

# *Destination India 2015*

## Unleashing the prowess

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**pwc**



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# Introduction

India is the world's third-largest economy as per gross domestic product (GDP) in purchasing power parity (PPP) terms and is expected to lead the world as well as emerging nations in terms of growth this year and the next. According to the International Monetary Fund (IMF)—at a time when global growth is projected at 3.3% in 2015 and 3.8% in 2016—India is projected to grow at 7.5% in each of these years, up from 7.3% in 2014.<sup>1</sup> The World Bank too has projected India's growth at 7.5% in 2015.

The Government of India has provisionally estimated GDP growth of 7.2% for FY 2014-15.<sup>2</sup> Further, the Reserve Bank of India (RBI) has projected the Indian economy to grow at 7.6% in FY 2015-16.

With over 7% projections from almost all sides, globally and domestically, the mood is positive. It is no wonder that India is expected to accelerate its growth among emerging nations, which are expected to grow at 4.2% on an average this year.

India ranks second in the world in terms of population. Apart from its demographic dividend of more than 1.2 billion people—out of which nearly two-third comprise its working-age population—the country is also increasingly becoming an investment hub with its pro-reform government announcing various enabling policies. This being said, India will also be a source of human resources for most of the ageing developed world in the coming decades.

With the current government completing one year in office this year, India looks poised to enter a secular growth phase with increased emphasis on inclusive growth. 'Jan-Dhan Yojana', a national mission on financial inclusion, 'Swachh Bharat Abhiyan', a campaign on hygiene and preventive healthcare, and 'Housing for all by 2022', are new initiatives that are expected to ensure sustainable development. Developing infrastructure, improving the business environment, building a robust and predictable tax regime, attracting more foreign direct investment (FDI) and nurturing international relations and empowerment of the masses are other growth-oriented initiatives that will help India intensify the vibrancy in its economy.

The signs are all around us and are highlighted below:

- With a view to make India an attractive global manufacturing hub, the government announced its 'Make in India' project last year. It has set an ambitious target to increase the contribution of manufacturing output in the country's GDP by 60% from 16% currently to 25% by 2025. The government's 'Make in India' programme, aimed at facilitating investment, encouraging innovation and building high-class manufacturing infrastructure, is expected to boost manufacturing activities in certain key sectors ranging from auto components and aerospace to defence.
- E-auctioning of coal blocks, curtailment of the discretionary powers of labour inspectors and implementation of a single-window compliance process on labour-related issues, and the intentions to roll out the Goods and Services Tax (GST) by April 2016 will go a long way in accelerating growth in the manufacturing sector.



Source: IMF, World Economic Outlook (WEO) Update, July 2015

1. World Economic Outlook Update Press Conference, July 2015  
<http://www.imf.org/external/pubs/ft/weo/2015/update/02/index.htm>  
 2. Growth rate of gross value added (GVA) at base price at 2011-12 prices in percentage



- In April 2015, Moody's revised India's sovereign rating outlook to 'positive' from 'stable' boosted investors' sentiments since the rating agency expects actions to be taken by policymakers to lift the country's economic growth.
- Standard & Poor's (S&P) upgrade of India's sovereign credit outlook to 'stable' from 'negative' within 120 days of the new government taking office indicates its expectation of a spell of continued fiscal discipline in the near future and a healthier outlook for the Indian economy.

The combination of a strong and stable democratic government and the relative free play of market forces today make India an attractive investment destination.

### Macroeconomic review

The Index of Industrial Production (IIP) continues to show a positive trend for India's economy. The General Index for the month of April 2015 stood at 179.7, which is 4.1% higher compared to the level in April 2014. This has lent credence to the government's view that a revival may be underway and this calls for a healthy expansion in capital and consumer goods. Out of 22 industry groups in the manufacturing sector, 16 showed positive growth in April 2015, compared to April 2014. The IIP for the manufacturing sector for the month of April 2015 stood at 190.6, up 5.1% compared to April 2014. The machinery and equipment sector has shown the highest positive growth of 20.6%, followed by 16.2% in wood and products of wood and cork (except furniture); articles of straw and plating materials, and 13.4% in electrical machinery and apparatus.

Consumer durables and non-durables have recorded a growth of 1.3% and 4.4% respectively, with overall growth in consumer goods being 3.1%. With pro-growth measures being undertaken by the Narendra Modi-led government, consumer demand is set for revival and will provide further impetus to the growth engine.

Over a period of time, India has responded reasonably well to some of its macroeconomic vulnerabilities. The key challenges were inflation, current account deficit and the overall fiscal situation. The government has taken several measures to produce long-run solutions to some of its structural problems.

Inflation has been declining during the last one year. In April 2015, less than a year after the new government took charge, the inflation rate came down to 4.87%. This is expected to help to boost lift the economy, considering that the inflation rate was 8.48% in April 2014. Although it touched 5% in May 2015, this is not really alarming. These rates, if sustained, will gradually help the government meet its inflation target of 4%, with a band of plus or minus two percentage points by fiscal 2017. A stable price regime sends positive signals to investors just as an unstable price situation dampens investors' interest in an economy, since it makes perspective planning relatively difficult.

The softening of global crude oil prices have helped the government tidy its books and is expected to help it reduce India's fiscal deficit to positively affect the overall inflationary scenario in the country.

The Economic Survey of 2014-15 mentions several measures taken by the government, such as deregulating energy prices, improving the efficiency of public programmes and breaking the wage-price spiral. Rationalisation of government support to farmers and revamping the Agricultural Produce Market Committee (APMC) Acts can help to rein in inflation.

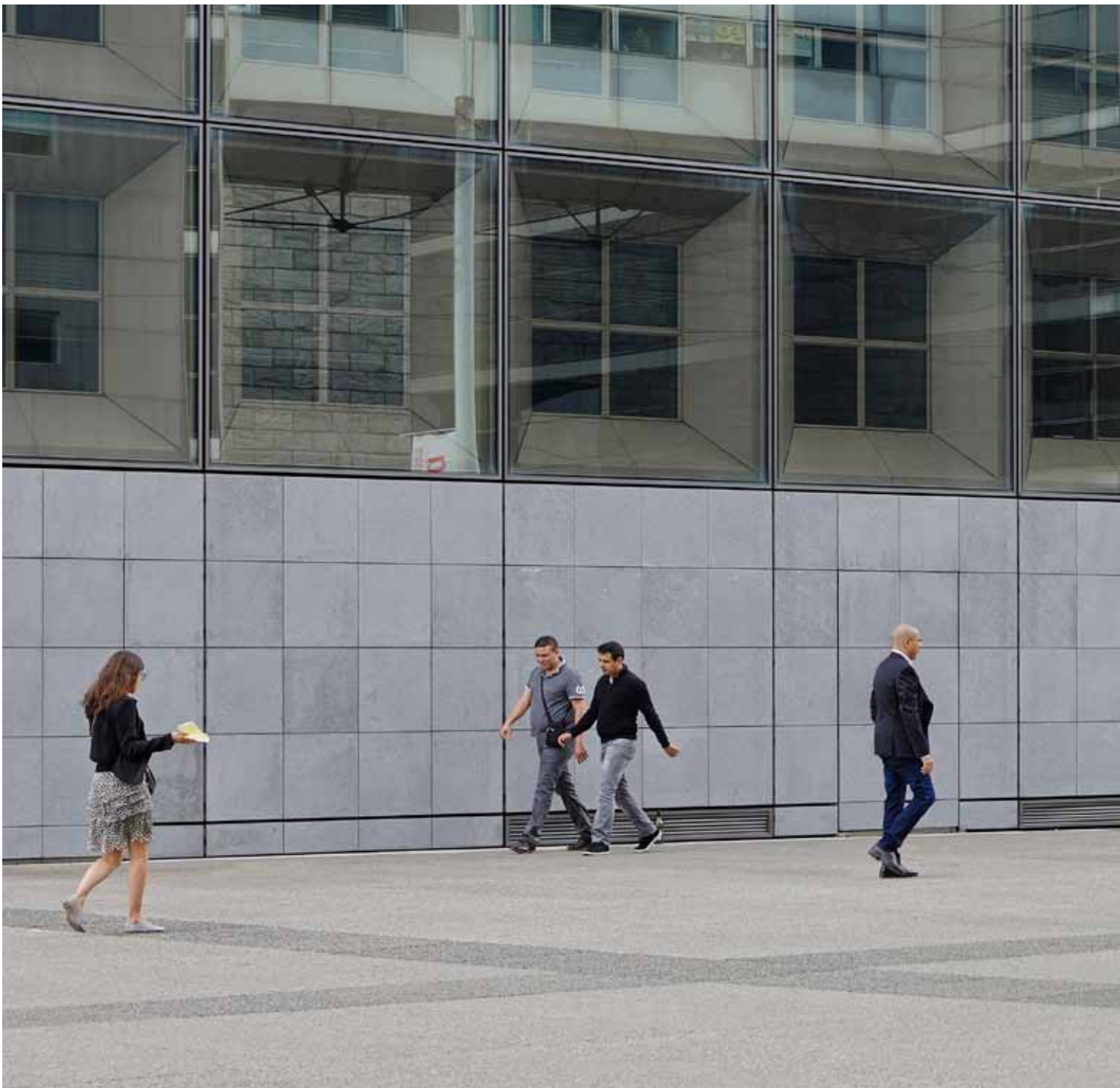
The high current account deficit (CAD), i.e. roughly the difference between a country's exports and imports in merchandise and services, has been an ongoing concern for India and a vital macroeconomic parameter. High CAD creates several macroeconomic imbalances—it puts pressure on a country's domestic currency and often leads to its depreciation, decreases the competitiveness of its domestic market and adds pressure on its foreign reserves. India's CAD has recently come down. It narrowed down sharply to 1.3 billion USD or 0.2% of its GDP in the fourth quarter of fiscal 2015 on a sequential basis mainly on account of a lower trade gap. For the full financial year 2014-15, the same shrank to 1.3% of the country's GDP, according to the RBI. The decrease in India's CAD has been on account of the declining crude oil prices, besides other developments.

Moreover, investors lose confidence in a currency as well as in an economy. India has witnessed some of this impact as its domestic currency sharply lost its value in comparison with other global currencies. The Government of India and RBI have taken several measures to manage CADs to a sustainable level. Measures were taken to promote exports, curb imports (especially of luxury items like gold and other non-essential items).

High fiscal deficit is also the cause of macroeconomic disability. This leads to high CAD, increased inflation, rising government debt, higher interest rate and crowding out of private investment. Foreign investors are nervous about the prospects of the economy of a country with a high budget deficit. International rating agencies assign higher weightage to budget deficit while giving sovereign ratings. India has shown its long-term commitment to become fiscally responsible by enacting the Fiscal Responsibility and Budget Management (FRBM) Act in 2003. It brought its budget deficit down to below 3% (the benchmark) during 2007-08. Since then, global development, coupled with domestic factors, led to a rise in the country's fiscal deficit, which reached 6.5% in 2009-10. It was gradually brought down to 4.5% in 2013-14. The government aimed to bring it down further to 4.1% in 2014-15 and seeks to reach a targeted deficit level of 3% by 2016-17.

