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Destination India 2017

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Introduction.. 3

Regulatory.. 6

Direct taxation..................................... 12

International Assignments.................. 20

Indirect taxes....................................... 24

Mergers & Acquisitions (M&A)............ 26

Transfer Pricing.................................. 29

Contents

Introduction

The fruits of a slew of measures taken by the current Government to implement liberal economic reforms and enable an investor-friendly business environment seemed to be on the fast track to becoming a reality when India became the most attractive investment destination in the world, with Foreign Direct Investment (FDI) inflows growing by an impressive 18% to a record USD 46.4 billion in 2016. This happened despite weak sentiments on investment around the world, resulting in global FDI flows falling by 7% during the year. India achieved this on the back of its manufacturing sector, in which the automobile industry is the largest segment and is likely to continue to draw significant foreign investments in the near term, with many eminent foreign companies planning to invest in India in a big way. Other manufacturing sub-sectors that brought in substantial foreign investment included the cement, electrical equipment and metallurgical industries. However, at the aggregate level, the services sector grabbed the largest share in the inflow of investment.

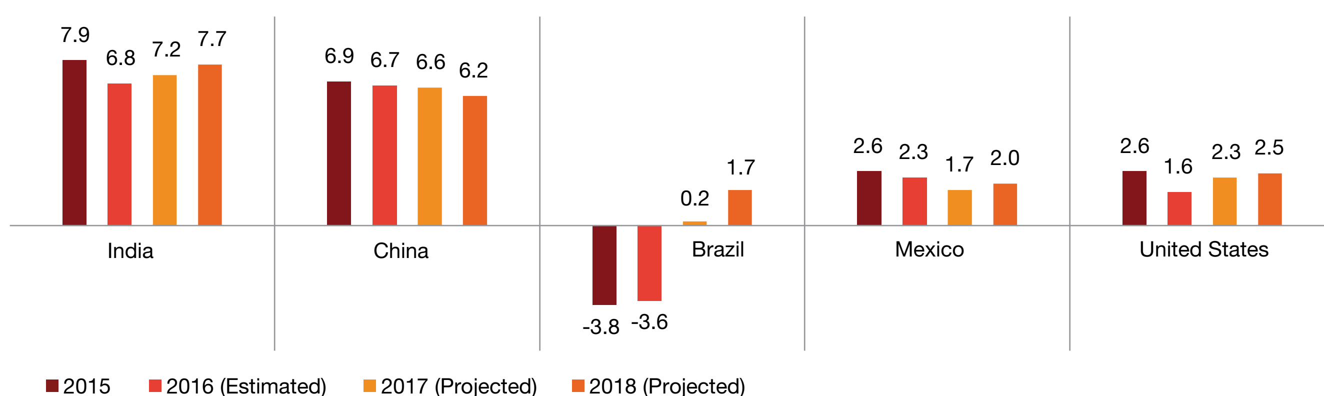
Historically, India's IT, telecom and construction sectors have been the most sought after investment options. Now, in addition to these, media, banking, non-financial services and insurance have emerged as the newly attractive industries for investment.

According to the latest World Economic Outlook (April 2017),[1] India's GDP growth slowed down from 7.9% in 2015–16 to 6.8% in 2016–17 as its cash-strapped economy hit its other-wise robust expenditure on consumption after demonetisation. Nevertheless, the pace of the country's economic growth has outstripped that of any other economy in the world (including China, which followed closely with a 6.7% growth). This trend is expected to continue, since the IMF expects this growth to accelerate to 7.2% and 7.7% in the following two years, respectively, and eventually rise to around 8%. The IMF's report cites implementation of structural reforms, loosening of supply-side bottlenecks and appropriate fiscal and monetary policies as the key drivers of this growth.

Unlike the case of many other export-led economies, what gives a tremendous boost to India's GDP is its high domestic consumption, which supports its growth and makes it resilient to global economic upheavals. The domestic demand or household consumption rates account for around 60% of India's GDP, compared to 37% in China.

With regard to its major economic sectors, agriculture employs more than half of India's population. And while the sector's contribution to the country's overall GDP has been declining over the years, the farm output in India is the second largest in the world. India is among the top three global producers of several crops, including wheat, rice, pulses, cotton, peanuts, fruits and vegetables.

Figure 1: IMF's projections of selected countries' GDP growth at constant prices



Moreover, in addition to the recent reforms set in motion in the country, India's strong economic growth inculcates confidence among international investors. The Indian economy is the third largest economy in the world, after China and the US, in terms of purchasing power parity (PPP) and the fifth largest in terms of nominal GDP. It is one of the major G-20 economies with an average growth rate of around 7% over the last two decades.

Although it contributes a miniscule 2%-3% of India's GDP, the country's mining sector places it on the world map by being the largest producer of mica, the third-largest producer of iron ore and the fifth-largest producer of bauxite in the world. Moreover, India is rich in various other major and minor minerals, which are used in several manufacturing industries.

[1] World Economic Outlook Update, April 2017
http://www.imf.org/en/Publications/WEO/Issues/2017/04/04/world-economic-outlook-april-2017

The manufacturing sector is the main area of focus of India's current government, which aims to bring up the segment's contribution to the country's GDP from 15–18% at present to an ambitious 25%. The main initiatives taken by the Government to achieve this goal are 'Make in India' and 'Skill India'. While the former aims to make India a global manufacturing hub and create employment opportunities for its unemployed and under-employed population, the latter focuses on training the unskilled labour-force and enhancing their employability.

