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# Destination India 2018

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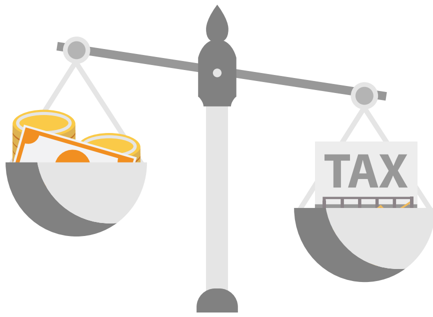
# Contents

# Introduction




## Has the elephant started to run ….?

After the apparent brakes demonetisation and introduction of the Goods & Services Tax (GST) applied on the growth rate in the country, recent reports issued by the International Monetary Fund (IMF)[1] suggest that India has stepped up the gas on its rate of development. Earlier in 2017, it overtook France to become the sixth largest economy in the world, measured in terms of GDP, and is expected to take over from the UK in 2018 to get onto the fifth position. This is particularly impressive considering the overall strain the global economy (except for the possible exception of the US), including China, is continuing to experience. If this upward trend continues, India's GDP is expected to touch US$ 9.6 trillion by 2020.[2]

The latest indicators from various authorities continue to place India on a relatively high growth trajectory, as indicated below:

The Indian economy is classified in three sectors — Agriculture and allied segments, Industry and Services.[5]

The Agriculture sector includes Agriculture (agriculture proper and livestock), forestry and logging, and fishing and related activities.

Industry includes mining and quarrying, manufacturing (registered and unregistered), electricity, gas, water supply and construction.

The Services sector includes trade, hotels, transport, communication and services related to broadcasting, financial, real estate and professional services; public administration, and defense and other services.

The Services sector is the largest segment in India. The Gross Value Added (GVA) at current prices for the sector was estimated at INR 73.79 lakh crore in 2016-17. It accounts for 53.66% of total India's GVA of INR 137.51 lakh crore.

***IMF[3]***

| Country/ Region | Expected GDP growth rate (%) | | | | | |
|---|---|---|---|---|---|---|
| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| India | 7.355 | 7.785 | 7.916 | 8.084 | 8.149 | 8.198 |
| China | 6.558 | 6.408 | 6.252 | 6 | 5.7 | 5.53 |
| United States | 2.933 | 2.66 | 1.854 | 1.7 | 1.479 | 1.388 |
| European Union | 2.5 | 2.1 | 1.8 | 1.7 | 1.7 | 1.7 |

***World Bank[4]***

| Country/ Region | Expected GDP growth rate (%) | | |
|---|---|---|---|
| | 2018 | 2019 | 2020 |
| India | 7.3 | 7.5 | 7.5 |
| China | 6.4 | 6.3 | 6.2 |
| United States | 2.5 | 2.2 | 2 |
| European Union | 2.1 | 1.7 | 1.5 |

With a GVA of INR 39.90 lakh crore, the Industry sector contributes 29.02% to the economy, while the Agriculture and allied segments share 17.32% with a GVA is around of INR 23.82 lakh crore.

At current prices, the Agriculture sector and allied segments, the Industry and the Services sectors account for 9.64%, 8.32% and 11.87%, respectively, in their GVA growth rates.

At current rates, India has registered the highest growth of 16.50% in Public Administration, Defence and other services segments, and the lowest at 4.44% in mining and quarrying.

The following include some key developments over the past 12 months, which have accounted for the resurgence in India's growth rate:

### FDI reforms[6]

Foreign Direct Investment (FDI) is a major driver of economic growth and a source of non-debt finance for economic development in India. The Government has put in place an investor-friendly policy, under which FDI up to 100% is permitted in the automatic route in most sectors and activities.

In the recent past, the Government has implemented reforms in its FDI policy in a number of segments including Defence, Construction Development,

[1] https://www.imf.org/en/Publications/CR/Issues/2018/08/06/India-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-Executive-46155
[2] https://www.forbes.com/sites/kenrapoza/2011/05/26/by-2020-china-no-1-us-no-2/#3971276a4aef
[3] http://statisticstimes.com/economy/countries-by-projected-gdp-growth.php (International Monetary Fund World Economic Outlook (April-2018)
[4] http://pubdocs.worldbank.org/en/393601515520396575/Global-Economic-Prospects-Jan-2018-statistical-appendix.pdf
[5] According to the Ministry of Statistics and Programme Implementation | Sector-wise GDP growth of India | 21 March 2017
[6] http://pib.nic.in/newsite/PrintRelease.aspx?relid=175501

Insurance, Pension, Other Financial Services, Asset Reconstruction Companies, Broadcasting, Civil Aviation, Pharmaceuticals, Trading, etc. Measures undertaken by it have resulted in increased FDI inflows into the country. During 2014-15, total FDI inflows into India amounted to US$ 45.15 billion as against US$ 36.05 billion in 2013-14. In 2015-16, it received total FDI of US$ 55.46 billion. In the financial year 2016-17, total FDI of US$ 60.08 billion was received an all-time high.

The following are some of the key amendments in the FDI policy during the past 12 months:

- 100% FDI under the automatic route for Single Brand Retail Trading
- 100% FDI under the automatic route in Construction Development
- Foreign airlines being allowed to invest in Air India up to 49% under the approval route
- FIIs and FPIs being allowed to invest in power exchanges through the primary market
- Definition of 'medical devices' amended in the FDI Policy

**Ease of doing business**[7]

India jumped a record 30 places to the 100th spot in the World Bank's Ease of Doing Business rankings in June 2017 and aims to reach the top 50th position by 2022. This has been the outcome of various measures introduced by the Government to combine processes and procedures, and its introduction of a digital interface for most licenses and approvals.

**Universal health care**[8]

India has announced a budget of INR 52,800 crore for schemes and initiatives planned to address health-related problems holistically. Its initiatives are well-timed with the WHO's initiative to strengthen efforts to make universal health coverage a reality.

The National Health Protection Scheme, a progressive programme, will cover over 10 crore poor and vulnerable families (around 50 crore beneficiaries), providing coverage of up to INR 5 lakh per family per year for secondary and tertiary hospitalisation. Timely implementation of the scheme is of prime importance.

The other major initiative taken by the Government is putting in place Health and Wellness Centers and making these the foundation of India's health system. INR 1200 crores has been allocated for this flagship programme. The 1.5 lakh centers will bring good and affordable health care facilities close to the homes of people, and provide comprehensive care for communicable diseases, and maternal and child health services. These government health centres will provide free essential drugs and diagnostic services. This, however, will require putting in place of proper health care infrastructure, both public and private, and adequately meet the needs of those covered by the scheme.

**Infrastructure**[9]

The Infrastructure sector has become the largest focus area of the Government of India. Under the Union Budget 2018-19, US$ 92.22 billion was allocated to the sector.

India needs investment of INR 50 trillion (US$ 777.73 billion) in infrastructure by 2022 to achieve sustainable development in the country. It is attracting the interest of international investors in the Infrastructure space. Some key investments in the sector are given below:

- In June 2018, the Asian Infrastructure Investment Bank (AIIB) announced a US$ 200 million investment in the National Investment & Infrastructure Fund (NIIF).
- Private equity and venture capital (PE and VC) investments in the Infrastructure sector reached US$ 3.3 billion with 25 deals during January-May 2018.
- India's Infrastructure sector witnessed 91 M&A deals worth US$ 5.4 billion in 2017.
- In February 2018, the Government of India signed a loan agreement (worth US$ 345 million) with the New Development Bank (NDB) for the Rajasthan Water Sector Restructuring Project for desert areas.
- In January 2018, the National Investment and Infrastructure Fund (NIIF) partnered with UAE-based DP World to create a platform that will mobilise investments worth US$ 3 billion into ports, terminals, and the transportation and logistics businesses in India.


[7] http://pib.nic.in/newsite/PrintRelease.aspx?relid=173116
[8] http://www.searo.who.int/india/topics/universal_health_coverage/Path_to_UHC/en/
[9] https://www.ibef.org/industry/infrastructure-sector-india.aspx

## Resolution of insolvency

The Insolvency and Bankruptcy Code is considered one of the most important economic reforms in recent times. The Code provides flexibility to financial and operational creditors and enables them to initiate insolvency-resolution procedures against companies that have defaulted in making payment of INR 1 lakh or more to repay the legitimate dues of financial or operational creditors. The entire process is altogether different from that prescribed by the erstwhile legislation, the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA).

The new law makes a commitment to deal swiftly with failing companies, removing the owners and blocking them from trying to buy back the businesses out of bankruptcy. Its architects have set a nine-month limit for completion of the entire process. This makes it one of the world's fastest bankruptcy regimes on paper, and strikes a marked contrast with the sluggish pace of other Indian legal processes. This process enables the emergence of new competitive firms and enables them to remain in business as long as they are competitive, but makes place for new entrants when they lose their competiveness.

Up to 31 March 2018, 701 cases were admitted for resolution of issues by the National Company Law Tribunal. Among these, 22 cases have been approved for a resolution plan and liquidation has commenced in 87 cases.

## Recapitalisation of banks

The Government announced a major recapitalisation drive in October 2017 by utilising three channels– the Budget, market borrowings and issue of recapitalisation bonds. According to the plan, a total of INR 2.11 lakh crores will be injected into public sector banks to enable them to meet their stressed asset-related problems at the earliest. The following are the three modes of mobilisation of funds under the

recapitalisation effort:

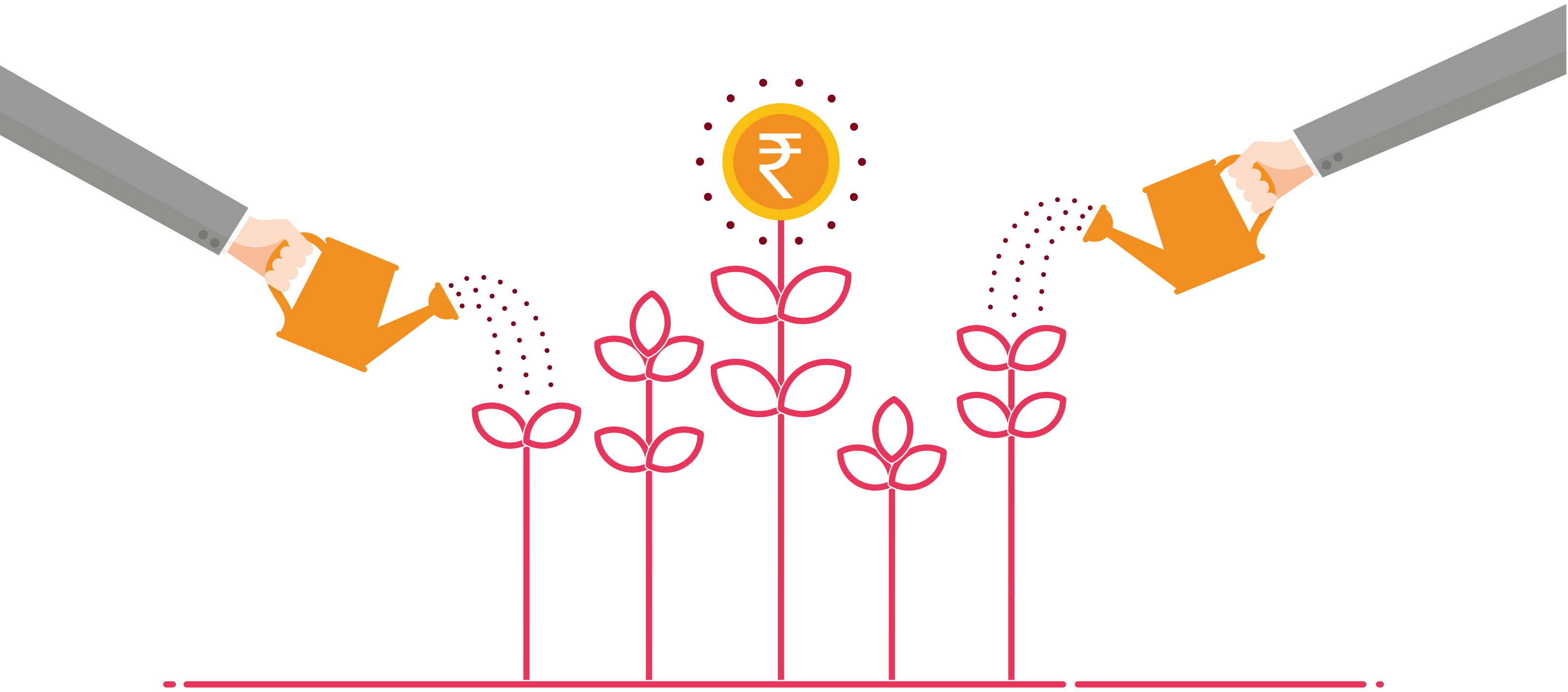
- **Budgetary allocations:** The Government will buy INR 18,000 crore worth of public sector bank shares.
- **Market borrowings:** PSBs will mobilise INR 58,000 crore through borrowings from the market.
- **Recapitalisation bonds:** The Government will issue Bank Recapitalisation Bonds worth INR 1,35,000 crore, which will be used to buy additional shares in public sector banks.

The latest recapitalisation fund of INR 2.11 lakh crores is expected to rejuvenate the banking sector and help banks extend fresh credits as well as sort out the stressed asset problem to some extent. At the same time, recapitalisation is not indiscriminate and banks will have to commit themselves to implement performance improvement measures by signing a Memorandum of Understanding with the Government.

## Digital governance

In Budget 2018, the Finance Minister announced a host of technology-driven projects in areas including budgeting, depositing of fees and penalties, among others. The Government will implement these e-Governance projects to make its functions more transparent and efficient, and ease citizens' interactions with it. The following are some of the highlights of the initiative:

- Allocation for the Digital India Programme doubled to INR 3,073 crore
- Announcement of the launch of a mission on cyber physical systems to support the establishment of Centers of Excellence for research on training and skilling in robotics, Artificial Intelligence (AI), digital manufacturing, analysis of Big Data and quantum communication
- NITI Ayog to commence a national programme for research and development of AI



- Department of Telecommunications to support setting up of an indigenous 5G Test Bed at IIT Chennai
- Focus on eliminating the use of crypto-assets in illegitimate activities
- Exploration of the use of Block Chain technology to propel India to a digital economy
- e-Assessment of Income Tax to be initiated to modernise the age-old assessment procedure

The UN e-Government Survey 2018 (July 2018) has ranked India at the 96th position for its development and execution of Information Technology, up from 107 in 2016 and 118 in 2014 a significant leap!