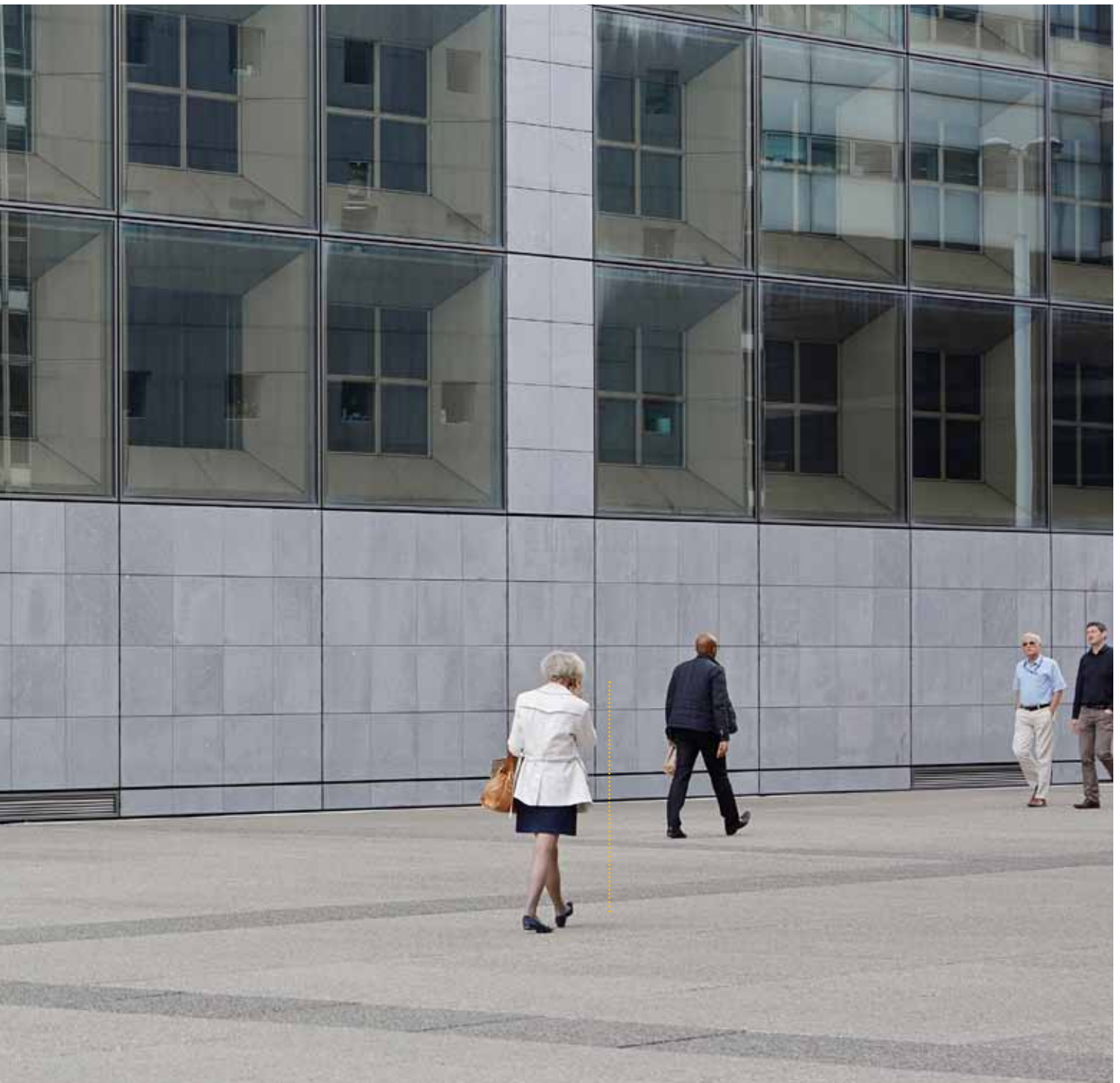
The government has taken a series of measures to bring fiscal deficit under control. Gradual decontrol of oil prices, targeted subsidy system, partial decontrol of fertiliser subsidy and capping on LPG cylinder are some of the major steps in the right direction. If the global crude oil price does not make a sudden move, the government can further bring down the deficit targeted in its budget.

India has the potential to be a major investment destination in the global community. Its macroeconomic stability, resilience to deal with external shocks and the extremely high optimism pervading the economy makes India one of the largest markets in the world, and capable of absorbing and yielding steady attractive returns for investors in the medium term.



## Takeaway

The writing on the wall seems clear. New policies, regulations and improvements in India's macroeconomic parameters, as well as its growth prospects, seem to be taking it to the next level of development. Investments within and outside the country are therefore expected to bear fruit. More importantly, these investments and the visible changes caused by them can be sustained over a period of time. It's time investors made the best use of these positive developments.



# Foreign investment

## Entry options

A foreign entity looking to set up operations in India can consider the following:

### Operating as an Indian entity

#### *Wholly-owned subsidiary company*

A foreign company can set up a wholly-owned subsidiary in India to carry out business activities. Such a subsidiary is treated as an Indian resident. At least two shareholders for a private limited company and seven shareholders for a public limited company are mandatory. In addition, there is also the requirement that the director should be an Indian resident.

The activities of such a company need to comply with the provisions of the foreign direct investment (FDI) policy.

#### *Joint venture (JV) with an Indian partner (equity participation)*

Although a wholly-owned subsidiary is generally the preferred option in view of the associated brands and technologies involved, foreign companies also consider carrying out operations in India by forming strategic alliances with Indian partners. Typically, foreign companies identify partners in the same area of activity, or those that can add synergies to the foreign investor's strategic plans in India. Sometimes, JVs are necessitated due to restrictions on foreign ownership in select sectors under the FDI policy.

#### *Limited liability partnership (LLP)*

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

With less stringent annual statutory compliance requirements and ease of set-up, maintenance and exit, compared to a company form, LLP is becoming a preference. There is no tax on distribution of profits in an LLP, unlike in a company, where dividend distribution tax or buy-back tax is applicable.

The setting up of an LLP requires prior approval of the Foreign Investment Promotion Board (FIPB).

### Operating as a foreign company

#### *Liaison offices (LOs)*

Setting up an LO or representative office is common practice for foreign companies seeking to enter the Indian market. The role of LOs is limited to collecting information about the market and providing information about the company and its products to prospective Indian customers. Such offices act as communication channels between the foreign company and its existing or prospective Indian customers. An LO is not allowed to undertake anything other than liaison activities in India, and therefore, cannot earn any income in the country under the terms of approval granted by the Reserve Bank of India (RBI).

In accordance with the Foreign Exchange Management (Establishment of Branch or Office or Other Place of Business) Regulations, 2000, a foreign company can set up an LO only for the following activities:

- Representing in India the parent company or a group company
- Promoting Indian export or import
- Promoting technical or financial collaborations between the parent or a group company and companies in India
- Acting as a communication channel between the parent company and Indian companies

An LO can be established with RBI's prior approval when the principal business of the foreign company falls under sectors in which 100% FDI is permitted under the automatic route. Otherwise, an additional approval from the central government is required. Foreign companies intending to establish an LO in India must have a net worth of at least 50,000 USD or its equivalent, and a profit-making track record in the home country during the three immediately preceding financial years.

Additionally, once the LO obtains RBI's approval, it must get registered with the Registrar of Companies (RoCs) and, upon establishment, its details must be reported to the director general of police (DGP) under whose jurisdiction it is established.

#### *Branch offices*

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

- Export and import of goods
- Professional or consultancy services
- Research work in which the parent company is engaged, to promote technical or financial collaboration between Indian companies and the parent company







- Representing the parent company in India and acting as a buying or selling agent in India
- Information technology (IT) and software development services in India
- Technical support for products supplied by the parent or group companies
- Acting as a foreign airline or shipping company

A branch office can be established if the principal business of the foreign entity falls under sectors where 100% FDI is permitted under the automatic route. Otherwise, the central government's approval is also required.

Foreign companies intending to establish a branch office in India need to have a net worth of at least 100,000 USD or its equivalent, and a profit-making track record in their home country during the five preceding financial years.

In general, manufacturing and retail trading activities cannot be undertaken through a branch office. However, foreign companies can establish a branch office as a unit in a special economic zone (SEZ) to undertake manufacturing and other service activities subject to the fulfilment of certain conditions.

The automatic route, however, is not available to a person registered in or who is a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong and Macau for establishing a place of business in India in the form of an LO, or a project or branch office.

In addition, a branch office must be registered with the RoCs and its details must be reported to the DGP under whose jurisdiction it is established.

#### **Project offices**

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

The RBI grants general permission to foreign companies for establishing project offices in India, provided they have secured a contract from an Indian company or a project sanctioning

authority for executing the project, and meet any of the following conditions:

- The project is funded directly by inward remittance from abroad
- It is funded by a bilateral or multilateral international financing agency
- It has been cleared by an appropriate authority
- A company or entity in India awarding the contract has been granted a term loan by a public financial institution or a bank in India for the project

However, if the above criteria are not met, the foreign entity must approach the RBI through its authorised dealer (AD) bank for prior approval.

Just as with a branch or LO, a project office must also be registered with the RoCs and its details must be reported to the DGP of the jurisdiction.

#### **Foreign direct investment policy in India**

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

- Activities and sectors not open to private sector investment, e.g. atomic energy and railway operations (other than railway infrastructure permitted in specific activities)
- Lottery business, including government or private lottery, online lotteries, etc.
- Gambling and betting, including casinos, etc.
- Agriculture (excluding cultivation under controlled conditions as prescribed)
- Plantations (excluding tea plantations)
- Real estate business or construction of farmhouses
- Chit funds, Nidhi companies, trading in transferable development rights
- Manufacturing of cigars, cheroots, cigarillos, cigarettes, tobacco and tobacco substitutes



The policy contains a list of 20 sectors/activities prescribing either conditionalities, or foreign equity cap, or approval requirements. These include sectors like financial services, civil aviation, telecom and media, retail, etc.

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

- Automatic route, which does not require prior FIPB approval
- Approval route, which requires approval from the government through the FIPB under the Ministry of Finance, or the Department of Industrial Policy and Promotion (DIPP) under the Ministry of Commerce and Industry, or both, subject to sectoral caps and/or any of the following circumstances:
  - Issue of shares for consideration other than cash, i.e. issue of shares against import of capital goods, machinery or equipment, pre-operative or pre-incorporation expenses, and share swap, subject to compliance with certain stated conditions
  - Investments by citizens and companies of Bangladesh and Pakistan in sectors/activities other than defence, and those prohibited for foreign investment such as space and atomic energy
  - Investment in an Indian company engaged only in the activity of investing in the capital of other Indian companies and companies which do not have any operations or any downstream investments. Additionally, a company which fulfils the criteria prescribed under the core investment companies' (CICs) guidelines issued by the RBI will have to comply with these norms.

The decision of the FIPB or DIPP is normally conveyed within 12 to 16 weeks from the date of submission of an application. A proposal for foreign investment is decided on case-by-case merit and according to the prescribed sectoral policy. Generally, preference is given to projects in high-priority industries and the infrastructure sector, those with export potential, large-scale employment opportunities, social relevance, high capital infusion, induction of technology, or links with the agriculture sector.

Foreign investment proposals under the FIPB route involving a total foreign equity inflow of more than 30 billion INR must be placed before the Cabinet Committee on Economic Affairs (CCEA) for further consideration.

### Computation of FDI

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

Any downstream investments made by an Indian company owned and controlled by non-residents is also required to comply with sectoral caps and conditions and has to be intimated to DIPP, FIPB, and Secretariat for Industrial Assistance (SIA).

Since 1991, the foreign investment regulatory environment has consistently been liberalised to make it investor-friendly. Continuing this trend, some of the changes undertaken by the government during the last one year include:

- The FDI cap has been increased from 26% to 49% in the insurance sector.
- Construction, operation and maintenance of specified activities of the railway sector have been opened up to 100% FDI under the automatic route.

- The FDI limit of 26% in the defence sector has been raised 49% under government approval.
- Hundred per cent FDI has been allowed in the manufacturing of medical devices.
- Policy relating to the construction and development sector has been liberalised.

### Foreign venture capital investors (FVCIs) permitted to acquire securities under private arrangement

FVCIs can invest in eligible securities (equity, equity-linked instruments, debt, debt instruments, debentures of an Indian venture capital undertaking (IVCU) or venture capital fund (VCF), units of schemes or funds set up by a VCF) by private arrangement or by purchase from a third party, subject to compliance with certain conditions.

### Portfolio investment by registered foreign portfolio investors (RFPIs)

The existing portfolio-investor class, namely, FIIs and QFIs registered with the Securities and Exchange Board of India (SEBI), has been subsumed under the broad category of RFPIs.

The individual and aggregate investment limits for RFPIs shall be 10% or 24% respectively, of the total paid-up equity capital. This limit can be increased up to the sectoral limit after a board resolution followed by a special resolution to this effect by the general body and subject to prior intimation to the RBI. Moreover, where there is a composite sectoral cap under the FDI policy, the limits for RFPI shall also be within the cap. RFPI investment up to 49% does not specifically require adherence to conditionalities or approval requirements, even if prescribed under the FDI Policy.

RFPIs may purchase and sell shares and convertible debentures of Indian companies through a registered broker on recognised stock exchanges in India as well as those offered to public or through private placement according to SEBI guidelines or regulations. Also, RFPIs shall be eligible to invest in government securities and corporate debt subject to limits specified by the RBI and SEBI from time to time.

### FDI in LLP

FDI up to 100% is permitted with prior FIPB approval in LLPs engaged in sectors or activities eligible for it under the automatic route. Such sectors or activities should not have any sectoral or other FDI-linked conditions. Some of the conditions, subject to which FDI in LLP will be permitted, are as follows:

- Only cash contributions are permissible for FDI in LLPs
- LLPs with FDI are not allowed to make downstream investments
- LLPs cannot raise external commercial borrowings (ECB)
- FIIs and FVCIs cannot invest in LLPs
- Investment through share acquisition



## Valuation norms

The issue of shares to non-residents, or transfer of shares from residents to non-residents and vice-versa is subject to valuation guidelines:

- The fair valuation of shares must be carried out in accordance with any internationally accepted pricing methodology on an arm's-length basis, duly certified by a chartered accountant (CA) or SEBI-registered merchant banker, where the shares of the company are not listed on any recognised stock exchange in India. However, if shares are listed, then the consideration price cannot be less than the price worked out in accordance with the SEBI guidelines.
- In case of issue or transfer of shares from a resident to a non-resident, where the shares of an Indian company are not listed on a recognised stock exchange in India, such issue or transfer of shares shall be at a price not less than the fair value worked out.