The Services sector is the largest contributor to India's GDP, and accounts for over 60% of its GDP. The sector attracts the highest foreign investment (among all the sectors) through its IT, banking and communication services and contributes significantly to the country's earnings from export.

Its favourable demographic dividend is another plus point for India. By 2025, it is projected to account for 20% of the world's working-age population, and by 2020, to be the youngest country in the world with the median age of 29 years. Also, by 2020, for every dependent person (the elderly or children), there are expected to be two employable individuals (in the working age group of 15–64 years). Its demographic edge is expected to play a significant role in India's growth story over the medium term. It also accentuates India's attractiveness as a very favourable investors' destination with an abundant supply of cheap, young and skilled labour.

Going forward, India's macroeconomic fundamentals are expected to remain strong and get a boost from a number of the Government's focused initiatives. Some of the key reform measures undertaken by it in 2016 included:

Demonetisation

On 8 November 2016, the Government announced demonetisation of INR 500 and INR 1,000 notes and thereby rendered 86% of cash in circulation in the country invalid. This had a short-term adverse impact due to the cash crunch situation, which adversely affected expenditure on private consumption (and hence India's GDP growth), but in the long term, it is expected to have a positive effect on the country's economy in the following areas:

- Enhanced tax compliance
- Reduced corruption
- Increased digitalisation
- Augmented flows of financial savings
- Increased formalisation of the economy

FDI reforms

Some of the Government's key initiatives to give a boost to FDI inflows into India:

- 100% FDI in several segments including railway infrastructure (excluding operations), manufacture of medical devices and financial services provided by Non-Banking Finance Companies (NBFCs)

- National Highway Authority of India (NHAI) offering a risk cover to foreign investors for faults in structural design, sub-standard quality of construction and loss of traffic
- Grant of Permanent Residency Status (PRS) to foreign investors investing a minimum of INR 10 crore within 18 months or INR 25 crore within 36 months
- 100% FDI in asset construction companies under the automatic route
- Easing of area restriction norms, reduction of minimum capitalisation and enablement of easy exit from projects in the Construction Development sector
- Raising of FDI cap on insurance from 26% to 49%
- Abolition of Foreign Investment Promotion Board (FIPB) and automatic route being permitted for over 90% of FDI inflows (without prior approval)

Implementation of GST

The Goods and Services Tax (GST), slated to be the biggest ever tax reform in India, was implemented on 1 July 2017. It will create a harmonised taxation system, which will subsume a host of indirect taxes. By implementing GST, the Government aims to substantially increase tax compliance, and thereby broaden India's revenue base while giving ample room for its expenditure on physical and social infrastructure. GST will also focus on significantly increasing internal trade of goods and services, leading to substantive gains in efficiency.

Ease of Doing Business (EoDB)

The Government has formulated an output-outcome framework to work towards improving India's ranking on the World Bank's Doing Business Survey. India's current ranking is 130. The ambitious measures proposed are aimed at helping it climb up 40 places in the world ranking by 2017–18 and another 60 places by 2020.

Development of infrastructure

The Government has been undertaking various initiatives on development of infrastructure in rural and urban India, which are crucial not only for India's holistic development, but also from the perspective of investors in the country. Some of the Government's infrastructure-related announcements in Budget 2017 include:

- A new Metro Rail Policy to facilitate increased private participation and investment in construction and operations (This is expected to create a significant number of jobs for urban youth in the country.)
- Construction of one crore houses for the poor by 2019
- 100% electrification in the country by 2018
- Increased allocation of funds for roads and highways—from INR 52,000 crore to INR 65,000 crore—with a target of constructing 43 km of highways and 133 km of rural roads every day
- Earmarking of selected airports in tier II cities for operationalisation and development in the Public Private Partnership (PPP) mode, leading to substantial private investment

Medium Small and Micro Enterprises (MSMEs) credit facility scheme

In order to facilitate easy flow of credit to MSMEs, the Government has doubled the limit for loans guaranteed to them to INR 2 crore and the cash credit limit for such businesses has been raised from 20% to 25%. The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) has been set up to reassure lenders that the Government will make good losses incurred by them in the event MSE units, which availed of collateral-free credit facilities, fail to discharge their liabilities.

Stand-Up India

The Government has launched its 'Stand-Up India' initiative with the objective of empowering deprived sections of society. Through this measure, it seeks to promote entrepreneurship among the Scheduled Castes (SCs), Scheduled Tribes (STs) and women by offering loans at cheap rates. It hopes to create significant employment opportunities in the country through these initiatives, with each of the around 1.5 lakh bank branches providing loans to at least one SC and/or ST person and one women entrepreneur to enable them to set up green-field enterprises.

Macro-economic review

According the Central Statistics Office's (CSO's) latest second advance estimates in February,[2] India's GDP grew by 7.1% in 2016–17. (The figure remained unchanged from the previous growth estimate released in January 2017). This suggests that demonetisation did not have a significant adverse impact on India's economic growth. However, its Gross Value Added (GVA), which is a true measure of economic activity in a country, grew slower at 6.7% in 2016–17, compared to the previously estimated growth of 7.0%. However, despite a slower than expected growth of its GVA, India's GDP growth estimate remained unchanged due to increased collection of indirect tax on products and reduction in disbursement of subsidies. Here, we need to remember that GDP is the sum of GVA and net indirect taxes.

