Destination India 2016
Unleashing the prowess

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pwc

Contents

12
Funding options
16
Significant exchange control regulations
34
Indirect taxation
30
International assignments
38
Mergers and acquisitions (M&A)
18
Direct taxation

Introduction

As the Bharatiya Janata Party-led National Democratic Alliance completes two years at the helm of the Central Government, it can claim credit to a number of initiatives it has taken on the international front, which have made India a better place in which to do business. To list a few of these, several sectors have been opened up to foreign direct investment (FDI) taxation has been made more transparent and visa norms have been eased. In 2015, the Government softened norms across 15 sectors, including defence, banking, construction, single brand retail, broadcasting and civil aviation, with the objective of boosting the investment environment in and bringing more foreign investments to the country. Furthermore, it relaxed visa norms for overseas tourists, businessmen as well as people of Indian origin. The Union Budget 2016–17 brought in further transparency in taxation regulations, including those for multinational corporations. Moreover, the Government has made a commitment to implement effective governance with a special focus on process-related reforms and IT-enabled processes.

That India has become a better investment destination is also reflected in the fact that its ranking has jumped 12 places in 'Ease of Doing Business' to 130 out of 189 countries in the World Bank's latest ratings on three counts—ease of starting a business, obtaining construction permits and accessing electricity in the country. Moreover, there have been several developments within the country and across the world that have made India a 'bright spot' and consequently an attractive business destination.

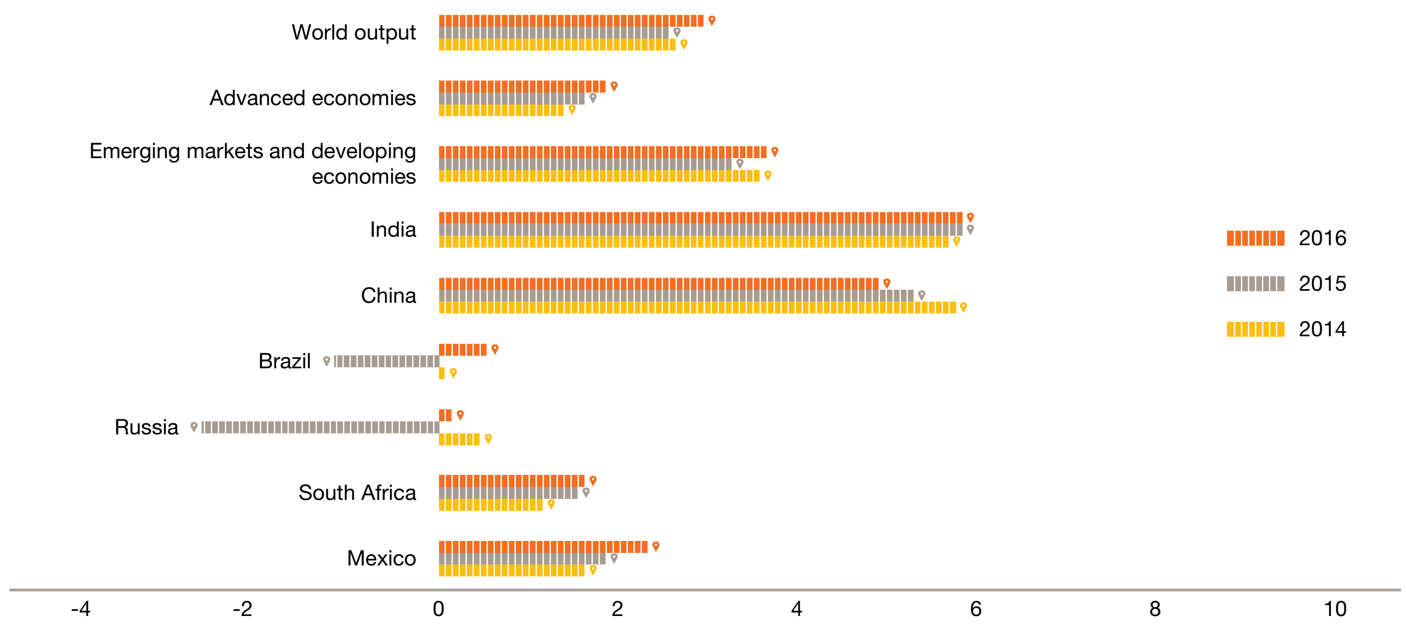
India, which is the world's third-largest economy based on its Gross Domestic Product (GDP) in purchasing power parity (PPP) terms, is expected to lead the world and emerging countries in terms of its growth this year and the next year as well. According to the International Monetary Fund (IMF), at a time when global growth is projected at 3.4% in 2016 and 3.6% in 2017, India is projected to grow at 7.5% in both these years, up from 7.3% in 2015 and 2016.

India's growth momentum is expected to be underpinned by private consumption, which has benefited from reduced energy prices and an increase in real incomes. On the other hand, growth in China is expected to slow down further at 6.3 and 6.0%, respectively, in these two years. The World Bank has projected India's growth at 7.8% in 2016–17 and 7.9% in 2017–18.

The Government of India has provisionally estimated a GDP growth of 7.6% for the financial year 2015–16, and the Reserve Bank has projected that the Indian economy will grow at 7.6% in the next fiscal.

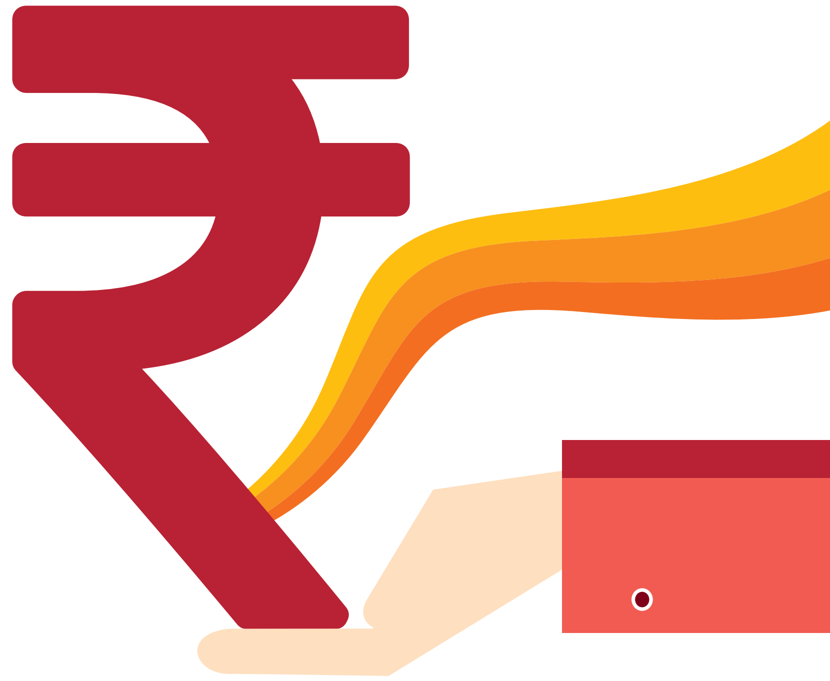
With 7% plus global and domestic projections, the mood is upbeat. It is no wonder therefore that India is slated to lead the growth amongst emerging nations, which on an average are expected to grow at 4.3% in 2016.

Figure 1: IMF projections of GDP growth at constant prices in select countries



Source: IMF, World Economic Outlook Update, January 2016

1.World Economic Outlook Update, January 2016. http://www.imf.org/external/pubs/ft/weo/2016/update/01/
2.India development update. http://www.worldbank.org/en/country/india
3.Growth rate of gross value added (GVA) in percentage



India ranks second in the world after China in terms of its population. Apart from enjoying a demographic dividend with more than 1.2 billion people, of which nearly two-third are of working age, it is also increasingly becoming an investment hub with several enabling policies being announced by a majority-led pro-reform Government. India is also expected to be a source of human resources for most of the ageing, developed world in coming decades.

With the present Government having completed two years, India seems poised to enter a growth phase, with an increased emphasis on inclusive growth. The Government has established the National Institution for Transforming India (NITI) Ayog, a policy think tank, with which it wants to replace the Planning Commission. It is proposed that NITI Ayog will include leaders from India's 29 states and 7 union territories. The Government's Jan Dhan Yojana initiative on financial inclusion, its Swachh Bharat campaign on inculcating civic sense in people, hygiene and preventive healthcare, and 'Housing for all by 2022' are schemes aimed at ensuring sustainable development in the country.

Some development-oriented flagship programmes launched by the Government in 2015:

- Smart City Mission: Ninety-eight cities have been selected for the 'Smart City Project'. According to the Union Development Ministry's communication, it has allocated INR100 crore per city per year over the next five years.
- Skill India: The 'Skill India' programme has been launched to enable India to emerge as the 'human resource capital' of the world. It aims to equip over 40 crore people with adequate skills by 2022.
- Atal Pension Yojana (APY): This scheme will provide a monthly pension to people above 60 years of age in the organised sector.
- Deen Dayal Upadhyaya Gram Jyoti Yojana: This project has been launched by the NDA Government to provide 24x7 electricity to all homes in rural India.
- Digital India: This programme aims is to ensure that the Government's services are available to citizens electronically and they have access to the latest information on and the benefits of technology.
- Atal Mission for Rejuvenation and Urban Transformation (AMRUT): This scheme seeks to enhance living conditions and drive economic growth in India by stressing the need for people-centric urban planning and development.
- Start-up India: This government initiative aims to foster entrepreneurship and promote innovation by creating an ecosystem that is conducive to the growth of start-ups in the country. Its objective is to make India a nation of job creators instead of job seekers.
- Pradhan Mantri Awas Yojana (PMAY): This is a 'housing for all' scheme, which focuses on improving living conditions for Indians. The NDA Government has identified 305 cities and towns in nine states where it will implement this programme.

Developing infrastructure, improving the business environment, building a robust and predictable taxation regime, attracting increased Foreign Direct Investment (FDI), nurturing international relations and empowering the people are the Government's other growth-oriented initiatives that seek to help India intensify vibrancy in its economy.

The signs are all around us:

- The Government announced its 'Make in India' project last year with a view to make India an attractive global manufacturing hub. It has set for itself the ambitious target of increasing the contribution of manufacturing output in the country's GDP by 60% from the existing 16% to 25% by 2025. The Make in India programme aims to facilitate and augment investment, encourage innovation and build high-class manufacturing infrastructure to boost manufacturing activities in key sectors ranging from auto components to aerospace and defence.
- e-Auctioning of coal blocks, curtailment of the discretionary powers of labour inspectors, implementation of a single-window compliance process for labour-related issues and the Government's intention to roll out the Goods and Services Tax (GST) are expected to go a long way in accelerating growth in the manufacturing sector.
- Global credit rating agencies Moody's Investors Service and Fitch Ratings have rated India's fiscal budget for 2016–17 as credit positive on its sovereign rating. They, however, highlighted uncertainties relating to its addressing structural fiscal challenges.
- In October 2015, Standard & Poor's retained India's sovereign credit outlook of 'stable'. This acknowledges the Indian Government's expectation of a spell of continued fiscal discipline in the near future and a rosier outlook for the Indian economy. These ratings, according to the rating agency, reflect the country's sound external profile and improved monetary credibility.

The combination of a strong and stable democratic government and a relatively free play of market forces combine to make India one of the most attractive investment destinations in the world today.

Macroeconomic review

Inflation seems to be stabilising in India and is in line with the Reserve Bank's target of bringing down retail inflation to 5% by March 2017. India's retail inflation eased to 4.83%—a six-month low—in March 2016 from a year ago. What is even more encouraging is that food inflation, which was fuelling overall inflation in the past, eased to 5.21% in March 2016 from 5.30% in the previous month.

Decreasing inflation will help policymakers strive for enhanced economic growth, without unleashing price pressures, and the Reserve Bank, to reduce its policy rates.

India's factory output (measured through the Index of Industrial Production [IIP] for the month of February 2016) registered a 2% growth after three straight months of decline.

The Government clearly wants to see India break out of the 'big-but-poor' category and take its rightful place at the high table with the most developed countries in the world. Initiatives such as 'Skill India', 'Digital India', 'Startup India' and the move towards a 'pensioned society', as well as the 'Make in India' and 'Swachh Bharat' schemes, are a clear indicator of this intent.

On the tax reform front, the Government is progressing towards a more transparent and reduced tax regime with a non-litigious approach. However, while compliant taxpayers can expect a supportive interface with the tax authorities, tax evasion will be countered strongly.

The Base Erosion and Profit Shifting (BEPS) agenda of the Organisation for Economic Co-operation and Development found a place in Budget 2016–17, and introduced international 'best practices' in the country. 'Country-by-Country Reporting' for multinationals with consolidated revenue of more than 750 million EUR was also proposed in the Budget. International players will therefore need to align their business activities better with their transfer pricing policies.

The Government has emphasised the need for good governance with a special focus on process reforms and IT-enabled processes, so that irritants faced by people in their interface with government agencies are substantially reduced.

A task force has been constituted to rationalise human resources in various ministries, and a comprehensive review and rationalisation of autonomous bodies is under way. These initiatives are expected to enhance 'ease of doing business' in India.

Over a period of time, India has addressed some of its macroeconomic vulnerabilities reasonably well. The key challenges include inflation, the current account deficit (CAD) and the fiscal situation in the country. The Government has taken several measures to implement long-term solutions in an effort to solve some of its structural problems.

Softening of global crude oil prices has helped the Government tidy its books and is expected to help it reduce its fiscal deficit, which should positively affect the overall inflationary scenario in the country.

The Indian economy has firmly held its ground amidst global headwinds, with our foreign exchange reserves at

their highest ever level of US$350 billion, and the current account deficit (CAD declining from US$18.4 billion in the first half of 2015 to US$14.4 billion in 2016. India's CAD is projected to be a low 1.4% of its GDP by the end of this year.

India's fiscal deficit for 2016–17 has been maintained at 3.5% of its GDP. The Government proposes to constitute a committee to review its implementation of the Fiscal Responsibility and Budget Management (FRBM) Act and provide its recommendations on the way forward for the country.

Takeaway

Despite global uncertainties, the Indian economy is expected to register a growth of more than 7% for the third year in succession if the present macroeconomic scenario continues and the monsoons are normal in 2016–17. There seems to be no doubt that under current circumstances, India is poised to become a major investment destination for the global community. Its macroeconomic stability, resilience and ability to deal effectively with external shocks and the Government's proactive initiatives are making India a large market that is capable of yielding steady and attractive returns to investors in the medium-to-long term. It's time they make the best use of these opportunities.

Policy announcements to encourage investment

Continuing the momentum towards enhancing ease of doing business in India, a host of reforms have been introduced by the Government during the year. Some of the key initiatives are as follows:

- The Government has liberalised the FDI Policy for various sectors, including Construction Development, Defence, Private Banking, Broadcasting and Trading, and has brought in the much-awaited policy on FDI in e-Commerce.
- Foreign investment in sectors including insurance and pension with investments of up to 49% and white labelled ATM operations, asset reconstruction companies, plantations, non-scheduled transport services and other carriage services with investments of up to 100% have been brought under the automatic route, subject to the conditions prescribed.
- Foreign investment in Limited Liability Partnerships LLPs has been liberalised and brought under the automatic route.
- A policy has been announced for foreign investment in Alternate Investment Funds and Infrastructure Investment Funds and permitted under the automatic route, subject to guidelines on Indian ownership and control.
- To boost the domestic food processing industry, it is proposed that FDI of up to 100% is to be allowed in food processing.
- In line with the proposals, NRI investment under the non-repatriation mode has been equated with domestic investment.
- Setting up business in India has been made easy by the introduction of a single integrated form for incorporation of companies. The minimum capital requirement for companies has been done away with and initiatives taken to reduce multiple interfaces and the processing time. Single window clearance on the e-Biz portal has been put in place for initial registrations required such as PAN, TAN, EPF and ESIC.
- One of the major reforms introduced by the Reserve Bank of India (RBI) with regard to foreign entities with a place of business India has been implemented by doing away with the need to seek the RBI's approval. Powers have been delegated to authorised dealer banks to grant approval for the establishment of a liaison/branch/project office in India, subject to its meeting the prescribed conditions.
- Introduction of the 'Startup India' policy is another important step towards fostering entrepreneurship and promoting innovation for the growth of start-ups in the country.
- Substantial amendments have been proposed in the Companies Act, 2013 by way of an amendment bill, based on suggestions received from the industry to minimise roadblocks and give a further impetus to ease of doing business in India.
- The Real Estate (Regulation and Development) Act, 2016 was brought into force to safeguard the interest of consumers in commercial/residential real estate markets.
- The constitution of NCLT and NCALT is being taken up expeditiously.
- The Insolvency and Bankruptcy Bill, 2016 has been introduced in and approved by the Lok Sabha.
- The Enforcement of Security Interest and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Bill, 2016 has been tabled in the Lok Sabha to bring in amendments in the SARFAESI Act, 2002 and other related Acts to further streamline the process of debt recovery.