- In case of transfer of shares from a non-resident to a resident, the price shall not be more than the minimum price at which the transfer of shares can be made from a resident to a non-resident.
- When non-residents (including NRIs) make investments in an Indian company by way of subscription to the memorandum of association, such investments may be made at face value.

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

# Funding options

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A foreign company which sets up an Indian entity (subsidiary or joint venture (JV)) can fund it through many modes.

## Equity capital

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

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

Investments in equity can be repatriated only on liquidation or through transfer of shares. Limited provisions allowing buy-back of equity shares are available under the Indian corporate law. Capital reduction can also be undertaken in certain circumstances after court approval. There are restrictions on repatriation of investment from the FDI policy perspective as well.

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

## Fully and compulsorily convertible preference shares and debentures

Indian companies can also receive foreign investment through the issue of fully and compulsorily convertible preference shares and debentures. The conversion formula or price for issue of equity shares upon conversion must be determined upfront at the time of their issue.

The above is subject to the following guidelines:

- Only compulsorily and fully convertible preference shares and debentures without any option or right to exit at an assured price can be issued
- Optionality clauses are allowed in fully and compulsorily convertible preference shares and debentures and equity shares under the FDI scheme, provided that it fulfils the following conditions:
  - There is a minimum lock-in period of one year
  - The lock-in period is effective from the date of allotment of such capital instruments
  - After the lock-in period of one year and subject to the FDI policy provisions, if any, the non-resident investor exercising the option or right shall be eligible to exit without any assured return, in accordance with the pricing and valuation guidelines issued by the RBI from time to time

The dividend rate on preference shares should not exceed the limit prescribed by the Ministry of Finance of the Government of India. This is currently fixed at 300 basis points above the State Bank of India's (SBI) prime lending rate.

## External commercial borrowings (ECBs)

ECBs refers to commercial loans (in the form of bank loans, buyers' credit, suppliers' credit, securitised instruments (e.g. floating rate notes and fixed rate bonds) obtained from non-resident lenders with minimum average maturity of three years or more.

ECB can be availed of either under the automatic or the approval route. Eligible borrowers such as corporates in the industrial, infrastructure and service sectors raise funds through ECBs for permissible end uses from recognised lenders. Under the approval route, prior permission of the RBI is required for raising ECBs. Under either route, post-facto intimation filings must be made periodically, as prescribed under the Foreign Exchange Management Act (FEMA) regulations.

The minimum maturity period of an ECB is at least three years if its amount does not exceed 20 million USD or its equivalent in a financial year. For ECBs in excess of 20 million USD and up to 750 million USD or its equivalent, the minimum maturity period is five years.



The FEMA regulations prescribe a ceiling for the cost of raising funds through ECB. This cost includes the rate of interest and other expenses in foreign currency and, in aggregate, must not exceed:

Average maturity period	Aggregate cost
From three years to five years	Six-month LIBOR+350 basis points
More than five years	Six-month LIBOR+500 basis points

Commitment fees, pre-payment fees or any other fees payable in INR, and withholding tax (WHT) in INR are to be excluded when calculating the cost ceiling.

Recognised lenders include certain international financial institutions, banks, export credit agencies, suppliers of equipment, foreign collaborators or foreign equity holders. In case of ECB from foreign equity holders, the shareholders should hold at least 25% of the total paid-up equity capital directly in the borrower company. In case of ECB exceeding 5 million USD from foreign equity shareholders, the proposed ECB together with the outstanding should not exceed four times the equity of the direct foreign equity holding. ECB from indirect equity holders is permitted, provided the indirect equity holding in the Indian company by the lender is at least 51%. ECB from a group company is permitted, provided both the borrower and the foreign lender are subsidiaries of the same parent.

ECB can be raised for investment in the real sector—industrial and infrastructure and specified service sectors such as hotels, hospitals and software—under the automatic route. However, ECB for companies in miscellaneous services is permitted with the approval of the authorised dealer (AD) banker only where the lenders are direct or indirect equity holders and group companies.

ECBs so raised can be used for certain prescribed purposes which include import of capital goods (as classified by the director general of foreign trade in the foreign trade policy), implementation of new projects, and modernisation or expansion of existing production units (including acquisition of land) in the real sector. ECBs are not permitted to be used for the following purposes:

- On-lending, investment in capital markets or acquisition of a company in India
- Activities in the real estate sector
- General corporate purposes (other than as provided below)
- Repayment of existing INR loans (except as provided under the approval route for telecom, infrastructure and power sectors and under the 10 billion USD scheme)

Eligible borrowers engaged in manufacturing, infrastructure, hotels, hospitals and software services can raise ECBs for general corporate purposes (including working capital) from their direct foreign equity holders under the automatic route with a minimum average maturity of seven years subject to the following conditions:



- Minimum paid-up equity of 25% should be held directly by the lender.
- Such ECBs must not be used for any purpose specifically not permitted.
- Repayment of the principal must commence only after completion of the minimum average maturity period of seven years.
- No prepayment is allowed before maturity.

ECBs can also be obtained for incurring rupee or foreign currency expenditure up to specified limits during a financial year under the automatic route. Raising further funds through ECB beyond these limits requires prior approval of the RBI.

### Pledge of shares

Promoters of an Indian company can pledge shares of the borrowing company or those of its associate resident companies to secure ECBs raised by the borrowing company, provided that a no objection is obtained from the AD bank and the prescribed conditions are met. A non-resident shareholder in an Indian company can also pledge its stake in the company in favour of an AD bank in India in order to secure a credit facility extended to such an Indian company.

### Global depository receipts (GDRs), American depository receipts (ADRs) and foreign currency convertible bonds (FCCBs)

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

The issue of ADRs or GDRs does not require any prior approval (either from the Ministry of Finance, Foreign Investment Promotion Board (FIPB) or RBI), except when the FDI after such issue exceeds sectoral caps or policy requirements, in which case prior approval from FIPB is required. There are no end-use restrictions on ADRs or GDRs, except for a ban on their deployment in the real estate business or the stock market.

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

### Foreign currency exchangeable bonds (FCEBs)

They can be issued under the FCEB scheme of the government, whose salient features are given below:

- FCEBs are bonds expressed in foreign currency, the principal and interest of which is payable in the same currency.
- An FCEB is issued by a company which is part of the promoter group of a listed company (offered company) and shall hold the equity share(s) being offered at the time of the issuance of FCEB. The offered company should be engaged in a sector eligible to receive FDI. The FCEB is subscribed to by a person residing outside India and is exchangeable into an equity share of the offered company on the basis of any equity-related warrants attached to debt instruments.

- Investment under the scheme must comply with the FDI as well as the ECB policy requirements. The proceeds of FCEBs can be invested in the promoter group companies, which must ensure that this investment is:
  - used in accordance with end-uses prescribed under the ECB policy; and
  - not utilised for investments in the capital market or in the real estate business in India.
- Proceeds of FCEB may also be invested by the issuing company overseas by way of direct investment (DI), including in a JV or a wholly-owned subsidiary, subject to existing guidelines on Indian DI in a JV or wholly-owned subsidiary abroad.

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





# Significant exchange control regulations

Foreign exchange transactions are regulated under the Foreign Exchange Management Act (FEMA). Under FEMA, foreign exchange transactions are divided into two broad categories—current account transactions and capital account transactions.

Transactions that alter the assets or liabilities, including contingent liabilities, outside India of a person residing in India, or assets or liabilities in India of a person residing outside India, including transactions referred under Section 6(3) of the FEMA, are classified as capital account transactions. Transactions other than these are classified under current account transactions.

The INR is fully convertible for current account transactions, subject to a negative list of transactions which are either prohibited or which require prior approval of the central government or the Reserve Bank of India (RBI).

## Current account transactions

The RBI has delegated its powers relating to monitoring and permitting remittances under the current account window to authorised dealer (AD) banks (entities authorised by the RBI). All current account transactions are generally permitted unless specifically prohibited or restricted.

As per the CAT Rules,<sup>3</sup> drawal of foreign exchange for the following purposes is prohibited:

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

The CAT Rules further specify those transactions<sup>4</sup> for which drawal of foreign exchange is permitted only with prior approval of the government. However, government approval is not required when payment is made out of funds held in the resident foreign currency account of the remitter.

3. Foreign Exchange Management (Current Account Transactions) Rules, 2000

4. Schedule II of CAT Rules

5. LRS is available for resident individuals for remittances towards permissible current and capital account transactions or a combination of both. It has an overall limit of remittance up to 250,000 USD (from the earlier 125,000 USD). However, LRS cannot be used for making remittances for any prohibited or illegal activity such as margins trading, lottery, etc.

Under the CAT Rules, drawal of foreign exchange by resident individuals for the following transactions is subject to an overall limit of 250,000 USD per financial year (remittance in excess of this requires RBI's prior approval) as prescribed under the Liberalised Remittance Scheme (LRS):<sup>5</sup>



Private visits to any country (except Nepal and Bhutan)



Gifts or donations



Going abroad for employment



Emigration



Maintenance of close relatives abroad



Business travel



Expenses in connection with medical treatment abroad



Studies abroad



Any other current account transaction

However, for remittances towards emigration, medical treatment abroad and studies abroad, individuals are allowed to avail of exchange facility in excess of 250,000 USD, if so required by the country of emigration, medical facility or the university, without needing any approval, subject to producing adequate supporting documentation.

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

- Remittances towards consultancy services procured from outside India for infrastructure projects of up to 10,000,000 USD per project per financial year and for other projects of up to 1,000,000 USD per project per financial year
- Pre-incorporation expenses of up to 5% of investment brought in or 100,000 USD, whichever is higher





- Donations for a specified purpose up to 1% of forex earning in the preceding three financial years subject to a maximum of 5,000,000 USD
- Commission per transaction to agents abroad for sale of residential flats or commercial plots up to 25,000 USD or 5% of inward remittance, whichever is more

Any remittance in excess of the above limits for the respective purposes will require RBI's prior approval.

### 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 list of permitted capital account transactions for persons residing in or outside India:

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

Under the LRS, resident individuals can remit up to 250,000 USD per financial year for any permitted capital account transaction. The permissible transactions are as follows:

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

For overseas investments in a JV or a wholly-owned subsidiary, the limit of financial commitment has been restored to 400% (from 100% in 2013) of the net worth of the Indian entity as on the last audited balance sheet date. However, any financial commitment exceeding 1 billion USD (or its equivalent) in a financial year requires RBI's prior approval, even when the total financial commitment of the Indian party is within the eligible limit under the automatic route (i.e. within 400% of the net worth as per the last audited balance sheet).

For the purpose of setting up offices abroad, AD banks may permit remittances towards initial expenses up to 15% of the average annual sales or income, or turnover during the last two financial years, or up to 25% of the net worth, whichever is higher. However, for meeting recurring expenses, remittances up to 10% of the average annual sales or income, or turnover

during the last two financial years may be made for the purpose of normal business operations subject to the following terms:

- The overseas branch or office has been set up or a representative is posted overseas for conducting normal business activities of the Indian entity.
- The overseas branch, office or representative shall not enter into any contract or agreement in contravention of the act, rules or regulations made.
- The overseas office (trading or non-trading), branch or representative should not create any financial liabilities, contingent or otherwise, for the head office in India, and not invest surplus funds abroad without RBI's prior approval. Any funds rendered surplus should be repatriated to India.

### Repatriation of capital

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

### Acquisition of immovable property in India

Foreign nationals of non-Indian origin residing outside India are not permitted to acquire any immovable property in India unless it is inherited from a person who was residing in India. However, they can acquire or transfer immovable property in India on lease not exceeding five years without RBI's prior permission.

Foreign companies that have been permitted to open a branch or project office in India are allowed to acquire any immovable property in India which is necessary for or incidental to carrying out such activity. In case of foreign companies that have been permitted to open a liaison office (LO), property can be acquired by way of lease not exceeding five years.