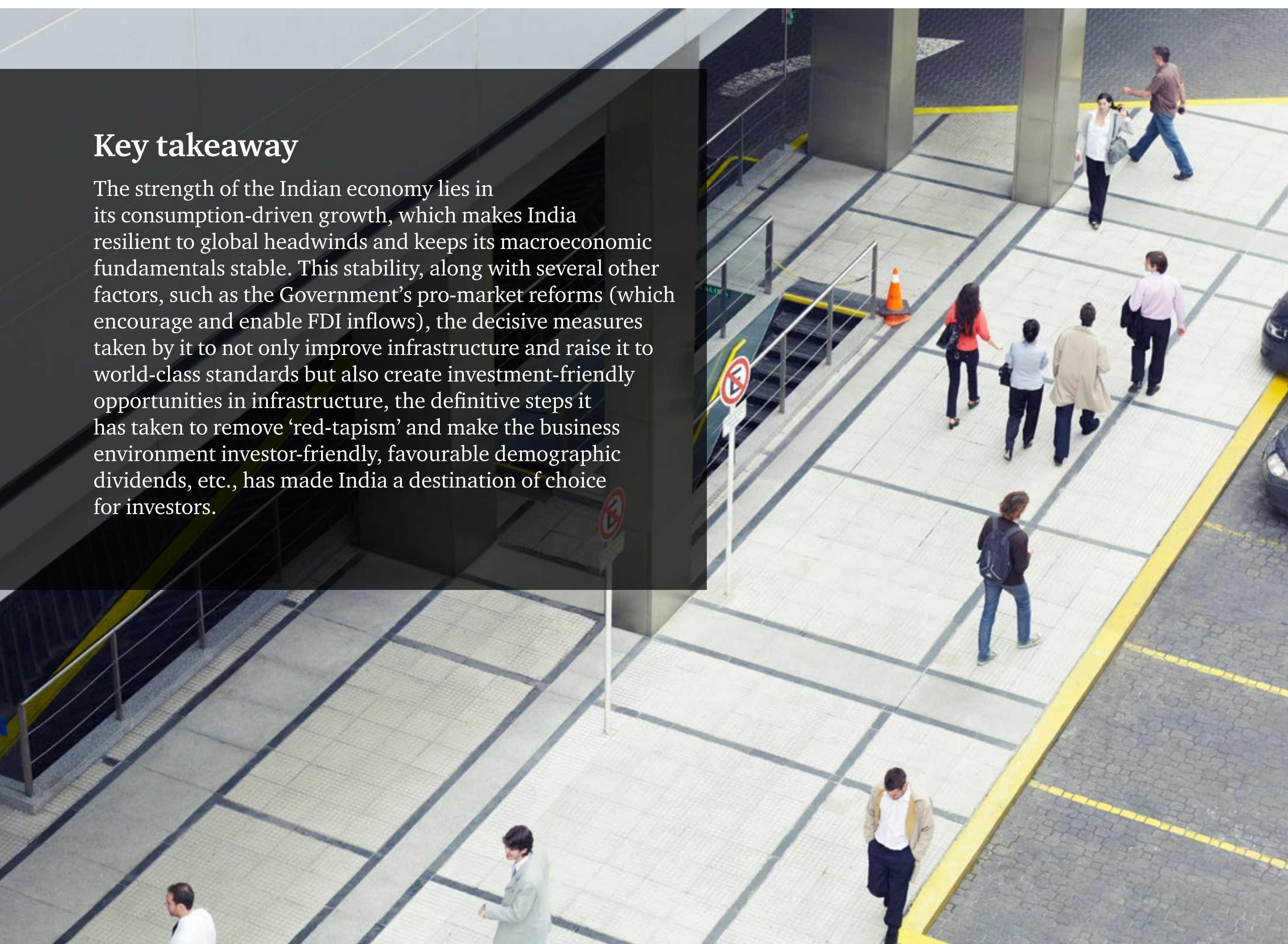
[2] http://mospi.nic.in/sites/default/files/press_release/nad_pr_28feb17r.pdf

Retail inflation in India is well within the RBI's target for 2017–18, despite the recent rise in prices. Inflation had been easing since July 2016, dipping from 6.1% to 3.2% in January 2017, first due to a good monsoon and then because of a squeezed demand scenario resulting from the general cash crunch situation in the country after demonetisation. The effects of demonetisation, however, started waning and retail inflation rose to 3.7% in February 2017 and then to 3.8% in March 2017.[3] The RBI expects such inflationary risks to continue for the next 6 to 12 months, and possibly result in a hike in rates.

India's industrial production, according to the Index of Industrial Production (IIP), saw a contraction of 1.2% in February 17,[4] compared to the growth of 3.3% witnessed in the previous month and 2% a year ago. Furthermore, weak manufacturing activity in the capital goods and consumer durables segments led to a fall in overall industrial production. Industrial growth has been fairly inconsistent in the country for quite some time, partly due to the base effect and partly because of the volatility in the prices of international commodities, resulting in an imbalance in the global demand and supply situation.

In the sphere of external trade, there was a perceptible improvement in the overall trade balance in 2016-17, compared to the previous year, with the trade deficit for the year being 14.5% lower in dollar terms than that in 2015-16.

On the bright side, the fiscal deficit has seen a gradual decline, leading to prudent fiscal consolidation without sacrificing public expenditure. In the new Budget, the fiscal deficit witnessed in 2016–17 was revised to 3.2% of India's GDP[5] —down from the earlier forecasted 3.5%. It is expected to be stable at 3.2 % in 2017–18 and then dip to 3.0% the following year, in accordance with the 3% fiscal deficit advocated for the next three years by the newly constituted Fiscal Responsibility and Budget Management (FRBM) Committee.