Foreign investment

Entry options

A foreign entity setting up operations in India can either operate as an Indian entity by creating a separate legal entity in the country or as a foreign entity with an office in India.

Operating as an Indian entity

Wholly owned subsidiary

A foreign company can set up a wholly owned subsidiary in India to conduct business activities. Such a subsidiary is treated as a separate legal entity and an Indian resident. An Indian corporate enterprise needs to have at least two shareholders in the case of a private limited company and seven shareholders for a public limited organisation.

Such companies are required to comply with the provisions of India's Foreign Direct Investment (FDI) policy.

Limited Liability Partnership (LLP)

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

No tax is levied on distribution of profits to partners in the dividends of an LLP, unlike in the case of a company where Dividend Distribution Tax is applicable on repatriation.

An LLP (with foreign investment) can be set up under the automatic route, subject to it operating in sectors that are open for 100% FDI under the automatic route without any performance-linked conditions.

Joint Venture (JV) with Indian partners (equity participation)

Although a wholly owned subsidiary is generally the preferred option in view of the associated brands and technologies involved, foreign companies also consider conducting their operations in India by forming strategic alliances with Indian partners. Typically, such foreign companies identify partners engaged in the same area of activity as them or those who can add synergies to their strategic plans in India. Sometimes, JVs are necessitated due to restrictions on foreign ownership in select sectors under the FDI policy, e.g. in the Insurance and Multi-brand Retail Trade segments.

A JV can be formed in India in the form of an Indian company or LLP.

Operating as a foreign entity

A foreign entity can set up an office in India in the form of a liaison office (LO), a branch office (BO) or a project office (PO), based on the nature of activities it proposes to engage in and its underlying commercial objective. Such an office can be set up by the foreign company by submitting an application to an authorised dealer (AD) bank. However, the approval of RBI is required if the foreign entity:

- is mainly engaged in the Defence, Telecom, Private Security, and Information and Broadcasting sectors;
- is registered or incorporated in Pakistan;
- is headquartered in Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau, and is opening a liaison office in Jammu & Kashmir, the Northeast region and the Andaman and Nicobar Islands;
- is a Non-Government Organisation/body/agency/ department of a foreign government.

Once an office has been set up, it needs to be registered with the Registrar of Companies.

Each type of office can be established for the specific objectives mentioned below.

LOs

Setting up an LO or representative office is common practice for foreign companies/entities seeking to enter the Indian market. The role of LOs is limited to collecting information about the market and providing data pertaining to the company and its products to prospective Indian customers. An LO is only allowed to undertake liaison activities in India, and therefore, cannot earn any income in the country.

BOs

Compared to an LO, a BO can be set up and engage in a wide scope of activities. It can undertake revenue-generating activities in India. Foreign entities can set up branch offices in India to carry out the following activities:

- Export and import goods
- Provide professional or consultancy services
- Conduct research in which their parent companies are engaged
- Promote technical or financial collaboration between Indian companies and their parent organisations
- Represent their parent companies in India and act as buying or selling agents in the country
- Offer Information technology (IT) and software development services in India
- Provide technical support for products supplied by their parent or group companies
- Act as foreign airlines or shipping companies

Project offices

Foreign companies planning to execute specific projects in India have the option of setting up temporary project and site offices.

Approval for a PO is typically valid for the tenure of a project. Where none of the criteria mentioned above are met, approval is required from RBI to set up a PO.

Foreign investment in India

Currently, FDI is permitted in all sectors except for:

- Activities and sectors that are not open to private sector investment, e.g. atomic energy and railway operations (other than railway infrastructure permitted in specific activities)
- The lottery business, including government or private lotteries, online lotteries, etc.
- Gambling and betting, including casinos
- Real estate business (including construction of farmhouses)
- Chit funds, Nidhi companies
- Trading in transferable development rights
- Manufacture of cigars, cheroots, cigarillos, cigarettes, tobacco and tobacco substitutes

India's FDI policy covers 27 sectors/activities, and prescribes conditions, a foreign equity cap or approval-related requirements. These sectors include Defence, Financial Services (insurance, construction and development), Retail, Telecom and Media.

Foreign investment can be made in India via the following routes:

- Automatic route: Prior approval is not required from the Foreign Investment Promotion Board (FIPB).
- Approval route: This requires the Government's approval through the FIPB under the Ministry of Finance, or the Department of Industrial Policy and Promotion (DIPP) under the Ministry of Commerce and Industry, or both, subject to sectoral caps and/or certain conditions.

Foreign investment proposals under the FIPB route (involving a total foreign equity inflow of more than INR50 billion) need to be placed before the Cabinet Committee on Economic Affairs (CCEA) for further consideration.

Computation of FDI

From the perspective of the FDI policy, investments made directly by a non-resident entity in an Indian company are counted for foreign investment limits or sectoral caps, along with any investment made by a resident Indian entity (the majority of which is owned or controlled by non-residents).

Any downstream investments made by an Indian company (owned or controlled by non-residents) also need to comply

with sectoral caps and conditions. Downstream investments made by foreign-owned and controlled companies need to be intimated to the DIPP, FIPB or Secretariat for Industrial Assistance (SIA).

India has been on the fast track to transform itself into an open and investor-friendly economy. The DIPP, Ministry of Commerce and Industry, has liberalised India's FDI policy with the objective of opening up the majority of sectors (barring a few strategic ones) in the country for FDI under the automatic route. Changes introduced in the FDI policy include an increase in sectoral caps, activities being brought under the automatic route, easing of conditions for foreign investment, etc. Some of the key changes are given below:

- FDI in LLPs has been brought under the automatic route. Subject to their compliance with the Limited Liability Partnership Act, 2008, LLPs are now permitted to make downstream investments. They are, however, not allowed to raise External Commercial Borrowing (ECB).
- Sourcing norms for entities undertaking single-brand retailing of products, using state-of-the-art/cutting-edge technology, have been relaxed for the first three years in cases where local procurement is an impossibility. After the third year, sourcing norms (as prescribed) need to be followed for the next five years.
- FDI of up to 100% has been permitted for marketing food products, produced and manufactured in India under the approval route.
- FDI of up to 100% has been permitted under the automatic route in the marketplace model of e-Commerce, but not in the inventory-based model.
- NRI investments under the non-repatriation window are regarded as domestic investment.
- The policy pertaining to the Construction and Development sector has been liberalised and has no minimum area- and capitalisation-related requirements. FDI of 100% under the automatic route has been allowed in the case of completed projects for operation and management of townships, malls/shopping complexes and business centres.
- FDI of up to 49% has been allowed in the Insurance and Defence sectors, which have been brought under the automatic route.
- The FDI cap under the automatic route has been increased from 26% to 49% in the Pension segment.
- FDI in Asset Reconstruction Companies (ARCs) has been increased from 49% to 100% under the automatic route.
- FDI of up to 74% has been permitted in the brownfield Pharmaceutical sector, which has been brought under the automatic route.
- The FDI cap in Indian stock exchanges has been increased from 5% to 15% under the automatic route.
- FDI of up to 100% has been allowed for tea plantations, which have been brought under the automatic route, and has also been permitted for coffee, rubber, cardamom, palm oil tree and olive oil tree plantations.
- The FDI cap has been increased from 49% to 74% in private security agencies under the Government's approval route.
- FDI of up to 100% has been permitted for broadcasting carriage services, i.e. teleports (setting up of uplinking HUBs/teleports), DTH, cable networks, mobile TV, Headend-in the Sky, which have now been brought under the automatic route.
- The FDI limit has been increased from 26% to 49% for broadcasting content-related services on Terrestrial Broadcasting FM radio and uplinking of news and current affairs channels under the Government's approval route. FDI of up to 100% as been allowed for uplinking of non-news and current affairs TV channels and downlinking of TV channels, and has been brought under the automatic route.
- FDI of up to 100% has been allowed in the Civil Aviation sector, which has been brought under the automatic route. The FDI cap has been increased from 49% to 100% in Scheduled Air Transport Services, with FDI of more than 49% requiring the Government's approval. The FDI cap for non-scheduled Air Transport Services has been increased from 74% to 100%.

- The FDI cap in establishment and operation of satellites and credit information companies has been increased from 74% to 100% under the Government's approval route and automatic route, respectively.
- Foreign investment in a company (without any operations or investments) is to be permitted without any conditions under the automatic route for activities undertaken.

Foreign Venture Capital Investors (FVCIs) permitted to acquire securities under private arrangements

FVCIs can invest in eligible securities (equity, equity-linked instruments, debt, debt instruments or debentures), the units of Indian Venture Capital Undertakings (IVCUs) or start-ups, a Venture Capital Fund (VCF), a Category I Alternative Investment Fund (AIF) and units of schemes or funds set up by a VCF, an AIF through private arrangements or purchase from third parties, subject to their complying with certain conditions.

Foreign investment made by Registered Foreign Portfolio Investors (RFPIs)

RFPIs are permitted to invest in India, subject to individual and aggregate investment limits of 10% and 24%, respectively, of the total paid-up equity capital of the investee companies. This limit can be increased up to the sectoral limit after a board resolution, followed by a special resolution passed by the general body and subject to prior intimation to RBI. Moreover, where there is a composite sectoral cap under the FDI policy, the limits for RFPIs are also to be within the cap. RFPIs' investments (of up to 49%) do not specifically require compliance with conditions or approval-related requirements, even if these are prescribed under the FDI policy.

RFPIs are also eligible to invest in government securities and corporate debt, subject to limits specified by RBI and the Securities and Exchange Board of India (SEBI), from time to time.

Valuation norms

Issue of shares to non-residents or transfer of shares from residents to non-residents, and vice versa, is subject to valuation-related guidelines where fair valuation of shares has to be carried out, in accordance with internationally accepted pricing methodologies on an arm's length basis, duly certified by a chartered accountant (CA) or SEBI-registered merchant banker in the case of unlisted companies. However, if shares are listed, the consideration price cannot be less than that worked out, in accordance with SEBI's guidelines.

When non-residents (including NRIs) make investments in Indian companies by subscribing to the Memorandum of Association, such investments may be made considered at face value.

Continuing the momentum towards enhancing ease of doing business in India, a host of reforms have been introduced by the Government during the year. Some of the key initiatives:

- A policy for foreign investment in AIFs, real estate investment trusts (REITs) and Infrastructure Investment Funds (InvITs) has been announced and permitted under the automatic route, subject to guidelines on Indian ownership and control.
- Setting up business in India has been made easy by the Government through the introduction of a single integrated form for incorporation of companies. The minimum capital requirement for companies has been done away with and initiatives taken to reduce the long interface and processing time through single window clearance on the e-Biz portal for requisite initial registrations including PAN, TAN, EPF and ESIC.
- The Government's launch of the Startup India initiative is an important step taken by it to foster entrepreneurship, promote innovation and encourage the growth of start-ups.
- Significant amendments have been proposed in the Companies Act, 2013, in an amendment bill, based on suggestions received from industry to minimise roadblocks and give an impetus to ease of doing business in India.
- The Real Estate (Regulation and Development) Act, 2016, has come into force to safeguard the interest of consumers in commercial/residential real estate markets.
- The National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCALT) are being constituted.
- The Insolvency and Bankruptcy Bill, 2016, has been introduced and approved by the Lok Sabha.
- The Enforcement of Security Interest and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Bill, 2016, has been tabled in the Lok Sabha to bring about amendments in the SARFAESI Act, 2002, and other related Acts to streamline the process of debt recovery further.

Funding options in India

A foreign company setting up an Indian entity (subsidiary or JV) can fund it through the following options:

Equity capital

Equity shares constitute the common stock of a company. Equity capital comprises securities representing equity ownership in a company, provides voting rights to and entitles the holder to a share in its success via dividends or capital appreciation or both.

Issue of equity shares by an Indian company to a foreign resident need to comply with the sectoral caps detailed in the Government's FDI policy.

Investments in equity can only be repatriated on a company's liquidation or through transfer of shares. There are limited provisions that allow buy-back of equity shares under India's corporate law. Reduction of capital is possible in certain circumstances after obtaining the court's approval. There are restrictions on repatriation of investments from the perspective of the Government's FDI policy.

Partly paid equity shares and warrants can be issued by an Indian company to a foreign resident in accordance with the provisions of the FDI policy, the Companies Act, 2013, and SEBI's guidelines, whichever are applicable. The pricing or conversion formula of partly paid equity shares and warrants should be determined upfront and 25% of the total consideration amount (including share premium, if any) received in advance. The balance consideration for fully paid equity shares and warrants should be received within 12 months of the partly paid shares and within 18 months in the case of warrants. The time frame for receipt of the balance consideration in the case of partly paid up shares may be exempted by the RBI in certain specified cases.

Foreign Institutional Investors (FIIs), Registered Foreign Portfolio Investors (RFPIs) and Qualified Foreign Investors (QFIs) are also allowed to invest in the capital of Indian companies under the Portfolio Investment Scheme, subject to an individual limit of 10% of a company's capital and an aggregate limit of 24%. The aggregate limit can be increased, based on the sectoral cap/statutory ceiling (individually or in conjunction with other kinds of foreign investment), as applicable, by an Indian company through a resolution passed by its Board of Directors, followed by a special resolution ratified by its shareholders, subject to its giving prior intimation to RBI.

Fully and compulsorily convertible preference shares and debentures

Indian companies can receive foreign investments through issue of fully and compulsorily convertible preference shares and debentures. The conversion formula or price for issue of equity shares, based on their conversion needs, needs to be determined in advance at the time they are issued.

This is subject to the following guidelines:

- Only compulsorily and fully convertible preference shares and debentures without any option or right to exit at an assured price can be issued.
- Optionality clauses are allowed in fully and compulsorily convertible preference shares, debentures and equity shares under the FDI scheme, provided:
  - There is a minimum lock-in period of one year.
  - This lock-in period is effective from the date of allotment of the capital instruments.
  - After the lock-in period of one year and subject to the provisions of the FDI policy, non-resident investors exercising the option or right will be allowed to exit without any assured returns, in accordance with the pricing and valuation guidelines issued by the RBI from time to time.

External Commercial Borrowings (ECBs)

ECBs are commercial loans, including bank loans; buyers' credit; suppliers' credit; securitised instruments, e.g. floating rate notes and fixed rate bonds; FCCBs; FCEBs or a financial lease from non-resident lenders in any freely convertible foreign currency or Indian rupees. However, the ECB framework is not applicable for investments in Non-convertible Debentures (NCDs) made by RFPIs in India.

ECBs can be availed either under the automatic or the approval route. Eligible borrowers such as corporate organisations in the industrial, infrastructure and service sectors raise funds through ECBs for permissible end uses from recognised lenders. Under the approval route, prior permission of RBI is required to raise ECBs. Under either route, periodic post-facto intimation filings are mandatory, as prescribed under the Foreign Exchange Management Act (FEMA), 1999.

The framework for raising loans through ECBs (herein after referred to as the ECB framework) comprises the following three tracks:

Track I: Medium-term foreign currency denominated ECB with minimum average maturity of 3 years

Track II: Long-term foreign currency denominated ECB with minimum average maturity of 10 years

Track III: Indian rupee (INR) denominated ECB with minimum average maturity of 3/5 years

Regulations under the Foreign Exchange Management Act (FEMA) prescribe a ceiling for the cost of raising funds through ECB. This includes the rate of interest and other expenses in foreign currency and depends on the track under which ECB has been obtained.

Borrowers eligible for ECB include companies in the manufacturing and software development sector, shipping and airline companies, core investment companies, enterprises in the Infrastructure sector, organisations engaged in the Miscellaneous Service sector, etc. The list is separate for each of the tracks mentioned above. The RBI has prescribed limits up to which ECB can be availed of. Raising further funds beyond these limits requires the prior approval of RBI.

The purpose for which ECB can be utilised also depends on the track under which it has been obtained. Some of the permitted end uses include import or local sourcing of capital goods, for general corporate purposes, etc. However, ECB is not permitted for the following purposes:

i. Real estate activities

ii. Investment in the capital market

iii. Use of the proceeds of equity investment in India

iv. Giving loans to other entities with any of the objectives mentioned above

v. Purchase of land

Conversion of ECB into equity has been permitted by the RBI, subject to prescribed conditions.

