelines issued by the Ministry of Defence. However, proposals beyond 26% may be considered on case-to-case basis by the Cabinet Committee on Security. One of the basis for approval for such cases will be to see if the proposal brings in state of the art and technology. These are likely to result in increased access to modern and state-of-the-art technology in the country. Additionally, the Indian company will need to comply with the condition that the largest Indian shareholder will hold at least 51% of its share capital.

According to the 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 a resident Indian. Further, there is a three-year lock-in period for the transfer of equity from one foreign investor to another.

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 (IRDA).

Micro and small enterprises (MSEs)

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

However, any industrial undertaking which is not an MSE and is engaged in manufacturing items reserved for the MSE sector, will require FIPB approval when FI is more than 24%. Such an undertaking will also require an industrial licence under the Industries (Development and Regulation) Act, 1951. This licence prescribes the export of a minimum of 50% of the new or additional annual production of the MSE reserved items to be achieved within a maximum period of three years.

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. It is subject to sectoral regulations and the conditions of the Mines and Minerals (Development and Regulation) Act, 1957.

Non-banking financial services

100% FDI 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
- Custodian services
- Factoring
- Credit rating agencies
- Leasing and finance (this will cover only finance lease)
- Housing finance
- Forex broking
- Credit card business
- Moneychanging business
- Micro credit
- Rural credit

Minimum capitalisation norms (foreign equity): Fund-based activities

For Non-Banking Financial Companies (NBFCs), investment would be subject to following the minimum capitalisation norms.

- US $0.5 million for foreign capital up to 51% to be brought upfront
- US $ 5 million for foreign capital more than 51% and up to 75% to be brought upfront
- US $ 50 million for foreign capital more than 75% out of which US$ 7.5 million to be brought upfront and the balance 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 0.5 million USD. The prescribed minimum capital is required to be brought upfront.

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

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

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

Petroleum

Other than refining

100% FDI is permitted under the automatic route in the following, subject to the existing policy and regulatory framework in the petroleum sector:

- Exploration activities of oil and natural gas fields
- Infrastructure related to marketing of petroleum products and natural gas
- Petroleum products and natural gas marketing
- Petroleum product and natural gas pipelines
- LNG re-gasification infrastructure
- Market studies and formulation in the petroleum sector

Refining

In the case of PSUs, FDI is permitted up to a maximum of 49% with automatic route.

In the case of private Indian companies, FDI up to 100% is permitted under the automatic route.

Power exchange

FDI up to 49% is permissible in power exchange under the automatic route (with FDI up to 26% and FII investment up to 23%). FII investment is restricted to the secondary market. No non-resident investor or entity including the persons acting in concert can hold more than 5% of the equity.

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% with prior FIPB approval.
- Publishing and printing of scientific and technical magazines, speciality journals and periodicals: FDI is permitted up to 100% with prior FIPB approval.
- Publication of facsimile editions of foreign newspapers: FDI up to 100% with prior FIPB approval 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 the 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:
  - minimum area to be developed
  - minimum capitalisation of 10 million USD for a wholly-owned subsidiary and 5 million USD 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
  - development of at least 50% of each project must be completed within 5 years of obtaining all statutory clearances

Investment by NRIs is not subject to the conditions 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 fulfillment of prescribed conditions.

"Industrial activity" has been defined to mean manufacturing; electricity; gas and water supply; post and telecommunications; software publishing, consultancy and supply; data processing, database activities and distribution of electronic content; other computer related activities; basic and applied R&D on bio-technology, pharmaceutical sciences and life sciences, natural sciences and engineering; business and management consultancy activities; and architectural, engineering and other technical activities.

Further, the conditions applicable to construction development activities would not be applicable provided the following conditions are complied with:

- Industrial park comprises of at least 10 units and no single unit occupies more than 50% of allocable area
- At least 66% of the total allocable area is allocated to industrial activity

Satellites: establishment and operations

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

Security agencies in the private sector

FDI up to 49% is permitted under approval route.

Stock exchanges, depositories, clearing corporations

Foreign investment up to 49% (FDI cap at 26% and FII cap at 23%) is permitted under automatic route. FIIs are allowed only through purchases in the secondary market.

Pharmaceuticals

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

Telecommunications

FDI up to 100% is permitted.FDI upto 49% is under automatic route, and beyond 49% on a prior FIPB approval in the telecom services including Telecom infrastructure Providers Category-I, viz. Basic, Cellular, United Access Services, Unified License (Access services), Unified License, National/International Long Distance, Commercial V-Sat, Public Mobile Radio Trunked services, Global Mobile Personal Communications Services, All types of ISP licenses, Voice Mail/Audiotex/UMS, Resale of IPLC, Mobile Number Portability services, Infrastructure Provider Category I (providing dark fibre, right of way, duct space, tower) except other Service Providers F subject to observance of licensing and security conditions by licensee as well as investors as notified by the Department of Telecommunication from time to time.

Trading

100% 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

- Cash-and-carry wholesale trading means sale of goods or merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers.

Operational guidelines for wholesale trading

- Sales made by the wholesaler qualify as wholesale trading where the sales are made to the following eligible customers (except in case of sales to the government):
  - Entities holding sales tax or value added tax (VAT) registration, service tax or excise duty registration
  - Entities holding trade licences under applicable local shops and establishment laws
  - 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 or companies among the same group should not exceed 25% of the total turnover of the wholesale venture. The term group means two or more enterprises which, directly or indirectly, are in the position to:
  - Exercise 26% , or more voting rights in the other enterprise
  - Appoint more than 50 % of its members of the board of directors in the other enterprise
- Full records indicating details such as name of entity, its licence, registration, permit number, amount of sale, etc should be maintained on a daily basis
- These companies can 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

Single brand retail trading

100% FDI is permitted with FIPB approval for single-brand product retailing with FDI up to 49% in this sector under the automatic route and beyond 49% with prior FIPB approval, 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
- A non-resident entity or entities whether owner of the brand or otherwise shall be permitted to undertake `Single Brand` product retail trading in the country for the specific brand, directly or through a legally tenable agreement with the brand owner for undertaking single brand product retail trading The onus for ensuring compliance with this condition will rest with the Indian entity carrying out single brand product retail trading in India. The investing entity shall provide evidence to this effect at the time of seeking approval, including a copy of the licensing/ franchise/sub-license agreement, specifically indicating compliance with the above condition. The requisite evidence should be filed with the RBI for the automatic route and SIA/FIPB for cases involving approval.
- 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 India, preferably from micro, small and medium enterprises-MSMES, village and cottage industries, artisans and craftsmen
- Multi brand retail trading

  51% FDI is permitted with prior FIPB approval for multi brand retail trading, subject to following conditions:

  - Fresh agricultural produce including fruits, vegetables, flowers, grains, pulses, fresh poultry, fishery and meat products, may be unbranded
  - Minimum capitalisation of 100 million USD by the foreign investor.
  - Mandatory investment in backend infrastructure- At least 50% of total FDI brought in the first tranche of US$ 100 million shall be invested in 'backend infrastructure' within three years. Subsequent investment in 'backend infrastructure' can be made depending upon business requirement
  - At least 30% of the value of procurement of manufactured or processed products purchased shall be sourced from Indian micro, small and medium enterprises which have a total investment in plant and machinery not exceeding 2 million USD. The 'small industry' status shall only be seen at the time of first engagement with the retailer
  - Retail sales outlets may be set up only in cities with a population of more than 1 million as per 2011 census or any other cities as per the decision of the respective State Governments and may also cover an area of 10 kms around the municipal or urban agglomeration limits of such cities
  - Retail trading, in any form, by means of e-commerce, would not be permissible, for companies with FDI, engaged in the activity of MBRT

    While the above policy has been approved by the central government, the state governments or union territories are given the right to take their own decisions in regard to implementation of the above policy

States that have allowed multi brand retail are Andhra Pradesh, Assam, Delhi, Haryana, Himachal Pradesh, Jammu & Kashmir, Karnataka, Maharashtra, Manipur, Rajasthan, Uttarakhand, Daman & Diu and Dadra and Nagar Haveli (union territories).