**Macro economic review**

India's GDP at current prices in Q1 2018-19 was estimated at INR 44.33 lakh crore, against INR 38.97 lakh crore in Q1 2017-18, which indicates a growth rate of 13.8 percent. Its GVA at current prices in Q1 2018-19 was estimated at INR 41.02 lakh crore, against INR 36.34 lakh crore in Q1, 2017-18, showing an increase of 12.9 percent.

Growth rates in various sectors are as follows agriculture, forestry and fishing at 7 percent; mining and quarrying at 18 percent; manufacturing at 17.7 percent; electricity, gas, water supply and other utility services at 13.2 percent; construction at 13.8 percent; trade, hotels, transport and communication at 11.7 percent); financial, real estate and professional services at 12.1 percent, and Public Administration, defense and Other Services at 15.4 percent.

**Key takeaways**

Despite global headwinds and the pressure placed by the upcoming General Elections (slated for early 2019) on policy development and continuity, India has the ability to continue on its robust and broad-based growth. Marrying investor-friendly policies with an apparatus of digital governance to put in place the right constituents to secure the benefits of various welfare schemes, it is on the path to creating a self-sustaining eco-system, which will encourage diversification of businesses and augment avenues for creation of capital and investment.

The elephant has started to run ….

# Corporate Tax

The OECD's Base Erosion and Profit Shifting (BEPS) recommendations have disrupted the way taxes are administered globally. 'Transparency' and 'lower rates' are the buzzwords that are resonating in the international tax environment. India has kept up with global trends by introducing sunset clauses in its complex exemption-related rules and deductions in its domestic tax laws. In line with these changes, it has reduced its Corporate Tax rate to 25%. The country's tax administration is fast moving to the electronic platform and initiatives are being taken to simplify the compliance process for taxpayers to help them resolve the issues they face with minimum human interaction.

India's endeavour is to become one of the most attractive investment destinations in the world, and it understands very well that the need of the hour is to simplify its tax regime and reduce Corporate Tax rates in the country.

Income Tax is levied in India under the Income Tax Act, 1961 (the IT Act), enacted by the Central Government. Income Tax Rules, 1962 (IT Rules), which lay down the procedures to be followed in compliance with the provisions of the IT Act. These 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**

The Indian tax year starts from 1 April of a year and ends on 31 March of the subsequent one. The due dates for companies to file their return of income in India are set out below:

| Nature of company | Deadline to file return of income |
|---|---|
| Companies that are required to submit an accountant's report with respect to their international or specified domestic transactions | 30 November of the subsequent tax year |
| Other companies | 30 November of the subsequent tax year<br>30 September of the subsequent tax year |

Non-resident taxpayers are required to file their tax returns in India, even in cases where taxes are withheld in it. However, in certain cases, exemptions are made for non-resident taxpayers regarding their compliance with this rule. Filing of a return of income in India is compulsory for all companies. Failure to do so may attract monetary fines of up to INR 10,000, in addition to imprisonment, which may extend up to seven years.

All resident companies are mandatorily required to obtain a Permanent Account Number (PAN) in India. Non-resident taxpayers need to obtain a PAN if their income is taxable in the country. This rule also applies to directors, partners, founders, office bearers or any other person competent to act on their behalf.

**Residential status of a company**

A company is considered to be a resident of India if it is incorporated in the country or if its place of effective management (PoEM) is in it. The term PoEM denotes a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are taken in substance. If the PoEM of a company is in India, its global income will be subject to tax in the country. The CBDT has issued guidelines on determination of a foreign company's PoEM and its taxation.

### Residential status of other forms of corporate entities

Various forms of corporate entities are permitted and operate in India. These include partnership firms and limited liability partnerships (LLPs), which comprise alternative entities that can avail of the benefits of limited liability. A corporate entity, other than a company, is considered to be resident in India if any portion of its control and management of affairs is located in the country during the tax year.

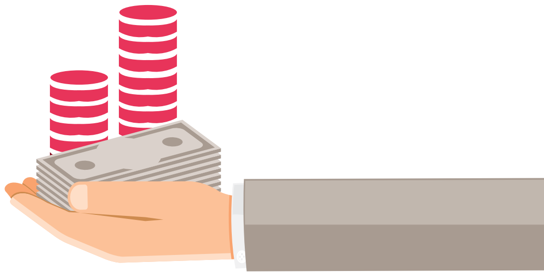
### Scope of taxable income for a company

A company that is resident in India is taxed on its global income. One that is resident outside India is taxed in it in respect of any income that:

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

The term 'business connection' is used in the IT Act instead of the word 'permanent establishment' (PE), used in tax treaties, to tax profits from business. The term is considered wider in its scope than PE. It has been recently amended to include business activity conducted by agents on behalf of non-residents who habitually conclude or have a principal role in conclusion of contracts in India. Accordingly, the income reasonably attributable to such activity is to be taxed in India.

The concept of a significant economic presence (SEP) has also been recently introduced under the term 'business connection'. SEP has been defined to include a transaction involving goods, services or property, and includes provision for downloading of data or software that is conducted via digital means by non-residents in India, subject to monetary limits yet to be prescribed. It also includes systematic and continuous soliciting of business-related activities or interaction with the number of users prescribed in India through digital means.



### Corporate Tax rates

Broadly, the Corporate Tax rate for entities ranges from 25% to 40%.

| Status of entity | Rates in force | Conditions |
|---|---|---|
| Domestic company | 25%* | Total turnover/Gross receipts in financial year (2016-17) not exceeding INR 2.5 billion |
| | 30% | All other companies |
| Foreign company | 40% | All foreign companies |
| Partnership firm/LLP | 30% | All firms and LLPs |

* Furthermore, domestic companies set up after 1 March 2016 that are engaged in manufacturing products and are not claiming certain specified deductions in computation of their taxable profits are taxable at 25%, subject to their fulfilling certain specified conditions.

The rates mentioned above are exclusive of surcharge, which is levied on the basis of the quantum of taxable income and cess levied on the tax amount (inclusive of the surcharge). Surcharge rates range from 0% to 12% for domestic companies, partnership firms and LLPs and 0% to 5% for foreign enterprises. The cess rate is 4% for all entities.

### Minimum Alternate Tax (MAT)

MAT is levied at 18.5% (plus applicable surcharge and cess) on the adjusted book profits of companies if the tax payable by these under normal tax provisions is less than 18.5% of their adjusted book profits. Credit for MAT is allowed against a tax liability that may arise in the subsequent 15 years computed under the provisions of the IT Act. MAT provisions are not applicable on the Indian PEs of foreign companies.

### Alternate Minimum Tax (AMT)

AMT is levied on entities (other than companies) at 18.5% on their adjusted total income (computed according to Income Tax provisions) if the AMT liability exceeds the tax payable under normal Income Tax provisions. Credit for AMT is allowed against a tax liability that may arise in the subsequent 15 years under the provisions of the IT Act. AMT is applicable in cases where taxpayers are obtaining certain specified deductions under IT Act.

### Dividend Distribution Tax (DDT)

Indian companies that distribute or declare dividends are required to pay DDT at the rate of 15% (effective rate 20.56%). This tax is payable on declaration, distribution or payment, whichever is earlier, and is in addition to the Corporate Tax payable on business profits.

DDT provisions are not applicable for an LLP. An Indian company has the option to pay tax at the rate of 15% for a dividend payable by its foreign associate enterprise if the former holds more than 26% the shares of the latter.

### Buyback of shares

An additional tax of 20% is payable by an unlisted company for buying back shares from its shareholders. This tax is payable by the company on the difference between the amount paid for the buyback and the issue price of the shares. The buyback amount received is exempt from tax in the hands of the recipient.

### Patent Box regime

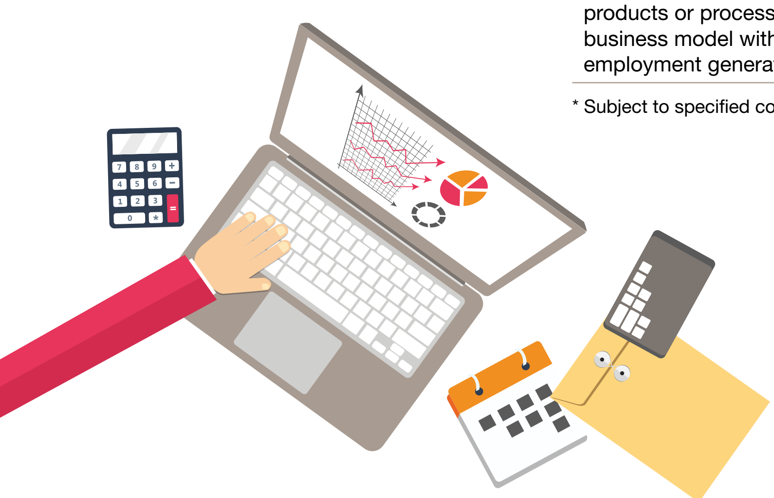
In order to encourage indigenous Research & Development (R&D) and make India a global R&D hub, a 10% tax is applicable on resident patentees' income from royalty for patents they have developed and registered in India. Under this regime, no expenditure or allowance is allowed for computation of taxable income.

## Key Corporate Tax-related considerations

### Computation of income

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

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



## Income from profits and gains of business or profession

### Tax audit of books of account

Taxpayers conducting a business or profession are required to have their books of account audited for Income Tax-related purposes if the total sales, turnover or gross receipts from their business exceed INR 10 million.

### Income Computation and Disclosure Standards (ICDS)

Taxpayers that use the mercantile system of accounting are required to follow the ICDS for computation of income chargeable under the head 'profits and gains of business or profession' and 'income from other sources'.

### Depreciation

Taxpayers are allowed depreciation on the written down value (WDV) of assets. Rates of depreciation generally range from 10% to 40%. In the case of a taxpayer engaged in manufacturing or production, incentive by way of additional depreciation at the rate of 20% is provided on the value of the new plant and machinery in the year of their installation. This rate may increase to 35% if certain additional conditions are satisfied.

Some tax deductions and incentives available to taxpayers

| Activity | Benefits* |
|---|---|
| All taxpayers, whose total sales, turnover or gross receipts exceed INR 10 million | Additional deduction of 30% of the cost incurred on a new employee |
| Scientific R&D | Weighted deduction of 150% of the expenditure |
| 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 |
| Deduction for specified business categories such as cold chain facilities; warehousing facilities for storage of agricultural produce, cross-country natural gas oil or distribution, infrastructure facilities, etc. | 100% deduction on capital expenditure |
| Business of processing, preservation and packaging of fruits or vegetables or meat and meat products or poultry or marine and dairy products; handling, storage and transportation of food grains | 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 |
| Expenditure on skill development project | Weighted deduction of 150% on expenditure incurred on a notified skill development project by a company |
| Start-up businesses engaged in innovation, development, deployment or improvement of products or processes or services or a scalable business model with a high potential for employment generation or wealth creation | 100% deduction for profits and gains for three consecutive years out of seven years, starting from the year the start-up was incorporated |

* Subject to specified conditions

### Presumptive taxation regime for non-residents

The provisions of the IT Act provides for presumptive taxation in the case of certain non-resident taxpayers. In such cases, taxable income is determined on the basis of a certain percentage of their total gross receipts. This is expected to reduce areas of uncertainty and compliance-related requirements.

| Particulars | Shipping | Aircraft | Oil and gas services | Turnkey power projects |
|---|---|---|---|---|
| Applicability | Shipping operations | Aircraft operations | Specified business activity relating to prospecting for, or extraction or production of mineral oils | Specified business activity in relation to approved turnkey power projects |
| 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 that is lower than the 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 |

The provisions of Minimum Alternate Tax (discussed above) are not applicable in computation of taxable income on a presumptive basis of such taxpayers.

**Losses incurred from business**

Losses from business are classified into business losses and unabsorbed depreciation. Business losses for a particular tax year can be set off against income taxable under other heads of income (except salary) earned during the same tax year and can be carried forward for eight subsequent tax years, to be set off against the business income earned in those years. Unabsorbed depreciation can be carried forward indefinitely and can be set off against taxable income of the subsequent years. In the case of reconstitution of business of closely held entities, 51% of the beneficial shareholding has to be maintained in order to carry forward losses. There are no provisions under the IT Act for carrying losses back to earlier years.

## Income from house property

Rental income earned from the use of buildings for residential or 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 capital gains

Income earned from transfer of capital assets is taxed under the head 'capital gains'. Capital assets are defined as any property, whether connected to a business or a profession as well as securities held by Foreign Institutional Investors (FIIs), according to the securities regulations applicable in India. However, a capital asset does not include certain personal effects held by taxpayers for their personal use.

| S. No. | Type of asset | Holding period | Classification of gains |
|---|---|---|---|
| 1 | Capital assets other than those specified in S. Nos. 2, 3 and 4 and below | More than 36 months | Long-term capital gains |
| | | Less than 36 months | Short-term capital gains |
| 2 | Listed securities, units of Unit Trust of India, units of equity-oriented mutual funds and zero-coupon bonds | More than 12 months | Long-term capital gains |
| | | Less than 12 months | Short-term capital gains |
| 3 | Unlisted securities | More than 24 months | Long-term capital gains |
| | | Less than 24 months | Short-term capital gains |
| 4 | Immovable properties | More than 24 months | Long-term capital gains |
| | | Less than 24 months | Short-term capital gains |

There is a variation in the tax rates applicable on short-term and long-term capital gains. Long-term capital gains are generally taxed at lower rates.

The IT Act provides for certain situations where tax on capital gains is not levied if the consideration amount or capital gains is reinvested in specified assets. Furthermore, certain transactions are not considered as 'transfers', and accordingly, do not give rise to capital gains (subject to satisfaction of prescribed conditions).

### Indirect transfer of shares

Under the IT Act, the shares of non-resident entities are deemed to be situated in India if they substantially derive their value, whether directly or indirectly, from assets located in India. Accordingly, transfer of such shares (i.e., of a non-resident entity) is considered as transfer of a capital asset situated in India. The provisions of indirect transfers are subject to certain prescribed conditions. There are some jurisdictions that provide exemption from taxability of indirect transfer of shares by virtue of tax treaty provisions. A recent trend noticed in the Indian judiciary is that it gauges substance and ownership requirements for meeting the eligible criteria given in the tax treaties mentioned above.

