Grant Thornton
An instinct for growth™

A guide to establishing presence in India

2015

Contents

Foreword

According to a recent World Bank report, India is today the world's third largest economy in terms of purchasing power parity (PPP). As per data compiled by the Organisation for Economic Cooperation and Development (OECD), the Indian economy recorded the strongest growth in the first quarter of 2015 amongst the major economies of the world.

Conducive demographics, higher disposable incomes, cost-competitive workforce and robust domestic demand make India a credible investment destination. With a stable government in place, the Indian economy is poised for high growth. Driven by strong economic fundamentals and external factors such as a structural shift in the world economy towards the "Emerging Economies", the country is expected to move on a higher growth trajectory.

During the past one year, the government has initiated several investment-friendly policies and streamlined regulations to attract foreign investors. The government is committed to ease regulatory shackles, unleash economic reforms, improve India's image globally, and make it an appropriate choice for investors. At Invest India, we have been facilitating investments into India since 2009, and after the launch of **'Make in India'** by the Hon'ble Prime Minister in September 2014, we have seen a tremendous increase in investor interest in India.

I am pleased that Grant Thornton is releasing the 2015 edition of **'Doing Business in India'** guide, which provides an overview of India's geographic and economic profile and explores the various options available to establish business in India. This guide will serve as a good reference point on issues pertaining to doing business in India and provides information on the regulatory framework, taxation systems and laws applicable to businesses operating in India.

I am sure that the readers will find this guide useful and informative.

Deepak Bagla
MD & CEO
Invest India
E: Deepak.Bagla@investindia.org.in

Introduction

On the back of a stable government and strong economic fundamentals, the Indian economy is on a rebound. Having clocked a growth of 7.3% in 2014-15, India is back on the radar of foreign investors looking to tap into a market of 1.2 billion people.

In the last one year, the government has taken several steps to remove regulatory bottlenecks and improve the ease of doing business. These include significant amendments to the Companies Act, 2013, the launch of a single-window portal, 'e-biz' that integrates 14 central government services and the roll out of Make in India campaign.

The Prime Minister has also launched a new website - PRAGATI - to address public grievances and monitor the progress of various central government schemes. The portal is designed to keep every complainant engaged with the government machinery at the highest level and to ensure systemic corrections through the redressal of the complaints.

If the reform process being undertaken by the government continues unabated over the next few years, the country will move swiftly up the ranks on the World Bank's Ease of Doing Business ranking. The government wants to see the country among 'Top 30' in the next three years.

The government has also notified the rules for implementation of Ind AS, new Indian accounting standards that are converged with IFRS, and efforts are underway to introduce the new Goods and Service Tax (GST) regime by early next year.

According to a recent report by United Nations Conference on Trade and Development (UNCTAD), India made it to the list of top 10 destinations for foreign direct investments (FDI) in 2014, after failing to secure a position in the list a year ago. In 2014, the FDI inflows into India grew 22% to US$ 34 billion even though the global FDI fell by 16% to US$ 1.23 trillion.

India is a vast and diverse marketplace that is blessed with democracy, demographic and demand - the essential 3Ds, provides unparalleled opportunities but also has an intricate regulatory environment. Foreign investors which have succeeded in India, in our experience, consider all the alternatives in detail (export, greenfield, acquisition, joint venture) before deciding on which one to pursue.

This Guide is intended to serve as a primer for companies planning to enter the Indian market to tap the significant opportunities in various sectors. It aims to provide businesses information on the country's legal, accounting and taxation framework.

I hope this Guide will provide impetus to your growth plans of either setting up a base or expanding in India. We look forward to being your growth advisers in this land of new opportunities.

Vishesh C. Chandiok
National Managing Partner
Grant Thornton India LLP

Country profile

Summary

India is emerging as a major market and investment destination globally. The U.S. Department of Commerce has identified India as one of the world's top ten "big emerging markets". Besides, the economy has also been named as the third most attractive destination for investment in the world in a recent survey conducted by the United Nations Conference on Trade and Development (UNCTAD).

Foreign investments in India are expected to increase and reach the US$ 60 billion mark in FY 2015. According to the Central Statistics Office (CSO), during the December quarter in 2014, India's Gross Domestic Product (GDP) growth rate, using the new methodology, was 7.5%. The corresponding figure stood at 8.2% in the quarter before that. Also, the government expects that the GDP will grow by over 8% and over 10% in the subsequent years. After 20 years of robust growth, India has finally overtaken China to become the world's fastest growing economy.

Outlined below are key facts and statistics that make India a favourable business destination worldwide:

- A growing middle class
- An abundant supply of raw material
- A fluent English speaking population
- Large pool of skilled manpower
- Lower labour cost and hence, reduced cost of manufacturing
- Geographical location, which makes India closer to markets including Middle East, South Asia and Europe
- **Main ports of entry:** Haldia, Chennai, Kandla, Kochi, Momugao, Kolkata, Vizag, Mumbai, Paradip, Tuticorin, Ennore and New Mangalore
- An extensive rail and road network
- **Major international airports:** Chennai, New Delhi, Mumbai, Hyderabad, Kolkata, Bangalore, Goa and Thiruvananthapuram

India is a Union of States with a parliamentary system of government	
Statistics (2014)	
Population	**1238.89 million (2014)**
Area	**3.29 million square kilometres**
GDP (purchasing power parity - PPP)	**US$ 1.875 trillion**
GDP – per capita (PPP)	**US$ 1,497.5**
Exports	**US$ 310.5 billion (2014-2015)**
Imports	**US$ 447.5 billion (2014-2015)**
Literacy rate	**74.04%**
Life expectancy	**65.5 years**
Urban population	**32%**
Local currency	**Indian Rupee (INR)**

Sources: Ministry of Statistics and Programme Implementation (MOSPI), World Bank, Ministry of Commerce and Industry, Ministry of Human Resource Development

Geographical location

India forms a natural subcontinent with the Himalayan mountain range to the North, and the Indian Ocean, the Arabian Sea and the Bay of Bengal to the South, West and East, respectively. The country is bordered by Pakistan on the northwest, China, Bhutan and Nepal on the northeast, and Bangladesh and Myanmar on the east. Near the country's southern tip, across the Palk Strait, lies Sri Lanka.

India has a land frontier of over 15,000 kilometres, stretching from the Himalayas in the north to the Palk Straits in the south, and from the Arabian Sea in the west to the Bay of Bengal in the east. It has a long coastline spanning over 7,000 kilometres. The climate varies from tropical in the south to temperate in the north.

Population and standard of living

India is the second most populated country in the world with a population of 1238.89 million (**Source:** MOSPI, 2014). Around 70% of the country's population resides in rural and semi-rural areas. One of the main reasons that India is considered an attractive, high-growth market is its large pool of untapped and upper middle class population. Also, the standard of living in metropolitan cities of the country is comparable to the best in other developing nations. There has also been a tremendous consumer spending boom in India since the post liberalisation era.

Education

The education system in India is considered as one of the best globally. The system comprises public and private schools, universities and other institutions for higher learning (MBA, PhD, MSc, etc.) These institutions are committed to impart excellent academic and vocational training, and encourage participation in sports and other extra-curricular activities.

The current literacy rate in India stands at 74.04%. The country offers quality education comparable to global standards in fields including finance, consulting, literature, computer engineering & programming, science & technology, and business management & administration.

Currency

The Indian Rupee (INR) is the official currency of the Republic of India. The Reserve Bank of India (RBI) is the national and sole currency issuing authority in the country. The exchange rate of the rupee is mainly market determined. The RBI takes a keen interest in the financial markets of the country and other countries globally to determine suitable monetary, regulatory and other measures. The current RBI reference rate for INR/ 1 USD is 63.56 (1 July 2015).

Key economic statistics

India's economic policies are designed to attract significant capital inflows in the country on a sustained basis, and encourage technological collaboration with foreign firms. Policy initiatives taken over the past few years have resulted in significant inflow of foreign investment in all areas of the economy, except the public sector.

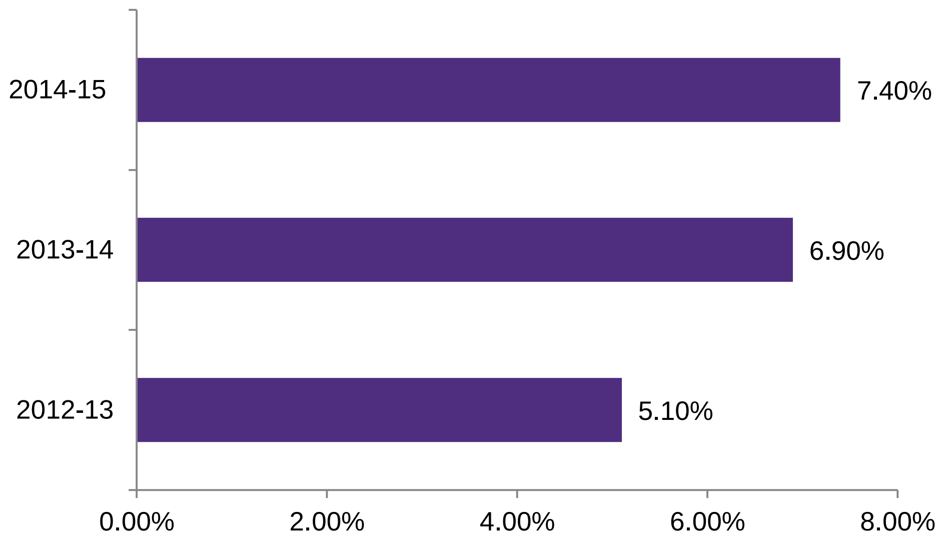
Key economic indicators of India

GDP and key fiscal indicators:

- According to the new methodology of taking the base year costs of 2011-2012, the GDP grew from 5.1% to 6.9% between FY 2012-13 and FY 2013-14, and to 7.4% [1] between FY 2013-14 and FY 2014-15
- During 2013-14, India's fiscal deficit stood at US$ 78.5388 billion, which is equivalent to 4.4% of the country's GDP. In 2014-15, the corresponding figure was US$ 80.0321 billion (Revenue Estimate), which is equivalent to 4.1% of the country's GDP[2]
- Revenue deficit stood at 2.9% of GDP for FY 2014-15

Source: MOSPI

Growth rates in GDP at factor cost (New base year: 2011-2012)



Source: CSO

External factor and per capita national income

- India's exports decreased from US$ 314 billion to US$ 310 billion, registering a drop of 1.23% in dollar terms and 0.42% in rupee terms (**Source:** Ministry of Commerce and Industry)
- For the previous fiscal year, the country's exports showed a growth rate of 3.98%
- The imports of the country decreased from US$ 450.02 billion to US$ 447.5 billion from 2013-14 to 2014-15, registering a drop of 0.59% (**Source:** Ministry of Commerce and Industry)
- According to the CSO, India's per capita income increased from US$ 104.5 per month to US$ 115.1 per month, growing at the rate of 10% since the last year, as per the new method of calculation (Base year as 2011-12)

Money and credit

- The gross bank credit for 2014-2015 stood at US$ 883 billion, clocking a growth rate of 6.6% [3]

---

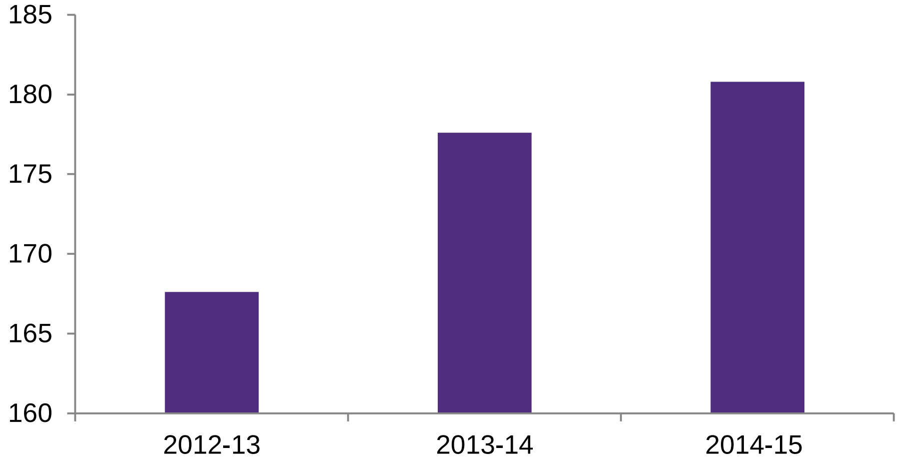
[1] **Source:** Ministry of Statistics and Programme Implementation, Government of India

[2] **Source:** Ministry of Finance, Department of Economic Affairs

[3] **Source:** RBI

- The gross fixed capital formation averaged US$ 55.6 billion during the period 2001-2014. By 2014, it had reached US$ 83.5 billion[4]
- India's current account deficit was 1.6% of the GDP in the December quarter of 2014 (**Source:** RBI)
- India's external debt stock stood at US$ 461.9 billion at the end of December 2014, registering an increase of 3.5% (US$ 15.5 billion) from March 2014, which is equivalent to 23.2% of the GDP. This is mainly due to increase in commercial borrowings and NRI deposits
- India's foreign reserves stood at US$ 340.4 billion as on 10 April 2015 (**Source:** Ministry of External Affairs, India in Business)
- Net foreign direct investment (FDI) equity inflows in India (April 2014-January 2015) stood at US$ 589.3 million[5]