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 need to comply with the provisions of the FDI policy.

Joint venture with an Indian partner (equity participation)

Although a wholly owned subsidiary has proven 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 FI 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, with less compliance levels is comparatively easier to manage than 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 (though Companies Act 2013 makes it voluntary for a company to transfer to reserves prior to distribution of profits, this would be applicable once it gets notified). 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.

Additionally, one would need registration with Registrar of companies and reporting of details of Liaison office is required with Director General of Police under whose jurisdiction the LO is established.

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 fulfillment 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. Additionally, one would need to report the details of project office with Director General of Police under whose jurisdiction the PO is established.

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 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 fulfillment of certain conditions.

Funding Options in India

A foreign company which sets up a subsidiary in India can fund its Indian subsidiary through the channels mentioned below:

Equity capital

Equity shares refer to the common stock of a company. Equity capital comprises securities representing the equity ownership in a company, providing voting rights, and entitling the holder to a share of the company's success through dividends and/or capital appreciation. In the event of liquidation, common stockholders have rights to a company's assets only after bondholders, other debt holders, and preferred stockholders have been satisfied.

The issue of equity shares by an Indian company to a foreign company must comply with the sectoral caps as stated in the FDI policy of the Government of India.

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 (though Companies Act 2013 makes it voluntary for a company to transfer to reserves prior to distribution of profits, this would be applicable once the Act comes in full force).

Amounts transferred to statutory reserves cannot 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 and construction and 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 of the internationally recognised sources 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 5 million USD: Minimum equity of 25% held directly by the lender
- ECB more than 5 million USD: Minimum paid up equity of 25% held directly by the lender and an ECB liability-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 received in foreign currency) 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 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 specific end-uses for ECB proceeds. ECBs can be availed only for the following:

- Import of capital goods, new projects, modernisation and expansion. This window can be availed only for projects in the real sector - industrial and infrastructure sector and specified services sector
- Import of services, technical know-how and payment of license fee as part of import of capital goods by companies in manufacturing and infrastructure sector subject to certain conditions
- Overseas acquisition by Indian companies
- For all stages of acquisition of shares in the disinvestment process under the government's disinvestment programme of the PSU shares; in other words, facility of ECB is available for multiple rounds of disinvestment of PSU shares under the Government disinvestment programme
- Companies engaged in the 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 (40% for power sector companies) for the repayment of local rupee borrowings under the approval route subject to the fulfillment of prescribed conditions
- Repayment of rupee loan availed for obtaining a licence or a permit for 3G spectrum. This scheme is valid till March 31, 2014
- Eligible borrowers can avail ECB under approval route from their foreign equity holder company with minimum average maturity of 7 years for general corporate purposes subject certain conditions
- Repayment of rupee loan or bridge finance availed by successful bidder of 2G Spectrum re-auction
- Consistent foreign exchange earning companies in manufacturing infrastructure and the hotel sector (with total project cost of 2.5 billion INR or more irrespective of the geographical location for hotel sector) can avail ECB for repayment of rupee loan availed for capital expenditure and fresh rupee capital expenditure subject to specified conditions, under the approval route.
- NBFCs exclusively involved in financing infrastructure projects i.e. infrastructure finance companies (IFCs) can avail ECB up to 75% of their owned funds under automatic route and beyond that under approval route, for onlending to the infrastructure sector as defined under the ECB policy and subject to compliance with the norms prescribed in the DNBS

Circular and hedging requirements as applicable.

- ECB for low cost affordable housing projects has also been allowed under approval route and is subject to specified conditions. Low cost affordable housing project is a project in which at least 60% FSI would be for units having maximum carpet area up to 60 square meters. Slum rehabilitation projects also qualify for this scheme based on specified eligibility criteria.
- Hotels, hospitals and software sector 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
- 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 fulfillment of conditions

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

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 the conditions in the loan agreement are met and the loan registration number is obtained. A non-resident shareholder in an Indian company can also pledge his or her stake in the company in favour of the AD in order to secure a credit facility extended to such a company. The pledge may also be made in favour 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.

Quantum restrictions on ECB

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

- 750 million USD for borrowers in the infrastructure and industrial sectors under the automatic route
- 200 million USD for borrowers in the service sector (hotels, hospitals and software) under the automatic route
- 10 million USD 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:

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 up to 500 million USD can be made without approvals, subject to compliance with the minimum average maturity of the loan and in any case three years.

Fully and compulsorily convertible preference shares

Indian companies can mobilise FIs through the issue of fully and 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:

- 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, government of India. 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 (CCDs) and with the ECB guidelines where the debentures are non-convertible or optionally convertible. In case of fully 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. There are no end use restrictions on ADRs or GDRs except for a ban on deployment of such funds in real estate or the stock market.

The issue of FCCBs up to 750 million USD 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.

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 the same
- 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:
  - can be invested in the promoter group companies. Promoter group companies would have to ensure it is
  - used in accordance with end uses prescribed under the ECB policy
  - not 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 (DI), including in a JV or a wholly owned subsidiary (WOS), subject to existing guidelines on Indian DI in a JV or WOS abroad

Significant Exchange Control Regulations

Foreign exchange transactions are 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 FI 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 FI.

Current account transactions

Foreign nationals or Indian citizens who are not permanently residing 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 10,000 USD per person p.a.
- Gift over 5,000 USD or donation over 5,000 USD per remitter or donor p.a.
- Business travel over 25,000 USD per person per visit
- Foreign studies as per the estimate of the institution or 100,000 USD per academic year, whichever is higher
- Consultancy services procured from abroad of over 1,000,000 USD per project (10,000,000 USD in case of infrastructure projects)
- Reimbursement of pre-incorporation expenses over the higher of 100,000 USD 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 except commission up to 10% of invoice value of exports of tea and tobacco
- 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 75,000 USD per financial year for any permitted current or capital account transaction, or a combination of both, subject to specified terms and conditions under the LRS Scheme in addition to specific limits provided under current account transaction rules. Acquisition of immovable property outside India (directly or indirectly) under LRS scheme would not be allowed.

In addition to above, the RBI has permitted eligible resident individuals to access the LRS window to acquire/set up overseas JV/WOS (which is an operating company) outside India for bona fide business activities by making remittance under the LRS within the limit of USD 75,000 with effect from August 5, 2013.

In addition, with respect to overseas investments in a joint venture, the limit of financial commitment is now 100% of networth of the Indian entity as on the last audited balance sheet date. Investment beyond this cap requires prior permission from Reserve Bank of India.

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 cases of inheritance, acquisition on lease for period not exceeding 5 years and, 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, plantation property and farmhouse).