Key takeaway

The strength of the Indian economy lies in its consumption-driven growth, which makes India resilient to global headwinds and keeps its macroeconomic fundamentals stable. This stability, along with several other factors, such as the Government's pro-market reforms (which encourage and enable FDI inflows), the decisive measures taken by it to not only improve infrastructure and raise it to world-class standards but also create investment-friendly opportunities in infrastructure, the definitive steps it has taken to remove 'red-tapism' and make the business environment investor-friendly, favourable demographic dividends, etc., has made India a destination of choice for investors.

[3] http://mospi.nic.in/sites/default/files/press_release/CPI_PR_12apr17w.pdf
[4] http://mospi.nic.in/sites/default/files/press_release/iip_PR_12apr17.pdf
[5] Budget at a glance, Union Budget, 2017, Ministry of Finance.

Regulatory

Key policy announcements aimed at encouraging investment in India

Several reforms have been introduced by the Government during the year in continuation of its effort to maintain the momentum in enhancing ease of doing business in India. Some of the key initiatives are given below.

- On 5 June 2017, the Ministry of Finance (MoF) issued an Office Memorandum listing the related administrative ministries/departments for 11 notified sectors/activities requiring the Government's approval under the FDI policy. Furthermore, the Department of Industrial Policy and Promotion (DIPP) will issue SoPs to help administrative ministries process FDI proposals.
- A consolidated appellate process has been put in place for several financial regulators and 32 labour law-related compliance requirements under four codes—wages; industrial relations; social security and welfare; and safety and working conditions—have been rationalised and simplified.
- Foreign investment-related rules have been liberalised in the financial services, airlines and defence sectors and introduced in the broadcasting carriage services sector.

Foreign investment

Entry options

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

Operating as an Indian entity

Wholly owned subsidiary

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

Limited Liability Partnership (LLP)

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

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

Foreign investment in LLPs is permitted in sectors where 100% FDI is permitted under the automatic route without any performance-linked conditions.

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

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

Operating as a foreign entity

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

- The applicant is a citizen of or is registered or incorporated in Pakistan.
- The applicant is a citizen of or is registered or incorporated in Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau and the application is for opening a BO, LO or PO in Jammu and Kashmir, the North East region or the Andaman and Nicobar Islands.
- The principal business of the applicant is concentrated in four sectors—Defence, Telecom, Private Security, and Information and Broadcasting. (However, it does not need separate approval from the Government to set up a PO pursuant to a contract awarded by the Ministry of Defence, Service Headquarters or Defence Public Sector Undertakings.)
- The applicant is a Non-Government Organisation (NGO), Non-Profit Organisation, an entity, agency or department of a foreign government.

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

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

LOs

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

BOs

Compared to an LO, a BO can be set up and engage in a wide range of activities, including revenue-generation, in India. Foreign entities can set up branch offices in the country to conduct the following activities:

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

Project offices

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

Foreign investment in India

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

- Lottery business, including government or private lotteries or online lotteries
- Gambling and betting, including in casinos
- Chit funds and 'Nidhi' companies
- Trading in Transferable Development Rights (TDRs)
- Real Estate business or construction of farmhouses
- Manufacture of cigars, cheroots, cigarillos and cigarettes, and tobacco or tobacco substitutes
- Activities and sectors not open to private sector investment, e.g. atomic energy and railway operations (other than those specifically permitted)

- Collaboration on foreign technology in any form, including licensing of franchises, trademark, brand names, management contracts for lotteries, and gambling and betting activities

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

Foreign investment is allowed in India via the following routes:

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

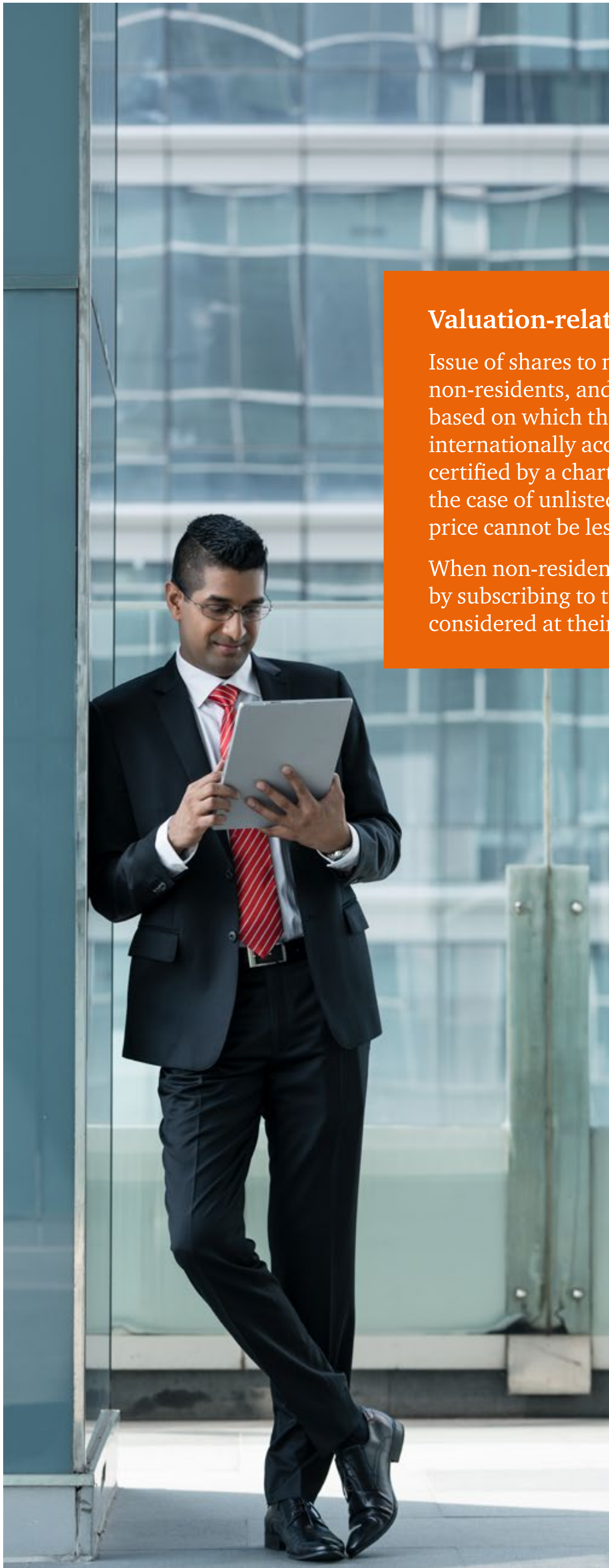
Foreign investment-related proposals under the FIPB route (involving a total inflow of foreign equity of more than INR 50 billion) need to be placed before the Cabinet Committee on Economic Affairs (CCEA) of the Government for further consideration.