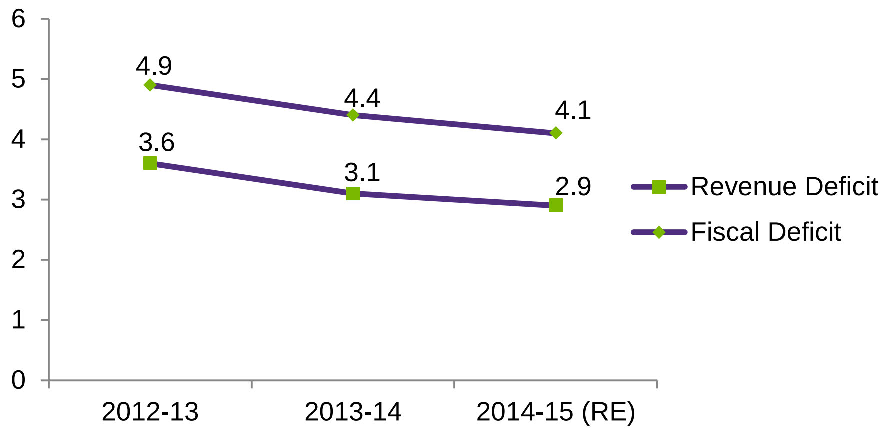
Wholesale Price Index: Base Year 2004-2005



(The figure for year 2014-15 includes WIP for the months of January, February and March for 2015)

Source: Office of the Economic Advisor, Government of India; Department Of Industrial Policy & Promotion (DIPP)

Key fiscal indicators (% of GDP)



Source: Department of Economic Affairs

[4] **Source:** Ministry Of Statistics and Programme Implementation

[5] **Source:** Ministry of External Affairs, India in Business, Investment and Technology Promotion

Key sectors: An overview[6]

Automobiles

India is the seventh largest producer of automobiles in the world and the fourth largest market by volume. The sector contributes 7% to the GDP and employs 19 million people. India is the world's largest motorcycle manufacturer. Further, India is the fifth largest manufacturer of commercial vehicles and the second largest manufacturer of two-wheelers worldwide. The growing middle class and working population are among the key growth drivers of the Indian automobile sector. According to the Automotive Mission Plan, output of India's automotive sector will reach US$ 145 billion by 2016[7]. Some of the key foreign players are Suzuki, Nissan, Piaggio, Volkswagen, Renault, Hyundai, General Motors, BMW, Ford and Toyota.

Food processing

India has 192 million hectares of gross cropped area and 89.9 million hectares of net irrigated area. A total of 42 mega food parks are being set up in India via Public Private Partnerships (PPPs). In addition, 121 cold chain projects are being set up to develop the country's supply chain infrastructure. In India, the cost of skilled manpower is lower as compared to other nations. A total of 127 agro-climatic zones have been identified in India. This sector is ranked fifth in the world in terms of consumption, production and exports. The National Food Processing Policy aims to increase the level of food processing in the country to 25% by 2025[8]. Some of the key foreign players in the country are Kraft, Mars, Nestle, McCain, Danone, Hershey, Cargill, Kellogg's, etc.

Textiles and garments

The Indian textile industry accounts for about 24% of the world's spindle capacity and 8% of the rotor capacity globally. In addition, it accounts for 14% of textile fibre and yarn capacities and the highest loom capacity with 63% of the world's market share. The 12th Five Year Plan of the government of India (2012–17) aims to train around 2,675,000 people under the Integrated Skill Development Scheme which covers all the sub-sectors of the textile industry[9]. Some of the key foreign players in this sector are Reter, CMT, Ahlstrom, Marks & Spencer, Benetton, Zara and Mango.

Electronics industry

The Indian electronics industry registered a Compound Annual Growth Rate (CAGR) of 9.88% during 2011-2015. Global demand in this sector is predicted to reach US$ 94.2 billion by the end of 2015[10]. India has abundant manpower resources for semiconductor design and embedded software. The main segments of the Indian electronics industry are electronics manufacturing services, semiconductor design, electronic products and electronic components. The main growth drivers of the Indian electronics industry are the significant rise in cost of production in other countries and increase in local demand. Special incentive schemes like electronics manufacturing clusters scheme and skill development scheme have been set up to drive further growth for this industry. Some of the key foreign investors in this sector are IBM, LG, Dell, Apple, Nokia and GE **(Source:** Department of Electronics and Information Technology, Government of India).

---

[6] **Source:** Department of Industrial Policy and Promotion

[7] **Source:** Department of Heavy Industries & Public Enterprises

[8] **Source:** Ministry of Food Processing, Government of India

[9] **Source:** Ministry of Textiles, Government of India

[10] **Source:** Department of Electronics and Information Technology, Government of India

Chemicals

The Indian chemicals industry is ranked 12th largest in the world and the third largest in Asia. The country's total production of chemicals in 2013-14 was approximately 19,308 thousand metric tonnes compared to 18,822 during the previous year[11]. The government is taking several measures such as initiating key policies for setting up of PCPIR (Petroleum, Chemicals and Petrochemicals Investment Regions) to boost the growth of this industry. The main segments of the Indian chemicals industry are agro-chemicals, specialty chemicals and colourant chemicals. Some of the key foreign players operating in this industry in India are Mitsubishi Chemical Corporation, DuPont, Dow Chemicals, DyStar and Rhodia.

Leather

The Indian leather industry registered a turnover of approximately US$ 11 billion during 2013-14. India is the second largest producer of footwear and leather garments in the world. Leather exports touched US$ 5.91 billion in 2013-14, registering a CAGR of 14.77% for the last five years[12]. Since 1991, leather exports have grown exponentially. The projected increase in the demand for leather products in the domestic market will further accelerate the growth of this industry. Also, the low cost of production due to affordable labour cost has made India a favoured exporter of leather goods. National Skill Development Corporation (NSDC) has also been providing monetary assistance for training and certification to new workers to be trained to join the Indian leather industry. The launch of mega leather cluster scheme has created even more opportunities of investment in this industry.

Defence manufacturing

India has the third-largest army in the world and at least 60% of the country's defence requirement is met by imports. At present, 49% FDI is permitted in the defence sector through the approval route. The recent notification of opening the sector to private players is expected to help foreign manufactures enter into partnerships with local manufacturers.

Renewable energy

Worldwide, India has the fifth-largest power generation portfolio. Further, India is the fifth largest producer of wind energy. The country has an installed capacity of 245 GW, as of March 2014. India has a massive potential to generate electricity from solar energy - the country's annual photo voltaic installed capacity has grown at a CAGR of 49.5% between 2010 and 2014. The Jawaharlal Nehru National Solar Mission aims to generate 20,000 MW of solar power by 2022.

Oil and Gas

India is the fourth largest consumer of crude oil and petroleum products in the world. The oil and gas industry forms a part of the country's core industries. As of May 2014, the total domestic consumption of oil comprised approximately 80% of India's total imports. At the start of 2014, India had 17 trillion cubic feet of natural gas resources. India permits up to 100% FDI in the petroleum and natural gas sector under the automatic approval route. All exploration and drilling costs are 100% tax-deductible.

---

[11] **Source:** Indian Chemical Council, Department of Chemicals and Petrochemicals

[12] **Source:** Council for Leather Exports India

Mining

India has the sixth largest bauxite reserves globally, in addition to 302 billion tonnes of coal reserves. The country holds a major advantage in cost of production and conversion costs in steel and alumina. In 2013, India ranked fourth in the global iron ore production. In India, minerals, in their finished form, are exempted from excise duty.

Business hours

The standard working hours are from 10 am to 6 pm. In most corporates, the standard working hours per day is eight. Most large corporates in India have a five-day working per week, from Monday to Friday, while it is six days a week for others.

Public holidays

There are three national holidays in India: Republic Day on 26 January, Independence Day on 15 August and Gandhi Jayanti (Mahatma Gandhi's Birthday) on 2 October. The majority of public holidays are decided by the governments in each State. The total number of holidays a year sum up to at least 10 for almost all the offices in India.

Manpower availability and labour relations

India has one of the largest pools of skilled, unskilled and semi-skilled workforce in the world. It also accounts for one of the cheapest workforces in the world. The government launches many skill development initiatives in various sectors to develop the skillsets of workers in a particular sector. There are legislations to protect employees from any kind of dismissal on false or baseless grounds. The employee gets a reasonable amount of compensation from the employer on termination of an employment contract. Also, there are trade unions, which keep a watch over the business, and initiate actions, especially on working conditions, terms of employment and employee benefits. Trade unions are also involved in resolving disputes and collective bargains. All the business organisations are required to recognise trade unions.

Facilities and infrastructure

Initially, infrastructure growth remained slow, but the pace picked up after liberalisation when many policies were launched to enable a steady growth of infrastructure in the country. The "Make in India initiative" aims to make India a global hub for manufacturing. This has further accelerated the growth of India's infrastructure sector. India has seen infrastructure development in terms of transportation, roads, railways, airports, telecom, ports, and electricity transmission when infrastructure became a prominent focus of the economic policies during the 1990s. Infrastructure became a key focus when India opened its trade barriers and realised the advantage trade could have on its economic growth.

Political and legal system

Introduction

India is the largest democracy in the world. It is estimated that the country, today, has more than 200 political parties. One feature of the political parties in India is the dominant role played by their leaders. There are both national and regional parties, one of which is the Indian National Congress (INC) that has been led by the Nehru-Gandhi family since the independence of the country. To compete on a national level, many political parties form alliances. The two main alliances in the country are National Democratic Alliance (NDA) - a coalition led by the Bharatiya Janata Party (BJP), and United Progressive Alliance (UPA) – a coalition led by the INC.

Structure of the government

India is the largest multi-party democracy in the world. It is a Sovereign Socialist Secular Democratic Republic with a parliamentary system of government, and is governed by the Constitution. The Constitution of India provides for a Parliamentary form of government which, although has certain unitary features, is federal in structure. The council of the Parliament of the Union consists of two legislative houses - the Rajya Sabha (Upper House), which represents the states of the Indian federation, and the Lok Sabha (Lower House), which represents the people of India as a whole. At present, the country is a Union of 29 states and seven Union Territories (UTs). Each State is governed by a government comprising elected representatives of the public.

The Central and State governments comprise a council of ministers headed by a Prime Minister and a Chief Minister, respectively. The head of the State is the President of India, while the head of the government is the Prime Minister. The Prime Minister and the Chief Minister are usually the heads of the political parties that are elected by the people. They have support of all the majority members in the Parliament. Elections for the State, Centre and UTs are held after every five years.

New Delhi is the capital of India. The seat of the Central government is New Delhi. All the other State governments have primary responsibility for matters such as law and order, education, health and agriculture.

Currently, Mr. Narendra Modi is the Prime Minister of India.

Judiciary and law

India has a well-established, independent judicial system. The Supreme Court of India is based in New Delhi. In each State, there is a High Court in its capital city. The States also have several district courts.

India derives most of its judicial framework from the British legal system. The main goal of the Indian law is to protect the promotion of business entities, provide a healthy industrial and social environment and ensure robust labour protection. Till 1991, many trade barriers were in place so as to promote the local industry, but since 1991 many barriers were lifted to promote the influx of foreign investors in the country.

Foreign investment

Introduction

Foreign investors keen to invest in India are required to comply, *inter alia*, with the foreign exchange control laws of the country, particularly the consolidated FDI Policy, issued by the Government of India from time to time. Accordingly, the Foreign Exchange Management Act, 1999 (FEMA) and the Regulations thereunder govern the setting-up of incorporated entities (joint ventures or wholly-owned subsidiaries) and of unincorporated entities (branch, liaison or project offices).

Investment structure

In recognition of the important role played by FDI in accelerating the economic growth of the country, the government initiated a slew of economic and financial reforms in 1991. India is now ushering in the second generation reforms aimed at furthering the integration of the Indian economy with the global economy.

FDI is freely allowed in almost all sectors in the country, including the services sector. However, FDI in some sectors is permitted, subject to certain specified conditions, for instance, minimum area norms in construction development sector, etc. On the other hand, in a few sectors, the existing and notified sectoral policy does not permit FDI beyond a ceiling.

For certain class of items/ activities, FDI can be brought in through the "automatic route" without seeking any prior approval from the government. For the remaining items/ activities, FDI can be brought in after obtaining an approval from the government. At present, FDI in defence, mining, broadcasting, print media, etc. requires prior approval from the government. In addition, investors also need to ensure compliance with certain specified conditions.

FDI is not permitted in the following sectors:

- Lottery business including government/ private lottery, online lotteries, etc.
- Gambling and betting including casinos, etc.
- Agriculture (including plantations other than tea plantations)
- Activities/ sectors not open to private sector investment e.g. atomic energy and railways (except Mass Rapid Transport Systems)
- Business of chit fund
- Nidhi company
- Trading in transferable development rights (TDRs)
- Real estate business, or construction of farmhouses (subject to certain exceptions)
- Manufacturing of cigars, cheroots, cigarillos and cigarettes, tobacco or tobacco substitutes

Foreign technology collaboration in any form including licensing for franchise, trademark, brand name and management contract is also prohibited for lottery business, gambling and betting activities.

To make India an attractive destination for foreign investors, the FDI policy allows repatriation of all profits, dividends, royalty, and know-how payments, freely. The exceptions to this policy are instances where the approval has been granted subject to specific conditions.

Exchange controls

FEMA replaced the Foreign Exchange Regulation Act, 1973 to facilitate external trade and payments, and to promote orderly development and maintenance of the foreign exchange market in India.