Other types of preference shares and debentures (non-convertible, optionally convertible or partially convertible) issued on or after 1 May, 2007 are considered as debt, and all norms applicable to ECBs relating to eligible borrowers, recognised lenders, amounts, maturity, end-use stipulations, etc., are applicable in such cases.

Rupee-denominated bonds (‘Masala’ bonds)

In addition to the tracks mentioned above for raising ECB, any corporate or body corporate as well as REITs and InvITs can issue rupee-denominated bonds of up to INR50 billion for one financial year, with a minimum maturity period of three years, to any investor from a Financial Action Task Force (FATF)-compliant jurisdiction.

The all-in cost of rupee-denominated bonds needs to be commensurate with prevailing market conditions. End use-related restrictions in the case of these bonds are generally aligned with end use restrictions relating to ECBs.

Depository Receipts (DRs) and Foreign Currency Convertible Bonds (FCCBs)

Foreign investments made through DRs and FCCBs can also be treated as FDI for the purpose of sectoral caps. Indian companies are permitted to raise capital in international markets by issuing DRs and FCCBs, subject to prescribed restrictions.

Issuance of DRs does not require prior approval to be obtained from the Ministry of Finance, FIPB or RBI, except when FDI exceeds sectoral caps or policy requirements, in which case the prior approval of FIPB is needed. There are no end-use restrictions on DRs, except for a ban on their deployment in the Real Estate sector or the stock market.

FCCBs are subject to all the regulations that are applicable for ECBs. AD banks have been permitted to allow Indian companies to refinance their outstanding FCCBs under the automatic route, subject to the conditions prescribed.

Foreign Currency Exchangeable Bonds (FCEBs)

FCEBs can be issued under the Government's FCEB scheme.

The salient features of the scheme:

- FCEBs are foreign currency bonds and their principal and interest are payable in the same foreign currency.
- An FCEB is issued by a company that is a part of the promoter group of a listed company (offered company), which is required to hold the equity share(s) offered at the time the FCEB was issued. The listed company should be engaged in a sector that is eligible to receive FDI. Individuals residing outside India subscribe to FCEBs, which are exchangeable with the equity shares of the company on the basis of any equity-related warrants attached to its debt instruments.
- Investments made under the scheme need to comply with FDI norms and ECB policy-related requirements. The proceeds of FCEBs can be invested in a promoter's group companies, which must ensure that this investment is:
  - Used in accordance with the end uses prescribed under the ECB policy
  - Not used to make investments in the capital market or the Real Estate segment in India

The proceeds of FCEBs can also be invested by an issuing company abroad through direct investment, including in a JV or wholly owned subsidiary, subject to existing guidelines on Overseas Direct Investment in a JV or wholly owned subsidiary.

Significant exchange control regulations

Foreign exchange transactions are regulated under FEMA, under which foreign exchange transactions are divided into two broad categories—current account transactions and capital account transactions.

Transactions that alter the assets or liabilities, including contingent liabilities, outside India of a person resident in India or the assets or liabilities in India of a person resident outside India, including transactions referred under Section 6(2) and 6(3) of FEMA, are classified as capital account transactions. Transactions other than capital account transactions are classified as 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 the prior approval of the Central Government or RBI.

Current account transactions

RBI has delegated its powers relating to monitoring of or granting permission for remittances under the current account window to Authorized Dealer (AD) banks (entities authorised by RBI). All current account transactions are generally permitted unless specifically prohibited or restricted.

According to CAT Rules, drawal of foreign exchange for the following purposes is prohibited:

- Remittances from lottery winnings
- Remittance of income from racing, riding, etc., or any other hobby
- Remittance for purchase of lottery tickets, banned or prescribed magazines, football pools, sweepstakes, etc.
- Payment of commission on exports made for equity investments in JVs or wholly owned subsidiaries of Indian companies abroad
- Remittance of dividend by a company for which the requirement of balancing dividends is applicable
- Payment of commission on exports under the rupee state credit route, except commission of up to 10% of the invoice value of exports of tea and tobacco
- Payment related to telephone 'call back services'
- Remittance of the interest income of funds held in a non-resident special rupee (account) scheme

CAT Rules also specify transactions for which drawal of foreign exchange is only permitted with the prior approval of the Central Government. However, government approval is not required where payment is made from funds held in the Resident Foreign Currency account of the remitter.

Under CAT rules, drawal of foreign exchange by resident individuals for the following transactions is subject to an overall limit of USD2,50,000 every financial year, as prescribed under the Liberalized Remittance Scheme (LRS), and any additional remittance in excess of the this limit would require the prior approval of the RBI.

1. Private visits to a foreign country (except Nepal and Bhutan)
2. Gifts or donations
3. Going abroad for employment
4. Emigration
5. Maintenance costs of close relatives abroad
6. Business travel
7. Expenses for medical treatment abroad
8. Studies abroad
9. Any other current account transaction

However, for remittances for emigration, medical treatment and studies abroad, individuals are allowed to avail of an exchange facility in excess of USD2,50,000 if required by the country of emigration, medical institute offering treatment or university, without any requirement for approval, subject to submission of adequate supporting documentation.

Current account transactions entered by residents other than individuals, undertaken in the normal course of business, are freely permitted except in the following cases of remittances made by corporate organisations:

- Remittances towards consultancy services procured from outside India for infrastructure projects of up to USD 1,00,00,000 per project per financial year and of up to USD 10,00,000 per project per financial year for other projects
- Pre-incorporation expenses of up to 5% of investment brought in or USD 1,00,000, whichever is higher
- Donations of a maximum of USD 50,00,000 for a specified purpose of up to 1% of forex earning in the preceding 3 financial years
- Commission, per transaction, to agents abroad for sale of residential flats or commercial plots of up to USD 25,000 or 5% of inward remittance, whichever is higher

Any remittance in excess of the limits given above for the specified purposes will require the prior approval of RBI.

Capital account transactions

The general principle for capital account transactions is that these are restricted unless specifically or generally permitted by RBI, which has prescribed a number of permitted capital account transactions for persons resident in or outside India, and includes amongst others the following:

- Investment made in foreign securities by a person resident in India
- Investment made in India by a person resident outside the country
- Borrowing or lending in foreign exchange
- Deposits between persons resident in India and persons resident outside India
- Export or import of currency
- Transfer or acquisition of immovable property in or outside India

Under the LRS, resident individuals can remit up to USD 2,50,000 per financial year for any permitted capital account transaction. The permissible capital account transactions of an individual under LRS include:

- Opening of foreign currency account outside India
- Purchase of property abroad
- Making investments abroad
- Setting up wholly owned subsidiaries and JVs abroad
- Giving loans, including in INR, to NRI relatives

With respect to overseas investments in a JV/wholly owned subsidiary, the limit for financial commitment is up to 400% of the net worth of the Indian entity as on the last audited balance sheet date. However, any financial commitment exceeding USD 1 billion (or its equivalent) in a financial year requires the prior approval of the RBI, even when the total financial commitment of the Indian party is within the eligible limit under the automatic route (i.e. within 400% of its net worth according to its last audited balance sheet).

For the purpose of setting up offices abroad, AD banks can permit remittances towards initial expenses of up to 15% of the average annual sales/income or turnover of an entity during the previous two financial years or up to 25% of its net worth, whichever is higher. However, remittances of up

to 10% of its average annual sales/income or turnover for meeting recurring expenses during the previous two financial years can be made for normal business operations, subject to the following terms and conditions:

a. The overseas branch/office has been set up or a representative posted overseas to conduct the normal business activities of the Indian entity.

b. The overseas branch/office/representative does not enter into any contract or agreement in contravention of the relevant act, rules or regulations.

c. The overseas office (trading/non-trading)/branch/representative does not create any financial liabilities, contingent or otherwise, for its head office in India, does not invest surplus funds abroad without the prior approval of RBI and repatriates any surplus funds to India.

Repatriation of capital

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

Acquisition of immovable property in India

Foreign nationals of non-Indian origin, who are resident outside India, are not permitted to acquire any immovable property in India unless this is acquired by way of inheritance. However, they can acquire or transfer immovable property in India on a lease that does not exceed five years without the prior permission of RBI.

Foreign companies that have been permitted to open branches or POs in India are only allowed to acquire immovable property in the country which is necessary for or incidental to their carrying out such activities. Foreign companies that have been permitted to open LOs in India can only acquire property by way of lease not exceeding five years to conduct their business in the country.

Royalties and fees for technical know-how

Indian companies can make payments against lump sum technology fees and royalties without being subject to any restrictions under the automatic route.

Remittances made by branch or PO

No prior approval is required for remitting the profits earned by the Indian branches of foreign companies to their head offices outside India. However, such remittances are subject to submission of prescribed documents that are to the satisfaction of the AD bank through which these are made. Remittances of the winding-up proceeds of a branch/LO or PO of a foreign company in India are permitted, subject to its furnishing the prescribed documentation to the AD bank.

Direct taxation in India

Overview

The authority to levy, collect and administer income tax in India has been granted to the Central Government by the Constitution of India. Income tax is levied in the country under the Income-tax Act, 1961 (the IT Act), enacted by the Central Government. Income-tax Rules, 1962 (IT Rules), lay down the procedures to be followed in complying with the provisions of the IT Act. The rules are administered by the Central Board of Direct Taxes (CBDT), which operates under the aegis of the Central Finance Ministry.

Tax year and tax return filing deadline

The Indian tax year starts from 1 April of one year and ends on 31 March of the subsequent year. Companies (except those that are required to submit a transfer pricing accountant's report with respect to their international or specified domestic transactions) are required to file their tax returns by 30 September. Those that are required to submit a transfer pricing accountant's report need to file their tax returns by 30 November.

Scope of taxable income for a company

A company resident in India (resident company) is taxed on its global income.

A company resident outside India (non-resident company) is only taxed in India in respect of income which:

- Accrues or arises in India
- Is received or deemed to have been received in India
- Accrues to the non-resident company from an asset in India or source of income in India (salary, interest, royalties and fees for technical services), a 'business connection' in India or transfer of a capital asset in the country.

Note: The term 'business connection' is used in Indian tax laws instead of permanent establishment (PE), as used in tax treaties for taxing business profits. The term business connection is considered wider in scope than PE.

Residential status of a company

Till 31 March 2016, a company was considered a resident of India if it was an Indian enterprise, i.e. incorporated in India, or if its control and management were wholly located in the country.

With effect from 1 April 2016, conditions for determining the residential status of companies have been modified so that a company is to be considered a resident of India if it is an Indian enterprise, i.e. incorporated in India, or if its Place of Effective Management (POEM) is in India.

Residential status of an LLP

An LLP is an alternative entity that can avail the benefits of limited liability, but allows its members the flexibility of organising their internal management on the basis of a mutually arrived at agreement, as is the case in a partnership firm. An LLP registered in India is said to be resident in India, except if the control and management of its affairs are located wholly outside the country during the year.

Corporate Tax rates

Broadly, the Corporate tax rate is 30% for domestic companies and 40% for foreign companies in India. These rates are exclusive of a surcharge, which is levied according to the quantum of taxable income and cess levied on the tax amount inclusive of the surcharge (i.e. the surcharge rate ranges from nil to 12% for domestic companies and nil to 5% for foreign companies, and the cess rate is 3% for all companies).

The corporate tax rate for new domestic companies* has been reduced to 25%, subject to satisfaction of certain conditions.

* Domestic companies set up or registered on or after 1 March 2016, engaged solely in the business of manufacture or production of a product, have been provided with the option to pay tax at the rate of 25% (plus applicable surcharge and education cess), provided they do not claim benefits such as accelerated and additional depreciation.

** Patent Box Regime – taxable @10%

In order to encourage indigenous R&D and make India a global R&D hub, a change has been made in the IT Act with effect from 1 April 2016, to tax the royalty income of resident patentees in respect of patents developed and registered in India at the rate of 10% (plus applicable surcharge and education cess) on the gross royalty amount. No expenditure or allowance is to be allowed to patentees in respect of royalty at the time their taxable income is computed.

Key corporate tax considerations

Indirect transfer of capital assets – shares or interest in a company incorporated outside India

The IT Act states that shares and interest in a company incorporated outside India will be deemed to be situated in India if the shares or interest substantially derive their value, directly or indirectly, from assets located in India. Therefore, gains arising on indirect transfer of such assets will be taxable in India in the hands of the transferor, subject to relief provided to minority shareholders with 5% of total voting power. Some reporting requirements have been mandated for Indian companies if foreign enterprises have made an investment in the former.

In this respect, the following has been clarified:

Meaning of substance

- Where the value of Indian assets (including tangible and intangible assets) exceeds INR100 million
- Represents at least 50% of the value* of all assets owned by such companies/entities

  * The value of assets refers to the fair market value (FMV) of such assets on specified dates, without reducing the liabilities.

Taxation of royalty and fees for technical services (FTS) in the hands of non-residents or foreign companies under the IT Act

Royalty or FTS payable by residents to non-residents that do not have a PE in India are taxable on a gross basis at the rate of 10% (plus applicable surcharge and cess).

Royalty or FTS paid by residents to non-residents are taxed on a net income basis if the underlying right, property or contract is effectively connected to the PE of the non-residents in India.

Royalties/FTS will be taxable accordingly if the relevant double taxation avoidance agreement (DTAA) provides for a reduced rate of tax or narrowed down scope of royalties/FTS.

Taxation of royalty: controversies

There have been certain controversies with regard to the meaning, characterisation, scope and taxability of royalty. Some of these are as follows:

- Whether consideration for use of computer software constitutes royalty payment
- Whether e-Commerce transactions are royalties/FTS
- Whether payments to foreign satellite companies are towards royalties/FTS
- Whether inter-connectivity charges are royalties/FTS

Equalisation Levy – Digital Economy (e-Commerce transactions)

In line with BEPS Action Plan 1 (Digital Economy), a new chapter has been inserted in the Finance Act to provide for an Equalisation Levy of 6% on the amount of consideration for any specified service to be received by a non-resident from a resident in India, engaged in a business or profession, or from a non-resident with a PE in the country.

'Specified service' has been defined to mean online advertisement or any provision for digital advertising space or any other facility or service for the purpose of online advertisement, and also includes any other service notified by the Central Government. 'Online' has been defined to mean a facility, service, right, benefit or access obtained through the Internet, or any other form of digital or telecommunications network. Apart from online advertisements, other services are yet to be specified by the Government.

Computation of income

A company's taxable income is divided into the following categories or heads of income:

- Income from profits and gains from business and profession
- Income from house property
- Income from capital gains
- Income from other sources

Income from profits and gains of business and profession

Books of accounts and tax audit

Every company engaged in a business and profession is required to maintain books of accounts and get them audited by an accountant if its total sales, turnover or gross receipts exceed INR10 million during the year.

Income computation and disclosure standards

Business income is computed by aggregating all business receipts and reducing these from deductions prescribed under the IT Act. However, with effect from 1 April 2015, the business income of a taxpayer needs to be computed in accordance with the following Income Computation and Disclosure Standards (ICDS) notified by the Central Government:

ICDS no.	Name
I	Accounting policies
II	Valuation of inventories
III	Construction contract
IV	Revenue recognition
V	Tangible fixed asset
VI	Effect of changes in foreign exchange rates
VII	Government grants
VIII	Securities
IX	Borrowing costs
X	Provisions, contingent liabilities and assets

Furthermore, the IT Act provides for deduction of business-related expenses from gross business income. These expenses include rent, interest on borrowing, etc. Personal expenses, capital expenditure (other than capital expenditure specifically allowed as a deduction, e.g. scientific research), expenses incurred in violation of any law, and in relation to exempt income, Income Tax, Wealth Tax, etc., are specifically not allowed as deduction.

Some specific deductions are discussed below:

Depreciation

Depreciation is allowed separately at the following rates on assets owned and used during a tax year :

Factory building	10%
Furniture and fittings	10%
Plant and machinery (general)	15%
Cars, other than those used in a business that runs them on hire	15%
Computers (including software)	60%
Intangible assets (know-how, patents, copyright, trademarks, licences, franchises or any other business or commercial rights of a similar nature)	25%
Depreciation is allowed at higher rates for certain priority items such as energy-saving devices and pollution control equipment.	