Royalties and technical know-how fees

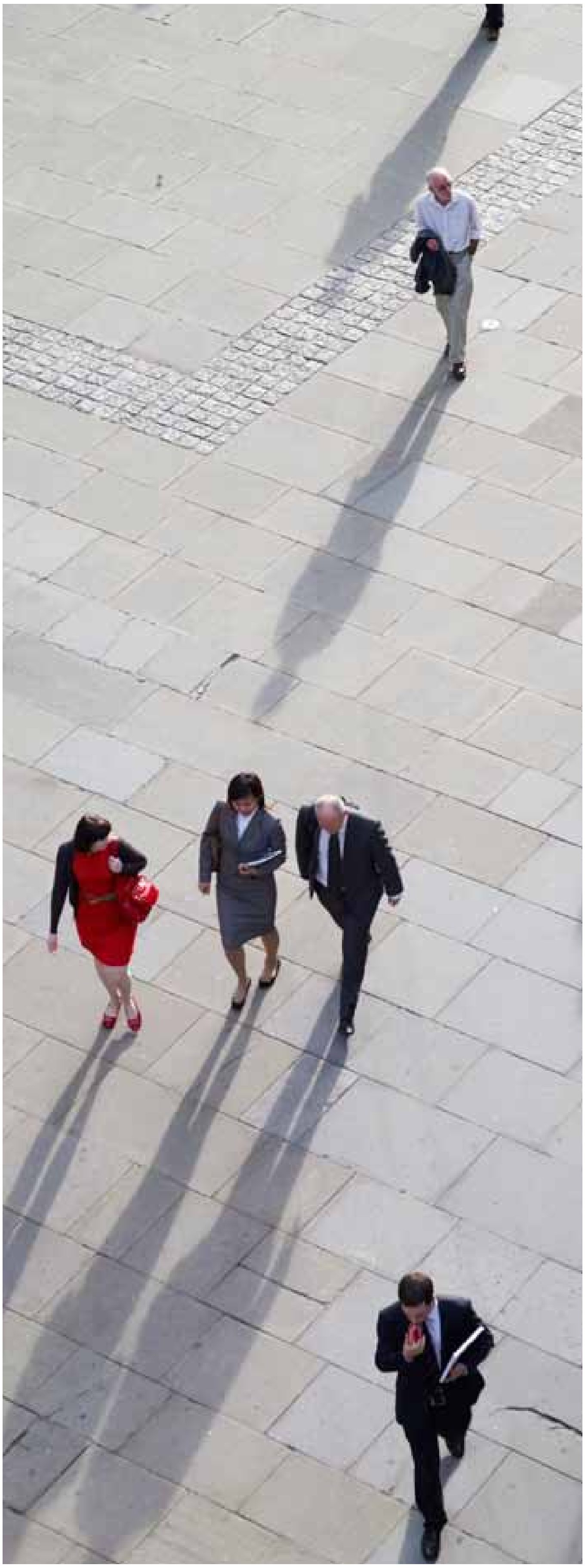
Indian companies can make payment for trademark or technology royalties without any restrictions under the automatic route.

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 fulfillment of the compliance requirements.



Direct Taxation in India

Corporate tax rates

For a company	Rates
Domestic company	30%
	(plus applicable surcharge and cess)
Foreign company	40%
	(plus applicable surcharge and cess)

Dividend distribution tax (DDT)

Indian companies distributing or declaring dividends are liable to pay DDT at 15% (plus 10% surcharge, 2% education cess, and 1% secondary and higher education cess). This tax is payable on declaration, distribution, or payment, whichever is earlier, and it is in addition to the income-tax payable on business profits. Special economic zone (SEZ) developers and units in an SEZ are liable to pay DDT at 15% (plus 10% surcharge, 2% education cess, and 1% secondary and higher education cess) with effect from 1 June 2011. A holding company does not have to pay DDT on dividends paid to its shareholders to the extent that it has received dividends from its Indian or foreign subsidiary company on which DDT has been paid by the respective subsidiary. However, the benefit will not be available if the holding company is itself a subsidiary of another company.

Tax on buyback of shares

An additional tax is payable on transaction involving the buyback of shares by unlisted companies from its shareholders. A tax at 20% (plus 10% surcharge, 2% education cess and 1% secondary and higher secondary education cess) is payable by the company on the difference between consideration paid on buyback and the issue price of shares. The buyback consideration received would be tax-exempt in the hands of the receiver. No tax credit would be allowed in case of such taxes paid either to the company or to the shareholder.

Minimum alternate tax (MAT)

To bring zero tax companies under the tax net, MAT at 18.5%, plus applicable surcharge and education cess, of the book 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 in a SEZ with effect from financial year (FY) 2011-12. The current effective rates are as follows:

For a company	Where taxable income exceeds 10 million INR	Other cases
Domestic company	18.5%	18.5%
Foreign company	18.5%	18. 5%

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

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.

Alternate minimum tax on all persons other than companies

MAT provisions (which were applicable only to companies) were extended to limited liability partnerships (LLPs) with effect from FY 2011-12 in the modified form of alternate minimum tax (AMT). AMT provisions have now been further extended to all other assessees with effect from FY 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, AMT credit will be available to LLPs and other assessees for the period of 10 years.

In the case of an individual, a Hindu undivided family (HUF), an association of persons, 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 2 million INR.

Capital gains

Particulars	Tax rates*	
	Resident	Non-resident
a. Short-term capital assets1 (other than (b) below)	Normal corporate/ individual tax rates	Normal corporate/ 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) above)	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 benefit)

** 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 at 10% (plus applicable surcharge and education cess) without providing indexation benefit to the taxpayer.

Computation of total income: General

- All income that accrues or arises or is deemed to accrue or arise or is received or deemed to be received in India is taxable in the hands of a non-resident taxpayer subject to the benefit of the 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 the sale of assets 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. Undertakings engaged in the business of generation or generation and 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%.	

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 distribution of power can be claimed as 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%.

Investment allowance

Investment allowance benefit is allowed for companies engaged in the business of manufacture of any article. The benefit of deduction is allowed for investment made in the 'new' plant and machinery acquired and installed during FY 2013-14 and 2014-15. The aggregate investment during these years should be more than 1 billion INR. A deduction of 15% of the value of the investment made is allowed. The assets have to be held for more than five years. If the asset is sold before the period, the investment benefit claimed will be reversed in the year of sale.

Investment in a new plant and machinery will not include assets such as plant or machinery used earlier in or outside India, any plant or machinery installed in any office premises or in residential accommodation (or guesthouse), any office appliances (including computers or computer software), vehicle, ship or aircraft.

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

Under 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 tax rate apply:

- W.e.f, 1 April 2013, the applicable rate is 25% for royalty and fee for technical services

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

Taxing 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%, this has been further extended to FY 2013-14. However, no expenditure will be deductible while computing this income. 'Specified foreign company' refers to the Indian company that holds 26% or more in nominal value of the equity share capital.

Double tax avoidance agreements

The DTAAs override the provisions of the Indian Income-tax Act to the extent that they are more beneficial to the assessee. India has signed DTAAs with 89 countries so far.

Tax residency certificate (TRC)

For obtaining DTAA benefit, it will be necessary for a nonresident assessee to furnish a certificate of it being a resident of that country, obtained by the assessee from the government of that country. The government had earlier prescribed the particulars to be contained in the TRC. However, the requirement of obtaining TRC containing prescribed particulars has been removed with effect from FY 2012-13. Particulars as may be prescribed can be provided separately, through supporting documents. The 2013 Budget has amended the provisions to provide that the TRC produced by a resident of a contracting state will be accepted as his or her residential evidence.

Note: *Concessional tax rates applicable under certain DTAAs that India has signed with various countries are provided in under Annexure 2.*

Tax information exchange agreements (TIEA)

Since 2011, India has entered into 14 TIEAs, with Argentina, the Bahamas, Bahrain, Bermuda, the British Virgin Islands, the Cayman Islands, Gibraltar, Guernsey, the Isle of Man, Jersey, Liberia, Liechtenstein (not yet in force), Macau (China) and Monaco. The objective is to promote international cooperation on tax matters through the exchange of information. These agreements facilitate information-sharing including the exchange of banking and ownership information. However, the nature of tax-related information that can be shared under a TIEA varies from one agreement to another. Besides, 27 other DTAAs so far signed by India also contain standard clauses similar to the operative clauses of a TIEA. These countries are Australia (not yet in force), Chinese Taipei, Colombia (not yet in force), Estonia, Ethiopia, Georgia, Indonesia (not yet in force), Lithuania, Malaysia, Malta (not yet in force), Mexico, Mozambique, Myanmar, Nepal, Netherlands, Norway, Poland (not yet in force), Singapore, Spain (not yet in force), Sweden (not yet in force), Switzerland, Tajikistan, Tanzania, the United Arab Emirates, the United Kingdom (not yet in force), Uruguay (not yet in force), and Uzbekistan (not yet in force).

Transactions with persons located in notified territories

Anti-avoidance measures have been introduced (from 1 June 2011) in order to discourage transactions with those 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 will be deemed as transactions between 'associated enterprises'. Transfer pricing regulations will apply accordingly. Transactions with those located in such jurisdictions will have the following additional implications:

- No deduction will 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 will 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, a non-resident can approach the Authority for Advance Rulings (AAR) 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 to be undertaken.