As per the current foreign exchange control regulations, transactions are divided into current account and capital account transactions. Capital account transaction refers to such a transaction which alters the assets or liabilities, including contingent liabilities, outside India, of a person resident in India; or assets or liabilities in India of a person resident outside India. Thus, investment by a body corporate or an entity in India and investment therein by a person resident outside India are capital account transactions.

Current account transactions, on the other hand, are transactions other than capital account transaction. Such transactions comprise, for instance, payments due in connection with foreign trade, other current business services, and short-term banking and credit facilities, in the ordinary course of business. Broadly speaking, current account transactions are permitted, unless specifically barred, and capital account transactions are prohibited, unless specifically permitted.

Foreign investment in India is governed by sub-section (3) of Section 6 of FEMA, read with relevant Regulations governing FDI. The said Regulations provide, *inter alia*, that Indian companies can issue equity shares, fully and mandatorily convertible debentures, fully and mandatorily convertible preference shares and warrants, subject to the pricing guidelines/ valuation norms and reporting requirements, among other requirements, as prescribed under the said Regulations. Further, it may be noted that general permission is also available for issuing shares/ preference shares against lump sum technical know-how fee, royalty due for payment, subject to entry route, sectoral cap and pricing guidelines, and compliance with applicable tax laws. Recently, the government has also allowed companies to issue equity shares against any other funds payable by the investee company, remittance of which does not require prior permission of the government or RBI under FEMA or any rules/ regulations framed or directions issued thereunder.

In terms of the FEMA and the relevant regulations governing External Commercial Borrowings (ECBs), Indian companies operating in certain specific sectors are permitted to avail ECB from certain categories of non-resident lenders with a specified minimum average maturity period for specified end users, under the general permission or specific permission route as applicable.

Money Laundering Regulations

The Undisclosed Foreign Income and Assets (Imposition of Tax) Bill, 2015 was introduced in the Lok Sabha on 20 March 2015. It penalises the concealment of foreign income, and provides for criminal liability for attempting to evade tax in relation to foreign income.

As per the Bill, tax at a flat rate of 30% would be applicable on undisclosed foreign income or assets of the previous assessment year. No exemption, deduction or set off of any carried forward losses (as provided under the Income-tax Act, 1961) would apply. The provisions are effective from 1 April 2016 onwards. Further, a one-time compliance opportunity to persons who have any undisclosed foreign assets (for all previous assessment years) will be provided for a limited period. Such persons would be permitted to file a declaration before a tax authority, and pay a penalty at the rate of 100%.

The Bill also prescribes prosecution for certain offences such as wilful attempt to evade taxes and failure to furnish returns, and punishment for abetment.

Import/ export controls

Over the years, Indian trade policy has undergone fundamental shifts to correct the previous anti-import bias, through the withdrawal of quantitative restrictions, reduction and rationalisation of tariffs, liberalisation in the trade and payments regime, improvement in access to export incentives, and establishment of a realistic and market-based exchange rate.

Export of goods and services from India is allowed under clause (a) of sub-section (1) and sub-section (3) of Section 7 of FEMA, 1999 (42 of 1999), read with Notification No. G.S.R. 381(E), dated 3 May 2000 viz. Foreign Exchange Management (Current Account) Rules, 2000, as amended from time to time. Similarly, import of goods and services in India are permitted under Section 5 of FEMA, 1999 (42 of 1999), read with Notification No. G.S.R. 381(E) dated 3 May 2000 viz. Foreign Exchange Management (Current Account) Rules, 2000, as amended from time to time.

The said Export and Import Regulations provide, *inter alia*, guidelines pertaining to settlement and payment of export and import transactions, realisation of proceeds, advance receipts and payments written off and limits permissible for the same.

Finance

Introduction

The Indian money market can be broadly classified into two parts:

- **The organised sector:** Comprises private, public and foreign owned commercial and cooperative banks, which are known as scheduled banks
- **The unorganised sector:** Comprises individual or family-owned money lenders and non-banking financial companies (NBFCs)

Since 1991, there have been significant banking reforms in the country. These reforms have attracted foreign players in the banking and insurance sectors.

Banking system

India has one of the largest banking networks worldwide. The Indian banking network comprises a large number of nationalised, cooperative, private and foreign banks. RBI is the central bank and has the sole authority to issue banknotes in the country.

The banking sector is dominated by scheduled commercial banks. Most nationalised banks have branches in semi-urban and rural areas of the country. Commercial banks deal in all types of commercial banking businesses including cash management system, automated teller machines (ATMs), credit cards, term and working capital loans, housing and consumer finance, and purchase and sale of foreign currencies. In addition, they also provide forward cover relating to foreign exchange, funded and non-funded guarantees and many other facilities.

After liberalisation, the government started licensing a small number of banks. This comprised a new generation of tech savvy banks which included Axis Bank, ICICI Bank, HDFC Bank and UTI Bank. The State Bank of India (SBI) is the oldest and the largest bank in India. Many financial institutions are becoming more and more dynamic and entering new domains within banking such as home loans, car finance, retail banking, etc. Currently, many banks offer facilities such as internet banking, debit cards, telebanking, etc. All the banks, at present, have separate departments for mutual funds, and for offering asset structuring services and consultation for investment purposes. India now also has Local Area Banks (LABS). Currently there are four LABS in the country. The Indian Banking Systems contain a core banking solution, wherein the customer directly becomes the bank's customer.

The current RBI policy rates are Bank rate: 8.50%; Repo rate: 7.5%; Reverse Repo rate: 6.5%. The reserve ratios are CRR: 4% and SLR: 21.5% (**Source:** RBI).

Capital markets

The Indian capital market comprises equity, debt, foreign exchange, derivative markets and futures markets in commodities. A key division that falls within the capital markets is the primary and secondary markets. They are one of the key components of the financial sector because of their transparency in disseminating the price information. They help in deducing the price of the assets and the risk in the economy.

Several measures have been taken by RBI and Securities and Exchange Board of India (SEBI) to attract long-term investors to invest in the Indian capital markets. Foreign investment in the Indian capital markets stood at around US$ 2575 million by the end of February 2015. Since the beginning of 2015 till the end of February 2015, the total investment inflow came up to around US$ 8.2 billion. According to the Economic Survey 2015, in the fiscal year 2014-15 (April-December), Foreign Institutional Investor (FIIs) pumped around US$ 33 billion in the Indian capital markets, while the outflow stood at US$ 539 million during the previous year[13]. The main growth driver for FIIs is the equity market.

Other sources of finance

Venture Capital

In India, Venture Capital (VC) is regulated by SEBI. A venture capital may be set up by a company or a trust after a certificate of registration is granted by SEBI. A VC can raise money from any investor – Indian or non-resident Indian (NRI). Recently SEBI proposed to enhance the investment limit for venture capital funds (VCFs) from 10% to 25% in offshore venture capital undertakings with an Indian connection. Some of the main venture capital companies in India are Accel Partners, Lightbox Ventures, Sequoia Capital, Trident Capitals, etc.

In recent years, India has emerged has the third largest base for start-ups in the world, after the US and UK. One of the most common ways a start-up raises money for its seed capital and further funding is by venture capital. Venture capitals are investors who provide capital to small entrepreneurs and start-ups with perceived long-term growth potential. Venture capital in India is promoted by the Central government, State government, public banks, private sector companies and overseas venture capital companies.

Angel investors

Angel investors are experienced entrepreneurs who have been through the same phase and understand what it takes to create a big company from an idea. There are various networks of angel investors in the country such as the Indian Angel Network. There are around 280 investors that are a part of this network[14]. The main sectors that prominently involve angel investment are e-commerce, information technology, healthcare, agriculture, and the mobile segment of the telecommunications sector.

The number of angel investors in India has risen from 300 to over 1,000. Many investors stay off the radar and invest in the early stages of a business. Entrepreneurship is now considered a top career choice and offers many opportunities. There are many success stories of start-ups in the country such as Flipkart, Mu Sigma, Ola Cabs and InMobi.

---

[13] **Source:** Central Depository Services Limited, India, and RBI

[14] **Source:** Indian Angel Networks

Business entities

Introduction

A foreign company has the following business entity options through which it can establish its presence in India:

- Liaison office
- Branch office
- Project office
- Partnership firms
- Limited Liability Partnership firms (LLP)
- Limited company (Public/ Private)

These forms of business entities are discussed in detail as follows:

Liaison office

A foreign company needs prior approval from the RBI to establish its liaison office (LO) in India. An LO is suitable for a foreign company, which wishes to set up a representative office as a first step to explore and understand the business and investment climate in the country. This office serves as a communication channel between the parent company overseas and its present/ prospective customers in India. The LO can also be set up to establish business contacts or gather market intelligence to promote the products or services of the overseas parent company. The LO cannot undertake any business activity or earn any income in India.

Branch office

A foreign company needs prior approval from the RBI to establish its branch office (BO) in India. The RBI does not permit a BO to undertake any manufacturing activity in the country. The range of activities that can be undertaken by a BO is also very restricted and permission has to be obtained from the RBI each time any new activity is to be started. The BO will not expand its activities or undertake any new trading, commercial or industrial activity other than those expressly approved by the RBI.

Project office

A foreign company may open a project office in India without prior approval from the RBI, provided it has met the prescribed conditions. The project office is generally opened to execute a specific project in India. Once the project execution is completed, as per the terms of the contracts awarded, the project office would have to be closed down.

Partnership firms

Under the current FDI policy and the Foreign Exchange Management Law, foreign investment into Indian partnership firms requires permission from the RBI. A partnership is an association of two or more persons to carry on as co-owners of a business for profit. Each partner of a partnership has unlimited liability.

LLP firms

A limited liability entity is a hybrid of existing partnership firms and full-fledged companies. It is a separate legal entity, liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP. Foreign investment into a LLP is permitted subject to the prior approval from the Foreign Investment Promotion Board (FIPB), generally only for those sectors in which 100% FDI is allowed.

Limited company

A limited company is an incorporated entity, which is a separate legal entity distinct from its members/ shareholders. As mentioned above, foreign investment in India is governed by the FDI policy of the government as well as the Foreign Exchange Management Law. As per the current policy, all companies in India have to be incorporated under the provisions of the Companies Act, 2013.

The minimum capital requirement is US$ 7,802.3 in case of public companies and US$ 1,560.5 in case of private companies. Further, a minimum of two members are needed to establish a private company, while a public company needs seven members.

Labour

Employment contract

India has adopted various measures to regulate the conditions under which fixed-term employment contracts are written, applied, and interpreted. Labour is a concurrent topic in the Indian Constitution - it is subject to legislation from both State and Central governments. The Indian Contracts Act, 1872 defines the term contract as an agreement legally enforceable by law. There must be a lawful offer and a lawful acceptance to result in an agreement.

Customary working hours and holidays

The normal working hours in a factory per day are eight. The usual working hours in India are 9 am to 5:30 pm or 9:30 am to 6 pm. In case of corporates, it is 7 hours per day, six days a week. Indian subsidiaries of multinational corporations usually follow a five day – eight hour per day week. Normally, 10 days of casual leave and 20-30 days of privilege leave is allowed in a year. May Day, which is known as the International Workers Day, is celebrated every year on 1 May in India.

Minimum wage

There are laws in India for workers to receive a minimum wage. It is one of the most important aspects of starting a new line of work or running an organisation successfully. There is a law as well, which enforces the employers to pay the set minimum wages in India. This law is known as the Minimum Wages Act, 1948. The main goal of this Act is to prevent exploitation of a worker. The current National Floor Level of Minimum Wage is US$ 1.7 per day for a worker[15].

Work permits for foreign workers

A foreign national entering India on a Business or an Entry Visa is free to work in India. However, all foreign nationals visiting India for a period exceeding six months i.e. more than 180 days are required to register with the Foreign Regional Registration Office (FRRO) within 14 days of his/ her arrival in the country.

Persons of Indian Origin (PIOs) that fall within a certain category, as specified, who have migrated from India and acquired citizenship of a foreign country other than Pakistan and Bangladesh, are eligible to avail the Overseas Citizen of India (OCI) status as long as their home countries allow dual citizenship in some form or the other under their local laws. Persons registered as OCI do not have right to vote, or eligibility to contest for elections to public/government offices, etc. Registered OCIs shall be entitled to the following benefits:

- Multiple entry, multi-purpose life-long visa to visit India
- Exemption from reporting to police authorities for any length of stay in India
- Parity with NRIs in financial, economic and educational fields, except in the acquisition of agricultural or plantation properties

A person registered as OCI for five years, is eligible to apply for Indian citizenship, if he/she has been residing in India for one year out of the five years, before making the request.

---

[15] **Source:** Paycheck.in

Social security

Social security is valid only for those individuals who are employed in the organised sector. The Employees' State Insurance Scheme provides medical care and other benefits for employees or labourers earning less than US$ 234 a month.

The Employees' Provident Fund Organisation (EPFO) is a statutory body under the Ministry of Labour and Employment, Government of India that administers social security regulations in India. It is mandatory for all employers who employ more than 20 people to apply the fund for the benefit of their workers. It covers all the pensions and the survivor benefits in the event of any employee's death. All employees are required to contribute 12% of their salary to EPFO. This is automatically deducted by the employer. Employees earn a tax-free interest on contributions made to the fund. Even foreign workers who are employed in India are subject to the terms of this fund. Recently, the Finance Ministry allowed EPFO to invest 5% of its corpus in exchange traded funds[16].

India also has a social security agreement, which is a bilateral agreement between two governments. This agreement serves to protect the interests of Indian citizens working in the following countries:

- The Swiss Confederation
- The Kingdom of Denmark
- Luxembourg
- Netherlands
- Belgium
- French Republic
- Germany
- Hungary
- Republic of Korea[17]

Sickness and pension arrangements

It is compulsory for an employer to provide medical facilities to its workforce by contributing towards Employees' State Insurance Scheme, or by providing medical benefits to its employees and their family members.