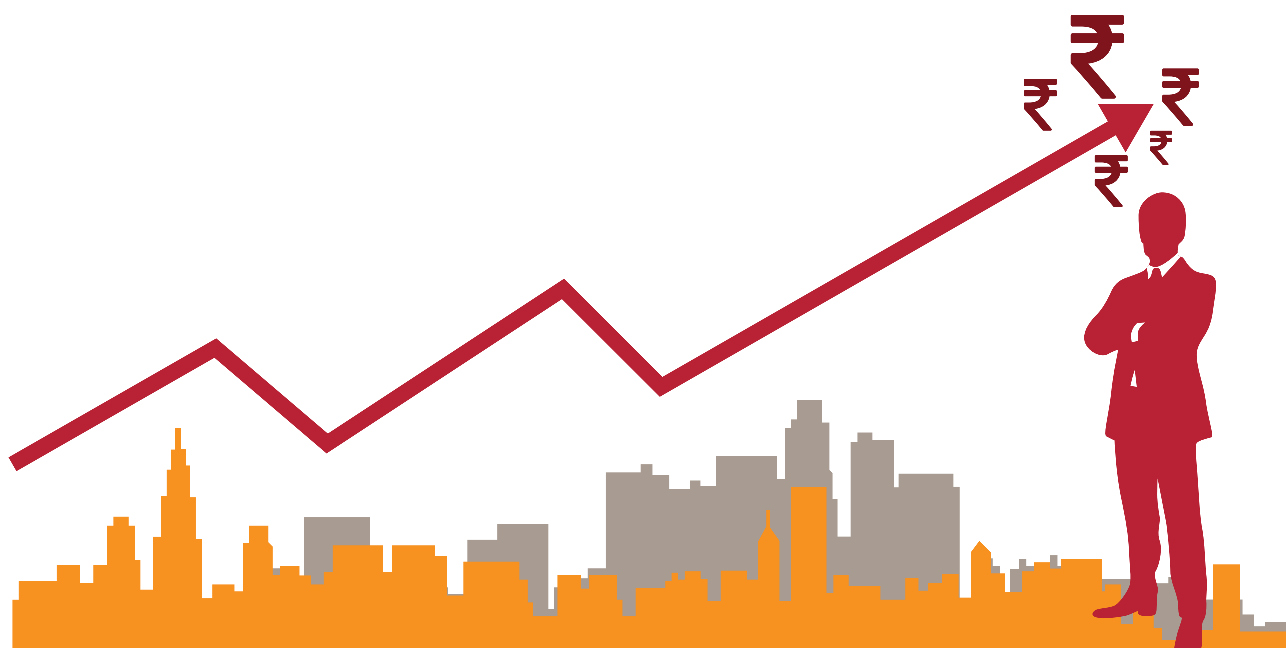
In addition to this, 20% additional depreciation is allowed to taxpayers on the actual cost of new plants or machinery in the year in which these are acquired and installed, provided they are engaged in manufacture or production of products or in the business of generation, distribution or transmission of power.

Furthermore, this benefit has been enhanced to 35% from 20% in the case of undertakings set up (between FY 2015–16 to FY 2019–2020) in backward areas in Andhra Pradesh, West Bengal, Bihar and Telangana.

Undertakings engaged in the generation and distribution of power can claim tax depreciation at the rates mentioned above or on a straight-line basis at rates prescribed in the Income-tax Rules, 1962. These rates vary from 1.95 to 33.40%.

Deductions and incentives

Activity	Benefits	Conditions
Companies engaged in the manufacture or production of products	Additional deduction of 15% of the actual cost of new plant and machinery	The actual cost of plants and machinery should exceed INR250 million and should have been installed before 31 March, 2017.
All taxpayers, whose total sales, turnover or gross receipts exceed INR10 million	Additional deduction of 30% of the cost incurred on a new employee	Emoluments paid to the employee are less than or equal to INR25,000 per month, and the employee should have been employed for or more than 240 days during the year
Scientific research and development	Weighted deduction of 200% of the expenditure (excluding cost of land or building) incurred for scientific research in an approved in-house research and development facility	The rate of deduction will be restricted to 150% within the period from 1 April 2017 to 31 March 2020 and to 100% from 1 April 2020 onwards.
Benefits to SEZ developers	Tax holidays for 100% of the profits and gains derived from the business of developing units for any 10 consecutive years out of 15, beginning from the year when the SEZ was announced by the Government Expenditure undertaken by the developer of an SEZ is also exempt from Customs, Excise and Central Sales Tax.	No such deduction will be available if this activity commences on or after 1 April 2017.
Units set up in SEZs	100% tax holiday for 5 years and 50% for the next 10 years out of profits derived from actual export of goods and services	The tax holiday period commences from the year in which the SEZ unit begins to manufacture or produce a product or provide services. No such deduction will be available to units commencing such activities on or after 1 April 2020.



Activity	Benefits	Conditions
For: • a cold chain facility • warehousing facility for storage of agricultural produce • an inland container depot or container freight station notified or approved under the Customs Act, 1962 • a warehouse facility for storage of sugar • a semi-conductor wafer fabrication-manufacturing unit notified by the Board Laying and operating of: • a cross-country natural gas, crude or petroleum oil pipeline • a slurry pipeline for transportation of iron ore For building and operation anywhere in India of: • a two-star or higher star hotel • a hospital with at least 100 beds	100% deduction on capital expenditure (other than expenditure on land, goodwill and financial instruments)	In the case of certain specified businesses such as cold chain facilities, warehousing for agricultural produce, hospitals with at least 100 beds, notified affordable housing projects and production of fertiliser, the deduction is 150% of capital expenditure incurred on or after 1 April 2012. However, with effect from 1 April 2017, the deduction will be reduced to 100% of the capital expenditure incurred during the year.
Developing and building a housing project under: • a slum redevelopment or rehabilitation scheme • a notified scheme for affordable housing • a fertiliser production plant • beekeeping and production of honey and beeswax		
Business of processing, preservation and packaging of fruits and vegetables; handling, storage and transportation of food grains; processing, preservation and packaging of meat and meat products or poultry, marine and dairy products	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	
Start-up businesses engaged in the innovation, development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property	100% deduction for profits and gains for three consecutive years out of five years beginning the year in which the start-up is incorporated	Eligibility criteria for start-ups: • Entity is incorporated between, on or after 1 April, 2016 and 1 April, 2019. • The total turnover of the business does not exceed INR250 million in the previous year beginning on or after 1 April 2016 and ending on 31 March 2021. • Entity holds a certificate certifying eligibility of its business from the Inter-Ministerial Board of Certification, as notified in the Official Gazette by the Central Government.

Tax holiday for enterprises engaged in infrastructure development

Profit-based tax incentives available to undertakings engaged in the infrastructure sector:

Sector	Applicability	Deduction	Eligibility
Power	• Generation, or generation and distribution of power • Transmission or distribution of power by laying a network, new transmission or distribution lines • Substantial renovation and modernisation of existing transmission or distribution network of lines	100% of profits and gains derived from such business for 10 consecutive years out of the first 15 years of operation	Operations should commence before 31 March 2017.
Ports and airports	• Developing or operating and maintaining or developing, operating and maintaining ports and airports • Applicable also to inland waterways, inland ports and navigational channels in the sea	100% of profits and gains derived from such business for 10 consecutive years out of the first 15 years of operation	• Operations should commence before 31 March 2017. • These should be new infrastructure facilities. • An agreement needs to be entered with the government/ statutory body.
Roads and highways	• Developing or operating and maintaining or developing, operating and maintaining roads and highway projects • Roads including toll roads, bridges and rail systems • Highway projects including housing or other integral activities	100% of profits and gains derived from such business for 10 consecutive years out of the first 20 years of operation	• Operations should commence before 31 March 2017. • These should be new infrastructure facilities. • An agreement needs to be entered into with the government/statutory body.
Water and waste management	• Developing or operating and maintaining or developing, operating and maintaining water supply projects, irrigation projects, sanitation and sewerage systems and solid waste management systems	100% of profits and gains derived from such business for 10 consecutive years out of the first 20 years of operation	• Operations should commence before 31 March 2017. • These should be new infrastructure facilities. • An agreement needs to be entered with the government/ statutory body.

Presumptive taxation regime for non-residents

The ITA Act includes special provisions whereby the total income of some non-resident assessees is computed on the basis of a certain percentage of their gross total receipts. This approach is expected to reduce areas of uncertainty and compliance-related requirements.

Particulars	Shipping	Aircraft	Oil and gas services	Turnkey power projects
Applicability	Shipping operations business	Aircraft operations business	Business of providing services or facilities in connection with, or supplying plant and machinery on hire, used or to be used, in prospecting for, extraction or production of, mineral oils	Business of civil construction, erection, testing or commissioning of plant or machinery in connection with a turnkey power project approved by the Central Government
Presumptive rate	7.5% of: Gross receipts from carriage of passengers, livestock, mail or goods	5% of: Gross receipts from carriage of passengers, livestock, mail or goods	10% of: Gross receipts from such business	10% of: Gross receipts from such business
Option of showing income lower than presumptive rate	Not available	Not available	Available, provided taxpayer maintains books of account and gets these audited	Available, provided taxpayer maintains books of account and gets these audited

Restriction on deduction of head office expenses

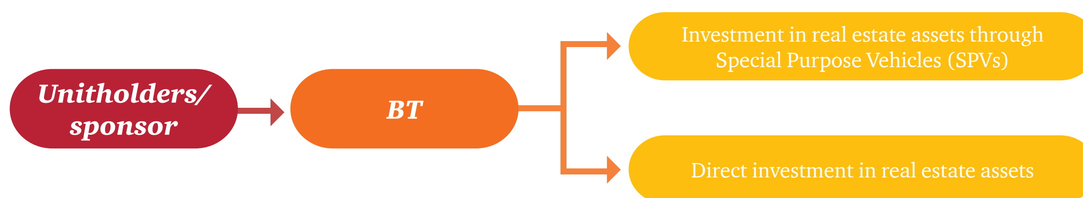
In case of non-resident taxpayers who are preparing books of account and claiming deduction towards general expenses incurred at the head office level, deduction in respect of such expenses will be limited to the following:

- Amount equal to 5% of the 'adjusted total income' for the relevant year
- Actual amount of head office expenditure attributable to business in India, whichever is the least

REIT/InVIT

The concept of a REIT/InVIT was introduced under the Indian tax regime in 2014 to give a boost to the Real Estate sector by adopting the pass-through regime for Business Trusts (BTs).

Structure of REIT/InVIT



Income from capital gains

Capital gains arising on transfer of	Tax rates*	
	Resident	Non-resident
(a) Short-term capital assets [other than (b) below]	Normal corporate/ individual tax rates	Normal corporate/ individual tax rates
(b) Short-term capital assets, which are listed equity shares, units of equity-oriented funds or of a BT, where Securities Transaction Tax (STT) is charged on a transaction (other than units of a business trust acquired on transfer of shares of an SPV)	15%	15%
(c) Long-term capital assets, which are listed equity shares in a company, units of an equity-oriented fund or of a BT (other than the units of a BT acquired on transfer of shares of an SPV) where STT is charged on the transaction	Exempt	Exempt
(d) Long-term capital assets, listed securities, units or zero-coupon bonds (other than [c] above)	For listed bonds and debentures—10% (no indexation benefit) For listed bonds and debentures—10% (no indexation benefit) 20% with indexation, whichever is lower	For other listed equity securities—10% without indexation; For other listed equity securities—0% without indexation; 20% with indexation, whichever is lower
(e) Other long-term capital assets	20%	20%
(f) Long-term capital gains arising to a non-resident (not being a company) or a foreign company from the transfer of unlisted securities (including shares of a company where the public is not substantially interested)	NA	10% (no indexation benefit)

* Applicable surcharge and education cess will also be levied on these taxes.

A short-term capital asset is one that is held for a period of not more than 36 months. However, in the case of listed securities or the units of equity-oriented mutual funds and zero-coupon bonds, the period is reduced to 12 months, and in the case of unlisted shares, to 24 months.

The benefit of indexation of cost of acquisition and the cost of improvement of a long-term capital asset of any nature (other than a bond or debenture capital-indexed bonds issued by the Government) is also available to non-residents, except in the case of the equity shares of an Indian company, which are purchased in foreign currency.

Characterisation of income in the case of FIIs

The IT Act has been amended to provide that any investment in securities made by FIIs in accordance with the regulations of SEBI will be treated as a capital asset in order to bring certainty to the characterisation of income arising to FIIs from transactions in securities. Accordingly, any income arising from the transfer of these securities by FIIs will be considered to be in the nature of capital gains. The FII regime was replaced with the FPI regime with effect from 1 June 2014.

Income from house property

Rental income earned from the use of buildings for residential/business purposes is taxable in India under this head. However, there is no deduction of expenses from rental income except for the following:

- Standard deduction of 30% of rental income
- Deduction of interest paid on loan taken for such property (as specified in the IT Act)

Income from other sources

Income not covered under any of the specific heads of income is liable to tax like income from other sources. Furthermore, while computing taxable income (following ICDS) from other sources, expenditure that is specially allowed or incurred wholly and exclusively for earning such income is allowed as a deduction.

Gift Tax

There is no Gift Tax liability in India. However, there are provisions for taxability of gifts in the hands of the recipient under the provisions of Income-tax laws.

Gifts received by individuals

Any sum of money exceeding, or immovable property whose stamp duty value exceeds or whose FMV exceeds, INR 50,000 received without consideration by an individual from any person is subject to tax as income from other sources. This does not apply to any sum of money received from the following:

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

Shares received by firms/closely held companies

If any firm/company receives the shares of a closely held company either free of cost or for an inadequate consideration, it is liable to pay tax on such shares if these meet the following conditions:

- The FMV of shares is treated as income in the hands of the recipient if these are received free of cost.
- If shares are acquired for an inadequate consideration and their FMV exceeds this consideration, the excess amount is considered as the recipient’s income.

Income is not taxable if it does not exceed the threshold of INR50, 000.

Issue of shares by closely held companies over and above the FMV of such shares:

- If any closely held company issues shares at a consideration that is greater than the fair market value of such shares, the amount over and above the FMV will be treated as income in the hands of the company.

Premium on allotment of shares

Privately held companies have to pay tax at normal rates on amounts received for issue of shares if the amounts are received from Indian residents and are in excess of the FMV of these shares.

Dividends paid by Indian companies

Indian companies have to pay DDT at 15% (plus applicable surcharge and education cess at an effective rate of 20.36%) on declaration, distribution, or payment, of dividends, whichever is earlier.

The dividends, subject to DDT, are not taxable in the hands of shareholders. However, in the case of dividends exceeding INR1 million, received by an individual, Hindu undivided family (HUF) or a firm resident in India, tax is levied at the rate of 10% with effect from 1 April 2016.

Dividends received from foreign companies

Indian companies also have to pay tax at 15% (in addition to applicable surcharge and education cess) on dividends received from foreign subsidiary companies.

Other Corporate Tax-related considerations

Minimum Alternate Tax (MAT)

MAT is levied at 18.5% (plus applicable surcharge and cess) on the adjusted book profits of companies whose tax payable under normal Income-tax provisions is less than 18.5% of their adjusted book profits.

Credit for MAT is allowed against the tax liability that may arise in the subsequent 10 years under the normal provisions of the IT Act.

The liability to pay a minimum tax of 18.5% on book profits is entrusted to Indian as well as foreign companies. However, a foreign company is not liable to pay MAT if India has entered a DTAA with the country in which the foreign company is a resident and it does not have a PE in India. In cases where India has not entered a DTAA with the country in which the foreign company is a resident, the company will not be liable to pay MAT if it is not required to seek registration in India under any law in force that relates to companies.

Alternate Minimum Tax (AMT) for entities other than companies

AMT is levied on entities (other than companies) at 18.5% on their adjusted total income (according to Income-tax provisions) if the AMT exceeds the tax payable under normal Income-tax provisions. Credit for AMT is allowed against tax liability that may arise in the subsequent 10 years under the normal provisions of the IT Act.

