# Doing business in India

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*"India is doing "very well" in terms of economic growth. We are seeing a global recovery that is a fact… India is doing very well and actually India is helping the averages (growth of world economy) look better..."*

Angel Gurria
Secretary General, Organization for Economic Cooperation and Development (OECD) (June 2011)

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*"In the next 25 years, we aspire to (having) growth rates of between 9 and 10 percent annually. This will enable us to lift millions of our people out of poverty so as to transform India into one of the largest economies of the world."*

Manmohan Singh
Prime Minister, India (March 2010)

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*"This coming year, I believe Indian participation at Davos can highlight the country's thought leadership. At a time when the world is searching for a new model of economic development, India's experience as a crucible for new types of inclusive growth gives it a special role among developing economies,"*

Klaus Schwab
WEF Founder and Chairman

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*India is no longer seen as America's back office. India has moved up the value chain as America's knowledge partner. We need help from Indian companies in job creation. If Indian firms can create jobs for the hinterland of America, it will dispel anti-outsourcing rhetoric.*

Ron Somers
President, US India Business Council, January 2011

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*"We are in the process of deepening policy reforms in the financial sector… discussions are under way to build consensus on further liberalisation of the FDI policy in retail and defence sectors...We have recorded one of the fastest growth rates in the world and are nearly back to our pre-crisis growth levels. We believe that growth potential of India is over 9%".*

Pranab Mukherjee
Finance Minister, India July 2011

This book has been prepared by Ernst & Young India with the intention of providing busy executives a quick overview of the investment climate, taxation, forms of business organizations, and business and accounting practices in India.

This publication should be used as a research tool only. However, as the information contained is in summary form, it should not be substituted for the tax professional's own work in relation to client matters. In those circumstances, reference should always be made to the original reference materials quoted against the related information to ensure added accuracy. The information presented in this book has been validated as of 15 June 2011.



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Please note: All figures quoted in this book in US Dollars have been converted from Indian Rupees, assuming a standard conversion rate of US$1 = INR45.

# Foreword

Over the past decade the Indian Economy has witnessed a paradigm shift and is on a robust growth trajectory. The Indian economy today boasts of a burgeoning annual growth rate, deep capital markets and liberalized foreign direct investment regime. As per the data available from various published sources, the Indian economy opened up to the globe in 1991 and has not looked back since. As a result of the liberalization, average GDP growth rate rose to nearly 6% per year during the 1990s, compared to a moderate rate of 4% per year which was the norm during the first 40 years following independence.

India is one of the few economies to have weathered the recent global financial crisis and its GDP has been growing and will continue to grow in excess of 8 percent per year. The resilience and depth of the Indian economy coupled with liberalized foreign exchange regime has not only attracted the world's largest multinational but also enabled Indian entrepreneurs to venture into and capture overseas markets reflected by India Inc's buying spree of close to USD44 billion during the last fiscal.

Keeping the above in perspective we have prepared this book. The complex decision-making process involved in undertaking foreign operations requires an intimate knowledge of a country's commercial climate as well as recognition of the fact that this climate is continuously evolving. For the companies that are doing business in India, or planning to do so, would be well advised to obtain current and detailed information from our experienced professionals.

I hope you find this book valuable and insightful.

**Gaurav Karnik**
Partner, Tax & Regulatory Services
Ernst & Young India

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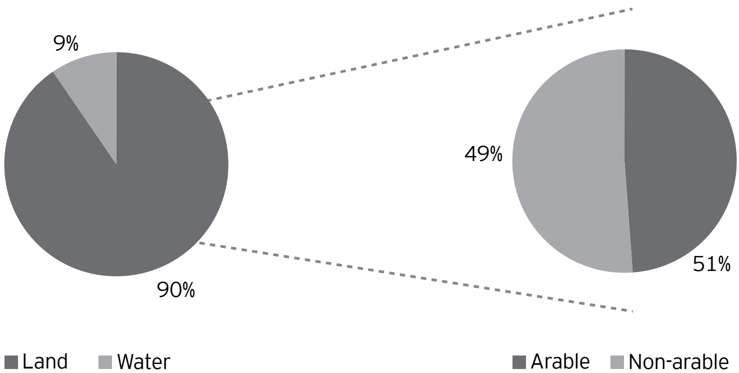
Chapter

# A. India: at a glance

# A.1. Geographical profile

**Total area: 3.29m sq km**

Distribution of total area occupied by India




**Capital: New Delhi**

India consists of 28 states and seven union territories.

Bordering countries: China, Nepal and Bhutan to the north, Afghanistan and Pakistan to the north–west, Myanmar and Bangladesh to the east and Sri Lanka to the south.

1 "CIA World Factbook", CIA website, https://www.cia.gov/library/publications/the-world-factbook/geos/in.html, accessed 14 June 2011

### A.1.1 Geological characteristics

| | |
|---|---|
| **Climate** | Broadly, India's climate can be classified as tropical monsoon. The country has four seasons – summer (March–June), monsoon (June–September), post-monsoon (October–November) and winter (December– February). |
| **Natural resources** | Coal (fourth-largest reserves in the world), manganese, bauxite, iron ore, mica, chromites, diamond, limestone, titanium ore, natural gas, petroleum, and arable land form India's natural resources. |
| **Flora and fauna** | More than 47,000 species of flora and more than 89,000 species of fauna are found here. |
| **Major rivers** | Ganga, Yamuna, Brahmaputra, Godavari, Krishna, Cauvery, Narmada, Tapti are the major rivers of the country. |
| **Coastline** | The coastline comprises 7,517 km encircling the mainland, the Andaman, Nicobar and Lakshadweep islands. |

### A.1.2 Transportation

| | |
|---|---|
| **Railways** | 108,706 km |
| **Roadways** | 4,200,000 km |
| **Waterways** | 14,500 km |
| **Number of airports** | 454 |

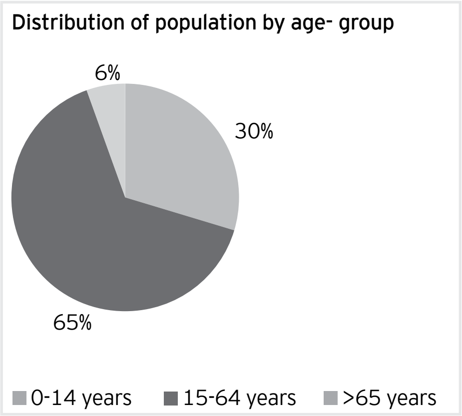
## A.2 Demographic profile

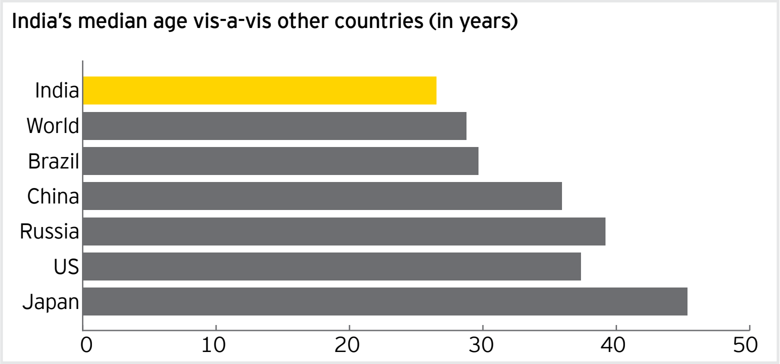
| | |
|---|---|
| **Population** | 1.2 b (urban: 30%, rural: 70%) |
| **Population growth rate** | 1.6% per annum |
| **Birth rate** | 20.97 (births/1,000 population) |
| **Death rate** | 7.48 (deaths/1,000 population) |
| **Life expectancy** | 66.8 years |
| **Sex ratio** | 940 females per 1000 males |
| **Households** | 240m |

## A.2.1 Age structure

India has a young population with approximately 65% of its population in the age group of 15 to 64 years.

The median age in the country is around 26.2 years, which is lower than many countries in the world.

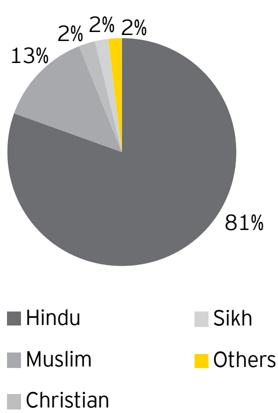


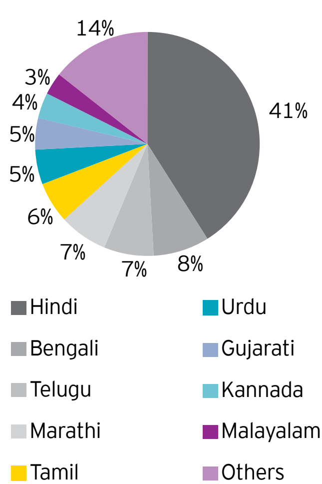
## A.2.2 Cultural diversity

| | |
|---|---|
| **Religions** | Hinduism, Islam, Christianity and Sikhism are the four main religions followed in India. Other religions include Buddhism, Jainism, Judaism and Zoroastrianism. |
| **Languages** | Hindi is the official language of India. Apart from Hindi, there are 21 official languages including Bengali, Telugu, Marathi, Tamil, Urdu, and Gujarati.<br><br>English is widely used in national, political and commercial communication. |
| **Festivals** | Deepawali, Holi, Guru Nanak Jayanti, Rakshabandhan, Christmas, Janamashtami and Id–ul–Zoha to name a few. |

**Distribution of population by religion**




**Distribution of population by language**



## A.2.3 Education and labor force

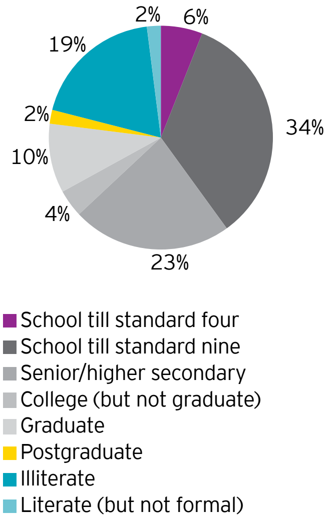
**Literacy rate: 74.04% (male: 82.1%, female: 65.5%)** [2]

Education: India has one of the largest school-age population in the world. It has a well-established education system with more than 1.6m schools enrolling in excess of 130m students.

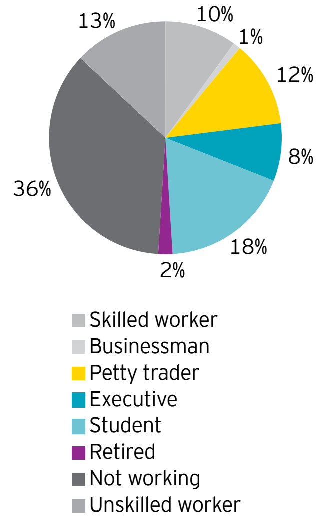
For higher education, India has more than 500 universities, as well as more than 25,000 colleges and 7,000 technical institutions with approximately 13m students.

Labor force: India's labor force stood at approximately 478.3m in 2010. It is estimated that around 13m people enter India's urban labor force every year.

**Distribution of population by education**




**Distribution of labour force by occupation**

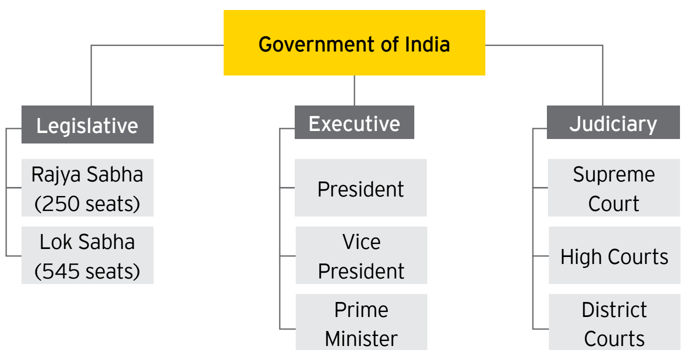



2 "Provisional Population Totals India," Census of India website, http://www.censusindia.gov.in/2011-prov-results/prov_results_paper1_india.html, accessed 14 June 2011.

## A.3 Political profile

India is a secular state and the largest democracy in the world with a parliamentary form of government. The Government of India (GoI), officially known as the Union Government, was established by the Constitution of India in 1950.

The GoI is divided into three distinct but interrelated branches – the legislative, executive and judiciary.




**Legislative branch:** At the central level, India has a bicameral parliament comprising the Rajya Sabha (Council of States) and the Lok Sabha (House of the People). The primary function of the Parliament is to pass laws on matters specified in the constitution to be under its jurisdiction.

At the state level, some states operate through a single Legislative Assembly while others have a bicameral structure and operate through a Legislative Assembly and a Legislative Council.

**Executive branch:** The Executive arm comprises the President, the Vice President and the Council of Ministers headed by the Prime Minister.

**The President:** The President of India is the Head of the State and the Commander-in-Chief of the armed forces. The role of the President is primarily ceremonial in nature and he/she acts in accordance with the advice of the Council of Ministers.

**The Vice President:** The Vice President is the ex-officio Chairman of the Rajya Sabha and acts as the President when the latter is unable to discharge his/her duties.

**The Prime Minister:** The real executive power of running the Central Government lies with the Council of Ministers led by the Prime Minister of India (collectively known as the Union Cabinet). The Prime Minister is appointed by the President after the Lok Sabha elections, which take place after every five years.

**Judiciary branch:** The Indian judiciary is independent of the Executive. The Supreme Court is the apex body in the judiciary branch and comprises the Chief Justice of India and 25 associate judges.

Apart from the Supreme Court, the judiciary consists of high courts at the state level and district courts at the district level.

**Political parties of India:** Major political parties in India include the Indian National Congress, the Bhartiya Janata Party, the Janta Dal, the Communist Party of India and the Samajwadi Party.

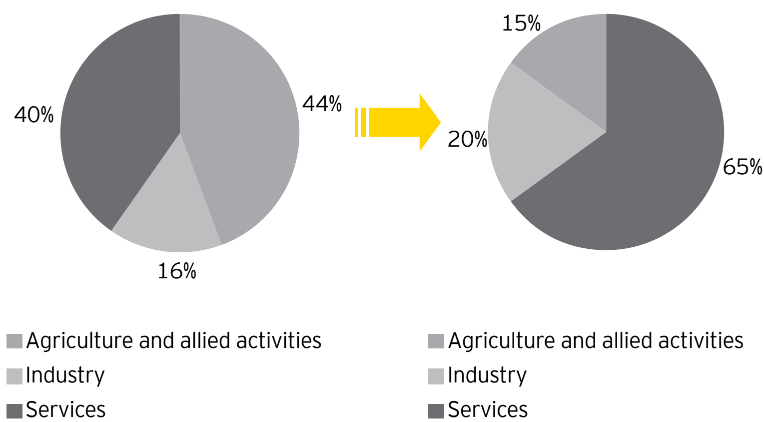
## A.4 Economic profile

India has seen a systematic transition from being a closed door economy to an open economy since the beginning of economic reforms in the country in 1991. These reforms have had a far-reaching impact and have helped India unleash its enormous growth potential. Today, the Indian economy is characterized by a liberalized foreign investment and trade policy, a significant role being played by the private sector and deregulation.

India has grown to become a trillion dollar economy with a largely self-sufficient agricultural sector, a diversified industrial base and a stable financial and services sector.

## Structural shift from an agrarian to a services-driven economy

**Distribution of GDP (1970–71)**



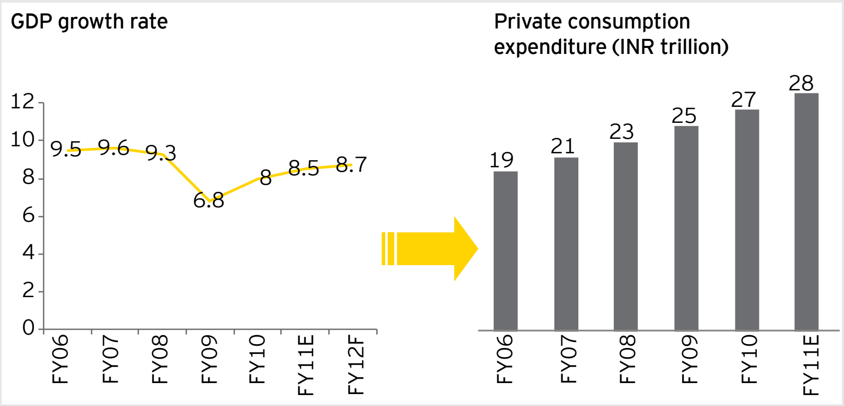

Source: Reserve Bank of India

**GDP:** Among the growing economies of the world, India ranks second to China. The country's GDP has been growing at an average rate of 8.6% for the last five years. India's GDP growth projection is 8.5% for FY11. Due to high level of inflation and a tight monetary policy, the GDP for FY12 is forecasted to grow by 8.7%.

**Domestic consumption fuelling economic growth:** As compared to other countries, India has been and continues to be relatively insulated from external shocks due to its strong domestic consumption pattern. Consequently, India was relatively unaffected by the global recession, which affected the whole world in FY09. India recorded a GDP growth rate of 6.8% during this period.

Increasing urbanization and modern technology have brought about a remarkable change in the lifestyles and consumption pattern of Indians. Private domestic consumption accounts for more than 50%

of the country's GDP and is one of the key factors driving overseas investments in the country.




## India's competitive position in the world[3]

India's economy has strong fundamentals and is host to several eminent global corporate giants that are leaders in their respective fields. According to the Global Competitiveness Report 2010–11, India ranks at 51 among 139 countries.

The country ranks higher than many countries in key parameters such as market size (4th) and innovation (39th). It also has a sound financial market (17th).

FDI in India: According to UNCTAD's World Investment Prospects Survey 2010-2012, India is the second-most attractive destination for FDI (after China) in the world. Indian markets have significant potential and offer prospects of high profitability and a favorable regulatory regime for investors. Mauritius has been the largest source of FDI inflows into India for many years.

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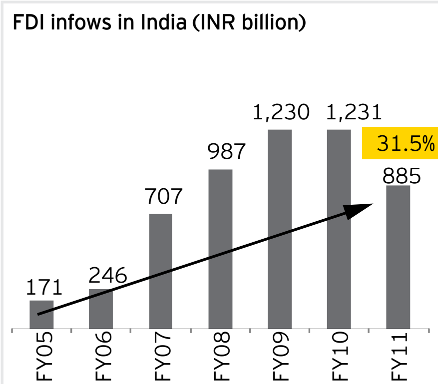
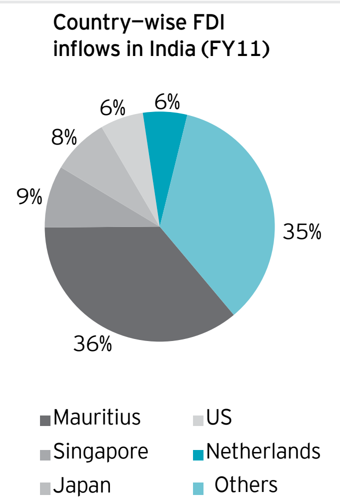
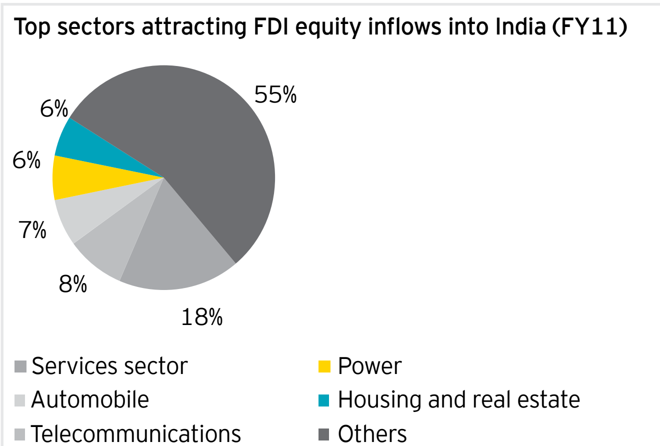
"The Global Competitiveness Report 2010-2011," World Economic Forum website, http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf, accessed 15 June 2011



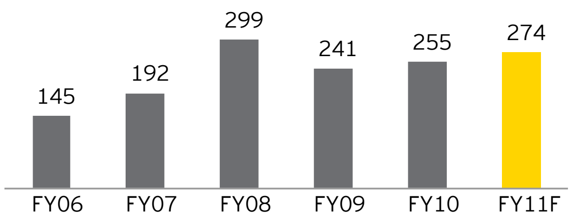




**Sectors attracting highest FDI equity inflow:** The services sector attracts the highest amount of foreign capital in India.



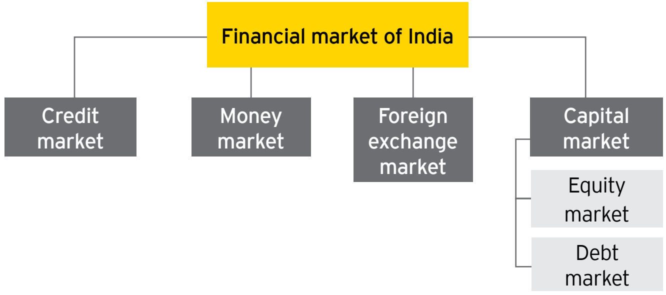
Foreign exchange reserves and industrial production: India has a robust corporate sector, which posted a year-on-year profit growth of 29.3% in FY10. The country's foreign exchange reserves stood at US$255b in FY10. The value of the industry's output (organized sector) has grown at a CAGR of 17% during FY06 and FY10 to reach at US$782b in FY10. The gross value added for industry sector stood at US$137b (factory sector) and US$64b (non-factory sector) in FY10.

**Foreign exchange reserves in India (US$ billion)**




## A.4.1 India's Financial Market

India has a robust, transparent and stable financial market, which has gradually transformed from a highly controlled system to one that is liberalized.



**Reserve Bank of India (RBI):** The RBI, established in 1935, is the central bank of India. The RBI regulates the credit market, the money market and the foreign exchange market in India. It is responsible for formulating the monetary policy, issuing currency, prescribing exchange control norms and acting as a banker to other banks.

## Credit market

India has a robust credit market with a wide range of financial institutions such as commercial banks, regional rural banks, co–operative banks and non-banking financial corporations. Indian commercial banks have outstanding advances of approximately INR40 trillion and deposits of more than INR54 trillion.

**The State Bank of India, a public sector bank, is the largest bank in the country.**

**Number of financial institutions in India**

| Type of institution | Total | Grand total |
|---|---|---|
| Commercial banks | | 79 |
| ‣ Public sector banks | 26 | |
| ‣ Private sector banks | 21 | |
| ‣ Foreign banks | 32 | |
| Regional rural banks | | 82 |
| Urban cooperative banks | | 1,674 |
| Rural cooperative credit institutions | | 96,751 |

## Foreign exchange market

India accounts for 1.4% of the global daily foreign exchange turnover (US$4 trillion) and is the sixteenth largest foreign exchange market in the world. It also has the world's fifth largest derivatives exchange (NSE).

## Capital markets

**Securities and Exchange Board of India (SEBI):** SEBI, established in 1992, is the regulatory authority for capital markets in India.

The National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE) are the premier stock exchanges of the country. NSE is the largest stock exchange of India. It records an average daily turnover of approximately INR140b.

Chapter

# B. Key sectors: an overview

# B.1 Aerospace and defence

The Aerospace and defence industry is an emerging market in India with the Indian military expected to spend roughly US$80b over the next four to five years. It ranks among the top ten countries in the world in terms of military expenditure. India is one of the largest users and importers of conventional defence equipment. About 65%–70% of India's defence requirement is imported from global aerospace and defence companies. India's defence spend has been increasing over time in the light of volatile neighbourhood and internal security issues.

Currently, India's national budget for 2011–12 pegged the defence outlays at US$36.54b. Of this capital expenditure, which primarily caters to acquisition of defence hardware and modernization requirements of defence services, accounts for US$15.38b. Of this the Indian army have the largest share of more than 50% followed by the Indian Air Force and the Indian Navy. Capital expenditure is expected to grow at the rate of 10% per annum, which is significantly positive as compared to other global economies. The revenue expenditure, which mainly accounts for the "operating expenditure', is pegged at US$21.16b.

The Indian aerospace and defence industry is witnessing an unprecedented growth with the sector on the threshold of entering a new era where it will assume greater responsibility in making the nation self-reliant in Defence Production. India is fast developing into a manufacturing hub for global aerospace corporations wanting to leverage India's proven skills in cost-efficient manufacturing, talent base, product design and IT competitiveness.

## Regulatory scenario

### a. Foreign direct investment

The policy for foreign direct investment (FDI) in the defence sector was notified in 2001, wherein the defence industry was opened up to 100% for Indian private sector participation, with FDI permissible up to 26%, both subject to licensing and GoI approval.

b. **Defence procurement procedures**

The defence procurement procedures (DPP) essentially lays down the procurement procedure of all capital acquisitions (except medical equipment) undertaken by the Ministry of Defence, the Defence Services and Indian Coast Guard both from indigenous sources and ex-import. DPP is a detailed procedure laid down to ensure expeditious procurement of the approved requirements of the Indian Armed Forces in terms of capabilities sought and time frame prescribed by optimally utilizing the allocated budgetary resources.

c. **Offset policy**

In its quest for self reliance in defence production, the GoI has been continuing its efforts to indigenize the production of defence equipment. One of the major initiatives by the GoI in this regard was the introduction of the "offset policy" as part of Defence Procurement Procedure 2005. Defence Procurement Procedures provides for an uniform offset of 30% in case of contract with foreign company where contract is valued at more than US$67m. The Defence Acquisition Council may, after due deliberation, also prescribe varying percentages above 30% or waive off the requirement for offset obligations in very special cases. Offset Policy is applicable for all Capital Acquisitions (in excess of US$67m) categorized as:

- "Buy (Global)", i.e., outright purchase from foreign or Indian vendor. Procurement offset is not applicable in case of a bid from an Indian firm offering an indigenously developed product (at least 50% of indigenous content in the product)
- "Buy and Make with Transfer of Technology", i.e., purchase from foreign vendor followed by licensed production

Offset obligations can be discharged by direct purchase of, or executing export orders for, eligible products and components manufactured by, or services provided by, Indian industries. Offset obligations can also be discharged through direct foreign investment in Indian industries for industrial infrastructure for services, co-development, joint ventures, and co-production of eligible products and components. The ambit of the offset policy has been enlarged vide Defence Procurement Policy in 2011 by including civil aerospace, internal security and bringing training in the list of eligible products and services.

Further, the defence procurement policy also allows banking of offset credits. If the vendor is able to create more offsets than his obligations under a particular contract, surplus offset credits can be banked.

d. **Industrial licensing**

   The defence sector is also subject to an industrial license (IL) regime. There are certain specific conditions related to the grant of an IL, which require, inter alia, (i) that the applicant should be an Indian company/partnership (ii) the majority of the Board of Directors and CEO should be resident Indians (iii) clearance through background checks for foreign collaborators and domestic promoters.

License applications are considered and licenses given by the Department of Industrial Policy and Promotion, Ministry of Commerce in consultation with the Ministry of Defence.

### Recent developments and industry outlook

With the Indian aerospace and defence expenditure projected to grow in double digits, India has emerged as one of the most promising markets for global aerospace and defence companies. This is primarily driven by factors such as progressive policy changes initiated by the GoI to modernize and develop its aerospace and defence industry, cost advantages, talent base and IT competitiveness. All segments in the aerospace industry, including civil and military aviation and space, are showing a significant level of growth.

## B.2 Automotive

The Indian automobile industry is estimated to have a total turnover of US$73b for the 12 month period ending 31 March 2011.

Today, India is among the top three markets across a number of vehicle segments attracting many global players. India is the world's largest three-wheeler, second-largest two-wheeler and heavy commercial vehicle and the third-largest light commercial vehicle market. The production of 800,000 three wheelers, 753,000 commercial vehicles, 13m two wheelers and 3.0m passenger vehicles in FY11 reflects growth in excess of 25% for two consecutive financial years, i.e., FY09–11.

India is developing into a small vehicle product development hub enabled by the large volumes needed for the domestic market and the ability to reduce costs through frugal engineering and manufacturing. There are as many as 12 multi-national players in the OEM segment in the Indian market. Further its proximity to the south-east Asian and African markets and well connected ports makes it an ideal location to develop as a small vehicle manufacturing hub. Exports of vehicles have grown at a CAGR of 25% over the period 2007–11 with 2.3m units exported in FY11.

India ranks fifteenth in the world in availability of engineers and scientists. The cost of manpower is also 20%–40% cheaper than counterparts in America. In addition to automotive OEMs, tier-I suppliers are viewing India as a sourcing base with more than 35 International Purchasing Office in the country operated by various multinational players and component suppliers, to source components.

## Regulatory scenario

The barriers to entry into the automotive industry are relatively low and setting up operations is fairly easy without the need for industrial licenses. FDI of up to 100% is allowed under the automatic route. Further, the GoI permits 200% weighted deduction on R&D expenditure. Moreover, most state governments offer additional incentives to vehicle manufacturers, given the large investments and employment generation capacity of this industry, in order to encourage them to set up units in their respective states.

The recent withdrawal of a rule, under which a foreign player had to take permission from its erstwhile or existing Indian JV partner to start its independent operations, has improved India's competitive positioning compared to other emerging auto markets of the world.

In 2006, the GoI drafted the 10-year Automotive Mission Plan 2016 (AMP), which is aimed at fuelling the growth of the automotive industry. It estimates that by 2016, the automotive industry will attain a turnover of US$145b, contributing more than 10% of the country's GDP, and providing employment to more than 25m people in the country. Implementation of AMP will require an investment of approximately US$35–40b.

### Recent developments and industry outlook

India is the second-fastest growing vehicle market in the world chiefly due to the rising personal disposable income and a growing middle class. The number of households in the middle income group is expected to rise to 170m (65%) by 2015. This provides immense scope for growth in the passenger car density, which is currently 11 per 1000 people, compared to 150 in countries such as Brazil. Other than that, the increasing working population, favorable government policies and availability of low cost finance were the chief drivers of domestic growth.

According to the industry forecasts, India is poised to become one of the top five vehicle producing nations. By 2020, the vehicle production is set to treble from the levels in 2009 and the size of the component sector is set to grow from US$30–110b.

## B.3 Banking

The financial sector reforms of the early 1990s brought about a complete overhaul of the Indian banking sector, which was hitherto a highly regulated and administered sector. These reforms encouraged new market entrants, being private players and foreign banks, making the banking sector a more market driven one with increased efficiency and productivity. This sector now broadly comprises three types of commercial banking entities, based on the nature of their ownership. These are public sector banks, private sector banks and foreign banks. However, public sector banks still continue to dominate the banking space with a deposit market share of more than 75%. Despite all efforts undertaken post-1990s to boost banking in India, the banking sector penetration remains low. The banking sector intermediation, as measured by the total loans as a percentage of GDP, was around 30% in 2010 and about 40% of total population in India has bank accounts. There is significant scope to drive financial inclusion in India, especially in rural areas.

## Regulatory scenario

**Regulator:** The sector is regulated by the RBI. Key enactments governing this sector include the Banking Regulation Act, 1949; Reserve Bank of India Act, 1934; and the Companies Act, 1956 ("the Cos Act"). The RBI has been reviewing and refining its regulatory and supervisory policies to enable a strong capital base, effective risk management and best corporate governance standards in the banking sector. In recent times, the focus has also been on improving credit delivery, increased vigilance, monitoring salaries of key personnel, customer service and promoting financial inclusion.

**FDI policy in banking:** The total aggregate foreign investment in private banks from all sources (FDI, FII and NRI) is limited to 74% with a limit of 10% for individual foreign institutional investors (FIIs) with the aggregate limit for all FIIs restricted to 24%, which can be raised to 49% with the approval of the board/general body. The FDI norms are not applicable to public sector banks where the FDI ceiling is still capped at 20%.

**Capital requirements:** Basel III stipulates that all banks should attain CRAR with a buffer of 9.25% by 1 January 2017 and a tier-1 CRAR along with add-on buffer of 4.5% by 1 January 2015. These targets have already been achieved by most Indian banks with CRAR of 14.5% including 10.1% of tier-1 capital as on 31 March 2010 as RBI had already stipulated a higher minimum capital ratio of 9% for the banks in India. Domestic and foreign banks have been allowed by RBI to augment their capital funds by issuing certain hybrid instruments.

## Recent developments and industry outlook

- Financial inclusion to drive banking growth: Financial inclusion is being accorded top-most priority by the GoI and the RBI, with the Finance Minister setting a target of extending banking facilities to 100,000 villages having a population of more than 2,000 by March 2012. Recently, the RBI extended the scope of the business correspondent (BC) model to allow listed companies with large distribution network in rural areas to act as BCs, which marked the entry of telecom operators and large FMCG companies in the BC model.
- Focus on mobile banking to drive penetration of banking services in India: Since only 40% of the adult population in India has bank accounts, whereas more than 70% own a mobile connection, offers significant opportunity for India's commercial banks. Several leading banks are tying up with telecom operators and handset manufacturers to provide mobile banking facility.
- Granting of additional banking licenses: During the Union Budget of 2010–11, the GoI, in consultation with the RBI, announced that it may consider granting additional banking licences to private sector players. Pursuant to this announcement, the RBI issued a discussion paper requesting public comments on minimum capital requirements of new banks, promoter's participation, foreign shareholding, eligibility of industrial houses and NBFCs. The final policy outcome on grant of new banking licenses is awaited.
- Consolidation of public sector banks: The consolidation process, which has been primarily confined to the private sector, is expected to gain momentum in public sector banks. Over the long term, the government plans to create a few large public sector banks, as against the present 25 banks to scale up the banks and reduce operating costs.

- Increase in key policy rates impacting credit growth and NIM: The RBI increased the policy rates for the tenth time in the past 15 months in June 2011, during which 47 commercial banks raised their base rates by 150–300 basis points. The higher cost of credit is restraining credit growth and gross capital formation, putting pressure on the bank's loan portfolio growth and net interest margin (NIM).
- Setting up of electronic payments systems: National Payments Corporation of India has set up IMPS and is in the process of rolling out an indigenous payments network, "RuPay". These initiatives are likely to reduce the costs of financial transactions through banks and make the process of payment transfer quicker.

**Revision in rules to set up foreign banks in India:** In 2005, the RBI announced a roadmap for the set up of foreign banks in India. The roadmap inter alia proposed two phases to achieve a wholly owned structure (WOS) for foreign banks in India wherein, during the first phase, foreign banks were permitted to establish presence in India by way of setting up a WOS or conversion of the existing branches into a WOS. The second phase proposed to accord full national acceptance to WOS structures set up by foreign banks in India. As a key step toward implementing the roadmap, the RBI issued a discussion paper in January 2011. The discussion paper lays down the intent behind adopting WOS as the preferred structure, proposed framework to operationalize this structure along with incentives to existing/new banks to set up a WOS vis-a-vis a branch. The way forward on the mode of presence of foreign banks in India is awaited.

# B.4 Capital markets

The Indian capital markets have made significant progress over the last decade which spans several dimensions of development such as accessibility, regulatory framework, market infrastructure, transparency, liquidity and the types of instruments available. All these factors have culminated into the emergence of much deeper and resilient primary as well as secondary capital markets in India.

## Regulatory scenario

SEBI was established as a statutory body in 1992 to achieve the following:

- Regulate and promote the development of the securities market and protect the interest of investors
- Regulate the functioning of capital markets and issue detailed guidelines relating to capital markets, disclosures by public companies, and investor protection
- Formulate regulations to govern various intermediaries and investors

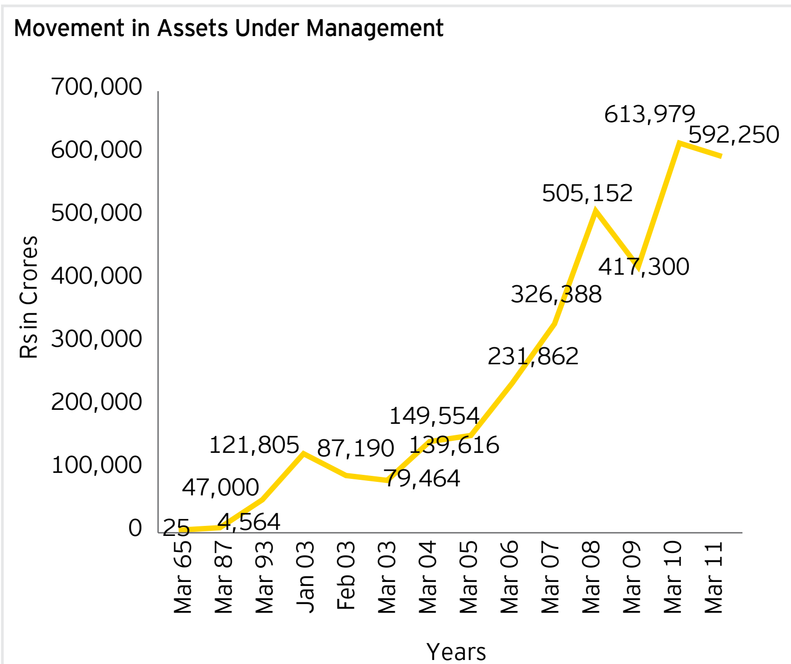
SEBI has proactively introduced measures to improve the integrity of the secondary as well as primary markets through better governance. SEBI has also introduced reporting requirements for the various capital market participants to enable increased transparency.

Dealings in securities are also governed by the provisions of The Securities Contracts (Regulation) Act, 1956.

## Mutual funds

The entry of private sector mutual funds in 1993 has given the Indian retail/corporate investor a wide choice of fund houses. Currently, there are 41 operational asset management companies in India offering schemes across three asset classes — equity, debt and gold.

The chart below indicates the movement in assets under management (AUM) over the years:




## Foreign Institutional Investors (FIIs)

The flow of funds from FIIs has given an impetus to the Indian capital markets. In addition, the sustained nature of FII investments has reiterated their belief in India's growth story, thus sending strong positive signals about the prospects of India as an investment destination to the global investment community

The number of SEBI registered FIIs stood at 1,722 at the end of March 2011, with 5,686 registered sub-accounts. Net FII investment in 2010-11 amounted to approximately US$32,226m as compared to US$30,252m in 2009-10.