Computation of foreign investment

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

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

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



resolution). The individual and aggregate limit for NRIs investing under the Portfolio Investment Scheme is capped at 5% and 10%, respectively (and the aggregate limit for them can be increased to 24% with a board and special resolution).

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

Valuation-related norms

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

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

Funding options in India

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

Equity capital

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

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

Fully and compulsorily convertible preference shares and debentures

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

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

- There is a minimum lock-in period of one year.
- This lock-in period is effective from the date the capital instruments are allotted.

- After the lock-in period of one year, and subject to the provisions of the FDI policy, non-resident investors exercising the option or right are allowed to exit without any assured returns, in accordance with pricing- and valuation-related guidelines issued by the RBI from time to time.

External Commercial Borrowings (ECBs)

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

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

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

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

ECB guidelines prescribe an 'all-in-cost' ceiling for raising funds through ECBs. This includes the rate of interest, other fees, expenses, charges, guarantee fees (whether paid in foreign currency or INR), but not commitment fees, pre-payment fees or charges and Withholding Tax payable in INR. In the case of fixed rate loans, the swap cost plus the spread should be equal to the floating rate in addition to the applicable spread. The all-in-cost ceiling depends on the track under which ECBs have been raised.

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

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

i. Real estate-related activities
ii. Investment in the capital market
iii. Use of the proceeds of equity investment in India
iv. On-lending to other entities with any of the objectives mentioned above
v. Purchase of land

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

Rupee-denominated bonds (Masala Bonds)

In addition to the tracks (mentioned above) for raising ECBs, any corporate or body corporate, as well as REITs and InvITs, can issue rupee-denominated bonds with the prior approval of RBI, with a minimum maturity period of three years for Masala Bonds raised up to USD 50 million (equivalent Indian rupee) per financial year and above USD 50 million (equivalent Indian rupee) should be five years for any investor from a Financial Action Task Force (FATF)-compliant jurisdiction. However, recognised investors should not be related parties (of borrowers) as per Ind AS 24.

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

Investment by FPIs in corporate debt securities

As announced in Union Budget 2016–17, the RBI and SEBI have increased the investment basket of eligible instruments for investment by FPIs under the corporate bond route to include unlisted corporate debt securities in the form of NCDs or bonds issued by public or private companies. This is subject to a minimum residual maturity of three years and an end-use restriction on investment in the real estate business, capital market and purchase of land.

Significant exchange control-related regulations

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

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

The Indian rupee is fully convertible for current account transactions, subject to a negative list of transactions, which are either prohibited or which require the prior approval of the Central Government or RBI.

Current account transactions

RBI has delegated its powers in relation to monitoring of or granting permission for remittances under the current account window to AD banks (entities authorised by RBI). All current account transactions are usually permitted unless they are specifically prohibited or restricted.[6]

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

- Remittance from lottery winnings
- Remittance of income from racing, riding, etc., or any other hobby
- Remittance for purchase of lottery tickets, banned or prescribed magazines, football pools, sweepstakes, etc.
- Payment of commission on exports for equity investments in the JVs or wholly owned overseas subsidiaries of Indian companies
- Remittance of dividend by a company for which the requirement of 'dividend balancing' is applicable
- Payment of commissions on exports under the 'rupee state credit' route, except for commissions of up to 10% of the invoice value of export of tea and tobacco
- Payment for the 'call back services' of telephones
- Remittance of the interest income of funds held in a non-resident special rupee (account) scheme (Such accounts have been discontinued according to Notification No. FEMA 5(R)/2016-RB, dated 1 April 2016.)

CAT Rules also specify transactions[7] for which drawal of foreign exchange is only permitted with the prior approval of the Central Government. However, the Government's approval is not required if payment is made from funds held in the Resident Foreign Currency account of the remitter.