## Income from other sources

Income not covered under any of the specific heads of income is liable to tax as under the head of 'income from other sources'. While computing taxable income from other sources, expenditure 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 recipients under the provisions of Income-tax laws. The applicable law provides that receipt of money or property, including shares, by taxpayers without consideration or for inadequate consideration in excess of INR 50,000 will be chargeable to tax in the hands of the recipients under the head 'Other sources'.

### Premium on allotment of shares

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

### Dividends paid by Indian companies

Dividends received from Indian companies that are subject to DDT are not taxable in the hands of recipients. However, in the case of individuals, Hindu Undivided Families (HUFs) or firms' residents in India, tax is levied at the rate of 10% on dividends received in excess of INR 1 million during a tax year.

## Other Corporate Tax-related considerations

### Withholding Tax (WT) provisions

Both resident and non-resident taxpayers making specified payments are obliged to withhold taxes according to the relevant provisions of the IT Act. Withholding Tax rates range from 0% to 40%, and in the case of payments made to non-residents, are increased by an additional surcharge, cess, etc., subject to benefits available under various tax treaties.

### General Anti-Avoidance Rule (GAAR)

GAAR provisions empower the Tax Department to declare an 'arrangement' entered by a taxpayer to be an Impermissible Avoidance Arrangement (IAA). The consequences include denial of the tax benefit either under the provisions of the IT Act or the applicable

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 only apply if the main purpose of the arrangement or step is to obtain a tax benefit. The provisions of GAAR will not apply if the tax benefit from an arrangement in a relevant tax year does not exceed INR 30 million. Furthermore, GAAR does not apply on investments made up to 31 March 2017.

## Other considerations for taxation of non-residents

### Multilateral Instrument (MLI)

The MLI seeks to help governments close the gaps in their existing bilateral tax treaties with a view to eliminate double taxation and counter treaty abuse, and improve dispute resolution mechanisms. India is among the 68 countries that signed the MLI on 7 June 2017. It has published a provisional list of notifications and listed 93 tax treaties, which it intends should be covered by the MLI.

### Equalisation Levy – digital economy (e-Commerce transactions)

An Equalisation Levy of 6% is applicable in India in line with BEPS Action Plan 1 (Digital Economy). As of now, the levy is applicable on payment made by a resident or the Indian PE of a resident to a non-resident providing specified services. A 'specified service' has been defined as an online advertisement, or 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.

### Tax Residency Certificate (TRC)

To avail of the benefits of the applicable tax treaty, non-residents need to provide a copy of the TRC issued by the revenue authorities of their countries of residence as well as other prescribed documents. Concessional tax rates applicable under certain DTAAs India has signed with various countries are provided in Annexure 1.

### Foreign Tax Credit (FTC)

The Indian Government has entered a DTAA with several countries to avoid the hardship of double taxation on taxpayers earning income that is taxable in multiple countries. The CBDT has specified rules and procedures by which an Indian resident can obtain the benefit of the taxes paid by it a foreign country.

### Recent renegotiation of DTAA

India has recently entered a DTAA with Hong Kong to improve transparency in tax-related matters and to curb tax evasion or avoidance. The DTAA is yet to be notified and will come into force after the completion of the procedures prescribed under the respective laws of both the countries.

### Thin capitalisation

Deduction for interest payments by the Indian PEs or Associated Enterprises of foreign companies are, under certain cases, restricted to 30% of their earnings before Interest, Taxes, Depreciation and Amortisation (EBITDA). Excess interest that is disallowed in a year is eligible for being carried forward up to eight consecutive years.

## Tax litigation in India

### Contentious tax issues

#### Determination of PE

The Supreme Court of India, the country's highest judicial forum, has recently pronounced some rulings that have enunciated various key principles for determination of PE in India. In one of the rulings, the Supreme Court held that a fixed place PE can be constituted in India even when the duration of its presence is less than six months. This would, of course, depend on the nature of the business it conducts in India.

#### Royalty from software

There is considerable litigation in India regarding characterisation of amounts received for supply of software (including off-the-shelf software). Indian High have taken divergent views on the issue of whether such consideration should be construed as royalty, and consequently, be taxable in India. The matter is now pending before the Supreme Court for final adjudication.

#### Offshore supply

Taxability of offshore supply is a vexing tax issue in India and assumes greater proportions when some onshore activities are also carried out in the country consequent to offshore supplies. Indian revenue authorities generally endeavour to attribute some portion of offshore supplies to India, and therefore, seek to bring consequent profits within India's tax net.

#### Virtual presence/Digital economy

Today, multinational organisations are not confined by geographical boundaries to conduct their business operations. Sale of goods and services and payments are made digitally through servers based in foreign countries. Indian revenue authorities have taken an aggressive stand in capturing online transactions within the ambit of tax.

## Appeal mechanism

The tax appellate mechanism in India can be split into the following four levels:

| Appellate authority | Nature of appeal |
|---|---|
| Commissioner of Income-tax (Appeals) (CIT (A)) | First level of appeal: Taxpayers can approach the CIT(A) against audit orders passed by lower authorities (tax officers). |
| Dispute Resolution Panel (DRP) | Alternate to filing an appeal with the CIT(A): This option can be availed by non-resident taxpayers and specified domestic taxpayers who can file objections with the DRP against 'draft audit orders' passed by Tax officers. The DRP, unlike the CIT(A) is required to issue directions within a prescribed time. |
| Income Tax Appellate Tribunal (ITAT) | Second level of appeal: Taxpayers or the Revenue can approach the ITAT against an order of the CIT (A) or a final order passed in pursuance to the DRP's directions. The ITAT is the final fact-finding authority in India. |
| Jurisdictional High Court (HC) | Third level of appeal: Taxpayers or the Revenue can approach the jurisdictional HC against an order of the ITAT, provided the matter pertains to a substantial question of law. |
| Supreme Court (SC) | Last level of appeal: Taxpayers or the Revenue can approach the SC against an order of a jurisdictional HC. The SC's order is binding on both the taxpayer and the Revenue. |

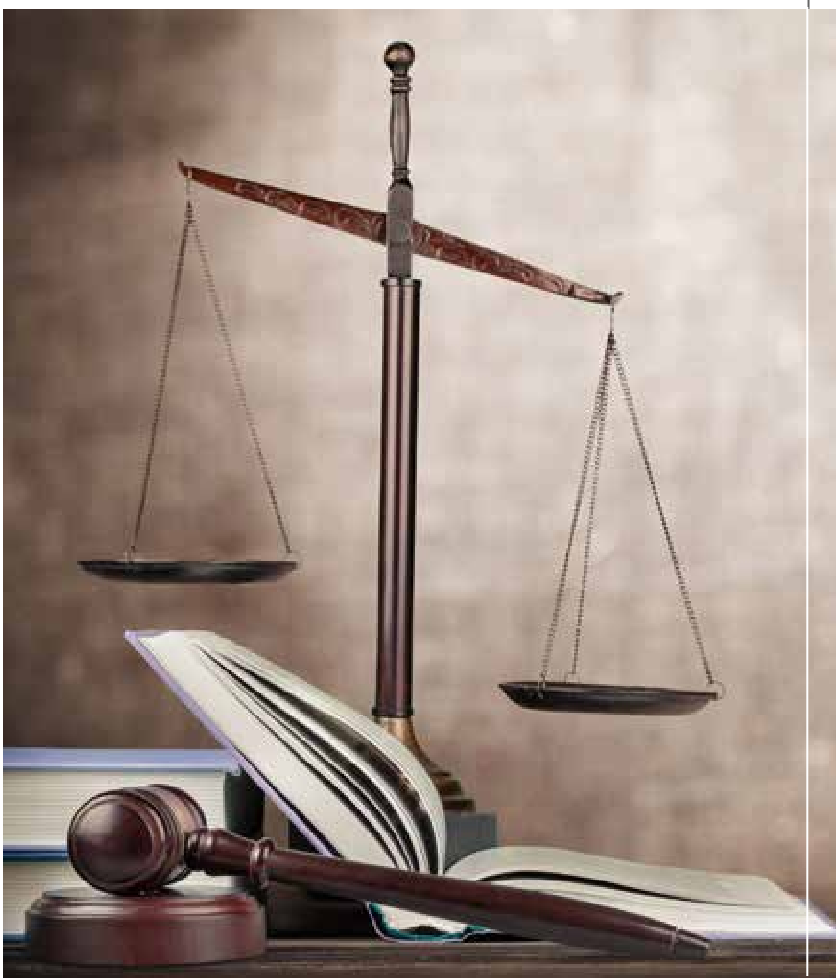
## Alternate Dispute Resolution Mechanisms

### Authority of Advance Rulings (AAR)

The AAR is an alternate dispute resolution forum that provides an opportunity to non-residents and certain residents to obtain upfront certainty with respect to tax liabilities arising from transactions undertaken by them. An order of the AAR is binding on both, the applicant and the Revenue, and can only be challenged under a writ jurisdiction before the jurisdictional High Court.

### Income-tax Settlement Commission (ITSC)

The ITSC is another alternate dispute resolution forum that is available to both residents and non-residents for resolution of their tax-related disputes only once. In order to file an application before the ITSC, taxpayers need to provide a full and true disclosure of income they have not disclosed earlier and pay tax amounting to INR 1 million in advance. The ITSC has to dispose of proceedings within 18 months of an application and has the power to grant immunity from penalty and prosecution. An order of the ITSC is binding on both the applicant and the Revenue and can only be challenged under writ jurisdiction before a jurisdictional High Court.



Annexure 1

## Tax rates under tax treaties India has entered with various jurisdictions

| Recipient | Withholding Tax (%) | | | |
|---|---|---|---|---|
| | Dividend (1) | Interest | Royalty (12) | Fee for technical services (12) |
| Albania | 10 | 10 | 10 | 10 |
| Armenia | 10 | 10 | 10 | 10 |
| Australia | 15 | 15 | 10 (refer to Note 2)/15 in other cases | 10 (refer to Note 2)/15 in other cases |
| Austria | 10 | 10 | 10 | 10 |
| Bangladesh | 10 (refer to Note 3)/15 in other cases | 10 | 10 | No specific provision (refer to Note 5) |
| Belarus | 10 (refer to Note 9)/15 | 10 | 15 | 15 |
| Belgium | 15 | 10 (refer Note 11)/15 | 10 | 10 |
| Bhutan | 10 | 10 | 10 | 10 |
| Botswana | 7.5 (refer to Note 9)/10 | 10 | 10 | 10 |
| Brazil | 15 | 15 | 25 (refer to Note 15)/15 | No specific provision (refer to Note 5) |
| Bulgaria | 15 | 15 | 15 (refer to Note 7)/20 | 20 |
| Canada | 15 (refer to Note 3)/25 | 15 | 10 (refer to Note 2)/15 | 10 (refer to Note 2)/15 |
| China (People's Republic of China) | 10 | 10 | 10 | 10 |
| Chinese Taipei (Taiwan) | 12.5 | 10 | 10 | 10 |
| Colombia | 5 | 10 | 10 | 10 |
| Croatia | 5 (refer to Note 3)/15 | 10 | 10 | 10 |
| Cyprus | 10 | 10 | 10 | 10 |
| Czech Republic | 10 | 10 | 10 | 10 |
| Denmark | 15 (refer to Note 9)/25 | 10 (refer to Note 11)/15 | 20 | 20 |
| Estonia | 10 | 10 | 10 | 10 |
| Ethiopia | 7.5 | 10 | 10 | 10 |
| Fiji | 5 | 10 | 10 | 10 |
| Finland | 10 | 10 | 10 | 10 |
| France | 10 (refer to Note 6) | 10 (refer to Note 6) | 10 (refer to Note 6) | 10 (refer to Note 6) |
| Georgia | 10 | 10 | 10 | 10 |
| Germany | 10 | 10 | 10 | 10 |
| Greece | (refer to Note 14) | (refer to Note 14) | (refer to Note 14) | No specific provision (refer to Note 5) |
| Hungary | 10 (refer to Note 6) | 10 (refer to Note 6) | 10 (refer to Note 6) | 10 (refer to Note 6) |
| Iceland | 10 | 10 | 10 | 10 |
| Indonesia | 10 /15 | 10 | 15 | No specific provision (refer to Note 5) |
| Ireland | 10 | 10 | 10 | 10 |
| Israel | 10 | 10 | 10 | 10 |
| Italy | 15 (refer to Note 3)/25 | 15 | 20 | 20 |
| Japan | 10 | 10 | 10 | 10 |
| Jordan | 10 | 10 | 20 | 20 |

| Recipient | Withholding Tax (%) | | | |
|---|---|---|---|---|
| | Dividend (1) | Interest | Royalty (12) | Fee for technical services (12) |
| Kazakhstan | 10 | 10 | 10 | 10 |
| Kenya | 15 | 15 | 20 | 17.5 |
| Korea | 15 | 10 | 10 | 10 |
| Kuwait | 10 | 10 | 10 | 10 |
| Kyrgyz Republic | 10 | 10 | 15 | 15 |
| Latvia | 10 | 10 | 10 | 10 |
| Libya | (refer Note 14) | (refer to Note 14) | (refer to Note 14) | No specific provision (refer to Note 5) |
| Lithuania | 5 (refer to Note 3)/15 | 10 | 10 | 10 |
| Luxembourg | 10 | 10 | 10 | 10 |
| Macedonia | 10 | 10 | 10 | 10 |
| Malaysia | 5 | 10 | 10 | 10 |
| Malta | 10 | 10 | 10 | 10 |
| Mauritius | 5 (refer to Note 3)/15 | 7.5 (refer to Note 14) | 15 | 10 |
| Mexico | 10 | 10 | 10 | 10 |
| Mongolia | 15 | 15 | 15 | 15 |
| Montenegro | 5 (refer to Note 9)/15 | 10 | 10 | 10 |
| Morocco | 10 | 10 | 10 | 10 |
| Mozambique | 7.5 | 10 | 10 | No specific provision (refer to Note 5) |
| Myanmar | 5 | 10 | 10 | No specific provision (refer Note 5) |
| Namibia | 10 | 10 | 10 | 10 |
| Nepal | 5 (refer to Note 3)/10 | 10 | 15 | No specific provision(refer to Note 5) |
| Netherlands | 10 (refer to Note 6) | 10 (refer to Note 6) | 10 (refer to Note 6) | 10 (refer to Note 6) |
| New Zealand | 15 | 10 | 10 | 10 |
| Norway | 10 | 10 | 10 | 10 |
| Oman | 10 (refer to Note 3)/12.5 | 10 | 15 | 15 |
| Philippines | 15 (refer to Note 3)/20 | 10 (refer to Note 13)/15 | 15 | No specific provision(refer to Note 5) |
| Poland | 10 | 10 | 15 | 15 |
| Portugal | 10 (refer to Note 9)/15 | 10 | 10 | 10 |
| Qatar | 5 (refer to Note 3)/10 | 10 | 10 | 10 |
| Romania | 10 | 10 | 10 | 10 |
| Russian Federation | 10 | 10 | 10 | 10 |
| Saudi Arabia | 5 | 10 | 10 | No specific provision (refer to Note 5) |
| Serbia | 5 (refer to Note 9)/15 | 10 | 10 | 10 |
| Singapore | 10 (refer to Note 9)/15 | 10 (refer to Note 11)/15 | 10 | 10 |
| Slovenia | 5 (refer to Note 3)/15 | 10 | 10 | 10 |
| South Africa | 10 | 10 | 10 | 10 |
| Spain | 15 | 15 | 10 (refer to Note 6)/20 | 20 (refer to Note 6) |
| Sri Lanka | 7.5 | 10 | 10 | 10 (refer to Note 6) |