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

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

General Anti Avoidance Rule (GAAR)

The provisions relating to GAAR were proposed in the 2012 Union Budget. After receiving various representations against the provisions, an expert committee under the chairmanship of Dr Parthasarathi Shome was set up. The 2013 Budget has considered most of this committee's recommendations and has extended the due date from which the GAAR provisions take effect on 1 April 2016. This means that the GAAR provisions will apply from FY 2015-16. The provisions empower the tax department to declare an 'arrangement' entered into by an assessee to be an 'impermissible avoidance agreement' (IAA). Consequences of this will be the denial of tax benefit either under the provisions of the Act or under the tax treaty. The provisions can be invoked for any step in or part of any arrangement entered and that arrangement or step may be declared as an IAA. The provisions will attract only the main purpose of the arrangement or step, which is to obtain tax benefit.

GAAR provisions will not apply in the following cases:

- Where tax benefit (to all the parties in aggregate) from an arrangement in a relevant tax year does not exceed INR 30 million;
- Foreign Institutional Investors (FIIs) registered with

Securities and Exchange Board of India (SEBI) and not availing any benefit under a Tax Treaty and also investment in FII made by non-resident investor

- Income earned by any person from transfer of investment on or after 1 April 2015 in respect of the investement made by such person before 30 August 2010

Royalty payments

The expression 'royalty' is defined as consideration received or receivable for transfer of all or any right for certain property or information. However, there were the 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 eliminate the above controversies, the definition of royalty provided under the domestic tax laws has been amended and clarified retrospectively with e effect from 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 a right, property or information is with the payer
- Such a right, property or information is used directly by the payer
- The location of such a 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.

Meaning not defined under the DTAA or domestic tax law

It has been recently provided that in case any term used in the DTAA is not defined either under it or the domestic tax law and a meaning is assigned to it by issue of a notification by the central government and such a notification is brought into force, then the meaning will become applicable to the DTAA from the date when it came 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 or she has any asset located outside India including any financial interest in any entity, or is a 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 3 million INR. 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 any assets that are included in 'net wealth'.

Direct Taxes Code (DTC)

On 30 August 2010 the government placed before the Parliament the Direct Taxes Code Bill, 2010. It 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.

Note: *The salient features of the 2010 Bill are summarised in Annexure 3 .*

Gift tax

However, 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 50,000 INR 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 schemes

Special economic zone 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.

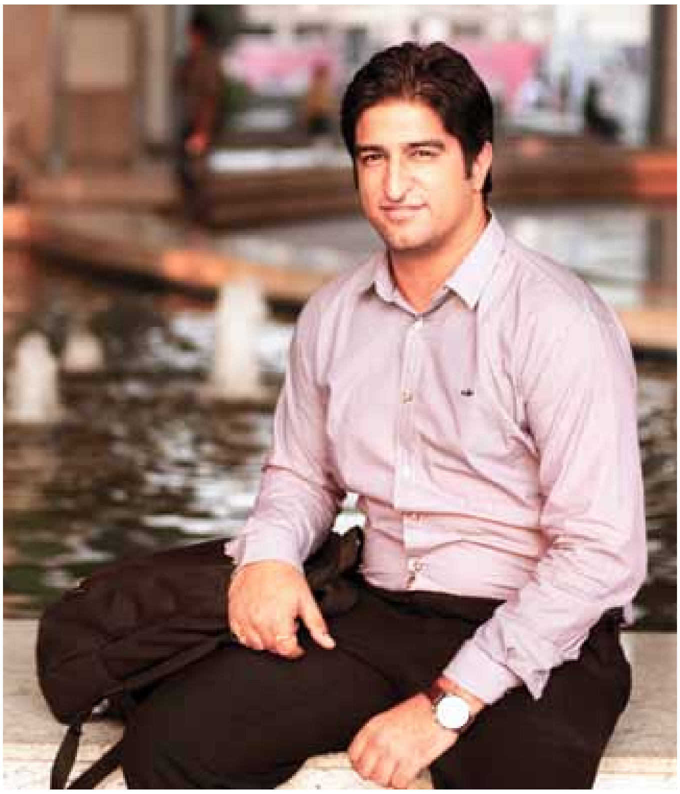
SEZ developers are entitled to tax holiday in respect of 100% of the profits and gains derived from the business of developing the units for any 10 consecutive years out of 15 beginning from the year when the SEZ is notified by the government. Exemption to SEZ developers from DDT has been discontinued with effect from 1 June 2011 and MAT exemption to developers has been discontinued from FY 2011-12. Expenditure undertaken by a developer on account of SEZ development 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 1 describes the salient features and benefits of the SEZ.

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 north eastern states, subject to certain conditions.



State	Incentives	Validity period	Eligible units
North- eastern states (including Sikkim)	100% income tax holiday Concessional rate of duty payable on ten years, value addition during manufacture or refund of duty in cash, subject to conditions	Ten years	Units that (a) begin manufacturing any eligible article or thing (b) undertake substantial expansion (c) carry on prescribed eligible business, from 1 April 2007 to 31 March 2017. New industrial units and units existing before 1 April which have undertaken substantial expansion by refund of duty paid in cash, subject to increase in investment by 25% or more commencement of production between 1 April 2007 and 31 March 2017

Deduction on investments for specified businesses

Tax incentives provided by allowing a 100% deduction on any capital expenditure (other than on land, goodwill and financial instruments) 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 onor after 1 April 2009
- Laying and operating a cross-country natural gas, crude, petroleum oil pipeline for distribution, including storage facilities being an integral part of such a 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 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 beeswax 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, a 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 such as 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, a university, r an Indian Institute of Technology (IIT), an approved scientific research programme also qualifies for a weighted deduction of 200% as against the earlier 175%.

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

- Scientific research and development as its main objective
- Approved by the prescribed authority, in the prescribed manner
- Fulfils other conditions as may be prescribed

International assignments in India

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

Under the domestic tax law, a person is considered to be a resident of India if either 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 during the relevant tax year, and 365 days or more in the preceding four financial years (also referred to as the '60 days rule')

However, in a situation where a citizen of India leaves the country for the purpose of taking up employment outside India, or in a case where an Indian citizen or a person of Indian origin, living outside India, comes on a visit to the country, only 182 days rule will be applicable.

In case an individual satisfies neither of the conditions, he or she will then qualify as a non-resident (NR) for that given financial year.

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

- He or she is a non-resident in nine out of the 10 years preceding the relevant financial year
- He or she is physically present in India for 729 days or less during the seven years preceding the relevant financial year

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

In determining the physical presence of an individual in India, it is not essential that his or her stay in the country needs to be continuous or at the same place. Further, both, the date of arrival as well as the date of departure are to be considered as days spent in India in order to determine the duration of stay of the individual in the country. If a foreign individual qualifies as a tax resident of both India as well as his or her home country, the conditions prescribed under the tie-breaker test of the relevant DTAA will have to be referred to in order to determine the tax residential status of the foreign individual.

Scope of taxation

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

- ***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 particular 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 the country
- ***NR:*** Income received in India or income accruing or arising from a particular source in India is liable to tax in India

Taxation of employment income

Employment income for services rendered in India is taxable in the country, irrespective of where the income is received.

Taxable income includes all kinds of amounts, received either in cash or kind, arising from an office of employment. Apart from income sources such as salaries, fees, bonuses and commissions, some of the most common remuneration items are allowances, reimbursement of personal expenses, education payments and perquisites or benefits provided by the employer, either free of cost or at concessional rates. All such payments are to be 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 the 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 the 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 that it exceeds an amount of 1,00,000 INR, are taxable as perquisites in the hands of the 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, in order to minimise Indian tax incidence.

Tax withholding

With respect to employment income, the employer will be required to withhold tax on the earnings from his or her 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 timeline is extended up to 30 April of the given financial year). This is applicable even if the employer is not resident in India.