[6] Foreign Exchange Management (Current Account Transactions) Rules, 2000 (CAT Rules)
[7] Schedule II of CAT Rules

Resident individuals can avail of the foreign exchange facility for the purposes mentioned in Para 1 of Schedule III of the FEM (CAT) Amendment Rules, 2015, dated 26 May 2015 (within a limit of USD 250,000), as prescribed under the Liberalized Remittance Scheme (LRS).[8]

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

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

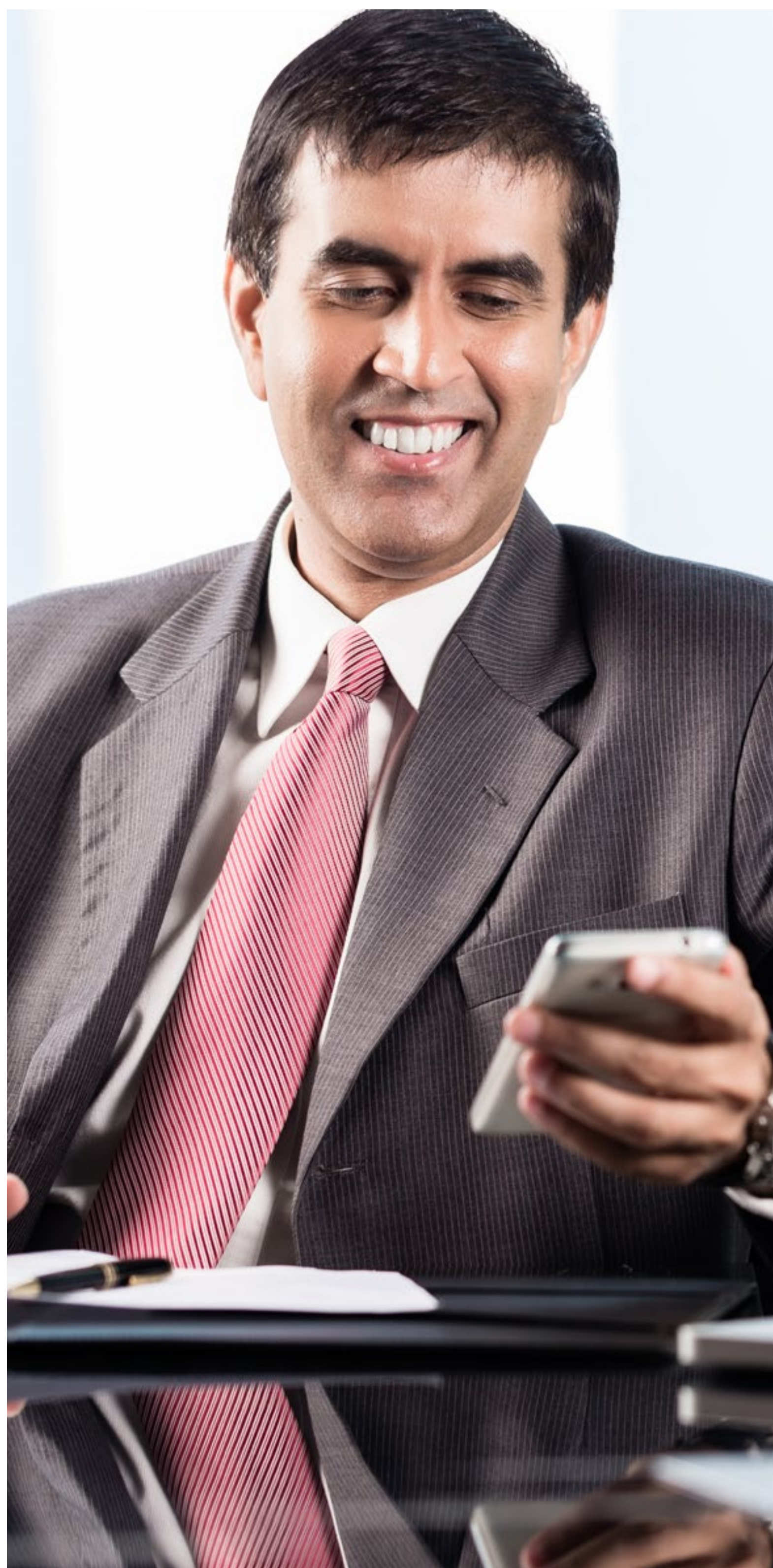
Any remittance in excess of USD 250,000 and the limits given above for the specified purposes mentioned will require the prior approval of RBI.

Capital account transactions

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

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

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



[8] The LRS is available for resident individuals for remittances towards permissible current and capital account transactions or a combination of both. The scheme has an overall limit of remittance up to USD 2,50,000. However, the scheme mentioned above does not allow remittances for any prohibited or illegal activities such as margin trading or lotteries.

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

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

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

Repatriation of capital

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

Acquisition of immovable property in India

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

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

Royalties and fees for technical know-how

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

Direct taxation

Overview

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

Tax year and tax return filing deadline

The Indian tax year starts from 1 April of one year and ends on 31 March of the subsequent year. Companies (except those that are required to submit a Transfer Pricing accountant's report with respect to their international or specified domestic transactions) are required to file their tax returns by 30 September. Those that are required to submit a transfer pricing accountant's report need to file their tax returns by 30 November. Taxpayers need to obtain a Permanent Account Number (PAN) to be tax-compliant in India.

Scope of taxable income for a company

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

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

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

The term 'business connection' is used in Indian tax laws instead of Permanent Establishment (PE), as in tax treaties, to tax profits from business. The term is considered wider in its scope than PE.

Residential status of a company

A company is considered a resident of India if it is an Indian enterprise, i.e. it is incorporated in India or its Place of Effective Management (POEM) is in the country.

Residential status of a Limited Liability Partnership (LLP)

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

Corporate Tax rates

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

Status of the entity	Rates in force	Conditions
Domestic company	25%	• Total turnover/gross receipts in previous year (2015-16) not exceeding INR 500 million • Companies set up or registered on or after 1 March 2016, engaged solely in manufacture or production of a product, have been given the option to pay tax at the rate of 25% (plus applicable surcharge and education cess), provided they do not claim benefits such as accelerated and additional depreciation.
	30%	All other companies
Foreign company	40%	All foreign companies
Partnership firm/LLP	30%	All firms/LLPs

The rates mentioned above are exclusive of surcharges, which are levied on the basis of the quantum of taxable income and cess levied on the tax amount (inclusive of the surcharge). Surcharge rates range from 0% to 12% for domestic companies and 0% to 5% for foreign enterprises; the cess rate is 3% for all organisations.