The Indian regulatory regime has adopted a cautious approach toward allowing foreign institutions to invest in the country. Over the years, the regulations have been liberalized gradually across several dimensions such as investment limits, eligibility criteria and the instruments permitted for FII investments.

Of late, infrastructure is one sector where the regulations pertaining to FII investment have been notably relaxed. In the first quarter of 2011, the SEBI allowed FIIs to invest US$25b a year in bonds issued by infrastructure companies as against the earlier limit of US$5b. This increased the annual FII investment limit in corporate bonds to US$40b.

## Venture Capital Funds (VCF)

The visibility of Venture Capital Funds (VCF) has increased over the last couple of years with several large funds looking actively at investments in India.

The number of SEBI registered VCFs and Foreign Venture Capital Investors (FVCIs) stood at 184 and 153, respectively during 2010–11. Investments by VCFs and FVCIs stood at approximately INR526,880m as at 31 March 2011.

FVCIs need to have firm commitment from their investors for the latter's contribution of an amount aggregating to at least US$1m at the time of registration with SEBI.

## Commodities markets

The commodities market is another rapidly growing market in India. They were highly unorganized till 2003, when the first national level commodity derivatives exchange, National Multi Commodity Exchange of India, was permitted to commence operations. Currently, there are four national and 17 regional commodity exchanges in India.

The four national exchanges in the country that enable the purchase and sale of commodity are:

- Multi-Commodity Exchange of India Ltd.
- National Commodities and Derivatives Exchange Ltd.
- National Multi-Commodity Exchange of India Ltd.
- Indian Commodity Exchange Limited

Indian commodity derivative markets are regulated under the Forward Contracts (Regulation) Act, 1952 (FCRA). The Act proposes a three-tier regulatory structure for the industry, including:

- Government of India, which is the primary regulator
- Forward Markets Commission (FMC) which acts as an intermediary between the government and the exchanges
- The exchanges

Key functions of the FMC include providing limits on speculative open positions, placing price limits for all commodities and providing directives for margin requirements.

Foreign investment is permitted in commodity exchanges, subject to a composite ceiling of 49%, with a FDI limit of 26% and FII limit of 23%. FDI is allowed with specific approval of the FIPB and FII purchases in equity of commodity exchanges are restricted to the secondary markets only.

## Derivative markets

The market for exchange traded derivatives has evolved rapidly in India over the last decade and the country today boasts of one of the most active derivatives markets across the globe. In fact, the turnover of derivatives trading on the National Stock Exchange of India (NSE), which increased from INR23,654m in 2000-01 to INR176,636,647m in 2009-10, has already surpassed that of the equity markets. Index options are the most popular type of derivative instrument and account for the highest share of the total derivatives turnover.

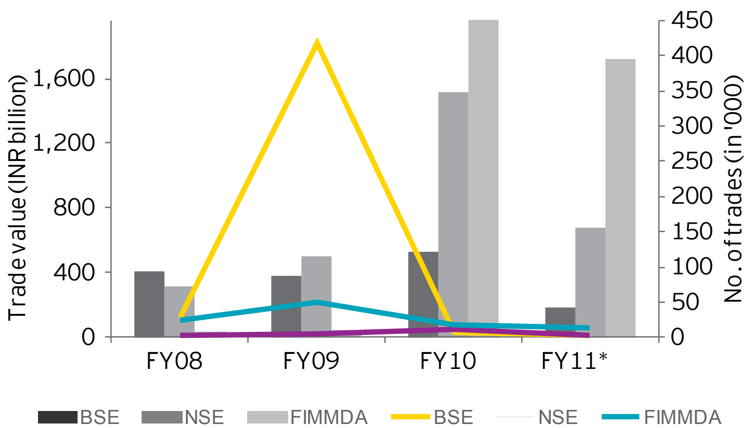
Credit default swaps (CDS) for corporate bonds are set to become the latest derivative instrument permitted in India when the recent guidelines for CDS issued the RBI become effective from 24 October 2011.

## Debt markets

The debt market in India, especially the corporate bond market, has not kept pace with the growth of equity markets in India.

Some of the reasons for the slow growth of corporate debt markets in India include poor transparency, absence of pricing of spreads against the benchmark yield curve, an inadequate supply of paper from corporate entities, large issuance of government securities and low-risk subordinated debts by banks.

**Trading statistics of the corporate debt market**




However, the government has been taking initiatives for the development of a robust corporate bond market in India. The measure to introduce CDS for corporate bonds, as mentioned above, is a step in that direction.

# B.5 Health sciences

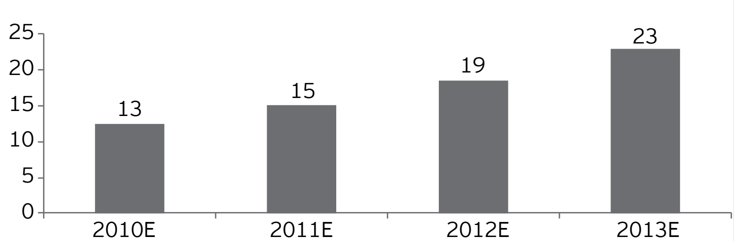
Indian life sciences industry has evolved tremendously, with pharmaceutical, biotechnology and health care domains contributing significantly to drive development and growth in the sector. A large population, evolving patient demographics, increasing healthcare expenditure, growing urbanization, rising life expectancy, increasing disposable income and active private-sector participation have augmented the growth of the country's healthcare sector in recent years.

## Pharmaceuticals

According to the Department of Pharmaceuticals, India is the third-largest pharmaceutical market in the world in terms of volume and fourteenth in terms of value, thereby accounting for nearly 10% of the world's production by volume and 1.5% by value[4]. Moreover, it ranks fourth in terms of the production of generics and seventeenth in terms of the export value of bulk actives and dosage forms[5].

Indian domestic pharmaceutical market size is estimated at US$12.76b in 2010 and is expected to grow at a CAGR of 9.5% till 2015[5]. The domestic sector has been steadily expanding over the years — from US$6.88b in 2003-04 to US$11.72 in 2008-09. Indian pharmaceutical exports in 2009-10 were valued at US$12.5b as compared to US$10.6b in 2008-09, thus growing 17.9% from the previous year.

**Pharmaceutical exports (US$ billion)**




4 Department of Pharmaceuticals 2009–10, annual report

5 Cygnus – Industry Insight – Indian pharmaceutical Markets

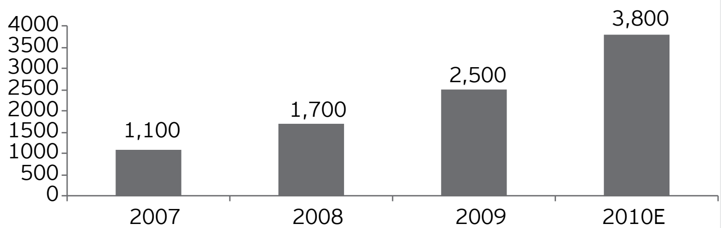
## Biotechnology

Indian biotechnology sector was valued at US$4b in 2010–11, growing at nearly 21% (in value) over 2000–10[6]. Within biotechnology, biopharmaceutical dominates the industry, with 61.7% share in 2010-11, followed by bio-services constituting 18.2% share, bio-agri constituting 14.38% share and bio-industrial and bio-informatics contributing the remaining. Exports across segments made up to 51% of the overall biotechnology market in India in 2010-11.

## Contract Research and Manufacturing Services (CRAMS)

India had more than 175 FDA-approved manufacturing facilities in 2009, which make it the only country outside the US to have highest FDA-certified manufacturing facilities[7]. The Indian CRAMS market was valued at US$2.5b in 2009 and is expected to reach US$3.8b by 2010, growing at a CAGR of 51.2% (2007–2010)4. It is estimated that as of 2012 the Indian CRAMS sector will be valued at US$7.6b growing at a CAGR of 47.2% from 2007 till 2012[4].

**Indian CRAMS market (US$ million)**



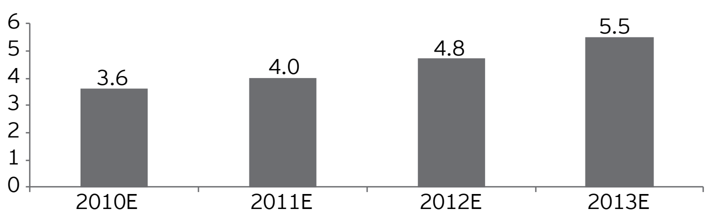

6 Association of Biotech Led Enterprises (ABLE)

7 Cygnus – Industry Insight – CRAMS; Ernst & Young and OPPI

## Medical devices and equipment

The Indian medical equipment and supplies market during 2010 was estimated at US$3.6b and is estimated to reach US$6.41b by 2014 with CAGR of approximately 15.5%. The market for medical supplies and disposables is largely dominated by local manufacturers and dealers and is largely an unorganized market. Based on industry reports, exports from India in 2009-10 were US$1.24b and the segment is projected to reach US$3.50b in 2014[8].

**Indian medical devices and equipment market (US$ billion)**




Source: Cygnus Research

### Regulatory scenario

The main regulatory body for the Indian pharmaceutical industry is the Central Drugs Standard Control Organization (CDSCO), which falls under the ambit of Ministry of Health and Family Welfare. Drug Controller General of India (DCGI) is the controlling body for CDSCO and is responsible for the approval of new drugs and clinical trials as well as establishment of quality standards. The regulator also monitors State Drug Authorities, which are mainly responsible for granting drug manufacturing and retailing licenses. Prices for essential drugs are defined under the Drug Price Control Order (DPCO) and are regulated by the government through National Pharmaceutical Pricing Authority (NPPA). Further, the government is also proposing to

8 Cygnus – Industry Insight – Medical Devices and Equipments

bring certain medical devices within the ambit of DPCO. The Department of Pharmaceuticals was promulgated on 2 July 2008 under the Ministry of Chemicals and Fertilizers. The department was established with the objective of providing greater focus on development of the pharmaceutical sector in India and to regulate complex issues related to affordability and availability of medicines, R&D, the protection of intellectual property (IP) rights and international commitments related to the pharmaceutical sector, all of which require integrating work with other ministries.

A range of regulatory reforms are underway to improve the current regulatory environment and make it comparable to global standards. The Central Government approved the formation of the Central Drug Authority (CDA), on similar lines to the US Food and Drug Administration (USFDA), in January 2007. The proposal is pending for the Parliament discussion following comments from the Parliamentary standing committee of Health and Family Welfare. The agency is expected to replace the national drug regulator and will ensure uniformity and speed of licensing while enacting stringent enforcement of various improved drug regulations.

The Department of Pharmaceuticals (DoP) has recently released draft marketing practices code for the pharma industry banning all kind of gifts to doctors.

Department of Biotechnology (DBT) is the nodal agency for policy formulation, the promotion of R&D, international cooperation and manufacturing activities pertaining to biotechnology in India. The government is also establishing a new regulator for biotech products, the National Biotechnology Regulatory Authority (NBRA), to ensure a single-window clearance for all segments within this industry.

Health care services come under the purview of the Union Ministry of Health and Family Welfare. National Accreditation Board for Hospitals & Healthcare Providers (NABH) has developed guidelines for accrediting hospitals, which is currently a voluntary process. The Parliament has passed the Clinical Establishments (Registration and Regulation) Bill, 2010 seeking to make registration of all clinical establishments mandatory in the country.

## Recent development and industry outlook

### Pharmaceuticals

The Indian pharmaceutical industry has progressed well in terms of infrastructure development, technology base and the wide range of products manufactured. Demand from the exports market has been growing rapidly due to the capability of Indian players to produce cost-effective drugs with world-class manufacturing facilities. Bulk drugs of all major therapeutic groups, requiring complicated manufacturing processes, are now being produced in India.

With India becoming a signatory to the WTO order, ushering in the product patent regime, the Indian pharmaceutical industry has witnessed exceptional growth. As part of the government's support to increase exports, duty free zones have been set up and several manufacturers of bulk drugs have been shifting their focus to Active Pharmaceutical Ingredients (APIs). Moreover, the favorable regulatory environment increased the spending on R&D and improved technical skills in the field of chemical synthesis have also played an important role.

### CRAMS

India is emerging as a low-cost, high quality option for outsourcing of research, manufacturing and other services. India is among the leading exporters of generic drugs in the world with exports to the tune of US$8b in 2008-09.

The Indian contract manufacturing industry is set to continue expanding as innovator pharma companies continue cutting costs by outsourcing their manufacturing to India. The manufacturing and labor costs in India are considerably lower than the US or EU.

Indian clinical trials market has been growing much more rapidly than that in the developed markets of the US and the EU, as well as other emerging economies such as Brazil, Russia and Central Europe. According to Express Pharma, India is projected to conduct 15% of all global clinical trials by 2011[9].

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9 "India: Preferred destination for outsourcing clinical trials," Express Pharma website, accessed 15 October 2010

### Biotechnology

India is counted among the top 12 global biotech hotspots and is the = third largest in Asia Pacific (in terms of number of biotech companies). The Indian biotech industry is already producing bio-generic equivalents of two patented drugs. With India becoming TRIPS compliant, local companies are looking forward to drugs going off-patent and also the bio-generics market so that they can produce and market the products at an affordable price.

With numerous comparative advantages in terms of research and development (R&D) facilities, knowledge, skills, and cost effectiveness, the biotechnology industry in India has immense potential to emerge as a key global player.

Also, opportunities over the next three years in the generic sector is set to boost as patents on a number of high-profile blockbuster products expire. At least 91 drugs worth more than US$150b will go off-patent (by 2015), which will generate significant opportunities for the generic market. Many Indian companies are aggressively filing Abbreviated New Drug Applications (ANDAs) in the US and maintaining a good track record of receiving approval for the same.

## Medical devices

Medical devices have advanced in the field of diagnostic kits and constitute a high growth segment in the medical devices market with a growth rate of 30%. Key factors contributing to this are increasing urban middle class population demanding better health care services, as well as expansion of corporate hospitals and research institutes in the country.

The industry has seen significant growth and has opened up for new entrants with mainly importers dominating the market, largely dependent on the private sector where investment is not a concern. Several joint ventures, agreements and loan licensing procedures have influenced the market.

## Mergers and alliances

In the Indian life science industry, it is common to have alliances with local companies for innovative products or generics. With more than 40 deals completed in 2010, strategic alliances continue to gain momentum and is expected to continue in future besides large acquisitions. Some of the key alliances include Biocon-Pfizer for commercialization of biosimilars, AstraZeneca-Intas Pharma supply agreement, Ranbaxy Laboratories– Pfenex Inc development agreement.

Further, key acquisitions that happened recently include Ranbaxy Laboratories-Biovel Life Sciences, Cipla-Mab Pharma and BioMab, Abbott-Piramal, Japanese firm Mitsui & Co Limited-Arch Pharmalabs Limited, US-based Cambrex Corporation-Zenara Pharma, Super Religare Labs acquisition of Piramal Diagnostics' 107 labs[10].

# B.6 Information Technology (IT)

Amidst speculation and an uncertain global economic environment, the Indian IT-BPO industry once again exhibited buoyancy and maturity, reflected through strong customer demand. The Indian Information Technology–Information Technology enabled Services (IT-ITES) industry has been a premier growth driver of India's economy for the past two decades. The industry has played a key role in transforming India into a knowledge-based economy. The sector's contribution to the country's GDP increased to 6.4% in 2010–11 from 4.8% in 2005–06 and is expected to account for 7% of the GDP by 2014–15.

According to the IT Annual Report 2010–11 issued by the Department of Information Technology, the Indian software and services exports, including ITeS-BPO exports, is estimated at US$59b in 2010-11, as compared to US$50b in 2009-10, an increase of 18.0%. The IT services exports is estimated to be US$33.5b in 2010-11 as compared

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10 Cygnus – Industry Insight – Indian pharmaceutical Market - Industry Overview - Dec 2010

to US$27.3b in 2009-10, showing a growth of 22.7%. BPO exports are estimated to grow from US$12.4b in 2009-10 to US$14.2b in 2010-11, a year-on year (y-o-y) growth of 14.5%. IT services contributed 57% of total IT-BPO exports in 2010-11, followed by BPO at 24% and Software products/engineering services at 19%. The industry's proportion of total exports was 26% in 2010–11, which is expected to increase to 30% by 2020.

The revenue from the domestic market (IT Services, software products and BPO) is expected to grow from US$14.2b in 2009-10 to US$17.1b in 2010-11, an expected growth of around 20.4%. IT services registered the fastest growth among all sub-segments of the IT industry between 2007 and 2011, increasing at a CAGR of 18.4%. Export growth was led by the revival of discretionary IT spending following the economic downturn.

India is regarded as the premier destination for the global sourcing of IT-ITeS, accounting for almost 55% in 2010 up from 51% in 2009, of the global sourcing market. India remains an integral part of the global sourcing strategy, and registered a growth rate of twice that of other competitors in the global sourcing arena. It is estimated that India-based resources account for around 60%–70% of the offshore delivery capacities available across the leading multinational IT-BPO players.

## Regulatory scenario

In its efforts to encourage the foreign investment in the IT–ITeS sector, the government had come up with conducive and facilitative trade policies, which included export-related incentives under the SEZ schemes. SEZs have been a huge success story especially for the IT/ITeS industry, in view of fiscal and tax incentives in the past.

The earlier position of the government to phase out export-related incentives enjoyed by the IT-ITeS sector under the Direct Tax Code has been revisited. The deduction allowed under the repealed Income Tax Act shall continue to be allowed under this Code, if manufacture or production of articles or things or provision of any service in the unit in the Special Economic Zone commence on or before 31 March 2014.

With the passage of Information Technology (Amendment) Act 2008, the Indian Computer Emergency Response Team (ICERT) has been designated as a nodal agency for coordinating all matters related to cyber security and emergency response. It is now assigned with the task of managing the Indian cyber space, including enhanced cyber protection, enabling security compliance and assurance in government and critical sectors, and facilitating early warning and response as well as information sharing and cooperation. In order to have the optimum uptime and to support 24x7 operations of ICERT, initiatives have been taken to setup a disaster recovery site.

## Recent developments and industry outlooks

The Indian IT industry continues to have a positive outlook given the improving global environment, growth and maturity of the domestic market and rising technology spends by corporate and the government in particular. Nevertheless, the industry will need to cope with rising inflationary trends, pricing pressures and competition from low-cost jurisdictions.

From a Technology Policy/e-governance stand-point:

- The government has clearly recognized the strong potential of IT to re-boot the progress on key national projects related to inclusive growth
- The implementation of the UID project, National Knowledge Network and other key projects such as National Information Utility, etc., are expected to improve efficiencies, as well as boost demand for IT in the country
- The government has also introduced a slew of significant IT initiatives to support and improve tax administration. On the GST roadmap, significant emphasis has been placed by the Finance Minister to set up the IT infrastructure/design

The phenomenal growth of the Indian IT-ITeS sector have resulted in the addition of 240,000 new jobs in 2010–11, taking the total number of employees to 2.54m in the sector. Further, the industry generated around 8.3m indirect jobs. The exports market accounts for 2m employees, or close to 80% of the industry's workforce. According to industry estimates, by 2020, the sector will provide 10m direct and 20m indirect jobs.

While India's GDP is expected to grow by more than 8% year-on-year (y-o-y) for the next five years, its IT industry is well on track to outpace this projection.

# B.7 Insurance

The Indian insurance industry has undergone a major transformation over the past decade and has evolved into a considerably competitive market.

A growing middle-class segment, rising income levels, increasing awareness about insurance, higher investments and infrastructure spending have laid a strong foundation to expand the insurance market in India. The total penetration of insurance (premium as a percentage of GDP) has increased manifold from 1.90% in FY00 to 6.72% in FY10.This progress has been further aided by better products, e.g., whole life, auto assistance, wellness and emergence of wide-ranging distribution channels, e.g., bancassurance, broking, corporate agency, online insurance etc.

## Regulatory scenario

The Insurance Regulatory and Development Agency (IRDA) regulates the insurance and reinsurance business in India. The IRDA Act of 2000 addresses issues related to ownership, solvency, investment portfolio construction, commission structures, reporting formats and accounting standards.

The minimum paid up equity capital requirement has been set at INR1b. The insurance business is a capital intensive one and the companies are likely to require regular capital infusion for funding expected losses and meeting solvency requirements. FDI (including FII and NRI investments) by a foreign partner is currently capped at 26% in an Indian insurance company joint venture.

The much-awaited Insurance Laws (Amendment Bill), 2008 was introduced in the Parliament and is pending with the standing committee on finance for its report.

Some of the key amendments proposed in the Bill are as follows:

- Increasing FDI limits in the insurance sector from 26% to 49%
- Introducing "Health insurance business" as a separate category of insurance (the other categories being life and general insurance); minimum paid-up capital of INR500m (US$10m approximately) prescribed for standalone health insurance companies.
- Allowing foreign reinsurance companies to set up their branches in India

## Recent developments and industry outlook

Years 2010 and 2011 have witnessed path-breaking changes across several dimensions of the insurance landscape, be it products, distribution, fund raising or strategy. Various regulatory changes that have come up are as follows:

- **To make the Unit Linked Insurance Plans (ULIPs) a long-term protection contract** IRDA made several structural changes in ULIPs, such as increasing the lock-in period, doing away with excesses, etc. These measures changed the overall landscape for private insurers, which had around 80% of their product portfolio consisting of ULIPs. This reduced the attractiveness of ULIPs for insurers, distributors and customers to some extent.
- **To increase persistency and bring discipline among agents** IRDA has issued strict license renewal norms such as need for minimum business requirement.
- **To improve claims ratio and solvency margin,** IRDA has increased the third party motor premium from April 2011.
- **To promote healthy competition and improve service standards,** health insurance portability is slated to be introduced from the second half of 2011. This will allow the consumers to shift their insurance companies without forfeiting the benefits.

- **To safeguard policyholder's interest and improve customer satisfaction,** outsourcing of "non-core" activities was allowed by the IRDA.

In February 2011, the IRDA released an exposure draft, laying down the framework for amalgamation of non-life insurance companies. This is expected to bring about a wave of consolidation among the non-life players, majority of which are incurring losses. Currently the private non-life sector is fragmented. There are several small players, which are likely to merge with large players or with each other to gain market share. With limited number of large players, the industry will experience healthy competition, improved customer service and operating efficiency.

The framework contains guidelines pertaining to protection of policy holders, rationalization of the branch network, streamlining of products, taxation and valuation issues and projected revenue of the merged entity. Subsequently, the IRDA released the Scheme of Amalgamation and Transfer of General Insurance Business Regulations.

In June 2011, the IRDA has also released draft regulations specifying the manner and procedure of issuing capital/divesting excess share capital by life insurance companies and disclosure requirements to be complied with.

The insurance sector in India has been through a bumpy ride for some time now. Though the premium income has grown at a CAGR of 20% in the last decade, the pace of growth is expected to slow down to around 15% for the next 10 years.

The sector is going through a transition phase. IRDA has been increasing its checks on the market practices adopted by insurance firms. This is basically to provide customers with products, which are more beneficial to them in the long run and improve the credibility of the industry in the market. Regulatory changes for pension plans and ULIPs are expected to push insurance companies to increase the term of the policies, reduce mis-selling of policies and promote traditional policies, which are not in vogue any more.

# B.8 Media & Entertainment

With more than 600 television (TV) channels, 100m pay-TV households, 70,000 newspapers and 1,000 films produced annually, India's vibrant media and entertainment (M&E) industry provides attractive growth opportunities for global corporations. In 2010, the industry size was estimated at US$17.1b and is projected to reach US$31.2b by 2015, at a CAGR of 12.8%[11].

## Regulatory scenario

The Ministry of Information and Broadcasting (MIB) is responsible for laws, rules and regulations related to information, broadcasting, the press and films. TRAI is the regulator for broadcasting and cable services.

The Cinematograph Act, 1952 and the Prasar Bharati (Broadcasting Corporation of India) Act, 1990 regulate the functioning of films as well as national television and radio. Cinema exhibition rules and entertainment tax regulations are state-specific and almost all states have enacted laws on these.

In recent years, the GoI has taken various initiatives such as relaxing foreign entry norms to create a conducive regulatory environment for the M&E industry.

FDI and foreign institutional investor (FII) investment by segments.

11 "Media in India," Datamonitor, September 2010, via Thomson Research

| Segment | Sectoral limits (%) |
|---|---|
| **Broadcasting** | |
| FM radio | 26 (FDI+NRI+PIO+FII)* |
| Cable network | 49 (FDI+NRI+PIO+FII) |
| DTH | 74 (FDI+NRI+PIO+FII) |
| Headend-in-the-sky | 74 (FDI+NRI+PIO+FII) |
| Setting up an uplinking facility hub | 49 (FDI+FII) |
| Uplinking news and current affairs channel | 26 (FDI+FII) |
| Uplinking non-news and current affairs channel | 100 |
| **Print media** | |
| Publishing of newspaper and periodicals dealing with news and current affairs | 26 (FDI+NRI+PIO+FII) |
| Publication of Indian editions of foreign magazines dealing with news and current affairs | 26 (FDI+NRI+PIO+FII) |
| Publication of scientific, technical or specialty magazines, journals and periodicals | 100 |
| Publication of facsimile editions of foreign newspapers | 100 |
| Others | |
| Advertising | 100 |
| Films, music and live entertainment | 100 |

*FDI=Foreign direct investment, NRI=Non-resident Indian, PIO=Person of Indian origin, FII=Foreign Institutional Investor

Source: Ministry of Commerce and Industry - Department of Industrial Policy and Promotion

## Recent developments and industry outlook

**Segmentwise recent developments:**

- **TV —** The expansion of digital distribution technologies such as Direct to Home (DTH), Conditional Access System (CAS), Internet Protocol Television (IPTV) is driving the growth in subscription revenue and reducing the reliance of TV players on advertising. Changing lifestyle patterns and increasing disposable incomes are fuelling the growth of niche channels. Further, consumption growth in tier-2 and tier-3 towns is driving advertiser interest in regional broadcast markets.
- **Print —** The segment continues to grow in India amid significant revenue decline across the globe. Newspaper companies are entering other businesses such as internet, TV, education, events and experiential marketing, radio and out-of-home advertising. Rising literacy rates and faster growth in non-metros have led the publishers to expand in these markets.
- **Film —** Digital distribution of films has reduced costs, increased scale and reduced piracy. Rising multiplex penetration in smaller towns is expected to drive per person realization. Film studios are exploiting ancillary streams of revenue such as pay-per-view, mobile and online gaming and licensing and merchandising. The pre-sale of satellite and home-video rights has also gained momentum. Low-budget, content-driven movies based on high-quality scripts are gaining acceptability among the mainstream audiences. On the financing side, producers are able to leverage organized sources of financing such as banks loans and film funds.
- **Radio —** Advertisers are warming up to the medium as radio companies develop integrated marketing solutions, including out-of-home advertising, events and activations. The yet-to-be-announced phase III FM radio licensing policy is likely to open up the sector to almost 700 new stations across 220 towns. A recent order by the Copyright Board linking royalty rates to stations' revenue will make several smaller stations commercially viable.

- **Sports –** The Indian Premier League (T20) has demonstrated the huge commercial potential of sports in India. Rising awareness and interest in sports other than cricket, such as hockey, soccer, wrestling and tennis presents significant commercialization opportunities. Large private groups have entered long-term agreements to develop sports other than cricket.
- **Others —** Consumption of music on mobile and internet is rising. Increasing internet penetration is driving the popularity of social media as marketing and gaming platform. Segments such as animation, gaming and VFX are gaining traction with the development of original IP-based movies and games. Improvement in street furniture and urbanization are increasing the growth of out-of-home (OOH) advertising.

## Industry outlook

- Digital technologies are likely to become increasingly pervasive across all segments of entertainment and media
- There is likelihood of Indian players scaling up through consolidation/diversification across the value chain
- Tier-2 and tier-3 markets are likely to drive growth in M&E companies
- It is expected that there will be a steady increase in the average revenue per user (ARPU) through digital distribution platforms

With favorable demographics and a rise in disposable incomes, the propensity to spend on leisure and entertainment is likely to continue growing. Low penetration of various media such as television and print provide attractive growth opportunities to the industry. The industry is projected to grow at double-digit rates over the medium term [12].

12 "Initiating Coverage on Media & Entertainment Sector," Spark Capital Advisors (India), 3 January 2011, via Thomson Research.

# B.9 Mining & metals

Mineral wealth of a country is pivotal to its industrial development, since minerals provide basic raw material for most industries. As an ancillary activity of the manufacturing industry, mining contributes to wealth creation through foreign exchange and employment generation. India develops 87 minerals, which include 4 fuels, 10 metallic, 47 non-metallic, 3 atomic and 23 minor minerals (including building and other material). The country holds abundant reserves of key minerals such as iron ore, bauxite, dolomite, gypsum, limestone and mica. In fact, India is one of the leading producers of key minerals such as iron ore and bauxite.

The mining sector is an important segment of the Indian economy and along with the quarrying sector contributes more than 2% to the country's economy.

## Regulatory scenario

The Mines and Minerals Development and Regulation Act 1957 (MMDR Act) lays down the overall framework for the regulation of mines and the development of minerals in India (except petroleum and natural gas). According to the Mineral Concession Rules 1960 (MCR 1960), which was framed under the MMDR Act, the Central Government gives concessions to all minerals other than atomic and minor minerals. State governments, on the other hand, frame rules for the mining of minor minerals.

The Ministry of Mines is the main regulating body for the administration of the MMDR Act for all mines and minerals (excluding coal, natural gas and petroleum). Key bodies under the Ministry of Mines include the Geological Survey of India (GSI), the Indian Bureau of Mines and the Directorate General of Mines Safety. At the state level, respective regional arms of the Directorate of Mining & Geology regulate industry activity. Meanwhile, the Ministry of Coal is responsible for the development of coal reserves in India.

FDI of up to 100% is allowed under the automatic route for exploration and mining of minerals, including diamond and precious stones. However, no FDI/private investment is permitted in coal mining, except for captive consumption by power, cement, iron and steel companies.

## Recent developments and industry outlook

In an effort to improve prospecting and mining activity in India, the GoI issued the National Mineral Policy in 2008. Succeeding the earlier National Mineral Policy 1993, this policy envisages an improved regulatory environment and more transparency in the allocation of mining concessions.

As a way forward to the policy, the GoI is presently undertaking a comprehensive review of key acts and regulations such as the MMDR Act. The draft version of the proposed legislation was referred to a group of ministers who have held a series of meetings with various stakeholders. After incorporating the suggestions made, the proposed legislation is at present under legal vetting and on completion of this exercise will be presented before the Cabinet for approval.

The amended legislation is expected to improve the country's regulatory environment; making it more transparent and simple; inculcate clarity on grants of mineral concessions and help build a sustainable development framework for the Indian mining sector.

Separately, in the Budget 2011, the effective rate of export duty for all types of iron ore was unified at 20% ad valorem. Moreover, full exemption was provided to iron ore pellets from export duty.

In terms of industry outlook, India's mineral basket is all set for unprecedented growth due to the rich mineral reserves. In such a scenario, the GoI, the industry and state governments must collaborate to showcase the country's mineral potential globally.

# B.10 Oil and gas

India is the world's fourth-largest consumer of primary energy, with its primary energy consumption growing at a CAGR of 5.9% between 2000 and 2010 as compared to a global average of 2.8%[13]. The country's primary energy requirement is expected to more than double over the next two decades. Oil and gas currently accounts for 40% of its primary commercial energy consumption, and this share is projected to increase marginally over the next two decades[14].

During the last decade, the consumption of oil and gas has risen sharply (at a CAGR of 3.9% and 8.9%, respectively, during 2000–2010) in the country [15]. This has resulted in increasing reliance on crude imports to meet domestic demand requirements, with approximately 80% of the demand for crude oil being met through imports during 2010–11[16].

The Indian oil and gas industry has been traditionally dominated by national oil companies. Private companies such as Reliance Industries Ltd., Essar Oil Limited, Gujarat Adani Energy Limited and Gujarat Gas Corporation Ltd. have emerged as prominent players across the country's industry segments over the past decade. Foreign players with a significant presence in the Indian oil and gas sector include BG, BP, Cairn Energy and Royal Dutch Shell.

## Regulatory scenario

The industry is under the administrative ambit of the MoPNG. FDI of up to 100% under the automatic route (subject to sectoral policy regulation) is permitted in all activities except in the case of refineries owned by national oil companies.

13 BP Statistical Review 2011

14 Hydrocarbons Vision 2025

15 BP Statistical Review 2011

16 Petroleum Planning and Analysis Cell

The Petroleum and Natural Gas Regulatory Board (PNGRB) has been constituted as an independent regulator for the midstream and downstream segments of the industry. In the upstream segment, the Directorate General of Hydrocarbons continues to function as a quasi-regulator under the aegis of the MoPNG.

## Recent developments and industry outlook

In the upstream segment, the NELP has given a boost to private investment and an added impetus to exploration and production (E&P) activity — production sharing contracts (PSC) for 234 blocks have been signed during the first eight rounds of NELP, in which exploration investments of US$15b are expected to be made. Increased E&P activity under NELP has also facilitated some world-class discoveries, among which, the Krishna-Godavari basin gas discoveries of Gujarat State Petroleum Corporation and Reliance Industries Limited are the most noteworthy.

In the downstream refining segment, India's capacity has increased by more than 65% between 2000 and 2010, making the country a net exporter of petroleum products, with net exports of 39.4 m tonnes (MT) during 2010–11[17]. India's growing petroleum product surplus will also provide it with the opportunity to emerge as a regional refining hub. Further, increased availability of gas has ramped up its consumption, particularly in the industrial and city gas distribution (CGD) segments.

In future, the demand-supply gap in the oil and gas segment is projected to increase even further, due to the high growth in demand of oil and gas. Significant investments are expected to be undertaken to capitalize on the opportunities created by this growing demand.

In the upstream segment, the plan of introducing open acreage licensing policy is expected to result in large investments and new opportunities for upstream companies and service providers.

17 Petroleum Planning and Analysis Cell

In the natural gas segment, significant investment is expected to take place to set up new gas transmission and distribution pipelines and CGD networks.

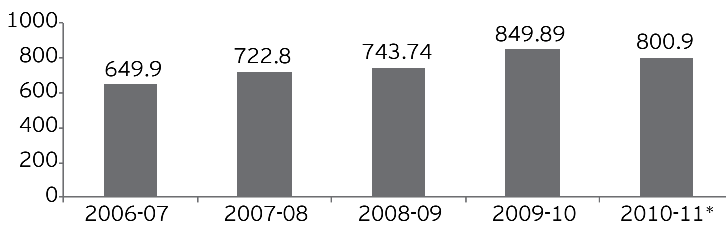
# B.11 Ports

## Overview

India has 13 major ports and approximately 200 non-major ports, accounting for 95% of the country's total trade in terms of volume and approximately 70% in terms of value. In FY10, major ports accounted for approximately 66.0% of the total cargo traffic, while the remaining traffic was handled by the non-major ports. Indian ports are currently operating at 90% utilization.

Cargo traffic at Indian ports has increased at a CAGR of 9.3% between FY07 and FY10.

**Total cargo traffic (in million tonnes)**




*Only for major ports and Gujarat Maritime Board (GMB)
Source: IPA; Sector focus- Ports and shipping, India Infrastructure

## Regulatory scenario

In India, ports are under the purview of the concurrent list of the Indian constitution. The major ports are governed by the GoI while non-major ports are administered by the state governments. Some of the key legislations formulated to govern Indian ports include the Major Port Trusts Act, 1963, Tariff Authority for Major Ports and The Major Ports Regulatory Authority Act, 2009.

FDI of up to 100% is permissible in Indian ports under the automatic route.

## Recent developments and industry outlook

In 2005, the GoI launched the National Maritime Development Programme (NMDP) with a total proposed investment of INR1,003b. The program was expected to enhance private investment and improve the service quality in the maritime sector. In July 2010, the GoI announced its plans to install radiation monitoring portals (RMPs) at all major ports by 2012. In 2010, another significant development was the declaration of Port Blair as the thirteenth major port by the GoI.

Further, the GoI has empowered all port authorities to provide contracts to the final bidders under the PPP mode. In FY10, 13 projects of 66m tonnes capacity were awarded under the PPP mode, and in FY11 the ministry targeted to award 25 PPP projects. More than 24 greenfield ports worth INR587b are expected to be commissioned between 2016 and 2025. These projects will add a capacity of around 835m tonnes. Recently, port-based special economic zones have also gained popularity.

Another focus area for the GoI has been the development of inland container depots and container freight stations to facilitate cargo distribution at Indian ports. Container traffic at major ports has increased at a CAGR of 13.0% between FY06 and FY10. It is expected to increase from the current 6.8m twenty-feet equivalent units (TEUs) to 20m TEUs by 2020.

According to the revised estimates of the Planning Commission, the investment in the port sector during the Eleventh Five Year Plan is expected to be approximately INR406.47b, of which 80% is expected to be contributed by the private sector[18].

## B.12 Power (including Cleantech) and utilities

India's power generation capacity, as on 31 May 2011 (according to the Ministry of Power, Government of India) is estimated at around 174.9 GigaWatt GW (excluding captive power generating capacity of 19.5 GW), with the private sector contributing just over 21.8% of the installed capacity. Coal, gas and diesel fuel-based thermal power plants form a major portion (65%) of the installed capacity, accounting for nearly 113.9 GW of the total installed capacity in the country[19]. The share of renewable energy in the installed capacity increased from 3% in 2002 to around 11% in 2010[20]. During the first four years of the Eleventh plan period, renewable power capacity addition has been 10.7 GW, while thermal power capacity addition has been 26.8 GW, which corresponds to around 65% of the total capacity addition[21].