Double taxation agreements

In a situation where an individual is treated as a tax resident of another country, he or she may then qualify for a relief from the Indian tax law under a double taxation agreement signed between the given country and India. Most of the current agreements lay down various tests in order to determine the actual residential status of the individual. Many agreements contain clauses, which exempt a resident of a specific country from tax on employment income incurred within India, if he or she has been residing in the country for less than 183 days within the given tax year, and if other conditions regarding the salary charge back and the payment of salary by a non-resident, etc are also satisfied (short stay exemptions). In a situation where the individual is coming from a non-treaty country, a short stay exemption is available under the domestic tax law, provided the individual's stay in India, during that particular 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 2013-14 are as follows:

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

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

A tax credit of up to 2,000 INR is provided to an individual earning an income between 200,000 and 500,000 INR. Further, a surcharge of 10% of tax will be levied in a situation where the total income of an individual exceeds 10 million INR. In addition to the above conditions, an education cess at the rate of 3% of the tax and surcharge (if applicable) will be levied so as to determine the final tax liability.

Tax registration

An individual needs to apply for and obtain his or her tax registration number called the permanent account number (PAN). A PAN is required in order to file the tax returns, and also has to be reported in the tax withholding returns or certificates of the individual.

Tax returns filing

At the end of each financial or tax year, a tax return has to be filed with the income tax authorities in the prescribed format. 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 500,000 INR or where the individual qualifies as a ROR and possesses foreign assets, or has the signing authority for any of his or her accounts located outside India.

Other matters

Visa

A foreign national coming to India must hold a valid passport and visa. A 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 within India, unless he or she holds an employment visa. An employment visa is issued to highly skilled talent or professionals provided that they draw a salary exceeding the prescribed limit. Such a visa is generally issued for a period of one to two years. Extension of the visa can be done in India itself.

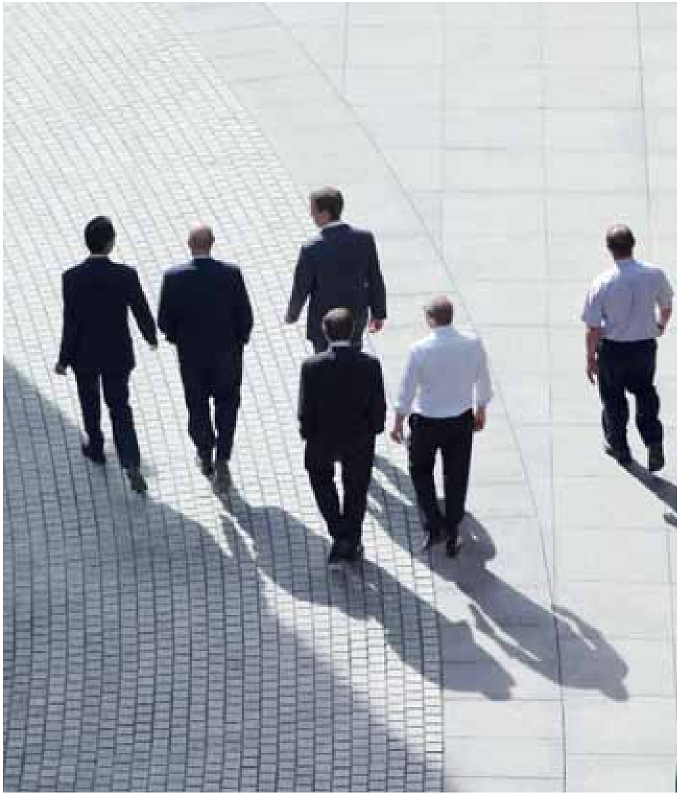
Foreign nationals coming for business meetings or to set up joint ventures (JVs) require a business visa. A business visa is cannot be converted into an employment visa within India.

Registration with the foreigners regional registration officer

A foreign national visiting India, who either has a valid employment visa or intends to stay for more than 180 days, must register himself or herself within 14 days of arrival into the country with the foreigners regional registration officer (FRRO). On submission of the prescribed documents to the FRRO, a residential permit is thereby issued to the foreign national.

Payment of salaries outside India

The current regulations for exchange control permit a foreign national, who is an employee of a foreign company, and is on secondment or deputation to the office/ branch/ subsidiary/ joint venture in India, to open, hold and maintain a foreign currency account with a bank outside India, and receive his or her entire salary from foreign company for the services rendered in India by credit to bank outside India, provided the tax on the foreign national's entire salary has been paid in India.



Social security in India

On October 2008, the government introduced its mandatory social security norms for foreign nationals, who will 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 located within India, to which the Indian social security regulations apply.

An international worker coming from a country, with which India has a reciprocal social security agreement (SSA), is exempted from the Indian social security norms in a situation where he or she meets the following criteria:

- He or she is contributing to his or her home country's social security, either as a citizen or resident; and
- He or she enjoys the status of 'detached worker' for the given period, and according to the terms specified in the relevant SSA

Similarly, an international worker from a country with which India has entered into a bilateral comprehensive economic agreement prior to 1 October 2008 is exempted Indian social security where he or she meets the following criteria;

- He or she is contributing to his or her home country's social security, either as a citizen or resident; and
- The agreement specifically exempts the natural person of the other contracting country from contributing to the social security system in India

India has, so far, signed SSAs with 17 countries. However, so far, only the SSAs signed with countries such as Belgium, Germany, Switzerland, Luxembourg, the Netherlands, Denmark, Korea, France and Hungary, have been notified and made operational. Every international worker has to contribute 12% of his or her salary, comprising mainly of basic wages, dearness allowance, retaining allowance (but excluding components such as bonus, house rent allowance, etc.) to the Employee's Provident Fund. The employer is required to make a matching contribution (that is, 12% of the salary) and deposit both the employer's as well as the employee's contributions, along with an administrative charge of approximately 1.1% of the 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 accumulated balance of the provident fund under the following circumstances:

- Retirement from service in the establishment or after reaching 58 years of age, whichever is later
- Retirement on account of permanent and total incapacity to work due to bodily or mental infirmity, as certified by a prescribed medical officer or a registered practitioner
- In a situation where he or she is suffering from certain categories of diseases, detailed in the terms of the scheme
- On ceasing to be an employee of a covered establishment, where the international worker is from an SSA country

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

For more detailed analysis and further information, please refer to our past publications, 'Assignments in India' and 'Indian social security for cross-border assignments'. Foreign nationals who are sent to India on secondment by their foreign employers, for services to be rendered in India, must ensure that a proper secondment structure is already in place. The following considerations need to 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 the foreign national's salary
- Corporate tax implications (permanent establishment exposure)
- Withholding tax
- Transfer pricing regulations
- Service tax implications

Indirect Taxation in India

Customs duty

Customs duty is levied by the central government on goods imported into and exported from India, though the list of goods on which export duty is levied is limited. The rate of customs duty applicable to a product to be imported or exported depends on its classification under the Customs Tariff Act, 1975 (CTA).

The customs tariff of India is aligned upto a six-digit level 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 (WTO) 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 duty applicable to any product is composed of a number of components. The types of customs duties applicable are as follows:

- Basic customs duty (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 BCD is currently set at 10% for all goods other than agricultural and other specified products. However, the government 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 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 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
- 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 imported goods, the total customs duties (i.e. BCD and CVD) and the applicable EC and SHEC

BCD, EC and SHEC levied on 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. The central government has exempted specific consumer goods imported for retail sale in India, from levy of ADC, subject to the fulfillment of conditions. Similarly, the government allows a refund for the ADC paid on specified goods imported for the purpose of trading in India, subject to the fulfillment 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, Education Cess (EC) at 2% and Secondary and higher education 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 charging excise duty. Goods other than those covered by an MRP-based assessment are generally chargeable to duty on the transaction value 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 operates as a pure value added tax (VAT), with full set-off of input tax credits in computing and discharging the tax liabilities on the output side. The input tax credit comprises excise duty on indigenously sourced inputs and capital goods, the CVD and ADC portion of customs duty on imported material and service tax on input services, with the exception of certain exclusion that have been provided under CENVAT credit rules in this relation.

There are different product, industry and geographical area specific exemptions available under CENVAT, which present excellent business opportunities to manufacturers in India.

Service tax

The service tax was first introduced in India in the year 1994 with a relatively limited number of services under its ambit. Since then, the list of services has been expanded year on year. In 2012, keeping in with the large number of different service categories and the resultant classification issues, a new concept of service taxation based on a negative list of services was introduced. In this new system of taxation, all services are taxable but for the services mentioned in the negative list.