| Recipient | Withholding Tax (%) | | | |
|---|---|---|---|---|
| | Dividend (1) | Interest | Royalty (12) | Fee for technical services (12) |
| Sweden | 10 (refer to Note 6) | 10 (refer to Note 6) | 10 (refer to Note 6) | 10 (refer to Note 6) |
| Switzerland | 10 | 10 | 10 | 10 |
| Syria | 5 (refer to Note 3)/10 | 10 | 10 | No specific provision (refer to Note 5) |
| Taipei | 12.5 | 10 | 10 | 10 |
| Tajikistan | 5 (refer to note 9)/10 | 10 | 10 | No specific provision (refer to Note 5) |
| Tanzania | 5 (refer to note 9)/10 | 10 | 10 | No specific provision (refer to Note 5) |
| Thailand | 15/20 | 10/25 | 15 | No specific provision (refer to Note 5) |
| Trinidad & Tobago | 10 | 10 | 10 | 10 |
| Turkey | 15 | 10 (refer to Note 11)/15 | 15 | 15 |
| Turkmenistan | 10 | 10 | 10 | 10 |
| Uganda | 10 | 10 | 10 | 10 |
| Ukraine | 10 (refer to Note 9)/15 | 10 | 10 | 10 |
| United Arab Emirates | 10 | 5 (refer to Note 11)/12.5 | 10 | No specific provision (refer Note to 5) |
| United Arab Republic (Egypt) | (refer to Note 14) | (refer to Note 14) | (refer to Note 14) | No specific provision (refer to Note 5) |
| United Kingdom | 15 (refer to note 16)/10 | 10 (refer to Note 13)/15 | 10 (refer to Note 2)/15 | 10 (refer to Note 2)/15 |
| United States | 15 (refer to Note 3)/25 | 10 (refer to Note 11)/15 | 10 (refer to Note 2)/15 | 10 (refer to Note 2)/15 |
| Uruguay | 5 | 10 | 10 | 10 |
| Uzbekistan | 10 | 10 | 10 | 10 |
| Vietnam | 10 | 10 | 10 | 10 |
| Zambia | 5 (refer Note to 10)/15 | 10 | 10 | 10 |

**Notes**

- Treaty tax rates for dividends are not relevant, since under current tax legislation in India, most dividend income from Indian companies, which is subject to DDT, is exempt from Income Tax in the hands of a recipient.
- Equipment rental and ancillary services are liable to 10% tax:
  - For cases in the first five years: 15% if the Government or a specified organisation is the payer and 20% for other payers
  - For subsequent years: 15% in all cases (income of government organisations being exempt from taxation in the country of source)
- If at least 10% of the capital is owned by a beneficial owner (company) of the company paying the dividend or interest
- If at least 20% of the capital is owned by the beneficial owner (company) of the company paying dividend or interest
- In the absence of a specific provision, the possibility of these being treated as business profit or independent personal services, whichever is applicable, under the respective treaties
- The 'most favoured nation' clause being applicable and the protocol to the treaty limiting the scope and rate of taxation to that specified in similar articles in treaties signed by India with an OECD or another country
- If royalty relates to copyright of literary, artistic, or scientific work other than cinematograph films, or films or tapes used in radio or television broadcasting
- If the company paying the dividend is engaged in an industrial undertaking
- If at least 25% of the capital is owned by the beneficial owner (company) of the company paying the dividend
- If at least 25% of the capital is owned by the company during at least six months before the date of payment
- If the dividend is paid on a loan granted by a bank or financial institution
- Applicable domestic law rate on royalty and fees for technical services at 10.558% (including surcharge and cess), with the taxpayer having the option to apply either the treaty rate or the domestic law rate, whichever is beneficial
- If interest is received by a financial institution
- Taxable in the country of source according to domestic tax rates
- If royalty payments arise from the use of or the right to use trademarks
- Subject to applicable conditions

# Indirect Taxes

The Goods and Services Tax (GST), considered the biggest ever tax reform in Independent India, was implemented on 1 July 2017 and received overwhelming support from industry. The GST has brought in many changes in tax- and compliance-related implications for various businesses because of which the acclimatisation phase during the rollover to the new regime was relatively long. However, the GST also afforded India Inc. a real opportunity to simplify and create value for key business processes, including procurement, manufacturing, distribution, logistics, and so on.

The year 2017 will forever be etched in Indian history as one that saw the implementation of the most important and far-reaching economic reform since Independence—the GST. The reform that took more than a decade of intense debate before it was finally implemented with effect from 1 July 2017, subsumed almost all Indirect Taxes at the Central and state levels.

India has a federal structure under which the authority to impose taxes has been distributed between the Central and state governments. This has made the Indian taxation system one of the most complex in the world.

The erstwhile Indirect Tax regime, which was applicable till 30 June 2017, had several shortcomings including the following, which resulted in an inefficient production and consumption structure, and thereby hindered economic growth:

- Tax cascading
- Divergent state-specific compliance-related requirements
- The need for interaction with multiple tax authorities at the Central and state levels
- No cross-utilisation of credits, inter se goods and services imposed at the state level and the Central level, respectively
- Input Tax Credit (ITC) of certain taxes or duties such as CST, Octroi or Local Body Tax not being creditable.

The Government has implemented the GST with effect from 1 July 2017 to address and eliminate the shortcomings mentioned above. It has opted for a dual GST model that is in line with the Canadian GST. By adopting this model, the Central and state governments have been empowered to levy the GST on supply of goods and services. The GST is a consumption-based tax. Consequently, revenue for a transaction accrues, based on rules in the consumption or destination state, unlike under the past Indirect Tax regime, wherein revenue only accrued to the supplying state.

The following are some of the key concepts of the GST, which companies looking at investing in India should take into consideration:

**A. Taxes applicable under the GST include the following:**

| Tax type | Levied on | Levied by |
|---|---|---|
| Central Goods and Services Tax (CGST) | Intra-state (within the state) supply of goods and services | Central Government |
| State Goods and Services Tax (SGST)* | Intra-state (within the state) supply of goods and services | State governments |
| Union Territory Goods and Services Tax (UTGST)* | Supply of goods and services in a Union Territory | Central Government |
| Integrated Goods and Services Tax (IGST) | • Inter-state supply of goods and services<br>• Import of goods and services<br>• Supplies to units and developers of Special Economic Zones (SEZs) | Central Government |

* Levy of SCGST and UTGST is mutually exclusive.

**B. Registration under the GST:** A supplier of goods and/or services is required to obtain GST registration in every state from which it supplies goods and/or services.GST registration is not required if the turnover of a supplier on a pan-India basis is less than the mandated threshold limit of INR 20 lakh in a financial year (in the case of the North Eastern states, the lower threshold of INR 10 lakhs). Furthermore, a supplier that only supplies GST-exempt goods and/or services is not required to obtain GST registration.

**C. Rates under the GST schedule:** The following are the GST rate slabs for goods and services:

- 0%
- 5%
- 12%
- 18%
- 28%

Essential items have been included in the 0% tax slab, most goods and services in the 18% bracket, and specified luxury goods or services and 'sin' goods in the 28% slab.

In addition, identified luxury goods and services are also liable to Compensation Cess. The rate of Compensation Cess varies from 1% to 15%. It is even higher for tobacco and tobacco products. However, while this Cess has been called a 'cess' (which should apply to the tax element), in reality it is levied on the base value of goods and services.

**D. Liability to pay GST:** Generally, a supplier of goods or services bears the liability to pay GST. However, the recipient is liable to pay tax for certain types of transactions (such as sponsorship services or import of services). This method of collecting GST is commonly referred to as a 'reverse charge mechanism'

**E. Compliance-related requirements:** The GST law prescribes stringent compliance-related requirements. A supplier of goods and services is required to file multiple returns for each registration within a month on a state-wise basis. Deliberations on substantial simplification of the return filing process under GST laws are currently ongoing.

**F. Composition Scheme for small taxpayers:** To ease the compliance burden, small taxpayers with an aggregate turnover of up to INR 150 lakhs have been given the option to opt for the Composition Scheme.

Under this scheme, suppliers can pay tax at a specified percentage of their turnover during the year without claiming benefit of ITC on their procurement. Such suppliers cannot recover taxes separately from buyers on their invoices. Consequently, buyers are not eligible for claiming ITC on the tax paid by suppliers under the Composition Scheme.

A supplier with interstate supplies of goods or a service provider is not eligible for the Composition Scheme and cannot opt for it. And while a regular taxpayer has to pay taxes on a monthly basis, a Composition supplier is required to file returns and pay taxes on a quarterly basis. Moreover, it does not need to maintain detailed transaction-wise accounts and records, unlike a regular taxpayer.

**G. Input Tax Credit (ITC):** The GST seeks to provide a seamless flow of credit across goods and services as against the erstwhile Indirect Tax regime wherein cross utilisation of VAT paid on goods was not allowed against the Output Service Tax or Excise Duty liability, or vice-versa. Taxpayers are permitted to avail ITC of the GST if have made payment on their procurement during the course of or in furtherance of their business to provide taxable supplies. ITC can also be utilised to pay for output GST liability.

ITC is currently not allowed for certain procurements such as rent-a-cab services, outdoor catering services and expenses for personal consumption. However, under imminent amendments in the ITC provisions, these restrictions are expected to be significantly relaxed. Moreover, a noteworthy departure from the erstwhile Excise and Service Lax laws is that under the GST a supplier's eligibility to claim ITC is subject to the vendor's compliance.

**H. Import of goods into India:** Import of goods into India continues to be governed by Customs law. Such imports attract Basic Customs Duty (BCD), Customs Cess, IGST and Compensation Cess (if applicable). BCD and Customs Cess paid at the time of import

**Tax rate prescribed under the Composition Scheme:**

| Composition Scheme – applicable GST rates | | | |
|---|---|---|---|
| Type of business | CGST | SGST | Total |
| Manufacturer (other than those specifically notified by the Government, e.g., ice-cream, pan masala and tobacco products) | 0.50% | 0.50% | 1% |
| Trader of goods | 0.50% | 0.50% | 1% |
| Restaurant not serving alcohol | 2.50% | 2.50% | 5% |

of goods is non-creditable and is therefore a cost. However, ITC of IGST will be available for adjustment against output GST liability. ITC of Compensation Cess is only available for utilisation against an output Compensation Cess liability.

I. **Exports and supplies to Special Economic Zones (SEZs):** Export of goods or services and supplies to SEZs have been categorised as zero-rated supplies. A supplier providing such supplies is eligible for either:

   - Supply goods or services under a bond or Letter of Undertaking without payment of tax
   - Supply of goods or services by paying tax and thereafter claiming a rebate for it

J. **Transactions between related persons:** Generally, only supplies made for a consideration are liable to the GST. However, in the case of transactions between related parties and their locations in different states, even supplies made without consideration attract this tax.

The GST, as described by our Hon'ble Prime Minister Mr. Narendra Modi, a "good and simple tax", has recently completed its first year. It marks the fundamental resetting of the Indian economy and redefines the way business is done in India (with increased formalisation), expands the market for goods and services (replacing many small and fractured markets with a single common one) and has totally overhauled the Indirect Tax regime in the country.

The Government and industry had great hopes that the GST will be instrumental in reducing economic distortion and give the necessary boost to India's economic growth.

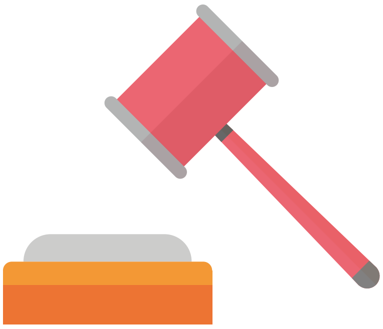
According to the latest numbers, growth picked up significantly in the last quarter (January-March 2018). Recent statistics indicate that our GDP growth rate increased by 0.7 percentage points during each successive quarter of 2017-18. Manufacturing, a sector that was expected to be adversely affected by the GST, grew by close to double-digits at 9.9%, while investment, as reflected in the formation of gross fixed capital, grew at 14.4% in the last quarter. Reports from financial institutions indicate that India's GDP is likely to grow to around 7-7.5% in 2018-19.

The Government's revenue collection for March 2018 crossed the INR 1 lakh crore mark for the first time in April 2018. This made Budget-related estimates for FY 2018-19 even more ambitious.

A favourable policy framework, including liberalisation of FDI in various sectors and launch of major national development programmes, including 'Make in India' and 'Digital India', has ensured significant inflow of foreign capital into India

Improved governance, favourable conditions for conducting business, transparency in government procedures and responsive policy-making, with an immediate focus on effective implementation of the Government's reforms, are expected to make India a preferred destination for foreign investment and set it on a growth trajectory that promises all-round development, economic welfare and strong macroeconomic indicators. The GST as a radical reform is acting as an enabler to vitalise the business environment in India and greatly enhance its stature around the world.