The total quantum of power generated in the country has increased from 704.5b units (BU) in FY07–08 to 788.4 BU in FY2010–11[22], recording a growth rate of 3.8% in the last four years. India's current inter-regional (national grid) power transmission capacity stands at

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18 "Eleventh Five Year Plan," Planning Commission website, www.planningcommission.gov.in, accessed 14 June 2011

19 "Monthly Review of Power Sector Reports (Executive Summary), May 2011," CEA website, http://cea.nic.in/executive_summary.html, accessed 13 July 2011.

20 Ministry of New and Renewable Energy annual report 2010-11

21 Monthly Review of Power Sector Reports (Executive Summary), March 2011," CEA website, http://cea.nic.in/reports/monthly/executive_rep/mar11/11.pdf, accessed 13 July 2011.

22 "Monthly Review of Power Sector Reports (Executive Summary), April 2011," CEA website, http://cea.nic.in/reports/monthly/executive_rep/apr11/25-26.pdf accessed 13 July 2011.

20.75 GW (February 2011) and is planned to be increased to 31.65 GW by the end of Eleventh plan, i.e., 31 March 2012[23].

However, the increase in power generation capacity and transmission networks has not kept pace with the growth in demand, which has resulted in a shortage in power supply in the country. Another major factor resulting in supply shortages is the persistent aggregate technical and commercial losses (AT&C) losses, which have averaged around 33% over the past years. At the end of FY11, the total electricity peak demand met was only 110.26 GW, resulting in a peak deficit of 9.8%, while the electricity energy availability was 788.4 BU, which has resulted in an energy deficit of 8.5%[24]. This is the situation, in spite of the stated aim of the government to achieve "power for all" by 2012.

According to the Union Minster of Power, Mr. Sushil Kumar Shinde, the scope of investment in sector is more than US$300b over the next few years. Investor confidence toward the sector is high given the oversubscription of IPOs by 13 to 77 times of the Ministry's undertakings[25] over the previous five to six years.

## Regulatory scenario

The power sector enjoys a favorable regulatory environment. The key turning point in reforms came through the Electricity Act of 2003, which was later amended in 2007. Some of the salient features of the act include allowing FDI of up to 100% in all power sector segments (excluding nuclear), freeing up open access terms, unbundling state-run utilities and paving way for privatization in distribution.

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23 "Existing Inter-Regional Power Transfer Capacity (MW)," Ministry of Power website, http://www.powermin.nic.in/JSP_SERVLETS/internal.jsp, accessed 13 July 2011.
24 Monthly Review of Power Sector Reports (Executive Summary), April 2011," CEA website, http://cea.nic.in/reports/monthly/executive_rep/apr11/25-26.pdf, accessed 13 July 2011.
25 "Scope for US$300b Investment in Power Sector: Sushilkumar Shinde India Invites Foreign Investors to Invest in Power Sector," Press Information Bureau website, http://pib.nic.in/newsite/erelease.aspx, accessed 13 July 2011.

In order to accelerate capacity addition and meet persistent supply shortages, the government is promoting ultra mega power projects (UMPPs). Each project is of 4 GW capacity. There are around 9 UMPPs proposed across India. Out of these, four projects have been successfully awarded and transferred to the winning bidders through a competitive bidding process.

The GoI has also taken many reforms to improve access to electricity to rural areas. Some of the notable initiatives include the Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY), which was launched in April 2005 aimed at electrifying villages in India and granting electricity connections to below poverty line (BPL) families, free of cost, with the GoI providing a 90% subsidy.

Further, the GoI also introduced the Restructured Accelerated Power Development and Reforms Programme (RAPDRP) to address high AT&C losses. Under this program, renovation and modernization of distribution networks along with establishment and upgrade of IT applications is being undertaken to increase efficiency across energy accounting/auditing and overall consumer services.

On the renewable energy front, the Renewable Purchase Obligation (RPO) policy of the GoI mandates distribution companies and other obligated entities to purchase a percentage of their total requirement from renewable sources. In addition, India launched the renewable energy certificate (REC) mechanism in late 2010, to facilitate transfer of electricity from renewables sources from surplus regions to deficit regions.

## Recent developments and industry outlook

The sector recorded highest ever capacity additions during 2010–11 of around 16 GW. These additions were made mainly across hydro and thermal projects and included developers such as Adani Power, Reliance Power, Tata Power and NTPC[26]. In May 2011, the GoI released

26 "15795 MW Highest Ever Capacity Addition in the Power Sector During 2010-11: Shinde," Press Information Bureau website, http://pib.nic.in/newsite/erelease.aspx, accessed 13 July 2011.

INR40b toward RAPDRP. Out of these around INR39b will be disbursed to state utilities as loans and the remaining will be given out as grants[27].

The Ministry of Power notified amendment to the Tariff Policy, 2006 in February 2011, requiring the State Electricity Regulators to fix a minimum percentage of total consumption of electricity for purchase of solar energy, which will go up to 0.25% by the end of financial year 2012–13 and further up to 3% by 2022. The same will be facilitated by solar specific Renewal Energy Certificate (REC) mechanism.

The Ministry has also unveiled a strategic plan to achieve achieving a power generation target of 41.4 GW through grid connective renewable energy resources by FY16–17.

India launched its Smart Grid Forum in March 2011, aimed at expediting development of smart grid technologies in the country. The forum will be a consortium of private and public stakeholders[28].

In terms of a long-term outlook of the sector, it is expected that in addition to domestic coal, which has been the mainstay of the Indian generation capacity, power plants based on imported coal and super critical technology and also nuclear energy are expected to drive growth in the conventional energy segment. The impetus given to the solar and wind segment through the Jawaharlal Nehru National Solar Mission (JNNSM) and generation-based incentive scheme (GBI), is likely to drive substantial renewable energy growth.

The government's independent transmission projects initiative, along with related state initiatives, is expected to open new opportunities in the transmission BOT sector, thereby attracting both Indian and international developers. Increasing number of distribution assets are expected to be owned by private players as a result of unbundling of

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27 "Government Releases Funds for Power Development and Reforms Projects," Press Information Bureau website, http://pib.nic.in/newsite/erelease.aspx, accessed 13 July 2011.

28 "India Smart Grid Forum Website Launched," Press Information Bureau website, http://pib.nic.in/newsite/erelease.aspx, accessed 13 July 2011.

state utilities in order to address high T&D losses and ensure long-term sustainability of the Indian power sector.

The Indian power sector faces challenge of equipment shortage in the boiler, turbine and generator (BTG) segment. This is expected to improve as Chinese exports increase and domestic private players in collaboration with foreign majors enter the power equipment manufacturing sector.

The sector will witness increasing private sector investments as the role of private players will become key to ensure viability of the Indian power sector, which is faced with a high historical demand supply gap. It is becoming a challenge to bridge this gap on the back of rapid pace of economic growth, increased per capita consumption, electrification of villages and rural households and the continuing pace of urbanization. As a result, increased participation of the private sector in the backdrop of a favorable regulatory environment is inevitable.

## B.13 Real estate

The Indian real estate industry has been on a roller coaster ride since 2007, riding through many highs and lows. The industry reached new heights with increased development activity during 2007 and early 2008, characterized by growth in demand and increased foreign investments. However, by mid-2008, this scenario took a U-turn, as the industry witnessed a decline due to the ripple effect of the global economic slowdown. The Indian real estate industry is witnessing some vibrancy and upbeat market sentiments after the steep corrections during the global financial crisis in 2008–09. Global economic performance is improving and so are the prospects of Indian businesses. With the Indian economy expected to grow at the rate of approximately 8% to 8.5% during the current year the real estate sector in India is now on a gradual improvement curve.

The residential segment makes up the most of real estate industry in the country. Growth in this segment is primarily driven by increasing urbanization, rise in the number of white-collar professionals and rising incomes, etc. The residential segment is again witnessing growth in the demand for luxury and super-premium homes among the globe-trotting executives, new and successful businessmen, non-resident Indians (NRIs), etc. However, this sub-segment is currently experiencing low volumes due to steep price rise and hike in interest rates; this may be a short term lull and with minor corrections the segment may continue to grow.

The commercial real estate segment (primarily office space) is growing in tandem with the country's booming economy. The demand for office space is driven by the influx of multinational companies and growth in services sector. Overall, on pan-India basis, the demand for office space is expected to total 180m square feet by 2013, with seven major cities (Bengaluru, Chennai, Hyderabad, Kolkata, Mumbai, the NCR and Pune) catering to 75% of the total demand.

Although the retail real estate segment has the smallest pie in the real estate industry, it is growing rapidly and the demand for good quality mall space is fuelled by the growth in organized retail and the entry of international retailers into India. Over the past few years, retail has become one of the fastest growing industries in the country. Increasing disposable incomes, rising consumption and shopping convenience have been driving the growth of organized retail. The Indian retail industry in expected to reach US$637b by 2015, with organized retail accounting for a 14% to 18% share. However, the rental market in the Indian retail segment is yet to stabilize as the supply continues to outstrip demand.

The hospitality segment has also been witnessing a robust demand, primarily due to a strong growth in tourism, including business and leisure travel. According to research conducted by the World Travel & Tourism Council, travel and tourism in India is expected to grow at 12.7% till 2019. India is emerging as a major tourist destination for international tourists. The Foreign tourist arrivals (FTAs) in India have increased at a CAGR of 7.7% between 2000 and 2010 to reach 5.5m. During the same period, foreign exchange earnings from tourism increased by a CAGR of more than 15% to INR648.8b. FTAs during the period January–June 2011 were 2.9m with a growth of 10.9% , FEE from tourism during the same period was INR35.1b with a growth of 12.1%, In 2010, the GoI introduced the Visa-on-Arrival (VoA) scheme for tourists from five countries, namely Singapore, Finland, New Zealand, Luxembourg and Japan. More recently, starting January 2011, the VoA scheme has also been extended to the nationals of Cambodia, Vietnam, Laos, the Philippines, Myanmar and Indonesia. Further, medical tourism has also been on an up-trend, especially in Kerala and Tamil Nadu. Also, attracted by India's fast growing hospitality industry, international hotel chains such as Hilton, Marriot, Starwood, etc have announced their plans for extensive expansion in the country.

Some of the key trends in the Indian real estate sector include geographic de-concentration of real estate activity from large metros (such as Bengaluru, Mumbai and Delhi-NCR) to medium and small cities (such as Chandigarh, Pune, Jaipur, Kochi, Visakhapatnam, etc.) and development of mixed-use projects encompassing residential, commercial and retail complexes, increase in demand for affordable housing, etc.

## Regulatory scenario

### Foreign direct investment (FDI) regulations

FDI up to 100% is permitted under automatic route in:

- Townships, housing, built-up infrastructure and construction – development projects (including housing, commercial premises, educational institutions, recreational facilities, etc) under automatic route, subject to prescribed conditions**
- Establishment and operation of hotels
- Establishment and operation of hospitals
- Set up of SEZs
- Set up of industrial parks

**The prescribed conditions are as follows:

- Subject to area restrictions (10 Hectares for service housing plots; others-50,000 sq mts)
- Minimum capitalization – US$10m (US$5m in case of JV with an Indian partner)
- Lock in — each tranche of foreign investment locked in for three years from infusion
- 50% of the project to be completed within 5 years of all statutory clearance
- Sale of undeveloped land not permitted

The abovementioned conditions will not be applicable on investments made into SEZ, Hotels, Hospitals, Industrial Parks and investments by NRIs.

**External Commercial Borrowings (ECBs) regulations**

ECBs, per se, are not permitted in the real estate sector in India. However, ECBs can be accessed by developers of Special Economic Zones (SEZs), under the approval route, to provide infrastructural facilities within the SEZ.

## Recent developments and industry outlook

Some key policy measures initiated by the government with relation to the real estate industry include:

- Interest subvention of 1% on all housing loans taken by individuals (up to INR1.5 m), provided the cost of a house does not exceed INR2.5m
- Allocation of INR30b made for Rural Housing Fund
- Creation of Mortgage Risk Guarantee Fund to enhance credit worthiness and guarantee housing loans taken by the Economically Weaker Sections (EWS) and Low Income Group (LIG) households
- To boost infrastructure development in railways, ports, housing and highways, tax free bonds of INR300b is to be issued by various government undertakings during 2011–12, including bonds to be issued by Housing and Urban Development Corporation of INR50b

Indian economy is currently going through an inflationary phase. This inflationary environment is leading to increase in input costs (e.g., for steel and cement) for developers, which has been putting pressure on the cost of projects and profit margins. The RBI has been taking various monetary measures to curb inflation, including tightening of interest rates, leading to curtailment of funds flowing into the Indian real estate industry. Recently, the rising home loan rates and the steep price rise of properties have also dampened demand for residential units.

Overall, the long-term view for the Indian real estate industry is positive since its fundamental demand drivers — increasing urbanization, favorable demographics, growth of the services sector and rising incomes are still intact.

## B.14 Retail and consumer products

With an estimated market size of US$395b in 2011, India's retail sector is at the peak of its appeal for international and Indian players. Being the second-largest employer after agriculture, this sector is expected to grow to US$785b by 2014, ensuring that the retail sector continues to be one of the mainstays of the Indian economy. Modern retail accounted for approximately 6.5% of the total retail market in India in 2008–09. This share is expected to increase to approximately 9.4% by 2013–14 with the entry of a number of corporate organizations into the segment.

### Regulatory scenario

Up to 100% FDI is allowed under the automatic route in cash-and-carry wholesale trading and export trading. Up to 51% FDI, with prior government approval is permitted in retailing of "single-brand" products. The GoI is likely to adopt a calibrated approach, to further open up the industry to foreign investment in areas such as multi-brand retail.

## Recent developments and industry outlook

Many large Indian conglomerates and business houses are showing a strong interest or making a significant headway in the retail sector. It is estimated that the organized retail segment will grow at 22.3% annually to reach a market size of approximately US$57b by 2013–14. The demand for international brands is showing a healthy uptrend. Further the growing presence of domestic companies across the different retail verticals is giving the Indian organized market a strong boost.

Changing lifestyles, strong income growth and favorable demographic patterns have resulted in huge expansion of Indian retail.

The small town and rural revolution in India is also proliferating rapidly, driven by rising purchasing power, changing consumption patterns, easy access to information and communication technology, as well as improved infrastructure and government initiatives to boost the rural economy.

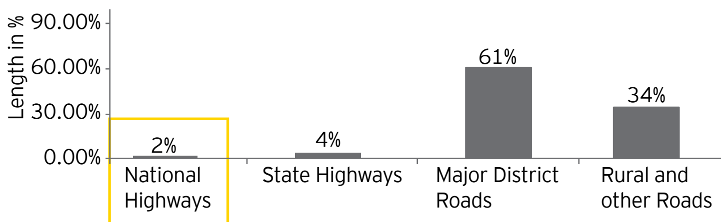
# B.15 Roads and highways

## Overview

India has one of the largest road networks in the world, spread across approximately 4.2m km. Roads are the preferred mode of transportation in the country and account for 87.4% of passenger traffic and 60% of freight traffic. National highways, which account for only around 2% of the country's total road length, bear around 40% of the total traffic. In the last five years, the number of vehicles in the country has grown at 10% annually[29].

29 Ministry of Road Transport and Highways 2010–11 annual report

**Road network (FY11)**




Source: Ministry of Road Transport and Highways 2010-11 annual report

## Regulatory scenario

In India, National Highways are administered by the Ministry of Shipping, Road Transport and Highways (MOSRTH) and the National Highway Authority of India (NHAI). State highways and major district roads are governed by state public works departments and road development corporations. Rural roads are monitored and maintained by the Ministry of Rural Development (MoRD).

As roads form an integral part of the economic and social development of a country, the GoI has made concerted efforts to improve road connectivity in India. It has announced policy measures to attract foreign and domestic private investment for road development. Some of these policy measures include permission of up to 100% FDI and provision of capital grants of up to 40% of the project cost to enhance the viability of projects.

Additionally, the government has also announced policy measures to create substantial opportunities for private investors and increase the scope of PPP on road projects. Over the years, private investment in the sector has increased considerably and is expected to increase from INR63b during the Tenth Five Year Plan (2002-07) to INR450b in the Eleventh Five Year Plan (2007-12)[30].

30 Sector focus- Roads and bridges, India Infrastructure, August 2010, p. 46

## Recent developments and industry outlook

The GoI has launched the National Highway Development Programme (NHDP) to improve and maintain the road network in the country. The primary objective of the NHDP is to develop and upgrade more than 50,000 kms of national highways, in seven phases, with an investment of INR2, 356.9b till 2015.

| Projects | Total length (km) | Already four-laned (km) | Under implementation (km) | Contracts under implementation (no.) | Balance length to be awarded (km) |
|---|---|---|---|---|---|
| GQ* | 5,846 | 5,824 | 22 | 8 | - |
| NSEW** Phase I and II | 7,300 | 5,683 | 1,038 | 88 | 421 |
| NHDP Phase III | 12,109 | 2,294 | 5,805 | 83 | 4,010 |
| NHDP Phase V | 6,500 | 596 | 1,918 | 18 | 3,986 |
| NHDP Phase VI | 1,000 | - | - | - | 1,000 |
| NHDP Phase VII | 700 | - | 41 | 2 | 659 |
| SARDP-NE | 388 | - | 112 | 2 | 276 |
| NHDP Phase IV | 14,799 | - | 765 | 5 | 14,034 |
| NHDP Total | 48,642 | 14,397 | 9,701 | 206 | 24,386 |
| Port connectivity | 380 | 316 | 64 | 4 | 0 |
| Others | 1,383 | 936 | 427 | 6 | 20 |
| **Total by the NHAI** | **50,405** | **15,649** | **10,912** | **216** | **24,406** |

The funds for the program are being arranged through budgetary allocation, a central road fund as well as external assistance and market borrowing. Till December 2010, a total of INR208.09b had already been spent on NHDP projects[31].

31 Ministry of Road Transport and Highways 2010–11 annual report

The GoI has also launched the Pradhan Mantri Gram Sadak Yojana (PMGSY) to provide connectivity to isolated rural habitations in the country. Under the program , around 4, 19,000 km roads have been cleared as of November 2010. This will benefit 1, 07,974 habitations, and will have an estimated cost of INR1,182.98b[32].

In FY11, the Ministry of Road Transport and Highways lowered its initial target of developing 20 km of national highways per day to around 12–13 km per day, due to lack of adequate infrastructure and technology[33].

According to the revised estimates of the Planning Commission, total investment in the road sector during the Eleventh Five Year Plan (2007–2012) will amount to approximately INR2,786.5b, of which 16.5% is expected to be contributed by the private sector[34].

## B.16 Telecommunications

The telecom sector has played a pivotal role in the socioeconomic development of India. In fact, the Indian telecom sector is one of the key architects of the accelerated growth and progress of other segments of the economy. Enhanced connectivity improves governance, business communication, security, response to emergencies and the overall strengthening of the country's socio-cultural ethos. The contribution of the telecom sector has had a multiplier effect on the socioeconomic growth due to associated individuals and businesses.

In recent times, India has emerged as one of the fastest growing telecom markets in the world, particularly due to the unprecedented growth in mobile telephony, and is currently the world's second-largest

32 "Economic survey 2010-11," Union Budget and Economic Survey website, indiabudget.nic.in/, accessed 15 June 2011

33 Sector focus- Roads and bridges, India Infrastructure, August 2010, p. 44

34 "Development of Infrastructure: Eleventh Five Year Plan- volume I, chapter 12," Planning Commission website, www.planningcommission.gov.in, accessed 14 June 2011

telecom market in terms of subscriber base. This high growth rate has been achieved primarily due to sharp fall in tariffs fueled by intense competition in the market. The Indian telecom network had 861.5 m connections by 2010–11[35]. With 826.9 m wireless connections [36], Indian telecom has become the second-largest wireless network in the world after China. The GoI is taking various measures to increase the tele-density in rural areas where it was at 33.35% in 2010–11 as compared to the overall tele-density of 70.89% as on 2010–11.

The considerable growth of the telecom industry in India is being followed by the urge to move toward better technology and the next level of service delivery. In September 2010, 3G and BWA spectrum was assigned to the telecom operators and service providers based on an auction conducted by the Department of Telecommunication (DoT), Government of India. The government has already initiated the consultation process for 4G and LTE technology. While the last five years have been transformational for Indian telecom industry, the next few years look even more exciting. BWA will overcome the key hindrance of last mile connectivity in India, while 3G has the potential to make the mobile phone a ubiquitous device to access internet-based services. It is further expected that 3G and BWA will increase the demand for data-based services such as mobile payment, m-health, m-governance and m-education services.

## Regulatory scenario

The Indian telecommunications industry is supported by a strong regulatory framework, which ensures efficient policy development and administration.

35 "Telecom Subscription Data as on 31st March 2011," TRAI press release, www.trai.gov.in/WriteReadData/trai/upload/PressReleases/823/Press_Release_Mar-11.pdf, 31 March 2011.
36 Telecom Subscription Data as on 31st March 2011," TRAI press release, www.trai.gov.in/WriteReadData/trai/upload/PressReleases/823/Press_Release_Mar-11.pdf, 31 March 2011.

The telecom regulatory framework in India consists of, among others, the following key bodies:

- DoT is the central governing body for the telecommunication industry. It formulates the policies for the development of the sector, awards telecom licenses and is also responsible for frequency management.
- The Telecom Regulatory Authority of India (TRAI) regulates tariffs, advises the government about introducing new technologies and tracks the service providers to ensure that they adhere to the guidelines and meet the quality of service benchmarks.
- Telecom Disputes Settlement and Appellate Tribunal (TDSAT) have been set up to resolve all disputes between a licensor and a licensee, two or more service providers, between a service provider and a group of consumers.
- Foreign Direct Investment (FDI) in companies engaged in various telecommunication services is permitted as follows:
- Telecom operators operating in basic, cellular, unified access, national/international long distance, V-Sat, public mobile radio trunked services (PMRTS), global mobile personal communications services (GMPCS), other value added services, ISP, radio paging and end to end bandwidth services — FDI up to 74% (49% under the automatic route) is permissible under the approval route.
- Infrastructure providers — FDI up to 100% (49% under the automatic route) is permissible under the approval route.
- Telecom equipment manufacturers — FDI up to 100% is allowed under the automatic route.

## Recent developments and industry outlook

### Allotment of 3G Spectrum and commercial launch of 3G telecom services

- Auction of 3G spectrum in 2.1 GHz band for 22 service areas and BWA spectrum in 2.3 GHz band was successfully completed in June

2010. The overall auction proceeds aggregated to INR1,062b, which was five times higher than the reserve price.

- DoT, vide notification dated 1 September 2010, amended the UAS license of various licensees to allow usage of 3G spectrum for provision of telecom access services.
- According to the terms of the amended license, the right to use 3G spectrum shall be valid for 20 years from the effective date (i.e., the later of 1 September 2010 and the date when the relevant service license is granted to the operator) unless revoked or surrendered earlier.
- The Licensee have been obligated to roll out 3G services in the relevant service area within five years of the effective date and shall be obligated to pay a spectrum usage charge (over and above the spectrum auction price) of 1% of Adjusted Gross Revenue (AGR) on a recurring basis from the date of award of right to use allocated spectrum commercially.
- Commercial operations of 3G services were launched by most operators by the end of 2010.

### Mobile Number Portability (MNP) services launched

Mobile Number Portability (MNP) service has been introduced in all telecom circles on 20 January 2011. MNP allows customers to retain their existing mobile number when they switch from one service provider to another or from one technology to another within the same service provider.

### Revised Security norms for Telecom Equipment used by telecom licensees

On 31 May 2011 DoT issued amendments in the telecom license to lay stringent rules regarding procurement of telecom equipment and making the service providers responsible for any security breach in their networks. Key features of the revised security norms are:

- Telecom operators are required to get the network security audited from a network audit and certification agency every year.

- Telecom operators can only import equipment certified as per Indian or international standards by any international agency till 31 March 2013. Thereafter, the equipment will have to be certified by authorized laboratories in India.
- The erstwhile clause, which required transfer of technology within three years for foreign equipment manufacturers and the requirement to keep the source code of their equipment in an escrow account has been removed.
- Before the aforesaid amendment, the penalty of up to 100% of the contract value can be imposed on vendors if spyware or malware are found on their equipment. Revised regulations make the telecom operator responsible for the security of equipment and the penalty amount has been rationalized to up to INR500m for each breach.
- Guidelines for monitoring and logging of all operation and maintenance commands for a period of 12 months has been prescribed. Moreover, storage of location details of subscribers has also been prescribed.

### Proposed New Telecom Policy (NTP) 2011

The existing telecom policy of India was formulated way back in 1999 with a view to propel the growth of telecommunication industry in India. On 1 January 2011 it has been announced that a New Telecom Policy (NTP) will be formulated, which will address key policy issues such as mergers and acquisitions, spectrum sharing and uniform revenue sharing license fee across circles. The New Telecom Policy (NTP) 2011 is proposed to be finalized by the end of this calendar year.

Chapter C.

# Investment climate and foreign trade

# C.1 Foreign investment framework

The Foreign Direct Investment (FDI) regime has been progressively liberalized during the course of the 1990s and continuing into the 2000s, with most restrictions on foreign investment being removed and procedures simplified. With limited exceptions, foreigners can invest directly in India, either on their own or as a joint venture.

Today, there are very few industries where foreign investment is prohibited. Moreover, investment ceilings, which are applicable in certain cases, are gradually being removed/phased out.

With the intent and objective to promote foreign direct investment through a policy framework, which is transparent, predictable, simple and reduces regulatory burden, the GoI has formulated on a biannual basis consolidated FDI Policy.

Features of the GoI's Consolidated FDI Policy and incentives offered by it:

- With the issue of consolidated FDI policy, all earlier press notes/press release/clarifications on FDI issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry (DIPP) stand rescinded and subsumed in the consolidated FDI Policy.
- Policy pronouncement on FDI by press notes/press releases take effect from the date of issue of press notes/press releases regardless of the procedural instructions, which shall be issued by the RBI vide relevant A.P. DIR series circulars for amending Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.
- Indian companies are permitted to issue equity shares, fully, compulsorily and mandatorily convertible debentures (FCD's) and compulsorily and mandatorily convertible preference shares (CCPS) to the non residents subject to pricing guidelines/valuation norms prescribed under FEMA.

- Issue of warrants, partly paid shares etc. require prior approval of Foreign Investment Promotion Board (FIPB). Issue of non-convertible, optionally convertible or partially convertible preference shares/debentures needs to comply with the external commercial borrowing (ECB) guidelines of RBI.
- Foreign Investment is calculated on the basis of ownership and control of the Indian company.
- No government approval is required for FDI in virtually all the sectors/activities, except for a small negative list formulated by the GoI.
- FIPB considers proposals for foreign participation that do not qualify for automatic approval.
- Decisions on all foreign investment proposals are usually taken within four to six weeks of submitting an application.
- Free repatriation of capital investment is permitted, provided the original investment (on a repatriable basis) was made in convertible foreign exchange. Further, free repatriation of profits on capital investment is permitted, subject to payment of taxes and other specified conditions.
- Use of foreign brand names/trademarks is permitted for the sale of goods in India.
- All royalty payments, lump sum fee for transfer of technology and for use of trademark/brand name are permitted under the automatic route without any monetary/duration limits.
- "Single window" clearance facilities and "investor escort services" are available in various states to simplify the approval process for new ventures.

## C.1.1 Foreign Investment Promotion Board

The FIPB is specially empowered and chaired by the Secretary of the Ministry of Finance (MoF). It has been specifically set up to expedite the approval process for foreign investment proposals.

Proposals for FDI may be sent to the FIPB, the Department of Economic Affairs, MoF or through any of India's diplomatic missions abroad. The FIPB has the flexibility to examine all the proposals in their totality, free from predetermined parameters or procedures.

The recommendations of the FIPB with respect to proposals under the ambit of the non-automatic route, involving an investment of US$266.67m (equivalent of INR12b) or less are considered and approved by the Finance Minister. Projects with an investment that is greater than this value are submitted by the FIPB to the Cabinet Committee on Economic Affairs for further approval.

## C.1.2 Foreign investment in India

### C.1.2.1 Foreign direct investment

The GoI permits FDI on an automatic basis, except with respect to a small negative list, which includes the following:

- Proposals falling under list of activities/sectors prohibited for FDI by the GoI
- Proposals falling outside the ambit of notified sectoral policy/caps

*For a list of the sectors in which FDI is prohibited/permitted with condition or sectoral cap, please see Appendix 4.*

### C.1.2.2 Foreign portfolio investment

Foreign Institutional Investments (FIIs) must register themselves with SEBI and comply with RBI's exchange control regulations.

Foreign pension funds, mutual funds, investment trusts, asset management companies, insurance or reinsurance companies, nominee companies and incorporated/institutional portfolio managers (or their power of attorney holders) are allowed to register as FIIs. FIIs can invest in securities traded in primary and secondary capital markets in India under the portfolio investment scheme. These securities include shares, debentures, warrants, units of mutual funds, government securities, treasury bills and derivative instruments.

Certain investment limits are prescribed in FII guidelines and RBI's regulations to regulate investments made by FIIs. However, these restrictions do not apply to the investments made by an FII through offshore funds, GDRs or Euro-convertible bonds.

#### Registration eligibility

FII guidelines require FIIs to meet certain qualifying conditions for registration. SEBI also examines whether the grant of registration is in the interest of the development of the Indian securities market.

#### Registration of sub-accounts

Apart from entities that are entitled to be FIIs, other foreign investors are also eligible for registration as sub-accounts. The sub-accounts can be categorized as (i) collective investment funds and institutions, (ii) proprietary funds or (iii) foreign corporations and nationals.

### C.1.2.3 Foreign Venture Capital Investment Route

A SEBI-registered Foreign Venture Capital Investor (FVCI) with specific approval from RBI under FEMA regulations can invest in Indian Venture Capital Undertaking (IVCU) or Indian Venture Capital Fund (IVCF) or in a scheme floated by such IVCFs, subject to the condition that the VCF should also be registered with SEBI.

FVCIs can purchase equity/equity-linked instruments, debt/debt instruments, the debentures of an IVCU, or of a VCF, through an IPO or private placement in units of schemes/funds set up by a VCF.

### C.1.2.4 Investment by NRIs

NRIs can invest in the shares or convertible debentures of an Indian company on a non-repatriable basis apart from investment in the form of FDI. These investments do not require FIPB approval and are not construed as FDI. NRIs cannot invest in companies that are engaged in certain financial service or agricultural/plantation activities. While the capital is non-repatriable, the dividends and interest income from such investments can be remitted as current account transactions.

## C.1.3 Foreign exchange controls

### Foreign exchange policy

Since 1991, the country's foreign exchange reserves have gone up from US$5b to approximately US$312.904b in June 2011.

Prior to 1999, India had stringent exchange control regulations under the Foreign Exchange Regulation Act, 1973 (FERA). In 1999, the GoI replaced controls under FERA with regulations under the FEMA.

With the introduction of FEMA in 1999, the objective of the GoI shifted from the conservation of foreign exchange to promoting orderly development and management of the foreign exchange market in India.

### Current account transactions

The rupee is fully convertible for trade and current account purposes. Except for certain specified restrictions where RBI approval is required, foreign currency may be freely purchased for trade and current account purposes.

### Capital account transactions

These transactions are not permitted unless they are specifically allowed and prescribed conditions are satisfied. Transactions specifically allowed include the following:

- Investment in India by a person resident outside India
- Acquisition and transfer of immovable property in India guaranteed by a person resident outside India in favor of or on behalf of a person resident in India
- Import and export of currency/currency notes into/from India by a person resident outside India
- Foreign currency accounts in India of a person resident outside the country
- Remittance outside India of the capital assets (held in India) of a person resident outside India

# C.2 Regional and international trade agreements

## Overview

Over the years, India has entered into numerous bilateral and regional trade agreements with key trading partners. Apart from offering preferential tariff rates on the trade of goods among member countries, these agreements also enable wider economic cooperation in the fields of trade in services as well as investment and intellectual property, resulting in greater trade liberalization.

## C.2.1 Existing trade agreements and regulatory scenario

Some of the existing key trade agreements entered by India include:

- Comprehensive Economic Co-operation Agreement (CECA) with Singapore
- Comprehensive Economic Partnership Agreement (CEPA) with Korea
- Comprehensive Economic Co-operation Agreement (CECA) with Malaysia
- Free Trade Agreement with Sri Lanka
- India-ASEAN Trade in Goods Agreement
- India Bhutan Trade Agreement
- Agreement on South Asia Free Trade Area executed by India, Bangladesh, Bhutan, Maldives, Nepal, Pakistan and Sri Lanka
- India Nepal Trade Treaty
- Framework Agreement with Thailand
- Asia Pacific Trade Agreement with Bangladesh, Republic of Korea, China and Sri Lanka
- Preferential Trade Agreement with Afghanistan
- Global System of Trade Preference with 46 countries

- Preferential Trade Agreements with MERCOSUR countries
- Preferential Trade Agreement with Chile
- Economic co-operation agreement with Finland

## C.2.2 Recent developments and outlook

India has signed a Comprehensive Economic Partnership Agreement (CEPA) with Japan, which is awaiting ratification by the Japanese parliament.

### C.2.2.1 Trade Agreements under Negotiation

Some of India's key prospective trade agreements that are currently under negotiation include:

- India-European Union FTA
- India-ASEAN (Services and Investment) CECA
- India-New Zealand FTA
- India-European Free Trade Association FTA
- India Canada FTA
- India-Mauritius Comprehensive Economic Co-operation and Partnership Agreement
- India-South African Customs Union PTA
- India-Sri Lanka FTA (to be expanded to include services and investment)
- Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
- India-Gulf Cooperation Council FTA
- India-Australia FTA
- India-Israel FTA
- India-MERCOSUR PTA
- India-Chile PTA

### C.2.2.2 Free Trade Agreements under Feasibility Study

A feasibility study for prospective Free Trade Agreements (FTAs) between two countries is undertaken on the basis of bilateral trade potential. Primarily, the objectives of conducting a "feasibility study" for Free Trade Agreement are:

- Identifying the benefits, which the countries entering into FTA is likely to derive under FTA
- Assessing the feasibility of a comprehensive FTA covering goods, services, investment and intellectual property rights
- Assessing prospects for expansion of trade in goods and services through liberalization of tariffs and non-tariff measures
- Creating a favorable environment for investment

Listed below are the Free Trade Agreements under Feasibility Study:

- India-China
- India-Russia
- India-Egypt
- India-Turkey

## C.3 Major trading partners and leading imports and exports

### Foreign trade in India

India accounts for 1.5%[37] of the global trade in goods and services worldwide. Foreign trade in the country is regulated by the Foreign Trade (Development and Regulation) Act, 1992. The Ministry of Commerce and Industry is the foremost body responsible for promoting and regulating foreign trade in India.

37 "Foreign Trade Policy 2009-14", Directorate General of Foreign Trade website, http://dgft.gov.in, accessed 15 September 2009

## C.3.1 Foreign Trade Policy (FTP)

India's FTP covers policies related to fiscal incentives, rationalized procedures, institutional changes, increased access to global markets and diversification of its export market.

To generate employment opportunities and increase India's share in global trade, the FTP lays special emphasis on key sectors including agriculture, handicrafts, leather, gems and jewelry, marine products, handlooms, electronics, IT hardware, sports goods and toys.

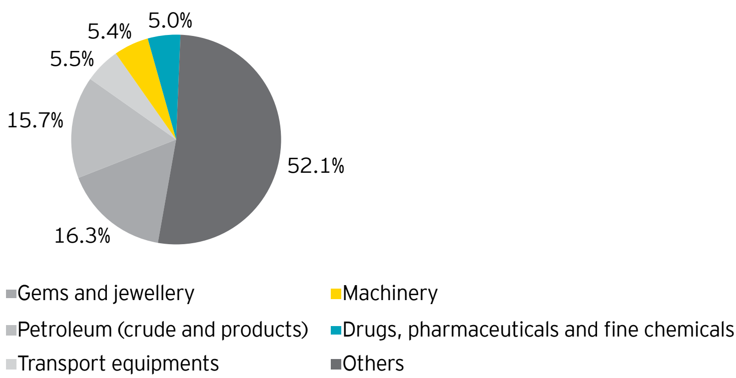
The policy focuses on market expansion and diversification to new markets in Africa, Oceania, Latin America and some parts of Asia.

## C.3.2 Exports: US$188b (FY10)

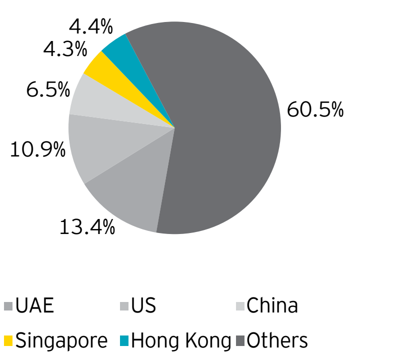
Most goods can be freely exported from India, except for a small number of prohibited items. Its key exports include gems and jewelry, petroleum, transport equipment, machinery, and drugs and pharmaceuticals. The country also accounts for approximately 3.7% of the global export of commercial services.

Principal destinations of exports: The UAE continues to be the top-most export destination for India's products standing ahead of the US in FY10 as well as FY09. Other countries include the US, China, Singapore, Netherlands, the UK, Germany and Hong Kong.

**Top commodities among India's exports (FY 10)**




**Top destinations for India's exports (FY10)**



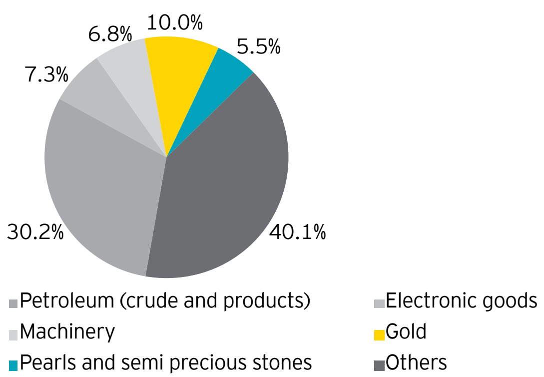

The cumulative value of exports for FY11 was US$245.87b as against US$178.75b in FY 10 registering a growth of 37.5% in dollar terms.