Generally, it is the service provider who is liable to pay the service tax. However, for some specified services, such as transport of goods by road, sponsorship, import of services, etc.

the obligation to pay service tax rests with the service receiver instead. In certain cases, this obligation has been divided between the receiver and the provider in a specified proportion.

The existing rate of service tax is 12%. In addition, EC of 2% and SHEC of 1% of the service tax are levied on taxable services. Thus, the effective rate of service tax is 12.36%.

There is a simple online procedure prescribed for the service provider and receiver to register under service tax. The service provider or receiver rendering services from multiple locations within India has been given an option to take either a centralised registration for all locations or opt for separate registration for different locations. Similar to excise duty, service tax is also a pure value added tax. Since both service tax as well as excise duty are federal levies, cross input tax credit has also been allowed. The scheme of input tax credit under service tax has been integrated under CENVAT credit rules and the benefits available to manufacturers have also being extended to the service provider.

The valuation methodology adopted under service tax is based on the gross value charged by the service provider. In certain circumstances, the value is derived as per specified valuation rules.

Service tax is a consumption-based tax. The peculiar nature of services makes it difficult sometimes to determine the origin and place of consumption of services or the time of completion and rendition of services. This aspect of service taxation in India has progressed tremendously in recent times. Introduction of Point of Taxation Rules, 2011, Place of Provision of Services Rules, 2012 along with the introduction of taxable or non-taxable territory under the negative list based service taxation regime has simplified the process of determination of time and place of rendition and completion of service.

In addition to the negative list of services, there are certain services such as education, infrastructure projects like development of roads and bridges, healthcare, sponsorship of sports events, etc which are specifically made exempt from the levy of service tax. There is an abatement scheme for valuation of certain specific service such as transportation, financial leasing, renting, etc and the rate of exemption varies from 10 to 70% of the taxable value. Export of services are completely tax neutral and benefits such as refund of input tax credit and rebate of duty payments are also available.

Sales tax

The sale of movable goods in India is chargeable to tax at the federal or state level. The Indian regulatory framework has granted power to state legislatures to levy tax on goods sold within that state. On the other hand, all goods sold in the course of interstate trade are subject to the federal sales tax i.e. central sales tax (CST).

CST is levied at the rate applicable on such goods under the VAT law of the originating state. 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 CST would be 2%, provided an appropriate declaration form (Form C in this case) is issued by the purchasing dealer to the selling dealer.

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

Value Added Tax

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.

In reference to the importance of each commodity with respect to the trade of goods in the state, varying tariff rates are assigned to different commodities. General tariff rates prevalent in the state VAT laws could vary from 1% to up to 20%. Apart from this, all those goods which are not covered under any of the tariff rates would be chargeable to the residual rate, which may vary from 12.5 to 15.5%.

Turnover thresholds have been prescribed so as to keep small traders out of the ambit of VAT. Small traders can also opt to pay tax under composition scheme, at a lower rate, levied in lieu of VAT.

Octroi duty or entry tax

Entry tax is 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 tax 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.

Goods and services tax (GST)

In 2006, the central government took a major step towards the transition to a national integrated GST. Implementation of the 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.

Once implemented, GST will create a single, unified Indian market and will diminish the multiple layers of indirect taxation that prevail in India at present. GST is also seen as a reform in administration of indirect taxation and will definitely be favourable for trade. Considering the various issues pending for discussion between State and Central government, GST is not expected to be roll out before April 2014.

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.

Mergers & Acquisitions

Among the emerging economies, India has witnessed decent activity in mergers and acquisitions (M&As) both cross border and domestic, with a remarkable feature of India being on the buyer side quite frequently in recent years. While the boom in the M&A space looks quite far back in the past, the Indian economy maintained a respectable volume of activity in 2012. Indian policymakers tried their best to prop up the M&A space in the economy with liberal tax laws, exchange control regulations and a more transparent environment driven by the objective of protecting the investor at large.

Part I: Indian M&A framework

The Indian regulatory framework broadly facilitates the acquisition or hive-off through multiple legal modes. While all of them may achieve similar objectives, each one is different from the other on tax outgo parameters as well as the regulatory ease of implementing the deal. The following are the most popular modes of acquisition:

- Share acquisition
- Business acquisition through asset purchase: Assets (itemised sale) or business (slump sale)
- Amalgamations and de-mergers

Share acquisition

Implications for the seller

Transfer of shares in Indian companies is taxable as capital gains in India, subject to benefits under the applicable DTAA, if any. Furthermore, taxability is dependent on whether the subject shares are listed or unlisted as explained below:

Listed shares

- Long-term capital gains (LTCG) i.e. gains resulting from shares held for more than 12 months, are exempt from tax if sale is on a recognised stock exchange in India. In case the transaction is carried off the stock exchange, gains are taxed at 10% (without indexation benefits) or 20% (with indexation benefits), whichever is beneficial
- Short-term capital gains (STCG) are taxed at 15%, plus surcharges if sale is on a recognised stock exchange in India. In case the transaction is carried off the stock exchange, it is taxable similar to the unlisted shares

Unlisted shares

- LTCG is taxed at 10% (without indexation benefits) for non-residents and 20% for residents, plus surcharges
- STCG is taxed at 40% for non-resident companies and 30% for resident companies, plus surcharges

Indian laws have been recently amended to bring under its net the indirect transfer of assets in India through a share or right transfer outside India. Therefore, a share transfer outside the country may be taxable in India, if such a foreign company derives its value substantially from assets located in India or if it results in the transfer of rights in relation to the management or control of an Indian company.

Implications for the buyer

- The 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 of voting power in a listed company
- The transfer of shares is subject to stamp duty at 0.25% of the value of shares transferred. However, no stamp duty may be payable if such shares are held in an electronic form
- Funding costs in the form of the interest burden on a loan applied for the acquisition of shares may not be tax-deductible as the corresponding dividend income will be exempt from tax in the hands of shareholders
- In case the corporate buyer receives shares of a closely-held company at less than their fair market value (FMV), the difference between the FMV and the sale consideration with respect to such shares is taxable in the hands of the buyer at the applicable corporate tax rate

Withholding tax

- The buyer (including non-residents) is required to withhold the applicable taxes resulting from the capital gains in the hands of the non-resident seller. Practically, this requires the buyer to obtain the India tax registration numbers
- No withholding of tax is required in case of acquisition of shares from Indian residents

Thin capitalisation rules

- Indian companies can be funded by a mix of debt, equity and convertible instruments. There are no prescribed guidelines with respect to the acceptable debt-equity ratios under taxation law

Preservation and carry-forward of tax losses

- There is no impact on carrying forward of tax losses on transfer of shares of a listed company
- Transfer of shares of non-listed companies beyond 49%, shall dis-entitle the company from carrying forward previous years' business losses
- No impact of transfer of shares on carrying forward unabsorbed depreciation allowance, irrespective of the Indian company's listing status

Business acquisition through asset purchase

In the Indian context, businesses can also be acquired through asset purchase. In case of the purchase model, the buyer may cherry-pick assets which he or she prefers and leave the liabilities in the seller entity itself. As against the asset purchase model, businesses can also be acquired through a slump sale model wherein the buyer acquires the entire 'business undertaking' inclusive of related assets and liabilities for a lumpsum consideration.

Asset purchase model

Implications for the seller

- Computation of gains is done with respect to each asset and this is taxable as short- or long-term capital gains, depending on the period of holding such assets. The 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 the cost inflation index
- The seller is liable to charge VAT or sales tax on the transfer of movable property at specified rates in case of the asset purchase model
- The cost of acquisition of self-generated intangible assets such as goodwill will be considered as nil for the purpose of calculating capital gains
- In case the asset purchase model involves the transfer of immovable property, the sale consideration is benchmarked at minimum value determined by stamp taxes authorities, for the limited purpose of calculating capital gains tax

Implications for the buyer

- The buyer is liable for stamp duty on the transfer of immovable property at the rate applicable in the concerned state
- The buyer is also liable for stamp duty on movable property at the applicable rate. However, this is generally minimised through innovations or physical delivery or both

Business transfer model

Implications for the seller

- Capital gains are determined by reducing the net worth of business undertaking from sales consideration which shall be determined in a prescribed manner
- 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. Taxable at 20% (plus surcharge) if long term else taxable at 30% (plus surcharge) if short term
- Business transfer (also known as Slump sale in India) is typically not subject to VAT or sales tax

Implications for the buyer

- In case of a slump sale, lumpsum purchase consideration is allocated to various assets based on a valuation report and hence the purchase of assets such as building, plant and specified intangible assets for use in business is entitled to increased depreciation allowance
- The buyer is liable for stamp duty on the transfer of business undertaking at the rate applicable in the concerned state

Funding costs

Interest on loan taken for the acquisition of assets or business undertaking through slump sale is generally tax-deductible, subject to certain prescribed rules.