### Royalties and technical know-how fees

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

### Remittances by branch or project office

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

# Direct taxation

## Overview

The authority to levy, collect and administer income tax in India has been granted to the central government by the Constitution of India. Income tax is levied in India under the Income-tax Act, 1961, (the IT Act) enacted by the central government. The Income-tax Rules, 1962 (IT Rules), lay down the procedures to be followed in complying with the provisions of the IT Act. The IT Act is administered by the Central Board of Direct Taxes (CBDT) which operates under the aegis of the Finance Ministry of the central government. The CBDT issues various circulars/instructions/notifications from time to time for the purposes of governing the IT Act.

## Tax year and tax return filing deadline

The Indian tax year starts from 1 April of a year and ends on 31 March of the subsequent year. Companies (except those which are required to submit a transfer pricing accountant's report with respect to international transactions or specified domestic transactions) are required to file their tax returns by 30 September following the end of the tax year. Companies which are required to submit a transfer pricing accountant's report are required to file their tax returns by 30 November following the end of the tax year. The CBDT has the power to relax tax return filing dates for a class of taxpayers.

## Corporate tax rates

Residential status	Base rate	Surcharge	Education cess	Effective tax rate
Resident in India	30%	12% surcharge on tax if income is greater than 100 million INR; 7% if income is between 10 and 100 million INR No surcharge in other cases	3% on the tax and surcharge (if any)	34.61% if income is greater than 100 million INR; 33.06% if income is between 10 and 100 million INR 30.9% in other cases
Resident outside India	40%	5% surcharge on tax if income is greater than 100 million INR; 2% if income is between 10 and 100 million INR 0% in other cases		43.26% if income is greater than 100 million INR 42.02% if income is between 10 and 100 million INR 41.2% in other cases

## Residential status of a company

Till 31 March 2014, a company was considered to be resident in India if it was an Indian company, i.e. incorporated in India, or if its control and management was situated wholly in India.

With effect from 1 April 2015, the conditions of determining the residential status of companies was introduced stating that a company shall be said to be resident in India if it is an Indian company, i.e. incorporated in India or if its place of effective of management (POEM) is in India.

In other words, the concept of control or management (wholly in India) has been replaced with POEM. Here, POEM means a place where key management and commercial decisions necessary for the conduct of the business of an entity as a whole are, in substance made.

## Residential status of limited liability partnership (LLP)

LLP is an alternative corporate business entity that provides the benefits of limited liability of a company but allows its members the flexibility of organising their internal management on the basis of a mutually arrived agreement, as is the case in a partnership firm. An LLP registered in India is said to be resident in India except where, during the year, the control and management of its affairs is situated wholly outside India.



## Scope of taxable income for a company

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

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

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

**Note:** The term 'business connection' is a term used in Indian tax laws instead of permanent establishment (PE) as used in the tax treaties for taxing business profits. The term business connection is considered to be a bit wider than the term PE.

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

The IT Act states that shares and interest in a company incorporated outside India will be deemed to be situated in India if the said shares or interest derive, directly or indirectly, their value substantially from assets located in India. Therefore gains arising on indirect transfer of such assets shall be taxable in India in the hands of transferor.

In this respect, the following has been clarified:

### Meaning of substance

- Where the value of Indian assets (including tangible and intangible assets) exceeds 100 million INR
- Represents at least 50% of the value\* of all assets owned by such company/entity

\* *The value of assets means the fair market value (FMV) of such assets without reducing the liabilities.*

### Relief to minority shareholders

As per the provision of the IT Act that capital gain from indirect transfers will not be taxable where a non-resident, along with its associated enterprises, does not hold rights of control or management and voting power or share or interest exceeding 5% of the total voting power or shares of a company or entity (which derives its value substantially from assets located in India) at any time during the 12 months preceding the date of transfer.

Indirect transfer of shares of an Indian company pursuant to amalgamation/demerger of foreign companies shall be exempt from capital gains, subject to specified conditions under the Act.

The Indian entity, in which such a foreign company or entity has investment, will be under obligation to furnish necessary information to the tax department within the prescribed time. Non-disclosure will lead to penal consequences as specified in the IT Act.

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

Royalty or FTS payable by a resident to non-residents till FY 2014-15, who do not have a PE in India, are taxable on a gross basis at the rate of 25% (plus applicable surcharge and cess).

Finance Act, 2015, effective from FY 2015-16, has reduced the tax rate for royalty or FTS to 10% from the aforesaid rate of 25%.

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

If the relevant double taxation avoidance agreement (DTAA) provides for a lower rate of tax or narrower scope of royalties/FTS, then the royalties/FTS will be taxable accordingly.

## Taxation of royalty: Controversies

'Royalty' is defined as the consideration received or receivable for transfer of all or any right for certain property or information.

However, there have been certain controversies with regard to the meaning, characterisation, scope and taxability of royalty, some of which are mentioned below:

- Whether consideration for use of computer software constitutes a royalty payment
- Whether a right, property or information has to be used directly by the payer or be located in India, and whether its control or possession has to be with the payer
- Meaning of the term 'process'

In order to address the aforementioned controversies, the definition of royalty provided under the IT Act was amended in the year 2012 with retrospective effect from 1 June 1976:

- The consideration for use, or right to use, of computer software is 'royalty' and transfer of all or any rights in respect of any right, property or information includes transfer of all or any right for use or right to use a computer software (including granting of a license) irrespective of the medium through which such a right is transferred.
- Royalty includes consideration for any right, property or information, whether or not the following conditions apply:
  - The possession or control of such a right, property or information is with the payer
  - Such a right, property or information is used directly by the payer
  - The location of such a right, property or information is in India
- The term 'process' includes transmission by satellite (including uplinking, amplification, conversion for downlinking of any signal), cable, optic fibre or by any other similar technology, whether or not such a process is a secret.



### Computation of income

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

- Income from business
- Income from house property
- Income from capital gains
- Income from other sources

### Income from business

Business income is computed by aggregating all business receipts and reducing therefrom the deductions prescribed under the IT Act.

The IT Act provides for deduction of business-related expenses from the gross business income. These expenses include rent and interest on borrowings, etc. The following are specifically not allowed as deductions—personal expenses, capital expenditure (other than capital expenditure specifically allowed as a deduction, e.g. scientific research), expenses incurred on violation of any law, and expenses in relation to exempt income, income tax, wealth tax, etc.

Some specific deductions are discussed below:

### Depreciation

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

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

In the case of a new asset, depreciation for the whole year is allowed only if the asset is put to use for 180 days or more during the tax year. Otherwise, depreciation is allowed at only half the prescribed rates in that financial year and the remaining half in the next financial year.

In addition, 20% depreciation on the actual cost of a new plant or machinery acquired and installed after 31 March 2005, is allowed to a taxpayer engaged in the manufacture or production of any article or thing, or (with effect from FY 2012-13) in the business of generation, or of generation and distribution, of power in the year in which such a new plant or machinery is acquired and installed. Furthermore, this benefit has been enhanced to 35% from 20% in case of an undertaking set up (during FY 2015-16 to FY 2019-2020) in backward areas in the states of Andhra Pradesh, West Bengal, Bihar and Telangana (eastern and south eastern states of India).

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

### Investment allowance

A taxpayer acquiring and installing a new plant and machinery aggregating to 1 billion INR during tax years 2013-14 and 2014-15, is entitled to investment allowance at 15%.

This benefit has been extended to new plant and machinery, acquired and installed, exceeding 250 million INR during financial years 2014-15 to 2016-17.

This benefit of additional 15% investment allowance during the period from FY 2015-16 to FY 2019-20 (without any monetary threshold of investment) has been extended to newly set up undertakings in the backward areas of state of Andhra Pradesh, Bihar, Telangana and West Bengal for the purpose of development of these states.

Investment in new plant and machinery will not include investment made in assets such as a plant or machinery used earlier in or outside India, any plant or machinery installed in any office premises or in residential accommodation (or guest house), any office appliances (including computers or computer software), vehicle, or any plant or machinery; the cost of which has been allowed as a deduction under any other provision.

A taxpayer availing the investment allowance is required to hold the plant and machinery for more than five years, failing which the investment allowance claimed will be taxed in the year of transfer of the plant and machinery.

### Disallowance of expenditure incurred on corporate social responsibility (CSR) activities

Expenditure incurred by a taxpayer on CSR activities under



the Companies Act, 2013, is not allowed as a deduction under section 37(1) of the IT Act (which provides for general deduction in respect of any expenditure incurred for the purposes of the business). However, expenditure on CSR activities can be claimed as a specific deduction under the other provisions of the Act, if it satisfies the conditions prescribed in the provisions.

### Scientific research and development

A deduction of 200% is available on the expenditure incurred for scientific research in an approved in-house research and development facility by a company engaged in the business of biotechnology or any business of manufacture or production of any article or thing except specified articles, subject to meeting of certain conditions. Currently, this weighted deduction is available until FY 2016-17.

Any sum paid to a national laboratory, a university, Indian Institute of Technology (IIT) or an approved scientific research programme qualifies for a weighted deduction of 200%.

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

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

### Special economic zone (SEZ) scheme

The SEZ policy was introduced by the government to provide an internationally competitive and conducive environment for exports.

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

SEZ developers are entitled to tax holidays in respect of 100% of the profits and gains derived from the business of developing the units for any 10 consecutive years out of 15, beginning from the year when the SEZ is announced by the government. Exemption to SEZ developers from dividend distribution tax (DDT) was discontinued with effect from 1 June 2011 and minimum alternate tax (MAT) exemption for developers was discontinued from FY 2011-12. Expenditure undertaken by a developer on account of SEZ development is also exempt from duties of customs, excise and central sales tax (CST).

A unit set up in an approved SEZ enjoys 100% tax holiday for

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

### Deduction on investments for specified businesses

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

- Setting up and operating a cold chain facility on or after 1 April 2009
- Setting up and operating a warehousing facility for storage of agricultural produce on or after 1 April 2009
- Laying and operating a cross-country natural gas, crude, or petroleum oil pipeline for distribution (including storage facilities being an integral part of such a network) commencing operations on or after 1 April 2007
- Building and operating, anywhere in India, a two-star or above hotel commencing operations on or after 1 April 2010
- Building and operating, anywhere in India, a hospital with at least 100 beds commencing operations on or after 1 April 2010
- Developing and building a housing project under a scheme for slum redevelopment or rehabilitation commencing operations on or after 1 April 2010
- Developing and building a housing project under a notified scheme of affordable housing framed by the central or a state government commencing operations on or after 1 April 2011
- Fertiliser production in a new plant or in a newly installed capacity in an existing plant commencing operations on or after 1 April 2011
- Setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962, on or after 1 April 2012
- Beekeeping and production of honey and beeswax on or after 1 April 2012
- Setting up and operating a warehouse facility for storage of sugar on or after 1 April 2012

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

## Tax holiday for other facilities such as food processing units

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

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

## Deductions for enterprises involved in infrastructure development

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



Sector	Applicability	Timeframe	Eligibility
Power	<ul style="list-style-type: none"> <li>• Generation of power</li> <li>• Transmission and distribution of power</li> <li>• Substantial renovation and modernisation</li> </ul>	<ul style="list-style-type: none"> <li>• 10 consecutive years out of first 15 years of operation</li> </ul>	<ul style="list-style-type: none"> <li>• Operations should commence before 31 March 2017</li> </ul>
Ports and airports	<ul style="list-style-type: none"> <li>• Developing and/or operating and maintaining ports and airports</li> <li>• Applicable also to inland waterway, inland port, navigational channel in the sea</li> </ul>	<ul style="list-style-type: none"> <li>• 10 consecutive years out of first 15 years of operation</li> </ul>	<ul style="list-style-type: none"> <li>• New infrastructure facility</li> <li>• Agreement with government/statutory body</li> </ul>
Roads and highways	<ul style="list-style-type: none"> <li>• Developing and/or operating and maintaining ports and airports</li> <li>• Roads, including toll roads, bridges</li> <li>• Highways, including housing or other integral activities</li> </ul>	<ul style="list-style-type: none"> <li>• 10 consecutive years out of first 20 years of operation</li> </ul>	<ul style="list-style-type: none"> <li>• New infrastructure facility</li> <li>• Agreement with government/statutory body</li> </ul>
Water	<ul style="list-style-type: none"> <li>• Water supply project, irrigation project, sanitation and sewerage system or solid waste management system</li> </ul>	<ul style="list-style-type: none"> <li>• 10 consecutive years out of first 20 years of operation</li> </ul>	<ul style="list-style-type: none"> <li>• New infrastructure facility</li> <li>• Agreement with government/statutory body</li> </ul>



## Presumptive taxation regime for non-residents

The IT Act contains special provisions whereby the total income of certain non-resident assessee is computed on the basis of certain percentage of their gross total receipts. This estimated income approach expects to reduce areas of uncertainty and compliances.