Corporate: WHTs

There is an obligation on the payer (either resident or non-resident) of income to withhold tax when certain specified payments are credited or paid. Some expenses that require tax withholding include:

Payments to residents

Nature of payment	Payment threshold for WHT (INR)[1]	WHT rate (%)
Specified type of interest (interest on securities)	None	10
Non-specified type of interest (interest other than on securities)	5,000[2]	10
Contractual payment (except for individual/Hindu undivided family [HUF])	30,000 (single payment) 1,00,000 (aggregate payment)	2
Contractual payment to individual/HUF	30,000 (single payment) 1,00,000 (aggregate payment)	1
Professional or technical service	30,000	10
Royalty or fees for technical services (FTS)	30,000	10
Commission and brokerage	15,000	5
Rent of plant, machinery or equipment	1,80,000	2
Rent of land, building or furniture	1,80,000	10

Notes

1. Payments have different threshold limits. A payer is only required to withhold tax if the total payment within a tax year for a single person (except where specified otherwise) is above the limits specified above.
2. The threshold limit for WHT for non-specified type of interest is INR5,000, except if interest received from a bank, co-operative society or deposit with post office, is INR10, 000.

If the Permanent Account number (PAN) of the deductee is not quoted, the WHT rate will be the one specified in relevant provisions of the IT Act, the rates in force or 20%, whichever is higher.

Payment to non-residents

Nature of payment	WHT rate (%)
Dividend	0
Interest on foreign currency	20
Interest on money borrowed in foreign currency under a loan agreement or via long-term infrastructure rupee-denominated bonds (The period for borrowing is July 2012 to July 2017.)	5
Interest on investment in long-term infrastructure bonds issued by an Indian company (rupee-denominated bonds or government security) (The period for borrowing is from June 2013 to July 2017.)	5
Royalty and technical fees	10
Long-term capital gains other than exempted income	20
Other income	40

Notes

1. The percentage is to be increased by a surcharge, education cess, and secondary and higher education cess to compute the effective rate of tax withholding, subject to treaty benefits.
2. Long-term capital gains on transfer of shares (through a stock exchange) in listed companies or units of an equity-oriented fund are exempt from tax if they have been subjected to STT.
3. If the PAN of the deductee is not quoted, the rate of WHT will be that specified in the relevant provisions of the Income-tax Act, the rates in force or at 20%, whichever is higher. However, with effect from 1 June 2016, this requirement will not apply to non-resident Indians or foreign companies, subject to certain other conditions, as may be prescribed.

Buyback of shares

An additional tax of 20% is payable in the case of buy-back of shares by an unlisted company from its shareholders. This tax is payable by the company on the difference paid by it on buy-back to buy back the shares and the amount received by it at the time the shares were issued. The buy-back amount received is exempt from tax in the hands of the receiver.

Other considerations for taxation of non-residents

Tax Residency Certificate (TRC)

To avail of the benefits of a DTAA, non-residents need to provide a copy of the TRCs issued by the revenue authorities of their countries of residence as well as other prescribed documents.

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

General Anti Avoidance Rule (GAAR)

Initially, provisions relating to GAAR were slated to come into effect from 1 April 2015. However, this has been deferred by two years and will be effective from FY 2017 onwards. The apparent reason for the deferment is the OECD BEPS project and India's active participation in it.

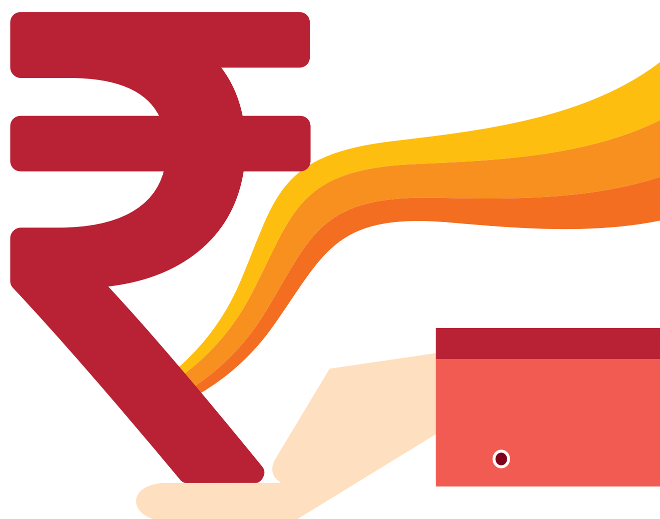
GAAR provisions empower the Tax Department to declare an 'arrangement' entered by an assessee to be an Impermissible Avoidance Agreement (IAA). The consequences include denial of the tax benefit either under the provisions of the IT Act or the tax treaty. The provisions can be invoked for any step in or part of an arrangement entered, and the arrangement or step may be declared an IAA. However, these provisions will only apply if the main purpose of the arrangement or step is to obtain a tax benefit.

The provisions of GAAR will not apply in the following cases:

- Where the tax benefit (for all parties) from an arrangement in a relevant tax year does not exceed INR30 million
- When FIIs registered with SEBI are not availing of any benefit under a tax treaty as well as investments made in FIIs by non-resident investors
- On investments made up to 31 March 2017

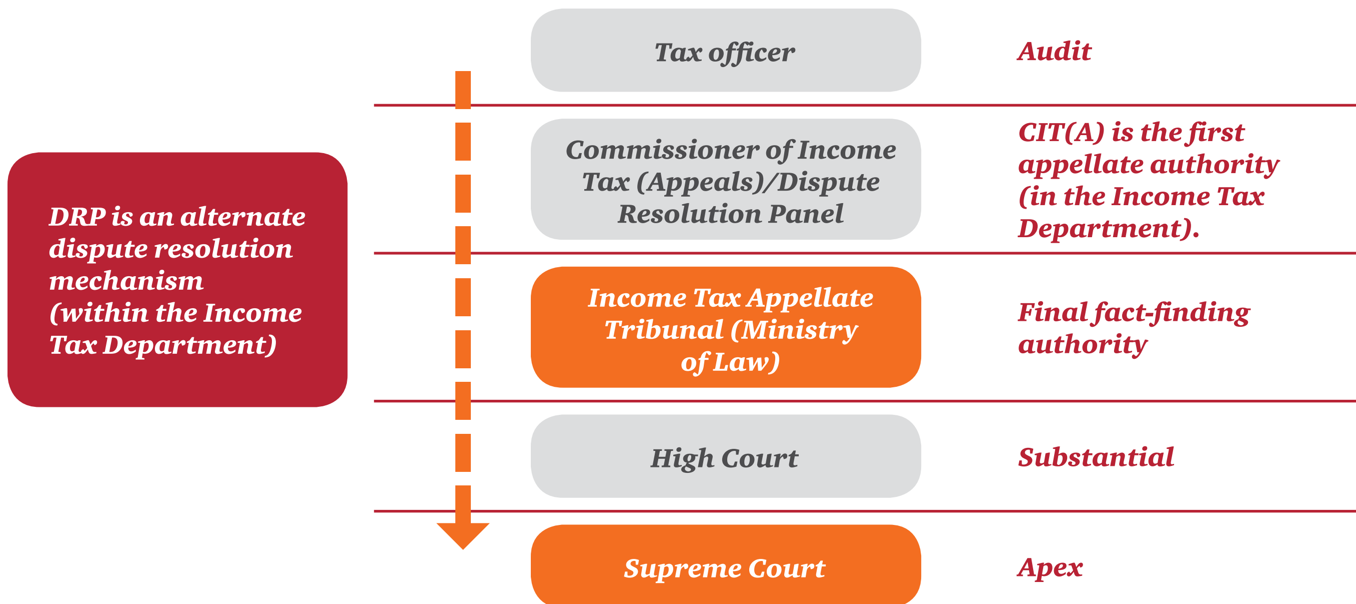
Wealth Tax

The Wealth Tax Act, 1957, stands abolished with effect from FY 2015–16.



Dispute resolution mechanism

Traditional approach for dispute resolution



Alternative approaches to dispute resolution

Authority for Advance Ruling (AAR)

The AAR can be approached fo r determination of tax liability from existing and proposed transactions to be undertaken by non-residents or residents engaged in transactions with non-residents, provided such issues are not pending with any tax authority. Now, the AAR can be approached for domestic transactions as well, subject to certain conditions. Under the law, AAR is to dispose of applications within six months. However, this generally takes one or two years, depending on the number of cases in queue. The AAR's ruling is binding on assessees and tax authorities, subject to writ jurisdiction under the HC or SC.

Income Tax Settlement Commission (ITSC)

ITSC is an independent forum that can be approached for settlement of legal or factual tax-related issues for any number of years. This option can be exercised by assessees once in a lifetime. It provides immunity from penalty and prosecution, provided full disclosure is made in the application. Proceedings need to be completed within 18 months. The ITSC's ruling is binding on assessees and tax authorities, subject to writ jurisdiction under the HC or SC.

Mutual Agreement Procedure (MAP)

MAP is a process of negotiation and consultation empowered under the DTAA, entered between two countries to resolve issues relating to taxability of cross-border transactions, interpretation of application of the DTAA and elimination of double taxation not provided in it. The resolution is binding on tax authorities, subject to taxpayers' acceptance.

Advance Pricing Agreement (APA)

The APA involves determination of arm's-length pricing by discussions within the APA team. It involves sharing of detailed information on assessees' Functional, Asset and Risk (FAR) profiles for decisions on covered transactions and other pertinent matters. It is a new process. Therefore, the revenue authorities' approach to such discussions and site visits is much more pragmatic and more open than what is normally the case in a transfer pricing audit.

International assignments in India

There is no distinct tax regime for foreign nationals working in India. Taxation of foreign individuals residing in India depends on their residential status for the relevant tax year, which in turn depends on the number of days they were physically present in the country. In India, a financial year (the tax year) extends from April 1 of any year to March 31 of the following year.

Under domestic tax law, individuals are considered to be tax residents in India if either of the following conditions are satisfied:

- They have been present in India for a period of 182 days (or more) in the relevant financial year (also referred to as the '182 days rule').
- They have been present in India for 60 days (or more) during the relevant tax year, and for 365 days or more in the preceding four financial years (also referred to as the '60 days rule').

However, only the 182 days rule will be applicable in a situation where a citizen of India leaves the country as a member of the crew of an Indian ship or for the purpose of employment outside India, or is an Indian citizen or person of Indian origin living outside India and on a visit to the country.

If individuals satisfy neither of the conditions above, they qualify as non-residents (NRs) for the particular financial year.

Resident individuals are treated as residents but not ordinarily residents (RNOR) of India, if they satisfy any one of the following conditions:

- They are NRs for 9 of the 10 financial years preceding the relevant financial year.
- They were physically present in India for 729 days (or less) during the seven financial years preceding the relevant financial year.

If individuals do not satisfy both the conditions listed above, they qualify as residents and ordinarily resident (ROR) for that specific financial year.

In determining the physical presence of individuals in India, it is not essential that their stay in the country needs to be continuous or at the same place. Furthermore, the date of their arrival and that of their departure are both considered as days spent in India in order to determine their duration of stay in the country. If individuals qualify as tax residents of India as well as of their home countries, the conditions prescribed under the tiebreaker test of the relevant DTAA need to be referred to determine their tax residential status.

Scope of taxation

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

- ROR: Global income of individuals is liable to tax in India for the relevant tax year.
- RNOR: Income received in India; accruing, arising or deemed to accrue or arise in India; derived from business controlled from India or from profession set up in India is liable to tax in India.
- NR: Income received in India, or accruing, arising or deemed to accrue or arise in India is liable to tax in the country.

Taxation of employment income

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

Taxable income includes all kinds of payment received, either in cash or kind, from the office of employment. Apart from sources such as fees, bonuses and commissions, some of the most common remuneration items include allowances, reimbursement of personal expenses, education payments and perquisites or benefits provided by employers, either free of cost or at concessional rates. All such payments are to be included, whether paid directly to employees or by employers on the former's behalf.

Housing benefits provided by employers are generally taxed at 15% of their salaries or actual rent paid for accommodation, whichever is less. Hotel accommodation is taxable at 24% of salary or the actual amount paid, whichever is less. Cost of meals and laundry expenses are fully taxable.

The value of any specified security, or sweat equity shares allotted or transferred directly or indirectly by employers or former employers, free of cost or at a concessional rate, and the contribution of employers to an approved superannuation fund, if this exceeds INR100,000, are taxable as perquisites in the hands of employees. Car and driver facilities provided by employers are also taxable as perquisites at a concessional value.

There are several issues relating to taxation of employment income, which depend 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 a remuneration package as a whole, in order to minimise tax incidence in India.

Withholding Tax

With respect to employment income, employers are required to withhold tax on earnings from employees' salaries at applicable rates, and give this to the Government's treasury within seven days from the end of the month during which the salaries are paid (except for March when the timeline is extended up to 30 April). This is applicable even if employers are not resident in India.

Double taxation agreements

In situations where individuals are treated as tax residents of other countries, they may qualify for relief under Indian Tax law (under the double taxation agreement signed between the countries and India). For most agreements currently in force, various tests are conducted to determine the actual residential status of individuals.

Many agreements contain clauses that exempt residents of specific countries from tax on employment income earned in India, if they have been residing in the country for less than 183 days in the given tax year, and if other conditions regarding salary chargeback and payment of salaries by NRs, etc., are satisfied (short-stay exemption).

However, to avail of the benefits of a treaty, individuals are required to obtain a TRC from their home countries' tax authorities, certifying that they are tax residents of the countries. 'Short stay exemption' can be availed under the domestic tax law by foreign nationals from countries with which India does not have a treaty in force, provided their stay in India during that particular tax year does not exceed 90 days and they meet certain other conditions.

Tax rates

Taxes are levied at progressive rates in India. Rates applicable for FY 2016–17 are as follows:

Taxable income over (INR)	Not over (INR)	Tax on income in column 1 (INR)	Rate of tax on excess (%)
0	2,50,000	–	0%
2,50,001	5,00,000	–	10%
5,00,001	10,00,000	25,000	20%
10,00,001	–	1,25,000	30%

Resident senior citizens aged 60 years or more, earning incomes of up to INR 3, 00,000 do not need to pay Income Tax. For senior citizens aged 80 years and above, the basic exemption limit is INR 5, 00,000.

A tax rebate of up to INR 5,000 is provided to resident individuals earning incomes between INR 2, 50,000 and INR 5, 00,000. Furthermore, a surcharge of 15% of tax is to be levied where the total income of individuals exceeds INR 10 million. In addition to these conditions, an education cess, at the rate of 3% of the tax and surcharge (if applicable), is levied to determine the final tax liability.

Tax registration

Individuals need to apply for and obtain their tax registration number, known as a Permanent Account Number (PAN. PAN is required to file tax returns and needs to be reported in tax withholding returns or withholding certificates issued to individuals.

Tax returns filing

At the end of every financial or tax year, a tax return needs to be filed in the prescribed format with the Income Tax authorities. The due date for filing returns is 31 July of the year immediately following the relevant tax year. However, as per the Finance Act, 2016, a belated return can be filed before the end of the relevant assessment year or before the completion of assessment, whichever is earlier. Also, now a belated return can also be revised. It is mandatory to file the return electronically if the total income exceeds INR5, 00,000 or where an individual qualifies as an ROR and owns foreign assets or has signing authority for any of his/her accounts located outside India. Wealth Tax, which was earlier levied on individuals' taxable wealth, is not applicable from tax year 2015–16.

There are detailed disclosure-related requirements in the return form for RORs in relation to their foreign accounts and assets. Non-disclosure or inaccurate disclosure can result in severe penalties, including prosecution under the Black Money Act (introduced on 1 July 2015).

Other matters

Visa

Foreign nationals wanting to come to India must have valid passports and visas. Visas are issued by Indian Consulates or High Commissions in their home countries, depending on the purpose and duration of their visit. Foreign nationals are not permitted to take up employment in India, unless they hold valid employment visas. An employment visa is issued to highly skilled individuals or professionals, provided they earn a salary exceeding the prescribed limit. Such a visa is generally issued for a period of one to two years and can be subsequently extended in India. Foreign nationals coming to India to attend business meetings or set up JVs require business visas. A business visa cannot be converted into an employment visa in India.

Registration with Foreigners' Regional Registration Officers

Foreign nationals visiting India, who either have valid employment visas or intend to reside in the country for more than 180 days, must register themselves with Foreigners' Regional Registration Officers (FRROs) within 14 days of their arrival in India. FRRO issue residential permits to such foreign nationals on their submitting the prescribed documents.

Payment of salaries outside India

Current exchange control regulations permit foreign nationals, who are employees of foreign companies and are on secondment or deputation to their offices/branches/ subsidiaries/JVs/group companies in India, to open, hold and maintain foreign currency accounts with banks outside the country. The foreign companies can remit the salaries of such employees (for services rendered in India) to their bank accounts in their countries, provided they have paid tax on their entire salaries in India.