The employer contributes towards a Provident Fund Scheme and a certain portion of the contribution is appropriated towards a Pension Scheme, which provides pension benefits to the employees and their family members. Workers are also entitled to gratuity on completion of five years of continuous service. However, contribution towards a Provident Fund Scheme is not required, if the number of employees in that organisation does not exceed 20.

---

[16] **Source:** Ministry of Labour and Employment

[17] **Source:** Ministry of Overseas Indian Affairs

Trade unions

The trade unions in India are generally divided on political lines. Trade unions have struggled hard to achieve an adequate measure of protection against exploitation. The trade unions work to protect the interest of the workers and discuss key workplace-related issues with the management such as wages and benefits.

The six major Central Trade Unions (CTU) in India are the United Trade Union Congress (UTUC), Bhartiya Mazdoor Sangh (BMS), Hind Mazdoor Sang (HMS), AH India Trade Union Congress (AITUC), Centre of Indian Trade Unions (CITU) and the Indian National Trade Union Congress (INTUC). A trade union will be recognised if it functions for more than a year after its registration. In case an organisation has more than one union, for it to be recognised, it must have at least 15% of workers as its members.

Accounting and reporting requirements

Summary

In India, accounting and reporting requirements of business entities are governed by the regulations issued by the Institute of Chartered Accountants of India (ICAI), SEBI, the Companies Act, 2013 Act (2013 Act) and the Income-tax Act, 1961 (IT Act).

For financial reporting purposes, provisions under the 2013 Act are applicable to all companies. Further, accounting standards issued by the ICAI apply to all other non-corporate entities. SEBI's requirements only apply to companies listed on stock exchanges. Also, the IT Act defines reporting and book keeping requirements for tax purposes. Some of the common requirements are discussed in the following sub-sections.

Records to be maintained

The statutory books are required to be maintained on accrual basis. The 2013 Act requires that the records are retained for a minimum period of eight years. Further, the Central government has the power to direct the company to retain the statutory books for longer periods, in certain cases.

Preparation of financial statements

Financial statements are normally prepared once a year under the 2013 Act. However, a listed company is also required to publish quarterly interim financial information in the prescribed formats. For tax purposes, financial statements, as on 31 March each year, must be prepared.

Contents of financial statements

Financial statements of a company are prepared in the form and structure prescribed under the 2013 Act and usually include a balance sheet, profit and loss account, cash flow statement and related notes.

Audit of financial statements

Every company in India, irrespective of its size, must have its financial statements audited by a member of the ICAI. Companies or other entities, which have exceeded the prescribed limit of turnover/ receipt (presently US$ 0.15 million, if engaged in business, and US$ 0.03 million, if engaged in profession), also have to get their accounts audited under the IT Act.

Review of interim financial results

Listed companies have to submit financial results within 45 days of the end of each quarter and have an option to submit such results as either audited or unaudited results. In case a company opts to submit unaudited results, it is subjected to limited review by the statutory auditor of the company.

Inspection of records

The books of accounts and other records are open to inspection by any director, Registrar of Companies and other government agencies such as those involved with excise and sales tax.

Accounting year

The accounting year of an organisation must end on 31 March every year for income-tax purposes. Further, the 2013 Act also requires financial year to end on 31 March for financial reporting purposes, beginning 31 March 2016. A company is required to hold an Annual General Meeting (AGM) within six months of the end of the financial year, and filing of the financial statements is required within 30 days of the AGM. However, listed companies need to file the audited (or reviewed, as applicable) financial statements with the stock exchange within 60 days, in case of annual periods, and 45 days, in case of quarterly periods.

Language in which business records are required to be maintained

There is no prescribed language for maintenance of books and business records. It can be maintained in any Indian language. Companies generally maintain their accounts in English.

Maintenance of accounting records in a foreign currency and presentation of financial statements

The accounting records, whether electronic or manual, have to be kept in Indian currency. However, the foreign currency amounts may also be disclosed.

Accounting framework

The 2013 Act requires books to be maintained in accordance with 'principles-based' standards provided by the Companies (Accounting Standard) Rules, 2006 (Indian GAAP). Besides there are certain recognition, measurement and disclosure principles enunciated in the 2013 Act and literature issued by the ICAI. Additionally, the Ministry of Corporate Affairs (MCA) has notified 39 Indian Accounting Standards (Ind-AS), which are based on International Financial Reporting Standards (IFRS). These would replace Indian GAAP in a phased manner for certain eligible companies.

Following is the roadmap for mandatory adoption of Ind-AS by all companies other than insurance companies, banking companies and non-banking finance companies:

- All companies, with net worth of US$ 78 million or more (whether listed or unlisted), would be required to implement Ind-AS from 2016-17, with 2015-16 as comparatives
- Other companies whose equity and/ or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India, and unlisted companies having net worth of US$ 39 million or more but less than US$ 78 million would be required to implement Ind-AS from 2017-18, with 2016-17 as comparatives
- Companies may voluntarily adopt Ind-AS for financial statements beginning on or after 1 April 2015. Once a company opts to follow Ind-AS, it will be required to follow the same for all the subsequent financial statements

Ind-AS shall apply to both standalone and consolidated financial statements. An exception to this is that the overseas subsidiaries, associates, joint ventures and other similar entities of an Indian company may prepare their standalone financial statements in accordance with the local requirements.

Further, SEBI provides an option for listed companies having subsidiaries to submit their consolidated financial results in accordance with IFRS, as issued by International Accounting Standards Board (IASB).

Differences between Indian GAAP, Ind-AS and IFRS

Indian GAAP compliant financial statements are structured and fashioned in the same manner as those for IFRS and Ind-AS, but significant differences exist. Some of the key differences include accounting for mergers & acquisitions (M&A) and financial instruments. Also, use of fair value under Indian GAAP is required only in very limited circumstances whereas IFRS and Ind-AS may require fair valuation of contingent liabilities, long-term obligations, financial instruments and certain other assets.

Ind-AS are substantially similar to IFRS but include some carve-outs for better presentation in the Indian economic environment. Some of the key differences include analysis of expenses recognised in profit or loss using a classification based only on the nature of expenses, treatment of lease rentals based on expected general inflation, etc.

ROC filing

The MCA requires filing of financial statements with the Registrar of Companies, using the eXtensible Business Reporting Language (XBRL) taxonomy, for the following companies:

- all companies listed in India and their subsidiaries;
- all companies having paid up capital of US$ 0.78 million and above; and
- all companies having turnover of US$ 15.6 million and above.

For the remaining companies, it is required to fill the prescribed forms. Such companies are required to make such filing (with audited financial statements and directors' report) on an annual basis.

Consolidation

The 2013 Act mandates preparation of consolidated financial statements, if a company has one or more subsidiaries, with certain exceptions.

Auditing standards

The Standards of Auditing established by the Auditing and Assurance Standards Board (AASB) of India are substantially similar to the auditing standards issued by the International Auditing and Assurance Standards Board (IAASB), of the International Federation of Accountants (IFAC).

Income Computation and Disclosure Standards (ICDS)

In view of the significant developments in convergence with IFRS, ICDS were notified under the IT Act, which are, in principle, closer to the existing Indian GAAP than the IFRS based Ind-AS. These standards are effective from the current financial year (2015-16) itself and are required to be followed by all taxpayers for the purpose of computation of business and other income chargeable to tax.

Direct tax

Income tax is chargeable on taxable income computed in accordance with the provisions of the IT Act. Income can be brought within the tax net under the following heads of income:

1 Income from salary

2 Income from house property

3 Profits and gains from business and profession (PGBP – Business income)

4 Capital gains

5 Income from other sources (Miscellaneous sources of income like royalty, interest, etc.)

All taxpayers are required to follow a uniform accounting year from 1 April to 31 March for tax purposes, referred to as “previous year”, irrespective of the financial year followed for accounting purposes.

Global income of a resident is taxable in India. Also, income of a non-resident which is received or is deemed to be received in India, or income which accrues or arises or is deemed to accrue or arise to him in India, is taxable.

Taxation of individuals

Depending upon the duration of physical presence in India, an individual can be:

- Resident and ordinarily resident (ROR)
- Resident and non-ordinarily resident (RNOR)
- Non-resident (NR)

Scope of taxation of an individual is as follows:

- ROR are taxable on their worldwide income
- RNOR and NR are taxable for their India-sourced income

The personal tax rates for the financial year 2015-16 are as follows:

Income slabs (US$)	Rate of tax (%)
Up to 0.003 million*	Nil
0.003 million to 0.007 million#	10%
0.007 million to 15,608.52 million	20%
Above 15,608.52 million	30%

*Minimum exemption limit for:

- Senior citizen (age 60 years and above but less than 80 years): US$ 0.004 million
- Very senior citizen (age 80 years and above): US$ 0.007 million

The rates, mentioned above, are exclusive of applicable surcharge, education cess and secondary and higher education cess. Please refer to the section on ‘Rate of surcharge, education cess and secondary and higher education cess’ for further details.

Taxation of Partnership firm (including LLP)

Scope of taxable income of a firm is as follows:

- Resident: Taxed on worldwide income
- Non-resident: Taxed on (a) receipt, (b) deemed receipt, (c) accrual and (d) deemed accrual - of income in India

The tax rates for the financial year 2015-16 is 30%, exclusive of applicable surcharge, education cess and secondary and higher education cess.

Corporate income tax rates

Scope of taxable income of a company is as follows:

- Resident*: Taxed on worldwide income
- Non-resident: Taxed on (a) receipt, (b) deemed receipt, (c) accrual and (d) deemed accrual - of income in India

*For FY 2015-16 onwards, a company shall be a resident in India, if it is an Indian company or its place of effective management is in India.

The corporate tax rates for the financial year 2015-16 is 30%, exclusive of applicable surcharge, education cess and secondary and higher education cess.

It has been proposed that the corporate tax rate shall be gradually reduced to 25% (for domestic companies) over a period of the next four years.

Rate of surcharge

Companies	Total income (US$)		
	< 0.15 million	0.15 million ~ 1.56 million	> 1.56 million
Domestic	Nil	7%	12%
Foreign	Nil	2%	5%
Non-companies (individuals/ firms, etc.)	< 0.15 million	> 0.15 million	
	Nil	12%	

Rate of education cess and secondary and higher education cess

Particular	Rate of tax (%)
Education cess	2%
Secondary and higher education cess	1%

Applicable on all taxpayers and all levels of income, and is computed on the amount of income tax rate and surcharge.

Minimum Alternate Tax (MAT)/ Alternate Minimum Tax (AMT)

MAT is payable at the following rates on the "book profits" of the company. It is applicable in cases where the income tax liability, determined under the normal tax provisions, is lower than 18.5% of book profits.

Type of taxpayer	Rate of tax (%)	Nature of levy
Company	18.5% of book profits	Applicable when income tax liability under the normal income tax provisions is lower than 18.5% of book profits***

***MAT credit (i.e. difference of tax on book profits and normal income tax) allowed against tax liability in the 10 subsequent years.

Similarly, AMT is payable by other persons on their "adjusted total income".

Type of taxpayer	Rate of tax (%)	Nature of levy
LLP claiming certain specified deductions Persons (other than company and LLP) claiming certain specified deductions$	18.5% on adjusted total income	Applicable when income tax liability under the normal income tax provisions is lower than 18.5% of adjusted total income###

$ It is applicable when the adjusted total income exceeds US$ 0.03 million.

Adjusted total income is total income as increased by profit-linked deductions, etc.

Tax credit for the difference between MAT and tax under normal provisions is allowed against tax liability over a course of 10 subsequent years, where tax becomes payable under normal provisions of the IT Act. Similar credit provisions are available for AMT as well.

There is a debate on the applicability of MAT on foreign companies. In a recent amendment, income accruing to all foreign companies from capital gains resulting from transactions in securities, interest, royalty or fees for technical services chargeable to tax at a rate lower than the rate of MAT (i.e. 18.5%), have been exempt from MAT liability.

Taxation of dividends

Particular	Rate of tax (%)	Basis for levy
Indian company paying dividend	15% as Dividend Distribution Tax (DDT)	Dividends declared, distributed or paid after specified adjustments**
Shareholder	Exempt	

The rate mentioned above is exclusive of applicable surcharge @ 12%, education cess and secondary and higher education cess @ 2% and 1%, respectively. Further, DDT is required to be calculated on the gross-up amount including such DDT.

**Deduction of dividends received from a subsidiary is allowed, subject to certain conditions, for computing DDT. However, no credit of DDT paid on the dividend received is allowed under the Indian laws. Further, DDT is not a tax deductible expense.

The domestic tax laws also contain a deeming provision, as per which loans given by a subsidiary company out of its accumulated profits to its parent company are deemed to be dividend (subject to certain conditions) and are taxable in the hands of the parent company. These are taxable at the normal corporate rate applicable to company. The provisions mentioned above do not apply to this dividend.

Dividend received from a foreign company is taxable in the hands of shareholders at their effective tax rates. However, an exception exists in the case of dividends received by an Indian company from a foreign subsidiary company (in which the Indian company holds 26% or more equity). In such cases, the dividend received is taxable at a concessional rate of 15% (as against the corporate tax rate of 30%).

Taxation on income distributed by way of buy-back of unlisted shares

Tax is levied @ 20% (plus applicable surcharge and cess) on the 'distributed income' paid by unlisted companies to their shareholders via buy-back.