Key Corporate Tax-related considerations

Computation of income

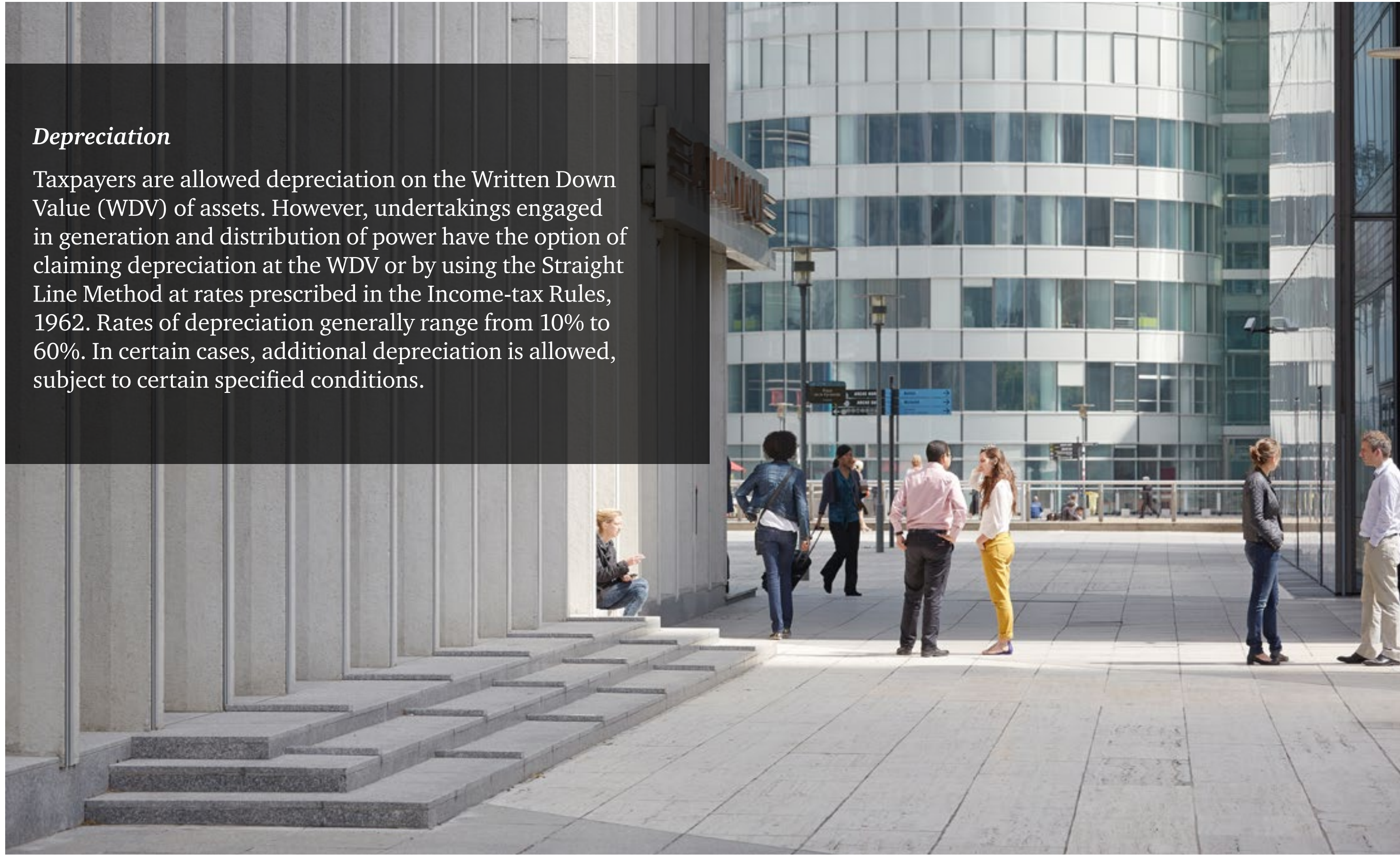
A company's taxable income is divided into the following categories or heads of income:

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

Income from profits and gains of business and profession

Books of accounts and tax audit

Every company engaged in a business and profession is required to maintain books of accounts and get them audited by an accountant if its total sales, turnover or gross receipts exceed INR 10 million during the year.



Depreciation

Taxpayers are allowed depreciation on the Written Down Value (WDV) of assets. However, undertakings engaged in generation and distribution of power have the option of claiming depreciation at the WDV or by using the Straight Line Method at rates prescribed in the Income-tax Rules, 1962. Rates of depreciation generally range from 10% to 60%. In certain cases, additional depreciation is allowed, subject to certain specified conditions.