Particulars	Shipping	Oil and gas services	Aircraft	Turnkey power projects
Applicability	Non-resident engaged in shipping business	Non-resident engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire, used or to be used, in the prospecting for, or extraction or production of, mineral oils	Non-resident engaged in business of operation of aircraft	Non-resident engaged in the business of civil construction or erection or testing or commissioning of plant or machinery in connection with turnkey power projects (such projects should be approved by the Central Government of India)
Presumptive rate	7.5% of the amount paid or payable to the non-resident or to any other person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any Indian port as also of the amount received or deemed to be received in India on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India	10% of the amount paid or payable to, or the amount received or receivable by, the assessee for provision of such services or facilities or supply of plant and machinery shall be deemed to be the taxable income of such non-resident assessee	5% of the amount received or receivable for carriage of persons, livestock, mail or goods from any place in India or the amount received or deemed to be received within India on account of such carriage from any place outside India	10% of the amount paid or payable to such assessee or to any person on his behalf, whether in or out of India
Option to maintain books of accounts and claim lower profit rate or losses	No	Yes (see note)	No	Yes (see note)

**Note:** The non-resident taxpayer has the option to maintain books of account and get them audited and offer lower profits and gains/losses in the tax return.

## Corporate: Branch income

Branches of foreign companies are taxed on income that is received in India, or which accrues or arises in India, at the rates applicable to foreign companies. There is no withholding tax (WHT) on remittance of profits to the company's head office.

## Restriction on deduction of head office expenses

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

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

## Income from capital gains

Capital gains arising on transfer of	Tax rates*	
	Resident	Non-resident
A. Short-term capital assets (other than (b) below)	Normal corporate/individual tax rates	Normal corporate/individual tax rates
B. Short-term capital assets, being listed equity shares, units of equity oriented funds or units of a BT, where securities transaction tax (STT) is charged on the transaction (other than units of a business trust acquired on transfer of shares of a special purpose vehicle)	15%	15%
C. Long-term capital assets, being listed equity shares in a company or units of an equity-oriented fund or units of a BT (other than units of a BT acquired on transfer of shares of SPV) where STT is charged on the transaction	Exempt	Exempt
D. Long-term capital assets being listed securities or units or zero-coupon bonds (other than (c) above)	10%	10%
E. Other long-term capital assets	20%	20%
F. Long-term capital gains arising to a non-resident (not being a company) or a foreign company from transfer of unlisted securities	NA	10% (no indexation benefit)

\* Applicable surcharge and education cess (EC) will also be levied on these taxes.



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

Benefit of indexation of cost of acquisition and cost of improvement of a long-term capital asset of any nature (other than a bond or debenture capital indexed bonds issued by the government) is available to residents.

#### **Characterisation of income in the case of foreign institutional investors (FIIs)**

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

#### **Income from house property**

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

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

#### **Income from other sources**

Income which is not covered under any of the specific heads of income is liable to tax as 'income from other sources'. While computing taxable income from other sources, expenditure specially allowed or incurred wholly and exclusively for earning such income is allowed as a deduction.

#### **Gift tax**

There is no gift tax liability in India. However, there are provisions for the taxability of gifts in the hands of the recipient under provisions of income tax laws.

#### **Gifts received by individuals**

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

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

#### **Shares received by firms/closely held companies**

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

- If shares are received for free; FMV of such shares is treated as income
- If shares are received for inadequate consideration; FMV of such shares as exceeds such consideration, is treated as income in the hands of the recipient

Income will not be taxable if it does not exceed the threshold of 50,000 INR.

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

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



## Dividends

Indian companies have to pay DDT at 15% (plus applicable surcharge and education cess) on declaration, distribution, or payment, of dividends, whichever is earlier. A company does not have to pay DDT on dividends paid to its shareholders to the extent it has received such dividends from the following:

- Its Indian subsidiary company on which DDT has been paid by the subsidiary
- A foreign subsidiary company on which tax has been paid at 15%

The dividends, subject to DDT, are not taxable in the hands of the shareholders.

## Other corporate tax considerations

### Minimum alternate tax (MAT)

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

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

The liability to pay minimum tax of 18.5% on book profits is entrusted to both Indian as well as foreign companies. However, foreign companies are not liable to pay MAT on specified incomes (i.e. capital gains on transfer of securities, interest, royalty or FTS), provided the tax otherwise payable on them is less than the minimum tax as mentioned. This relief has been provided to foreign companies amidst long-drawn judicial controversies on the applicability of MAT on them. This relief is applicable from FY 2015-16.

### Alternate minimum tax (AMT) on all persons other than companies

AMT is levied on persons (other than companies) at 18.5% on the adjusted total income (as per income tax provisions) if the AMT exceeds the tax payable under normal income tax provisions. Credit for AMT is allowed against the tax liability which may arise in the subsequent 10 years under the normal provisions of the IT Act.

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

## Corporate: WHTs

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

### Payments to residents

Nature of payment	Payment threshold for WHT (INR) <sup>(1)</sup>	WHT rate (%)
Specified type of interest (interest on securities)	None	10
Non-specified type of interest (interest other than interest on securities)	5,000 <sup>(2)</sup>	10
Professional or technical service	30,000	10
Commission and brokerage	5,000	10
Rent of plant, machinery, or equipment	1,80,000	2
Rent of land, building, or furniture	1,80,000	10
Contractual payment (except for individual/HUF)	30,000 (single payment) 75,000 (aggregate payment)	2
Contractual payment to individual/HUF	30,000 (single payment) 75,000 (aggregate payment)	1
Royalty or FTS	30,000	10

## Notes

1. Payments have different threshold limits. The payer is only required to withhold tax if the total payment within a tax year to a single person (except where specified otherwise) is above the limits specified above.
2. The threshold limit for WHT for non-specified type of interest is 5,000 INR, except in the case of interest received from a bank, cooperative society, or deposit with post office, for which it is 10,000 INR.

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

## Payment to non-residents

Nature of payment	WHT rate (%)
Dividend	0
Interest on foreign currency	20
Interest on money borrowed in foreign currency under a loan agreement or by way of long-term infrastructure bonds (or rupee denominated bonds) (time period for borrowing is July 2012 to July 2017)	5
Interest on investment in long-term infrastructure bonds issued by an Indian company (rupee denominated bonds or government security) (time period for borrowing is June 2013 to July 2017)	5
Royalty and technical fees	10
Long-term capital gains other than exempt income	20
Income by way of winning from horse races	30
Other income	40

### Notes

- Percentage is to be increased by a surcharge, education cess, and secondary and higher education cess to compute the effective rate of tax withholding.
- Income from units of specified mutual funds is exempt from tax in the hands of unitholders.
- Dividends received from Indian companies are tax-free in the hands of the shareholder.
- Short-term capital gains on the transfer of shares of a company or units of an equity-oriented fund will be taxable at 15% if they have been subjected to STT.
- Long-term capital gains on the transfer of shares (through the stock exchange) in listed companies or units of an equity-oriented fund are exempt from tax if they have been subjected to STT.
- There is no threshold for payment to non-resident companies up to which no tax is required to be withheld.
- If the PAN of the deductee is not quoted, the rate of WHT will be the rate specified in relevant provisions of the IT Act, the rates in force, or the rate of 20%, whichever is higher.

## Buy-back of shares

An additional tax is payable on transactions involving the buy-back of shares by unlisted companies from its shareholders. A tax at 20% is payable by the company on the difference of consideration paid on buyback and the issue price of shares. The buy-back consideration received will be tax exempt in the hands of the receiver.

## Other considerations for non-residents taxation

### Tax residency certificate (TRC)

In order to avail the benefits of a DTAA, a non-resident is required to furnish a copy of the tax residency certificate issued by the revenue authorities of the country of residence, as also other prescribed documents.

### Tax information exchange agreements (TIEA)

Since 2011, India has entered into many TIEAs with territories such as the Bahamas, Bermuda, Belize, the British Virgin Islands, the Cayman Islands, Guernsey, the Isle of Man, Jersey, Liberia, Monaco and San Marino. The objective of entering into TIEAs is to promote international cooperation on tax matters through the exchange of information.

### Transactions with persons located in notified territories

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

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

### General Anti Avoidance Rule (GAAR)

Initially, the provisions relating to GAAR were to come into effect from 1 April 2015. However, GAAR provisions have been deferred by two years, i.e. effective from FY 2017-18. The deferment comes in the wake of the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project and India's active participation in the project.

The GAAR provisions empower the tax department to declare an 'arrangement' entered into by an assessee to be an 'impermissible avoidance agreement' (IAA). Consequences of this will be the denial of the tax benefit either under the provisions of the IT Act or under the tax treaty. The provisions can be invoked for any step in, or part of, any arrangement

entered, and that arrangement or step may be declared as an IAA. The provisions will be attracted only if the main purpose of the arrangement or step is to obtain tax benefit.

The GAAR provisions do not apply in the following cases:

- Where tax benefit (to all the parties in aggregate) from an arrangement in a relevant tax year does not exceed 30 million INR
- FIIs registered with SEBI and not availing any benefit under a tax treaty and also investment in FIIs made by non-resident investors
- On investments made up to 31 March 2017

### Wealth tax

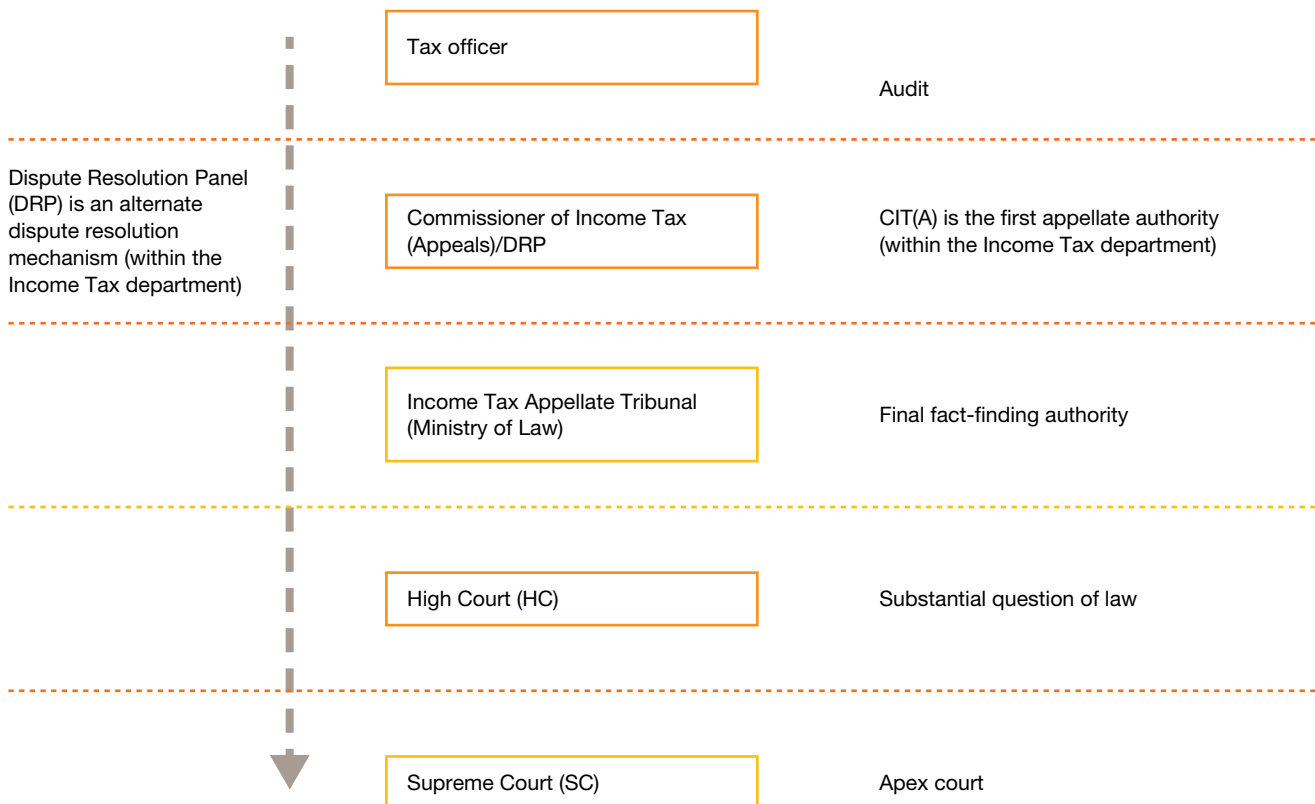
The Wealth Tax Act, 1957, has been abolished with effect from FY 2015-16.