'Distributed income' is computed as the difference between the amount paid as consideration for buying back the unlisted shares and the consideration received by the company on the issue of such shares. Such tax would be paid by the company while buying back its own shares.

Buy-back receipt taxed in the hands of the company would be exempt from taxability in the hands of the shareholders.

Capital gains tax

Capital gains tax is leviable under the Indian tax laws, in case an assessee transfers any capital asset during a particular financial year for a value greater than its cost of acquisition. The capital gains so earned are further categorised into short-term and long-term capital gain depending on the period of holding of the asset sold. Capital gains are generally not taxed at the general corporate tax. Instead, different rates have been specified for the taxation of different kinds of capital gains.

Capital gains tax on transfer of a capital asset is levied in the form of short-term capital gains (STCG) on assets held for less than 36 months*, and long-term capital gains (LTCG) in other cases.

Nature of capital asset transferred	LTCG	STCG
Listed securities	Exempt	15%
Unlisted securities (Non-resident)	10%	40%
Other (Resident)	20%	30%
Other (Non-resident)	20%	40%

*For determining the nature of capital gain arising on transfer of listed securities and units of an equity-oriented mutual fund, the minimum duration of holding for a long-term asset is a reduced period of 12 months.

*On disposal of depreciable capital assets held as business assets, any excess realised over the written down value of the block of assets is treated as a STCG and is taxed at normal rates applicable to business profits.

Taxation of non-residents

Business income: Business income of a non-resident is taxable in India, if it is effectively connected with a 'business connection' of such non-resident in India. The term business connection is not defined in the IT Act. Though it has a wider scope, it is conceptually similar to permanent establishment (PE) as defined in tax treaties. Profits from a business income of a non-resident, attributable to operations carried out in India, are taxable in India.

Fees for Technical Services (FTS): Fees for managerial, technical or consultancy services rendered by a non-resident is taxable (on gross) in India (where a non-resident does not have a PE in India) @ 10%.

Royalty income: Royalty payable to a non-resident is taxable @ 10% on the gross receipt basis. The Finance Act, 2012 has introduced retrospective explanations with respect to tax payments for use of computer software and telecommunication charges under the ambit of Royalty.

Interest income: Tax @ 20% is applicable on interest payable by an Indian company to a non-resident. A lower rate of 5% is provided for interest on monies borrowed in foreign currency from a source outside India, either under a loan agreement or by way of issue of long-term infrastructure bonds, subject to certain conditions. Similarly, tax @ 5% is applicable on interest payable to a FII or a Qualified Foreign Investor (QFI) on a rupee denominated bond of an Indian company or a government security, subject to certain conditions.

The rates mentioned above are exclusive of applicable surcharge, education cess and secondary and higher education cess. Please refer to the section on 'Rate of surcharge, education cess and secondary and higher education cess' for further details.

Capital gains: Gains accrued on a non-resident on account of transfer of an asset situated in India, are taxable in India. The Finance Act, 2012 introduced a retrospective amendment clarifying that shares or an interest in a company situated outside India shall be deemed to be situated in India, if such shares or interest derives, directly or indirectly, its value substantially from assets located in India. In this regard, the Finance Act, 2015 has proposed certain threshold limits and exceptions for taxation of gains from transfer of off-shore assets. Further, detailed provisions for the computation of gains, disclosures and penalties for non-compliance are prescribed.

Tax treaty benefit: A non-resident eligible for a tax treaty can be taxed under the provisions of tax treaty, at a location deemed more beneficial. India has a vast network of favourable tax treaties. Till date, India has entered into comprehensive tax treaties with 85 countries. Tax treaties with Mauritius, Singapore and Netherlands are extensively used for claiming capital gains exemption on transfer of shares of Indian companies. Further, tax treaties with Australia, the US, UK, Singapore, etc. provide beneficial tax treatment for income from FTS.

A non-resident needs to furnish a Tax Residency Certificate, which is issued by the Revenue authorities of his/ her State of residence. In addition, he/she needs to furnish a declaration in the prescribed format to be eligible for claiming tax treaty benefit.

Security Transaction Tax (STT)

Security Transaction Tax (STT) is levied on the following types of security transactions that are carried out through a recognised stock exchange in India:

Type of transaction	Rates
Delivery based equity shares and units of equity-oriented fund – only seller	0.001%
Futures in securities – only seller	0.01%
Sale of equity-oriented mutual fund to the mutual fund – only seller	0.001%

Commodities Transaction Tax (CTT)

The Commodities Transaction Tax (CTT) is levied along the lines of STT. CTT is levied on taxable commodities traded at recognised associations. CTT shall be levied at the rate of 0.01% on the value of such transaction (i.e. price at which the commodity derivative is traded) and shall be payable by the seller.

Wealth Tax

The Finance Act, 2015 has proposed to abolish the wealth tax.

Gift Tax

India does not levy gift tax under a separate statute. However, receipts of sum of money or property (in excess of US$ 780.544), without adequate consideration, are taxed as other income in the hands of an individual recipient. Similarly, receipt of shares of a closely held company by another closely held company or a firm (in excess of US$ 780.544), without consideration/ adequate consideration, are taxed as other income in the hands of the recipient firm/ company. Further, where a closely held company issues shares to a resident at a value more than the face value of shares, consideration received in excess to the fair value of shares shall be taxed as other income in the hands of the company issuing such shares.

Estate duty

No estate or death duty is charged.

Computation of business income

Business income is generally taxable on the net basis i.e. gross income less allowable tax deductions. Generally, all expenses laid out and expended for business purposes (other than capital expenses) are deductible (subject to compliance with withholding tax provisions) from the income of the taxpayer for income-tax purposes. The deductibility is further subject to exceptions and fulfilment of conditions as stated in the IT Act.

The following principles are generally applied for examining the admissibility of an expense:

- Expense should be incurred for the business
- Expense should be incurred in the previous year
- Expense should not be of a personal nature
- Expense should be of a revenue nature - expenses of a capital nature are not allowed
- Expense should not be for a purpose prohibited by law
- No deduction of expenses incurred in respect of exempt income
- No deduction of provision made for a contingent liability
- Requisite tax withholding is undertaken in case of specified expenses

Certain expenses are specifically disallowed or the quantum of deduction is restricted. These include:

- Income-tax
- Expenditure incurred on CSR activities as per the provisions of the 2013 Act
- Provision for taxes, duties, interest on loans from public financial institutions or on term loans from a scheduled bank and certain contributions to statutory funds on behalf of employees, not actually paid. However, such expenditure is deductible in the year in which it is actually paid

Depreciation of capital assets is allowed on the basis of the declining balance method using varying rates, depending on the nature of assets. All similar type of assets eligible for the same rate of depreciation are clubbed together in a 'block' and depreciation is charged on the value of that block. Depreciation is available for a full year, irrespective of the actual period of use of the asset. However, in the year of acquisition of the asset, depreciation is allowed at half the normal rates, if the asset is used for less than 180 days in that year.

Depreciation on intangible assets such as know-how, patents, copyrights, trademarks, licences, franchises or other similar business or commercial rights, is also available.

The rates of depreciation for different blocks of assets are as follows:

Blocks of assets	Rates (%)
Residential buildings except hotels and boarding houses	5
Buildings meant for non-residential purposes such as hotels and boarding houses	10
Furniture and fittings	10
General plant and machinery	15
Intangible assets	25
Computers	60

In addition to the above, additional depreciation at the rate of 20% (over and above normal depreciation) is available for plant and machinery (other than ships and aircrafts), in the first year, upon fulfilment of the prescribed conditions.

Income Computation and Disclosure Standards (ICDS)

The Central government has notified ICDS, which prescribes the detailed provisions to be applied while computing tax under the heads – Profits and Gains from Business and Profession and other income. These standards are effective from 1 April 2015.

Business loss and unabsorbed depreciation

Business losses, other than from speculation business, are permitted to be set off against income from any other source (except income from employment i.e. salary income) in the same year. Business losses, not so set off, are permitted to be carried forward for setting off against business profits arising in the eight subsequent years. Unabsorbed depreciation is permitted to be carried forward for an unlimited period.

Key direct tax incentives/ tax holidays

Research & Development (R&D) activities

- 200% weighted deduction on in-house scientific R&D expenditure (not being expenditure in the nature of cost of any land or building)
- 125% weighted deduction with respect to payments made for outsourced R&D activities to approved Indian companies, for which scientific R&D is the main object
- 100% deduction on capital expenditure (other than land) on scientific R&D related to the business carried on by the company

Manufacturing companies

- 100% deduction available for 10 consecutive tax years to any undertaking involved in the manufacture and production of any article/ thing, located in North-Eastern states (provided the undertaking commences manufacturing by 31 March 2017) and carries on any eligible business

SEZs

- A specifically delineated duty-free enclave deemed to be a foreign territory for purposes of trade operations, duties and tariffs
- Deductions
  - **To SEZ developer:** For 100% of profits and gains derived from developing and maintaining a SEZ
  - **To entrepreneur:** For profits and gains derived by its unit set up in any SEZ from export of articles/ things or from services as follows:
    - i 100% export profits for the first five tax years
    - ii 50% of export profits for the next five tax years
    - iii Upto 50% of export profits for the next five tax years (subject to transfer of profits to a special reserve)

It has been proposed that tax incentives available to SEZs will soon be phased out to minimise tax evasion, expectantly within the next four years, in line with the proposed timeline of reduction in the corporate tax rate.

Business specific incentives for capital expenditure

- Allowance of 15% to manufacturing companies for investment of more than US$ 3.9 million in plant and machinery during the period between 1 April 2015 and 31 March 2017, subject to a holding/ lock-in period of five years from the date of installation (subject to fulfillment of certain conditions). An additional allowance of 15% is also available in case new assets are acquired in the states of Andhra Pradesh and Telangana between 1 April 2015 and 31 March 2020
- 150% deduction on capital expenditure available for the following categories of specified businesses:
  - Setting up and operating a cold chain facility
  - Setting up and operating a warehousing facility for storage of agricultural produce
  - Building and operating a hospital with at least 100 beds for patients
  - Developing and building a housing project under specific schemes
  - Production of fertilizer
  - Laying down or operating cross country natural gas or crude pipeline
  - Laying down and operating slurry pipeline for transportation of iron ore
  - Setting up and operating semi-conductor and wafer fabrication manufacturing facility

Corporate Tax Compliance

Withholding Tax

The IT Act casts an obligation on each taxpayer to withhold tax on specified payments, among others, on the following:

- Salaries
- Interest
- Rent
- Commission or brokerage
- Payments to contractors

- Professional/ technical fees/ royalty
- Consideration payable on transfer of immovable property

All payments to non-residents, which are taxable in India, attract tax withholding.

Indian tax withholding provisions also extend to payments made by non-residents. Thus, in certain situations, a non-resident making payment to another non-resident/ resident is required to undertake tax withholding as per the Indian regulations.

Further, the deductee, i.e. the person whose receipts are subject to tax withholding, needs to disclose his/ her Permanent Account Number (PAN). In case the person fails to do so, withholding tax rate would be the higher of the following rates:

- The rate prescribed in the IT Act
- At the rate in force i.e. the rate mentioned in the Finance Act, 2015
- At the rate of 20%

Quarterly returns (in prescribed form depending on the nature of payment) need to be filed with respect to taxes withheld during the relevant quarter.

Extensive provisions are built in for enforcing compliance with tax withholding obligations.

Advance Tax

Every taxpayer is required to pay his/ her tax liability for the year during the previous year itself, in instalments prescribed. The tax liability is to be worked out on the basis of an estimate of current income, and the income tax thereon shall be calculated at the rates in force during the relevant previous year. Advance tax would be payable only if advance tax liability is expected to be more than the prescribed amount (US$ 156.1 for the previous year - 2015-16). Interest shall be levied for non-compliance with advance tax provisions.

Self-assessment Tax

Every taxpayer is liable to compensate the required tax payable (if any) on the basis of actual income, after considering the credit for the advance tax paid, with taxes deducted at source. Self-assessment tax is payable after the completion of the previous year, but before filing the return of income.

Permanent Account Number (PAN)

All taxpayers are required to make an application for the allotment of tax registration number, termed as PAN. The application is to be made in Form 49A, Form 49AA of Form INC 7 (depending upon the residential and/ or registration status of an assessee).

This number is to be quoted on all tax returns, correspondence with the tax authorities and documents relating to the prescribed categories of transactions. Failure to quote PAN by the income recipient results in a higher rate of tax withholding.

Tax Deduction Account Number (TAN)

Every person responsible for withholding tax in accordance with the provisions of the IT Act is required to make an application for the allotment of withholding tax registration number which is called the Tax Deduction Account Number (TAN). The application is to be made in Form 49B or Form INC 7, within one month from the end of the month in which the tax is deducted.

Other compliances

Most tax compliances in India are due on an annual basis. All the companies or firms are required to file a return of income for a previous year within the prescribed due dates. Any person, other than a company or a firm, is required to file a return of income for a previous year, on or before the due date, where their taxable income exceeded the maximum amount which is not chargeable to income-tax.