## C.3.3 Imports: US$303b (FY10)

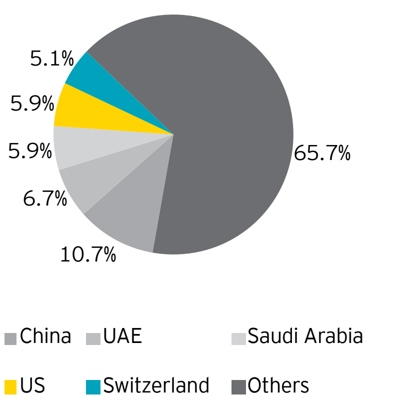
Import of all commodities is free in India, except for items regulated by any law or policy in force. Some items in the prohibited list, such as fat or oils of any animal, beef, hazardous dies as well as ivory, cannot be imported into India. The country's key imports include petroleum, electronic goods, machinery, gold, pearls and semi-precious stones.

Principal countries from which India imports: China has the largest share in India's imports. Other countries include the UAE, Saudi Arabia, the US and Switzerland.

**Top commodities among India's imports (FY 10)**




**Top countries for India's imports (FY 10)**



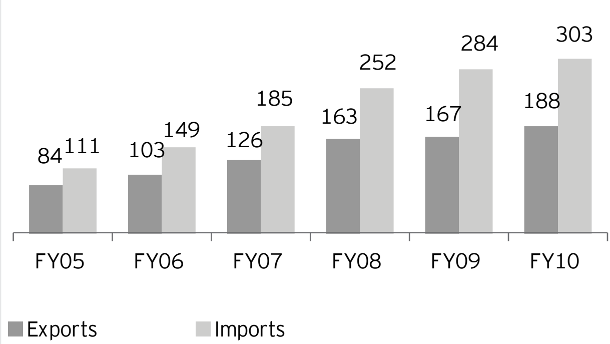
The cumulative value of imports for FY11 was US$350.69b as against US$288.37b in FY10, registering a growth of 21.6% in dollar terms. The oil imports during FY11 were valued at US$101.69b which was 16.7% higher than the oil imports of US$87.14b in FY10. Non-oil imports during FY11 were valued at US$249b, which was 23.7% higher than the level of such imports valued at US$201.24b in FY10.

## C.3.4 Balance of trade

India's trade deficit for FY11 is estimated at US$104.83b as against US$115b in FY10.

Due to brisk industrialization, imports into India are increasing rapidly recording a CAGR of 22.2% during the period FY05–10. Similarly exports from India are also rising rapidly recording a CAGR of 17.5% during the period FY05–10. India's export-to-GDP ratio stood at 13.4% in FY10.

**Balance of trade (USD billion)**



## C.3.5 Tariff liberalization

India's tariff regime has seen a considerable decline in rates over a period of time. Tariffs have fallen from the peak rate of 350% in 1991 to 10% in 2010. Non-oil imports attract an average import tariff of 7.5%. All machinery and parts imported for industrial/mining/power/irrigation purposes attract tariff duty of 7.5%-10%.

**Targets of the FTP 2009-2014:**

- Export growth of 15% p.a. till FY11 with the aim to achieve exports worth US$200b in FY11
- Export growth of 25% p.a. between FY12 to FY14
- Doubling of India's current share in global trade by 2020

Chapter

# D. Entry options in India

Structures typically used by foreign investors in India:

## D.1 Liaison office

Foreign corporations are permitted to open liaison/representative offices in India (subject to obtaining specific approval from RBI), to undertake liaison activities on their behalf. These offices act as a communication channel between the foreign corporations and Indian customers. Such offices are normally established by foreign corporations to promote their business interests by spreading awareness about their products and also to explore opportunities to set up a more permanent presence in the country.

A liaison office is not allowed to undertake any business activity in India and cannot earn any income in India. Expenses of such offices are to be met entirely through inward remittances of foreign exchange from the head office outside India.

A liaison office in India is permitted by the RBI to undertake the following activities:

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

Foreign insurance companies can establish liaison offices in India after obtaining approval from the IRDA, without a specific approval from the RBI.

Foreign Banks can establish LO in India only after obtaining approval from the Department of Banking Operations and Development (DBOD), RBI.

# D.2 Branch office

Foreign corporations may open branch offices to conduct business in India, and this requires a specific approval from the RBI. A foreign corporation cannot undertake any activity in India that is not specifically permitted by the RBI.

A branch office is permitted by the RBI to undertake the following activities:

- Export/import of goods
- Rendering professional or consultancy services
- Carrying out research work in which the parent company is engaged
- Promoting technical or financial collaboration between Indian companies and parent or overseas group company
- Representing the parent company in India and acting as a buying/selling agent in the country
- Providing IT services and developing software in India
- Rendering technical support for the products supplied by parent/group companies
- Undertaking activities for foreign airline/shipping companies

A branch office is not allowed to carry out retail trading, manufacturing (except manufacturing within SEZs) or processing activities in India. Branch offices are allowed to be set up in SEZs to carry out manufacturing and service activities in the country without specific approval from the RBI, subject to prescribed conditions.

A branch office provides the advantage of ease of operation and an uncomplicated closure. However, since such operations are strictly regulated by exchange control guidelines, a branch may not provide a foreign corporation with the optimum structure required for its expansion/diversification plans.

For income tax purposes, a branch office is treated as an extension of the foreign corporation in India and is taxed at the rate applicable to foreign companies. Indian transfer pricing regulations are also applicable to a branch office.

## D.3 Local Indian subsidiary companies

Foreign corporations can set up wholly owned subsidiary (WOS) companies in India in the form of private companies, subject to the prescribed FDI guidelines. Further, foreign corporations can set up a joint venture company with an Indian or foreign partner.

As compared to branch, liaison and project offices (discussed in the following paragraphs), a subsidiary company provides the maximum flexibility to conduct business in India. However, the exit procedure norms of such companies are relatively more cumbersome. Given below are some of the salient features of a subsidiary company:

- Funding can be via equity, debt (both foreign and local) and internal accruals
- Indian transfer pricing regulations apply
- No approval is required for repatriation of dividend

The subsidiary company, incorporated under the laws of India, is treated as a domestic company for tax purposes.

## D.4 Project office

A foreign corporation that has secured a contract from an Indian company to execute a project in India may set up a project office in the country without obtaining prior permission of the RBI, subject to prescribed reporting compliances.

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

However, if the above criteria are not met, the foreign entity has to approach the RBI, Central Office for approval. Like a branch office, a project office is also treated as an extension of a foreign corporation in India and taxed at the rate applicable to foreign corporations.

## D.5 Limited liability partnership (LLP)

Limited liability partnership (LLP) has emerged as a new corporate form of business that aims to provide the benefits of limited liability of a company and at the same time allows its members the flexibility of organizing their internal management on the basis of a mutually arrived at agreement.

LLP is a body corporate and legal entity, which has perpetual succession and is separate from its partners. The liability of the partners is limited to their agreed contribution to the LLP.

The GoI passed the LLP Act, 2008 in January 2009. However, foreign investment in an LLP was not allowed until recently. DIPP vide Press Note 1 of 2011 has opened the LLP route as an alternate form of business to foreign investors. The following are the key conditions for foreign investment in LLP.

- 100% FDI permitted in LLP with prior approval of FIPB in sectors where 100% FDI is allowed under automatic route
- Foreign institutional investors/foreign venture capital investors not permitted to invest in LLPs
- LLPs not permitted to avail ECBs
- LLPs with FDI not eligible to make any downstream investments
- Indian companies with FDI permitted to make downstream investment in LLPs only if both the Indian company and the LLP operate in sectors where 100% FDI is permitted under automatic route and no FDI-linked conditions attached
- Capital contribution by partner only in cash
- Conversion of company with FDI into LLP permitted with prior approval of FIPB/GoI

# D.6 Comparative summary of entry operations in India

| Particulars | Liaison office | Project office/ branch office | Subsidiary company | Limited liability partnership |
|---|---|---|---|---|
| 1. Setting up – requirements | Prior approval of RBI | Prior approval of RBI for branches (other than SEZs)<br><br>Prior approval not required to set up project office if certain conditions are fulfilled | If activities/sectors fall under the ambit of the automatic route, no prior approval but only post facto filings with RBI required<br><br>Otherwise, Government/ FIPB approval and thereafter compliance with post facto filings required | Allowed in sectors which are under 100% automatic route with prior Government approval |
| 2. Permitted activities | Only liaison/ representation/ communication role permitted<br><br>No commercial or business activities allowed to be undertaken | Activities listed/ permitted by RBI allowed to be undertaken<br><br>Manufacturing (except in SEZ units) not permitted | Any activity specified in the memorandum of association of the company<br><br>Wide range of activities permitted, subject to FDI guidelines | LLP should be engaged in sectors/ activities for which 100% FDI is allowed without any approval<br><br>LLPs having foreign investment would not be eligible to make any downstream investments |

| Particulars | Liaison office | Project office/ branch office | Subsidiary company | Limited liability partnership |
|---|---|---|---|---|
| 3. Funding of local operations | Local expenses to be met out of inward remittances received from abroad from Head Office through normal banking channels | Local expenses to be met through inward remittances from Head Office or from earnings from permitted operations | Funding to be through equity or other forms of permitted capital infusion or borrowings (local as well as overseas as per prescribed norms) or internal accruals | Contribution in the capital of the LLP should be through inward remittance or by debit to NRE/ FCNR account of the designated partner<br>LLP would not be eligible to raise External Commercial Borrowing |
| 4. Limitation of liability | Unlimited liability | Unlimited liability | Liability limited to the extent of equity participation in the Indian company | Liability of the partners is limited to their agreed contribution to the LLP except in case of fraud, wrongful act, etc |
| 5. Compliance requirements under Companies Act | Registration and periodical filing of accounts/other documents required | Registration and periodical filing of accounts/other documents required | Compliance needed with substantial higher statutory compliance and filing requirements | Registration with ROC required<br>File annual accounts and submit annual statement on solvency |
| 6. Compliance requirements under foreign exchange management regulations | Required to file an annual compliance certificate (from auditors in India) with RBI | Required to file an annual activity/ compliance certificate (from auditors in India) with RBI | Required to file periodic and annual filings relating to receipt of capital and issue of shares to foreign investors | No filing requirements prescribed as of now |

| Particulars | Liaison office | Project office/ branch office | Subsidiary company | Limited liability partnership |
|---|---|---|---|---|
| 7. Compliance requirements under IT Act | Generally, no tax liability, since it cannot carry out any commercial or income earning activities<br>LO is required to file annual information in prescribed form | Company obliged to pay tax on income earned and required to file returns of income in India<br>No further tax on repatriation of profits, which are permissible in both cases, required | Liable to be taxed on global income on a net income basis<br>Dividend declared freely remittable but subject to distribution tax of 16.2225% on dividends declared/ distributed/paid, pursuant to which dividend is tax free for all shareholders – limited inter-corporate dividend setoff applicable | Liable to be taxed @ 30.90% on net income basis<br>No DDT levied on profit distribution |
| 8. Permanent Establishment (PE) | LOs generally do not constitute PE under Double Taxation Avoidance Agreements (DTAA) due to limited scope of activities in India. However, an examination is required to check if the activities of the LO go beyond the realm of preparatory or auxiliary character as provided for in the DTAA. In such cases or in the absence of a DTAA, a PE/ taxable presence is constituted. | Generally constituting a PE and being a taxable presence under DTAA and domestic IT provisions | An independent taxable entity and not a PE of the foreign company. | An independent taxable entity. However, whether interest in LLP results in a PE for a foreign partner, is still an ambiguous position under LLP |

Chapter E.

# Funding of Indian businesses

**A foreign corporation can fund its Indian subsidiary through the following options:**

## E.1 Equity share capital

Issuing equity shares is the conventional means of funding a local Indian subsidiary.

The amount of equity capital a company can issue is limited by the authorized capital specified in its Memorandum of Association. A company can increase its authorized capital only if permitted by its Articles of Association. Equity capital can be repatriated on liquidation or on transfer of shares.

A non-resident entity may infuse funds in an Indian LLP as contribution to capital. Capital in a LLP can be repatriated by way of withdrawal of capital or transfer/assignment of partnership interest or through winding up of LLP.

## E.2 Preference share capital

Another option for investors to invest in a company in India is through the issue of preference share capital. Foreign investments through convertible preference shares, which are compulsorily convertible into equity shares, are treated as FDI. Preference shares that are not compulsorily convertible into equity shares are construed as External Commercial Borrowings (ECBs) and hence need to conform to the ECB guidelines. The following guidelines are relevant:

- According to Indian Company Law, preference shares have to be redeemed within a period of 20 years, and issue of preference shares is permissible only as a rupee denominated instrument
- The rate of dividends paid to non residents should not exceed the limit prescribed by the MoF (currently fixed at 300 basis points above State Bank of India's prime lending rate)

- Equity shares, compulsorily convertible preference shares and compulsorily convertible debentures need to be issued by the Indian company within 180 days of receipt of funds from the foreign investor.

# E.3 Debentures and borrowings

Companies can raise funds by issuing debentures, bonds and other debt securities. They can also raise funds by accepting deposits from the public. Debentures can be redeemable; perpetual, bearer or registered; and convertible or non-convertible. Foreign investments through convertible debentures, which are convertible into equity shares, are treated as FDI. Debentures that are not compulsorily convertible into equity shares are construed as ECBs and hence need to conform to ECB guidelines.

## E.3.1 External commercial borrowings

Debts raised in foreign currency by an Indian company (from internationally recognized sources) fall within the purview of the definition of ECBs, and are regulated by the MoF and RBI. ECB can be accessed under two routes: the automatic route and the approval route.

ECBs up to US$500m for rupee and foreign currency expenditure fall under the ambit of the automatic route, subject to compliance with the ECB policy. ECBs can be availed by corporate organizations registered under the Companies Act and Infrastructure Finance Companies, except in the case of financial intermediaries, and must be availed from internationally recognised sources such as international banks and capital markets, multilateral financial institutions, export credit agencies, suppliers of equipment, foreign collaborators and foreign equity holders (subject to certain minimum equity holding requirements in the borrower's company). ECB proceeds are subject to end-use restriction and can, under no circumstances, be used for on-lending, investment in a capital market, acquiring a company, working capital, general corporate purposes, repayment of existing rupee loan and real estate. In this context, redeemable preference shares/optionally convertible shares, partially convertible preference shares and debentures are considered as ECBs, and hence also need to conform with the ECB guidelines.

The minimum average maturity period of the loan will be three years for a loan amount of up to US$20m, and for ECBs above US$20m, the minimum average maturity period will be five years.

The following are the all-in-cost ceilings for ECBs:

| Average maturity period | All-in-cost ceiling over six months London Interbank Offered Rate (LIBOR) |
|---|---|
| Three years and up to five years | 300 basis points |
| More than five years | 500 basis points |

Proceeds from ECBs are allowed to be retained outside India (in prescribed liquid assets) or brought into rupee accounts in India pending their utilization. An empowered committee of RBI decides all the cases outside the purview of the automatic route.

LLPs with FDI are not permitted to avail ECB's.

# E.4 ADRs/GDRs/FCCBs

Qualifying Indian companies are allowed to raise equity capital overseas through the issue of American Depository Receipts (ADRs)/ Global Depository Receipts (GDRs)/Foreign Currency Convertible Bonds (FCCBs). Where the issue of ADRs, GDRs or FCCBs by a company is likely to increase the permissible investment limits of FDI under the automatic route, or where such an investment is made in the form of a project that requires government approval, the company must seek the approval of the FIPB.

Investments through the instruments mentioned above may be made through the automatic route or the approval route according to the relevant sectoral policy/guidelines.

Chapter F.

# Repatriation of funds

# F.1 Repatriation of capital

Foreign capital invested in India is generally allowed to be repatriated along with capital appreciation, if any, after payment of taxes due on them, provided the investment was made on a repatriable basis. The repatriation is however subject to any lock-in conditions that may be applicable on the industry sector under the foreign direct investment control regulations.

## F.1.1 Royalties and technical know-how

Indian companies that enter technology transfer agreements with foreign companies are permitted to remit payments for know-how and royalty under the terms of the foreign collaboration agreement subject to tax withholding, if any, without any limits.

## F.1.2 Technical service fees

Companies can hire the services of foreign technicians and make remittances for technical service fees, subject to certain conditions, regardless of the duration of the engagement of a foreign national in any calendar year and subject to tax withholding, if any.

# F.2 Repatriation of dividends

Profits and dividends earned from an Indian company are repatriable after payment of dividend distribution tax due on them. Permission of the RBI is not required to carry out remittances, subject to compliance with certain specified conditions.

Profits of LLP are repatriable without any payment of taxes and without any regulatory approval.

## F.2.1 Consultancy services and pre-incorporation expenses

### Consultancy services

Remittance of up to US$1m per project for any consultancy service procured from outside India can be made without prior RBI approval. Further, for entities in the power, telecommunications, railways, roads including bridges, sea ports and airports, industrial parks, urban infrastructure (water supply, sanitation and sewage projects) sector, this limit is extended to US$10m per project.

### Pre-incorporation expenses

Remittance on the reimbursement of pre-incorporation expenses incurred in India amounting to up to 5% of the investment brought into the country or US$100,000, whichever is higher, on the basis of certification from statutory auditors is permitted without RBI approval.

## F.3 Other remittances

No prior approval is required to remit profits earned by Indian branches of companies (other than banks) incorporated outside India to their head offices outside the country. Remittances from the winding-up proceeds of a branch of a foreign company in India are permitted, subject to the RBI's approval. In addition, sundry remittances are allowed for certain items, including gifts, repair charges for imported machinery, maintenance and legal expenses, subject to prescribed limits.

Chapter G.

# Forms of business enterprise

## G.1 Sole proprietorship

Sole proprietorship is the oldest and most common form of business. It is a one-man organization where a single individual owns, manages and controls the whole business. Sole proprietorship has the following features:

- There is ease of formation because it does not require elaborate legal formalities. There is no formal agreement required since it is a one-man show. In addition, it is not necessary to register such a firm. However, the owner may be required to obtain a license from the local administration that is specific to the line of business.
- The owner has complete control over all the aspects of the business and takes all the decisions although he/she may hire employees/support staff for assistance in day-to-day activities.
- Profit or loss from the operation is borne solely by the proprietor.
- There is no legal existence separate from the owner of the business.
- The liability of the proprietor is unlimited, i.e., it extends beyond the capital invested.
- A non-resident Indian (NRI) or a person of Indian origin (PIO) residing outside India are allowed to do business in India through a sole proprietorship concern. The investment should be made on non-repatriation basis subject to satisfying certain other conditions.
- NRIs or PIOs can make investment with repatriation benefits after obtaining approval from the RBI.
- A person resident outside India other than NRIs or PIOs can make investment in sole proprietorship concerns after obtaining approval from the RBI.

## G.2 Partnerships

A partnership is defined as a relation between two or more persons who have agreed to share the profits of a business carried out by them or any of them acting for all. The owners of a partnership business are individually known as partners and collectively as a firm. Its main features include the following:

- A partnership is easy to form as no cumbersome legal formalities are required — registration is also not essential. However, if the firm is not registered, it is deprived of certain legal benefits. The Registrar of Firms is responsible for registering partnership firms.
- The minimum number of partners in a partnership must be 2, while the maximum number can be 10 in the case of banking business and 20 in all other types of businesses. Further, specific regulatory approvals may be required for partnerships engaged in banking operations.
- The firm has no separate legal existence of its own, i.e., the firm and the partners are one in the eyes of the law.
- In the absence of any agreement to the contrary, all the partners have a right to participate in the activities of the business
- Ownership of property usually carries with it the right of management. Every partner, therefore, has a right to share in the management of the business.
- The liability of the partners is unlimited. Legally, the partners are said to be jointly and severally liable for the liabilities of the firm. This means that if the assets and property of the firm are insufficient to meet its debts, the creditors can recover their loans from the personal property of the individual partners.
- There are restrictions on transfer of interest, i.e., none of the partners can transfer his/her interest in the firm to any other person (except to the existing partners) without the unanimous consent of all the partners.

- The firm has a limited span of life, i.e., legally the firm must be dissolved on the retirement, bankruptcy or death of any partner or in the event one of the partners becomes insane.
- An NRI or a PIO residing outside India is allowed to invest in a partnership firm in India. The investment should be made on non-repatriation basis subject to satisfying certain other conditions.
- NRIs or PIOs can make investment in partnership firm with repatriation benefits post obtaining approval from the RBI.
- A person resident outside India, other NRIs or PIOs, can make investment in partnership firm after obtaining approval from the RBI.

## G.3 Limited liability partnerships

Refer discussion in section D.5.

Chapter H.

# Companies

| | |
|---|---|
| **H.1** | **Types of companies** |
| H.1.1 | Share capital |
| H.1.2 | Board of directors/Directors |
| H.1.3 | Audit committees, DIN, meetings and e-filing |
| **H.2** | **Financial reporting and auditing** |
| H.2.1 | Sources of accounting standards and convergence with IFRS |
| H.2.2 | Significant fundamental concepts |
| H.2.3 | Disclosure requirements, reporting and filing requirements |

Companies incorporated in India and foreign corporations with a presence in India are regulated by the provisions of the Companies Act. The Registrar of Companies (RoC) and the Company Law Board (CLB), both working under the Ministry of Company Affairs (MCA), have been entrusted with the responsibility of ensuring compliance with the provisions of the Companies Act. An amendment was passed under the Companies Act, through which it is proposed to set up a National Company Law Tribunal (NCLT) to take over the functions hitherto performed by the CLB as well as to discharge various other functions under the Companies Act.

## H.1 Types of companies

Companies in India may be broadly classified as public and private companies. A company can be registered with its liability as limited or unlimited. In the former case, the personal liability of the members is limited to the amount unpaid on their shares, while in the latter case their personal liability is unlimited by a pre-decided nominated amount. A company can also be registered as a guarantee company.

A company established for a charitable purpose is allowed to be formed under the provisions of section 25 of the Companies Act. The profit generated from the activities of such a corporation is not allowed to be distributed to its shareholders, but must be used for the purpose for which it was established.

### Private companies

A private company incorporated under the Companies Act has the following characteristics and is therefore popular in the case of small and medium-sized businesses.

- In a private company, the right to transfer shares is restricted.
- The maximum number of shareholders is limited to 50.
- No offer can be made to the public to subscribe to its shares and debentures.

- No invitation or acceptance of deposits from persons other than members, directors or relatives is allowed.

A private company is required to have a minimum paid-up capital of approximately US$2,223 (equivalent to INR0.1m) with a minimum of two directors and two shareholders.

## Public companies

A public company is defined as one that is not a private company. A subsidiary of an Indian public company is also treated as a public company. A public company is required to have a minimum paid-up capital of approximately US$11,112 (equivalent to INR0.5m) with a minimum of seven members and three directors.

Note: There are certain requirements with regard to the name of an Indian subsidiary. In the event the subsidiary's name contains the word "India" within its name not being the first word of the name, the minimum authorized capital needs to be approximately US$11,112 (equivalent to INR0.5m). Similarly, there are certain restrictions for some other specific names used to incorporate an Indian subsidiary.

Some basic comparisons between private and public companies are given in the table below.

| S No. | Particulars | Private company | Public company |
|---|---|---|---|
| 1. | Minimum number of shareholders | 2 | 7 |
| 2. | Maximum number of shareholders | 50 | Unlimited |
| 3. | Minimum number of directors | 2 | 3 |
| 4. | Maximum number of directors | As per the Article of Association of the company | 12 (can be increased with the government's approval) |
| 5. | Minimum paid-up capital requirement in general | INR100,000 (US$2,223) | INR500,000 (US$11,112) |
| 6 | Managerial remuneration | Payable with approval of board of directors | In case of unlisted public companies, remuneration is payable with approval of the Board of Directors and the shareholders. In case of listed public companies, approval of Central Government is required if the remuneration payable is beyond the limits specified under the Companies Act. |

## H.1.1 Share capital

The Companies Act permits companies to issue two kinds of shares to its shareholders: equity shares (common stock) and preference shares (preferred stock). Equity share capital with differential as to dividend, voting or otherwise can be issued subject to the prescribed conditions and rules.

Capital issued by public listed companies needs to comply with the guidelines issued by SEBI, a body that regulates companies that have a public interest and are listed on the Indian stock exchanges.

## H.1.2 Board of Directors, Directors

### Board of Directors/Directors

The management of a company is entrusted to its Board of Directors (Board). The Board acts on behalf of its shareholders and has an overall responsibility for the company's business activities. It acts on behalf of the shareholders for the company's day-to-day operations and seeks the confirmation/approval of the shareholders on major decisions. The Companies Act prescribes more restrictions to the power of the Board of Directors, in case of public companies.

However, shareholders can restrict the powers of the Board by passing specific resolutions. The Board may also delegate its powers to the committee of directors or managing directors by passing board resolutions to this effect.

### Directors

A company can appoint Executive, Non-Executive and Independent Directors. An Executive Director can be a Managing Director or a Whole time Director.

### Whole time/Managing directors

- Every public or private company which is a subsidiary of a public company with a paid- up share capital of INR50m is required to appoint a Managing Director or Whole time Director. The

Companies Act prescribes certain conditions that need to be fulfilled for the appointment of a Managing Director or a Whole time Director. In the event the conditions are not adhered to, the company has an option to seek the approval of the Central Government.

There is no such requirement in the case of a private limited company.

### Independent directors/Non-Executive directors

- The Central Government has introduced the concept of Independent directors for public listed companies. The limits prescribed for these independent directors ranges from half to one-third, depending on whether the company has an Executive Chairman. The concept of independent directors has been enabled to create an external control on the operations of a company and safeguard the interest of the public.

## H.1.3 Audit committees, DIN, meetings and e-filling

### Audit committees

Every public company with a paid-up capital of INR50m or more should have an audit committee to ensure the integrity of the company's financial management. Other than the management's nominees, a company's auditor also needs to be present during committee meetings.

### Director Identification Number (DIN)

DIN is a unique identification number allotted to an existing director of a company or to an individual who is to be appointed as a director in the organization. DIN is now mandatory in the case of any individual, who is an existing director of a company or is to be appointed on the board of a company as director.

The process of allotment of DIN has been simplified by the Ministry of Corporate Affairs and has to be performed online by paying a nominal fee.

### Meetings

The Companies Act requires companies to hold meetings at regular intervals and pass resolutions, ordinary or special, according to requirements. The company is required to hold a minimum of four board meetings in a calendar year and at least one shareholders' meeting as an Annual General meeting. Any specific shareholder meeting is known as an extraordinary general meeting

### e-Filing and digital signature

The MCA has amended the provisions of filing documents with the RoC and now accepts filings through electronic media. It also provides authentication in the forms by authorized signatories using digital signatures to affix their signatures, issued by authorized agents and registered with the Ministry. Thus, process has eliminated the need for manual filings and also reduced the paper load in RoC offices.

## H.2 Financial reporting and auditing

The Institute of Chartered Accountants of India (ICAI) issues accounting standards that are to be followed by all entities engaged in commercial, industrial or business activities. The GoI communicates the accounting standards issued by the ICAI under the Companies (Accounting Standards) Rules, with a view to provide legal status to accounting standards. Till date, the ICAI has issued 32 accounting standards of which one, AS 8 Accounting for Research and Development, has already been withdrawn. Of the remaining 31 accounting standards, 28 have been notified under the Companies (accounting standards) Rules and are mandatory.

ICAI also issues guidance notes as well as standards on auditing, which are primarily designed to guide auditors on matters during the course of their professional work. In addition, certain statutes and regulatory bodies also prescribe accounting treatments that need to be complied with by the respective entities. For example, Schedule VI to the Companies Act includes requirements relating to the presentation of financial statements by companies. Similarly, RBI has issued various circulars that deal with the specific aspects of accounting by banks.

### Statutes/bodies governing reporting requirements

The ICAI, the National Advisory Committee on Accounting Standards (NACAS), SEBI, the Companies Act and the IT Act primarily govern the financial reporting requirements of companies in India. In addition, the Central Government, through special Acts and orders, also governs financial reporting requirements. The ICAI has clarified in the Preface to the Statements of Accounting Standards that if it is found that a particular accounting standard is not in conformity with the law, the provisions of the said law will prevail and the financial statements will need to be prepared in conformity with the law.

## H.2.1 Sources of accounting standards and convergence with IFRS

India's accounting standards are based on International Accounting Standards (IAS), now renamed International Financial Reporting Standards (IFRS). Phase 1 entities were preparing to converge with IFRS starting from 1 April 2011. Toward this, the MCA notified 35 Ind-ASs. Further, the MCA stated that the notified Ind-AS will be applied in a phased manner, after resolving various issues including tax-related issues. This indicates that Ind-AS may not apply from the dates announced in the original roadmap, and at the same time, the date of applicability is not fixed and is made subject to satisfactory resolution of tax issues.

With a view to enable Indian entities to present IFRS-compliant financial statements, the ICAI and the MCA as well as the GoI, had announced their commitment to achieving complete convergence with IFRS for accounting periods commencing on or after 1 April 2011.

MCA has decided that there will be two separate sets of accounting standards:

i. India's accounting standards converged with the IFRS known as Ind AS

   Ind AS are the standards, which are being converged by eliminating the differences of the India's accounting standards vis-à-vis IFRS. These standards shall be applied by the specified companies falling under Phase 1 to Phase 3. Phase 1 is applicable to specified companies from 1 April 2011. However, this has been postponed and no effective date has been notified as yet. The GoI is in the process of finalisation of Ind AS.

ii. India's accounting standards

   The companies not falling within the threshold limits prescribed for IFRS compliance in the respective phases shall continue to apply these standards in the preparation and presentation of financial statements.

## H.2.2 Significant fundamental concepts

### Accounting methodology

The fundamental accounting assumptions of efficiently operating businesses as well as the consistency and accrual of income and expenses need not be disclosed in financial statements. Departures from these basic concepts, must however be disclosed.

All significant accounting policies should be disclosed in one separate statement or schedule to financial statements.

Inflation accounting is not used in India; accounts are prepared by using traditional cost accounting conventions.

### Change in accounting policy

An entity may change an accounting policy to comply with a statute or accounting standard, or if it is felt that the change will result in more appropriate presentation of the financial statements of the entity. The new policy should be followed consistently. A description of the change and the reasons for it should be disclosed in the financial statements during the year of the change.

## H.2.3 Disclosure requirements, reporting and filing requirements

### Disclosure requirements

General requirements — financial statements should consist of the following:

- Balance sheet
- Profit and loss account
- Notes to the financial statement
- Auditor's report
- Cash-flow statement (not required for small- and medium-sized entities)

The balance sheet and the profit and loss account should provide all the disclosures required to provide a true and fair view of the entity's financial position and the results of its operations.

Companies are also required to disclose their basic and diluted earnings per share along with their accounting policy and method of computation. However, organizations classified as small- and medium-sized enterprises are not required to disclose their diluted earnings per share.

Financial statements must be signed and dated by the Company Secretary, if any, and by at least two directors, including a managing director, if any, apart from the statutory auditor.

Directors' report: The directors' report must accompany each set of financial statements and must contain certain prescribed information, including a separate section on corporate governance with a detailed compliance report on corporate governance (for listed companies). Non-compliance with any mandatory requirement with reasons thereof, and the extent to which the non-mandatory requirements have been adopted, should be specifically highlighted.

**Auditors' report:** The auditors' report must include an opinion on the financial statements of the company and must state whether the company and its branches have maintained its books of account as required by law, and whether these books agree with its balance sheet and profit and loss account.

In addition to the above, the auditors are also required to report on matters stated in the Companies (auditor's report) Order, 2003 issued by the Central Government, which includes inter alia reporting on various specific aspects of internal control, inventory valuation, payment of statutory dues, description of contingent/contested liabilities or fraudulent transactions by or on the company and utilization of long-term/short-term funds.

## Interim financial reporting requirement of listed entities

**Quarterly financial statement:** Each listed entity is required to provide its unaudited financial results on a quarterly basis, within 45 days from the end of a quarter, in the specified format, announce this in the newspapers and subject the results to a limited review by its statutory auditors.

If the sum total of the first, second, third, and fourth quarterly results, with respect to net profit or loss after tax or exceptional or extraordinary items provided in the format, varies by 10% or approximately US$22,223 (equivalent to INR1m), whichever is higher as compared to the audited results for the full year, the entity must explain the reasons to the stock exchange.

**Secretarial audit:** Issuer companies are to subject themselves to a secretarial audit that is to be undertaken by a qualified chartered accountant or a company secretary for the purpose of reconciliation of the total admitted capital with the depositories and the total issued and listed capital.

The issuer companies are to submit the audit report on a quarterly basis to the stock exchange(s) where they are listed. Any difference observed in the admitted, issued and listed capital shall immediately be brought to the notice of SEBI and both the depositories by the stock exchanges.

## Annual reporting requirements

**Reporting:** Companies are required to comply with various reporting requirements, which are higher for public companies than for private organizations. Significant documents that need to be filed include the annual return, balance sheet, profit and loss account, as well as the auditor's and directors' reports and charges. The formats of the balance sheet and the profit and loss account are prescribed by the Companies Act.

Annual financial statements must be sent to all shareholders and debenture holders at least 21 days before the annual general meeting (AGM). Listed companies must send annual financial statements to their stock exchange. In addition, they need to publish their quarterly financial statements.

**Dividend payment:** Companies with shares are allowed to pay dividends only out of their profits after providing for depreciation on fixed assets in the manner prescribed and certain minimum amounts that have been transferred to the company's reserves. Further, payment of dividends is permitted from the company's accumulated reserves, subject to its compliance with certain prescribed rules.

Dividends can be only recommended by the Board of Directors and require shareholder approval — dividends are declared in percentage terms and can be declared more than once a year.

## Filing requirements

After the annual financial statements have been presented at the AGM, copies must be electronically filed with the Registrar of Companies within 30 days of their adoption by the shareholders.

On 1 April 2011, the MCA in India posted a circular on its website mandating a certain class of companies (Phase 1) to file balance sheets and profit & Loss accounts for the year 2010-2011 onwards by using eXtensible Business Reporting Language (XBRL). The financial statements required to be filed in XBRL format will based upon the taxonomy on XBRL developed for the existing schedule VI and non-converged accounting standards notified under the Companies (Accounting Standards), Rules, 2006 (as amended).

## Requirement for different industries

The GoI requires certain manufacturers to maintain their cost accounts and may order an audit by a qualified cost auditor to conduct this procedure.

Banking, electricity and insurance companies are governed by special Acts apart from the Companies Act.

## Audit requirements

All companies, banks, and financial institutions must have their accounts audited by an auditor who is a practicing member of the ICAI. The branches of a company also need to be audited.

The first auditor of the company is usually appointed by its directors. The shareholders appoint subsequent auditors at every AGM and fix their remuneration. The Companies Act sets out the matters on which an auditor has to report.

All companies with gross revenues in excess of approximately US$13,334 (equivalent to INR6m) must get their accounts audited under the IT Act. The Companies Act also grants the government the power to order other audits, including cost audits and investigations. In addition, the auditors of every listed company or company with paid-up capital and reserves exceeding approximately US$111,112 (equivalent to INR5m) at the commencement of the financial year, or average annual sales above approximately US$1, 111,112 (equivalent to INR50m) for three consecutive financial years immediately preceding the relevant financial year, are required to comment on the internal audit system of the company.

## Value Added Tax audit

Value Added Tax (VAT) legislation requires a VAT audit certificate/ report issued by a chartered accountant in a prescribed format. The format for each state is different, but generally has the same requirements. The due date for signing the VAT audit report/ certificate varies from state to state and ranges between the months of September and December.

Generally, VAT audit is applicable to all dealers who are liable to pay VAT provided their turnover of either sale or purchase exceeds a specified limit. Further, VAT audit is also mandatory for specified categories of dealers, as prescribed by the state legislation.

Chapter I.

# Economic laws and regulations

# Key economic laws

- Indian Contract Act, 1872
- Copyright Act, 1957
- Trademarks Act, 1999
- Geographical Indications of Goods Act, 1999
- Indian Patents Act, 1970
- Designs Act, 2000
- The Industrial Disputes Act, 1947
- The Trade Union Act, 1926
- The Plantation Labour Act, 1951
- The Payment of Bonus Act, 1965
- The Payment of Gratuity Act, 1972
- The Workmen's Compensation Act, 1923
- The Industrial Employment (Standing Orders) Act, 1946
- The Minimum Wages Act, 1948
- The Payment of Wages Act, 1936
- The Factories Act, 1948
- The Employees Provident Fund and Miscellaneous Provisions Act, 1952
- The Maternity Benefit Act, 1961
- Employees State Insurance Act, 1948
- The Contract Labour (Regulation and Abolition) Act, 1970
- The Monopolies and Restrictive Trade Practices Act, 1969
- The Competition Act, 2002
- The Consumer Protection Act, 1986
- The Negotiable Instruments Act, 1881
- The Sale of Goods Act, 1930
- The Arbitration and Conciliation Act, 1996

## I.1 Indian Contract Act, 1872 (ICA)

The Indian law that governs contracts is codified as the ICA, which encapsulates provisions governing the entire life of a contract from its formation to its implementation and conclusion. ICA also provides remedies for breach of contract. Through subsequent amendments, the provisions relating to certain specific forms of contract, including contract of partnership, contract of carriage and contract for sale of goods, have been removed from the ICA and been enacted in separate legislation.

## I.2 Protection of intellectual property rights

Laws relating to intellectual property are still in the process of transition in India and are becoming harmonized with corresponding laws in developed countries.

As a signatory to the GATT and trade-related aspects of intellectual property rights (TRIPS) agreements, and in its capacity of being a member of WTO, India is required to lay down minimum norms and standards with respect to the following areas of intellectual property:

- Copyrights and other related rights
- Trademarks
- Geographical indications
- Patents
- Industrial designs

### I.2.1 Copyrights

India's copyright law, laid down in the Indian Copyright Act, 1957 and amended by the Copyright (Amendment) Act, 1999, fully reflects the Berne Convention on copyrights to which India is a party.