### Measures to curb black money

A separate act has been introduced for black money parked outside India. Stringent measures have been introduced for non-disclosure of overseas income and assets, including rigorous imprisonment and steep penalties.

### Dispute resolution mechanism

Traditional approach for dispute resolution





## Alternative approaches for dispute resolution

### *Authority for Advance Ruling (AAR)*

The AAR can be approached for the determination of tax liability from existing and proposed transactions to be undertaken by non-residents or residents having transactions with non-residents, provided such an issue is not pending with any tax authority. Now, the AAR may be approached for domestic transactions as well subject to certain conditions. As per the law, the AAR is to dispose off the application within six months. However, practically, it takes one to two years depending upon the number of cases lined up. The AAR's ruling is binding on the assessee and tax authorities, subject to writ jurisdiction under the HC or SC.

### *Income Tax Settlement Commission (ITSC)*

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

### *Mutual agreement procedure (MAP)*

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

### *Advance pricing agreement (APA)*

The APA involves determining arms-length pricing by holding discussions within the APA team. It involves sharing of detailed information on functional, asset and risk (FAR) profile about the assessee for deciding on covered transactions and other pertinent matters. It is a new process and therefore the approach of revenue authorities in the discussions and site visits is much more pragmatic and more open than what is normally followed in a TP audit.

# International assignments

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

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

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

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

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

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

- He or she is an NR in 9 out of the 10 financial years preceding the relevant financial year
- He or she is physically present in India for 729 days or less during the seven financial years preceding the relevant financial year

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

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

## Scope of taxation

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

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

## Taxation of employment income

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

Taxable income includes all kinds of sums received, either in cash or kind, arising from an office of employment. Apart from income sources such as salaries, fees, bonuses and commissions, some of the most common remuneration items are allowances, reimbursement of personal expenses, education payments and perquisites or benefits provided by the employer free of cost or at concessional rates. All such payments are to be included, whether paid directly to the employee or paid by the employer on his or her behalf.

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

The value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer or the former employer, free of cost or at a concessional rate and the amount of any contribution to an approved superannuation fund by the employer to the extent that it exceeds 1,00,000 INR are taxable as perquisites in the hands of the employee. Car and driver facilities provided by the employer are also taxable as perquisites at a concessional value.

There are many issues relating to the taxation of employment income, depending on the facts and circumstances of each case and on the views of the tax authorities. Therefore, it is advisable to seek professional advice on the remuneration package as a whole to minimise Indian tax incidence.



## Withholding tax (WHT)

With respect to employment income, the employer will be required to withhold tax on the employee's salary at applicable rates and hand it over to the government's treasury within seven days from the end of the month during which the salary is paid (except for March, wherein the timeline is extended up to 30 April). This is applicable even if the employer is not residing in India.

## Double taxation agreements

In a situation where an individual is treated as a tax resident of another country, he or she may then qualify for relief under the double taxation agreement signed between that country and India. Most agreements currently in force lay down various tests in order to determine the actual residential status of the individual.

Many agreements contain clauses which exempt a resident of a specific country from tax on employment income incurred within India if he or she has been residing in the country for less than 183 days within the given tax year and if other conditions regarding the salary chargeback and payment of salary by an NR, etc. are also satisfied (short-stay exemptions).

However, to avail the treaty benefit, an individual will be required to obtain the Tax Residency Certificate (TRC) from his or her home country's tax authorities certifying that he or she is a tax resident of that country. In a situation where the individual comes from a country with which India does not have a treaty in force, a short-stay exemption is available under the domestic tax law, provided the individual's stay in India during that particular tax year does not exceed 90 days and certain other conditions are met.

## Tax rates

Taxes are levied at progressive rates in India. Rates applicable for FY 2015-16 are as follows:

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

Resident senior citizens aged 60 years or above, earning an income up to 3,00,000 INR, do not have to pay any income tax. For senior citizens aged 80 years and above, the basic exemption limit is 5,00,000 INR.

A tax rebate of 2,000 INR is provided to a resident individual earning an income between 2,50,000 and 5,00,000 INR. Furthermore, a surcharge of 12% of the tax will be levied where the total income of an individual exceeds 10 million INR. In addition to these conditions, an education cess at the rate of 3% of the tax and surcharge (if applicable) will be levied so as to determine the final tax liability.

## Tax registration

An individual needs to apply for and obtain his or her tax registration number—Permanent Account Number (PAN). A PAN is required to file tax returns and also has to be reported in the tax withholding returns or withholding certificates issued to an individual.

## Tax returns filing

At the end of each financial or tax year, a tax return has to be filed with the income tax authorities in the prescribed format. The due date for filing of returns is 31 July of the year immediately following the relevant tax year. However, a belated return can be filed before the expiry of two years from the end of the relevant tax year. It is mandatory to file returns electronically if the total income exceeds 5,00,000 INR or where the individual qualifies as ROR and possesses foreign assets, or has the signing authority for any of his or her accounts located outside India. Wealth tax, which was earlier levied on the possession of taxable wealth, has been done away with from tax year 2015–16.

## Other matters

### Visa

A foreign national coming to India must hold a valid passport and visa. A visa is issued by the Indian consulate or high commission situated in the respective home country, depending on the purpose and duration of the visit. A foreign national is not permitted to take up employment within India unless he or she holds a valid employment visa. An employment visa is issued to highly skilled individuals or professionals, provided they draw a salary exceeding the prescribed limit. Such a visa is generally issued for a period of one to two years. The visa can be subsequently extended in India itself.

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

### **Registration with Foreigners' Regional Registration Officer (FRRO)**

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

### **Payment of salaries outside India**

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

### **Social security in India**

In October 2008, the government made social security norms mandatory for foreign nationals who qualify to be 'international workers'. A foreign national qualifies as an international worker if he or she is coming to India to work for an establishment in India to which the Indian social security regulations apply.

An international worker coming from a country with which India has a reciprocal social security agreement (SSA) in force is exempted from the Indian social security norms if the following criteria are met:

- He or she is contributing to his or her home country's social security either as a citizen or resident
- He or she enjoys the status of 'detached worker' for the given period in accordance with the terms specified in the relevant SSA (i.e. he or she has obtained a Certificate of Coverage from his or her home country's social security authorities)

Similarly, an international worker from a country with which India has entered into a bilateral Comprehensive Economic Cooperation Agreement (CECA) prior to 1 October 2008 is exempted from Indian social security if the following criteria are met:

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

Singapore is the only country with which India has signed a CECA prior to 1 October 2008. India has signed SSAs with 18 countries. However, so far, only the SSAs with the following countries—Belgium, Germany, Switzerland, Luxembourg, Netherlands, Denmark, Korea, France, Hungary, Finland, Sweden, the Czech Republic, Norway and Canada—have been signed and made operational. Every international worker has to contribute 12% of his or her salary, consisting mainly of basic wages, dearness allowance, retaining allowance (but excluding components such as bonus, house rent allowance, etc.) to the provident fund.



The employer is required to make a matching contribution (i.e. 12% of the salary) and deposit both the employer's as well as the employees' contributions with the Indian social security authorities by the 20<sup>th</sup> of the following month. Out of the employer's contribution of 12%, an amount equal to 8.33% of the salary is allocated to the pension fund of the international worker and the balance goes to the provident fund. However, no such allocation towards the pension fund is required in cases where an international worker has joined a covered establishment in India on or after 1 September 2014 and draws a salary of more than 15,000 INR per month. In such a case, the employer's entire contribution (i.e. 12% of the salary) will go to the provident fund of the international worker.

An international worker can withdraw the accumulated balance of the provident fund under the following circumstances:

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

In cases where the international worker is from an SSA country, withdrawal from the provident fund shall be payable in the payees' bank account directly, or through the employer. In all other cases, the amount withdrawn will be credited to the international worker's Indian bank account. Amendments have been made in the Indian regulatory framework to permit





international workers to open their Indian bank accounts in order to realise provident fund money.

The accumulated sum in the pension fund is paid as pension to employees upon retirement or in certain circumstances as specified in the pension scheme. International workers are not entitled to pension benefits from the pension fund unless they have rendered eligible service for a period of 10 years with the covered establishment in India. However, an option of early withdrawal of pension contributions (i.e. before completing 10 years of service) is available to international workers coming from SSA countries.

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

- Exchange control regulations
- Corporate tax implications (permanent establishment exposure)
- WHT
- TP regulations
- Service tax implications
- Companies Act
- Indian social security regulations

### **Black Money Act**

To curb black money, a new act has been passed by the Indian Parliament, namely The Black Money (Undisclosed Income and Foreign Assets) and Imposition of Tax Act, 2015. The act contains stringent penalties and prosecution provisions for concealment of income in relation to foreign income or assets and/or non-disclosure of foreign assets in the income tax returns of ROR taxpayers. Undisclosed foreign income or assets detected will be taxed under this new law at 30%. In addition, there is a provision for penalty of 300% of tax and imprisonment up to 10 years. Non-disclosure or inaccurate disclosure attracts a penalty of 1 million INR and imprisonment of up to seven years.

# Indirect taxation

## Overview

India follows a federal structure under which the authority to impose taxes has been distributed between the central and various state governments. The Centre levies taxes such as customs, excise, service and central sales tax (CST), while the states levy value added tax (VAT), entry tax, octroi, and so forth.

While the present Indian indirect tax regime is beset with many flaws, it is expected to soon be replaced with the more integrated Goods and Services Tax (GST).

## Customs duty

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

The customs tariff of India is aligned up to a six-digit level with the internationally recognised Harmonised Commodity Description and Coding System of Tariff Nomenclature provided by the World Customs Organisation (WCO).

Customs duty is levied on the transaction value of the imported or exported goods. While the general principles adopted for the valuation of goods in India are in conformity with the World Trade Organisation (WTO) agreement on customs valuation, the central government has established independent valuation rules applicable to the export and import of goods. While normally, customs duty is payable on the transaction value (based on the price at which the goods are imported), imports from related parties are typically subject to scrutiny by the Special Valuation Branch of the customs department.

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

- **Basic customs duty (BCD):** The basic component of customs duty levied at the effective rate notified under the First Schedule to the CTA and applied to the landed value of the goods (i.e. cost, insurance and freight (CIF) value of the goods plus landing charges at 1%).
- The peak rate of BCD is currently set at 10% for all goods other than agricultural and some other specified products. However, the government has the power to exempt specific goods, wholly or in part, from the levy of customs duties. In addition, preferential or concessional rates of duty are available under various bilateral and multilateral trade agreements that India has entered into with other countries.
- **Countervailing duty (CVD):** It is equivalent to, and is charged in lieu of, the excise duty applicable on like goods manufactured in India. CVD is calculated on the landed value of goods and applicable BCD. However, CVD on specific consumer goods intended for retail sale is calculated on the basis of the maximum retail price (MRP) printed on their packs after allowing specified abatements. The general rate of excise duty is currently 12.5% and, consequently, so is the CVD rate.

- Education cess (EC) at 2% and secondary and higher education cess (SHEC) at 1% are also levied on aggregate customs duties.
- Additional duty of customs (ADC) at 4% is charged in addition to the above duties on imports, with a few exceptions. ADC is calculated on the aggregate of the assessable value of imported goods, the total customs duties (i.e. BCD and CVD) and the applicable EC and SHEC.

BCD, EC and SHEC levied on aggregate customs duties are a cost on any import transaction. The duty incidence arising on account of all other components may be set off or refunded, subject to prescribed conditions. Where goods are imported for manufacturing, the Indian manufacturer may take credit for the CVD and ADC paid at the time of import to set off such credit against the output excise duty. In the case of service providers, CVD credit is available to set off against the output service tax.

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





## CENVAT (excise duty)

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

Its rate depends on the classification of goods under the excise tariff, which is primarily based on the HSN classification adopted to conform to the customs tariff. The standard rate of excise duty for non-petroleum products is 12.5%.

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

Goods other than those covered by an MRP-based assessment are generally chargeable to duty on the transaction value at which they are sold to an independent buyer. In addition, the central government has the power to fix tariff values for charging ad valorem duties on goods.

The excise duty operates as a pure VAT, with the full set-off of input tax credits in computing and discharging tax liabilities on

the output side. The input tax credit comprises excise duty on indigenously sourced inputs and capital goods, the CVD and ADC portion of customs duty on imported material, and service tax on input services, with some exceptions provided under CENVAT credit rules.

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

## Service tax

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

Generally, the service provider is liable to pay the service tax. However, for some specified services, such as transport of goods by road, sponsorship, legal services, import of services, etc., the obligation to pay service tax rests with the service receiver



instead. In certain cases, this obligation has been divided between the receiver and the provider in a specified proportion.

With effect from 1 June 2015, the rate of service tax has been increased to 14% from the earlier 12.36%.