Different due dates have been prescribed for this purpose under the IT Act, which are as below:

In case of:	
• A company; • A person (other than a company) whose accounts are required to be audited under the IT Act or under any other law in force during the period; • A working partner of a firm whose accounts are required to be audited under the IT Act or under any other law in force during the period.	30th day of September of the assessment year
• In the case of a taxpayer who is required to file an accountant's report under the transfer pricing regulations	30th day of November of the assessment year
• In the case of any other assesse	31st day of July of the assessment year

General Anti-Avoidance Rules (GAAR)

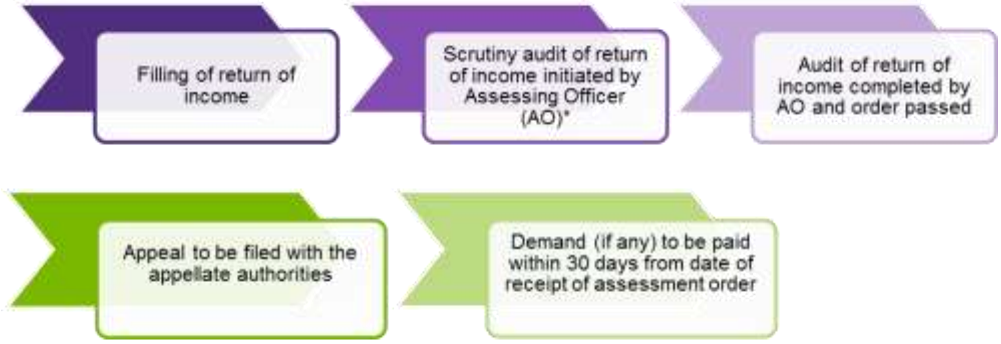
To control 'impermissible avoidance arrangement' (IAA) entered into by a person to avoid taxes, the provisions of General Anti-Avoidance Rules (GAAR) have been introduced in India. It is noted that an arrangement would be considered an IAA where its main purpose is to obtain a tax benefit. An agreement will also be treated as an IAA if it lacks 'commercial substance' and does not meet the criteria of being a bona-fide business transaction in the ordinary course.

GAAR deals with aggressive tax planning involving the use of sophisticated structures. The provisions of GAAR would be effective from 1 April 2017.

Foreign assets and income located outside India

Recently, the lower house of the Parliament passed the Undisclosed Foreign Income and Assets (Imposition of New Tax) Bill, 2015. This Bill mandates assessees to disclose all foreign assets owned and income generated from outside India during a financial year. The Bill provides for a flat tax rate of 30% on all such assets and income. It prescribes stringent penalties and prosecution in case of non-compliance. The disclosures will be incorporated in the annual income tax return to be filed at the end of each financial year.

Direct tax enforcement in India

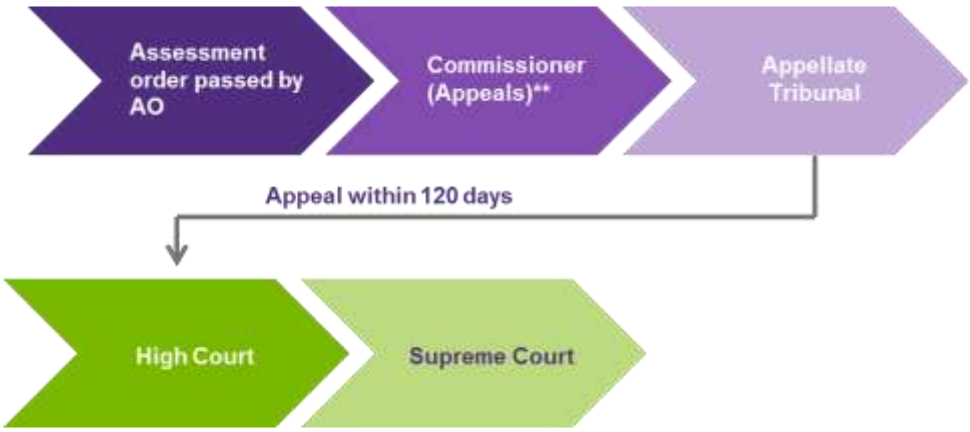


*AO can make a reference to the Transfer Pricing Officer (TPO) for Transfer Pricing (TP) audit. The TPO completes TP audit on receipt of reference from AO and forwards the TPO order to the AO for merging it with the assessment order on completion of the audit of return on income.

It takes about 24 to 36 months (depending upon whether a reference is made to TPO) to complete an audit, beginning from the end of the year in which a return of income is filed.

Direct tax dispute resolution process

Dispute resolution is a multi-layered process in India.



**Alternatively, application may be filed with the Dispute Resolution Panel objecting to variations proposed by the AO to the income of the taxpayer.

The entire litigation, till the Supreme Court level, generally gets settled over a period of 10 years.

Other alternatives to resolve tax litigation

- Settlement commission
- Advance ruling for transactions (including proposed ones) involving non-residents
- MAP - An alternate mechanism under tax treaties for resolving international tax disputes by the Competent Authorities of each State

Indirect tax

India has a dual taxation structure, which results in the levy of multiple indirect taxes by the Federal and State government(s). Key indirect taxes applicable are as follows:

- **Customs duty**: Federal levy on import of goods into India
- **Central excise**: Federal levy/ duty on manufacture/ production of goods in India
- **Service tax**: Federal tax leviable on services delivered
- **R&D cess:** Federal cess on import of technology to India
- **Value Added Tax (VAT)**: State-based tax on intra-state sales of goods
- **Central Sales Tax (CST)**: Federal tax on inter-state sales of goods, administered and controlled by the appropriate State(s)
- **Entry tax/ Octroi**: State-based tax on the entry of goods into a State/ municipality for use, consumption or sale therein
- **Other State taxes**: Include professional tax, luxury tax, property tax, entertainment tax, etc.
- **Professional tax**: State-based tax leviable on professions, trades, callings and employments
- **Luxury tax**: State-based tax on specified luxuries and certain facilities, services, enjoyment, utilities, etc.
- **Property tax:** Leviable by a government on a person's real or personal property
- **Entertainment tax**: State-based levy on entertainment activities such as cinema, video shows, cable TV operators, amusement, exhibitions, performance, pageant and game/ sports and horseraces, etc.

The government of India has proposed that the indirect tax regime in India be replaced with a comprehensive dual Goods and Service Tax (GST), to be levied concurrently by the Centre (CGST) and the States (SGST). Integrated GST (IGST) is also proposed to be levied, which will replace CST. It aims to tax both goods and services traversing between states. The following key taxes are proposed to be included in GST.

Central taxes	State taxes
Central excise duty (including additional excise duties)	VAT/ Sales tax
Service tax	Entry tax not in lieu of Octroi
Additional customs duty	Entry tax in lieu of Octroi
Special additional customs duty	Entertainment tax
Surcharge and cess	Octroi Local Body Tax (LBT) & cesses
CST*	Luxury tax

*CST intended to be phased out and additional tax @ 1% may be imposed on inter-state supply of goods.

The government has already proposed relevant amendments, pertaining to GST, in the Constitution, vide the 122nd Constitutional Amendment Bill. The Bill has to be passed by two-thirds majority. It is proposed to implement GST with effect from 1 April 2016.

Customs duty

Customs duty, a federal government levy, is leviable on import/ export of goods to/ from India. The taxable event for levy is **'import/ export'** and import/ export duty is payable at the time of import/ export of goods to/ from India. India follows the Harmonised System of

Nomenclature (HSN) classification rules and the goods are classified under different chapter/ tariff headings, primarily according to their description, components and use. The customs duty component comprises:

- Basic customs duty - 'BCD' (standard rate of 10%)
- Countervailing duty - 'CVD' (equivalent to excise duty on goods manufactured in India, at the standard rate of 12.5%)
- Customs cess (leviable on component of BCD & CVD at the rate of 3%)
- Special Additional Duty - 'SAD' (equivalent to sales tax on goods sold in India, leviable at the rate of 4% on BCD plus CVD plus customs cess)

Presently, the effective standard rate of customs duty that is applicable on the import of goods is approximately 29.44% (for capital goods, effective standard rate is 26.43%), subject to exemption/ concessions as may be available/ notified from time to time and Free Trade Agreements entered into by India with other countries. However, presently there is no export duty leviable on goods exported from India, except for a few goods such as minerals, etc. (which are scarcely available).

Central excise

Central excise duty, a federal government levy, is leviable on the manufacture/ production of excisable goods in India. The taxable event for levy is '**manufacture/ production**' and is payable at the time of removing excisable goods from the factory/ plant. Generally, there is no excise duty liability on export of goods from India or supplies to SEZs/ EOU, etc. ('deemed exports').

Manufacture/ production is generally meant to include any process, which brings into existence a new commodity that has a distinct name, character, use and marketability. However, for certain products, specific processes/ activities, e.g. labelling, relabeling, packing, repacking, etc. have been deemed as manufacture ('deemed manufacture').

The standard rate of excise duty has been increased to 12.5%, subject to exemption/ concessions as may be available/ notified from time to time, *vide* the Union Budget 2015. Further, education cess, and secondary and higher education cess have been subsumed at this rate.

India follows the HSN classification rules, and the goods are classified under different chapter/ tariff headings primarily according to their description, components and use. Generally, duty is leviable on transaction value (that is sale price generally agreed between buyer and seller). However, in respect of certain products (primarily goods intended for retail sale), MRP-based duty rates are also prescribed/ applicable.

Credit of duties/ taxes paid on procurements/ imports is usually available to manufactures for offsetting output duty liability, subject to the prescribed conditions.

Service tax

Service tax, a federal government tax, is leviable on provision of services. Effective July 2012, India follows a negative list regime wherein all services are deemed to be taxable, except those specifically notified to be exempted vide entry/ insertion in negative list/ mega exemption notification. Presently, the standard rate of service tax is 12%, subject to exemption/ concessions, as may be available/ notified from time to time. Education cess, and secondary and higher education cess is levied on the service tax at the rate of 2% and 1% respectively, thereby effective rate of service tax is 12.36%. However, the rate of service tax has been increased to 14% (subsuming all cess), *vide* the Union Budget 2015. However, this change is yet to be notified.

Place of provision of services

The Place of Provision of Service Rules, 2012 (PoPS Rules) specify the manner to determine the place of provision for a service (i.e. whether the services are provided in taxable territory or outside the taxable territory), which is primarily determined based on the nature of service, along with certain other factors such as location of service recipient, location of goods/ individual/ property on which or in relation to which service has been provided.

Export of services

Also, Service Tax Rules prescribe conditions for any service to qualify as export of service (not liable to service tax), which primarily includes conditions such as:

- The recipient of the service is located outside India
- The payment for such services has been received by the provider of service in convertible foreign exchange
- The provider of service and recipient of service are not merely establishments of a distinct person

Person liable to pay service tax

Generally, the person liable to pay service tax is the service provider who claims such tax from the clients, deposits the amount with the government treasury, and undertakes associated compliances.

However, in certain cases, the liability to pay service tax is upon the service recipient, including instances where the service is received by a service recipient from a person who is located outside the taxable territory and who does not have a place of business in India. This scheme of tax payment by the service recipient is commonly termed as 'reverse charge mechanism'.

R&D cess

R&D cess, a federal cess, is leviable at the standard rate of 5% on 'import of technology' into India. It is leviable when technology is imported under a foreign collaboration agreement. The term technology includes technical know-how/ knowledge, designs, drawings, publications and technical personnel. The amount is to be deposited with the RBI.

VAT/ CST

VAT is an intra-state multi-point tax system administered at the State-level and is levied on sale of goods at each stage of the sales process. CST is levied on inter-state sale of goods and is administered/ monitored/ collected by the State from where the movement of goods, which are meant for sale, commences.

The rate of local VAT depends on the description of the goods, the rate of tax mentioned in the applicable State VAT tax legislation, various VAT tax concessions/ exemptions as may be available in such State, etc.

Every State has its own VAT legislation and independent tariff for fixing the rate of goods for intra-state sale of goods.

The basic rate slabs under VAT are as follows:

- 0% for natural and unprocessed products and other essential goods, including life-saving drugs
- 1% to 2% for special goods such as gold, bullion, silver, etc.
- 4%/ 5% for industrial input, drugs and medicines, IT products, capital goods and intangible goods, i.e. patents and others, as well as items of basic necessity
- 12.5% to 15% for all other goods that do not fall under any of the categories mentioned above

Octroi/ Entry tax/ LBT

Octroi/Entry tax/LBT is levied on the entry of goods into a particular municipal/ State jurisdiction for use, consumption or sale. Depending on the municipal/ State jurisdiction where the goods are proposed to be used, consumed or sold, either octroi or entry tax may be levied. Further, with effect from August 2015, it has been proposed to repeal LBT.

Professional tax

Professional tax is a levied by the State on professions, trades, a calling or employment in a State. Thus, every person who is engaged in any of the activities mentioned above is liable to pay professional tax. Not all the State governments levy professional tax, currently. In States where such a levy exists, every enterprise and employee earning a salary is required to register and pay professional tax.

Luxury tax

Luxury tax is levied by the State on certain specified luxuries and facilities, services, enjoyment, utilities, etc. Generally, luxury tax is levied on specific accommodation and services provided in hotels and clubs of a specific kind, and on special commodities.

Property tax

The owner of a property (usually real estate) is liable to pay property tax. The amount of tax is estimated on the value of the property being taxed (ad valorem tax) at applicable rates. Property tax is levied on residents by local municipal authorities of the respective cities, to sustain basic civic services in the city.

Entertainment tax

State and local governments levy entertainment tax on businesses engaged in various entertainment and amusement activities. Traditionally, films, cable/ DTH subscriptions, video games, amusement parks and events have been subject to entertainment tax. Some of the States also subject entertainment provided through telecom and the internet to entertainment tax.

GST

GST, introduced for the first time in France in 1954, is a comprehensive value-added system of levying tax. This system of levying tax is operational in more than 140 countries today. While announcing the Indian Union Budget for the Year 2006-2007, the then Finance Minister had expressed the government's desire of introducing GST on the national level.