Social security in India

In October 2008, the Government made it mandatory for foreign nationals who qualify as 'international workers' (IWs) to comply with social security norms. Foreign nationals qualify as IWs if they come to India to work for an establishment in the country to which Indian social security regulations apply.

International workers from countries with which India has entered a reciprocal social security agreement (SSA) are exempted from application of Indian social security regulations if they meet the following criteria:

- They contribute to social security in their home countries, either as citizens or residents.
- They qualify for the status of 'detached workers' for the given period, in accordance with the terms specified in the relevant SSA, and they have obtained a Certificate of Coverage from social security authorities in their home countries.

Similarly, IWs from countries with which India has entered into a bilateral comprehensive economic agreement (CECA) prior to 1 October 2008 are exempted from Indian social security regulations if they meet the following criteria:

- They are contributing to their home countries' social security system, either as citizens or residents.
- The CECA specifically exempts natural persons of the contracting countries from contributing to the social security system in India.

Singapore is the only country with which India had signed a CECA before 1 October 2008. It has signed SSAs with 18 countries. However, so far, only SSAs signed with Belgium, Germany, Switzerland, Luxembourg, the Netherlands, Denmark, Korea, France, Hungary, Finland, Sweden, the Czech Republic, Norway and Australia have been notified and made operational.

All international workers are required to contribute 12% of their salaries, comprising basic wages, dearness allowance, retaining allowance (but excluding components such as bonus and house rent allowance) to their Provident Fund accounts in India. Employers need to make a matching contribution (12% of salary) and deposit both employer's as well as the employee's contributions with the Indian social security authorities by the 15th 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 IW's Pension Fund, and the balance is deposited in the person's Provident Fund account. However, no such allocation towards the Pension Fund is required where an international worker has joined a covered establishment in India on or after 1 September 2014 and is drawing a salary of more than INR15,000 per month. In this case, the employer's entire contribution (12% of salary) is deposited in the Provident Fund account of the IW.

IWs can withdraw the accumulated balance in their Provident Fund account in the following circumstances:

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

When international workers come from SSA countries, withdrawal from their Provident Fund accounts is payable in their bank accounts. In all other cases, the amount withdrawn is to be credited to their Indian bank accounts. Amendments have been made in India's regulatory framework to permit IWs to open Indian bank accounts to transfer funds to these from their Provident Fund accounts. To simplify the process of withdrawal, an option is also available wherein IWs from SSA countries can provide details of their overseas bank accounts in which they wish to receive their Provident Funds (PF) funds. The PF authorities, after completing the necessary formalities and documentation, can then facilitate payment to the overseas bank accounts.

The accumulated sum in Pension Funds is paid as pension to employees on retirement, or in certain circumstances, as specified in the Pension Scheme. International workers are not entitled to pension benefits from the Pension Fund unless they have rendered eligible service for a period of 10 years with the covered establishment in India. However, the option of early withdrawal of pension contributions before completing 10 years of service is available to international workers from SSA countries.

Secondment structures need to be duly supported with appropriate and robust documentation, and reviewed, keeping in view the following considerations:

- Exchange control regulations
- Corporate Tax-related implications (exposure to permanent establishment)
- Withholding Tax
- Transfer Pricing regulations
- Service Tax-related implications
- Companies Act
- Indian social security regulations

Black Money Act

The Black Money (Undisclosed Income and Foreign Assets) and Imposition of Tax Act, 2015 (the Black Money Taxation Act) was enacted on May 26, 2015, and made effective from 1 July 2015. This Act covers all persons who are residents in India, in accordance with the provisions of the Income Tax Act, 1961. However, those qualifying as RNOR in India are excluded from the ambit of this Act. Any undisclosed foreign income/assets detected are to be taxed at 30% under this new law. In addition, there is a provision for penalty of 300% of tax and imprisonment of up to 10 years. Non-disclosure or inaccurate disclosure will attract a penalty of INR1 million and may attract imprisonment of up to seven years.

Income Declaration Scheme, 2016

The Income Declaration Scheme, 2016, has been introduced as Chapter IX of the Finance Act, 2016. It is an opportunity provided to persons who have not fully paid their taxes in the past to come forward and declare their undisclosed income and pay tax. There is a 45% tax, surcharge and penalty (in total) levied on such undisclosed income declared. The scheme is available for a limited period starting 1 June 2016 and extends to September 30, 2016. Applicable tax and penalty are to be paid on or before November 30, 2016.

Indirect taxes

India follows a federal structure under which the authority to impose taxes has been distributed between the Central and state governments. The Centre levies taxes such as Customs, Excise, Service and Central Sales Tax, while the states levy Value Added Tax, Entry Tax, Octroi, Entertainment Tax, and so forth.

Although the present Indirect Tax regime in India is beset with many flaws such as tax cascading, multiple tax authorities at the state and central levels, disputes, etc., this scenario is expected to be shortly replaced with the implementation of the single integrated Goods and Services Tax (GST).

Current Indirect Tax regime

Customs Duty

Customs Duty is levied by the Central Government on goods imported into and exported from India, although the number of exported goods on which this duty is levied is limited. The rate at which it is levied on a product to be imported or exported depends on its classification under the Customs Tariff Act, 1975 (CTA).

Customs Duty in India is aligned up to 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 imported or exported goods. India is a signatory to the World Trade Organisation's (WTO's) agreement on customs valuation and conforms with its regulations relating to valuation of goods. The Central Government has implemented independent valuation rules that are applicable on export and import of goods. Normally, Customs Duty is payable on the transaction value of goods (based on the price at which they are imported), and the imports of related parties are typically subjected to the scrutiny of the Special Valuation branch of the Customs department, to ascertain whether such transactions have been undertaken on an arms-length basis.

India does not have a single uniform element in the Customs Duty levied, and the tax applicable to any product includes a number of components. The following are the different types of Customs Duty levied:

- **Basic Customs Duty (BCD):** BCD is the basic component of Customs Duty levied at the effective rate notified under the First Schedule of the CTA and applied to the landed value of goods (i.e., the cost, insurance and freight (CIF) and the value of the goods plus landing charges at 1%).

  The BCD peak rate is currently set at 10% for all goods other than agricultural and some other specified products. However, the Government has the power to exempt specific goods, wholly or in part, from levy of Customs Duty. In addition, preferential or concessional rates of duty are levied under various bilateral and multilateral trade agreements India has entered with other countries.
- **Additional Customs Duty (ACD) levied in lieu of Excise Duty:** ACD is equivalent to and is charged in lieu of Excise Duty, and is applicable on goods manufactured in India. It is calculated on the landed value of goods and the applicable BCD. However, ACD on specific consumer goods intended for retail sale is calculated on the basis of the maximum retail price (MRP) printed on the packs, after allowing specified abatements. The general rate of Excise Duty levied is currently 12.5%, and consequently, so is the ACD rate. Education Cess (EC) at 2% and secondary and higher education cess (SHEC) at 1% are also levied along with aggregate Customs Duties.
- A special additional Customs Duty (SAD) is charged at 4% in addition to taxes levied on the imports mentioned above, with some exceptions. SSAD is calculated on the aggregate of the assessable value of imported goods, the total Customs Duty (i.e., BCD and ACD) and the applicable EC and SHEC levied.

The general Customs Duty rate, i.e., the aggregate of BCD, ACD, cesses and SAD, is 29.44%.

BCD, EC and SHEC levied as aggregate Customs Duty constitute a cost in any import transaction. The incidence of duty arising on account of all other components can be set off or refunded, subject to prescribed conditions. Where goods are imported for manufacturing, Indian manufacturers can take credit for the ACD and SAD they have paid at the time they imported the goods to set off such credit against Output Excise Duty. In the case of service providers, ACD credit is available to service providers to set it off against Output Service Tax. However, SAD is a cost for a service provider.

The Central Government has exempted specific consumer goods imported for retail in India from levy of SAD, if they fulfil certain conditions. Similarly, the Government allows a refund for SAD paid on specified goods imported for trading in India, subject to fulfilment of the conditions prescribed under governing notifications and circulars issued in this regard.

Individuals intending to import or export goods into or from India, respectively, are required to obtain an Importer-Exporter Code.

CENVAT (Excise Duty)

Central Value Added Tax (CENVAT), commonly referred to as Excise Duty, is levied by the Central Government on manufacture or production of movable and marketable goods in India.

The CENVAT rate depends on classification of goods under the excise tariff, which is primarily based on the HSN classification adopted to conform with the customs tariff. The standard rate of Excise Duty levied on non-petroleum products is 12.5%.

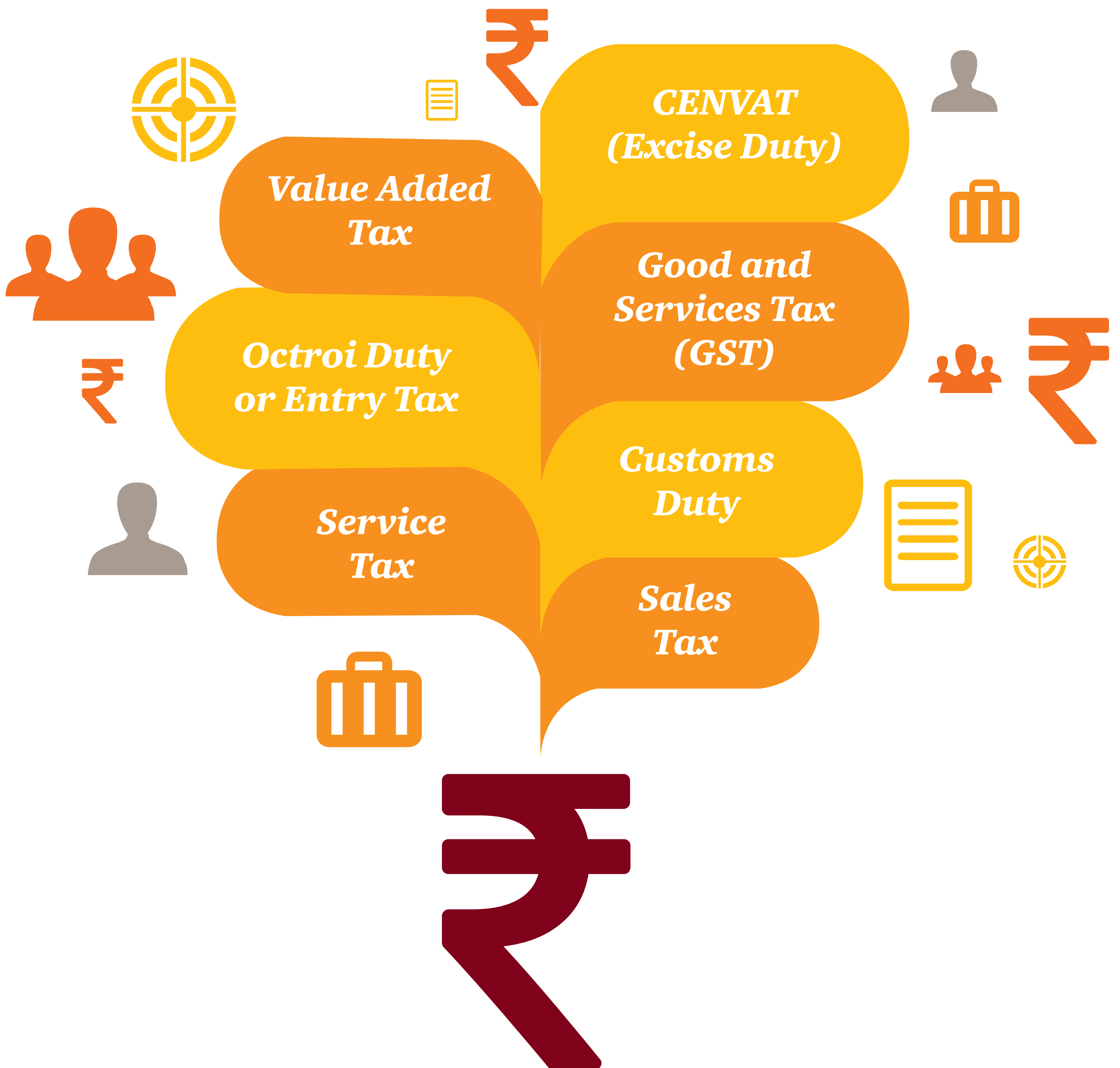
Excise Duty on most consumer goods intended for retail is levied on the basis of the MRP printed on their packaging. However, abatements are admissible at rates ranging from 15% to 55% of the MRP.

Goods other than those covered by an MRP-based assessment are generally taxed on the transaction value at which they are sold to independent buyers. In addition, the Central Government has fixed tariff values for specified goods.

Excise Duty is levied as a pass-through tax, with the complete set-off of input tax credits available for computing and discharging tax liabilities on the output. Credit of Input Tax includes Excise Duty on indigenously sourced input and capital goods, the ACD and SAD portion of Customs Duty on imported material and Service Tax on input services (with some exceptions specified under CENVAT credit rules).

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

Entities manufacturing goods that are subject to Excise Duty are required to obtain Excise registration and undertake related compliance measures (such as filing of periodical returns).



Service Tax

Service Tax was first introduced in India on a limited number of services in 1994. Since then, the list has expanded on a yearly basis. Keeping in view the large number of service categories and resultant classification-related issues faced, a new concept was introduced in Service Tax, based on a negative list of services, in 2012. Under this system, all services are taxable, except for those included in the negative list or those that are specifically exempt from tax.

Normally, service providers are liable to pay Service Tax. However, for some specified services, such as transport of goods by road, sponsorship and import of services, obligation to pay Service Tax rests with those who receive the services. In certain cases, this obligation has been divided between the receiver and the provider in a specified proportion.

Currently, the rate of Service Tax levied on the taxable value charged for services is 14%. In addition to Service Tax, taxable services also attract other specified cesses.

The Government has recently introduced the following cesses, which are levied on the value charged for all taxable services:

- *Swachh Bharat* cess at 0.5% on the value of services — applicable from November 15, 2015
- *Krishi Kalyan* cess at 0.5% on the value of services — applicable from June 1, 2016

The effective rate of Service Tax (including the cesses mentioned above) is 14.5% (from November 15, 2015 to May 31, 2016) and 15% (from June 1, 2016).

Like Excise Duty, Service Tax is also a 'pure pass through' tax, and since these are both federal levies, cross-input tax credit has been allowed. Input Tax credit under Service Tax has been integrated under CENVAT credit rules, and benefits available to manufacturers have been extended to service providers.

Under CENVAT credit rules, credit of the Swachh Bharat cess is not available for utilisation against output Swachh Bharat cess/Service Tax liability. It is therefore a tax cost. Credit of the Krishi Kalyan cess is available for utilisation against the output Krishi Kalyan cess liability. Therefore, it should not be a cost for a service provider. However, this cess is a cost for manufacturers and/or a traders.

The valuation methodology adopted for Service Tax is based on the gross value charged by providers. In certain circumstances, the value is derived from specified valuation rules.

Service Tax is consumption-based. Sometimes, the peculiar nature of services makes it difficult to determine the origin and place where they are consumed or the time when they are provided and completed. However, this aspect of Service Tax has progressed significantly in India recently. The introduction of Point of Taxation Rules, 2011, Place of Provision of Services Rules, 2012, and delineation of taxable or non-taxable territory under the negative list-based service taxation regime has made it easier to determine the time and place at which services are provided and completed.

In addition to the negative list of services, there are certain services such as education, infrastructure projects including development of roads and bridges, healthcare and sponsorship of specified sports events, which are exempt from levy of Service Tax. There are also abatement schemes for valuation of specific services including transportation, financial leasing, renting, etc., and the rate of abatement varies from 10% to 70% of their taxable value. Export of services is completely tax-neutral, and benefits such as refund of input tax credits and rebate of tax payments are also available.

Individuals/Entities liable to pay Service Tax are required to obtain a Service Tax registration number and undertake related compliance measures (such as filing periodical Service Tax returns). The Service Tax registration number can be obtained through a simple online procedure prescribed for service providers and receivers. Those providing services from multiple locations within India have been given the option of registering all their locations under a centralised registration number or registering the locations separately under different registration numbers.

Sales Tax

Sale of movable goods is taxable at the federal or state level in India. The country's regulatory framework empowers states to levy tax on goods sold within them. However, all goods sold in the course of inter-state trade are subject to Central Sales Tax (CST). Import of goods into India does not attract CST.

CST is levied at the applicable rate on goods under the VAT law of the originating state. When such goods are bought and sold by registered dealers for trading or for use as input in manufacture of other goods or specified activities (such as mining or telecommunications networks), the CST rate levied is 2%, provided an appropriate declaration form (Form C in this case) is issued by the purchaser to the seller.