# Regulatory



Ease of doing business and creating a conducive regulatory environment have been two pillars of the Government's reforms agenda. Consistent efforts have been made by it to simplify compliance-related requirements, liberalise rules pertaining to investments and enhance accountability. Some of the key reforms in this regard include:

- Reporting of foreign investments by Indian entities has been simplified and consolidated under a single form by the RBI.
- FDI for investing companies registered as Non-Banking Financial Companies (NBFCs) has been allowed under the 100% automatic route.
- Under the automatic route, 100% FDI has been allowed for real estate broking services.
- Under the automatic route, 100% FDI has been allowed in single brand product retail trading, subject to sourcing norms and certain conditions.
- Clarification has been provided on 100% FDI being permitted for medical devices.
- Permission on capitalisation of Indian companies' payables into equity shares without the Government's approval in the automatic route sectors.
- Restrictions have been removed on primary market trading by FII or FPI in power exchanges.
- Enforcement measures by Reserve Bank of India on non-compliances have increased with stricter penalty proceedings
- Corporates have enhanced accountability in terms of better corporate governance. Shell, inactive and defaulting companies are being constantly scrutinised
- Director KYC confirmation drive has been initiated by the Ministry of Corporate Affairs
- Corporate Social Responsibility compliance by companies is under stricter vigilance
- Shareholders are now required to declare significant beneficial ownership to ensure proper accountability

## Ease of Doing Business (EoDB)

The Government had formulated an output-outcome framework to work towards improving India's position on the World Bank's Doing Business Survey rankings, and has led to India moving up to 100 in its ranking from 130 last year. This has been a result of consistent efforts made by the Government, which has a clear point-wise agenda to achieve an improvement on each of the parameters for enhancing ease of doing business in India.

With its overall objective of making it easier to do business in the country, the Government is also empowering states to formulate policies relating to investment and incentives or subsidies in order to attract investments. It has also put in place a mechanism for competitive ranking of the states on ease of doing business and has provided them with a clearly set out agenda for improvement on various aspects, including developing a single window clearance process for licensing, approvals and the registrations, and doing away with archaic laws. The states will be competitively ranked index on an annual basis going forward.

## Foreign investment

### Entry options

A foreign entity setting up operations in India can either operate as an Indian company (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 engage in business activities permitted under the country's FDI policy. Such a subsidiary is treated as a separate legal entity and requires at least two shareholders (in the case of a private limited company) and seven shareholders (in the case of a public limited organisation). In addition, two directors are required, with one of them being an Indian resident.

### Limited Liability Partnership (LLP)

In India, an LLP is structured as a hybrid entity, with the advantages of a company (since it is a separate legal entity with 'perpetual succession'), and at the same time enjoys the benefits of organisational flexibility associated with a partnership structure. At least two designated partners are required, of which one needs to be an Indian resident.

No tax is levied on distribution of profits as dividends to partners, unlike in the case of a company for which Dividend Distribution Tax (DDT) is applicable on repatriation of dividends.

Foreign investment in LLPs is permitted in sectors where 100% FDI is permitted 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 have the option of conducting their operations in India by forming strategic alliances with their Indian partners. Typically, such foreign entities identify partners engaged in the same area of activity or those that can add synergies to their strategic plans in India. Sometimes, formation of JVs is necessitated due to restrictions on foreign ownership in selected sectors under the FDI policy, e.g., the Insurance and Multi-brand Retail Trade segments.

## 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 commercial objective. This can be done by submitting an application to an Authorised Dealer (AD) bank. However, the approval of the RBI is required under the following circumstances:

- The applicant is a citizen of or is registered or incorporated in Pakistan.
- The applicant is a citizen of or is registered or incorporated in Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau and the application is for opening a BO, LO or PO in Jammu and Kashmir, the North East region or the Andaman and Nicobar Islands.
- The principal business of the applicant is concentrated in four sectors—Defence, Telecom, Private Security, and Information and Broadcasting. (However, it does not need separate approval from the Government to set up a PO pursuant to a contract awarded by the Ministry of Defence, Service Headquarters or Defence Public Sector Undertakings.)
- The applicant is a Non-Government Organisation (NGO), Non-Profit Organisation, or an entity, agency or 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 a common practice among foreign companies or 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 range of activities, including revenue-generation, in India. Foreign entities can set up branch offices in the country to conduct the following activities:

- Export and import goods
- Provide professional or consultancy services
- Participate in 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 their buying or selling agents in the country
- Offer IT and software development services in India
- Provide technical support for products supplied by their parent or group companies
- Represent foreign airlines or shipping companies

### Project offices

Foreign companies planning to execute specific projects in India have the option of setting up project and site offices. Such project offices (POs) can be operational during the tenure of a project. Where the criteria prescribed are not met, approval is required from the RBI to set up a PO.

### Foreign investment in India

Currently, FDI is permitted in all sectors except in the following:

- Lottery business, including government or private lotteries or online lotteries
- Gambling and betting, including in casinos
- Chit funds and 'Nidhi' companies
- Trading in Transferable Development Rights (TDRs)
- Real Estate business or construction of farmhouses
- Manufacture of cigars, cheroots, cigarillos and cigarettes, and tobacco or tobacco substitutes
- Activities and sectors not open to private sector investment, e.g., atomic energy and railway operations (other than those specifically permitted)
- Collaboration on foreign technology in any form, including licensing of franchises, trademark, brand names, management contracts for lotteries, and gambling and betting activities

India's FDI policy covers 27 sectors and activities with sectoral caps or conditions for receiving foreign investment. Insurance, Construction and Development, Retail, Telecom and Media are some of these sectors.

Foreign investment is allowed in India via the following routes:

- **Automatic route:** Prior approval is not required from the Government to receive foreign investment
- **Approval route:** This requires the Government's approval for receiving foreign investment.

Foreign investment-related proposals under the government approval route (involving a total inflow of foreign equity of more than INR 50 billion) need to be placed before the Cabinet Committee on Economic Affairs (CCEA) of the Government for further consideration.

**Computation of foreign investment**

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

Any downstream investments made by an Indian company (owned or controlled by non-residents either under the FDI route or the portfolio investment route) also need to comply with sectoral caps and conditions. Details of downstream investments made by foreign-owned and controlled companies have to be intimated to the DIPP or Secretariat for Industrial Assistance (SIA).

Any portfolio investment made by a Securities and Exchange Board of India (SEBI)-registered Foreign Portfolio Investor (FPI), known as a Registered Foreign Portfolio Investor (RFPI), is also regarded as a 'foreign' investment. Such investments are subject to individual and aggregate investment limits of 10% and 24%, respectively (and the aggregate limit can be increased up to the sectoral cap with a board and special resolution). The individual and aggregate limit for NRIs investing under the Portfolio Investment Scheme is capped at 5% and 10%, respectively (and the aggregate limit for them can be increased to 24% with a board and special resolution).

In addition, RFPIs are eligible to invest in government securities and corporate debt from time to time, subject to limits specified by RBI and SEBI.

**Valuation-related norms**

Issue of shares to non-residents or transfer of shares by residents to non-residents, and vice versa, is subject to valuation-related guidelines, based on which there needs to be a fair valuation of shares. This valuation is done 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 arrived at 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 without the need for a valuation.

## 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 an enterprise. It 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 needs to comply with the sectoral caps detailed in the Government's FDI policy.

**Fully and compulsorily convertible preference shares and debentures**

Indian companies can also 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.

Optionality clauses are allowed in fully and compulsorily convertible preference shares, debentures and equity shares under the FDI scheme in the following circumstances:

- There is a minimum lock-in period of one year.
- This period is effective from the date the capital instruments are allotted.
- After the lock-in period, and subject to the provisions of the FDI policy, non-resident investors exercising their option or right are allowed to exit without any assured returns, in accordance with pricing- and valuation-related guidelines issued by the RBI from time to time.

**External Commercial Borrowings (ECBs)**

ECBs are commercial loans and include 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 either be availed of under the automatic route or the approval route. Under the approval route, prior permission of the RBI is required to raise ECBs. Under either route, it is mandatory to periodically provide post-facto intimation to the RBI, as prescribed under the Foreign Exchange Management Act (FEMA), 1999.

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

- **Track I:** Medium-term foreign currency-denominated ECBs with a minimum average maturity of 3 to 5 years
- **Track II:** Long-term foreign currency-denominated ECBs with a minimum average maturity of 10 years
- **Track III:** Indian rupee (INR )-denominated ECBs with a minimum average maturity of 3 to 5 years

ECB guidelines prescribe an 'all-in-cost' ceiling for raising funds through ECBs. This includes the rate of interest, other fees, expenses, charges and guarantee fees (whether paid in foreign currency or INR ), but not commitment fees, pre-payment fees or charges and Withholding Tax payable in Indian rupees. In the case of fixed rate loans, the swap cost and the spread should be equal to the floating rate in addition to the applicable spread. The all-in-cost ceiling depends on the track under which ECBs have been raised, and is prescribed through a spread over the benchmark, i.e., 450 basis points per annum over a six-month London Interbank Offered Rate (LIBOR) or applicable benchmark for the particular currency.

Borrowers eligible for ECBs include companies operating in the manufacturing and software development sector, shipping and airline companies, core investment companies, enterprises in the infrastructure sector and organisations engaged in the miscellaneous services sector. The list is separate for each of the tracks mentioned above. The RBI has prescribed the limits up to which ECBs can be availed and its approval is required to raise funds beyond these limits.

The purpose for which ECBs can be utilised depends on the track under which they have been obtained. Some permitted end uses include import or local sourcing of capital goods for general corporate purposes, etc. The negative list for all tracks, as stated above, include the following:

- Investment in real estate or purchase of land except when used for affordable housing (as prescribed), construction and development of SEZs and industrial parks or integrated townships
- Investment in capital markets
- Investment in equities

ECBs can be raised for the following purposes by eligible entities from permitted lenders under Track II or from a group company /foreign equity holders of eligible entities under Track I & III:

- Working capital purposes
- General corporate purpose
- Repayment of rupee loans

Furthermore, ECBs raised under any of the tracks cannot be used for on-lending for any of the negative list items given above.

Non-convertible, optionally convertible or partially convertible preference shares and debentures issued on or after 1 May 2007 are considered as debt, and all the norms applicable to ECBs in relation 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 ECBs, any corporate or body corporate, as well as REITs and InvITs, can issue rupee-denominated bonds with the prior approval of the RBI, with a minimum maturity period of three years for Masala Bonds raised up to US$ 50 million (equivalent Indian rupee) per financial year and for above US$ 50 million (equivalent Indian rupee) five years for any investor from a Financial Action Task Force (FATF)-compliant jurisdiction. However, recognised investors should not be related parties (of borrowers) according to Ind AS 24.

The all-in-cost ceiling for the bonds is 300 basis points over the prevailing yield of the Government of India's securities of corresponding maturity. End use-related restrictions in the case of these bonds are generally aligned with those pertaining to ECBs.

**Investment by FPIs in corporate debt securities**

FPIs can make investment under the corporate bond route, including in unlisted corporate debt securities in the form of NCDs or bonds issued by public or private companies.

Investment by a FPI with a maturity of below one year should not exceed 20% of its total investment. This norn should be complied with on a continuous basis, subject to an end-use restriction on investment in the real estate business, capital market and purchase of land. The RBI has also imposed concentration limits for FPIs and their related entities on investment in debt securities such as G-secs, State Development Loans and corporate bonds.

## Significant exchange control-related regulations

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

Transactions that alter the foreign assets or liabilities, including contingent liabilities, of a person resident in India or the assets or liabilities of a person in India who is resident outside the country, including transactions referred to under Section 6(2) and 6(3) of FEMA, are classified as capital account transactions. Transactions other than these 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 the RBI.


**Current account transactions**

The RBI has delegated its powers to AD banks (entities authorised by the RBI) in relation to monitoring of or granting permission for remittances under the current account window. All current account transactions are usually permitted unless they are specifically prohibited or restricted.

According to the Current Account Transaction (CAT) Rules, withdrawal of foreign exchange is prohibited for the following purposes:

- Remittance 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 for equity investments in the JVs or wholly owned overseas subsidiaries of Indian companies
- Remittance of dividend by a company for which the requirement of 'dividend balancing' is applicable
- Payment of commissions on exports under the 'rupee state credit' route, except for commissions of up to 10% of the invoice value of export of tea and tobacco
- Payment for the 'call back services' of telephones
- Remittance of the interest income of funds held in a non-resident special rupee (account) scheme

CAT Rules also specify transactions for which withdrawal of foreign exchange is only permitted with the prior approval of the Central Government. However, the Government's approval is not required if payment is made from funds held in the Resident Foreign Currency Account of the remitter.

Resident individuals can avail of the foreign exchange facility for the purposes mentioned in Para 1 of Schedule III of the FEM (CAT) Amendment Rules, 2015, dated 26 May 2015 (within a limit of US$ 250,000), as prescribed under the Liberalized Remittance Scheme (LRS).

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 being made by corporate organisations:

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

Any remittance in excess of US$ 250,000 and the limits given above for the specified purposes mentioned will require the prior approval of the RBI.

## Capital account transactions

The general principle for capital account transactions is that these are restricted unless specifically or generally permitted by the RBI, which has prescribed a number of permitted capital account transactions for individuals resident in or outside India. These include the following:

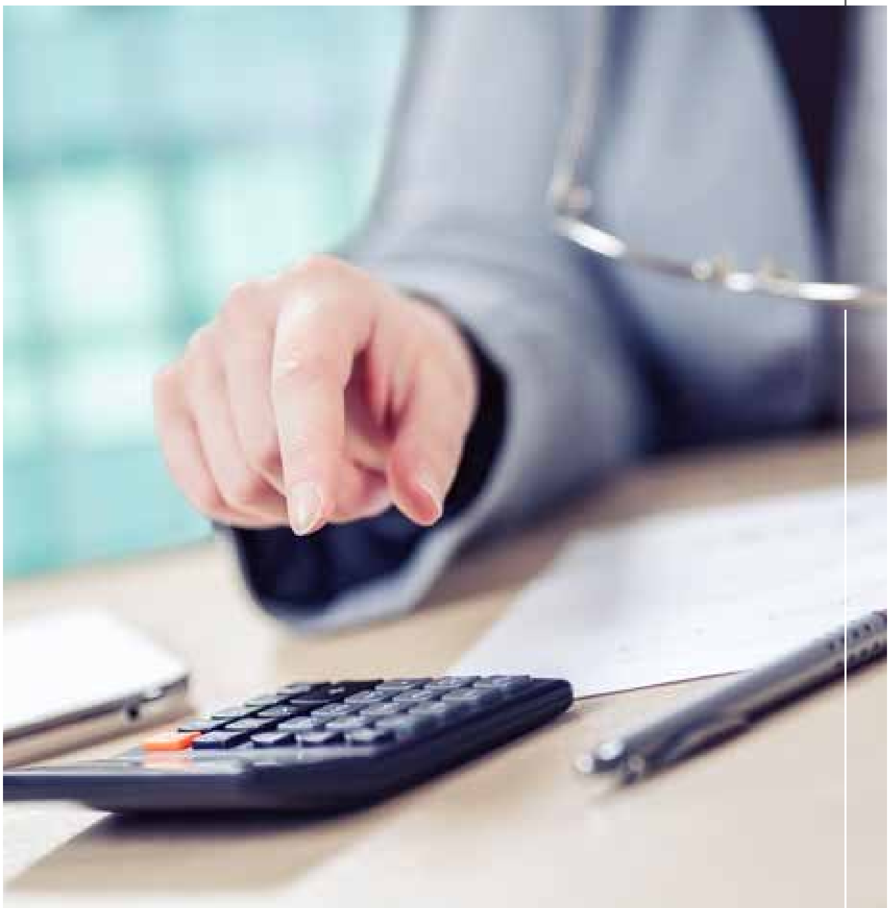
- Investment made in foreign securities by a person resident in India
- Investment made in India by a person resident outside the country
- Borrowing or lending in foreign exchange
- Deposits between persons resident in India and persons resident outside the country
- Export or import of currency
- Transfer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

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

- Opening of a foreign currency account outside India
- Purchase of property outside the country
- Making investments in foreign countries
- Setting up wholly owned subsidiaries and JVs outside India
- Giving loans, including in Indian rupees, to NRI relatives

With respect to overseas investments in a JV or wholly owned subsidiary, the limit for a financial commitment is up to 400% of the net worth of an Indian entity as on its last audited balance sheet date. However, any financial commitment exceeding US$ 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 entity is within the eligible limit under the automatic route (i.e., within 400% of its net worth according to its last audited balance sheet).