Proposed structure

The Empowered Committee of State Finance Ministers (EC), set up by the Finance Minister to study and recommend the proposed structure and form of GST, has suggested a dual GST regime entailing a Federal and State level GST.

Currently, around 120 countries follow the GST model. However, Brazil and Canada are the only two countries that have adopted the dual GST model. The dual GST model for India, as recommended by the EC, appears to be in closer approximation to the Canadian model.

Ambit of dual GST in India

Despite various reforms carried out in the past few years, the prevailing indirect tax regime in India is still in a state of evolution. The pattern of such evolution is rather haphazard and is characterised by several 'stop-gap' arrangements. The outcome of the ad hoc process is the prevailing complicated indirect tax system, with multi-layered levies, both at the Federal and State levels.

The Federal government has the power to levy tax on goods at point of import (customs duty), manufacture (excise duty), inter-state sales (Federal/ CST), and on provision of services (Service tax). The States have been vested with powers to levy tax on sale of goods within the State (Sales tax/ VAT), and on entry of goods into the State (Entry tax and Octroi), besides multiple local levies such as entertainment tax, luxury tax, etc.

Although the transition to GST does envisage abolition of such local levies, in a Federal structure like ours, States may be unwilling to forgo their revenue from multiple local levies. Further, there are still differences among States on this issue. Hence, it appears that getting the State governments to abolish various local taxes may be one of the key challenges in achieving a timely and effective implementation.

Besides arriving at a consensus on the basic contours of GST, the Federal and State governments also need to ensure that several other important issues that are likely to be a departure from the existing indirect tax regime and are fundamental to the GST framework such as place of supply rules, point of levy of tax, credits between Federal and State GST etc., are deliberated upon at length, before being finalised.

Point of levy under dual GST

The indirect tax regime currently prevailing in India entails multiple points of levy. For instance, excise duty is levied on the manufacture of goods even though it is payable at the time the goods are removed from the factory. Service tax is levied on the provision of taxable services but payable on receipt of consideration (including advances). For other levies such as VAT, the taxable event is not linked to the receipt of consideration but to the transfer of title.

It is possible that the Federal and State GST could both be based on place of supply. Hence, the tax incidence may be at the 'point of supply' as against multiple points of levy under the current regime. Even globally, VAT/ GST is typically based on a set of rules, which define the place as also the time of supply in order of its taxation.

However, the convergence of all these taxes to arrive at a common 'taxable event' would certainly be a challenge.

Taxable base and rate

At present, various taxes apply on different 'taxable base'. For example, service tax is applicable on gross amount received from the client (including reimbursements), whereas VAT is typically levied on the 'sale price' after certain permissible deductions such as freight, discounts, etc. Further, under the excise laws (and not under VAT and service tax laws), there are related party rules, which outline principles for arriving at the taxable base in situations where goods are sold to affiliate entities.

Under the proposed dual GST model, both Federal and State GST should be charged on an appropriate common base. It appears that the GST regime may entail a broadened tax base with a moderate tax rate of 12-27%. With the deadline for the proposed transition inching closer, it is imperative to zero in on the GST rate slabs, and then initiate the process for realignment of multiple and varied tax rates existing in the current regime. Given the parallel systems of indirect taxation at the Federal and State levels, a lot needs to be done before the realignment process is complete.

Transfer pricing in India

Background

Globalisation and increased integration between economies worldwide has paved way for global business operations and subsequently complex inter-company transactions. These transactions could lead to base erosion and shifting of profits to opaque tax jurisdictions. Therefore, transfer pricing is under constant scrutiny of tax authorities globally.

Indian Transfer Pricing Regulations (TP Regulations or TPR) contained in Section 92 through Section 92F of the IT Act and Rules 10A to 10TG of the Income-tax Rules, 1962 (the Rules) were introduced in India in 2001 to avoid shifting of profits from India to another jurisdiction arising due to the international transaction with the related parties i.e. associated enterprise(s) (AEs). Further, the scope of TP Regulations was extended to include specified domestic transactions (SDT) with effect from 2012.

Legislation

As per the TP regulations, the international transaction and SDT between the AEs should comply with the arm's length principal i.e. a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.

International transaction

Section 92B of the IT Act defines the term "International Transaction" to mean a transaction between two or more AEs, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, financing or any other transaction having a bearing on the profits, income, losses or assets of such enterprises or any cost contribution agreement.

Further, the Finance Act, 2012, clarified that the expression "International Transactions" shall include:

- **Tangible property:** Includes purchase, sale, transfer, lease or use of building, machinery, equipment, etc.
- **Intangible property:** Includes purchase, sale, transfer, lease or use of land rights, patents, designs, brands, etc.
- **Capital financing:** Includes any type of long-term or short-term borrowing, guarantee, deferred payment or receivable, etc.
- **Provision of services:** Includes market research, market development, technical service, scientific research, etc.
- Business restructuring or reorganisation, irrespective of the fact that it has a bearing on the profits, income, losses, or assets of such enterprises at the time of transaction or at any future date

Section 92B (2) of the IT Act further expands the scope of the definition of international transaction by including within its purview the concept of "deemed international transaction". The aforementioned section provides that a transaction entered into by an enterprise with a person other than an AE (whether resident or non-resident) shall be deemed as an international transaction, if:

- there exists a prior agreement between such other person and the associated enterprise; or
- the terms of such a transaction are, in substance, determined between such other person and the associated enterprise.

Specified Domestic Transactions (SDT)

Transfer pricing provisions were also introduced for SDT so as to curb the shift of profits between resident entities. Section 92BA was inserted in the IT Act to define SDT as follows:

- Expenses/ payment transactions between related persons as covered under the provisions of Section 40A(2)(b) (which includes directors of a company/ partner/ member in case of a corporate and their relatives, subsidiaries or entities in which the taxpayer directly or through its directors of a company/ partner/ member in case of a corporate or their relatives have substantial interest in an entity);
- Transfer of goods/ services/ business from one unit/ undertaking of the taxpayer to another unit/ undertaking of the taxpayer, being a tax holiday unit under Section 80A, 80 IA or Section10AA where the provisions of Section 80IA are applicable; and
- Where the aggregate of such transactions exceeds a sum of US$ 3.1 million[18] in a year.

Associated enterprises

International transactions

In the Indian TP Regulations, the definition of AEs[19] is broadly similar to the definition in the OECD TP Guidelines[20]. AE(s) in relation to another enterprise means an enterprise:

- which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; and
- in respect of which, one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

In addition to the above, Section 92A (2) of the IT Act prescribes 13 situations where two or more enterprises are considered as AEs viz. shareholding of 26% or more by one entity in the other or common shareholding of 26% or more, dependence on the finance provided by one enterprise to the other, or raw material supplied or technology provided by the other enterprise, etc.

Specified Domestic Transactions[21]

The AEs, for the purpose of SDT, are as follows:

- Direct relationships defined u/s 40A(2)(b) of the IT Act
- For entities claiming benefit under Section 80A, 80 IA or Section10AA, where the provisions of Section 80IA are applicable on any closely connected entity

Arm's length price (ALP)

The arm's length price (ALP), as defined under Section 92F (ii), means "a price which is applied or proposed to be applied in a transaction between persons other than AEs, in uncontrolled conditions". Under the regulations, an "uncontrolled transaction" is defined as a transaction between enterprises other than AEs, whether resident or non-resident.

---

[18] The limit is applicable from FY 2015-16. Earlier, the limit was US$ 0.77 million
[19] Refer to Section 92A of the IT Act
[20] OECD Transfer Pricing guidelines for Multinational Enterprises & Tax Administrations, July 2010
[21] Refer to Section 92D of the IT Act

The legislation states that where more than one ALP is determined by the most appropriate method, the ALP is taken to be the arithmetic mean of such prices.

The Finance Bill, 2014 highlighted the introduction of inter-quartile range concept for determining ALP in case of insufficient comparable data. This concept is applied/ followed worldwide. However, guidelines relating to the same are still awaited.

Further, the taxpayer is also permitted a prescribed tolerance band from the transfer price. For wholesale traders, variation of 1% is allowed from the transfer price, while for all other taxpayers, variation of 3% is allowed from the transfer price. If the difference between the ALP and the transfer price does not exceed this variation, the transfer price would be deemed as the ALP.

Methodologies

The ALP, in relation to an international transaction and SDT, is required to be determined by any of the following methods:

- Comparable uncontrolled price method
- Resale price method
- Cost plus method
- Profit split method
- Transactional net margin method
- Any other method as prescribed

The Indian TPR prescribes no priority in terms of selection/ application of methods.

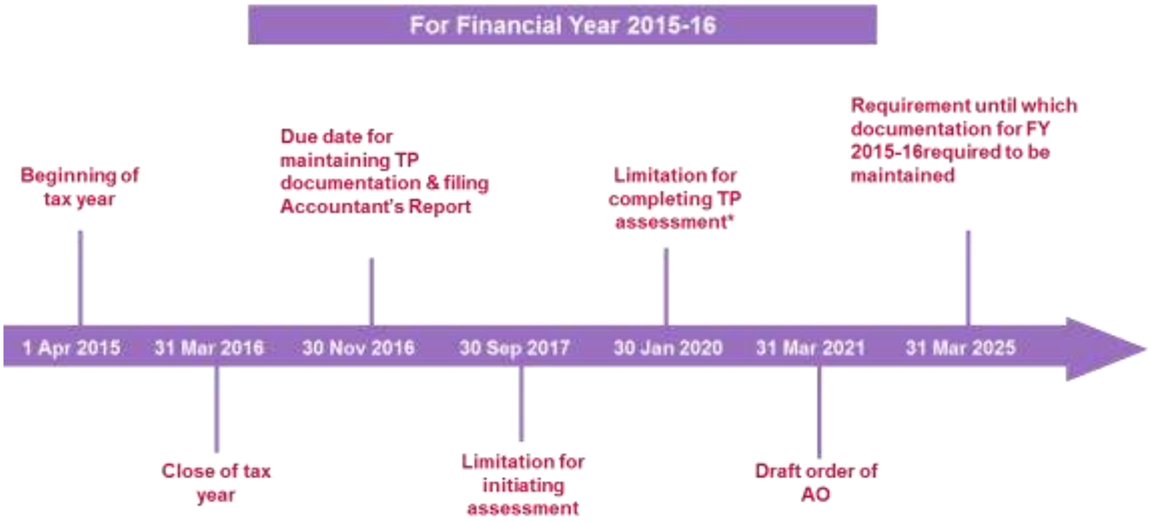
Compliance requirement

Compliance requirement	Due date of submission
Obtain accountant's report in Form 3CEB Accountant's report is a brief summary of international transaction(s) and SDT (if **aggregate value of SDT exceeds US$ 0.31 million)** along with the method used to justify the **arm's length** nature. **This document is to be certified by a Chartered Accountant or a firm of Chartered Accountants**	**30 November** of each **Assessment Year** for international transactions or SDT undertaken during the relevant financial year (April – March)
TP documentation (TP Study) TP study is a detailed documentation* relating to international transaction(s) or SDT which is used to justify their **arm's length** nature. This documentation is to be maintained, and updated on an annual basis, if the aggregate value of the **international transaction(s) entered by the enterprise exceeds US$ 0.15 million**	Enterprise is required to maintain **contemporaneous documentation** and needs to submit documentation on **request by the Income-tax department**

*Key documentation requirements are as follows:

- Business and group's overview (description of the ownership structure, business of the group, etc.)
- Description of international transactions
- Functional Asset and Risk analysis (FAR analysis)
- Selection and application of the most appropriate method
- Benchmarking and identification of comparables
- Other supporting details/ documents which help in demonstrating the arm's length nature of the transaction

Compliance timelines



*Transfer Pricing Officer (TPO) to pass his order 60 days prior 31 March 2020

Safe Harbour Rules

"Safe harbour" is defined as the circumstances in which the income-tax authorities shall accept the transfer price that is declared by the assessee. Safe Harbour Rules are effective in India from the financial year 2012-13, and are available for a period of five years.