Additionally, India is also party to the Geneva Convention for the Protection of Rights of Producers of Phonograms and to the Universal

Copyright Convention. It is also an active member of the World Intellectual Property Organisation (WIPO) at Geneva.

According to the Copyright Act, 1957, copyright subsists in original literary, dramatic, musical and artistic work, a cinematographic film or a sound recording.

India's copyright law has been amended from time to time to keep pace with changing requirements. The amendments made to its copyright laws have resulted in comprehensive changes and brought them in line with new developments in satellite broadcasting, computer software and digital technology.

Several measures have been adopted to strengthen and streamline the enforcement of copyright protection. These include setting up a Copyright Enforcement Advisory Council, conducting training programs for enforcement officers and setting up special police cells to deal with cases related to infringement of copyright.

## I.2.2 Trademarks

The Trade Marks Act, 1999 (TM Act) and the Trade Marks Rules, 2002 governs the law relating to trademarks in India. The TM Act provides for the registration of trademarks for services and goods, including collective marks, and for the assignment and transmission of trademarks. Under the TM Act, a trademark is a mark that can be represented graphically and can distinguish the goods or services of one person from those of others.

There is a provision for an appellate board for speedy disposal of appeals, rectification of applications and simplification of procedures to register a user. This provision also enables extension of the scope of the permitted use of trademarks as well as prohibition on the use of another entity's trademarks as part of a corporate name or the name of a business facility.

The TM Act also provides for the incorporation of other provisions, for instance, the amendment in the definition of "marks," provision for filing a single application for registration in more than one class, a 10-year period for the registration and renewal of trademarks as well as for making the trademarks offence cognisable. Trademarks Rules were implemented on 26 February 2002.

The Controller General of Patents, Trademarks and Designs has been appointed by the GoI to administer the various provisions of the Trademarks Act. According to the provisions of the TM Act, and with the object of fulfilling the obligations of WTO agreements and the other treaties entered by India, the Act grants the holder of a foreign trademark the right to register a trademark in India.

## I.2.3 Geographical Indications of Goods (Registration and Protection) Act, 1999

The Geographical Indications of Goods (Registration and Protection) Act, 1999 (GI Act) was implemented in December 1999 and the Geographical Indications of Goods (Registration and Protection) Rules under the GI Act was put in effect in March 2002.

The GI Act has been introduced to ensure compliance with the TRIPS regime. It seeks to provide for the registration and enhanced protection of geographical indications related to goods in India, is designed to protect the use of such geographical indications from infringement by others, and to protect consumers from deception. The Central Government has established the Geographical Indications Registry, with all-India jurisdiction, at Chennai in Tamil Nadu, where right-holders can register their geographical indications.

## I.2.4 Patents

The Indian Patents Act, 1970 provides for the grant, revocation, registration, license, assignment and infringement of patents in India. Any infringement of a patent is punishable under the terms of this Act.

The Indian Patents Act, 1970 and the Patent Rules, 1972 were amended by the Patents (Amendment) Act and Rules, 1999. The main objective of these amendments was to grant product patents for inventions related to drugs and medicines and to outline the procedure to deal with claims made in applications filed on or after 1 January 1995. The Indian Patents Act, 1970 was modified through the amendment of 2005, resulting in India recognizing products as well as process as patentable property.

It is pertinent to note that India also recognizes the concept of "compulsory licensing" of patents under which the Controller of Patents can permit an interested party to commercially exploit the patent after a period of three years from it being granted.

To harmonize the law pertaining to patents and other forms of intellectual property, and to fulfil its obligations under the WTO agreement, India has become an active party to the International Convention for the Protection of Industrial Property (Paris Convention) and the GATT and TRIPS agreements.

## I.2.5 Designs Act, 2000

The Designs Act, 2000, passed to provide recognition to obligations under WTO agreements, encourages and protects those who produce new and original designs and seeks to enhance industrial development and competitive progress. The purpose of the Designs Act and the Design Rules, 2001 is to protect novel designs formulated with the object of applying them to specific articles, to be manufactured and marketed commercially for a specific period of time, from the date of registration.

Under the Designs Act, designs are protected by two legal rights, registered designs and artistic copyright. Design registration in India gives the owner a monopoly on his or her product, i.e., the right (for a limited period) to stop others from making, using or selling the product without the owner's permission. This is in addition to any design right or copyright protection that may exist automatically in the design.

The Controller General of Patents, Designs and Trademarks, appointed under the Trade and Merchandise Marks Act, 1958, is the Controller of Designs and is responsible for administering the various provisions of the Act.

# I.3 Labor laws

India is a member of the International Labour Organization (ILO) and complies with the conventions it has ratified. It has enacted comprehensive legislations to provide a good working environment for human labor and protect their interests.

In the following paragraphs, the key labor laws applicable to employers and employees in India have been outlined.

## I.3.1 Industrial Disputes Act, 1947

The Industrial Disputes Act, 1947 (IDA) is the main legislation in India that provides for the investigation and settlement of industrial disputes. Disputes or differences between employers and employers, employers and employees or employees and employees, which relate to employment or non-employment, the terms of employment or conditions of labor of any person have been defined as industrial disputes. IDA is administered by the Ministry of Labour and Employment through its Industrial Relations Division.

IDA provides the conditions for laying off, retrenching, discharging or dismissing an employee, circumstances under which an industrial unit can be closed down, situations when a lock-out can be lawfully resorted to and when it can be declared as unlawful. Additionally, IDA prescribes penalties for any person who indulges in unfair labor practices. Further, recently the grievance redressal machinery has also been incorporated under the provisions of IDA.

## I.3.2 Trade Unions Act 1926

The Trade Unions Act, 1926 (TUA) provides for the registration of trade unions of employers and workers and is administered by state governments. It confers legal and corporate status on registered trade unions.

TUA was amended in 2001, bringing about some critical changes in the original legislation. Pursuant to the amendment, no trade union of workmen can be registered unless at least 10% or 100, whichever is less, subject to a minimum of seven workmen engaged or employed in the establishment or industry with which it is connected, are the members of such a trade union on the date of making an application for registration. Additionally, to promote the civil and political interest of its members, unions are now authorized to set up separate political funds.

## I.3.3 Plantation Labour Act, 1951

The Plantation Labour Act, 1951 (PLA) provides for the welfare of plantation labor and regulates the condition of work in plantations. PLA is administered by state governments and is applied to any land used as plantations, which measures 5 hectares or more in which 15 or more persons are working. The state governments are, however, free to declare any plantation land less than 5 hectares or with less than 15 persons working on it to be covered by the PLA.

## I.3.4 Payment of Bonus Act, 1965

The Payment of Bonus Act, 1965 (PBA) provides for the payment of bonus to persons employed in certain establishments on the basis of profits or on production or productivity, as well as for matters connected therewith. PBA is applicable to every factory and other establishments in which 20 or more persons are employed on any day during an accounting year, excluding some categories of employees enumerated therein. PBA mandates payment of bonus to every employee in an accounting year, in accordance with the provisions of this legislation, provided that he or she has worked in the establishment for not less than 30 days.

PBA provides for the appointment of inspectors by the government by notification. These inspectors can ask the employer to furnish any information that may be considered necessary by them. They can also ask the employer to submit books and registers and other documents related to the employment of persons or relating to the payment of salaries, wages or bonus.

Penalties are prescribed for contravention of the provisions of PBA rules or failure to comply with the directions or requisitions made under PBA.

## I.3.5 Payment of Gratuity Act, 1972

The Payment of Gratuity Act, 1972 (PGA) provides a scheme for the payment of gratuity to all employees earning wages to do any skilled, semi-skilled, unskilled, manual, supervisory, technical or clerical work, whether the terms of such employment are express or implied, and whether or not such employees are employed in a managerial or administrative capacity.

Gratuity is payable to an employee on his or her retirement/ resignation, termination of service on account of death or disablement due to accident or illness. Gratuity is payable at the rate of 15 days' wages for every completed year of service, or part thereof, in excess of six months. There is a wage ceiling of INR1m for coverage under PGA.

PGA lays down conditions under which an employer can deny payment or forfeit the gratuity of an employee. It also prescribes penalties and prosecutions for contravention of the provisions of PGA.

## I.3.6 Workmen's Compensation Act, 1923

The object of the Workmen's Compensation Act, 1923 (WCA) is to compensate an employee or his or her survivors in the event of industrial accidents or occupational diseases, resulting in disablement or death during the course of the person's employment.

The WCA also prescribes conditions under which compensation may be denied to an employee.

## I.3.7 Industrial Employment (Standing Orders) Act, 1946

The Industrial Employment (Standing Orders) Act, 1946 (IEA) requires employers in industrial establishments to clearly define the conditions of employment to their workers by issuing standing orders or implementing service rules related to matters set out in the schedule of IEA. The standing orders are certified by the certifying officer appointed under the IEA.

The Industrial Employment (Standing Orders) Central Rules, 1946 provides model standing orders with respect to the classification of workmen, holidays, shifts, payment of wages, leave, termination of service, etc.

## I.3.8 Minimum Wages Act, 1948

The Minimum Wages Act, 1948 (MWA) seeks to determine the minimum rates of wages in certain employments, a list of which is contained in the legislation. The MWA applies to any person who is employed for hire or reward to do any work in a scheduled employment, and includes an outdoor worker to whom any articles or material are given for doing work either at home or at any other premises.

## I.3.9 Payment of Wages Act, 1936

The Payment of Wages Act, 1936 (PWA) seeks to regulate the payment of wages to certain classes of employees in an industry. It seeks to ensure that the wages payable to the employees covered under the PWA are disbursed by the employers within the prescribed time limit without any unauthorized deductions.

The PWA lays down that a wage period exceeding one month should not be fixed and payment of wages must be made on a specific day after the last day of the wage period. All wages must be paid in current legal tender, but it can also be paid by cheque or credited to the bank account of the employed persons. The main beneficiaries of the PWA are, however, those who earn wages below the prescribed limit per month.

Under the PWA, defaulting employers are advised to pay full wages in time, and in the event of non-adherence to this advice, there are provisions of prosecutions as well.

## I.3.10 Factories Act, 1948

The Factories Act, 1948 (FA) extends to the whole of India, and is the principal legislation that governs the health, safety and welfare of factory workers. Many amendments have been made with the aim to keep the FA in tune with developments in the field of health and safety. However, it was not until 1987 that the elements of occupational health, safety, as well as the prevention and protection of workers employed in hazardous processes, were fully incorporated in the FA.

The FA also comprises regulations for the functioning of factories and detailed procedures related to the inspection, registration and licensing of factories.

The FA is enforced by state governments through their factory inspectors. The Directorate General Factory Advice Service & Labour Institute functions as a technical arm of the Ministry of Labour and Employment to co-ordinate matters relating to the safety, health and welfare of workers in factories with state governments.

## I.3.11 Employees Provident Fund and Miscellaneous Provisions Act, 1952

The Employees Provident Fund and Miscellaneous Provisions Act, 1952 (EPFMPA) seeks to ensure the financial security of employees in an establishment by providing a system of compulsory savings. A provident fund, required to be established under the EPFMPA, is a contributory fund created to secure the future of employees after their retirement. Employees are also allowed to withdraw a part of their provident fund before retirement for certain specified purposes.

The EPFMPA is regulated by the Ministry of Labour and Employment, but is administered by a representative body called the Central Board of Trustees, Employees' Provident Fund.

The GoI has prescribed various penalties for any default, which the employer may make with relation to payments including contributions, arrears, accumulation and administrative charges to the fund and/or also prescribes imprisonment.

The latest amendment of 1 October 2008 has extended the applicability of the EPFMPA and the schemes therein for an additional category of employees, i.e., international workers, mandating the compulsory participation of such employees.

## I.3.12 Maternity Benefit Act, 1961

The Maternity Benefit Act, 1961 (MBA) regulates the employment of women in certain establishments for a prescribed period before and after childbirth and provides certain other benefits, including leave, to a woman who has undergone miscarriage, illness arising from pregnancy, and delivery and/or premature birth of a child.

The MBA prescribes penalties for contravention of its provisions by employers.

## I.3.13 Employees State Insurance Act, 1948

The Employees State Insurance Act, 1948 (ESI) is another social welfare legislation in India that is jointly administered by the Central Government and state governments. The ESI provides healthcare and cash benefits to employees in the event of sickness, maternity or injury suffered during employment, whether they are working in a factory, establishment or elsewhere, or they are directly employed by the principal employee or through an intermediate agency, if the employment is incidental or in connection with a factory or establishment.

## I.3.14 Contract Labour (Regulation and Abolition) Act, 1970

The Contract Labour (Regulation and Abolition) Act, 1970 (CLRA) was promulgated to regulate the employment of contract labor in certain establishments and to provide for its abolition in certain circumstances as well as for matters connected therewith. A workman is deemed to be employed as contract labor when he is hired in connection with the work of an establishment or through a contractor.

The establishments covered under the CLRA are required to be registered as principal employers with the appropriate authorities. Every contractor is required to obtain a licence and is not to undertake or execute any work through contract labor except in accordance with the license issued by the licensing officer.

In addition to the legislations mentioned above, several states have enacted Shops and Establishment Acts, which regulate working hours, prescribe minimum standards of working conditions and make overtime and leave salary payments to workers in certain categories of shops and other establishments.

Recent years have seen many companies successfully using the voluntary retirement scheme in an effort to restructure their operations or to exit from a particular line of business. Retraining schemes for workers have also been used to increase their productivity and competitiveness.

## I.4 Anti-trust regulations

In line with global norms and to prevent monopolies from creating restraints on trade or commerce and reducing competition in India, the GoI has evolved an anti-trust regulatory framework that principally relates to the following legislations:

- The Monopolies and Restrictive Trade Practices Act, 1969, which is in the process of being replaced by the Competition Act, 2002 (No. XII of 2003)
- Certain provisions under the Cos Act
- The Consumer Protection Act, 1986

### I.4.1 Monopolies and Restrictive Trade Practices Act, 1969

The Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act) governs the activities/practices of all industrial undertakings that are engaged in the production, storage, supply or distribution of articles/goods either directly or indirectly through any of their units or divisions. However, the GoI undertakings do not come under the purview of the MRTP Act. It encompasses within its ambit certain prohibited trade practices such as restrictive trade practices, unfair trade practices and monopolistic trade practice.

The regulatory body under the ambit of the MRTP Act is the Monopolies and Restrictive Trade Practices Commission. The Commission is assisted by the Director General of Investigation and Registration, who is responsible for providing assistance to it in carrying out investigations and maintaining a register of agreements, which are required to be regulated under the Act as well as to carry out proceedings during the enquiry before the Commission.

There are certain provisions in Part IV of the Cos Act that regulate the acquisition and transfer of shares of a body corporate owning any undertaking to which the provisions of Part A of Chapter III of the MRTP Act will be applicable. These provisions are aimed at preventing the acquisition or takeover of companies to avoid concentration of economic power. Accordingly, the provisions stipulate that certain types of acquisitions require the prior approval of the Central Government.

The primary objective of the MRTP Act is to curb monopolies and not to promote competition. In light of this, the GoI appointed a committee in October 1999 to examine the existing MRTP Act, to remove this deficiency and formulate a modern competition law. Pursuant to the recommendation of this committee, the Competition Act, 2002 was enacted on 13 January 2003 to succeed the MRTP Act.

As of date, no substantive provision of the Competition Act is in force. It will come into force as and when notified by the Central Government. Although the Competition Act provides for the repeal of the MRTP Act, the provision dealing with the repeal is yet to be notified and hence the MRTP Act still is in effect.

## I.4.2 The Competition Act, 2002 (Competition Act)

The Competition Act, which has replaced the MRTP Act, seeks to achieve the following objectives:

- Promote and sustain competition in markets
- Protect the interest of consumers
- Ensure freedom of trade carried on by participants in markets in India
- Prevent practices having adverse effect on competition

The Competition Act provides for the establishment of the Competition Commission of India (CCI) and Competition Appellate Tribunals to hear and dispose off appeals against the orders of the CCI and also to adjudicate on the claims of compensation that may arise from the findings of the CCI or the orders of the Appellate Tribunal.

The Competition Act seeks to:

- Prohibit anti-competitive agreements
- Prohibit abuse of dominant position
- Regulate combination (acquisition, mergers and amalgamations etc.) that causes or likely to cause appreciable adverse effect on competition.
- Entrust the CCI with the responsibility of undertaking competition advocacy

The Competition Commission of India (CCI) has, on 11 May 2011, issued the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 (Combination Regulations). The Combination Regulations together with the relevant provisions of the Competition Act, regulates in India (a) acquisitions; (b) acquiring of control; and (c) mergers or amalgamations that exceed specified thresholds. Transactions falling within the purview of CCI will now require mandatory pre-notification to CCI (subject to the exemptions and transitional provisions as provided in the Combination Regulations) and will not come into effect until 210 days or by order of the CCI, whichever is earlier. Fee payable to CCI ranges from INR0.05m to INR1m. Failure of an enterprise to notify CCI about the proposed combination can attract penalty, which can extend up to 1% of the total turnover or the assets of the combination, whichever is higher.

### I.4.3 Consumer Protection Act

The Consumer Protection Act (CP Act) is a legislation, which has been enacted for the protection of consumer interest. It provides for the establishment of consumer councils and other authorities to settle consumer disputes. Under the terms of the CP Act, an entity that provides any goods/services in India is required to avoid any trade practice that may be classified as "unfair" or "restrictive", as defined under the Act.

The CP Act aims to regulate the activities of a manufacturer or service provider to ensure that the consumer does not suffer due to defective goods and/or deficient services.

The Act includes provisions for district, state and national consumer disputes, redressal forums to adjudicate over claims as well as complaints and disputes.

## I.5 Negotiable Instruments Act, 1881

The law related to promissory notes, bills of exchange, cheques and other negotiable instruments is codified in India under the Negotiable Instruments Act, 1881 (NI Act). The main object of the NI Act is to legalize the system by which the instruments contemplated by it could pass from hand to hand through negotiations such as in the case of any other goods.

The NI Act provides for the liability of an agent, legal representative, drawer, drawee, maker and acceptor of a bill, an endorser and a holder in due course and surety. Detailed provisions have been made in the Act relating to presentation, payment, interest, discharge from liability, notice of dishonor, noting and protest, reasonable time for payment, acceptance and payment for honor and reference in the event of need, compensation, special rules of evidence, providing for certain presumptions and estoppels, cross cheques, bills in sets, etc.

Additionally, it provides a speedy mechanism in cases when cheques are dishonored and criminal and punitive punishment in such cases.

## I.6 Sale of Goods Act, 1930

The Sale of Goods Act, 1930 (SG Act) is complementary to the Indian Contract Act, 1872 (ICA). The basic provisions of the ICA also apply to the contract of sale of goods. The basic requirements of a contract include offer and acceptance, legally enforceable agreement, mutual consent, parties competent to contract, free consent, lawful object and considerations that apply to the contract of sale of goods.

In a contract of sale of goods the seller transfers or agrees to transfer the property (ownership) of the goods to the buyer for a price. A sale is an executed contract, i.e., there is a contract as well as a conveyance. In other words, the property of the goods is transferred from the seller to the buyer.

Certain stipulations are essential for the main purpose of a contract of sale of goods. These are the root of the contract and non-fulfilment means loss of the foundation of contract. These are known as conditions. Other stipulations, which are not essential, are known as warranty. These are collateral to the contract of sale of goods. A contract cannot be avoided for breach of warranty, but the aggrieved party can claim damages.

The SG Act requires that goods transferred by the seller to the buyer must be ascertained and it should be an intention of the seller to pass such goods to the buyer. The Act also deals with transfer of the title of the goods by a person who is not the owner of the goods.

The Act entrusts various duties and grants certain rights to both the buyer and the seller, e.g., it is the duty of the seller to deliver the goods and of the buyer to accept and pay for them in accordance with the terms of the contract of sale.

If goods are sold and property transferred to the buyer and he or she refuses to pay for them, the only remedy available to the seller is to approach the court. The seller does not have the right to take forceful possession of the goods from the buyer once the property of goods is transferred to him. However, some rights have been given to the buyer.

## I.7 Arbitration and Conciliation Act, 1996

The Arbitration and Conciliation Act, 1996 (A&C Act) has been enacted to replace three previous laws dealing with the various aspects of arbitration. This legislation is based on the Model Law on International Commercial Arbitration adopted by the United Nations Commission on International Trade Law (UNCITRAL) in 1985. The A&C Act has been consolidated into one statute, the law relating to domestic arbitration, international commercial arbitration, enforcement of foreign arbitral awards and conciliation. It allows the contracting parties to decide on the venue and procedure of the arbitration proceedings.

The application of the A&C Act is mandatory for all arbitrations that take place in India. Where a party to the dispute, which has been referred for arbitration, is Indian and the venue of arbitration is outside the country, the provision of the A&C Act applies, unless the parties have expressly or impliedly rejected its applicability or the rules that govern such arbitration are contrary to its provisions. Under the mandate of the Act, there is limited scope for an appeal being made to an arbitrator.

Chapter J.

# Mergers and Acquisitions

India is emerging as a active player in the world of mergers and acquisitions (M&As). M&As continue to be an important tool for inorganic growth, which is evident from the plethora of deals Indian companies have entered in the recent past.

## J.1 Reorganization and mergers

Reorganization of a company by a compromise (sacrifice by shareholders, creditors and others on their claims and entitlements to resurrect the company) or by an arrangement between the company and its shareholders or creditors requires the sanction of the jurisdictional High Court and approval of shareholders, creditors and other regulatory authorities. The power to approve reorganization and mergers has recently been shifted from the High Courts to the National Company Law Tribunal (NCLT). However, the NCLT is still in the process of being formed.

## J.2 Acquisitions

Acquisition entails gaining control over the management of another company, typically by acquiring shares with voting rights. Thus, in case the shares of the company are closely held by a small number of persons, an acquisition may be effected in agreement with the shareholders. However, where the shares of the company are largely held by the general public, provisions of the Substantial Acquisition of Shares and Takeovers (SEBI) Regulations, 1997 (the Takeover Code) as well as other relevant regulations issued by SEBI need to be complied with. A Takeover Regulations Advisory Committee (TRAC) was constituted to review the Takeover Code, which has proposed a draft of a new set of regulations to replace the existing Takeover Regulations along with detailed justifications for the changes proposed. The recommendations of TRAC are presently under consideration of the SEBI and Ministry of Corporate Affairs based on feedback and consultations with stakeholders.

## J.3 Demergers

A demerger is a reorganization tool that is increasingly being used by companies to segregate their core and non-core businesses. Similar to mergers, demergers are also a court-driven process, which require the sanction of jurisdictional High Courts/the NCLT, along with the approval of shareholders, creditors and other regulatory authorities.

## J.4 Slump sale

A slump sale involves the transfer of an identified business activity from one entity to another for a lump sum consideration without assigning values to individual assets/liabilities. Unlike a demerger, a slump sale is not mandatorily a court-driven process and can be achieved through a simple shareholders' resolution and legal agreements.

## J.5 Buy-back of shares

The Companies Act permits a company to buy back its share capital up to a ceiling of 10% of the paid-up equity capital and free reserves, provided this is sanctioned in the company's board meeting. A company may also buy back up to 25% of its paid-up capital and free reserves, provided the buy-back is sanctioned by a special resolution of shareholders.

The Companies Act also prescribes certain conditions relating to reserves, as well as a bar on the company issuing further shares of the same class for a period of six months, and debt equity ratios, etc., for a company to be eligible to buy back shares. The procedure for affecting a buy-back is relatively simple and does not require a court process. Companies listed on a stock exchange in India are subject to the guidelines prescribed by SEBI in this regard. Private and unlisted public companies are governed by the "Private Limited Company and Unlisted Public Limited Company (Buy-Back of Securities) Rules, 1999" prescribed in this regard.

# J.6 Capital reduction

Capital reduction is a court-regulated process whereby a company can pay off its shareholders by cancelling or reducing their capital or cancelling their share capital against accumulated losses.

Capital reduction requires the sanction of the jurisdictional High Court/ NCLT and other regulatory authorities. The process also requires the company to obtain the sanction of various parties whose interest is likely to be affected as a result of the capital reduction scheme.

# J.7 A comparative study of mergers, demergers, slump sale and acquisition

| Regulations/ provisions | Merger | Demerger | Slump sale | Acquisition |
|---|---|---|---|---|
| Companies Act | Section 391 – 394 procedure | Section 391 – 394 procedure | Section 293 approval | Section 372 (for acquirer) |
| IT Act - Taxability | | | | |
| Shareholders Shareholders Company | Tax neutral[1] | Tax neutral[1] | Not applicable | Taxable |
| Company | Tax neutral[1] | Tax neutral[1] | Taxable[3] | Not applicable |
| Carry forward of losses | Available[1] | Available[1] | Non Available | Available[6] |
| The Takeover Code (open offer)2 | Specific exemption | Specific exemption | May be triggered[4] | May be triggered[7] |
| Exchange control regulations/Foreign Direct Investment guidelines | Intimation to RBI[5] | Intimation to RBI[5] | Guidelines for issue of shares to be followed[5] | Approval from RBI and FIPB[8] |
| Typical time frame | 4-5 months | 3-4 months | 1-2 months | 1-2 months |

1 Subject to fulfilment of certain prescribed conditions
2 Only applicable to listed entities
3 Specific computational methodologies prescribed
4 If shares are issued as a consideration
5 Subject to sectoral caps
6 In the case of widely held companies – certain conditions need to be complied with in the case of closely held companies
7 If prescribed limits are exceeded
8 Subject to sectoral caps and declarations in prescribed form

Chapter

# K. Individuals

# K.1 Visa and registration requirements

## K.1.1 Visa on arrival

A visa-on-arrival (VoA) facility is available for the citizens of Finland, Japan, Luxembourg, New Zealand and Singapore. In general, foreign passengers should ensure that they are in possession of a valid Indian visa before they begin their journey to India. However, nationals of Bhutan and Nepal do not need a visa to enter India, and nationals of Maldives do not require a visa for entry into India for a period up to 90 days. A separate visa regime exists for diplomatic and official passport holders.

## K.1.2 Temporary landing facility/permit (TLF/TLP)

There is provision to grant a temporary landing facility (TLF)/ temporary landing permit (TLP) to allow the entry of foreigners arriving in emergent situations without an Indian visa, for instance, death or serious illness in the family, on payment of specified amount. This facility can also be extended to transiting foreigners who have acquired confirmed onward journey tickets within 72 hours. Apart from this, foreign tourists in groups of four or more arriving by air or sea, sponsored by recognized Indian travel agencies, with a pre-drawn-up itinerary can be granted a collective landing permit for a specified period of time. This needs a written request from a travel agency to the Immigration Officer, giving the complete personal and passport details of the group members and undertaking to conduct the group according to the itinerary, with an assurance that no individual will be allowed to drop out from the group at any place. The provisions of TLF/ TLP are however not available for nationals of Sri Lanka, Bangladesh, Pakistan, Iran, Afghanistan, Somalia, Nigeria, Ethiopia and Algeria.

## K.1.3 Tourist visas

Visitors to India need visas to enter the country unless they are Indian citizens. Ten-year visas are only available for US citizens under a bilateral arrangement. Non-resident Indians, who are citizens of another country, are also required to obtain visas before arriving in India unless they hold a person of Indian origin (PIO) card issued by the GoI. Visas should be obtained from the Indian embassy or consulate in the applicant's home country. Special permits are required to visit the Andaman and Nicobar Islands, Bhutan, Lakshadweep, remote North Eastern states and Sikkim.

Tourist visas are valid for one to six months, usually beginning on the date it was issued and not on the date of entry into India. Tourist visas are usually multiple-entry visas; however, this option should be specifically requested at the time of application.

## K.1.4 Business and employment visas and self-employment visas

Business visas: Business visa will be granted to individuals visiting India for business purposes and not for full time employment. They are granted under specific conditions that include the assurance of financial standing of the applicant, as well as his or her expertise in the field of the business in question.

The guidelines provide that a business visa may be issued to a foreign national visiting India for the purpose of carrying out the following activities:

- Establishing a business venture
- Exploring the possibility of an industrial or business venture in India
- Purchase and sale of industrial, commercial or consumer products
- Attending technical meetings or discussions
- Attending board meetings and general meetings
- Recruitment of manpower
- Functioning as partners or directors in a business

- Consultation or participation with respect to exhibitions, trade fairs or business fairs
- Meeting with suppliers or potential suppliers to evaluate or monitor quality, negotiate supplies, place orders and provide specifications for goods procured from India
- Monitoring progress on ongoing projects
- Meeting with Indian customers on ongoing projects
- Meeting to provide high-level technical guidance on ongoing projects
- Activity before and after a sale that does not amount to the execution of a contract
- In-house training at the regional hubs of a foreign company
- Serving as a tour conductor or travel agent

Business visas with multiple entry facilities will be granted for a period up to five years or for a shorter duration according to the individual's requirements. Further, a business visa will be granted with the stipulation of a maximum stay of six months for each visit. If the length of the stay has not been stipulated, an endorsement requiring registration with the Foreigner Regional Registration Office (FRRO) within 14 days will be made on the visa.

India missions can grant a business visa with a validity of 10 years and a multiple-entry facility to US nationals.

Employment visas: Employment visa will be issued subject to the applicant being skilled and qualified and on the condition that the job for which the visa is being applied is neither routine, ordinary or secretarial in nature nor for which there are already a large number of qualified Indians. An employment visa will be granted to a foreign national if his or her salary exceeds US$25,000 per annum. The salary threshold of US$25,000 however, does not apply to ethnic cooks, language teachers (other than English teachers), translators and professionals working for the concerned Embassy or High Commission in India.

An employment visa may be issued to a foreign national visiting India for the purpose of carrying out the following activities:

- Execution of projects or contracts, regardless of duration
- Installation and commissioning of machinery with respect to a contract for supply
- Transfer of know-how for which an Indian company pays fees or royalties
- Consulting on a contract basis for an Indian company that pays fixed remuneration
- Taking up employment as a coach of a national- or state-level team or reputed sports club
- Performing as a foreign sportsperson for a specific period under contract with an Indian club or organization
- Providing engineering, medical, accounting, legal and other highly skilled services in the capacity of an independent consultant
- Serving as a foreign language teacher or interpreter
- Serving as a foreign specialist chef

A foreign technician/expert coming to India to pursue a bilateral agreement between the GoI and the foreign government, or to pursue a collaboration agreement that has been approved by the GoI, can be granted an "employment visa" for the duration of the agreement, for a period of five years, whichever is less, with multiple-entry facilities.

Highly skilled foreign individuals employed in the IT software and IT-enabled sectors will be granted "employment visas" with a validity of up to three years or the term of the assignment, whichever is less, with multiple-entry facilities. Foreign nationals employed in sectors other than IT software and IT-enabled services will be granted employment visas with a validity of up to two years or the term of the assignment, whichever is less, with multiple-entry facilities. In the case that an employment visa is issued for a period of more than 180 days, it is mandatory to register with the FRRO within 14 days of arrival. However, certain visas specify certain "specific endorsements" for which registration formalities are to be processed accordingly. In cities, which do not have a FRRO office, expatriates must register with the local police station.

Business visas and employment visas will be issued only from the country of origin or from the country of domicile of the individual provided the period of permanent residence of the individual in that country is more than two years.

Self-employment: Foreign nationals seeking to practice their professions or engage in an occupation, trade or business in India must register with the RBI.

Project visa: The GoI has introduced project visa for foreign nationals coming to India for "execution of projects in the power and steel sectors". The validity of the visa will initially be for the duration of the project/contract with a multiple-entry facility, but the duration cannot exceed one year.

Conference visa: A new category of visa has been introduced as — "Conference visa" which will be granted to foreign nationals visiting India to attend a conference, if all of the following conditions are met:

- The individual holds a valid passport and re entry permit as per the laws of their home country.
- The individual should not be a persona-non-grata or the subject of a negative list or warning circular or other restrictive list.
- He should be a person of assured financial standing.

Conference visa will be issued for the duration of the conference and the travelling time.

Journalist visa: This is given to professional journalists and photographers. (If the professional intends to make a documentary in India, he or she may contact the Press and Information wing in the Embassy/Consulate General of India). Journalists are required to be accredited members of the Press Information Bureau and should be full-time personnel of a newspaper, magazine or journal.

Other visas issued in India include student visas, yoga visas, research visas and missionary visas, among others.

## K.2 Foreign exchange regulations

Under the prevailing foreign-exchange rules, salaries earned locally may be repatriated only by individuals holding employment visas. The following individuals are permitted to remit their salaries (net of retirement plan contributions and Indian taxes) to their home countries for maintenance of close relatives abroad:

- Foreign nationals who are residents but not permanently resident in India and who are regularly employed with Indian firms or companies and receive a monthly salary
- Indian nationals on deputation to an office, branch, subsidiary or joint venture in India of an overseas company

The definition of residential status of individuals under the exchange control law differs from the definition under the Income Tax Act, 1961.

A foreign national, who is an employee of a company incorporated in India, may open an Indian bank account, receive salary in the Indian bank account and remit the whole salary received in India to a foreign bank account maintained by him overseas, provided income tax is paid on the entire salary in India.

A special rule applies to an expatriate worker (whether a foreign national or an Indian citizen) who is employed by a foreign company outside India who is deputed to the office, branch, subsidiary, joint venture in India of such foreign company. Such expatriate workers may receive salary in the foreign bank account outside India, provided income tax is paid on the entire salary accrued in India. However, where an expatriate worker referred to above is deputed to work in India in an entity, which is not directly related to its foreign employer (as a directly related subsidiary, branch, liaison office, joint venture of its foreign employer), then a specific RBI approval for payment of salary outside India may be required.

India regulates the acquisition, holding, transferring, borrowing, or lending of foreign exchange and the acquisition of foreign security or immovable property located outside India by persons resident in India. However, a person resident in India may hold, own, transfer or invest in foreign currency, foreign security or an immovable property located outside India if the person acquired, held or owned such currency, security, or property when he or she was resident outside India or such person inherited the currency, security or property from a person who was resident outside India.

Under a liberalized remittance scheme for resident individuals, which has been notified, total remittances of up to US$200,000 per financial year per individual are allowed for permissible current-account and permissible capital-account transactions, subject to certain exceptions. The scheme allows individuals to acquire and hold immovable property or shares, maintain foreign-currency accounts or other assets outside India without RBI approval, subject to the fulfilment of specified conditions.

## K.3 Residential permit

All foreign nationals are required to register with police authorities at the local registration office within two weeks from their date of arrival if their visas are valid for more than than six months (or if the visa stamps specifically require this registration). A foreign national holding a visa valid for six months or less, who wishes to stay back in India beyond the period of validity, must register within two weeks after 180 days from the time of his or her arrival in India. A PIO card holder, whose continuous stay in India exceeds 180 days, is required to register within 30 days after the 180 days from his or her arrival in the country.

The following documents need to be presented to register with the local registration office:

- Application form
- Photocopy of the passport and initial visa
- Four photographs of the applicant
- Details of residence/proof of residential address in India
- Notarized documents submitted to the President of India by a

guarantor willing to reimburse the GoI if the individual continues to reside in India or if he or she is being supported by the GoI

- Copy of the marriage certificate in the case of those seeking extension of stay on grounds of being married to an Indian national
- Accreditation certificate from the Press Information Bureau in the case of a visitor with a journalist visa-level appointees in public limited companies
- Two copies of the approval of the GoI in the case of a joint venture or collaboration
- Copy of permission from the RBI in the case of a business/joint venture
- Terms and conditions of appointments and copy of contract or agreements in the case of an employment visa
- Undertaking from the concerned Indian company (typically specifying the nature of work, etc.) in the case of employment/ business visa
- Copy of the passport of an individual signing the undertaking mentioned above (Please note that only an Indian passport holder can provide such an undertaking)
- Copy of the Certificate of Incorporation, Articles of Association and Memorandum of Association
- In the case of a student visa, bonafide certificate from school/ college
- In the case of a research visa, bonafide certificate and letter from the nodal agency/ministry sponsoring the research
- The original passport and visa are also required at the time of filing for verification with the authorities.
- Registration is valid for the term of the visa and may be extended upon application. Failure to register may result in the immigration authority's refusal to allow the foreign national to leave the country.

### K.3.1 Formalities to be observed by registered foreigners

A registered foreigner is issued a registration booklet containing his latest photograph, details of residence and other requirements. An endorsement is also made in the passport relating to registration. The foreigner is required to intimate any permanent change in his or her address to the registration authorities. The person is also required to inform the Registration Officer if he/she proposes to be absent from his/her registered address for a continuous period of eight weeks or more. Similarly, a foreigner, who stays for a period of more than eight weeks at any place other than the district of his/her registered address, should inform the Registration Officer of that district of his/her presence. Every foreigner is required to furnish to the Registration Officer of the district, in which his/her registered address is located, particulars relating to any circumstances affecting in any manner the accuracy of the particulars recorded in his/her certificate of registration within 14 days after the circumstance has occurred, and should provide to the Registration Officer all information as may be required to maintain the accuracy of the certificate.

Every foreigner who is about to depart finally from India should surrender his or her certificate of registration either to the Registration Officer of the place where he/she was registered, of the place from where he/she intends to depart or to the Immigration Officer at the port/check post of exit at the time of his/her final departure from India.

## K.4 Family and personal considerations

### Work visas for family members

Entry visas are issued to accompanying family members of individuals visiting India on business or for employment. Spouses or dependents of working expatriates must obtain separate work permits to be employed in India. As per guidelines issued, the visa of the spouse of an employee on an intra-company transfer may be converted from an "X" Visa (Entry visa) into an employment visa subject to specified conditions. Family members intending to reside with a working expatriate must register separately at the local registration office. Children of working expatriates must obtain student visas to attend Indian schools.

### Driver's permit

Foreign nationals are not permitted to drive in India using their home country drivers' licenses. They should obtain international drivers' licenses in their home countries. Such licenses are normally valid for six months.