In order to set up offices abroad, AD banks are permitted to allow remittances by Indian entities towards initial expenses of such offices. The limit set is 15% of their average annual sales, income or turnover during the previous two financial years or up to 25% of their net worth, whichever is higher. Remittances of up to 10% of an entity's average annual sales, income or turnover are allowed for the recurring expenses it has incurred on its normal business operations during the previous two financial years.



## Repatriation of capital

Foreign capital invested in India is usually repatriable, along with capital appreciation, 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 the country unless this is by way of inheritance. However, they can acquire or transfer immovable property in India on a lease, which does not exceed five years, without the prior permission of the RBI.

Foreign companies that have been permitted to open branches or POs in India are only allowed to acquire immovable property in the country that is necessary for or incidental to their carrying out such activities. Foreign enterprises that have been permitted to open LOs in India can only acquire property by way of a lease (that does not exceed 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.

# Global Mobility International assignments to India

Taxation of foreign individuals coming to work in India depends on their residential status during the relevant tax year, which in turn takes into account the number of days they were physically present in the country. The tax year extends from 1 April of any year to 31 March of the following year.

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

- They have been present in India for 182 days or more in the relevant tax year (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 tax years (referred to as the '60 days rule').

However, only the 182 days rule is 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 tax year.

Resident individuals are treated as Residents but Not Ordinarily Residents (RNOR) of India if they satisfy either of the following conditions:

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

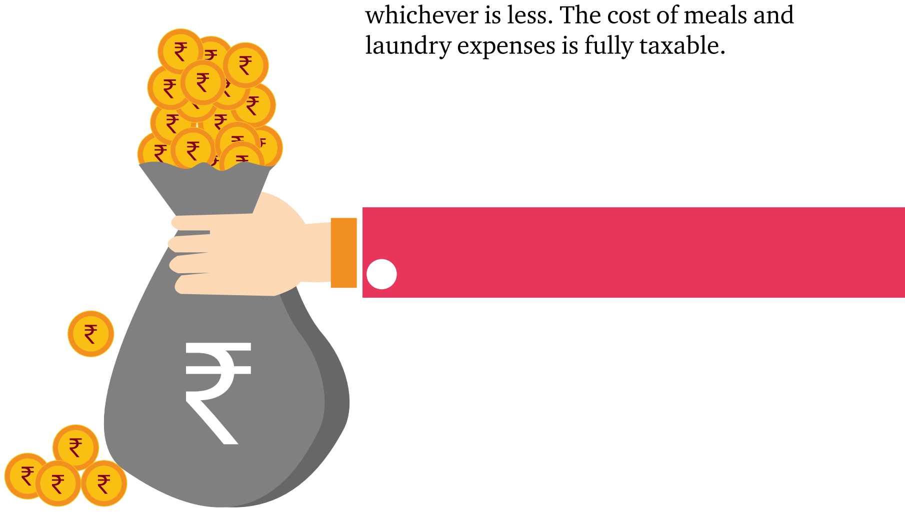
If individuals do not satisfy both the conditions listed above, they qualify as Resident and Ordinarily Resident (ROR) for that specific tax year.

In determining the physical presence of individuals in India, it is not essential that their stay in the country is continuous or at the same place. Furthermore, their date of arrival in India and date of departure from it are both to be included for determining their period of stay in the country. However, the purpose of their stay in India is irrelevant, and even if it is for a visit to their families or tourism, it is counted for determining their residency. If individuals qualify as tax residents of India as well as of their home countries, the conditions prescribed under the tie-breaker test of the relevant DTAA need to be referred to shift the residency to either of the two countries.

## Scope of taxation

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

- **ROR:** The global income of individuals is liable to tax in India, i.e., income received or deemed to be received in India; accruing, arising or deemed to accrue arise in the country and accruing or arising outside India.
- **RNOR:** Income received in India; accruing, arising or deemed to accrue or arise in the country, derived from business controlled from India or from a profession set up in the country is liable to tax in it.
- **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-generated income

Employment-generated income for services rendered in India is taxable in India, irrespective of where it 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 modes of remuneration include allowances, reimbursement of personal expenses, payment of education and the 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-related benefits provided by employers are generally taxed at 15% of their salaries or on the actual rent paid for accommodation, whichever is less. Hotel accommodation is taxable at 24% of the salary or the actual amount paid, whichever is less. The cost of meals and laundry expenses is 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 INR 150, 000, are taxable as perquisites in the hands of employees. Car and driver facilities provided by employers are also taxable as perquisites, although at a concessional value.

There are several issues relating to taxation of employment-generated income, which depend on the facts and circumstances of each case as well as on the tax authorities' views. Therefore, it is advisable to seek professional advice on a remuneration package as a whole, for appropriate tax cost estimation.

## Withholding Tax

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

## DTAA

In situations where individuals are treated as tax residents of other countries, they may qualify for relief under Indian Tax law under the DTAA 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 include clauses that exempt residents of specific countries from tax on employment-generated 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 relating to 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 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.

It is important to note that appropriate advice should be taken with respect to specific facts before adopting such positions.

## Tax rates

Taxes are levied at progressive rates in India. The rates applicable for tax year 2018-19 are as follows:

| Taxable income (INR ) | Tax rate |
|---|---|
| Up to INR 250,000 | NIL |
| INR 2,50,001 to INR 5,00,000 | 5% |
| INR 5,00,001 to INR 10,00,000 | 20% |
| Above 10,00,000 | 30% |

The basic exemption limit for resident individuals above 60 years but less than 80 years of age at any time during the tax year is INR 3, 00,000 and for resident individuals who are 80 years of age or more, it is INR 5, 00,000.

A surcharge of 10% is to be levied where the total income of individuals exceeds INR 5 million, but does not exceed INR 10 million. Where the total income of individuals exceeds INR 10 million, the rate of surcharge will be 15%. In addition to this, a health and education cess at the rate of 4% of the tax and surcharge (if applicable) will be levied to compute the final tax liability of individuals.

The maximum marginal tax rate for individuals with an income of up to INR 0.5 million is 31.2%. It is 34.32% for those with a total income of above 0.5 million, but not more than 10 million, and 35.88% for those with a total income of more than 10 million.

A tax rebate of up to INR 2,500 is offered to resident individuals earning an income of up to INR 0.35 million.

## Tax registration

Individuals are required to apply for and obtain their tax registration number, known as a Permanent Account Number (PAN). A PAN is needed to file tax returns and has to be reported in tax withholding returns and withholding certificates issued to individuals.

### Filing of tax returns

At the end of every tax year, a personal tax return needs to be filed with the Income Tax authorities in the prescribed format. The due date for salaried individuals filing returns is typically 31 July of the year immediately following the relevant tax year (a different date may apply for individuals who have business or professional income). The tax return can be filed after the due date also but with monetary implications. A fee of INR 5,000 is levied where the tax return is filed after the due date, but by 31 December of the relevant assessment year, and a fee of INR 10,000 if filed after 31 December. This fee is capped at INR 1,000 for taxpayers earning a total income of up to INR 0.5 million. It is mandatory for individuals to file returns electronically if their total income exceeds INR 5,00,000, if they qualify as RORs and own foreign assets or they have signing authority for any of their accounts located outside India.

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). Furthermore, the Income-tax Return Form requires individuals with total income exceeding INR 5 million to report details of their assets and their corresponding liability at the end of their year in India. This includes assets such as immovable and movable property; cash in hand; other tax assets; jewellery; bullion; archaeological collections; drawings, paintings, sculptures or any works of art; vehicles, yachts, boats and aircraft; financial assets such as bank, shares and securities; insurance policies; loans and advances given or interest held in the assets of a firm or association of persons or members.

## Other matters

### Visa

Foreign nationals wanting to come to India need to have valid passports and visas. Visas are issued by Indian Consulates or High Commissions in their home countries. The type of visa required to be obtained depends 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, which are 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 Joint Ventures (JVs) require business visas, which cannot be converted into employment visas in the country.

### 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 issues 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 or group companies in India, to open, hold and maintain foreign currency accounts with banks outside the country. Such foreign nationals can remit their salaries to their bank accounts outside India, provided tax on their salaries has been duly paid in India.

### Social security in India

Foreign nationals holding the passports of foreign countries are mandatorily required to contribute to Indian social security schemes, provided they are working for establishments to which Indian social security laws apply. However, if such foreign nationals belong to countries with which India has a Social Security Agreement (SSA) and they contribute to the social security schemes in their home countries, they are exempt from contributing to Indian social security schemes, provided they obtain a Certificate of Coverage (COC) from their home countries' social security authorities.

India has signed SSAs with 19 countries and most are operational, except the SSA with Brazil, which is not operative yet.

Similarly, International Workers (IWs) from countries with which India has entered a bilateral Comprehensive Economic Cooperation Agreement (CECA) prior to 1 October 2008 are exempted from India's social security regulations if they meet the following criteria:

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

Singapore is the only country with which India had signed such a CECA before October 1, 2008.

IWs who are not exempt for reasons given above are required to contribute 12% of their salaries to India's social security system. Employers need to deduct this amount from their employees' monthly salaries, and after making a matching contribution of 12%, deposit the amount with the country's social security authorities. Currently, for any IW coming to work in India for a covered establishment, and drawing a salary of more than INR 15,000 per month, the employer's contribution of 12% is deposited in the Provident Fund account and no allocation is made to the Pension Fund. However, for IWs who joined before 1 September 2014 and are still working in India, an amount equal to 8.33% of their salaries is allocated to the Pension Fund and the balance is deposited in the Provident Fund account.

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

- On their retirement from service in the organisation 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 employees of a covered establishment (when the international employee is from an SSA country)

In the case of international employees 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 from their Provident Fund accounts. To simplify the process of withdrawal, an option is also available whereby IWs from SSA countries can provide details of their overseas bank accounts in which they wish to receive their Provident Fund amounts. The Provident Fund authorities, after completing the requisite formalities and documentation, can facilitate payment to these overseas bank accounts.

The accumulated sum in Pension Funds is paid as pension to employees on their retirement, or in certain other circumstances as specified in the Pension Scheme. International employees are not entitled to pension benefits from the Pension Fund unless they have rendered eligible service for a period of 10 years to 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 documentation

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

- Corporate Tax implications (viz. exposure to permanent establishment)
- Withholding Tax implications
- Transfer Pricing regulations
- GST implications
- Indian social security regulations
- Exchange control regulations
- Company law regulations

## 'Black Money' Act

The Black Money (Undisclosed Income and Foreign Assets) and Imposition of Tax Act, 2015 (the Black Money Taxation Act), covers all persons who are resident in India, in accordance with the provisions of the Income-tax Act, 1961 (the Act). Those qualifying as RNOR in India are excluded from the ambit of this Act. Any undisclosed foreign income or 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 can attract a penalty of INR 1 million and imprisonment of up to seven years.

## Aadhaar registration in India

The Aadhaar number is a 12-digit individual identification number issued by the Government of India. It is based on an individual's biometric and demographic data. It is not a proof of Indian citizenship and only serves as proof of identity. Currently, the applicability of Aadhaar for different purposes such as banking operations, mobile telephone connections, etc. is under consideration at the Central Government level. It is advisable to check the requirement of applying for Aadhaar after arrival of the foreign national in India.

# Financial Services Sector

## Overview

The Indian Financial Services sector is expected to dominate the Indian economy over the next decades. Banking, capital markets, asset management, etc., are expected to grow significantly in the next few years. Foreign Portfolio investors are again keen to invest in India in the long term. In addition, large players in the fund management industry are exploring investment opportunities and are setting up their business presence in India.

India's Financial Services sector is operating in a fast-evolving and dynamic regulatory and tax landscape with an ever-growing demand for transparency and efficiency. This makes it extremely important for industry players or new entrants to understand the tax and regulatory framework, which could make an impact on their business goals. We have mentioned certain key vehicles below, which are the drivers of India's Financial Services sector and has specific tax regime for the reference.

## Banking and financing

The Banking sector in India is governed by the RBI, the country's central bank, which is the supervisory authority for all banking operations in the country. The RBI has put in place a regulatory framework and guidelines to not only regulate banking companies in India, but also non-banking financial companies, asset reconstruction companies, investment holding companies, etc.