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

Value Added Tax

State-level Sales Tax was replaced by Value Added Tax (VAT) with effect from April 1, 2005 in most Indian states. VAT is levied on sale of goods within a state. At present, all the states have transitioned to the VAT regime, under which VAT paid on goods purchased within the state is eligible for VAT credit. Input VAT credit can be utilised against VAT or CST payable on sale of goods. This restricts the cascading effect of taxes and ensures that only value addition is taxed.

Currently, there is no VAT levied on goods imported into India. Exports are zero-rated, i.e., while they are not charged to VAT, exporters can claim refund of VAT paid on input used in manufacture of goods to be exported.

Regarding the importance of commodities when they are traded in a state, varying tariff rates are assigned to different goods. General tariff rates prevalent in a state's VAT laws can vary from 1% to 20%. Apart from this, all goods that are not covered under any tariff rates are to be charged on the basis of the residual rate, which may vary from 12.5% to 15.5%.

Turnover thresholds have been prescribed to keep small traders out of the ambit of VAT. They can also opt to pay tax under composition schemes at a lower rate compared to the general applicable VAT rate.

Octroi Duty or Entry Tax

Entry Tax is charged on entry of specified goods into a state or areas in the state where they are used or sold. Levy of Entry Tax continues under the VAT regime, although in certain states it has been included in VAT and can be set off against the output VAT liability in the state.

Entry Tax is generally levied on the purchase value, i.e., the amount payable on purchase of goods. The value of specified goods can be ascertained from the original invoices for their purchase. If this value cannot be ascertained from an invoice, Entry Tax may need to be paid on the wholesale cash price determined by an authorised officer.

Octroi is a municipal tax, levied when specified goods enter the limits of a municipal corporation. Thus, it can be levied if goods are moved from one city to another in the same state if the cities come under different municipal jurisdictions.

Goods and Services Tax (GST)

In 2006, the Central Government took a major step towards putting in place a national, integrated GST. Its implementation will be a historic reform in the country, since it will subsume ACD, Excise Duty, SAD, Service Tax, cesses relating to goods and services, CST, state VAT and other state levies. At present, a dual GST model is envisaged, under which Central GST and State GST will be levied on intra-state supply of goods and services while an Integrated GST will be levied on inter-state supplies. It is expected that the tax rate will be uniform in all states with a common peak rate for goods and services. Furthermore, tax revenue under GST will accrue to the consumption/destination state unlike in the present, where this revenue goes to the supplying state.

Under the proposed model, a central and a state GST will be levied on the taxable value of transactions involving supply of goods and services. The Centre and the states will both legislate, levy and administer their respective GST regimes.

Once it is fully in place, GST is expected to create a single, unified Indian market and peel away the multiple layers of indirect taxation currently prevailing in the country. GST, which is also seen as a reform in administration of indirect taxation, will definitely be favourable for trade.

Proposed introduction of GST in India

The Bill for the amendment of the Constitution of India has been passed by the Parliament as a pre-cursor to the introduction of GST, to e enable the Centre and the states to levy tax on both supply of goods and services. The amendment is pending for ratification by 50% of the states and the President's assent, which is expected to come through within September 2016.

Once the Bill receives the President's assent, the Central Government and the state governments will be required to pass their respective GST laws.

Furthermore, the GST Council will be formed (chaired by the Union Finance Minister and comprising the Finance Ministers of all the states), and will be the key decision-making body under GST. The GST Council will have the power to decide the rate of GST to be levied, exemptions, etc.

The Central Government has issued a road map in which it has reiterated its intent to implement GST from 1 April 2017. It will be interesting to see whether it is able to meet its targeted date of implementation.

The Government of India has also recently released the Model GST Law in the public domain to seek comments from various stakeholders. This law provides an insight into the kind of legislation we can expect. However, clarity is still awaited on several essential aspects (including tax rates).

Stamp Duty

Stamp Duty is levied by the Government 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 Development Cess of 5% is levied on all payment made to import technology under foreign collaborations. The term 'technology' includes import of designs, drawings and publications, as well as the services of technical personnel. Research and Development Cess is levied by the Central Government

Mergers and Acquisitions (M&A)

Indian M&A framework

India's regulatory framework facilitates acquisitions or hive-offs through several legal modes, each different in its tax outgo parameters and regulatory ease of carrying out deals. Common modes of executing transactions include:

- Share purchase
- Business purchase through purchase of assets (itemised sale) or of an entire business undertaking as a going concern (slump sale)
- Amalgamations and demergers

Transactions through share transfer

Implications for sellers

Transfer of shares in Indian companies is taxable as capital gains and is provided benefits under DTAA. Taxability also depends on whether these shares are listed or unlisted.

Listed shares

- Long-term capital gains (LTCGs), i.e. gains from shares held for more than 12 months (in the case of listed securities), are exempt from tax if the sale is conducted on a recognised stock exchange in India. If the transaction is conducted outside the stock exchange, resident sellers' gains are taxed at 10%* (without indexation benefits) or 20%* (with indexation benefits), whichever is more beneficial to them. In the case of non-resident sellers, LTCG is taxed at 10% (without indexation benefits).
- Short-term capital gains (STCGs) are taxed at 15%* if the sale is conducted on a recognised stock exchange in India. If it is not, the transaction is taxable, just as in the case of unlisted shares.

Unlisted shares

- In the case of non-residents, LTCG is taxed at 10%*(without indexation benefits) on the sale of the unlisted shares of companies (including private companies), as proposed in the Finance Bill, 2016. In the case of residents, LTCG is taxed at 20%* (with indexation benefits).
- Unlisted shares need to be held for more than 24 months for them to qualify as long-term capital assets.
- STCG is taxed at 40%* for non-resident companies and 30%* for resident companies.

Indirect transfer of shares

Transfer of underlying assets in India (including the shares of an Indian company) due to transfer of the shares of a foreign company is taxable if the shares of the latter derive their value substantially from assets located in India.

It will be presumed that the shares of a foreign company derive their value substantially from assets located in India if the FMV of such assets (without reduction of liabilities) (a) exceeds INR10 crore and (b) if it represents at least 50% of the value of all the assets owned by the foreign company.

Capital gains chargeable to tax in India will be proportional to the value of the foreign company's assets located in India.

Minority shareholders holding a 5% stake (or less) in a foreign company, without control or management rights in it, are provided relief on their exit from the company, which derives a substantial part of its value from assets located in India.

This provision may impose tax liability in India on global deals with substantial underlying Indian assets.

Implications for buyers

Acquisition of the shares of a listed company requires the buyer to be compliant with the Takeover Code. An open offer needs to be made to acquire 25% or more voting power in a listed company or to acquire control of it.

The transfer of shares document is subject to stamp duty at 0.25% of the value of the shares transferred. But no stamp duty is payable if such shares are held in electronic form.

Funding costs in the form of interest charged on a loan for acquiring shares may not be tax-deductible, since the corresponding dividend income will be exempt from tax in the hands of shareholders.

If a corporate buyer receives the shares of a closely held company at less than the tax FMV determined according to the prescribed methodology, the difference between the FMV and sale consideration of such shares is taxable in the hands of the buyer at the applicable Corporate Tax rate.

Withholding tax

Buyers (including non-residents) are required to withhold taxes resulting from capital gains in the hands of non-resident sellers. Therefore, buyers need to obtain tax registration numbers in India.

Parties can seek clarity on withholding tax aspects by obtaining prior clearance from the Tax authorities.

Preservation and carry-forward of tax losses

There is no tax-related impact on a listed company carrying forward tax losses as a result of a change in its shareholding. A non-listed company is entitled to carry forward and set off its previous years' business losses if at least 51% of its shares are beneficially held by the same shareholders who beneficially held at least 51% shares when it incurred losses.

A change in shareholding has no impact on the carrying forward of an unabsorbed depreciation allowance, irrespective of an Indian company's status.

Valuation of shares

The RBI regulates the pricing of every share-related transaction between the resident and non-resident shareholders of an Indian company. It has standardised the valuation methodology, so that the parties can value the shares according to internationally accepted methodologies.

Business or asset purchase model

In India, businesses can be acquired through (a) the asset purchase model when the buyer can cherry-pick the assets it wants, and leave the liabilities and other assets behind in the seller entity or (b) the business purchase model when the buyer acquires an entire business undertaking, with all its assets and liabilities, for a lump sum consideration on a going-concern basis.

Asset purchase model

Implications for the seller:

- Gains are computed for every asset and these is taxable as STCG or LTCG, depending on the period during which the assets are held. Sale of depreciable assets always results in STCGs.
- Capital gains are determined by reducing the acquisition cost of assets from the sale consideration. In the case of LTCGs, the acquisition cost is indexed, based on the cost inflation index, which is notified by the Tax authorities every financial year.

- The seller is liable to charge VAT or Sales Tax on the transfer of movable property at specified rates.
- There is no cost of acquisition of self-generated intangible assets, such as goodwill, for calculating capital gains.
- If a purchase involves transfer of immovable property, the sale consideration is benchmarked at the minimum value determined by the stamp valuation authorities on the date of the agreement, fixing the amount of sales consideration solely to calculate Capital Gains Tax.

Implications for the buyer:

- Buyers are liable to pay stamp duty on the transfer of immovable property at the rate applicable in the state in which the property is situated.
- They are liable for stamp duty on movable property. However, this is generally minimised through novation, physical delivery or an invoice.
- They are eligible to claim depreciation on the purchase consideration of an asset.

Business purchase model

Implications for the seller:

- Capital gains are determined by reducing the net worth of the business undertaking from the sales consideration, which shall be determined in a prescribed manner.
- Capital gains are taxable as LTCGs if the business undertaking is held for more than three years. No indexation benefit is available for a slump sale.
- Taxable at 20%* if long term, or taxable at 30%* if short term
- Business transfers are typically not subject to VAT or sales tax

Implications for the buyer:

- In a slump sale, a lump sum purchase consideration is allocated by the buyer to various assets, based on a valuation report, and hence, purchase of assets such as buildings, plants and specified intangible assets (for use in business) is entitled to an increased depreciation allowance.

Funding costs

Interest on loans taken for acquisition of assets or business undertakings through slump sales is generally tax-deductible and subject to certain prescribed rules.

Amalgamations and demergers

In some situations, an acquired entity can be integrated into the buyer's group through an amalgamation or a demerger. While there are variants of this procedure, it involves a court process. An amalgamation or demerger can be conditionally tax-neutral.

Amalgamation (merger)

This refers to the merger of one or more companies into another through a court/tribunal process.

Conditions for claiming tax exemption:

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

Demerger

This refers to transfer or division of a company's undertaking (or one of its parts) to another company through a court/ tribunal process.

Conditions for tax exemption:

- All the assets and liabilities of the transferor's business undertaking should be transferred to the resulting company at its book values.
- Transfer of the business undertaking should be on a going-concern basis.
- Consideration for a demerger settled by issuing shares to shareholders of the demerged company should be proportionate to their current shareholding.
- Shareholders holding at least 75% of shares (in value) in a demerged company should become shareholders in the resulting company.

Carrying forward of accumulated loss and unabsorbed depreciation

Amalgamation

The accumulated losses or unabsorbed depreciation of an amalgamating company running an industrial undertaking will be carried forward by the amalgamated company. Specified conditions, e.g. continuance of business and holding of assets, are laid down for this.

Demergers

Accumulated losses or unabsorbed depreciation directly related to the undertaking being demerged is transferable for the unexpired period. Proportionate common losses are also transferable.

Other matters

Amalgamations and demergers normally attract stamp duty at varying rates prescribed in state laws. Clearance is needed from stock exchanges, High Courts and other regulatory bodies. A more robust process has now been notified for obtaining approval from stock exchanges and the SEBI, but this can be time-consuming, and lead to delays during tight schedules.

Transfer Pricing (TP)

The separate code for TP under sections 92 to 92F of the Indian Income-tax Act, 1961 (the Act), covers intra-group transactions, and has been applicable since 1 April 2001. The intent of TP provisions is to avoid profits being shifted from India to offshore jurisdictions. Since the introduction of the code, TP has become an important international tax issue affecting multinational enterprises operating in India. Broadly based on the Organisation for Economic Cooperation and Development Transfer Pricing guidelines for MNEs (OECD's guidelines), these regulations describe various TP methodologies and mandate extensive requirements for annual documentation of TP.

TP legislation

India's TP code stipulates that the price of any international transaction between associated enterprises (AEs) should be computed in line with the arm's length principle. Effective FY 2012–13, TP provisions have been widened to include specified domestic transactions.

However, TP legislation is not applicable when computation of arm's length price (ALP) has the effect of reducing income chargeable to tax or increasing companies' losses in India. This is aligned with the Government's 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 restructuring or reorganisation transactions, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises. The Finance Act, 2012, broadened the definition of international transaction and included various classes of intangibles to be covered under it, with a view to clarifying the inclusion of certain transactions.

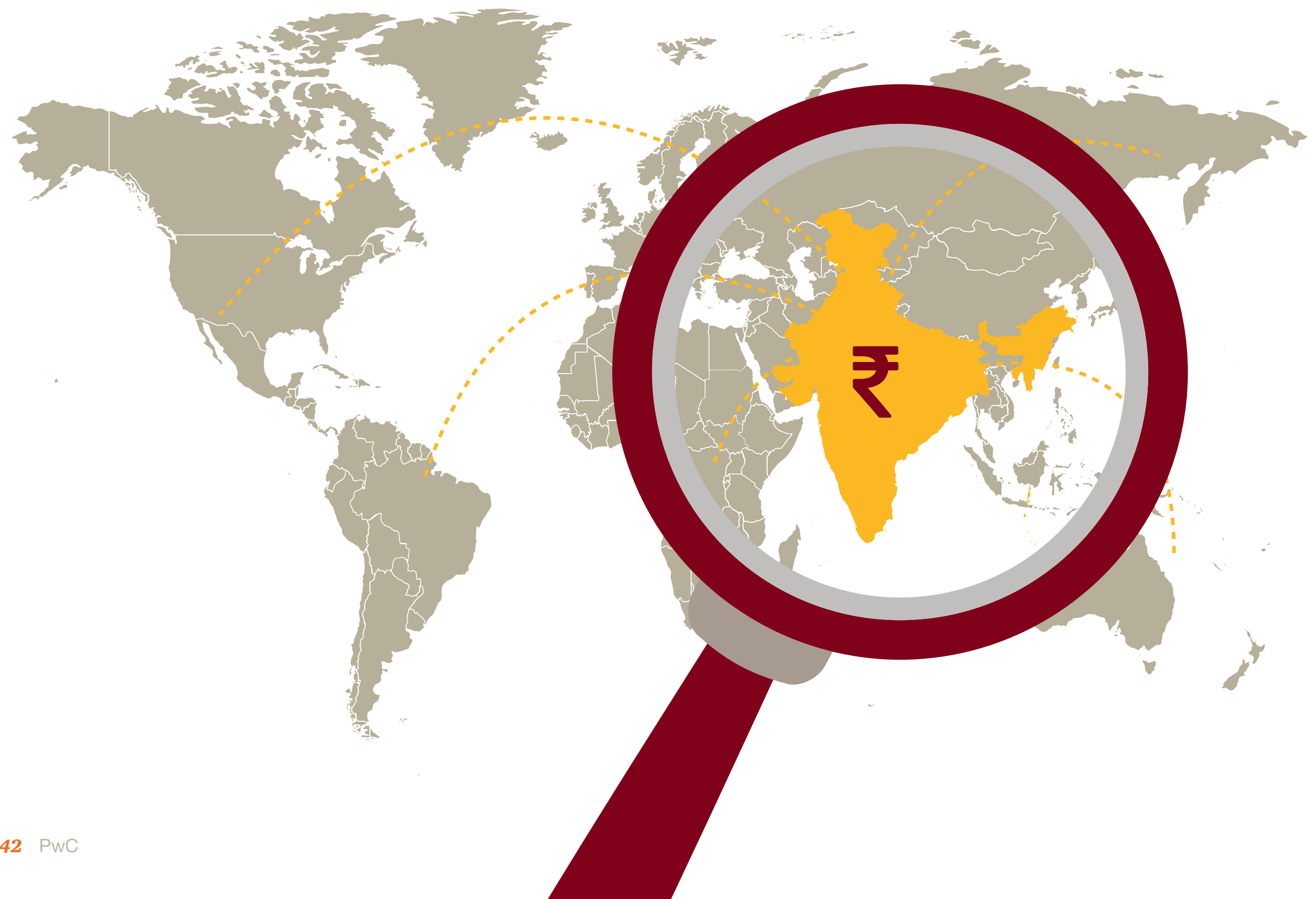
AEs can either be two NRs or a resident and a NR. The PE of a foreign enterprise in India also qualifies as an AE. Accordingly, transactions between a foreign enterprise and its Indian PE are included within the ambit of the code.