Amalgamations and de-mergers

In some situations the acquired entity can be integrated into the buyer group through amalgamation or de-merger. While some variants to the process of amalgamation or de-merger exist, it involves a court process.

Such amalgamation or de-merger can be tax neutral for the parties involved subject to achieving certain prescribed conditions.

Amalgamation (or merger)

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:

- All the assets and liabilities of the transferor entity should be transferred to the transferee entity
- Shareholders holding at least 75% of shares (in value) in transferor company to become shareholders in the transferee company

De-mergers

A de-merger refers to the transfer or division 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:

- All the assets and liabilities of the relevant undertaking of the transferor company should be transferred to the resulting company
- The transfer of such business undertaking is on a going concern basis
- Consideration for a de-merger settled through the issue of shares to the shareholders of the de-merged company should be done on a proportionate basis
- Shareholders holding at least 75% of shares (in value) in a de-merged company are to become shareholders in the resulting company

Carrying forward of accumulated loss and unabsorbed depreciation

Amalgamation

- Accumulated loss or unabsorbed depreciation of an amalgamating company running an industrial undertaking (defined under the law) 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

Other matters

- Amalgamations and de-mergers normally attract stamp duty at varying rates. Such rates are derived from the laws of the state involved
- Stock exchange, high court and other regulatory clearances are required for amalgamations or de-mergers. A more robust process has been recently notified for obtaining approval from the stock exchanges and theSEBI , which can be time consuming, especially if timelines are water tight

Part II: Inbound investments

- At the first stage, any investment in India is governed by the Indian Exchange Control Regulations which are administered by the RBI. The RBI has issued a Foreign Direct Investment Policy which requires the prior approval from the Ministry of Finance in some cases and also permits the investments in India without any approval subject to certain sectoral and general conditions. Most of the investments in India are permitted without any prior approval of RBI subject to satisfying certain conditions.
- On a broad basis, Indian policymakers have been encouraging the green field as well as brown field investments in India and there are minimal approval requirements in general sectors. Few sectors like telecom, single or multi brand retail, defence, aerospace and banking may require approvals from respective ministries.
- On a tax front, there are numerous benefits given to any new investment in India. For instance, purchase of additional plant and machinery has been allowed an increased depreciation allowance. Also, establishing units in special economic zones entails tax holidays for 15 financial years beginning with the year in which the operations commenced.

Part III: Profit and capital repatriation

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 Indian company.

Dividend

- It attracts DDT of 15% (plus surcharges) and is payable by the company paying the dividend
- In case the dividend is distributed by the subsidiary and such a subsidiary has paid DDT on the dividend declared to its holding company, then such a company is eligible to take the credit of DDT paid by the subsidiary company when distributing dividend to its shareholders
- Dividend is exempt from tax in the hands of shareholders and accordingly, 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 and a prescribed minimum depreciation allowance in the books of accounts
- Since the dividend distribution tax is a unilateral levy on company and hence there remains ambiguity with respect to credit of such taxes in the parent country.

Share buy-back

- A new tax regime has been introduced to tax the share buy-back transactions effected by unlisted companies, effective from 1 June 2013
- Under the new regime, difference between the share buy-back price and the amount received by the company for the corresponding shares, is taxable at the rate of 20% (plus surcharges)
- New regime of the share buy-back is taxed, which is also a unilateral levy on company and hence there remains ambiguity with respect to credit of such taxes in the parent country

Capital reduction

- Requires the approval of the high court
- The amount of distribution on the capital reduction is deemed as a dividend to the extent of accumulated profits of the company. The balance distribution, over and above the accumulated profits is taxable as capital gains in the hands of the shareholders
- Residuary provisions like withholding of taxes, categorisation of capital gains into long term and short term shall equally apply here

Part IV: 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 (except for financial service sector) for bonafide business purposes subject to maximum investment upto 100% of the net worth of the Indian investor
- Presently, the existing regulations do not provide for outbound investments in the partnership firms or any other form of entity other than a company, without prior approval of the RBI

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 the 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 15% (plus surcharges) in hands of the Indian company for FY 2013-14 on a gross basis
- Currently, India has not controlled foreign corporation (CFC) rules and there is no Indian tax on foreign profits that remain with offshore subsidiaries. The government has proposed to introduce CFC regulations in the proposed DTC , yet to become a law

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

Transfer Pricing in India

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 the 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

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 FY 2012-13, the TP provisions have been extended to specified domestic transactions as well.

However, the TP legislation is not applicable when 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 Indian tax base.

Transactions covered

The term 'international transaction' has been defined to indicate 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 re-structuring or re-organisation transactions or any other transaction having a bearing on the profits, income, losses or assets of such enterprises. The AEs can 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 and indirect participation in the management, control or capital of an enterprise by another. It also covers situations in which the same person (directly or indirectly) participates in the management, control or capital of both the enterprises.

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

- A direct or 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 another 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 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 transactions 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[3]
- Transactions of tax holiday undertakings with other undertakings of the taxpayer[4]

This provision is applicable only if the aggregate value of such transaction exceeds 50 million INR 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[5]

3. Covers expenditure in respect of which payment has been made or to be made to a person referred to in section 40A(2)(b)
4. Transactions covered in sections 80A, 80-IA(8) and 80-IA(10) and Chapter VI-A and section 10AA of the Act.
5. The CBDT has for FY 2011-12 onwards notified the 'other method'. It has been described as any method which takes into account the price charged or paid or would have been charged or paid for a same or similar uncontrolled transaction, with or between non-AEs, under similar circumstances.

No particular method has been accorded a preference over the other. The most appropriate method for a particular transaction will need to be determined according to the nature and class of that 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. . The Indian legislation does not recognise the concept of arm's length range but requires the determination of a single ALP, which is computed on the basis of arithmetic mean of comparable prices.

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 will notify the variance percentage but for the FY 2012-13 and onwards the variance percentage has been capped at 3%.

Further, the central government has now issued a notification FY 2012-13, which specifies the tolerance band to be 1% for wholesale traders and 3% in all other cases. There is however, no clarification provided in the notification as to which taxpayers will be classified as 'wholesale traders'.

It is also to be noted that prior to FY 2009 - 2010, the flexibility of 5% was allowed around the ALP and not the transaction value. The law as it stood before FY 2009-2010, resulted in a 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

The Central Board of Direct Taxes (CBDT) has notified the Safe Harbour (SH) Rules on September 18, 2013. These rules 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.

The below table provides a snapshot of the SH Rules:

However, it is pertinent to note that no comparability adjustments are permitted and the benefit of tolerance band (+/- 3 %) is also not available to taxpayers opting for SH provisions. Also a taxpayer opting for Safe Harbour rules would not be entitled to invoke Mutual Agreement Procedure (MAP) proceedings.

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 and 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 an agreement shall be valid for a period not exceeding five years. The CBDT notified 'Advance Pricing Agreement Scheme' (Rules 10F to 10T of Income Tax Rules, 1962) on 30 August 2012 covering detailed rules and procedures (including necessary forms) for application and administration of the APAs.

Documentation and report 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).