India's banking sector is broadly represented by public sector banks (most of which are owned by the Government of India), private sector banks, foreign banks operating in the country through their branches, subsidiaries, etc. While taxation of these banks is similar to that applicable for the general corporate entities of the branches of foreign companies in India, there are certain provisions that specifically relate to banks in India, such as the following:

a. Deduction of provision for bad and doubtful debts in the range of 5% to 8.5% of the total income computed in the prescribed manner, depending on the type of bank

b. Fexibility to offer interest on non-performing assets for levy of Income-tax on a cash basis (instead of accrual basis)

## Alternative Investment Funds (AIFs)

In 1996, Venture Capital Fund (VCF) regulations were framed by the Securities and Exchange Board of India (SEBI) to encourage funding of entrepreneurs' early stage companies. However, it was found over the years that VCFs were being used as a vehicle for many other funds such as private equity, private investment in public equity and real estate. Therefore, in 2012, VCF regulations were replaced by the SEBI's Alternative Investment Funds regulations with the intention to regulate unregistered pooling of vehicles, to avoid regulatory gaps and to offer a level playing field for the same type of fund or industry.

An AIF is a privately pooled investment vehicle, established or incorporated in India, and can be set up in the form of a trust or company or limited liability partnership. Pooling of funds is permissible by domestic and foreign investors, and investments should be made in line with a defined investment policy, depending on the category of AIF on the basis of the AIF regulations.

AIFs are divided into three categories, based on their investment-related focus:

- Category I AIFs, include funds that invest in start-up or early stage ventures, social ventures, small and medium enterprises (SMEs), infrastructure or other sectors regarded socially or economically desirable (These comprise venture capital funds, SME funds and infrastructure funds.)
- Category II AIFs, which include funds that do not specifically fall under either Category I or Category III (A typical private equity fund or a debt fund falls within this category.)
- Category III AIFs, which include funds that employ diverse or complex trading strategies and leverage, including through exposure to derivatives (Hedge funds typically fall within this category.)

An AIF can be set up if it satisfies the minimum criteria:

| Parameter | Particulars |
|---|---|
| Minimum fund size | INR 200 m |
| Minimum investment by an investor | INR 10 m |
| Number of investors | 1 (min) to 1,000 (max) |
| Mode of raising capital | Private placement |

Category I and II AIFs are regarded as (i) 'tax transparent' vehicles for all investment income, i.e., the AIF pays no tax, and its income is clubbed in the investor's tax return and is taxable in the hands of the investor at applicable rates and (ii) 'tax opaque' vehicles for all its business income.

The following table summarises the taxability of each income stream:

| Type of income | Taxability in the hands of Category I and II AIFs | Taxability in hands of the investors |
|---|---|---|
| Dividend | Exempt | Tax in investor's hands at the applicable rates; AIF to withhold tax:<br>• At 10%, for all residents<br>• At applicable rates, for non-residents (except exempt income) |
| Capital gains | Exempt | |
| Interest | Exempt | |
| Business income | 30% (plus applicable surcharge and cess) | No further tax for investors |

Tax transparency allows each investor to pay taxes based on its individual status, rather than pay tax in India at 30% (plus applicable surcharge and cess). For non-residents, this also includes any benefits or concessions that may be available under a tax treaty between India and the country of residence of the investor.

Currently, no pass-through status has been accorded to a Category III AIF, and accordingly, the general principles of trust taxation applies to it. Taxation of a trust depends on the nature of a transfer or contribution made by an investor (revocable or irrevocable), and whether beneficiaries and their respective interests in the AIF are identified or determined upfront (determinate or indeterminate trust) and the nature of activity undertaken by the AIF (i.e., whether any business activity has been undertaken)

From the perspective of exchange control in India, foreign investment is permitted in AIFs under the automatic route. Furthermore, there are no restrictions on downstream investments by AIFs if the sponsor or the manager or investment manager of the AIF is not controlled and owned by resident Indian citizens. In this scenario, AIFs are regarded as Indian resident vehicles, regardless of their investor base. As Indian resident vehicles, AIFs have no restrictions on their choice of investment instrument and sectors in which they can invest. Where the sponsor or manage or investment manager of an AIF is not owned and controlled by an Indian, it is treated as a 'non resident'. In this case, the AIF's investments are subject to India's prevailing Foreign Direct Investment policy.

Furthermore, AIFs are permitted to make overseas investments, subject to certain conditions.

## Foreign Portfolio Investors (FPIs)

In a bid to encourage and simplify foreign portfolio investments in India, the SEBI introduced the Foreign Portfolio Investors Regulations in 2014, which considerably eased entry norms for foreign investors wanting to access the growing Indian Capital Markets. The FPI regulations replaced the SEBI's Foreign Institutional Investor Regulations and Qualified portfolio Investors framework.

An FPI has been defined to signify a person who satisfies the prescribed eligibility criteria and is registered under the FPI regulations. The primary condition for an applicant desirous of seeking an FPI registration is that it should not be a resident in India or a non-resident Indian.

FPIs are divided into three categories, based on the perceived risk attached to each category:

| Category | Type of investors |
|---|---|
| Category I (low risk) | Government and government-related investors such as central banks, governmental agencies, sovereign wealth funds and international or multilateral organisations or agencies |
| Category II (moderate risk) | • Appropriately regulated* broad-based funds such as mutual funds, investment trusts and insurance companies<br>• Unregulated broad-based funds that can register themselves if their investment managers are appropriately regulated<br>• Includes mutual funds, investment trusts, insurance or reinsurance companies<br>• Also includes banks, asset management companies, investment managers or advisors, portfolio managers, university funds and pensions funds |
| Category III (high risk) | Residuary category, such as endowments, charitable societies, charitable bodies, foundations, corporate bodies, trusts, individuals** and family offices |

*These are regulated or supervised by the banking regulator or the securities market regulator of home country or another country. The regulator must permit investment activities in India.

** NRIs are not permitted to register as FPIs, but can invest in FPIs, subject to certain conditions.

FPIs are investment vehicles that primarily invest in listed Indian securities. Apart from these, FPIs are allowed to invest in various other specified securities such as perpetual debt instruments, government securities, commercial papers, unlisted non-convertible debentures subject to certain conditions and security receipts.

Notably, FPIs cannot invest in unlisted equity shares. Consequently, they are not used for making investments in the private domain.

FPIs are subject to a special tax regime under Indian tax law. Tax rates applicable to the typical income streams earned by an FPI are as follows:

| Nature of income | Rate of tax (%) | |
|---|---|---|
| | Foreign corporates | Non-corporates |
| Dividends declared, distributed or paid | Nil | Nil |
| Interest other than interest on government securities and Indian Rupee- denominated bonds of Indian companies | 20 | 20 |
| Interest on government securities and Indian Rupee-denominated bonds up to 30 June 2020 | 5 | 5 |
| Short-term capital gains:<br>• Sale of listed securities on which securities transaction tax has been paid | 15 | 15 |
| • Others | 30 | 30 |
| Long-term capital gains | 10 | 10 |
| Business income and any other income | 40 | 30 |

The rates given above need to be increased by applicable surcharge and cess. This tax regime is subject to any relief the FPI may be entitled to under an applicable tax treaty.

## Real estate investment trusts and Infrastructure investment trusts

Infrastructure and real estate are the two most critical sectors in any developing economy. A well-developed infrastructural set up propels the overall development of a country. It also facilitates steady inflow of private and foreign investments, and thereby augments the capital base available for the growth of key sectors in it, as well as its growth, in a sustained manner. A robust real estate sector, comprising sub-segments such as housing, retail, hospitality and commercial projects, is fundamental to the growth of an economy and helps several sectors develop significantly through the multiplier effect.

However, both these sectors need a substantial amount of continuous capital for their development. In view of their importance in India and the paucity of public funds available to stimulate their growth, it is imperative that additional channels of financing are put in place. Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) are investment vehicles that can be used to attract private investment in the infrastructure and real estate sectors, and also relieve the burden on formal banking institutions. Regulations governing REITs and InvITs were introduced SEBI in 2014.

| Sr No | Key stakeholders | Features / benefits |
|---|---|---|
| 1. | Sponsor (person who sets up a REIT) | • Generally a developer or financial investors<br>• Increased exit opportunities for developers and financial investors<br>• Availability of last-mile funding for stalled projects. |
| 2. | Investors | • Participation in asset class not easily accessible otherwise<br>• Diversification of investment holdings helping in management of overall risk<br>• Ease of entry and exit for investors from the real estate sector |

## Key aspects of SEBI's regulations

### Main eligibility criteria for setting up of an Investment Trust

To set up an Investment Trust, the sponsor needs to meet the following criteria and have the following:

- Asset size of INR 500 million
- Offer size INR 2500 million;
- Minimum public float 25%
- Minimum number of investors 200 in the case of REITs and 20 in the case of InvITs

Furthermore, the sponsor is required to make a contribution, as prescribed under SEBI's regulations, in order to set up an Investment Trust.

### Regular distribution of cash flows

Investment Trusts are required to distribute a significant portion of their net distributable cash flows as dividends to unit-holders on a regular basis.

## Foreign investments in Investment Trusts

Foreign investments in Investment Trusts have been allowed by the Government in an attempt to provide further avenues from which the former can access funds. Investments in Investment Trusts was allowed through the FDI route by the introduction of the concept of 'investment vehicle' which inter alia includes REITs and InvITs.

While FDI is prohibited in 'real estate business', in order to enable foreign investments in REITs, it has been specifically excluded from the definition 'real estate business'.

Similar to AIFs, the sponsor, investment manager and asset manager of an Investment Trust is owned and controlled by an Indian citizen or citizens. The investment made by such an Investment Trust in SPVs is treated as domestic investment. Moreover, sale, redemption or repatriation of units of Investment Trusts is permissible under the automatic route.

### Overview of taxation of Investment Trusts

| | Setup | Income recognition & distribution | Exit |
|---|---|---|---|
| Sponsor<br>Inverstor | Capital gains - Exempt#MAT deferred | Dividend - exempt^<br>Interest - taxable<br>(Domestic @ 30%<br>Foreign @ 5%) | STCG - 15%<br>LTCG - 10% (without indexation) ##<br>(equity shares + REIT units, held for more than 36 months in aggregate) |
| REIT | | Tax exemt<br>WHT on interest paid | Gains on sale of securities- taxable |
| Asset SPV | | Income Tax / MAT/ AMT<br>No DDT* (in case of single-tier structure)<br>No WHT on interest | Gains on sale of assets- taxable |

# On exchange of shares of comapny for REIT units
^ exposure of dividends above INR 10,00,000 being taxed at 10%
## on gains above INR 100,000
* Dividend Distribution Tax (DDT) is not applicable if REIT holds 100% of equity share capital of the Asset SPV and dividend is paid out of current income
**Note:** Rates are excluding surcharge and eduaction cess

# Mergers and Acquisitions (M&A)

## India's M&A framework

India's regulatory framework facilitates acquisitions, transfers or hive-offs through different modes, each with its distinct tax-related characteristics and varying regulatory ease of conducting deals. Common modes of executing transactions include:

- Share purchase
- Business purchase or asset purchase
- Amalgamations or demergers

## Transactions through share transfer

### Implications for sellers

Transfer of the shares of an Indian company is taxable as capital gains, subject to any tax treaty benefits that may be available for the seller. Taxability varies for listed and unlisted shares and is summarised in the table below:

| Nature of capital gain | Unlisted shares/shares of private company | Listed shares |
|---|---|---|
| Long Term Capital Gains (LTCG) (gains from shares held for more than:<br><br>12 months in the case of listed shares<br><br>24 months in the case of unlisted shares) | For residents – 20% (with indexation)<br><br>For non-residents – 10% (without indexation and giving effect to currency conversion) | • If sold through stock exchange –<br>Gains in excess of INR 100,000 will be taxable in the hands of residents and non-residents at the rate of 10% (without indexation).<br>However, gains up to 31 January 2018 are grandfathered and exempt.<br><br>• If sold other than through stock exchange:<br>  • Resident – 10% (without indexation)/20% (with indexation), whichever is beneficial to the taxpayer<br>  • Non-residents:<br>    a. When acquired in foreign currency – 20% (without indexation, but benefit of currency conversion available)<br>    b. When acquired in INR – 10% (without indexation)/20% (with indexation), whichever is beneficial to the taxpayer |
| Short Term Capital Gains (STCG)<br><br>(gains that do not qualify as long term) | For resident companies, LLPs and firms – 30%/25% (in the case of companies with turnover of up to INR 250 crores in previous yea r– 2016-17)<br><br>For resident individuals – taxable according to applicable slab rates<br><br>For non-resident companies – 40% | • If sold paying Securities Transaction Tax – 15%<br><br>• If sold otherwise– tax implications similar to treatment of sale of unlisted shares |

### Taxability of indirect transfer

Transfer of the shares of a foreign company with underlying assets in India is also taxable in the hands of the seller, if the shares of the foreign company substantially derive value from its assets in India (i.e., the fair market value of Indian assets (a) exceeds INR 10 crore and (b) represents at least 50% of the value of all the assets owned by the company, as prescribed).

However, no indirect transfer taxation applies if the transferors hold minority stakes (of 5% or less) and have no right of management or control in the foreign company. Additionally, in the event of a merger or demerger of the foreign company, exemption from Capital Gains Tax is available in India on fulfilment of the prescribed conditions.

### Implications for buyers

- According to SEBI's Takeover Code, acquisition of 25% shares (or more) or control of a listed company obligates the acquirer to make an offer to its remaining shareholders on the same terms.
- Stamp duty at 0.25% of the value of the shares is levied if shares are physically transferred.
- Funding costs, i.e., interest charged on a loan for acquisition of shares, may not be tax-deductible, since the corresponding dividend income is tax-exempt in the hands of the shareholders.
- In the case of non-resident sellers, a buyer (including a non-resident) is required to withhold Indian tax arising to the sellers, and therefore, needs to obtain a tax registration number in India. Parties can seek clarity on the aspects of Withholding Tax by obtaining a prior No Objection certificate from the Tax authorities.
- If a buyer receives any property, without consideration or at a consideration that is less than the fair market value (FMV) determined on the basis of prescribed rules, the difference between the FMV and sale consideration is taxable in the hands of the buyer.