To obtain an Indian driver's license, individuals should apply to the Regional Transport Authority, which issues learners' permits. This will enable the individual to drive when accompanied by an adult who has a valid Indian driver's license. One month after the learner's permit is issued, a driving test and a verbal examination on local driving laws needs to be taken. On successful completion of the examinations, the Regional Transport Authority issues a driver's license.

## K.5 Other matters

### K.5.1 PIO card

A PIO card can be obtained by any individual who is in possession of the passport of any other country except for Afghanistan, Bangladesh, Bhutan, China, Nepal, Pakistan, Sri Lanka or any other country specified by the GoI, and who satisfies any of the following conditions:

- The individual has held an Indian passport at any time.
- The individual or any of his or her parents, grandparents or great-grandparents were born in and are permanently resident in India.
- The individual's spouse is a citizen of India or a PIO (This implies that even a foreign spouse of a citizen of India or of a person of Indian origin may apply for a PIO card)

PIO card holders are granted certain benefits including:

- A waiver of the requirement to obtain a visa to visit India
- Exemption from the requirement to register if the individual's stay in India does not exceed 180 days
- Acquisition, holding, transfer and disposal of immovable properties in India except acquisition of agriculture or plantation properties
- Facilities to obtain admission to educational institutions in India
- Benefits under various housing schemes of the Life Insurance Corporation of India, state governments and other government agencies

## K.5.2 Dual citizenship

A foreign national, who was eligible to become citizen of India on or after 26 January 1950 or belonged to territory that became part of India after 15 August 1947 and his/her children and grand children, provided his/her country of citizenship allows dual citizenship in some or the other form under the local laws is eligible for registration as Overseas Citizen of India (OCI). However, if the applicant had ever been a citizen of Pakistan or Bangladesh, he/she will not be eligible to be OCI.

Chapter L.

# Direct taxes

India has a well-developed tax structure and the authority to levy taxes is divided between the Central and state governments. The Central Government levies direct taxes including income tax, wealth tax, corporate tax and indirect taxes comprising customs duty, excise duty, central sales tax and service tax. The states are empowered to levy professional tax and state sales tax apart from various other local taxes, including entry tax and octroi.

## L.1 Administration

Administration, supervision and control in the area of direct taxes lie with the Central Board of Direct Taxes (CBDT). The CBDT works under the MoF, exercises significant influence over the working of the country's direct tax laws and also ensures effective discharge of executive and administrative functions.

The Indian tax year extends from 1 April of a year to 31 March of the subsequent year. A corporation tax year also ends on the same date. All corporations (except those who are required to submit transfer pricing certificate in Form 3CEB in respect of international transactions) are required to file a return of income (ROI) by 30 September, even in the event of loss. However, corporations who are required to submit transfer pricing certificate in Form 3CEB in respect of international transactions are required to file a ROI by 30 November. Non-resident corporations must file a ROI in India if they earn income in India, or they have a physical presence/economic nexus in India.

Corporate tax liability needs to be estimated and discharged by way of advance tax in four instalments on 15 June, 15 September, 15 December and 15 March every year.

Filing of late ROI and delay in payment/shortfall in taxes are liable to attract penal interest at prescribed rates. Interest is generally imposed on the balance of the unpaid tax due and on underpayment of the advance tax due.

# L.2 Corporate income tax

For Indian income tax purposes, a corporation's income comprises :

- Income from house property
- Income from business
- Capital gains on disposition of capital assets
- Residual income arising from non-business activities

Corporations resident in India (whether owned by Indians or non-residents) are taxed on their worldwide income arising from all sources. Non-resident corporations are taxed on the income earned from a business connection in India or from other Indian sources. A corporation is deemed to be resident in India if it is incorporated in India or if its control and management is entirely located in India.

If there is a tax treaty between India and the country of residence of the taxpayer, the provisions of the IT Act or the tax treaty, whichever is more beneficial, will apply. Accordingly, the taxability of a non-resident in India may be restricted or modified and lower rates may apply. In general, India's tax treaties provide that corporation residents of other countries are subject to Indian tax on business profits derived from a business in India, only if the non-resident has a permanent establishment in India.

## L.2.1 Rates of corporate tax

### Normal rate

Domestic corporations are subject to tax at a basic tax rate of 30%, as well as a 5% surcharge. Foreign corporations are subject to a basic tax rate of 40%, as well as a 2% surcharge. The surcharge is only applicable in cases where the total income of the taxpayer (domestic or foreign corporation) exceeds INR10m. Further, the tax payable by all companies is enhanced by an education cess at the rate of 3% on the tax payable, inclusive of surcharge. The effective tax rate for domestic corporations is 32.4% (including surcharge and education cess) and for foreign corporations 42.0% (including surcharge and education cess).

| Nature of income | Tax rates (corresponding note) |
|---|---|
| **Corporate income tax** | |
| Domestic Corporation (h) | 30 (a) |
| Foreign corporation | 40 (a) |
| Dividend distribution tax | 15 (a) |
| Long term capital gains tax | 20 (a) (d) (e) |
| **Withholding Tax** | |
| *Dividends* | |
| Paid to domestic companies | 0 (g) |
| Paid to foreign companies | 0 (g) |
| *Interest* | |
| Paid to domestic companies | 10 (a) |
| Paid to foreign companies | 20 (a) (b) |
| *Royalties from patents, know how etc* | |
| Paid to domestic companies | 10 (a) |
| Paid to foreign companies | 10 (a) (f) |
| *FTS* | |
| Paid to domestic companies | 10 (a) |
| Paid to foreign companies | 10 (a) (f) |
| *Net operating losses* | |
| Carry back | 0 |
| Carry forward | 8 (c) |

a. For the tax year ending 31 March 2012, the rates listed above for corporate income tax, including capital gains Tax and DDT, have to be increased by a surcharge of 5% of such taxes in the case of domestic corporations. In the case of foreign corporations and branches, income tax, capital gains tax and withholding taxes have to be increased by a surcharge of 2% of such taxes. The surcharge (except in the case of DDT) is only applicable in cases where the total income of the taxpayer (resident corporation or foreign corporation/branch) exceeds INR10m. In addition, the tax payable by corporations (except in the case of withholding taxes on payments to domestic corporations) has to be increased by an education cess, which is imposed at the rate of 3% of the tax payable, inclusive of the surcharge

b. (b) This rate only applies to interest on foreign currency loans. Any other interest is subject to tax at the normal rates applicable for foreign corporations. However, any interest paid by an infrastructure debt fund to a non-resident or to a foreign company attracts a withholding of only 5% (plus applicable surcharge and cess).

c. (c) Unabsorbed depreciation may be carried forward indefinitely to offset taxable profits in subsequent years. Unabsorbed business loss may be carried forward to offset the profits of eight years succeeding the year when the loss occurred.

d. (d) Capital gains arising from the sale of assets held for more than three years (one year in the case of certain assets such as shares, the unit of a mutual fund, etc.) are known as long-term capital gains. Capital gains other than such long-term gains are known as short-term capital gains, which are taxed at normal corporate rates.

e. (e) Long-term capital gains arising from the transfer of equity shares or the units of an equity-oriented mutual fund on any recognized stock exchange in India are exempt from tax if STT has been paid on such transactions and short-term capital gains on such transactions are taxed at 15%.

f. (f) Subject rates apply in the case of royalty/FTS being received by a foreign company in pursuance of an agreement made on or after 1 June 2005

g. (g) Dividends paid by domestic corporations are exempt from tax in the hands of the recipients, if DDT is paid on the dividends paid.

h. (h) Dividend received by a domestic corporation after 1 April 2011 from a specified foreign company is taxable at the rate of 15% (plus surcharge and education cess). Specified foreign company is a foreign company in which Indian company holds 26% or more in nominal value of the equity share capital of the company.

## Special rates for non-resident corporations

Royalty or fees for technical services: Foreign corporations are taxed with respect to royalty or fees for technical services (FTS), which are received from the Government, from Indian organizations under agreements that are approved by the GoI or which are in accordance with the country's industrial policy (refer to notes 1 and 2).

| | |
|---|---|
| In pursuance of agreements made on or after 1 June 2005 | Taxable at 10% on a gross basis (plus surcharge at 2% and education cess at 3%) |

Notes:

i. Royalties and FTS which are effectively connected with the foreign corporation's permanent establishment in India, are taxed on a net income basis at the normal rates applicable to foreign corporations.

ii. Royalties and FTS, which are not received from the GoI or Indian organizations, are taxed on a net income basis at the normal rates applicable to foreign corporations. So also are royalties and FTS payable under agreements that are not approved by the GoI or under arrangements that are not in accordance with India's industrial policy. These are taxed on a net basis at the normal rates applicable to foreign corporations.

**Dividend income:** Dividend income distributed by domestic corporations (on which dividend distribution tax has been paid by the company distributing the dividend) is exempt from tax in the hands of the recipients.

**Interest on foreign currency loans:** Foreign corporations earning interest on foreign currency loans given to an Indian concern or to the GoI are taxed at the rate of 20% on the gross interest.

**Income earned by overseas financial organizations:** Specified overseas financial organizations earning an income from units of specified mutual funds, purchased in foreign currency, are taxed at the rate of 10% on the gross amount of such income. Long-term capital gains arising from the transfer of such units are also taxed at the rate of 10%.

**Income earned by FIIs:** FIIs are taxed at the rate of 20% on income received with respect to securities, at the rate of 10% on long-term capital gains and the rate of 30% on short-term capital gains arising from the transfer of securities. However, if the transaction is liable to STT, an FII's long-term capital gains are exempt from tax and its short-term capital gain is liable to taxation at 15%.

The rates given above may be subject to more beneficial provisions of the tax treaty between India and the country in which the taxpayer is resident.

See Appendix 5 for a sample corporate tax calculation.

## L.2.2 Determination of taxable income (corporate)

### i. Income from house property

Income earned by renting out of house property is taxable in the hands of the owner. Valuation of income from house property is prescribed under various scenarios of occupancy ranging from rented, vacant to self-occupied. The owner is entitled to a deduction on account of municipal taxes actually paid.

Further, a standard deduction for repairs from such income at 30% of the prescribed value is permitted. Interest on borrowed capital, up to specified limits and on fulfilment of prescribed conditions, is also allowed as a deduction while computing the net income liable to tax.

### ii. Income from business

Taxable profits are computed in accordance with common business or accounting principles, modified by statutory tax provisions.

#### Business deductions

Taxpayers may deduct all business-related expenses from their gross income. Personal expenses and capital expenditure, other than expenditure on scientific research, are not deductible.

#### Inventories

Inventories should be valued in accordance with the accounting policy regularly complied with by the tax payer at cost or net realizable value (whichever is lower).

#### Provisions

In general, ad hoc provisions for expenses or losses are not tax-deductible. Provisions for duties, taxes (apart from income tax and wealth tax), bonuses, leave salary and interest on specified loans are deductible on an accrual basis, provided corresponding payments are discharged before the due date for filing the ROI. Otherwise, the deduction is allowed in the year of actual payment.

General provisions for doubtful debts are not deductible unless the bad debt is actually written off in the accounts. However, relief is available to banks and financial institutions with respect to non-performing assets.

### Retirement payments

Payments made to employees under Voluntary Retirement Schemes are deductible over a period of five years commencing from the year in which the sum has been paid.

Contributions to retirement benefits and other similar welfare funds are deductible, provided the corresponding payments are discharged before due date for filing the ROI. Otherwise, deduction is allowed in the year of actual payment.

### Depreciation and amortization allowances

Depreciation or amortization included in financial statements is not deductible. Except in the case of undertakings engaged in the generation or the generation and distribution of power, depreciation for tax purposes must be calculated on a block of assets according to the declining balance method at prescribed rates. Block of assets is a group of assets falling within a class of assets, comprising tangible and intangible assets, in respect of which specific tax depreciation rates are prescribed. Allowance for depreciation is only available after the asset is ready for use for its business purpose. In the event assets are acquired during the year and put to use for a period of less than 180 days, only half of the admissible depreciation is allowable during that year.

Depreciation is computed on the amount arrived at after adding to the declining balance value at the beginning of the year for a particular block of assets the actual cost of the assets acquired during the year, reduced by the sale proceeds arising from the disposition of any asset in that block.

Tax depreciation rates (declining balance method):

| Assets | Percent (%) | Assets | Percent (%) |
|---|---|---|---|
| Plant and machinery | 15* | Ships | 20 |
| Cars other than those that are hired out | 15 | Residential buildings | 5 |
| Computers (including software) | 60 | Buildings other than residential ones | 10 |
| Furniture and fittings, including electrical fittings | 10 | Intangible assets such as know-how, patents, copyrights trademarks, licenses, franchises or any other business or commercial right of similar nature | 25 |
| Buses, lorries and taxies that are hired out | 30 | | |

* In respect of plant and machinery (other than ships and aircraft) installed after 31 March 2005, accelerated depreciation equal to 20% of the actual cost is allowed in the year of acquisition to the taxpayer engaged in the business of manufacturing or producing any article.

Corporations engaged in the generation of or the generation and distribution of power have the option of claiming depreciation on a straight-line basis, but when this option is exercised once, it cannot be changed later.

### Restrictions on interest deductions

India does not currently have mandatory thin capitalization rules. However, banks and financial corporations are required to comply with prescribed capital adequacy norms. Interest is allowed as a deduction, provided it is with respect to capital borrowed for the purpose of business.

### Disallowance of payments to residents and non-residents

To enforce tax-withholding provisions, certain payments on which tax has not been withheld or withheld taxes are not deposited according to the law are not allowed as a tax deduction. These are however allowed as deductions in the subsequent tax year in which the appropriate taxes withheld are deposited.

### Foreign exchange losses

Foreign exchange fluctuations are considered while computing taxable income, provided they are on revenue account. Realized exchange fluctuations on a liability, with respect to assets acquired outside India, can be adjusted with their declining balance value.

### Relief for losses

Business losses, other than unabsorbed depreciation, may be carried forward to be set off against taxable business income derived during the next eight years, provided the ROI for the year of loss is filed by the due date. However, closely held corporations are required to satisfy a 51% continuity of ownership test to carry forward business losses.

Unabsorbed depreciation may be carried forward indefinitely, to be set off against the taxable income of subsequent years.

## iii. Capital gains and losses

Proceeds in excess of cost from the disposition of capital assets are generally taxed as capital gains. Capital assets include all kinds of property except stock-in-trade, raw materials and consumables used in businesses or professions, personal effects (except jewellery), agricultural land and notified gold bonds.

### General provisions

Long-term capital gains: Profits earned from the transfer of long-term capital assets are referred to as long-term capital gains. Generally, assets that have been held for more than three years are treated as long-term capital assets for the purpose of capital gains. However, the following assets are treated as long-term capital assets if held for more than one year:

- Shares (both listed and unlisted) or any other listed security
- Units of Unit Trust of India (UTI)

- Units of specified mutual funds
- Specified zero coupon bonds

In general, long-term capital gains are taxed at a basic rate of 20%. The cost of a capital asset is adjusted for inflation (indexation) to arrive at the indexed cost, which is allowed as a deduction while computing such long-term capital gains.

Gains derived from the transfer of UTI units, specified mutual fund units, listed securities or zero coupon bonds could be taxed at the rate of 10% (plus applicable surcharge and education cess), without allowing indexation adjustments, or at the rate of 20% (plus applicable surcharge and education cess) with the benefits of indexation, at the option of the taxpayer.

Long-term capital gains arising on the transfer of equity shares or the units of an equity-oriented fund (> 65% equity) on any recognized stock exchange in India is exempt from tax and STT has been paid on the transaction.

For assets acquired on or before 1 April 1981, the fair market value, as of 1 April 1981, or the actual cost of acquisition at the option of the taxpayer, will be treated as the cost of the asset. To compute capital gains arising from the transfer of bonus shares acquired after 1 April 1981, its cost is considered to be nil.

Long-term capital losses are allowed to be carried forward for eight consecutive years (subject to ROI filed on or before the due date), but may only be offset against taxable long-term capital gains.

Long-term capital gains are exempted from tax if an investment has been made as prescribed by the law in certain specified modes, including investment in residential property and specified bonds of institutions.

**Short-term capital gains:** Capital gains arising from the transfer of short-term capital assets (assets that do not qualify as long-term capital assets) are referred to as short-term capital gains and are taxed at the normal corporate income tax rates.

Short-term capital gains arising on the transfer of equity shares, the units of an equity-oriented fund on any recognized stock exchange in India (on or after the date on which STT came into force), on which STT has been paid, are taxed at the lower rate of 15% (plus applicable surcharge and education cess).

Short-term capital losses are allowed to be carried forward for eight consecutive years (subject to filing of ROI on or before the due date) and may only be offset against taxable capital gains (both long term and short term).

**Capital gains on depreciable assets:** To compute capital gains arising from the sale of assets on which depreciation has been allowed, the sale proceeds of the assets are deducted from the declining balance value of the block of assets (including additions made during the year) of which the former form a part. If the sales proceeds exceed the declining balance value of the entire block, the excess is treated as short-term capital gain. Otherwise, there is no capital gain from the sale of such assets, even if the sales proceeds of a particular asset is greater than the cost of such an asset. If all the assets that form a part of a block are sold, the excess/deficit of the declining balance (including additions made during the year) over the sale proceeds is treated as a short-term capital gain/capital loss.

### Special provisions relating to capital gains

Domestic tax law has a special provision for the taxation of capital gains earned by non-residents by the transfer of the shares and debentures of an Indian corporation acquired by utilizing foreign currency. Any gain (short or long term) is reconverted into Indian rupees at the exchange rate prevailing on the date of the transfer, to calculate taxable capital gains.

This special provision is a measure that is aimed at mitigating the effect of any fluctuation in the exchange rates of foreign currency on the capital gains earned by non-residents. No indexation benefits are offered in the calculation of capital gains in such cases.

### Amalgamations, demergers and slump sales

Amalgamations: Amalgamations are tax-neutral, subject to the satisfaction of prescribed conditions. In the case of non-compliance with any of the prescribed conditions, any brought forward business loss and unabsorbed depreciation, which has been set off by the amalgamated corporation, is treated as its income for the year in which it failed to fulfil any of the prescribed conditions.

**Demergers:** The demerger of businesses by existing corporations is tax-neutral, subject to the fulfilment of prescribed conditions. The accumulated losses and depreciation of the demerged corporation, attributable to the resulting corporation, can be carried forward and set off by the latter, subject to its compliance with prescribed conditions.

**Slump sale:** Profits derived from a slump sale are taxed as long-term capital gains if the transferred undertaking has been held for more than 36 months. Taxable capital gain arising from a slump sale is the excess of the consideration received over the net worth of the undertaking. The net worth is the difference between the value of the undertaking's total assets (the sum of the tax-depreciated value of assets that are depreciable for income tax purposes and the book value of the other assets) and the book value of its liabilities.

## iv. Income from other sources

Income that does not specifically fall under any of the types above is liable to tax as "income from other sources", including investment income and winnings from lotteries.

### Investment income

Dividends are taxed in the following manner:

- Domestic corporations are required to pay Dividend Distribution Tax (DDT) on profits distributed as dividends at the rate of 16.2225%, including the applicable surcharge at the rate of 5% and education cess at the rate of 3% with effect from 1 April 2011.
- The amounts declared, distributed or paid as dividends by Indian corporations are not taxable in the hands of the shareholders.

The dividends paid by foreign corporations are subject to tax in the hands of the shareholders. Dividend received by a domestic corporation after 1 April 2011 from a specified foreign company is taxable at the rate of 15% (plus surcharge and education cess). A specified foreign company is a foreign company in which an Indian company holds 26% or more in nominal value of the equity share capital of the company.

# L.3 Other direct taxes (corporate)

## L.3.1 Minimum Alternate Tax (MAT)

Indian tax law requires MAT to be paid by corporations on the basis of profits disclosed in their financial statements. In cases where the tax payable according to regular tax provisions is less than 18.5% of their book profits, corporations must pay 18.5% (plus surcharge and cess as applicable) of their book profits as tax. For domestic corporations, the effective tax rate works out to a little more than 20%. Book profits (for this purpose) are computed by making the prescribed adjustments to the net profit disclosed by corporations in their financial statements.

The tax credit (i.e., difference between tax paid under MAT provisions and the amount payable under normal provisions of the IT Act) may be carried forward for 10 years and set off against income tax payable under the normal provisions of the IT Act. A report from a Chartered Accountant, certifying the quantum of book profits, must be filed along with the ROI.

## L.3.2 Alternate Minimum Tax (AMT)

Indian tax law requires AMT to be paid by limited liability partnerships. Where the regular income tax payable for a previous year by a limited liability partnership is less than the AMT payable for such previous year, the adjusted total income shall be deemed to be the total income of the limited liability partnership for such previous year and it shall be liable to pay income tax on such total income at the rate of 18.5% (plus applicable cess). Since surcharge is not levied on firms, the effective tax rate works out to 19.05%. Adjusted total income for computation of AMT shall be the total income before giving effect to specified deductions.

The tax credit, carry forward and set off provisions are similar to provisions under MAT.

## L.3.3 Dividend Distribution Tax (DDT)

Dividends paid by domestic corporations are exempt from tax in the hands of the recipients. However, resident corporations must pay DDT at the rate of 16.2225% (including a 5% surcharge and a 3% education cess) on dividends declared, distributed or paid by them. Such tax is a non-deductible expense. Further, credit for dividend so received by a company is available for computation of dividend on which dividend distribution tax is to be paid (where it further declares dividend) provided:

- The dividend was received from the subsidiary
- The subsidiary has paid dividend distribution tax on such dividend
- Holding company is not a subsidiary of any other company

Under the said provisions, a company is deemed to be a subsidiary of another company where the other company, holds more than half in nominal value of the equity share capital of the company.

## L.3.4 Wealth tax

In India, wealth tax is payable at the rate of 1% if the taxable value of a corporation's net wealth exceeds INR3m. Assets subject to tax include residential houses, cars, yachts, boats, aircraft, urban land, jewellery, bullion, precious metals, any amount of cash not recorded in books of account and commercial property not used as business, office or factory premises. However, a residential house or houses owned by an employer and provided to an employee earning less than INR500,000 a year are exempt from tax. Assets such as a house for residential or commercial purposes or a residential property are exempt from tax if they are owned as stock-in-trade or used for hire. Productive assets such as shares, debentures and bank deposits etc. are not subject to wealth tax. A deduction is allowed for debts owed that have been incurred in relation to taxable assets. Tax is levied on net wealth, as of 31 March of the financial year.

## L.4 Industry-specific tax schemes

An optional tonnage tax scheme was introduced for the Indian shipping industry from 1 April 2004, which taxes income on a deemed profit basis.

Oil and insurance corporations have a separate code of taxation.

## L.5 Foreign tax relief

Tax treaties entered by India with several other countries govern foreign tax relief to avoid double taxation. If there is no such agreement, resident corporations may claim a foreign tax credit for the tax paid by them in other countries. The credit amount granted to such corporations is the lower of — the tax payable in India on income that is subject to double taxation or the foreign tax paid.

For a list of indicative tax rates prescribed under the various treaties, see Appendix 6.

## L.6 Appeal mechanism for non-residents

### L.6.1 Conventional route

The following is the conventional appellate route that a taxpayer can adopt:

- Appeal to Commissioner of Income Tax (Appeals)

  An aggrieved taxpayer can file an appeal within the prescribed time, i.e., 30 days, and on payment of the prescribed fees, with the Commissioner of Income Tax (Appeals) (CIT-A) against any appealable order passed in his/her tax assessment by a lower authority.

- Appeal to Income Tax Appellate Tribunal (ITAT)

  If a taxpayer or the revenue department feels aggrieved about an order passed by the CIT-A, he or she may prefer an appeal, within the prescribed time, i.e., within 60 days, and on payment of the prescribed fees, with the ITAT on any question of fact or law or both. ITAT is the final fact-finding authority.

- Appeal to the High Court (HC)

  The IT Act provides for appeals to the HC from every order of the ITAT wherever the taxpayer/revenue department feels aggrieved, provided the appeal involves a substantial question of law. The appeal needs to be filed within the time limit allowed under the IT Act, i.e., 120 days, along with the payment of the necessary fees.

- Appeal to the Supreme Court (SC)

  This is the final appellate authority under the IT Act. Where either the taxpayer or the revenue department is aggrieved by the order of the HC, an appeal can be preferred to the SC. The time limit and fee payment rule applies to this appeal as well.

### L.6.2 Dispute Resolution Panel (DRP)

In recognition of the fact that the tax dispute resolution mechanism presently in place is time consuming and finality is attained only after protracted litigation, an Alternate Dispute Resolution (ADR) mechanism has been introduced. The ADR mechanism is expected to resolve transfer pricing disputes for all categories of taxpayers, as well as disputes relating to the taxation of foreign companies in general (eligible taxpayers), on a fast-track basis. A DRP has been established for this purpose with the notification of the DRP rules. The DRP rules provide for establishment of the DRP at eight different locations in India and prescribe the procedure to be followed by the eligible taxpayers while seeking intervention of DRP in income-tax assessments.

Key features of the ADR mechanism through the constitution of the DRP are as follows:

- The Tax Authority is required to forward a copy of a draft assessment order to the eligible taxpayer if the former proposes a variation to the income or loss, which is prejudicial to the eligible taxpayer.

- The eligible taxpayer who objects to the draft assessment order has to file its objections with the DRP in a prescribed form, accompanied by certain other documents relating to the income tax assessment within 30 days of the receipt of the draft assessment order. The objections need to be specific and must, on each issue, indicate areas of disagreement with the Tax Authority.
- After hearing the objections, the DRP will issue appropriate directions to the Tax Authority for completion of the income tax assessment within a maximum period of nine months from the end of the month in which the draft assessment order was forwarded to the eligible taxpayer.
- The directions of the DRP are binding on the Tax Authority and the Tax Authority cannot appeal against these directions or an assessment order passed pursuant to these directions. However, the eligible taxpayer can file an appeal directly with the ITAT, against such assessment order.

Each DRP consists of a collegium of three "commissioner" level officials nominated by the CBDT, the highest tax administration body in India. The DRP is given powers vested in a "court" under the Code of Civil Procedure, 1908, while trying a suit with respect to discovery and inspection, enforcing the attendance of any person, compelling the production of books of accounts and issuing commissions.

The ADR mechanism through the constitution of the DRP is expected to facilitate an expeditious resolution of transfer pricing and international tax disputes. It is expected that the DRP will help in resolving transfer pricing and international tax controversies, reducing taxpayer grievance and litigation, on a basis which is fair and impartial to both the tax administration and the taxpayer and in a manner that will enhance public confidence in the integrity and efficiency of the DRP.

## L.6.3. Authority for advance ruling (AAR)

- A scheme of advance rulings is available under the IT Act to determine tax liability. Under the scheme, the power to issue advance rulings, which are binding on the tax authorities as well as the applicant, has been entrusted to an independent adjudicatory body.

- Advance ruling relates to the written opinion by an authority, which is empowered to render it with regard to the tax consequences of a transaction or proposed transaction.
- The question raised in the application should not be already pending before any income-tax authority or ITAT or involve determination of fair market value of any property or relate to a transaction, which is prima-facie designed for avoidance of income-tax.

A ruling can be obtained by an applicant (who may be either a non-resident or a resident who has entered a transaction with a non-resident) with respect to any question of law or fact in relation to the tax liability of the non-resident, arising out of a transaction undertaken or proposed to be undertaken.

## L.7 Income tax (individuals)

### L.7.1 Liability for income tax

Liability for income tax is governed by the residential status of individuals during the tax year.

Individuals are considered to be residents if they meet either of the following criteria:

- They were present in India for 182 days or more during the tax year, which extends from 1 April to 31 March.
- They were present in India for 60 days or more during the tax year and for at least 365 days in total during the preceding four tax years (The period of 60 days may be extended to 182 days in certain cases).

Individuals who do not meet either of the criteria mentioned above are considered to be non-residents. Individuals are considered to be "not ordinarily resident" if, in addition to meeting one of the criteria mentioned above, they satisfy either of the following conditions:

- Non-resident in India for 9 of the preceding 10 tax years; or
- Present in India for 729 days or less during the previous 7 tax years.

All individuals are subject to tax, unless they are exempt under the Income- tax Act or applicable tax treaties.

Income liable to be taxed in India depends on the residential status of the taxpayer. Categories of income liable to be taxed, according to residential status, have been depicted in the table below:

| Residential status | Taxability |
|---|---|
| **Resident and ordinary resident** | ▸ Worldwide income |
| **Resident and not ordinarily resident** | ▸ Income received in India or deemed to be received in India<br>▸ Income accruing or arising in India or deemed to accrue or arise in India<br>▸ Income accruing or arising outside India, either from a business controlled from India or a profession setup in India |
| **Non-resident** | ▸ Income received in India or deemed to be received in India<br>▸ Income accruing or arising in India or deemed to accrue or arise in India* |

## L.7.2 Types of incomes subject to tax in India

In general, all income received or accrued in India is subject to tax. Taxation of various types of income is detailed below. See the table in Appendix 7.1, which indicates individual income tax calculation and Appendix 7.2, which depicts the taxability of income items.

### i. Employment income

All salary income related to services rendered in India is deemed to accrue or arise in India, regardless of where it is received or the residential status of the recipient.

Employees of foreign enterprises, who are citizens of foreign jurisdictions, are not subject to tax if all of the following conditions are satisfied:

- The enterprise is not engaged in trade or business in India.
- The employee does not stay in India for an aggregate period of more than 90 days in the tax year.
- The compensation paid is not claimed by the employer as deduction from taxable income in India.

Similar exemptions are available under tax treaties if an individual's stay is less than 183 days, but conditions vary. Non-resident foreign citizens employed on foreign ships, who do not stay in India for longer than 90 days in a tax year, are also exempt from tax on their earnings.

In general, most elements of compensation are taxable in India. However, certain benefits (listed below) may receive preferential tax treatment, subject to certain requirements.

Corporation housing: The benefits of corporation housing (owned by the employer) is generally taxed at 15% of an individual's salary (10% of salary in cities with a population of less than 2,500,000 and 7.5% of salary in cities with a population of less than 1,000,000, according to the 2001 census. In the event accommodation is taken on lease by the employer, the employee is taxed at either 15% of his or her salary or the actual lease rental paid by the employer, whichever is lower. However, where the rent paid by the employer for the accommodation is recovered from the employee, the perquisite value is reduced by this amount. Furniture and appliances provided by the employer are taxed at the rate of 10% of their cost if the employer owns the items or the rent paid if the employer hires these.

Hotel accommodation: If an employee is provided with hotel accommodation, tax is imposed on either the hotel charges paid by the employer or 24% of the employee's salary, whichever is lower, reduced by the amount recovered from the employee, unless such accommodation is provided free of cost to the individual for up to 15 days on relocation. Such accommodation, provided for 15 days in aggregate, is exempt from tax.

Superannuation fund: Contributions made by an employer (in excess of INR0.1m) to a superannuation fund are taxable in the hands of the employee.

Interest-free or low-interest loans: The benefit of interest-free loans or low-interest loans exceeding INR20, 000 to an employee or a member of an employee's household is taxable, based on the purpose of availing the loan. The rate of interest is notified by the State Bank of India.

Employer-paid taxes on non-monetary benefits: In general, the tax paid by an employer on behalf of an employee is grossed and taxed in the hands of the employee. However, any tax paid by an employer, on behalf of the employee, on non-monetary benefits is exempt in the hands of the employee.

The following employer-paid items are not included in an employee's taxable compensation or included in his or her taxable income at a value lower than the actual cost incurred by employer (to the extent that they do not exceed specified limits and satisfy the prescribed conditions):

- Reimbursable medical expenses
- Contributions to retirement benefit funds, including provident and gratuity funds, in India
- Certain allowances, including house rent and leave travel

There is tax exemption of up to INR100 per month per child for up to two children on an education allowance provided by the employer to an employee for meeting the cost of his or her children's education. An allowance granted to an employee to meet the hostel expenses (boarding expenses in residential schools and colleges) of his or her children is exempt up to INR300 per month per child for up to two children.

## ii. Taxation of Employer-provided stock options (ESOPs)

ESOPs allotted/transferred by an employer, free of cost or at a concessional rate, are taxable in the hands of the employee. ESOPs are taxed at the fair market rate on the date they are exercised by an employee, reduced by the amount actually paid by or recovered from the employee.

### iii. Income from house property

As per the provisions of the IT Act, taxability of income from house property in the case of corporations and individuals is the same. For taxability of income from house property, kindly refer to Para L.2.2.i.

### iv. Self-employment and business income

All self-employed individuals or those doing business in India are subject to tax. The general principles of taxation in respect of business income in the case of individuals are similar to those of a corporation as discussed in Para L.2.2.ii.

#### Deemed basis of taxation

With the objective of increasing compliance with taxation provisions for small businesses, and reducing the administrative burden on the tax machinery, the GoI has introduced a presumptive taxation scheme, which is applicable to individuals, any Hindu undivided family (HUF) and partnership firms (excluding LLPs) for all businesses (except the business of plying, hiring or leasing goods and carriages) with a turnover of INR6m or less. Under the scheme, the taxpayer has the option to declare total income on a deemed basis at 8% of the gross receipts.

### v. Capital gains on assets

The provisions in respect of taxability of capital gains in the case of individuals are similar to those in respect of corporations as discussed in Para L.2.2.iii.

However, the following provisions are applicable only in respect of individuals and HUF:

- Long-term capital gains are exempt from tax in certain cases if such gains are reinvested within six months in certain specified long-term assets. This exemption can be claimed for investments up to INR5 m. If, within three years of such reinvestment, the new assets are sold or, in certain cases, used as security for a loan or an advance, the capital gains derived from the sale of the original asset are subject to tax in the year the new assets are sold or used as security.

- Exemptions are available for long-term gains derived from the sale of a residential house and other capital assets if such gains are used to acquire a residential house or specified bonds within the prescribed time.
- Further, capital gains arising from the transfer of land is exempt if such land has been used by a tax payer or a tax payer's parents for agricultural purposes for at least two years immediately preceding the date of transfer, and if the taxpayer uses the gains to purchase other land for agricultural purposes within two years from the date of the transfer. If gains from the sale of agricultural land are not reinvested, they are taxed as short-term gains if this land is held for less than three years, and as long-term gains if it is held for more than three years.

### vi. Income from other sources (investments, lotteries)

The general principles of taxation in respect of income from other sources in the case of individuals are similar to those of a corporation as discussed in Para L.2.2.iv. However, certain transactions are taxable only in the case of individuals or HUFs. These are discussed below.

NRIs (including persons of Indian origin) may exercise an option to be taxed at the flat rate of 20% on their gross investment income and a flat rate of 10% on their long-term capital gains on certain specified assets (without any deductions) arising from their foreign currency assets, acquired in India through remittances in convertible foreign exchange.

Interest payable on savings banks or fixed deposits in India is taxable and taxes are withheld at source by the banks if the interest exceeds INR10,000 in the tax year. The interest payable by scheduled banks (on approved foreign currency deposits) to non-residents, and not ordinary residents, is exempt from tax.

Taxability of certain transactions

- Any sum of money received (in excess of INR-50, 000) without consideration is taxable in the hands of the recipient.
- Where immovable property or any other property is received without consideration and the stamp/fair value of such property exceeds INR50, 000, the stamp/fair value of such property is taxable as income from other sources.
- Where immovable property or any other property is received for a consideration and such consideration is less than the fair value of the property by an amount exceeding INR50,000, the fair value reduced by the consideration received is taxable as income from other sources.
- The provisions given above are not applicable where the sum of money or property is received from a relative, on the occasion of the individual's marriage, under a will or inheritance, in contemplation of the death of the payer or donor or from a local authority, approved fund or trust.

## L.7.3 Deductions

For individuals, a deduction of up to INR100, 000 can be claimed from their gross total income for prescribed contributions to savings instruments and pension funds. Further, deduction may be claimed from gross total income for payment of tuition fees for the education of specified family members. In addition, interest paid on loans obtained to pursue higher education (senior secondary education or above) is fully deductible. However, no deduction is available for repayment of the principal amount.

In addition to the above mentioned deduction, an individual can also claim an additional deduction amounting to INR20,000 for subscription to long- term infrastructure bonds notified by the GoI.

Health insurance premiums for recognized policies in India paid for insurance of the health of an individual or his/her family may be deducted, up to a maximum of INR15,000 (INR-20,000 if insured person is more than 65 years) from their gross total income.

### L.7.4 Income tax rates (individuals)

The following tax rates have been proposed that will apply to resident and non-resident individual tax payers for the year ending 31 March 2012.

| Income slabs (INR) | Income tax |
|---|---|
| **0–180,000*** | Nil |
| **180,001–500,000** | 10% of income in excess of INR180,000 |
| **500,001–800,000** | INR32,000 plus 20% of income in excess of INR500,000 |
| **800,001 upwards** | INR92,000 plus 30% of income in excess of INR800,000 |

The tax calculated at the above mentioned rates is further increased by education cess at 3% for individuals.

*Resident individuals with income of up to INR180,000 do not need to pay income tax and education cess. The exemption limit is INR190, 000 for resident women below 60 years and INR250,000 for resident individuals above 60 years and below 80 years of age. In case of very senior citizens (defined as individuals above the age of 80 years), the exemption limit is INR500,000.

For a sample tax calculation, see Appendix 7.3.

## L.8 Income tax filing and payment process

All income is taxed on the basis of the financial year from 1 April to 31 March. All taxpayers, including non-residents, must file ROI if their income exceeds the maximum amount that is not liable to taxation.

Recently the government of India has, by way of a notification, exempted certain classes of persons from the requirement of filing a return of income, subject to certain conditions. Broadly these are individuals whose total income for the relevant year does not exceed INR0.5m and consists of only income under the head salaries and other sources.

ROI for salary income need to be filed by 31 July, ROI for self-employment or business income must also be filed by 31 July, or, if accounts are subject to a tax audit, by 30 September every year. Wealth tax returns for individuals need to be filed by the same deadline applicable to them in the case of income tax returns.

India does not have the concept of joint filing. As a result, married persons are taxed separately. The passive income of minor children is aggregated with that of the parent with the higher income.