There is a simple online procedure prescribed for the service provider and receiver to register under service tax. Providers or receivers rendering services from multiple locations within India have been given an option between taking a centralised registration for all locations and choosing a separate registration for different locations.

Like excise duty, service tax is also a pure VAT. Since service tax and excise duty are federal levies, cross-input tax credit has been allowed. The scheme of input tax credit under service tax has been integrated under CENVAT credit rules and the benefits available to manufacturers have been extended to the service provider.

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

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

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

## Sales tax

The sale of movable goods in India is taxable at the federal or state level. The Indian regulatory framework empowers states to levy tax on goods sold within the state. On the other hand, all goods sold in the course of inter-state trade are subject to (CST).

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

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

## Value added tax (VAT)

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

Currently, there is no VAT on goods imported into India. Exports, meanwhile, are zero-rated. That is, while exports are not charged to VAT, the exporter can claim refund of VAT paid on inputs used in the manufacture of export goods.

Regarding the importance of each commodity during the trade of goods in a state, varying tariff rates are assigned to different commodities. General tariff rates prevalent in the state VAT laws can vary from 1 to 20%. Apart from this, all those goods not covered under any of the tariff rates will be chargeable to the residual rate, which may vary from 12.5 to 15.5%.

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

## Octroi duty or entry tax

Entry tax is charged on the entry of specified goods into the state where they are used or sold. Entry tax continues to exist under the VAT regime, though in certain states it has been made VAT-able and can be set off against the output VAT liability in the state.

This tax is levied on purchase value, that is, the amount of valuable consideration payable on the purchase of any goods. The value of the specified goods can be ascertained from the original invoice for their purchase.

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

## Goods and Services Tax (GST)

In 2006, the central government took a major step towards a national, integrated GST. Its implementation will be a historic reform in India as it will subsume CVD, excise duties, service tax, CST, state VAT and other state levies.

At present, a dual-rate GST model is envisaged, under which the tax rate will be converged to one standardised rate on goods and services.

Under the proposed model, a central and a state GST will be levied on the taxable value of a transaction of supply of goods and services. Both the centre and the state will legislate, levy and administer their respective GST regimes.

Once fully in place, GST will create a single, unified Indian market and peel off the multiple layers of indirect taxation that currently prevail. GST, also seen as a reform in the administration of indirect taxation, will definitely be favourable for trade.

### Status of introduction of GST in India

In the past year, there has been significant progress towards the introduction of GST in India. The central and state governments have agreed on the broad contours of a GST-based tax regime.

As a first step, the Constitution of India is required to be amended to permit the Centre and the states to levy tax on the supply of goods and services. The Constitution Amendment Bill is required to be passed by both houses of Parliament (Lok Sabha and Rajya Sabha). After getting Parliament's nod, it will need to be ratified by at least 50% of the states.

Currently, the Bill has been passed by the Lok Sabha and is pending in the Rajya Sabha.

After the constitutional amendment is made, the Centre and states will need to pass respective legislations for implementing GST.

The central government has time and again iterated its intention to implement GST by 1 April 2016. It has also taken tangible action to resolve the concerns shown by the states. However, clarity on several essential aspects, such as tax rates, valuation of goods, transition provisions, etc., is still awaited.

In any case, introduction of GST in India is imminent.

### Stamp duty

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

### Research and development cess

A research and development cess of 5% is levied on all payments made for the import of technology under foreign collaboration. The term 'technology' includes the import of designs, drawings, publications and services of technical personnel.



# Mergers and acquisitions (M&A)

## Indian M&A framework

The Indian regulatory framework broadly facilitates acquisitions or hive-offs through many legal modes, each different when it comes to tax outgo parameters and the regulatory ease of carrying out the deal. Common modes of executing the transactions are as follows:

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

## Transaction through share transfer

### Implications for the seller

The transfer of shares in Indian companies is taxable as capital gains, and is subject to benefits under the Double Taxation Avoidance Agreement (DTAA), if any. Taxability also depends on whether the subject shares are listed or unlisted.

### Listed shares

- Long-term capital gains (LTCG), i.e. gains resulting from shares held for more than 12 months (in case of listed securities), are exempt from tax if the sale is on a recognised stock exchange in India. In case the transaction is carried out off the stock exchange, gains in case of resident seller are taxed at 10%\* (without indexation benefits) or 20%\* (with indexation benefits), whichever is beneficial. In case of a non-resident seller, the LTCG will be taxed at 10%\* (without indexation benefits).
- Short-term capital gains (STCG) are taxed at 15%\* if sale is on a recognised stock exchange in India. If carried out off the stock exchange, the transaction is taxable just as unlisted shares are.

### Unlisted shares

- In case of non-residents, LTCG is taxed at 10%\* (without indexation benefits) on sale of shares of a public company and at 20%\* on sale of shares of a private company. In case of residents, LTCG is taxed at 20%\* (with indexation benefits).
- The period of holding unlisted shares must be more than 36 months for a share to qualify as a long-term capital asset.
- STCG is taxed at 40%\* for non-resident companies and 30%\* for resident companies.

## Indirect transfer of shares

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

The Finance Act, 2015, explains 'substantial' in relation to indirect transfer of shares by providing a monetary and asset value threshold for determining the taxability in India.

The shares of the foreign company shall be presumed to derive their value substantially from assets located in India if the fair market value (FMV) of such assets (without reduction of liabilities) a) exceeds 10 crore INR, and b) represents at least 50% of the value of all assets owned by the foreign company.

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

The Finance Act, 2015, also provides relief to minority shareholders on exit from a foreign company deriving its value substantially from assets located in India. This is subject to a minority shareholder holding 5% stake or less in the foreign company and not holding any right of control or management in it.

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

### Implications for the buyer

- Acquisition of shares of a listed company requires compliance with the Takeover Code. An open offer needs to be made for acquiring 25% or more voting power in a listed company, or for acquiring control in an Indian listed company.
- The document evidencing a transfer of shares is subject to stamp duty at 0.25% of the value of shares transferred. But no stamp duty is payable if such shares are held in electronic form.
- Funding costs in the form of interest burdens on a loan applied for acquiring shares may not be tax-deductible, as the corresponding dividend income will be exempt from tax in the hands of shareholders.
- If a corporate buyer receives shares of a closely-held company at less than the tax FMV determined according to the prescribed methodology, the difference between FMV and sale consideration of such shares is taxable in the hands of the buyer at the applicable corporate tax rate.

\* plus cess and surcharge



## Withholding tax (WHT)

- The buyer (including non-residents) is required to withhold taxes resulting from capital gains in the hands of a non-resident seller. Practically, this requires the buyer to get Indian tax registration numbers.
- Parties can seek to bring clarity on WHT aspects by getting a prior clearance from the tax authorities.

## Preservation and carry forward of tax losses

- There is no impact on carrying forward tax losses on change in shareholding of a listed company.
- A non-listed company is entitled to carry forward and set off prior years' business losses if at least 51% of its shares are beneficially held by the same shareholders who beneficially held at least 51% shares when the losses were incurred.
- Change in shareholding has no impact on carrying forward unabsorbed depreciation allowance, irrespective of the Indian company's status

## Share valuation

The Reserve Bank of India (RBI) regulates the pricing of each share transaction between resident and non-resident shareholders of an Indian company. It has standardised the valuation methodology, so the parties can value the shares according to internationally accepted methodologies.

## Business purchase or asset purchase

In India, businesses can be acquired through the following:

- **Asset purchase model:** The buyer may cherry-pick the assets it wants, and leave the liabilities and other assets in the seller entity itself.
- **Business purchase model:** The buyer acquires an entire business undertaking, with all its assets and liabilities, for a lump sum consideration on a going-concern basis.

### Asset purchase model

Implications for the seller

- Gains are computed for each asset and this is taxable as short-or long-term capital gains, depending on the period of holding the assets. The sale of depreciable assets always results in STCGs.
- Capital gains are determined by reducing the acquisition cost of assets from the sale consideration. In case of LTCGs, the

acquisition cost is indexed based on the cost inflation index, which is notified by the tax authorities each financial year.

- The seller is liable to charge value added tax (VAT) or sales tax on the transfer of movable property at specified rates.
- The cost of acquisition of self-generated intangible assets, such as goodwill, is considered nil for calculating capital gains.
- If the purchase involves transfer of immovable property, the sale consideration is benchmarked at the minimum value determined by stamp taxes authorities, solely for calculating capital gains tax.

Implications for the buyer

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

### Business purchase model

Implications for the seller

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

Implications for the buyer

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

Funding costs

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

\* plus cess and surcharge

## Amalgamations and demergers

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

### Amalgamation (merger)

It refers to the merger of one or more companies into another through a court/tribunal process. Conditions to claim tax exemption are as follows:

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

### Demerger

It refers to the transfer or division of an undertaking or its part from one company to another through a court/tribunal process. Conditions for tax exemption are as follows:

- All assets and liabilities of the transferor's business undertaking should be transferred to the resulting company at their respective book values.
- The transfer of the business undertaking should be on a going-concern basis.
- Consideration for a demerger settled through issuing shares to shareholders of the demerged company should be done proportionately.
- Shareholders holding at least 75% of shares (in value) in a demerged company are to become shareholders in the resulting company.

### Carrying forward of accumulated loss and unabsorbed depreciation

#### Amalgamation

- Accumulated loss or unabsorbed depreciation of an amalgamating company running an industrial undertaking are to be carried forward by the amalgamated company.
- Specified conditions are laid down, like continuance of business, holding of assets, etc.

#### Demerger

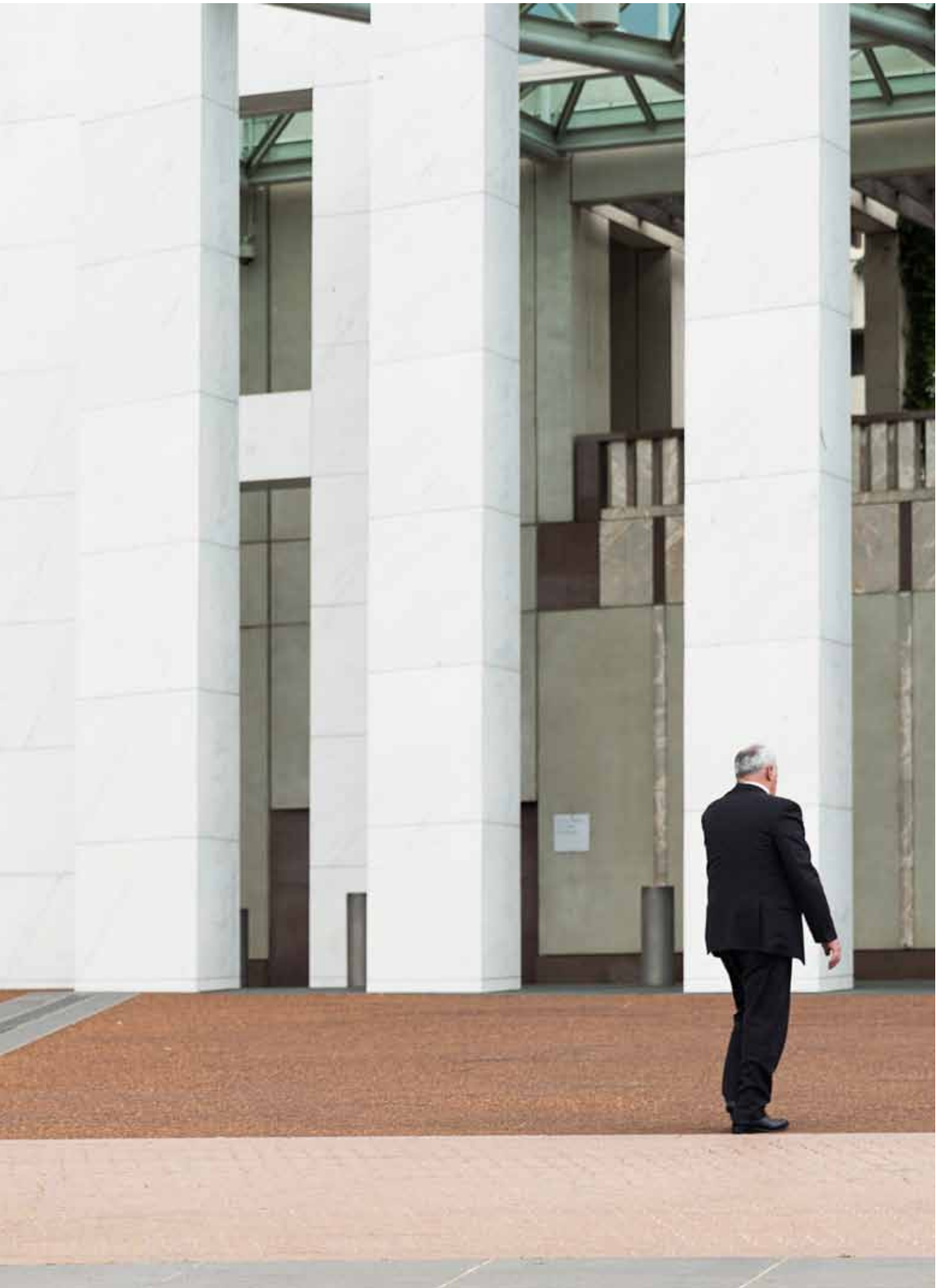
- Accumulated loss or unabsorbed depreciation directly related to the undertaking being demerged is transferable for the unexpired period.
- Proportionate common losses are also transferable.