Eligible International Transaction	Proposed Safe Harbour
Software Development services Information Technology enabled services	If annual transaction value is: • up to INR 5 billion, operating margin of 20% or more, • more than INR 5 billion, operating margin of 22% or more
Knowledge Process Outsourcing (KPO) Services	Operating margin of 25% or more
Advancing of intra-group loans by Indian companies to their wholly owned subsidiaries	The interest rate is equal to or greater than the base rate of State Bank of India as on 30th June of the relevant previous year plus: • 150 basis points (Loan does not exceed INR 500 million) • 300 basis points (Loan exceeds INR 500 million)
Provision of corporate guarantees by Indian companies to their wholly owned subsidiaries	The commission or fee is: • 2% p.a. or more of the guaranteed amount in case the amount guaranteed is up to INR 1 billion, and • 1.75% or more p.a. of the guaranteed amount if the amount guaranteed exceeds INR 1 billion, provided the credit rating of the AE is of adequate to highest safety
Contract research and development (R&D) services with insignificant risks	Software Development - operating margin of 30% or more Generic Pharmaceutical drugs - operating margin of 29% or more
Manufacture and export of auto components	Core auto-components - operating margin of 12% or more Non-core auto-components - operating margin of 8.5% or more

The code prescribes detailed information and documentation that the taxpayer has to maintain for demonstrating 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 eight 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 10 million INR 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 corporate entities having international transactions). Effective from FY 2012-13, SDT are also required to be reported in the accountant's report (under Part C of the recently modified Form 3CEB format) along with the international transactions entered into with the AEs. The accountant's report from FY 2012-13 and onwards is required to be filed electronically. It 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 or produce adequate and correct documents, information, data, the tax officer may readjust or re-compute 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 or document	2% of transaction value
Maintains or furnishes any incorrect, information or documents	2% of transaction value
Failure to report any international transaction which is required to be reported	2% of transaction value
Adjustment to taxpayer's income	100 to 300% of the total tax adjustment amount
Failure to furnish accountant's report	100,000 INR

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.

Amendments to SEZ Rules,2006

The Department of Commerce amended the SEZ Rules on 18 April 2013 and announced a series of measures in the annual supplement (2013-14) to Foreign Trade Policy 2009-14. Key changes proposed include reduction in minimum land area requirements for multi-product and sector-specific SEZs, doing away with minimum area requirements for IT/ITeS SEZs, graded scale for minimum land area criteria, sector broad-banding, issues on vacancy of land and exit policy for SEZ units.

The SEZ Rules, 2006 (the Rules) were amended very recently, on 12 August 2013. The key amendments carried out in the SEZ Rules were:

- Expansion of the definition of a 'sector' by addition of a provison;
- Reduction of minimum contiguous land area requirement by half;
- Allowing addition of a 'sector' to a sector-specific SEZ or a service in a port/ airport subject to higher contiguous land parcel being available;
- extending duty benefits to cases where additions are proposed to existing non-operational structures; and
- introduction of new Rule 74A permitting transferring ownership of SEZ unit assets subject to a few conditions.

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.
- Indirect tax benefits are similar to those applicable to a SEZ developer /co-developer
- Exemption from payment of 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
- Period for export realization is 12 months from the date of export
- Branches of foreign company is eligible for carrying out manufacturing activities in SEZ

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)

- FTWZ 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 thereto
- 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. Will require to obtain requisite approval from the jurisdictional Development Commissioner/ Unit Approval Committee for setting up a unit in a FTWZ.

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:

- Unit can carry FTWZ to DTA and DTA to FTWZ transactions
- Unit 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
- Can carry out trading, with or without labeling
- Can carry out packaging and repacking without any processing
- Re-sale, re-invoice or re-export of goods
- Other value optimisation services

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 (NFE) earner over five years. A unit has to comply with the NFE

requirement as stipulated in the SEZ Rules. There is no NFE obligation on clients of service units in a FTWZ

- 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

National Policy on Electronics, 2012

- The Govt. of India has rolled out the National Policy on Electronics, 2012 under which it has formulated an incentives scheme viz. Modified Special Incentive Package Scheme ('M-SIPS' or the 'Scheme') for attracting investments in the Electronics Systems Design and Manufacturing ('ESDM') sector.

Applicability

- The scheme is applicable to new and existing ESDM units desirous of making investments and/ or carrying out substantial expansion/ modernization or diversification for design and manufacturing of electronic products. The units should be located in notified electronic manufacturing clusters (whether Greenfield or brownfield clusters).
- As on date, 29 verticals have been notified under M-SIPS, which are eligible for incentives and covers electronic products, nano-electronic products, telecom products, intermediates and electronic manufacturing services (covering all stages of value chain).

Available incentives

- The M-SIPS scheme offers two incentives to ESDM units – in the nature of capital subsidy and fiscal incentives. The capital incentives vary depending on the quantum of investment made, classification of products, location of the project etc. The fiscal incentives include exemption from customs duty, reimbursement of excise/CVD, service tax etc. The State level incentives are granted over and above these.

Disbursement of incentives

- The incentives would be available for investments made in the project within a period of 10 years. Incentives against capex would be released after the end of the financial year in which the total investments exceed the threshold value and on annual basis thereafter.
- Reimbursement of Central taxes/ duties actually paid is available after the end of the financial year in which the unit commences production and on an annual basis thereafter.

Approval Procedure

- In order to avail the benefits under the Scheme, an ESDM unit is required to obtain the prior approval of the Department of Electronics and Information Technology (DeiTY). The project can be carried out in multiple phases but the procedure for approval is similar in all.

Validity of the scheme

- The application process is open for a period of 3 years from the date of the notification (i.e. upto July 26, 2015) for receiving applications.

Annexure 2

Tax Rates under Double Taxation Avoidance Agreements

Name of the country	Interest	Dividend	Royalty	
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	10%
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)
China	10%	10%	10%	10%
Czech Republic	10%	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%
Estonia	10%	10%	10%	10%
Finland	10%	10%	10%	10%
France	10%	10%	10%	10%
Germany	10%	10%	10%	10%
Georgia	10%	10%	10%	10%
Hungary	10% (f)	10% (f)	10% (f)	10% (f)
Iceland	10%	10%	10%	10%
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%
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%
Libya Arab Jamahriya	14%	14%	14%	No specific provision (e)
Grand Duchy of Luxembourg	10%	10%	10%	10%
Malaysia	10%	5%	10%	10%

Name of the country	Interest	Dividend	Royalty	
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)
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%	5% (c); in other cases 10%	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 10%	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%
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)
Tajikistan	10%	5% (i), in other cases 10%	10%	No specific provision, (e)
Tanzania (p)	10%	5%(j); in other cases 10%	10%	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%

Name of the country	Interest	Dividend	Royalty	
United States of America	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

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 Parliamentary Standing Committee of 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 was earlier proposed to be effective from 1 April 2013 to provide the 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 as proposed in the DTC Bill 2010 are 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, watches 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 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.

Other significant proposals

- Applicable tax rates for payments to non-residents- ITAA
- 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 be subjected 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

Name of the country	Interest
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

Contacts

Ahmedabad
President Plaza, 1st Floor
Plot No. 36, Opposite Muktidham Derasar
Thaltej Cross Roads, S G Highway
Ahmedabad 380054
Phone: +91 79 3091 7000

Bangalore
6th Floor, Tower 'D'
The Millenia
1 & 2 Murphy Road, Ulsoor
Bangalore 560 008
Phone: +91 80 4079 7000

Chennai
8th Floor, Prestige Palladium Bayan
129-140, Greams Road
Chennai - 600 006
Phone: +91 44 4228 5000

Hyderabad
8-2-293/82/A/113A
Road No.36, Jubilee Hills
Hyderabad 500 034
Phone: +91 40 6624 6600

Kolkata
56 & 57, Block DN. Ground Floor, A-Wing
Sector - V, Salt Lake,
Kolkata 700 091
Phone: +91 33 2357 9101

Mumbai
PwC House, Plot no.18/A
Gurunanak Road (Station Road)
Bandra (West), Mumbai 400 050
Phone: +91 22 6689 1000

New Delhi / Gurgaon
Building no. 10, 17th Floor
Tower -C, DLF Cyber City
Gurgaon 122002
Phone: +91 124 3306 6000

Pune
GF-02, Tower C Panchshil Tech Park Don Bosco School Road
Yerwada, Pune - 411 006
Phone: +91 20 4100 4444

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