Taxpayers with income earned from employment pay tax through tax withheld by employer from their monthly salaries each pay period. Taxpayers with tax liability exceeding INR10, 000 need to make advance tax payments, after deducting credit for tax withheld, in three instalments on 15 September, 15 December and 15 March every year.

Non-residents are subject to the same filing requirements as residents. However, non-residents and NRI nationals (including persons of Indian origin), who only have investment income or long-term capital gains (on foreign exchange assets), need not file ROI if the required tax is withheld at source. Non-residents are subject to the same assessment procedures as residents.

Before leaving India, any individual who is not domiciled in the country is required to furnish an undertaking to the prescribed authority and obtain a no objection certificate (NOC) if the person has been in India to engage in business, professional or employment activities and has derived income from the said activities. Such undertakings must be obtained from the individual's employer or the payer of the income, and these undertakings must state that the employer or the payer of income will pay the tax payable by the individual. An exemption to obtain an NOC is granted to foreign tourists or individuals visiting India for purposes other than business or employment, regardless of the number of days spent by them in the country. At the time Indian nationals domiciled in India depart from the country; they need to provide their Permanent Account Number (PAN), the purpose of their visit and the estimated period of their stay outside India to the prescribed authority. However, a person domiciled in India may also be required to obtain an NOC in certain specified circumstances.

# L.9 Other direct taxes (individuals)

## L.9.1 Wealth tax

In India, wealth tax is payable at the rate of 1% if the taxable value of an individual's net wealth exceeds INR3 m. Assets subject to tax include residential houses, cars, yachts, boats, aircrafts, urban land, jewellery, bullion, precious metals, cash in excess of INR50, 000 and commercial property not used as business, office or factory premises. However, a residential house or houses owned by an employer and provided to an employee earning less than INR500, 000 a year are exempt from tax. The assets mentioned above, other than urban land, are exempt from tax if they are owned as stock-in-trade or used for hire. Productive assets, including shares, debentures and bank deposits, are not subject to wealth tax. A deduction is allowed for debts owed that have been incurred with relation to taxable assets. Tax is levied on net wealth, as of 31 March, preceding the year of assessment.

## L.9.2 Social security

Social security in India is governed by the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPF Act). The EPF Act contains the following two principal schemes:

- Employees' Provident Funds Scheme, 1952
- Employees' Pension Scheme, 1995

**Coverage**

The Ministry of Labour and Employment has issued notifications extending the applicability of the Provident Fund and Pension Scheme rules to a new class of employees called "International Workers." Under the EPF Act, the following employees are considered to be "International Workers":

- An Indian employee (an Indian passport holder) who has worked or is going to work in a foreign country with which India has entered a social security agreement and who is or will be eligible to avail of the benefits under a social security program of that country, in accordance with such agreement

- A foreign national who works for an establishment in India to which the EPF Act applies

The EPF Act applies to the following establishments:

An establishment employing 20 or more persons engaged in a specified industry or an establishment or class of establishments notified by the central Government

An establishment employing less than 20 persons that opts voluntarily to be covered by the EPF Act

Covered employers must make a contribution toward the Provident and Pension Fund for their employees who are international workers.

An "excluded employee" is not covered by the EPF Act. An employee is considered to be an "excluded employee" if the following conditions are satisfied:

- The employee is an international worker who is contributing to a social security program of his or her country of origin, either as citizen or resident.
- The employee's home country has entered a social security agreement with India on a reciprocity basis and the employee is considered to be a detached worker under the social security agreement.

India has entered social security agreements with Belgium, Germany, Switzerland, Luxembourg and France. It has also signed social security agreements with Denmark, Czech Republic, Korea, Norway, Hungary and the Netherlands, but these agreements have not yet entered into force.

#### Contribution

Every covered employer is required to contribute 24% (12% each for the employer's and the employee's share) of the employee's "monthly pay" (as defined) toward the Provident Fund and Pension Fund. The employer has the option to recover the employee's share from the employee.

Out of the employer's 12% share of the contribution, 8.33% of monthly pay is allocated to the Employees Pension Fund. The balance of the contributions is deposited into the Employees Provident Fund.

Local employees drawing a monthly salary of INR6,500 or more are excluded from the legislation, but this exclusion does not apply to International Workers. Consequently contributions are required for International Workers even if the monthly pay of the employee exceeds INR6,500.

Refunds of Provident Fund contributions are possible, subject to the satisfaction of certain conditions.

The employer contributions are exempt from tax up to 12% of monthly pay.

**Withdrawal**

An international worker can withdraw from Provident Fund only in the following cases –

- On retirement or on reaching the age of 58 years, whichever is later, or
- On account of permanent and total incapacitation.

However, in respect of members covered under a Social Security Agreement (SSA), withdrawal may be made on such terms as may be specified in such SSA.

## L.10 Direct Taxes Code Bill, 2010 (DTC 2010)

DTC 2010 marks a new era in the Indian tax scenario after more than 50 years of operation of the current Income Tax Act, 1961 (IT Act). DTC 2010 appears to broadly retain the scheme of the existing IT Act, but, under a modified structure. DTC 2010 intends to lend simplicity, flexibility and stability to the taxation system and also to reduce the scope for ambiguity and litigation.

With regard to taxability of income, DTC 2010 classifies the total income into "ordinary source" (includes income from employment, income from house property, business income, capital gains and income from residuary sources) and "special source" (such as winnings from lottery, in case of non-residents). Further, with regard to the rate of taxes there has not been much change under DTC 2010 as compared to IT Act. The key tax rates proposed under DTC 2010 is enumerated below along with comparative figures contained under existing IT Act:

| Particulars | Current tax rates under IT Act | Tax rates under DTC 2010 |
|---|---|---|
| **Domestic Company** | 30%* | 30% |
| **Foreign Company** | 40%* | 30% |
| **Branch Profit Tax (BPT)** | Not Applicable | 15% (New Tax) |
| **DDT** | 15%* | 15% |
| **MAT** | 18.5%* of adjusted book profits | 20% of adjusted book profits |
| **Wealth tax** | 1% on net wealth exceeding INR3m | 1% on net wealth exceeding INR-10m |

*excluding surcharge and education cess

With regard to taxation of income from letting of house property, DTC 2010 provides that such income should be taxed under the head of "income from house property" notwithstanding that letting is in the nature of trade, commerce or business subject to exception in respect of Special Economic Zones, hotels, hospitals, convention centre, and cold storage. Further, standard deduction on account of repairs and maintenance reduced from existing 30% of net annual value under the IT Act to 20% of the gross rent under DTC 2010. However, DTC 2010 does not contemplate taxing vacant or self occupied property on a deemed basis as provided under existing IT Act, which is a welcome move.

With regard to the taxability of business income, DTC 2010 provides for a similar regime as contained under the current IT Act. However, DTC 2010 proposes a wide scope for taxing business as compared to the IT Act. Further, an important change proposed by the DTC 2010 is that every business will constitute a separate source of income, necessitating separate computation of income for each business separately. Deduction of business expenditure is allowed under 3 broad categories — operating expenditure, permitted financial charges and capital allowance. No deduction for any expenditure is allowed from special source income. Further, DTC 2010 does not provide for inter se set off of losses between ordinary source and special source.

Under DTC 2010 it is also proposed that, all assets will be classified into business assets and investment assets. The business assets will be further classified into business trading assets and business capital assets. The income from transactions in all business assets will be taxed under the head "business income."

Income from transactions in all investment assets, i.e., other than business assets, will be taxed under the head "capital gains". The present distinction between short-term investment asset and long-term investment asset under the IT Act, on the basis of length of holding of the asset, will be eliminated except that, for assets transferred after a year of holding, the indexation benefit will be available in the computation of capital gains. However, an exception in this regard has been provided in the case of equity shares or unit of an equity-oriented fund (listed securities) on which Securities Transaction Tax (STT) has been paid. In this regard, where the aforesaid listed securities is held by the taxpayer for a period of more than one year (i.e., long-term securities), 100% deduction will be available from capital gains arising on transfer of such securities and in case where the aforesaid listed securities are held for a period of up to one year (i.e. short-term securites), deduction will be restricted to 50%. Further, the base date to determine cost of acquisition under the IT Act, i.e., 1 April 1981 will be shifted to 1 April 2000. As a result, appreciation in value of the asset till 1 April 2000 will not be liable to tax under DTC 2010.

DTC 2010 also seeks to replace profit-based tax holiday incentives (as provided under IT Act) with investment-based incentives. Under the investment-based tax incentive scheme, the taxpayer will be allowed to recover all capital and revenue expenditure (except land, goodwill and financial instrument) and will be liable to tax on profits made thereafter. The period consumed in recovering all capital and revenue expenditure will be the period of tax holiday.

With regard to levy of Minimum Alternate Tax (MAT), DTC 2010 has adopted the same approach as provided under the existing IT Act for levying MAT with reference to "book profits" but with an enhanced tax rate of 20% (18.5% under IT Act).

DTC 2010 has further proposed some of the significant changes in the international tax regime as well. Some of the key proposals in this regard are as under:

- Introduction of GAAR to serve as a deterrent against tax evasion and avoidance and to dissuade taxpayers from entering an arrangement to obtain tax benefit
- Foreign company to be considered as Indian tax resident if its "place of effective management" (POEM) is situated in India. In this regard, POEM is defined to mean:
- Place where the board of directors (BOD)/executive directors (ED) make their decisions
- Where BOD routinely approve commercial and strategic decisions made by ED/officers, the place where ED/officers make such decisions
- Taxation of capital gains arising from "indirect transfer" of capital assets located in India

- Introduction of Controlled Foreign Company (CFC) regime as an anti-avoidance measure aimed to provide for taxation of passive income earned by a foreign company that is directly or indirectly controlled by a resident in India.
- Levy of Branch Profit Tax (BPT) on branch office of foreign companies in India, etc.

Further, the current IT Act enables a taxpayer to choose between a tax treaty and the IT Act, whichever is more beneficial to it. DTC 2010 adopts the same principle in this regard. However, provisions of DTC 2010 will continue to apply irrespective of beneficial tax treaty provisions if GAAR is invoked or in cases where provisions of CFC are attracted or on levy of BPT.

Overall, DTC 2010 proposes some key changes in the direct tax legislation in India aimed at eliminating distortions in the tax structure, introduce moderate levels of taxation, expand the tax base, improve tax compliance, simplify the language and lower tax litigations. However, DTC 2010 is presently in the draft stage, which has not reached its finality. One has to wait and watch on how the final DTC Bill is enacted. Once the final DTC Bill is passed by the Parliament, it will be possible to assess the actual impact on the business community.

Chapter

# M. Transfer pricing

Comprehensive transfer pricing regulations (TPRs) were introduced, effective 1 April 2001, with the objective of preventing MNCs from manipulating prices in intra-group transactions, e.g., by transferring their profits outside India.

Indian transfer pricing provisions are generally in line with transfer pricing guidelines for MNCs and tax administrators issued by the Organization for Economic Co-operation and Development (OECD Guidelines). However, there are some significant differences, e.g., these guidelines encompass a wider definition of the term "associated enterprise" and follow the concept of arithmetic mean as opposed to statistical measures of median/arm's length range followed internationally.

Under TPRs, any international transaction (ITN) between two or more associated enterprises (including permanent establishments) must be at arm's length price (ALP). These regulations also apply to cost-sharing arrangements. TPRs require the application of the most appropriate among all prescribed methods.

The following methods have been prescribed:

- Comparable uncontrolled price method
- Resale price method
- Cost plus method
- Profit split method
- Transactional and net margin method

However, TPRs do not mandate a hierarchy of methods. They require taxpayers entering ITNs to maintain prescribed documents and information and also obtain and furnish an accountant's report, which includes prescribed details related to the ITNs being carried out, to the tax authorities.

The prescribed documents include details of the ownership structure, description of the functions performed, risks undertaken, assets used by the parties to the relevant transaction, etc. Failure to maintain the documentation required by TPRs or to furnish the report of a Chartered Accountant result in imposition of a penalty.

| Nature of default | Possible penalty |
|---|---|
| Failure to keep and maintain documents and information with respect to an ITN | An amount equal to 2% of the value of the ITN |
| Failure to furnish the documents or information required by TPRs | An amount equal to 2% of the value of the ITN for each such failure |
| Failure to furnish the report of a Chartered Accountant mandated by TPRs | INR-100,000 |

According to TPRs, enterprises are considered to be "associated" if there is direct/indirect participation in the management, control or capital of an enterprise or by the same persons in both the enterprises. Further, TPRs suggest certain other deeming provisions, which also trigger an associated enterprise relationship. Some of the important ones among these include:

- Direct/indirect shareholding giving rise to 26% or more of voting power
- Dependence on source of raw material/consumables as well as on customers in the case of manufactured/processed goods, price and other conditions being influenced by the contracting party
- Authority to appoint more than 50% of board of directors or one or more of executive directors or members of the governing board of the other enterprise
- Dependence on borrowings, i.e., advancing loans amounting to not less than 51% of the total assets of the enterprise or providing a guarantee amounting to not less than 10% of the total borrowings

## M.1 Safe harbor rules

According to the amendment of the Finance Act (No. 2) 2009, determination of ALP with respect to ITN is subject to "safe harbor" rules, which the CBDT is empowered to draft. Safe harbor indicates the circumstances under which tax authorities accept a transfer price declared by a taxpayer. Currently, safe harbor rules are yet to be notified by the CBDT.

## M.2 Dispute Resolution Panel

Please refer to the discussion in Para L.6.2

## M.3 Advance Pricing Arrangements (APAs)

APAs are currently not in force in India. These are proposed to be introduced in the new Direct Tax Code (DTC) likely to be effective from 1 April 2012.

## M.4 Changes in Transfer Pricing Litigation

The Finance Act 2011 has made the following amendments in the TPRs:

- The proviso benefit of the arm's length range of +/- 5% has been abolished with effect from 1 April 2011, in respect of ITNs entered on or after 1 April 2011. The GoI proposes to bring in notified percentages as allowable variations from arms length price. The new arm's length percentages/range is yet to be notified.
- Section 92E read with section 139(1) has been amended. As per the amended provision the due date of filing the Accountant's report in Form 3CEB and maintenance of documentation is 30 November of the assessment year.
- Section 92CA has been amended to included sub-section 2A, which provides that where any other ITNs (other than those referred by the Assessing Officer), comes to the notice of the Transfer Pricing Officer during the course of proceedings before him, then the transfer pricing provisions shall apply to those ITNs also.
- The power of the Transfer Pricing Officer has been enhanced to exercise powers such as discovery and inspection; enforcing attendance of any person and examining him on oath; compelling production of books of accounts and other documents, etc. The Transfer Pricing Officer may further require, any person to furnish information/statement of accounts verified in the manner specified, giving information in relation to such matters as will be useful for or relevant to any proceeding under the Act.

Chapter

# N. Indirect taxes

## N.1 Excise duty

Excise duty is applicable on the manufacture of goods within India and is payable by the manufacturer.

Most products attract a uniform rate of 10% plus education cess at 3% of the excise duty, making the effective duty exposure 10.30%, i.e., excise duty of 10% and education cess of 0.30%.

Excise duty is generally levied on an ad valorem basis, either expressed as a percentage of the transaction value or maximum retail price (for certain specified goods). Goods manufactured in India can be exported without payment of excise duty, subject to specified conditions. Similarly, input used in the manufacture of these goods can be procured without payment of excise duty.

The GoI has prescribed certain rules that allow manufacturers to take credit for specified duties, including excise duty, CVD, SAD paid on varied input and capital goods, as well as service tax paid on input services used in the manufacture of taxable goods. The manufacturer can utilize such credit to pay the excise duty applicable on the final goods manufactured.

A lower Excise duty of 1% has been introduced with effect from 1 March 2011 on 130 specified goods without Cenvat credit, which were hitherto fully exempt or chargeable to zero excise duty. Alternatively, an option to avail Cenvat credit by charging duty of 5% on specified 76 items is also available.

## N.2 Service tax

Service tax is applicable on the provision of specified services in India. It is also applicable on import of services. In this regard, import rules have been issued by the GoI, which prescribe the criteria based on which a service qualifies as an import.

Service tax is applicable on more than 114 services, and is levied at an uniform rate of 10% of the value of service plus education cess at 3% of service tax, making the effective tax exposure 10.30%, i.e., service tax of 10% and education cess of 0.30%.

The Government has prescribed rules to determine the value of taxable service.

The individual providing the service collects service tax from the receiver and is responsible for depositing it with the Government. However, when a service is imported, as mentioned above, the importer of the service is responsible for depositing it with the GoI.

No service tax is applicable, subject to fulfilment of export conditions, on export of a service. The GoI has issued rules that include specific criteria, based on which a particular service qualifies as an export. In the case of export of a specified service, a mechanism has been provided, which prescribes the option to claim rebate/refund of excise duty/CVD/service tax paid on input/input services used to export the service.

Alternatively, the provider of a specified service can also avail credit for duties, including excise duty, CVD paid on input and capital goods and service tax paid on input services used to provide such export services. The credit can thereafter be utilized to pay the output service tax liability arising from services that are not exported. The balance, if any, can be claimed as refund from the GoI.

Credit of SAD paid on import of goods is not available to offset output service tax liability. There is no credit of duty/tax paid on input/output services that are used exclusively to provide non-taxable or exempt services.

Point of Taxation Rules, 2011 (POTR), have been introduced with effect from 1 April 2011. However an option has been provided to the assessee to comply with provisions under POTR with effect from 1 July 2011. Under POTR, the liability to deposit service tax will arise on earliest of issue of invoice or receipt of payment for service. However, where the invoice is not raised within 14 days of completion of provision of service, the point of taxation shall be date of completion of service.

## N.3 VAT/CST

VAT is an intra-state multi-point tax system and is levied on value added products at each stage. Presently, all the states have replaced their erstwhile sales tax regime with VAT.

The basic rate slabs under VAT are as follows:

- 0% for natural and unprocessed products and other essential goods
- 1% for special goods such as gold, bullion, silver, etc.
- 4%/5% for agricultural and industrial input, 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

Interstate sales continue to be liable to Central Sales Tax (CST), which is imposed by the Central Government and administered by the state Governments. The rate of CST is 2%, subject to the provision of prescribed declaration forms. The applicable VAT rate in the relevant state applies in the event the prescribed declaration has not been provided. Declaration forms are only issued when the goods are procured for (i) resale, (ii) for use in manufacture or processing of goods for sale, (iii) a telecommunications network, (iv) for use in mining or (v) for use in generation or distribution of electricity or any other form of power.

Further, a sale involving import of goods from outside India is not liable to CST, subject to the prescribed conditions. Moreover, sale of goods (including penultimate sale) involving export of goods from India is also not liable to CST. However, no input credit is available in respect of CST paid on procurements.

It is proposed that CST will be phased out over the next one or two years.

Input tax credit is available with respect to VAT paid on locally procured goods, including capital goods (other than the "negative list" of goods provided under respective state VAT laws). The credit can be set off against output tax liability, including CST. However, no input credit is available in respect of CST paid on procurements.

## N.4 Octroi/entry tax

Entry tax/Octroi is levied by state/local authorities on the entry of goods within its jurisdiction, for use, consumption or sale on the purchase value of the goods. For this purpose, the state is divided into different local areas. The value of the entry tax levied on different products may vary from state to state.

It is relevant to note that the constitutional validity of entry tax laws is presently a subject of dispute. The applicability and status of the dispute needs to be examined on a state to state basis.

## N.5 Research and Development Cess

The Research and Development Cess is levied by the GoI at 5% on import of technology into India through a foreign collaboration. This cess is required to be paid by the importer of technology on payments made for such imports.

## N.6 Other significant indirect taxes

### N.6.1 Stamp duty

Stamp duty is paid for a transaction executed by way of a document or instrument under the provisions of the Indian Stamp Act or the State Acts. Stamp duty is applicable on purchase of land and various other transactions, e.g., lease, conveyance, mortgage, partitions, transfers, etc. Levy of stamp duty is generally dependent on the state where the agreement is executed. Typically, for immovable property, this duty is payable in the state where the property is located. Payment of accurate stamp duty on instruments gives them legality. Such instruments have evidentiary value and can be admitted as evidence in a court of law. Instruments that are not properly stamped are not admitted as evidence in a court of law. The rates of stamp duty on instruments related to the transfer of immovable property vary from state to state. Stamp duty can be paid by using stamp paper, adhesive stamps or by franking.

The rate of duty is generally calculated on an ad valorem basis, depending on the nature of the instrument and the state where it is executed. Further, stamp duty can be levied at a flat rate on a certain document, irrespective of the amount involved.

## N.6.2 Profession tax

Profession tax is a state levy 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 profession tax. Not all the state governments levy profession tax currently.

In states where such a levy exists, every enterprise with employees earning salaries may be required to register itself and withhold profession tax from the salary paid to its employees at specified rates and deposit it into the Government treasury. The employer is liable to pay the requisite amount of profession tax on such salaries or wages, irrespective of whether it has deducted an equivalent amount from the salaries paid.

Further, employers are also required to pay profession tax at specified rates in their own capacity.

## N.6.3 STT

STT is levied on the value of a taxable securities transaction, as depicted below:

| Transaction | Rates | Payable by |
|---|---|---|
| Purchase/Sale of equity shares, units of equity- oriented mutual funds (delivery-based) | 0.125% | Purchaser/ Seller (both) |
| Sale of equity shares, units of equity-oriented mutual funds (non-delivery based) | 0.025% | Seller |
| Sale of an option in securities | 0.017% | Seller |
| Sale of an option in securities, where an option is exercised | 0.125% | Purchaser |
| Sale of futures in securities | 0.017% | Seller |
| Sale of units of equity- oriented funds to a mutual fund | 0.250% | Seller |

## N.6.4 Luxury tax

Luxury tax is a state levy on certain specified luxuries and certain facilities, services, enjoyments, utilities, etc. Generally, luxury tax is levied on specific accommodation and services provided in hotels and clubs of a specific kind and on certain commodities.

## N.6.5 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 in India, to sustain basic civic services in the city.

### N.6.6 Entertainment tax

State and local governments levy entertainment tax on various entertainment and amusement activities. Traditionally, film exhibition, cable/DTH subscriptions, video games, amusement parks, and events have been subject to entertainment tax. Some of the states are considering entertainment provided through telecom and the internet to be subject to entertainment tax. Entertainment tax rates are fairly high as compared to taxes levied on other luxury goods and services. For example, the entertainment tax rate for movie exhibition in Mumbai is as high as 45% while the same movie sold on a DVD is liable to a 20% tax rate. Most of the states offer entertainment tax exemptions to new multiplexes, sports events and certain films subject to specific conditions.

## N.7 Goods and Services Tax legislation (GST)

The GoI has proposed that the indirect tax regime in India be replaced by a comprehensive dual GST, to be levied concurrently by the Centre (CGST) and the States (SGST). It is anticipated that the base for the GST will be comprehensive, including virtually all goods and services, with minimum exemptions. The GST structure will follow the destination principle, i.e., imports will be included in the tax base, while exports will be zero-rated. In the case of inter-state transactions within India, the state tax will apply in the state of destination as opposed to that of origin.

The following are the key taxes proposed to be subsumed under the GST Central Taxes

**Central Taxes**

- Central Excise Duty (including additional excise duties)
- Taxes on newspaper and advertisements
- Service tax
- Additional customs duty

**State Taxes**

- VAT/Sales tax (including CST and Purchase tax)
- Entry tax (other than entry tax levied by local bodies)
- Entertainment tax (other than entertainment tax levied by local bodies)
- Taxes on advertisement
- Taxes on entertainment, betting and gambling (not levied by local bodies)

*The following are the key taxes not to be subsumed under the GST Central Taxes*

**Central Taxes**

- Customs and Export duties
- Taxes on goods/passenger transport
- Stamp duties
- Duties of Excise on specified petroleum products, natural gas and tobacco

**State Taxes**

- Entry tax, levied by local bodies
- Taxes on goods/passenger transport
- Stamp duties
- Taxes on Electricity
- Taxes on entertainment, betting and gambling, levied by local bodies
- Excise duty on Alcohol

Full input credit system will operate parallelly for CGST and SGST. GST paid on the procurement of goods and services will be available for credit against that payable on the supply of goods or services. The consumer, being the last person in the supply chain, will bear the tax, with no right of input tax credit. Cross utilization of input tax credit between CGST and SGST will not be permitted.

GST has been envisaged as a more efficient tax system that will widen the tax base, do away with the multiplicity of taxes and their cascading effects, minimize competitive distortions, and encourage better compliance.

The new tax structure will have a significant impact on all businesses — manufacturers, traders and service providers — and on all aspects of their activities, including supply chains and logistics, product pricing, dealer margins, and IT and accounting systems.

Many of the design features of the GST are yet to be finalized. They are being discussed by the Centre and the states.

The Empowered Committee of State Finance Ministers, a collective forum for the State Finance Ministers, brought out the "First Discussion Paper on GST in India" (FDP) on 10 November 2009 to share its views on the GST design and elicit views of the stakeholders. The GST model outlined in the FDP has the following features:

- The tax to be a dual GST, consisting of the CGST and the SGST. Inter-state transactions to be subjected to Integrated GST, to be collected by the Centre, but will appropriate transfer of funds to the destination state.
- Both CGST and SGST to be consumption-based, credit-Invoice type, and levied on the basis of the destination principle.
- There are three tax rates: a nominal rate for precious metals, a lower rate for essential commodities, and a standard rate for all other goods and services. The tax rates and classification of goods and services under each rate is not specified.
- Registration threshold of INR1m for SGST and INR15m for CGST.
- Octroi, Purchase tax on food grains, Municipal Entertainment Tax, and Stamp Duties not to be subsumed. The paper is silent on the treatment of other levies such as the electricity cess, and the passenger/transportation/vehicle taxes.
- Real Property, Alcohol, and Petroleum (and possibly Natural Gas and Electricity) to be kept outside the purview of GST.

- Industrial incentives to be converted into cash refunds. Special Industrial Area Incentives to be continued up to the legitimate expiry date.

The Thirteenth Finance Commission – the constitutional body appointed to give recommendations for sharing of resources between the Centre and the States also released a technical paper on 15 December 2009 (Technical Paper), providing an alternative model for a flawless GST. While the basic structure of the flawless GST outlined in the Technical Paper is similar to that proposed in the FDP, it is more comprehensive in scope and places much greater emphasis on inter-state and Centre-State uniformity. The following are the key distinguishing features of the flawless model.

- The Technical Paper recommends a single rate of GST — 5% for CGST and 7% for SGST. These rates are calculated to satisfy the criterion of revenue neutrality.
- The base to include all goods and services (including real property, tobacco products, alcohol, petroleum, and financial services), with possible exemption for certain unprocessed food items, and health, education, and service transactions between an employer and employee and public services.
- Emission fuels, alcohol and tobacco products to be subject to supplementary excises.
- All transaction-based taxes (including Octroi, stamp duties, and purchase taxes) to be subsumed under the GST.
- Common registration threshold of INR-1m for both CGST and SGST.
- Compounding scheme for dealers with turnover of up to INR4m, and for dealers in high value goods such as gold, silver and platinum ornaments, precious stones without any turnover limit.
- All future changes in GST design to be subject to approval of a new Constitutional body — the Council of Finance Ministers — that will include all Centre and State Finance Ministers.

The Empowered Committee of State Finance Ministers and the Union Finance Minister, keeping in mind the significant differences in the GST models outlined in the FDP and the Technical Paper, came out with certain changes on 21 July 2010 outlining certain features to achieve political consensus on the important aspects of the tax, such as the tax base, rates, compensation to the States for any loss in their revenues, treatment of inter-state supplies of goods and services, and the nature and extent of inter-state and Centre-State harmonization. The following are the key features on GST development:

- The exemption threshold for both goods and services under both components of GST, i.e., CGST and SGST to be uniform at INR1m
- Similarly, the threshold of compounding for small dealers should be uniform under CGST and SGST whether it is fixed at INR5m of turnover per annum or INR10m per annum.
- To review the existing exemptions from Central Excise Duty so that the list of goods exempt from CGST is aligned to the SGST list and 99 items currently exempt from VAT are exempt from both components of GST.
- GoI has proposed to keep CGST as the lower rate for goods at 6% and standard rate at 10%. Services to be charged with a CGST rate of 8%.
- States have been requested to adopt similar rates for SGST, i.e., lower rate of SGST for goods at 6%, standard rate at 10% and services at 8%.
- The adoption of above rates will ensure a single rate for CGST and SGST in the range of 12% to 20% in the first year of GST introduction.
- During the second year of implementation of GST it is proposed that the standard rate for SGST and CGST may be reduced to 9% and lower rate retained at 6%. However, such reduction will be subject to revenue receipt of the Centre and the states during this period.
- During the third year of GST implementation the standard rate may be reduced to 8% and lower rate increased to 8%. However, the CGST and SGST rate for services may be retained at 8%.

On 22 March 2011, the Constitution (One Hundred and Fifteenth Amendment), Bill, 2011 (GST Bill) was introduced in the Parliament, which seeks to introduce articles effecting the introduction of the Goods and Services Tax (GST) and the introduction of the GST Council. As per the existing structure of indirect taxation, the Parliament has the power to make laws on the manufacture of goods and the provision of services while the State Legislatures have the power to make laws on the sale and purchase of goods within their respective states. The Parliament has retained the exclusivity to make laws pertaining to sale of goods in the course of inter-state trade or commerce. The key highlights of the GST bill are as under:

- Article 246A introduced for enabling concurrent powers to levy GST
- GST has been defined to mean any tax on supply of goods or services or both except taxes on supply of:
    - Petroleum Crude
    - High Speed Diesel
    - Petrol
    - Natural Gas
    - Aviation Turbine Fuel
    - Alcoholic Liquor for human consumption

- State governments shall have the power to levy tax on sale of petroleum crude, high speed diesel, petrol, natural gas, aviation turbine fuel alcoholic liquor for human consumption and municipalities or Panchayats shall have the powers to levy tax on entry of goods into local area for consumption, use or sale therein and tax on entertainment and amusement.
- Parliament given exclusive powers to levy GST on interstate trade imports, exports, apportion revenues between states and Centre, constitute GST Council, to constitute GST Dispute Settlement Authority etc.

The Centre had initially proposed 1 April 2010 as the target date for implementation of the GST. However, keeping in mind the current state of affairs, the expected date of implementation of GST is still uncertain, a clear roadmap for implementation of GST is still awaited.

Chapter O.

# Incentives

### Tax incentives

The GoI, for the purpose of accelerated growth of Indian economy, have extended incentives in the form of tax holiday, deductions, rebates etc under the direct taxes. Primarily, such incentive relates to export promotion, new industrial undertaking, infrastructural facility, software industry, research, promotion of backward areas etc.

Herein we have briefly referred to incentives provided under the IT Act. The provisions herein, may need to read with the terms and conditions specific to each incentive provided in the law.

The incentives herein have been provided under the following broad categories:

## O.1 Incentives for Special Economic Zone (SEZ)

SEZ is defined as a specifically delineated duty free enclave deemed to be foreign territory for the limited purposes of trade operations and duties and tariffs. With SEZs scheme, GoI aims to promote export-led growth of the economy, supported by integrated infrastructure for export production and a package of incentives to attract foreign and domestic investment.

The SEZ Act, 2005, supported by SEZ Rules, came into effect on 10 February 2006, which provides for drastic simplification of procedures and for single window clearance on matters related to central as well as state governments. The new SEZ policy focuses on creation of an internationally competitive and hassle-free environment for exports.

## Tax holiday for units in SEZ

Undertakings located in SEZ and engaged in manufacture or production of articles or things or provision of services is eligible to claim 100% deduction in respect of export profits for a period of five years. For subsequent 10 years, deduction of 50% of the profits is allowed (for last 5 years, deduction subject to transfer of profits to investment reserve).

Though tax holiday is enjoyed by units in SEZ, they are required to pay Minimum Alternate Tax on book profits and Dividend Distribution Tax on income distributed as dividend.

## Tax holiday for SEZ developers

SEZ developers are eligible to claim 100% deduction of its business profits for 10 years (out of 15 years) beginning from the year in which SEZ is notified by Central Government.

Though tax holiday is enjoyed by units in SEZ, they are required to pay Minimum Alternate Tax on book profits and DDT on income distributed as dividend.

## Tax holiday for Offshore Banking Units and International Financial Services Centers located in SEZ

A scheduled bank or an Offshore Banking Unit of a foreign bank or a unit of International Financial Services Centre located in SEZ is eligible to claim 100% deduction of its income for 5 years and 50% for the next 5 years.

# O.2 Profit linked incentives

| Nature of business undertaken | Quantum of Deduction | Commencement period |
|---|---|---|
| **Incentives for Infrastructure Sector** | | |
| Developing/developing and maintaining/developing, operating and maintaining infrastructure facilities such as –<br>▸ a road including toll road, a bridge or a rail system<br>▸ highway project including housing or other activities being an integral part of the highway project<br>▸ water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system<br>▸ a port, airport, inland waterway, inland port or navigational channel in the sea | 100% of profits and gains - 10 years (out of 20 years) | On or after 1 April 1995 |
| Operating and maintaining a hospital (with at-least 100 beds) | 100% for 5 years | 1 April 2008 to 31 March 2013 |
| Hotel in the specified district having a World Heritage Site | 100% for 5 years | 1 April 2008 and 31 March 2013 |
| **Incentives for Oil & Gas Sector** | | |
| Commercial production of mineral oil | 100% for 7 years | On or after 1 April 1997 |
| Refining of mineral oil | | 1 October 1998–31 March 2012 |
| Commercial production of natural gas in licensed blocks | | On or after 1 April 2009 |

| Nature of business undertaken | Quantum of Deduction | Commencement period |
|---|---|---|
| **Incentives for undertakings in specified geographical locations** | | |
| Manufacture/production of article or thing or operation of cold storage plant by undertaking in Jammu & Kashmir | First 5 years - 100%<br>Next 5 years - 30% | 1 April 1993 to 31 March 2012 |
| Manufacture or production of specified article or thing or substantial expansion in Himachal Pradesh/ Uttaranchal | First 5 years - 100%<br>Next 5 years - 30% | 7 January 2003 to 31 March 2012 |
| In North Eastern states[39] permitted activities:<br>‣ manufacture or production of eligible articles or product<br>‣ substantial expansion<br>‣ hotel (not below 2 star category)<br>‣ adventure and leisure sports including ropeways<br>‣ providing medical and health services in the nature of nursing home with a minimum capacity of 25 beds<br>‣ manufacture of IT related hardware<br>‣ biotechnology<br>‣ Operational vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and para-medical, civil aviation related training, fashion designing and industrial training<br>‣ IT related training centre<br>‣ Old age home | 100% for 10 years | 1 April 2007 and 31 March 2017 |

39 North Eastern States comprise of Assam. Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Tripura

| Other incentives | | |
|---|---|---|
| Processing, preservation and packaging of fruits or vegetables or from the integrated business of handling, storing and transporting food grains | First 5 years – 100%<br><br>Next 5 years – 30% | On or after 1 April 2001 |
| Collecting and processing or treating of bio-degradable waste for generating power or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas or] making pellets or briquettes for fuel or organic manure | 100% for 5 years | |

Profit linked incentives not available for potential investments though deduction available for eligible existing business

- Provision of telecommunication services (whether basic or cellular, including radio, paging, domestic satellite service, network of trunking, broadband, network and internet services)
- Processing, preservation and packaging of meat/meat products, or poultry or marine or dairy products
- Development/development and maintenance/development, operations and maintenance of an industrial park notified by the Central Government.
- Generation or generation and distribution of power
- Transmission or distribution of power by laying a network of new transmission or distribution lines
- Substantial renovation and modernization of the existing network of transmission or distribution lines.
- Reconstruction or revival of a power generating plant
- Manufacture or production of article or thing or operation of cold storage plant by industrial undertaking in small scale sector/industrially backward state/industrially backward district
- Indian company carrying on scientific research and development as its main object

- Establishment and operation of a cold chain facility for agricultural produce
- Operating and maintaining a hospital in a rural area
- Manufacture or production of any article or thing other than those specified in Thirteenth Schedule/Fourteenth Schedule
- Hotel located in specified area
- Build, own and operate a convention centre, located in specified area

## O.3 Investment-linked incentives

### O.3.1 Deduction for specified businesses

With a view to encourage diversion of profits from the taxed sector to the exempt/untaxed sector, investment-linked incentives in the form of 100% deduction for expenditure incurred prior to the commencement of operations shall be allowed for specified business mentioned below. In terms of the books of accounts of assessee, such expense is capitalized on the date of commencement of business.

- Laying, operating a cross-country natural gas pipeline network for distribution including storage facilities being integral part of such network
- Building and operating a new hotel of two-star or above category as classified by the Central Government
- Building and operating a new hospital (with at least 100 beds)
- Developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government) or state government and which is notified by the board in this behalf in accordance with the guidelines prescribed
- Developing and building a housing project under a scheme for affordable housing framed by the Central Government or state government and which is notified by the board on this behalf in accordance with the guidelines prescribed
- Producing fertilizer in a new plant or in a newly installed capacity in an existing plant

- Setting up and operating a cold chain facility
- Setting up and operating a warehousing facility for storage of agricultural produce

### O.3.2 Incentive for R&D

| Nature of expense | Quantum of deduction |
|---|---|
| Revenue expenditure incurred on payment of salary to an employee engaged in scientific research or on purchase of materials used in such scientific research during 3 years preceding the commencement of business | 100% |
| Payment to a research association/university, college or other institution for scientific research | 175% |
| Payment to an Indian company to be used for scientific research and development that fulfills certain conditions | 125% |
| Payment to a research association/university or college or other institution for research in social science or statistical research (notified by Central Government) | 125% |
| Capital expenditure incurred in any previous year and within the 3 years immediately preceding the previous year (other than on acquisition of land) | 100% |
| Expenditure by company engaged in bio-technology/manufacture or production of any article or thing (except mentioned in XI Schedule) for scientific research or in- house research and development facility (other than expense on land or building). No deduction for expenditure incurred after March 31, 2012 | 200% |
| Payment to a National Laboratory/University/Institute of Technology/specified person (notified by Central Government) for scientific research undertaken under an approved programme | 200% |

## O.4 Accelerated depreciation

An Undertaking engaged in the business of manufacture or production of any article or thing, any new machinery or plant acquired and installed is entitled to additional depreciation of a sum equal to 20% of the actual cost of such machinery or plant.