Following safe harbours are prescribed for eligible assesses for transactions with their non-resident AEs:

Eligible International Transaction	Threshold	Safe harbour circumstance
Provision of Software development services 'with insignificant risk'	Not to exceed US$ 7.7 million	Operating profit margin in relation to operating expense incurred is **20% or more**
	Exceeds US$ 7.7 million	Operating profit margin in relation to operating expense incurred is **22% or more**
Provision of IT enabled services (ITeS) 'with insignificant risk'	Not to exceed US$ 7.7 million	Operating profit margin in relation to operating expense incurred is **20% or more**
	Exceeds US$ 7.7 million	Operating profit margin in relation to operating expense incurred is **22% or more**
Provision of KPO services 'with insignificant risk'	No threshold	Operating profit margin in relation to operating expense incurred is **25% or more**
Advancing of intra-group loan sourced in Indian Rupees, for a fixed tenure	Not to exceed US$ 7.7 million	Interest rate declared is **1.5% plus Base Rate of State Bank of India** (SBI) as on 30 June of the relevant FY or more
Advancing of intra-group loan sourced in Indian Rupees, for a fixed tenure	Exceeds US$ 7.7 million	Interest rate declared is **3% plus Base Rate of SBI** as on 30 June of the relevant FY
Providing corporate guarantee	Guaranteed amount does not	Commission or fee declared is **2% p.a or**

Eligible International Transaction	Threshold	Safe harbour circumstance
	exceed US$ 1.5 million	**more on the amount guaranteed**
	Guaranteed amount exceeds US$ 1.5 million and the credit rating of the AE, done by an agency registered with the SEBI, is of adequate to highest safety	Commission or fee declared is **1.75% p.a or more on the amount guaranteed**
Provision of contract R&D services wholly or partly relating to software development 'with insignificant risk'	No threshold	Operating profit margin in relation to operating expense incurred is **30% or more**
Provision of contract R&D services wholly or partly relating to generic pharmaceutical drugs 'with insignificant risk'	No threshold	Operating profit margin in relation to operating expense incurred is **29% or more**
Manufacture and export of core auto components	No threshold	Operating profit margin in relation to operating expense incurred is **12% or more**
Manufacture and export of non-core auto components	No threshold	Operating profit margin in relation to operating expense incurred is **8.5% or more**

Penalty provisions

Penal provision under Section	Default	Penalty
271 (1) (c)	Concealment of income	100-300% of tax on adjusted amount
271 AA (i)	Failure to maintain statutory TP documents	2% of value of transaction
271 G	Failure to furnish statutory TP documents	2% of value of transaction
271 AA (ii)	Failure to report a transaction in accountant's report	2% of value of transaction
271 AA (iii)	Maintaining or furnishing incorrect information or documents	2% of value of transaction
271 BA	Failure to furnish accountant's report	US$ 1,559.81

Transfer Pricing Audit Cycle

The transfer pricing audit is conducted by the Transfer Pricing Officer (TPO), a specialised officer from the Revenue department. If the regular Assessing Officer (AO) of a taxpayer considers it necessary or expedient so to do, he may, with the previous approval of the Commissioner, refer to the computation of the ALP in relation to the international transactions or SDT of the taxpayer to the TPO.

At present transfer pricing is a highly litigated area. However, there are methods to resolve the litigation. These methods are as follows:

Advance Pricing Agreement

The Advance Pricing Arrangement (APA) program was introduced in the Indian TPR by the Finance Act, 2012. Under the APA scheme available from FY 2013-14, any person can enter into an agreement with the Board, after the approval of the Central government, for determining the ALP or for specifying the manner in which the ALP is to be determined in relation to an international transaction to be entered into by that person.

APA can be entered in relation to an international transaction only. The APA can be unilateral, bilateral or multilateral. Any person willing to enter into an APA agreement may voluntarily go for a pre-filing consultation with the APA Directorate before applying for an APA. The application for the APA has to be accompanied with relevant fees as prescribed in the relevant rules. The application fees are summarised below:

Amount of international transaction entered into or proposed to be undertaken in respect of which APA is proposed	Fees (US$)
Transaction not exceeding US$ 1.5 million	0.015 million
Transaction not exceeding US$ 3.1 million	0.02 million
Transaction exceeding US$ 3.1 million	0.031 million

The Finance Act, 2014 has introduced roll-back provisions in the Indian APA scheme, which enable the persons entering into an APA to roll-back the results of the APA to a period not exceeding four preceding years from the year from which the APA is proposed to be applicable. Following are the conditions to opt for roll-back provision:

- The international transaction for which roll-back is sought should be the same as the international transaction to which the agreement/ application has been made
- Roll-back is requested for all roll-back years in which the international transaction, on which roll-back has been requested, has taken place

However, in case of an international transaction covered under APA, if the Income Tax Appellant Tribunal (ITAT) has passed an order, then APA cannot be opted for it. Also, the applicant is required to withdraw any appeal for the roll-back year, if the appeal is pending before Commissioner (Appeals), ITAT or the High Court to extent of issue covered under the signed APA, before furnishing the modified return for such year.

Mutual Agreement Procedure

In order to avoid double taxation, Mutual Agreement Procedure (MAP) has proved to be an effective method where the Revenue Authorities of two different nations try to resolve a dispute together.

Under MAP, an agreement, which seeks to avoid economic double taxation or conflicting taxation, would be reached between the tax authorities. Also, under MAP, disputes are resolved through Competent Authorities (CAs) of the contracting States.

Trade

Top government for trade and manufacturing

The government of India has been focusing on extending the incentives currently available to Special Economic Zones (SEZs) and on promoting more foreign trade in India. In April 2015, the government unveiled a five-year plan to make the country an even bigger player on the global trade forum. This new simplified foreign trade policy for 2015-20 aims to double the exports to US$ 900 billion by 2020. It focuses on reducing the transaction costs and on providing more incentives to the Indian e-commerce market.

Merchandise exports account for one-fifth of the country's economy. So, several promotional schemes have been consolidated into a single Merchandise Export from India Scheme (MEIS). The Serve from India Scheme (SFIS) will be replaced by the Services Export from India Scheme (SEIS) to promote sectors such as medical tourism, accountancy and architecture[22]. In addition to simplifying the Foreign Trade Policy (FTP), several initiatives were undertaken by the Department of Industrial Policy and Promotion, Government of India, during the year 2014-15 to provide a boost to the manufacturing sector and improve the ease of doing business in India. Some of these policies are as follows:

Ease of doing business in India

This policy aims to improve the existing rules and regulations for doing business in India. It also aims to introduce better information technology for good governance and to make the process easier than before.

Make in India

This programme was launched on 25 September 2014. It is primarily designed to transform India into a global manufacturing hub. This programme is linked with four important pillars to simplify the ease of doing business in India. These pillars are new processes, new infrastructure, new sectors and new mind-set.

National workshop on sectoral perspectives and initiatives

This workshop was held on December 2014 with an aim to develop a Plan of Action for stimulating investment in the Indian manufacturing sector as well as in other allied industries.

The E-biz project

The E-biz project is under the National e-Governance Plan of the government of India. The project's main goal is to set up a government to business (G2B) portal for serving the needs of investors, businesses and industries.

Facilitating intellectual property

This scheme aims to improve the transparency in doing business. It also aims at protecting intellectual property and at cutting down the transaction costs.

---

[22] **Source:** Government of India, Department of Commerce, Ministry of Industry and Commerce, Directorate General of Foreign Trade

Liberalisation in FDI

This scheme aims to increase the amount of FDI in certain sectors, which was not permitted earlier. For instance, FDI upto 49% has been permitted in the defence sector.

SEZ scheme

With a view to attract greater foreign investment in India and provide an internationally competitive hassle-free environment for exports, a policy was introduced in April 2000 to set up SEZs. The SEZ Act was passed in May 2005. The main objectives of this policy are generation of additional economic activity, promotion of exports of goods and services, promotion of investment from domestic and foreign sources, creation of more employment opportunities and development of infrastructure facilities.

The government has provided a number of incentives to the units in SEZs to attract investment. Some of the incentives are duty free import, a tax emption of 100% on the export income earned for the SEZ units, no Central sales tax and service tax, no State tax or any other tax levied by the State governments, and no issues around approvals at the Central and State levels. Further, commercial borrowing up to US$ 500 million is allowed by the SEZ units externally. Also, the infrastructure facilities available to the SEZs are quite impressive. Any kind of support services such as banking, post office, clearing agents, etc. are made available within the SEZ complex. In addition, developed plots and ready to use built-up space are available to establish factories and offices, contract farming is allowed for horticulture or agriculture, and manufacturing trading or any kind of service activity is permitted. There are about 199 exporting SEZs operational in the country as on 10 March 2015[23].

Export oriented unit scheme

The new FTP aims to double the exports of the country by 2020. Export Oriented Units (EOUs) constitute a very important part of the government's agenda to promote exports from India.

Some of the incentives offered by EOUs are similar to those offered by the SEZs. The main incentives offered by EOUs are:

- No import license
- No Central excise duty charged on procuring any capital goods
- No custom duty on import of capital goods
- 100% FDI is allowed
- Central sales tax is reimbursed for domestic purchases
- Industrial license can be easily procured
- An EOU can be set up in a domestic tariff area as well

For corporates to successfully run an EOU and for the government to offer these units greater incentives, it is imperative that an EOU achieves a net foreign exchange, earning consecutively for a period of five years from the date of start of the operation. Under the "Make in India Initiative", the EOUs seem to have a long and prosperous road ahead[24].

---

[23] **Source:** SezIndia
[24] **Source:** EouIndia

Imports

Imports in India for the fiscal 2014-15 stood at US$ 447.5 billion. It has decreased from US$ 450.2 billion since the previous year. The main reason for the drop in imports has been the sharp decline in the global oil prices. Due to the decline in oil prices, the import level and the import payment of crude oil also dropped. Oil imports during April-March 2014-15 were valued at US$ 1,38,261.66 million, 16.09% lower than the previous year. The non-oil imports were valued at US$ 28,331.38 million for 2014-15, 10.55% higher than in the previous fiscal[25].

The top five products imported by India are crude petroleum, gold, coal, diamonds and petroleum gas. India is expected to be the world's largest importer of thermal coal in the coming years. The country's gold imports for March 2014 stood at around 125 tonnes, compared to 60 tonnes during the same period in the previous year. It has actually doubled in the last year.

India is, at present, the second-biggest buyer of oil from Iran annually after China. Going forward, the country's import of crude oil is expected to increase further.

[25] **Source:** Ministry of Commerce and Industry, Department of Commerce, Economic Division

Grant Thornton in India

Who we are

Grant Thornton in India is one of the largest assurance, tax, and advisory firms in India. With over 2,000 professional staff across 13 offices, the firm provides robust compliance services and growth navigation solutions on complex business and financial matters through focused practice groups. The firm has extensive experience across a range of industries, market segments, and geographical corridors. It is on a fast-track to becoming the best growth advisor to dynamic Indian businesses with global ambitions. With shorter decision-making chains, more senior personnel involvement, and empowered client service teams, the firm is able to operate in a coordinated way and respond with agility.

Over the years, Grant Thornton in India has added lateral talent across service lines and has developed a host of specialist services such as Corporate Finance, Governance, Risk & Operations, and Forensic & Investigation. The firm's strong Subject Matter Expertise (SME) focus not only enhances the reach but also helps deliver bespoke solutions tailored to the needs of its clients.

How we work

The firm has extensive experience across industries, namely; technology, healthcare, real estate and infrastructure, general manufacturing, food & beverage, automotive and auto components, financial services, and public sector.

What we do

We offer a comprehensive range of professional services:

Assurance
- Attest Services
- Financial Reporting Advisory Services

Tax
- Direct Tax
- Compliance & Outsourcing
- Indirect Tax
- Transfer Pricing
- US Tax

Advisory
- Corporate Finance
- Governance, Risk and Operations
- Forensic & Investigation
- Specialist Advisory

About Grant Thornton International Ltd.

Grant Thornton is one of the world's leading organisations of independent assurance, tax and advisory firms. These firms help dynamic organisations unlock their potential for growth by providing meaningful, forward looking advice. Proactive teams, led by approachable partners in these firms, use insights, experience and instinct to understand complex issues for privately owned, publicly listed and public sector clients and help them to find solutions. More than 40,000 Grant Thornton people, across over 130 countries, are focused on making a difference to clients, colleagues and the communities in which we live and work.

Contact us

To know more about Grant Thornton in India, please visit **www.grantthornton.in** or contact any of our offices as mentioned below:

NEW DELHI
National Office
Outer Circle
L 41 Connaught Circus
New Delhi 110001
T +91 11 4278 7070

AHMEDABAD
BSQUARE Managed Offices
7th Floor, Shree Krishna Centre
Nr. Mithakali Six Roads
Navrangpura
Ahmedabad 380009
T +91 76000 01620

BENGALURU
“Wings”, 1st Floor
16/1 Cambridge Road
Ulsoor
Bengaluru 560008
T +91 80 4243 0700

CHANDIGARH
B-406A, 4th Floor
L&T Elante Office Building
Industrial Area Phase I
Chandigarh 160002
T +91 172 4338 000

CHENNAI
Arihant Nitco Park, 6th Floor
No.90, Dr. Radhakrishnan Salai
Mylapore
Chennai 600004
T +91 44 4294 0000

GURGAON
21st Floor, DLF Square
Jacaranda Marg
DLF Phase II
Gurgaon 122002
T +91 124 462 8000

HYDERABAD
7th Floor, Block III
White House
Kundan Bagh, Begumpet
Hyderabad 500016
T +91 40 6630 8200

KOCHI
7th Floor, Modayil Centre point
Warriam road junction
M.G.Road
Kochi 682016
T +91 484 406 4541

KOLKATA
10C Hungerford Street
5th Floor
Kolkata 700017
T +91 33 4050 8000

MUMBAI
16th Floor, Tower II
Indiabulls Finance Centre
SB Marg, Elphinstone (W)
Mumbai 400013
T +91 22 6626 2600

MUMBAI
9th Floor, Classic Pentagon
Nr Bisleri factory, Western
Express Highway
Andheri (E)
Mumbai 400099
T +91 22 6176 7800

NOIDA
Plot No. 19A, 7th Floor
Sector – 16A
Noida 201301
T +91 120 7109 001

PUNE
401 Century Arcade
Narangi Baug Road
Off Boat Club Road
Pune 411001
T +91 20 4105 7000

For more information or for any queries, write to us at contact@in.gt.com.

Follow us @GrantThorntonIN

“Grant Thornton in India” means Grant Thornton India LLP, a member firm within Grant Thornton International Ltd, and those legal entities which are its related parties as defined by the Companies Act, 2013 read in conjunction with the applicable Accounting Standards issued by the Institute of Chartered Accountants of India.

Grant Thornton India LLP (formerly Grant Thornton India) is registered with limited liability with identity number AAA-7677 and has its registered office at L-41 Connaught Circus, New Delhi, 110001.