### Preservation and carry-forward of tax losses on a change in shareholding[10]

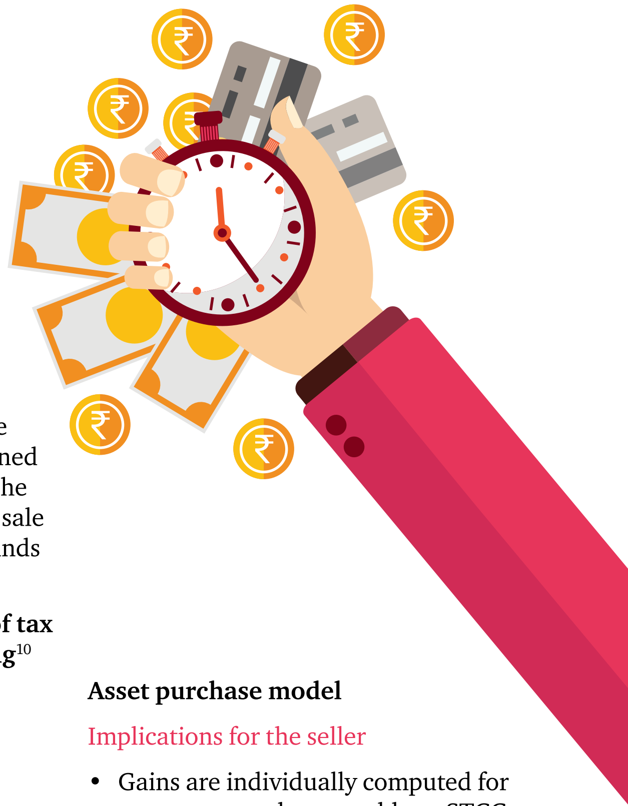
- There is no impact on the carry forward or set off of losses on a change in the shareholding of a listed company.
- Unlisted companies are not entitled to carry forward and set off their tax business losses (excluding unabsorbed depreciation), if any, if there is a change of 50% or more in their shareholding.

### Valuation of shares

The RBI regulates the pricing of every transaction between residents and non-residents in the shares 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, where the buyer can cherry-pick the assets, leaving the liabilities and certain other assets behind in the seller entity or (b) the business purchase model, where 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 individually computed for every asset and are taxable as STCG or LTCG, depending on the period during which they were held. Sale of depreciable assets always results in STCGs. Gains for every asset other than capital assets are taxable as business income.
- Capital gains are determined by reducing the acquisition cost of assets from the sale consideration. In the case of LTCGs, the cost of acquisition is indexed, based on the cost inflation index notified by the tax authorities every year. For self-generated intangible assets, the cost of acquisition is taken as 'nil' for calculation of capital gains.
- On transfer of movable property, the seller is liable to charge the Goods and Services Tax (GST) at specified rates.
- If the sale consideration is less than its FMV on transfer of immovable property, the FMV is deemed to be the value determined by the stamp valuation authorities on the date of the agreement.

[10] Provisions not applicable on unabsorbed depreciation

- In the case of transfer of investments in unquoted shares at a price that is less than its FMV (determined in the manner prescribed), the FMV is deemed to be the total value of the consideration, for the purpose of computing capital gains on the transfer.

### Implications for the buyer

- On transfer of immovable property, buyers are liable to pay stamp duty at the rate applicable in the state in which the property is located.
- Stamp duty may also be chargeable on transfer of movable property.
- Depreciation can be claimed on the purchase value of assets acquired.

**Business purchase model**

### Implications for the seller

- Capital gains are determined by reducing the net worth of a business undertaking (determined in the manner prescribed) from the sales consideration.
- Capital gains are taxable as LTCGs if the business undertaking is held for more than three years. However, no indexation benefit is available.
- Capital gains are taxable at 20%[1] if long term or at 30%1 if short term.
- Business transfers on a 'going concern' basis are not subject to the GST.
- Implications for the buyer
- The purchase cost in the hands of the buyer is computed by allocating the lump sum purchase consideration along with the value of the liabilities proportionately on each asset on the basis of its fair value.
- Interest on loans taken for acquisition of assets or business undertakings through a slump sale is generally tax-deductible.
- Expenses incurred in connection with business purchase are not deductible as business expenditure.
- In the case of a business purchase, the tax losses of the business undertaking are not transferred.

## Amalgamations and demergers

In some situations, an acquired or to be acquired entity can be integrated into the buyer's group through an amalgamation or a demerger. The procedure for this is governed by specific provisions in the Companies Act, 2013, and typically involves the approval of the National Company Law Tribunal (NCLT).

Amalgamations and demergers normally attract stamp duty at varying rates prescribed in state laws. Clearance may be needed from other statutory authorities such as stock exchanges and the Securities Exchange Board of India (SEBI) in the case of a listed company, the RBI and other regulatory bodies. An amalgamation or demerger can be a tax-neutral subject to compliance with prescribed conditions. The following are the relevant provisions:

| Basis | Amalgamation | Demerger |
|---|---|---|
| Definition under Income-tax Act | Merger of one or more companies with another company, or merger of two or more companies to form one company, subject to the following conditions:<br>• All the assets and liabilities of the transferor should be transferred to the transferee.<br>• Shareholders holding at least 75% of the shares (in value) in the transferor become shareholders in the transferee company. | Transfer by a demerged company of one or more of its undertakings to any resulting company pursuant to a scheme of arrangement under Section 230-232 of the Companies Act, 2013, subject to the following conditions:<br>• All the assets and liabilities of the transferor's business undertaking are transferred to the resulting company at its book values.<br>• Shareholders holding at least 75% of the shares (in value) in the demerged company become shareholders in the resulting company.<br>• The consideration is discharged by issuance of the shares of the resulting company to the shareholders of the demerged company on a proportionate basis.<br>• The transfer is on a 'going concern' basis. |
| Carry forward of losses and unabsorbed depreciation | If the amalgamating company owns an industrial undertaking, its losses and unabsorbed depreciation is to be carried forward by it, provided specified conditions, e.g., continuance of business and holding of assets, are met. | Accumulated losses or unabsorbed depreciation directly related to the undertaking being demerged are transferable for the unexpired period.<br>Proportionate common losses are also transferable. |

## Cross-border mergers

The Ministry of Corporate Affairs (MCA) has notified the provisions for cross-border mergers under the Companies Act, 2013.

Bringing about a significant change from the old regime under the Companies Act, 1956, where only the merger of a foreign company with an Indian company was permitted (i.e., inbound mergers), the notified provisions of the Companies Act, 2013 confer a legal status to both inbound and outbound mergers.

Outbound mergers (i.e., the merger of an Indian company with a foreign one) are only permitted if the foreign company is incorporated in the specified jurisdiction.

Valuation of the Indian company and the foreign company should be conducted by valuers who are members of a recognised professional body in the jurisdiction of the transferee, and such valuation is in accordance with internationally accepted principles of accounting and valuation.

Any transaction on account of a cross-border merger undertaken in accordance with Foreign Exchange Management (Cross Border Merger) Regulations, 2018 is deemed to have the approval of the RBI, as required under the provisions of the Companies Act, 2013.

India has seen a substantial economic upswing in 2017-18, with its economy growing to ~US$ 2.6 trillion, a significant rise in its 'ease of doing business' ranking in the World Bank's ratings, the implementation of various reforms, revamping of several tax and regulatory laws, etc. In this environment, the inorganic growth of an individual or entity is fuelled by several factors such as strong cash flows, availability of cheap finance, a dynamic global demand, upgraded technologies and the requirements of new markets. Keeping this in mind, we have endeavoured to provide above a clear understanding of the M&A-related scenario and norms in the country during the previous year. In the final analysis, it is amply clear that today, M&A activity has become a crucial part of India's growth story.

# Transfer Pricing

A separate code for Transfer Pricing (TP) under sections 92 to 92F of the Indian Income-tax Act, 1961, (the Act) covers intragroup transactions, and has been applicable since 1 April 2001. India's Transfer Pricing Code prescribes that income arising from international transactions or specified domestic transactions between associated enterprises should be computed with regard to their arm's length price. The regulations are broadly based on the guidelines of the Organisation for Economic Cooperation and Development's (OECD's) TP rules for multinational enterprises (MNEs). They describe various TP methodologies and mandate extensive requirements for annual documentation of TP.

The intent of TP provisions is to avoid profits being moved from India to offshore jurisdictions. Since the introduction of the Transfer Pricing Code, TP has become an important international tax-related issue that affects multinational enterprises operating in India. To ease this problem, the Indian Government has tried to simplify tax and regulatory norms to bring about a paradigm shift in the country's TP regulations.

Furthermore, scrutiny of multinationals' TP operations has intensified year on year around the world, and 2018 also saw significant changes being introduced in TP regulations and documentation in response to the OECD's Base Erosion and Profit Shifting (BEPS) project.

Presented below are the key TP highlights of the Financial Year (FY) 2017-18:

## Budget: TP provisions

### Secondary adjustment

The Indian Finance Act, 2017, introduced a secondary adjustment mechanism vide section 92CE of the Act. The primary adjustment results in addition to income or reduction in expenses and creates an additional tax liability for taxpayers in India.

Primary adjustment represents the 'excess money' with an associated enterprise that needs to be repatriated to India. If this excess money is not repatriated, it is considered an advance and interest is computed on it.

During FY 2017-18, the time limit for repatriation of this excess money was prescribed by the Central Board of Direct Taxes (CBDT) by the insertion of Rule 10CB in the Income-tax Rules, 1962 (the Rules). According to this rule, in the case of an APA or a MAP resolution, the excess money should be brought into India within 90 days from the date on which the return of income (ROI) is filed. Furthermore, in the case of an APA, this mandatory 90 days commences from the date on which the APA was entered by the taxpayer. Similarly, in the case of a MAP resolution, the 90 days commences from the date it is given effect by the Tax Officer to the resolution arrived at under the MAP under Rule 44H.

### General Anti-avoidance Rules

GAAR codifies the principle of substance over form and brings into the law principles that several landmark cases have dealt with over the years. An Impermissible Avoidance Arrangement (IAA) has been defined to signify only those transactions where "the main purpose" is to obtain a tax benefit in addition to satisfaction of at least one of the four tainted elements tests.

GAAR provisions apply to investments made after 1 April 2017 and are applicable for arrangements where tax benefits exceed INR 30 million. Once GAAR is invoked, tax treaty benefits may be denied for such arrangements.

### Advanced Pricing Agreement (APA)

The CBDT released its second APA Annual Report for FY 2017-18 (APA report) on 31 August 2018.

APA statistics continue to be encouraging, with the total number of applications surging to 985 applications (821 unilateral and 164 bilateral), and filed by 31 March 2018. The APA report card is impressive, with a total of concluded APAs having reached 219 (of which 67 were signed during FY 2017-18) in five years. With FY 2017-18 witnessing the conclusion of 67 APAs (58 unilateral and 9 bilateral), taxpayers should be upbeat about the continuing efforts of the CBDT to conclude APAs.

A noteworthy development is the shift in focus from Unilateral APAs to Bilateral APAs. It has been observed that there was a slight increase in the time taken (now 31.75 months) to conclude unilateral APAs in FY 2017-18 compared to the average of prior periods.

**TP audits:** Some key issues scrutinised during TP audits include international transactions such as the creation of marketing intangibles, valuation of infusion of equity share, intragroup cross charges and financial transactions. The following are some of the key observations on recently concluded TP audits:

a. **Advertising, Marketing and Promotion (AMP) expenses:** Despite the Delhi High Court's decisions, TPOs are trying to make additions to excess AMP expenses on different counts.

b. **In the area of management fees,** TPOs are not following the Tribunal's rulings, which mandate that they can only determine the Arm's Length Price (ALP) and cannot question the commercial need. TPOs are pondering on the option of depicting their ALP as nil.

**Advertising, marketing and promotion-related expenses (AMPs):** AMPs are the hot topic in India's TP market today. Several taxpayers have filed Special Leave Petitions before the Supreme Court, challenging the ruling of the Delhi High Court in the case of Sony Ericsson. It is learnt that these taxpayers filed their petitions mainly on the ground that incurrence of AMP by taxpayers cannot be considered to be international transactions. Furthermore, the Supreme Court has admitted the Revenue Department's petition against the ruling of the Delhi High Court in the case of Maruti Suzuki, where tax authorities sought to challenge the High Court's ruling that incurring AMP-related expenses do not constitute an international transaction.

**Country by Country Report (CbCR)**

The Government, vide Finance Act 2016, has introduced a three-layer TP documentation process, keeping in mind India's commitment to implementing the OECD and G20's BEPS recommendations. Taxpayers are now required to prepare a master file, a local file and a CbCR. The local file will have to be maintained in the same manner as in earlier years.

From FY 2016-17, CbCR requirements have been applicable for international groups with consolidated revenue exceeding INR 55,000 million in the preceding year. On 31 October 2017, the CBDT issued the final rules governing Master File (MF) and Country by Country Reporting (CbCR) that need to be furnished under section 92D and section 286 of the Act, respectively.

The final rules provided temporary relief to taxpayers in the form of extended timelines (31 March 2018 instead of 30 November 2017) for them to furnish their CbCR and MF in the first year these were implemented.

The rules were amended (vide Finance Act 2018) to align these with the OECD's recommendations as follows:

- The time limit for furnishing the CbCR is 12 months from the end of the reporting accounting year, compared to the earlier time limit of the return filing date.
- A CbCR needs to be filed in India by the Indian affiliates of foreign headquartered MNEs, if they are not required to file it in their home jurisdictions and the parents have not designated any 'Alternate Reporting Entity' outside India.

## Other key developments

**Kenya-India DTAA**

In relation to the revised India-Kenya DTAA, the CBDT had notified that all the provisions of the revised DTAA or

protocol would be effected in India from 11 July 2016. The revised India-Kenya DTAA was signed on 19 February 2018.

**India-Kuwait tax treaty**

A Protocol in relation to the existing Double Taxation Avoidance Agreement (DTAA) between India and Kuwait, signed on 15 June 2006 for avoidance of double taxation and prevention of fiscal evasion, was amended with respect to taxes on income and was signed on 15 January 2017. This amendment to the Protocol came into force on 26 March 2018 and was notified in the Official Gazette on 4 May 2018.

The Protocol updates the provisions in the DTAA for exchange of information according to international standards. Furthermore, it enables sharing of information received from Kuwait with other law enforcement agencies for tax-related purposes, with the authorisation of Kuwait's competent authority, and vice versa.

**Permanent Establishment (PE)**

The Finance Bill 2018 proposes to align the scope of a 'business connection' by amending Section 9 of the Act to provide that this business connection should include any business-related activity carried out through a person who habitually plays the principle role in conclusion of contracts.

Furthermore, in line with an observation made by the OECD in Action 1 (Digital Economy), the term 'business connection' has been widened to include 'significant economic presence' in its ambit. A significant economic presence is established in India if a non-resident conducts transactions in the country beyond a specified monetary threshold or undertakes systematic and continuous soliciting of business through digital means with customers beyond a threshold (as may be specified). The CBDT has invited input from taxpayers in preparing rules on the threshold.

# Notes

# Notes

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