Chapter

# Appendices

# Appendix 1: List of frequently used abbreviations

| | |
|---|---|
| ADR | American Depository Receipt |
| BPO | Business Process Outsourcing |
| CAGR | Compounded Annual Growth Rate |
| CBDT | Central Board of Direct Taxes |
| CCI | Competition Commission of India |
| Cos Act | Companies Act |
| FCCB | Foreign Currency Convertible Bond |
| FDI | Foreign Direct Investment |
| FEMA | Foreign Exchange Management Act, 1999 |
| FII | Foreign Institutional Investor |
| FIPB | Foreign Investment Promotion Board |
| FTP | Foreign Trade Policy |
| FY | Financial Year |
| GATT | General Agreement on Tariffs and Trade |
| GDP | Gross Domestic Product |
| GDR | Global Depository Receipt |
| INR | Indian Rupee |
| IRDA | Insurance Regulatory and Development Authority |
| IT | Information Technology |
| IT Act | Income Tax Act, 1961 |
| ITES | IT Enabled Services |

| | |
|---|---|
| Km | Kilometers |
| MNC | Multinational Company |
| MoF | Ministry of Finance |
| MoP | Ministry of Power |
| MoPNG | Ministry of Petroleum and Natural Gas |
| NBFC | Non-Banking Financial Company |
| NELP | New Exploration and Licensing Policy |
| NRI | Non-resident Indians |
| PIO | Person of Indian Origin |
| ROI | Return of Income |
| RBI | Reserve Bank of India |
| SEBI | Securities and Exchange Board of India |
| SEZ | Special Economic Zone |
| STT | Securities Transaction Tax |
| TRAI | Telecom Regulatory Authority of India |
| VAT | Value Added Tax |
| WTO | World Trade Organization |

# Appendix 2: Useful addresses and telephone numbers

| | |
|---|---|
| **Securities and Exchange Board of India** | Plot No.C4-A, 'G' Block, Bandra -Kurla Complex, Bandra (East), Mumbai 400051<br>Tel: (22) 2644 9000/4045 9000<br>Fax: (22) 2644 9016-20/4045 9016-20<br>Website: www.sebi.gov.in |
| **Ministry of Corporate Affairs** | 'A' Wing, Shastri Bhawan<br>Rajendra Prasad Road, New Delhi - 110 001<br>Tel : (11) 23384158, 23384660, 23384659<br>Website: www.mca.gov.in |
| **Telecom Regulatory Authority of India** | Mahanagar Doorsanchar Bhawan,<br>(next to Zakir Hussain College)<br>Jawaharlal Nehru Marg, (Old Minto Road)<br>New Delhi : 110 002<br>Tel: (11) 2323 6308/2323 3466/2322 0534/2321 3223<br>Fax: (11) 2321 3294<br>Website: www.trai.gov.in |
| **Central Revenue Building (Income Tax Office)** | IP Estate<br>New Delhi: 110002<br>Website: www.incometax.gov.in |
| **Directorate General of Shipping** | Jahaz Bhavan, Walchand H. Marg,<br>Mumbai - 400 001<br>Tel: (22) 2261 3651-4<br>Fax: (22) 2261 3655<br>Website: www.dgshipping.com |

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|---|---|
| **Central Drugs Standard Control Organization** | FDA Bhavan, ITO, Kotla Road,<br>New Delhi -110002<br>Tel: (11) 2323 6965/2323 6975<br>Fax: (11) 2323 6973<br>Website: www.cdso.nic.in |
| **National Highways Authority of India** | National Highways Authority of India, G 5&6,<br>Sector-10, Dwarka, New Delhi - 110 075<br>Tel: (11) 2507 4100/2507 4200<br>Fax : (11) 2509 3507/2509 3514<br>Website: www.nhai.org |
| **Department of Commerce** | Department of Commerce<br>Ministry of Commerce and Industry<br>Udyog Bhawan, New Delhi 110 107<br>Tel: (11) 2306 2261<br>Fax: (11) 2306 3418<br>Website: www.commerce.gov.in |
| **Ministry of Environment and Forests** | Paryavaran Bhavan, CGO Complex,<br>Lodhi Road, New Delhi - 110 003<br>Tel: (11) 2436 0605/2436 0570/2436 0519<br>Website: www.moef.nic.in |
| **Ministry of Mines** | 3rd Floor, A wing, Shastri Bhawan,<br>New Delhi 110001,<br>Tel: (11) 2307 3233<br>Website: www.mines.nic.in |
| **Ministry of Steel** | Government of India<br>Udyog Bhavan New Delhi - 110107<br>Tel : (11) 2306 3417<br>Fax : (11) 2306 3236<br>Website: www.steel.nic.in |

| | |
|---|---|
| **Ministry of Textiles** | Udyog Bhavan, New Delhi-110011<br>Tel: (11) 2306 1338/18/14<br>Fax: (11) 2306 3711/2306 3681<br>Website: www.texmin.nic.in |
| **Indian Banks Association** | 6th Floor, Center 1, World Trade Center Complex Cuffe Parade, Mumbai 400005<br>Tel: (22) 2217 4040<br>Fax: (22) 2218 4222<br>Website: www.iba.org.in |
| **Bulk Drugs Manufacturers Association** | C-25, Industrial Estate Near SBH, Sanath Nagar, Hyderabad 500018<br>Tel: (40) 2370 3910/6718<br>Fax: (40) 2370 4804<br>Website: www.bdmai.org |
| **Association of Mutual Funds in India** | One Indiabulls Centre, Tower 2, Wing B, 701, 7th Floor, 841 Senapati Bapat Marg, Elphinstone Road, Mumbai - 400 013<br>Tel: (22) 2421 0093/2421 0383/4334 6700<br>Fax: (22) 4334 6712/4334 6722<br>Website: www.amfiindia.com |
| **Chemicals and Petrochemicals Manufacturers' Association** | 610, Naurang House (6th Floor) 21, Kasturba Gandhi Marg, New Delhi – 110001<br>Tel: (11) 4359 8337/4150 3672<br>Fax: (11) 4359 8338<br>Website: www.cpmai.com |
| **All India Plastics Manufacturers' Association** | AIPMA House, A-52, Street No. 1, M.I.D.C. Marol, Andheri East, Mumbai - 400 093<br>Tel: (22) 2821 7324-25/2835 2511-12<br>Fax: (22) 28216390<br>Website: www.aipma.net |

| | |
|---|---|
| **Organization of Pharmaceutical Producers of India** | Peninsula Chambers, Ground Floor, Ganpatrao Kadam Marg, Lower Parel, Mumbai 400 013<br>Tel: (22) 2491 8123/2491 2486/6662 7007<br>Fax: (22) 2491 5168<br>Website: www.indiaoppi.com |
| **Association of Biotechnology Led Enterprises** | ABLE Secretariat # 123/C, 16th Main Road<br>5th Cross, 4th Block Koramangala,<br>Bangalore – 560034<br>Telefax: (80) 4163 6853/2563 3853<br>Website: www.ableindia.in |
| **India Semiconductor Association** | UNI Building, Millers Tank Bund Road,<br>Bangalore - 560 052<br>Tel: (80) 4147 3250<br>Fax: (80) 4122 1866<br>Website: www.isaonline.org |
| **The Indian Broadcasting Foundation** | B-304, Third floor, Ansal Plaza, Khelgaon Marg, Andrewsganj, New Delhi – 110049<br>Tel: (11) 4379 4444<br>Fax: (11) 4379 4455<br>Website: www.ibfindia.com |
| **Federation of Indian Export Organizations** | Niryat Bhawan, Rao Tula Ram Marg<br>Opp. Army Hospital Research & Referral,<br>New Delhi-110 057<br>Tel: (11) 4604 2222/2615 0101-04<br>Fax: (11) 2614 8194/2615 0066/2615 0077<br>Website: www.fieo.org |
| **Invest India** | Federation House, Tansen Marg<br>New Delhi 110001<br>Tel: +91-11-2376 8760-70<br>Fax: +91-11-2332 0714, 2372 1504<br>Website: www.investindia.gov.in |

# Appendix 3: Exchange rates

The table below provides RBI reference exchange rates for the Indian rupee against the four major currencies as on 15 June 2011.

| Currency | Exchange rate |
|---|---|
| US dollar | 44.705 |
| Euro | 64.43 |
| UK pound | 73.205 |
| Japanese yen (per 100 JPY) | 55.585 |

Source: State Bank of India (SBI)

# Appendix 4: FDI policy

Illustrative list of sectors/activities in which FDI is prohibited/permitted with conditions or sectoral caps

## Sectors/activity prohibited for investment in India

- Retail trading (except single brand product retailing)
- Lottery business including government/private lottery, online lotteries, etc.
- Gambling and betting including casinos etc.
- Business of chit fund
- Nidhi company
- Trading in Transferable Development Rights (TDRs)
- Real estate business or construction of farm houses
- Manufacturing of cigars, cheroots, cigarillos and cigarettes of tobacco or of tobacco substitutes
- Activities/sectors not opened to private sector investment including Atomic Energy and Railway Transport (other than Mass Rapid Transport Systems).
- Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract for lottery business and gambling and getting activities

## Sector/activity permitted with conditions or sectoral caps

- Agriculture and animal husbandry
- Tea plantation
- Mining
- Manufacture of items reserved for production in micro and small enterprise ( MSEs)
- Defence
- Electric generation, transmission, distribution and trading
- Civil aviation sector
- Asset reconstruction companies
- Banking – private and public sector
- Broadcasting
- Commodity exchanges
- Development of townships, housing, built-up infrastructure and construction-development projects
- Credit information companies (CIC)
- Industrial parks
- Insurance
- Non-banking finance companies (NBFCs)
- Petroleum and natural gas sector
- Print media
- Security agencies in private sector
- Satellites – establishment and operation
- Telecommunication
- Trading
- Courier services
- Investment in sectors that are otherwise permitted under the automatic route through limited liability partnerships in India

# Appendix 5: Corporate tax calculation

The following example illustrates the computation of taxable income and tax liability of a domestic company for the tax year 1 April 2011 to 31 March 2012:

| | | |
|---|---|---|
| **Net profit as per financial statement** | | **14,500,000** |
| Less: | | |
| Net dividends received from domestic company | (2,000,000) | |
| (exempt from tax) | | |
| Income from sub-leased property | (200,000) | |
| (considered separately) | | (2,200,000) |
| Add: | | 12,300,000 |
| Provision for tax | 9,000,000 | |
| Depreciation as per financial statements | 3,000,000 | |
| Disallowed expenses | 200,000 | |
| (such expenses are not related to the business) | | 12,200,000 |
| | | **24,500,000** |
| Less: | | |
| Tax depreciation | | (5,560,000) |
| Business income | | 18,940,000 |
| Income from other sources: | | |
| Net income from sub-leased property | | 200,000 |
| Gross total income | | 19,140,000 |
| **Taxable income** | | **19,140,000** |
| *Calculation of tax* | | |
| Income tax at 30% on Rs. 19,140,000 | | 5,742,000 |
| Add: | | |
| Surcharge at 5% (since total income more than INR10 m) | | 287,100 |
| Education cess at 3% | | 180,873 |
| **Tax payable** | | **6,209,973** |
| Less: | | |
| Advance tax paid during the tax year | | (5,700,000) |
| *Balance tax payable/(refundable) with ROI (1)* | | 509,973 |

*Liability for tax excludes the interest chargeable on account of underpayment of advance tax.*

# Appendix 6: Treaty tax rates

The following table presents the treaty rate or the rate under the domestic tax laws on outbound payments for countries that have concluded double tax avoidance treaties with India, whichever is lower.

| Country | Interest (%) | Royalty(%) |
|---|---|---|
| Armenia | 10 (b) | 10 (d) |
| Australia | 15 | 10 (c)(k) |
| Austria | 10 (b) | 10 (d) |
| Bangladesh | 10 (b) | 10 (d) |
| Belarus | 10 (b) | 10 (c) |
| Belgium | 15 (b) | 10 (e) |
| Botswana | 10 (b) | 10 (d) |
| Brazil | 15 (b) | 10 (c) |
| Bulgaria | 15 (b) | 10 (c) |
| Canada | 15 (b) | 10 (c)(k) |
| China | 10 (b) | 10 (d) |
| Columbia (o) | 10 | 10 (d) |
| Cyprus | 10(b) | 10 (c) |
| Czech Republic | 10 (b) | 10 (d) |
| Denmark | 15 (b) | 10 (c) |
| Ethopia (n) | 10 | 10 (d) |
| Finland (j) | 10 (b) | 10 (d) |
| France | 10(b)(e) | 10 (d)(e) |
| Germany | 10 (b) | 10 (d) |
| Greece | 20 (a) | 10 (c) |
| Hungary | 10(b)(e) | 10 (c)(e) |

| Country | Interest (%) | Royalty(%) |
|---|---|---|
| Iceland | 10 (b) | 10 (d) |
| Indonesia | 10 (b) | 10 (c) |
| Ireland | 10 (b) | 10 (d) |
| Israel | 10(b)(e) | 10 (d)(e) |
| Italy | 15 (b) | 10 (c) |
| Japan | 10 (b) | 10 (c) |
| Jordan | 10 (b) | 10 (c) |
| Kazakhstan | 10(b)(e) | 10 (d)(e) |
| Kenya | 15 (b) | 10 (c) |
| Korea | 15 (b) | 10 (c) |
| Kuwait | 10 (b) | 10 (d) |
| Kyrgyz Republic | 10 (b) | 10 (c) |
| Libya | 20 (a) | 10 (c) |
| Luxembourg | 10 (b) | 10 (d) |
| Malaysia | 10 (b) | 10 (d) |
| Malta | 10 (b) | 10 (c) |
| Mauritius | 20 (a)(b) | 10 (c) |
| Mexico (g) | 10 (b) | 10 (d) |
| Mongolia | 15 (b) | 10 (c) |
| Montenegro | 10 (b) | 10 (d) |
| Morocco | 10 (b) | 10 (d) |
| Mozambique (l) | 10 (b) | 10 (d) |
| Myanmar | 10 (b) | 10 (d) |
| Namibia | 10 (b) | 10 (d) |
| Nepal | 15 (b) | 10 (c) |
| Netherlands | 10 (b)(e) | 10 (d)(e) |

| Country | Interest (%) | Royalty(%) |
|---|---|---|
| New Zealand | 10 (b) | 10 (d) |
| Norway (i) | 10 | 10 (c) |
| Oman | 10 (b) | 10 (c) |
| Philippines | 15 (b) | 10 (c) |
| Poland | 15 (b) | 10 (c) |
| Portugal | 10 (b) | 10 (d) |
| Qatar | 10 (b) | 10 (d) |
| Romania | 15 (b) | 10 (c) |
| Russian Federation | 10 (b) | 10 (d) |
| Saudi Arabia | 10 (b) | 10 (d) |
| Serbia | 10 (b) | 10 (d) |
| Singapore | 15 (b) | 10 (d)(k) |
| Slovenia | 10 (b) | 10 (d) |
| South Africa | 10 (b) | 10 (d) |
| Spain | 15 (b) | 10 (c)(e)(k) |
| Sri Lanka | 10 (b) | 10 (d) |
| Sudan | 10 (b) | 10 (d) |
| Sweden | 10 (b)(e) | 10 (d)(e) |
| Switzerland | 10 (b)(e) | 10 (d)(e) |
| Syria | 10 (b) | 10 (d) |
| Tajikistan | 10 (b) | 10 (d) |
| Tanzania (m) | 10 | 10 (d) |
| Thailand | 20 (a)(b) | 10 (c) |
| Trinidad and Tobago | 10 (b) | 10 (d) |
| Turkey | 15 (b) | 10 (c) |
| Turkmenistan | 10 (b) | 10 (d) |
| Uganda | 10 (b) | 10 (d) |

| Country | Interest (%) | Royalty(%) |
|---|---|---|
| Ukraine | 10 (b) | 10 (d) |
| United Arab Emirates | 12.5 (b) | 10 (d) |
| United Arab Republic | 20 (a) | 10 (c) |
| United Kingdom | 15 (b) | 10 (c)(k) |
| United States | 15 (b) | 10 (c)(k) |
| Uzbekistan | 15 (b) | 10 (c) |
| Vietnam | 10 (b) | 10 (d) |
| Zambia | 10 (b) | 10 (d) |
| Non-treaty countries | 20 (a) | 10 (c) |

a. This rate is provided under the Indian Income Tax Act, 1961, being the rate lower than that prescribed under the relevant treaty. This rate applies to the interest on monies borrowed, or debts incurred, in foreign currency. Other interest is taxed at the rate of 40% plus a surcharge of 2% (only where the aggregate income exceeds INR10m) and an education cess of 3% (on income-tax and surcharge).

b. A reduced rate of 0% to 10% applies generally to banks, and, in a few cases, to financial institutions local authorities, political subdivisions and the GoI.

c. This rate is provided under the Indian Income Tax Act, 1961, being the rate lower than that prescribed under the relevant tax treaty. This rate is increased by a surcharge of 2% (only where the aggregate income exceeds INR10m) and further enhanced by an education cess of 3% (on income tax and surcharge). It applies to royalties (not effectively connected to permanent establishment or fixed base in India) paid to foreign corporations under agreements that are approved by the GoI or are in accordance with the industrial policy, and that are entered into after 31 May 2005. However, if the royalty is paid under an agreement, which is not approved by the Central Government or is not in accordance with the industrial policy, the royalty is taxed on a net basis at a rate of 40% plus a surcharge of 2% (only where the aggregate income exceeds INR10m) and an education cess of 3% (on income-tax and surcharge).

d. This rate is provided under the relevant treaty. It applies to royalty not effectively connected with permanent establishment in India.

e. A more restrictive scope of the definition of royalty may be available under the most favored nation clause in the relevant treaty.

f. Most of India's tax treaties also provide for withholding tax rates for technical services fees. In most cases, the rates applicable to royalties also apply to the technical services fees.

g. The tax treaty is effective from 1 April 2011.

h. Dividends: Under the Indian Income Tax Act, 1961, Indian companies must pay DDT at the rate of 15% plus a surcharge of 5% and an education cess of 3% on dividends declared, distributed or paid by them. Such dividends are exempt from tax in the hands of the recipients.

i. India and Norway have renegotiated a new treaty. The renegotiated DTAA was approved by the Indian Cabinet in its meeting held on 20 October 2010. It provides for a reduced rate of 10% for interest as against 15% in existing DTAA. The revised agreement still requires to be notified by both the countries. (Press release dated 2 February 2011).

j. A revised DTAA and protocol has been signed between India and Finland. According to the agreement, tax rates have been reduced on royalty from 15% to 10%. The revised DTAA is effective from 1 April 2011.

k. A 10% rate applies to royalties relating to the use of industrial, commercial or scientific equipment and technical or consultancy services that are ancillary and subsidiary to the application or use of such equipment.

l. The GoI has notified the DTAA with Government of Mozambique vide notification dated 31 May 2011. The agreement is effective from 1 April 2012.

m. The GoI signed a revised DTAA with United Republic of Tanzania for avoidance of double taxation on 27 May 2011. The tax rate applicable on interest and royalty is reduced to 10% as per the press release dated 28 May 2011. The effective date of the agreement will be known after the text of the treaty is released.

n. The GoI has signed a revised DTAA with the Federal Democratic Republic of Ethopia on 25 May 2011. The tax rate applicable on interest and royalty is reduced to 10% as per the press release dated 27 May 2011. The effective date of the agreement will be known after the text of the treaty is released.

o. The GoI signed a DTAA with Republic of Columbia on 13 May 2011. The text of the comprehensive agreement is still to be issued by both the countries. The above rates have been taken from the press release dated 13 May 2011. The effective date of the agreement will be known after the text of the treaty is released.

## Tax Information Exchange Agreements (TIEA) entered into by India

To exercise the powers conferred by Explanation 2 to section 90 of the Income Tax Act, 1961 the GoI has notified certain territories outside India as "specified territory" for the purposes of the said section. This enables the GoI to initiate and negotiate agreements for exchange of information for the prevention of evasion or avoidance of income tax and assistance in collection of income tax with these specified territories.

Following are the TIEA's signed by the GoI:

i. India has entered a Tax Information Exchange Agreement (TIEA) with Bahamas. The agreement is effective from 1 April 2011. The agreement provides for sharing of information, including exchange of banking and ownership information. (Notification dated 13 May 2011).

ii. India has entered a TIEA with British Virgin Islands on 9 February 2011. The agreement provides for sharing information, including exchange of banking and ownership information, and also of past information in criminal tax matters. (Press release dated 10 February 2011).

iii. India has entered a TIEA with Bermuda. The agreement is based on international standards of transparency and exchange of information and also permits exchange of past information in criminal tax matters. With respect to criminal tax matters, the agreement is effective from 3 November 2010. With respect to all other matters, the agreement is effective from 1 April 2011. (Notification dated 24 January 2011).

iv. India has entered into a TIEA with Isle of Man. The information relates to determination, assessment and collection of taxes, recovery and enforcement of tax claims or investigation or prosecution of matters. With respect to criminal tax matters, the agreement is effective from 17 March 2011. With respect to all other matters, the agreement is effective from 1 April 2011. (Notification dated 13 May 2011).

v. It is also reported that India has entered a TIEA with Cayman Islands. The notification for making the agreement effective is still to be issued by the GoI.

## Other recent developments from standpoint of international taxation

i. India entered its first multi-lateral agreement (MA) with the South Asian Association for Regional Cooperation (SAARC) nations comprising Bangladesh, Bhutan, Maldives, Nepal, Pakistan and Sri Lanka. This is a limited MA on avoidance of double taxation and mutual administrative assistance in tax matters with a view to promote economic cooperation among its member states. The MA was signed on 13 November 2005 and came into force from 19 May 2010. In India, the MA will be effective from 1 April 2011 and will apply in respect of income derived in tax year beginning from 1 April 2011 and subsequent years. The MA provides taxation rules in the hands of professors, teachers and students who are residents of a member state with respect to income earned in another member state. The MA also has provisions on exchange of information, assistance in collection of taxes, training sessions to tax administrators, sharing of tax policies and such other related issues aimed at tax cooperation among member states.

ii. The legislature has introduced Section 206AA through Finance Act, 2010 with a non obstante clause making it mandatory for every person including non residents to provide Permanent Account Number (PAN) to the deductor in each and every case where the tax is deductible on the said transaction. If the PAN is not provided by the deductee to the deductor it is the responsibility of the deductor to deduct tax at higher of rates in force or @ 20%.

iii. Therefore in a case where PAN is not furnished, tax shall be deducted in accordance with the provisions of section 206AA, notwithstanding the effective rate applicable to the transaction, i.e., lower of the rate provided in DTAA or Income Tax Act.

iv. The legislature has introduced Section 94A through Finance Act 2011 with effect from 1 June 2011 to curb the practices of Round Tripping etc. through tax heavens or non-cooperative jurisdictions. For this the Central Government shall specify by notification such country or territory as a Notified Jurisdictional Area (NJA) in relation to the transactions entered into by the assessee. The highlights of the section are as under:

   a. Anti avoidance measures introduced to discourage transactions with persons located in countries or territories which do not have effective information exchange arrangements with India

   b. Central Government will be authorized to notify countries or territories outside India as a NJA

   c. Any transaction between the taxpayer and a person located in a NJA will be deemed to be an international transaction subject to Transfer Pricing provisions and all parties to such international transaction will be deemed to be associated enterprises

   d. While determining ALP of such international transactions, benefit of allowable variance will not be available

   e. No deduction will be allowed for any expenditure or allowance (including depreciation) arising from such international transactions unless taxpayer maintains such documentation and furnishes such information as may be prescribed

   f. No deduction will be allowed for any payment made to a financial institution located in a NJA, unless the taxpayer authorizes revenue authorities to seek on its behalf such relevant information from the said financial institution

g. Any sum received or credited by the taxpayer from a person located in the NJA will be deemed to be income of the taxpayer, unless the taxpayer satisfactorily explains the source of such money in the hands of such person or in the hands of beneficial owner located in the NJA

h. Where any person located in a notified jurisdictional area is entitled to receive any sum or on which tax is deductible, then tax will be deducted at the highest of the following rates:

   a) At the rate or rates in force

   b) At the rate specified in the relevant provisions of this Act

   c) At the rate of 30%.

i. Therefore, in such a case tax shall be deducted in accordance with the provisions of section 94A(5), notwithstanding the effective rate applicable to the transaction as per section 90 of the Income Tax Act, i.e., lower of rate provided in DTAA or Income Tax Act.

# Appendix 7.1: Individual Income Tax calculation

The following example illustrates the method of calculating taxable income and Income Tax liability of an individual for the tax year 1 April 2011 to 31 March 2012.

| Calculation of taxable Income | | |
|---|---|---|
| Salary and perquisites | | 430,000 |
| Income from selfoccupied property | | 0 |
| Less: interest paid on construction loan | | |
| (limited to RS.150,000) | | 150,000 |
| Capital gains (longterm on sale of property) | | 30000 |
| Interest income | | 20000 |
| Gross total income | | 330,000 |
| Deductions allowable from the taxable Income: | | |
| Medical insurance, | 10,000 | |
| Investments in: (a) | | |
| ▸ Provident fund | 20,000 | |
| ▸ Life insurance | 10,000 | |
| ▸ Other tax saving investments | 20,000 | 60,000 |
| Taxable income (b) | | 270,000* |
| Calculation of tax liability | | |
| Ordinary taxable income at rates from the personal income tax rate table | | |
| [(240,000180,000) x 10%] (c) | | 6,000 |
| Capital gains (longterm of 30,000 x 20%) | | 6,000 |
| Total tax liability | | |
| Education cess @ 3% | | 12,000 |
| **Less:** | **8,240** | **360** |
| Taxes withheld on salary | 4,120 | |
| Advance tax payment | | 12,360 |
| Balance tax payable while filing of Return of Income | | 0 |

a. Contributions/investments in the tax savings plan will be allowed as deduction from gross total income up to INR100,000

b. Taxable income consists of long-term capital gains (INR30,000) on sale of property

c. In the case of a resident woman, resident senior citizen and resident very senior citizen, the minimum taxable income threshold is INR190,000, INR250,000 and INR500,000 respectively, as against INR180,000 for any other individual

# Appendix 7.2: Taxability of income items

| Compensation | Taxable | NonTaxable | Comments |
| --- | --- | --- | --- |
| Base salary | X | - | (a) |
| Bonus | X | - | (a) |
| Cost-of-living allowance | X | - | (a) |
| Tax perquisite (employee's obligation of tax born by employer) | X | - | (b) |
| Rent-free housing | X | - | (c) |
| Utilities | X | - | (a) |
| Education reimbursement | X | - | (a) |
| Hardship allowance | X | - | (a) |
| Entertainment allowance | X | - | (a) |
| Other allowance | X | - | (a) |
| Moving expenses | - | X | (d) |
| Medical reimbursement | - | X | (e) |
| Value of meals provided during working hours | - | X | (f) |
| Other Items | | | |
| Foreign-source personal ordinary income (interest and dividends) | - | X | (g) |
| Capital gain from sale of personal residence in home country | - | X | (g) |
| Capital gains from sale of other assets in home country (stocks and shares) | - | X | (g) |

a. Compensation paid for services performed in India is taxable in India, regardless of where the compensation is paid. Remuneration includes any salary payable to the employee for a rest or leave period, which is preceded or followed by the performance of services in India and is provided for in the employment contract.
b. Tax paid by the employer is subject to multiple gross-up in the hands of the employee. However, tax paid on non monetary benefits provided to an employee can be claimed as exempt, subject to the satisfaction of certain conditions.
c. The taxable value of a perquisite with respect to rent-free housing is calculated using a formula.
d. Moving expenses incurred at the time of transfer are not taxable to the employee, subject to the satisfaction of certain conditions.
e. Medical expenditures or reimbursements are exempt, subject to certain conditions and limits.
f. This item is not taxable, subject to satisfaction of certain conditions.
g. These items are non taxable for individuals who are considered resident and not ordinarily resident or who are considered non resident, provided these are not received in or directly remitted to India.

# Appendix 7.3: Sample tax calculation

The following is a tax calculation for an expatriate who was sent to India on 1 April 2011 for a period of two years. The calculation reflects the tax rates for the year ending 31 March 2012.

Computation of Taxable Income (In US$)

| | | |
|---|---|---|
| Basic salary | 120,000 | |
| Bonus | 12,000 | |
| Employer pension contribution to home country plan (a) | 8,400 | |
| Children education allowance (after exemption) | 12,000 | |
| Cost of living allowance | 24,000 | |
| Foreign-service premium | 30,000 | |
| Housing utilities | 1,200 | |
| **Total of salary, bonus and taxable allowances** | | **207,600** |
| Perquisite (b): | | |
| Rent paid by employer for unfurnished housing (lower of amount paid of US$36,000 or 15% of salary, bonus and taxable allowances, i.e., US$198,000 which equals US$29,700 ) | | |
| Taxable perquisite | | |
| Taxable income | | 29,700 |
| Taxable income in Indian currency | | 237,300 |
| (US$237,300 X 45) (c) | | 10,678,500 |
| Calculation of tax payable | | |
| Income tax | | |
| Education cess at 3% | | 3,055,550 |
| **Total tax payable** | | **3,147,217** |

Employer contributions to a home country plan may be claimed as non-taxable based on judicial precedents.

a. **For the purpose of the example, the conversion rate is US$1 = INR 45**

# India Compliance Calendar 2011

| Sunday | Monday | Tuesday | Wednesday | Thursday | Friday | Saturday |
|---|---|---|---|---|---|---|
| | | | | | 1<br>**April** | 2 |
| 3 | 4 | **5**<br>Payment of Excise and Service Tax Liability other than E-Payment | **6**<br>E-Payment of Excise and Service Tax Liability | 7 | 8 | 9 |
| **10**<br>Filing of Excise return | 11 | 12 | 13 | 14 | 15 | 16 |
| 17 | 18 | 19 | 20 | 21 | 22 | 23 |
| 24 | **25**<br>Service tax return for the period 1 October 2010 till 31 March 2011 | 26 | 27 | 28 | 29 | **30**<br>Payment of taxes withheld/collected in Mar 2011 |
| 1<br>**May** | 2 | 3 | 4 | **5**<br>Payment of Excise and Service Tax Liability other than E-Payment | **6**<br>E-Payment of Excise and Service Tax Liability | **7**<br>Payment of taxes withheld/collected in April 2011 |
| 8 | 9 | **10**<br>Filing of Excise return | 11 | 12 | 13 | 14 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **15**<br>**Filing quarterly returns for taxes withheld/ collected in qtr Jan-Mar 2011 of financial year 2010-11** | 16 | 17 | 18 | 19 | 20 | 21 |
| 22 | 23 | 24 | 25 | 26 | 27 | 28 |
| 29 | 30 | 31 | | | | |
| | | | 1<br>**June** | 2 | 3 | 4 |
| **5**<br>**Payment of Excise and Service Tax Liability other than E-Payment** | **6**<br>**E-Payment of Excise and Service Tax Liability** | **7**<br>**Payment of taxes withheld/ collected in May 2011** | 8 | 9 | **10**<br>**Filing of Excise return** | 11 |
| 12 | 13 | 14 | **15**<br>**Advance tax (15% of the estimated tax for the financial year 2011-12)** | 16 | 17 | 18 |
| 19 | 20 | 21 | 22 | 23 | 24 | 25 |
| 26 | 27 | 28 | 29 | 30 | | |

# India Compliance Calendar 2011

| Sunday | Monday | Tuesday | Wednesday | Thursday | Friday | Saturday |
|---|---|---|---|---|---|---|
| **31** Filing of income tax returns in case of individuals, non corporate persons (whose accounts are not required to be audited under this Act) for financial year 2010-11 | | | | | 1 **July** | 2 |
| 3 | 4 | **5** Payment of Excise and Service Tax Liability other than E-Payment | **6** E-Payment of Excise and Service Tax Liability | **7** Payment of taxes withheld/collected in June 2011 | 8 | 9 |
| **10** Filing of Excise return | 11 | 12 | 13 | 14 | **15** (i) Filing of Qtr 1st (1 April 2011 to 30 June 2011) return for taxes withheld/ collected (ii) Indian company (having FDI) to file an annual return on foreign assets and liabilities with RBI | 16 |
| 17 | 18 | 19 | 20 | 21 | 22 | 23 |
| 24 | 25 | 26 | 27 | 28 | 29 | 30 |
| | 1 **August** | 2 | 3 | 4 | **5** Payment of Excise and Service Tax Liability other than E-Payment | **6** E-Payment of Excise and Service Tax Liability |

| | | | | | | |
|---|---|---|---|---|---|---|
| **7**<br>**Payment of taxes withheld/ collected in July 2011** | 8 | 9 | **10**<br>**Filing of Excise return** | 11 | 12 | 13 |
| 14 | 15 | 16 | 17 | 18 | 19 | 20 |
| 21 | 22 | 23 | 24 | 25 | 26 | 27 |
| 28 | 29 | 30 | 31 | | | |
| | | | | 1<br>**September** | 2 | 3 |
| 4 | **5**<br>**Payment of Excise and Service Tax Liability other than E-Payment** | **6**<br>**E-Payment of Excise and Service Tax Liability** | **7**<br>**Payment of taxes withheld/collected in Aug 2011** | 8 | 9 | **10**<br>**Filing of Excise return** |
| 11 | 12 | 13 | 14 | **15**<br>**Advance tax (45% of the estimated tax for financial year 2011-12)** | 16 | 17 |
| 18 | 19 | 20 | 21 | 22 | 23 | 24 |
| 25 | 26 | 27 | 28 | 29 | 30<br>File **corporate** tax (Note 2) | |

# India Compliance Calendar 2011

| Sunday | Monday | Tuesday | Wednesday | Thursday | Friday | Saturday |
|---|---|---|---|---|---|---|
| | | | | | | 1<br>**October** |
| 2 | 3 | 4 | **5**<br>Payment of Excise and Service Tax Liability other than E-Payment | **6**<br>E-Payment of Excise and Service Tax Liability | **7**<br>Payment of taxes withheld/collected in Sept 2011 | 8 |
| 9 | **10**<br>Filing of Excise return | 11 | 12 | 13 | 14 | **15**<br>Filing of Qtr 2nd (1 July 2011 to 30 September 2011) return for taxes withheld/collected |
| 16 | 17 | 18 | 19 | 20 | 21 | 22 |
| 23 | 24 | **25**<br>Service Tax return for the period 1 April 2011 till 30 the September 2011. | 26 | 27 | 28 | 29 |
| 30 | 31 | | | | | |
| | | 1<br>**November** | 2 | 3 | 4 | **5**<br>Payment of Excise and Service Tax Liability other than E-Payment |

| | | | | | | |
|---|---|---|---|---|---|---|
| **6**<br>E-Payment of Excise and Service Tax Liability | **7**<br>Payment of taxes withheld/collected in Oct 2011 | 8 | 9 | **10**<br>Filing of Excise return | 11 | 12 |
| 13 | 14 | 15 | 16 | 17 | 18 | 19 |
| 20 | 21 | 22 | 23 | 24 | 25 | 26 |
| 27 | 28 | 29 | **30**<br>File corporate tax return for financial year 2010-11 (Refer Note 2) | | | |
| | | | | 1<br>**December** | 2 | 3 |
| 4 | **5**<br>Payment of Excise and Service Tax Liability other than E-Payment | **6**<br>E-Payment of Excise and Service Tax Liability | **7**<br>Payment of taxes withheld/collected on Nov 2011 | 8 | 9 | **10**<br>Filing of Excise return |
| 11 | 12 | 13 | 14 | **15**<br>Advance tax (75% of estimated tax for financial year 2011-12) | 16 | 17 |
| 18 | 19 | 20 | 21 | 22 | 23 | 24 |
| 25 | 26 | 27 | 28 | 29 | 30 | 31 |

# India Compliance Calendar 2012

| Sunday | Monday | Tuesday | Wednesday | Thursday | Friday | Saturday |
|---|---|---|---|---|---|---|
| 1 **January** | 2 | 3 | 4 | **5** Payment of Excise and Service Tax Liability other than E-Payment | **6** E-Payment of Excise and Service Tax Liability | **7** Payment of taxes withheld/collected in Dec 2011 |
| 8 | 9 | **10** Filing of Excise return | 11 | 12 | 13 | 14 |
| **15** Filing of Qtr 3rd (1 October 2011 to 31 December 2011) return for taxes withheld/collected | 16 | 17 | 18 | 19 | 20 | 21 |
| 22 | 23 | 24 | 25 | 26 | 27 | 28 |
| 29 | 30 | 31 | | | | |
| | | | 1 **February** | 2 | 3 | 4 |
| **5** Payment of Excise and Service Tax Liability other than E-Payment | **6** E-Payment of Excise and Service Tax Liability | **7** Payment of taxes withheld/collected in Jan 2012 | 8 | 9 | **10** Filing of Excise return | 11 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 12 | 13 | 14 | 15 | 16 | 17 | 18 |
| 19 | 20 | 21 | 22 | 23 | 24 | 25 |
| 26 | 27 | 28 | 29 | | | |
| | | | | 1 **March** | 2 | 3 |
| 4 | **5** Payment of Excise and Service Tax Liability other than E-Payment | **6** E-Payment of Excise and Service Tax Liability | **7** Payment of taxes withheld/collected in Feb 2012 | **8** Advance tax (100% of the estimated tax for financial year 2011-12) | 9 | **10** Filing of Excise return |
| 11 | 12 | 13 | 14 | 15 | 16 | 17 |
| 18 | 19 | 20 | 21 | 22 | 23 | 24 |
| 25 | 26 | 27 | 28 | 29 | 30 | **31** (i) Last day for payment of advance tax (financial year 2011-12) (ii) Payment of excise and Service Tax liability for the month March 2012 |

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