### Other matters

- Amalgamations and demergers normally attract stamp duty at varying rates derived from the state laws.
- Clearances are needed from the stock exchange, high court and other regulatory bodies. A more robust process has now been notified for getting approvals from the stock exchanges and the Securities and Exchange Board of India (SEBI). But this can be time-consuming, leading to delays during tight schedules.







# Transfer pricing (TP)

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

## TP legislation

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

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

## Transactions covered

The term 'international transaction' has been defined to indicate a transaction between two or more AEs involving the sale, purchase or lease of tangible or intangible property, provision of services, cost-sharing arrangements, various modes of capital (debt) financing, guarantees, business restructuring or reorganisation transactions, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises. With a view to clarify on the inclusion of certain transactions, the Finance Act, 2012, had broadened the definition of the term and provided various classes of intangibles to be covered.

The AEs can be either two non-residents or a resident and a non-resident. A permanent establishment (PE) of a foreign enterprise also qualifies as an AE. Accordingly, transactions between a foreign enterprise and its Indian PE are within the ambit of the code.

## Associated enterprises

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

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

- A direct or indirect holding of 26% or more voting power in an enterprise by the other enterprise, or in both the enterprises by the same person

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

Furthermore, a transaction between an enterprise and a third party may be deemed to be between AEs if there exists a prior agreement in relation to such transaction between the third party and the AE, or if the terms of such transactions are determined in substance between the third party and the AE. From FY 2014-15, the third party does not necessarily need to be a non-resident.

## Specified domestic transactions

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

- Payment to related parties
- Transactions of tax holiday undertakings with other undertakings of the taxpayer

This provision is applicable only if the aggregate value of such a transaction exceeds 50 million INR (The Finance Act, 2015, enhanced the threshold limit 200 million INR with effect from FY 2015-16) in the relevant tax year.

## Arm's-length principle and pricing methodologies

### Most appropriate method

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

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

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



The legislation requires a taxpayer to determine an ALP for international and specified domestic transactions.

### Multiple year data

From FY 2014-15, an announcement has been made that the rules will be amended to allow more liberal use of multiple year data. Presently, the rules allow data for the relevant financial year and permit the use of three years' data only where the taxpayer is able to establish that such data reveals facts which can influence the determination of transfer prices.

The Central Board of Direct Taxes (CBDT) has developed a draft scheme, containing detailed provisions as regards the use of multiple year data subject to certain conditions. These have been effective from 1 April 2014, i.e., applicable for FY 2014-15 and onwards.

The CBDT has invited comments and suggestions of stakeholders and the general public on the proposed scheme for final implementation.

### Range concept

Since FY 2014-15, legislation has been amended to permit the use of ranges instead of the arithmetic mean concept, though detailed rules on the definition of range, minimum threshold, the number of comparables required to consider the range, and the manner of computing the adjustment where the tested party falls outside the specified range, are still to be notified. Given that the legislation has evolved over the years, the position across the various years is summarised below:

Timeframe	Flexibility allowed
FY 2001-02 to FY 2008-09	5% of the arithmetic mean The law as it stood then, resulted in a tax controversy on the availability of the benefit of 5% as a standard deduction in computing the ALP. Therefore, the Finance Act, 2012, clarified that the law had never intended to allow any standard deduction for computing the ALP.
FY 2009-10 to FY 2011-12	It remains 5% of the transfer price.
FY 2012-13	A 5% tolerance band was removed and the variance percentage was capped at 1% of the transfer price for wholesale traders and 3% of the transfer price in all other cases.
FY 2013-14	The variance percentage was capped at 1% of the transfer price for wholesale traders and 3% of the transfer price in all other cases.
FY 2014-15 and for subsequent years	The CBDT has developed a draft scheme, containing detailed provisions as regards the application of 'range concept', subject to certain conditions. These would be effective from 1 April 2014, i.e., applicable for FY 2014-15 and onwards. The CBDT has invited comments and suggestions of stakeholders and the general public on the proposed scheme for final implementation.

### Safe harbour provisions

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

The table below provides a snapshot of the SH Rules:

Eligible international transaction	Proposed SH
Software development services	If annual transaction value is: <ul style="list-style-type: none"> <li>• up to 5 billion INR, operating margin of 20% or more; or</li> <li>• more than 5 billion INR, operating margin of 22% or more.</li> </ul>
Information technology enabled services (ITeS)	
Knowledge process outsourcing (KPO) services	Operating margin of 25% or more
Advancing of intra-group loans by Indian companies to their wholly-owned subsidiaries	The interest rate is equal to or greater than the base rate of the State Bank of India (SBI) as on 30 June of the relevant previous year plus: <ul style="list-style-type: none"> <li>• 150 basis points (where the loan does not exceed 500 million INR); or</li> <li>• 300 basis points (where the loan exceeds 500 million INR).</li> </ul>
Provision of corporate guarantees by Indian companies to their wholly-owned subsidiaries	The commission or fee is: <ul style="list-style-type: none"> <li>• 2% per annum or more of the guaranteed amount, in the case the amount guaranteed is up to 1 billion INR; and</li> <li>• 1.75% or more per annum of the guaranteed amount if the amount guaranteed exceeds 1 billion INR, provided the credit rating of the AE is of adequate to highest safety.</li> </ul>
Contract research and development services with insignificant risks	Software development: Operating margin of 30% or more Generic pharmaceutical drugs: Operating margin of 29% or more
Manufacture and export of auto-components	Core auto-components: Operating margin of 12% or more Non-core auto-components: Operating margin of 8.5% or more

However, it is pertinent to note that no comparability adjustments are permitted and the benefit of a tolerance band (+/-3 %) or the proposed range will not be available to taxpayers opting for SH provisions. Also, a taxpayer opting for SH rules will not be entitled to invoke Mutual Agreement Procedure (MAP) proceedings. Furthermore, SH rules are not available for transactions with low tax jurisdictions.

### Advance pricing agreements (APAs)

Provisions relating to advance pricing agreements (APAs) have been introduced, effective from 1 July 2012.

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

The CBDT, with the approval of the central government, has been empowered to enter into an APA with any taxpayer undertaking international transactions, to determine the ALP or specify the manner in which ALP shall be determined. The APA so entered into shall be binding on the taxpayer and the tax authorities with respect to the transaction covered under the agreement. Such an agreement shall be valid for a period not exceeding five years. The CBDT notified the Advance Pricing Agreement Scheme (Rules 10F to 10T of Income Tax Rules, 1962) on 30 August 2012, covering the detailed rules and procedures (including necessary forms) for the application and administration of APAs. More than 500 APA applications have been filed in the first three cycles of filing with 13 unilateral APAs and one bilateral APA reaching conclusion between taxpayers and the CBDT till date.

With effect from 1 October 2014, the legislation has introduced the provisions of the roll-back of APAs for four years prior to the APA period (e.g. APAs applicable from FY 2013-2014 onwards—being the year of introduction of APAs—may now be extended back to FY 2009-2010). The detailed rules regarding roll-back provisions and the procedure for giving effect to them were announced in March 2015. Recently, the CBDT has issued FAQs clarifying various aspects pertaining to the applicability of roll-back. The CBDT signed its first unilateral rollback APA with a US multinational company in August this year.

### Documentation and report requirements

Taxpayers are annually required to maintain a set of extensive information and documents related to international transactions undertaken with AEs. As mentioned above, TP provisions are applicable to specified domestic transactions as well. Therefore, the taxpayer is also required to maintain

the prescribed documentation in respect of such transaction (effective FY 2012-13).

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

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

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

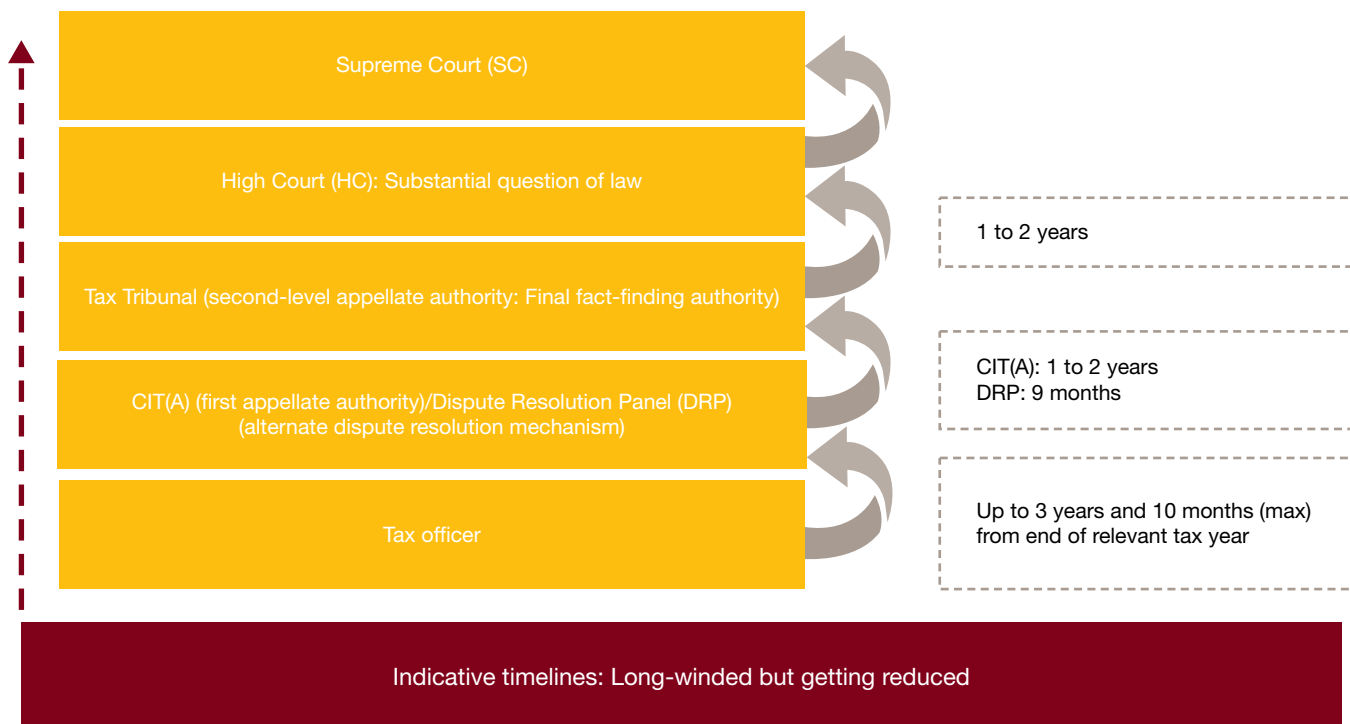
### Accountant's report

All taxpayers need to mandatorily obtain an independent accountant's report with respect to all international transactions between AEs. The report has to be submitted by the due date of the tax return filing (i.e. on or before 30 November for corporate entities having international transactions). Effective from FY 2012-13, SDT are also required to be reported in the accountant's report (under Part C of the recently modified Form 3CEB format) along with the international transactions entered into with the AEs.

The accountant's report from FY 2012-13 and onwards is required to be filed electronically. This requires the accountant to provide an opinion on whether the taxpayer has properly maintained the prescribed documents and information. Additionally, the accountant is required to certify the 'true and correct' nature of an extensive list of prescribed particulars in Form 3 CEB.

### Burden of proof

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



## Penalties

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

Timeframe	Nature of penalty
Failure to maintain documents Failure to report a transaction in the accountant's report Maintaining or submitting incorrect information or documents	2% of the value of transaction
Failure to submit documents	2% of the value of transaction
Failure to submit Form 3CEB by the due date	100,000 INR
In the case of a TP adjustment, in the absence of good faith and due diligence by the taxpayer in applying the provisions and maintaining adequate documentation	100 to 300% of tax on the adjusted amount

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