Associated Enterprises (AEs)

The relationship between 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 can be deemed as AEs in the following circumstances:

- An enterprise/person directly or indirectly holding 26% or more voting power in another enterprise, or the same enterprise/person holding voting power in both the enterprises



- A loan given by an enterprise, which constitutes 51% or more of the total book value of the assets of the borrowing enterprise
- Guarantee provided by an enterprise for 10% or more of the total borrowings of another 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 appointment of specified directors in both the enterprises by the same person
- An enterprise's dependence (in conducting its business) on intellectual property licensed to it by another enterprise
- Purchase of 90% or more of raw material required by an enterprise from another enterprise or any person specified by this 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 the other enterprise at prices and conditions influenced by the latter
- Existence of any prescribed relationship of mutual interest (none prescribed till date)

Furthermore, a transaction between an enterprise and a third party may be deemed to be between AEs if there is a prior agreement in relation to such transactions 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. From FY 2014–15, a third party does not necessarily need to be a non-resident.

Specified domestic transactions

From FY 2012–13, TP provisions have extended their scope to specified domestic transactions (SDTs). The following domestic transactions have been specified for this purpose:

- Payment to related parties
- Transactions of undertakings (enjoying a tax holiday) with other undertakings of a taxpayer or with entities with a 'close connection' with the taxpayer
- Any other transaction notified by CBDT

These provisions are only applicable if the aggregate value of a transaction exceeds INR50 million during the relevant year. The Finance Act, 2015, has increased this threshold limit to INR 200 million with effect from FY 2015–16.

Arm's-length principle and pricing methodologies

Most Appropriate Method (MAM)

The following methods have been prescribed for determination of ALP:

- Comparable Uncontrolled Price (CUP) method
- Resale Price Method (RPM)
- Cost Plus Method (CPM)
- Profit Split Method (PSM)
- Transactional Net Margin Method (TNMM)
- Other methods prescribed

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

Multiple-year data

From FY 2014–15, CBDT issued rules that permitted more liberal use of multiple-year data. Earlier, the rules only allowed data pertinent to the relevant FY and only permitted the use of three years' data where a taxpayer is able to establish that this data revealed facts that could influence determination of transfer prices.

The new rules allow taxpayers to use multiple-year data relating to comparables to determine ALP, subject to the following conditions:

- This is only applicable in cases where RPM, CPM or TNMM are the most appropriate methods for the taxpayer.
- Data pertaining to up to two preceding FYs may be used.
- Current year data of comparables, if available later at the time of audit, may be used.
- If a comparable is selected on the basis of data relating to the preceding year, but fails the quantitative and qualitative filter in the current year, such a comparable has to be rejected.
- The weighted average of multiple-year data is to be considered.

Range concept

India's TP regulations allow use of the arithmetical mean as a measure of ALP. A tolerance range benefit of (+/-) 3% is allowed for TP. Since FY 2014–15, this legislation has been amended to permit the use of range instead of the arithmetical mean concept. The CBDT has mandated detailed rules on the range concept, where the arm's length range is the data point lying between the 35th and 65th percentile of the data set. If the price of a transaction is within this range, it will be deemed to be at ALP. If it is outside the range, ALP will be taken as the median of the set. The concept of range is applicable when:

- The MAM is either CUP, RPM, CPM or TNMM.
- There are at least six comparables in the final set of comparables.

If the conditions given above are not fulfilled, the arithmetical mean continues to apply, along with the benefit of the tolerance range.

Safe harbour provisions

The CBDT notified the Safe Harbour (SH) Rules on 18 September 2013. These rules specify the circumstances under which tax authorities accept the ALP declared by a taxpayer, without detailed analysis, for up to a period of five years, although nominal compliance is still required. The intention behind the introduction of these rules is to reduce the scope for tax litigation in determination of the transfer prices of international transactions.

The table below provides a snapshot of SH Rules:

Eligible international transactions	Proposed SH
Software development services Information Technology-enabled Services (ITeS)	If the value of an annual transaction is: • up to INR 5 billion and operating mark-up of 20% or more • more than INR 5 billion and operating mark-up of 22% or more
Knowledge Process Outsourcing (KPO) services	Operating mark-up of 25% or more
Indian companies advancing intra-group loans to their wholly owned subsidiaries	The interest rate is equal to or greater than the base rate of the State Bank of India (SBI, as on June 30 of the relevant previous year: • 150 basis points where the loan does not exceed INR 500 million • 300 basis points where the loan exceeds INR 500 million
Provision of corporate guarantees by Indian companies to their wholly owned subsidiaries	The commission or fee is: • 2% per annum or more of the guaranteed amount if the amount guaranteed is up to INR 1 billion • 1.75% or more per annum of the guaranteed amount if the amount guaranteed exceeds INR 1 billion, provided the credit rating of the AE is adequately to highly safe
Contract research and development services	Software development: operating mark-up of 30% or more Generic pharmaceutical drugs: operating mark-up of 29% or more
Manufacture and export of auto components	Core auto components: operating mark-up of 12% or more Non-core auto components: operating mark-up of 8.5% or more

However, it is pertinent to note that the benefit of a tolerance band (+/– 3%) or range is not available to taxpayers opting for SH provisions. Furthermore, a taxpayer opting for SH rules will not be entitled to invoke Mutual Agreement Procedure (MAP) proceedings. Moreover, SH rules are not available for transactions with low tax jurisdictions.

Advance Pricing Agreements (APAs)

Provisions relating to APAs were introduced effective 1 July 2012.

An APA is an agreement between a taxpayer and the tax authorities for upfront determination of the ALP and pricing methodology (acceptable to the Revenue) of a related party transaction. Usually, taxpayers seek APA to determine the ALP of a transaction, thereby ascertaining their tax liability (from the transaction) and mitigating tax litigation at a later time.

The CBDT, with the approval of the Central Government, has been empowered to enter into an APA with any taxpayer undertaking international transactions, to determine the ALP or specify the manner in which it will be determined. The APA entered into will be binding on taxpayers and tax authorities with respect to transactions covered under the agreement, which will be valid for a period not exceeding five years.

The CBDT notified the Advance Pricing Agreement Scheme (Rules 10F to 10T of Income-tax Rules, 1962) on 30 August 2012. It covers detailed rules and procedures (including necessary forms) for the application and administration of APAs.

With effect from 1 October 2014, legislation has notified the provisions for roll-back of APAs for four years prior to the APA period, e.g. APAs applicable from FY 2016–2017 onwards may now be extended back to FY 2012–2013. Detailed rules regarding roll-back provisions and the procedure for giving effect to these were announced in March 2015. The CBDT has published FAQs clarifying the various areas where roll-back is allowed.

According to media reports, more than 650 APA applications were filed during the first four cycles of APA applications being filed, and around 60+ unilateral and 3 bilateral APAs were concluded between taxpayers and the CBDT till March 2016.

Risk-based audit

In March 2016, CBDT issued instructions to provide guidance on the selection of cases for TP audits. Prior to this instruction, any taxpayer with international transactions exceeding INR150 million was compulsorily selected for TP audit. Companies will now be selected for TP audit based on risk-based assessments.

The instructions enumerate the following instances when a case should be selected for TP audit:

- Cases selected on the basis of TP risk parameters: All cases selected for scrutiny on the basis of TP risk parameters need to be mandatorily referred to a Transfer Pricing Officer (TPO).
- Cases not selected on the basis of TP risk parameters: Cases that are not selected on the basis of TP risk parameters but relate to international transactions or SDT are to be referred to a TPO under the following circumstances:
  a) Where an AO comes to know that such transactions have been entered, but either Form 3CEB has not been filed or the transactions have not been disclosed in Form 3CEB
  b) When there has been TP adjustment of INR 100 million or more in any of the earlier years, and been upheld by the judicial authorities or is still under litigation
  c) Where search and seizure or survey operations have been carried out under the Act and findings relating to TP issues have been recorded
- Cases set aside by the courts: Cases involving TP adjustment in earlier assessment years that has been fully or partially set aside by the Income Tax Appellate Tribunal (ITAT), High Court or the Supreme Court for fresh adjudication by lower authorities will also have to be referred to a TPO.

Grievance Committee

The CBDT has issued instructions on the constitution of local committees (also known as grievance committees) to resolve taxpayers' grievances due to unreasonable additions and 'high-pitched' completed assessments within a period of two months from the end of the month when a grievance petition was filed. The objective of a grievance committee is to examine

Whether there has been:

- non-observance of the principles of natural justice
- non-application of mind
- gross negligence
- lack of involvement of the Assessment Officer
- an addition not based on sound reason or logic

If there was:

- misinterpretation of the provisions of the law
- ignorance of obvious and well-established facts

If there is:

- a prima-facie case of high-pitched completed assessment

The department's position, as determined by the Grievance Committee, will be presented before the Appellate Authorities and is likely to have persuasive value before them. However, the Grievance Committee is not an alternative or additional appellate channel.

The intent of the constitution of such a committee is to resolve taxpayers' grievances, which not only reflect harassment of taxpayers but also generate unproductive work for the Revenue and Appellate authorities.

Country-by-Country Reporting (CbCR)

The Finance Act, 2016, proposes to introduce a three-layered TP documentation process. Taxpayers will now be required to prepare a master file, a local file and CbCR. The contents of the master file are yet to be notified. A local file will need to be maintained in the same manner as in earlier years. The new regime will be effective from FY 2016–17 onwards.

However, CbCR will only be applicable for large groups with headquarters in India, i.e. those with an annual consolidated group turnover of over Euro 750 million in the immediately prior year. The due date for filing CbCR is the same as that for filing returns of income, and the first filing will need to be done by 30 November 2017.

In the case of Indian subsidiaries with parent companies resident outside India, CbCR will ordinarily be filed by the parents or designated entities in their home countries. Indian tax authorities will have access to CbCR through mutual exchange of information agreements with such countries, failing which the Indian subsidiaries will be required to furnish the reports.

Aligned with the OECD BEPS Action Plan 13, the CbCR will include the following information for each of the countries where a group operates:

- Revenue, profit/loss before tax, tax paid, tax accrued, stated capital and accumulated earnings
- Number of employees
- Tangible assets—not cash or equivalents
- Details of each group entity, including its main business activity
- Any other prescribed information

Stringent penalties have been proposed for non-compliance with the three-layered TP documentation.

Documentation- and report-related requirements

Taxpayers are required to maintain comprehensive information and documents relating to international transactions undertaken with AEs on an annual basis (local file). As mentioned above, TP provisions are applicable for specified domestic transactions. Therefore, taxpayers need to maintain updated prescribed documentation in respect of such transactions (effective FY 2012–13).

The code prescribes detailed information and documentation, which taxpayers will need to maintain to demonstrate that their prices comply with the ALP. All such information or documents should be contemporaneous and in place by the due date for filing returns of income (30 November following the close of the relevant tax year). Prescribed documents will have to be maintained for a period of eight years from the end of the relevant tax year, and will need to be updated annually on an ongoing basis.

Taxpayers with an aggregate value of international transactions below INR10 million are exempt from maintaining the prescribed documentation. However, even in such cases, it is imperative that documentation is adequate to substantiate the ALP of international transactions.

Documentation-related requirements are also applicable for foreign companies with income taxable in India.

Accountant's report

All taxpayers need to mandatorily obtain an independent accountant's report with respect to all international transactions between AEs. The reports are to be submitted by the due date of tax return filing (on or before 30 November for corporate entities engaged in international transactions). Effective FY 2012–13, SDTs also need to be reported in accountants' reports along with details of international transactions they have entered with AEs.

An accountant's report requires accountants to provide their opinion on whether taxpayers have maintained the prescribed documents and information. Additionally, accountants need to certify the 'correct' nature of an extensive list of prescribed particulars in Form 3 CEB. From FY 2012–13 onwards, accountants' reports need to be filed electronically.

Burden of proof

The burden of proving the arm's length nature of a transaction primarily lies with the taxpayer. Tax officers may readjust or recompute the price given in a transaction after giving the taxpayer the opportunity of being heard if during audit proceedings 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 a transaction or that the taxpayer did not maintain or produce adequate and valid documents, information or data.

Penalties

The following penalties have been prescribed for defaults in compliance with the provisions of the TP code:

Default	Nature of penalty
Failure to maintain documents Failure to report a transaction in an accountant's report Maintaining or submitting incorrect information or documents	2% of the value of the transaction
Failure to submit documents to the TPO at the time of audit	2% of the value of the transaction
Failure to submit Form 3 CEB by the due date	INR1,00,000
Failure to furnish master file	INR 5,00,000
Failure to furnish CbCR or further information in respect of CbCR	INR5,000-50,000 per day, depending on period of delay
Submission of inaccurate information on CbCR	INR 5,00,000
In the case of TP adjustment:	
Where TP documentation is maintained, transaction declared and material facts disclosed	No penalty
Where TP documentation is not maintained	50% of tax on TP adjustment
Where transaction is not declared or material facts not disclosed	200% of tax on TP adjustment

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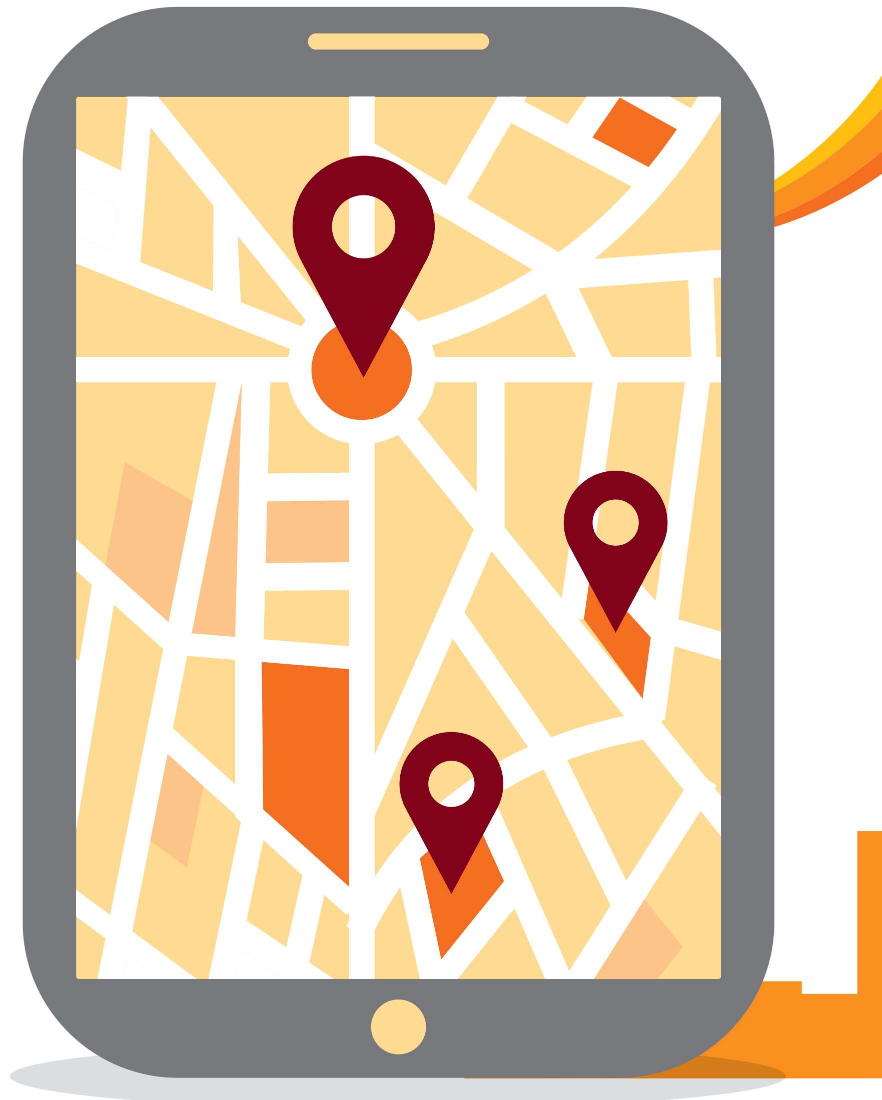

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