Some tax deductions and incentives available to taxpayers

Activity	Benefits*
All taxpayers, whose total sales, turnover or gross receipts exceed INR 10 million	Additional deduction of 30% of the cost incurred on a new employee
Scientific research and development	Weighted deduction of 150% of the expenditure
Units set up in SEZs	100% tax holiday for 5 years and 50% for the next 10 years out of profits derived from actual export of goods and services
Deduction in respect to specified business categories such as cold chain facilities; warehousing facilities for storage of agricultural produce; cross-country natural gas oil/distribution, infrastructure facilities, etc.	100% deduction on capital expenditure
Business of processing, preservation and packaging of fruits and vegetables; handling, storage and transportation of food grains; processing, preservation and packaging of meat and meat products or poultry, marine and dairy products	100% tax holiday for the first five years and a deduction of 30% (25% if the assessee is not a company) of profits for the subsequent five years
Expenditure on skill development project	Weighted deduction of 150% on expenditure incurred on a notified skill development project by a company
Start-up businesses engaged in innovation, development, deployment or commercialisation of new technology- or intellectual property-driven products, processes or services	100% deduction for profits and gains for three consecutive years out of seven years, starting from the year the start-up was incorporated
Companies located in International Financial Service Centres (IFSCs)	• Exemption from paying Dividend Distribution Tax • Relaxation in levy of Minimum Alternate Tax from 18.5% to 9% • Specified relaxation from Securities Transaction Tax, Long-term Capital Gains Tax and Commodities Tax

* Subject to specified conditions

Presumptive taxation regime for non-residents

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

Particulars	Shipping	Aircraft	Oil and gas services	Turnkey power projects
Applicability	Shipping operations	Aircraft operations	Specified business activity relating to prospecting for, or extraction or production of mineral oils	Specified business activity in relation to approved turnkey power projects
Presumptive rate	7.5% of gross receipts from carriage of passengers, livestock, mail or goods	5% of gross receipts from carriage of passengers, livestock, mail or goods	10% of gross receipts from such business	10% of gross receipts from such business
Option of showing income that is lower than the presumptive rate	Not available	Not available	Available, provided taxpayer maintains books of account and gets these audited	Available, provided taxpayer maintains books of account and gets these audited

Restriction on deduction of expenditure on head office

In the case of non-resident taxpayers preparing books of account and claiming a deduction for general expenses incurred at their head offices, deduction in respect of such expenses will be limited to the following:

- An amount equal to 5% of the taxpayers' 'adjusted total income' for the relevant year
- The actual amount of expenditure on their head offices attributable to taxpayers' businesses in India, whichever is the least

Income from house property

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

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

Income from capital gains

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

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

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

Income from other sources

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

Gift Tax

There is no Gift Tax liability in India. However, there are provisions for taxability of gifts in the hands of recipients under the provisions of Income-tax laws. The applicable law provides that receipt of money or property, including shares, by taxpayers without consideration or for inadequate consideration in excess of INR 50,000 will be chargeable to tax in the hands of the recipients under the head 'Other sources'.

Premium on allotment of shares

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

Dividends paid by Indian companies

Indian companies are liable to pay DDT at 15%, along with the applicable surcharge and education cess at an effective rate of 20.36%, on dividends paid. However, dividends that are subject to DDT are not taxable in the hands of the recipients. In the case of dividends exceeding INR 1 million received by an individual, a Hindu undivided family (HUF) or a firm resident in India, tax is levied at the rate of 10%.

Other Corporate Tax-related considerations

Minimum Alternate Tax (MAT)

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

Credit for MAT is allowed against the tax liability that may arise in the subsequent 15 years under the normal provisions of the IT Act.

Alternate Minimum Tax (AMT) for entities other than companies

AMT is levied on entities (other than companies) at 18.5% on their adjusted total income (according to Income-tax provisions) if the AMT liability exceeds the tax payable under normal Income-tax provisions. Credit for AMT is allowed against the tax liability that may arise in the subsequent 15 years under the provisions of the IT Act.

Withholding Tax provisions

Entities making specified payments are obliged to withhold taxes according to the relevant provision of the law. Withholding Tax rates range from 0% to 40% on payments (subject to fulfilment of stipulated conditions). Tax rates are increased in the case of non-residents by an additional surcharge, cess, etc., subject to the benefits available under various treaties. If the PANs of deductees are not available for non-residents, a higher tax withholding rate may be applicable. However, this provision is relaxed if certain conditions are fulfilled.

Concessional Tax rate on interest payments

A Concessional Withholding Tax rate of 5% is applicable to interest paid on foreign currency borrowed. However, this benefit is subject to specified conditions.

Buyback of shares

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

Other considerations for taxation of non-residents

Tax Residency Certificate (TRC)

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

General Anti-Avoidance Rule (GAAR)

Initially, the provisions mandated under GAAR were slated to come into effect from 1 April 2015. However, this was deferred by two years and the provisions became effective from FY 2017–18 onwards. The OECD BEPS project and India's active participation in it was the apparent cause of the deferment.

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

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

- Where the tax benefit (for all parties) from an arrangement in a relevant tax year does not exceed INR 30 million
- When FIIs registered with SEBI are not availing of any benefit under a tax treaty or investments made in FIIs by non-resident investors
- On investments made up to 31 March 2017
- Equalisation Levy – digital economy (eCommerce transactions)

An Equalisation Levy of 6% is applicable in India in line with BEPS Action Plan 1 (Digital Economy). As of now, the levy is applicable on payment made by a resident or the Indian PE of a resident to a non-resident providing specified services. A 'specified service' has been defined as an online advertisement, or provision for digital advertising space or any other facility or service for the purpose of online advertisement, and also includes any other service notified by the Central Government.

Patent Box regime

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

Recent renegotiation of DTAA

India had mutually beneficial DTAA provisions with Singapore, Mauritius and Cyprus. The primary benefit related to taxation of capital gains, which were only taxable in the resident states. Recently, such DTAAs have been amended to confer taxation rights for capital gains due to the sale of the shares of Indian companies to India. However, specific grandfathering provisions have also been laid down to provide benefits for existing investments.

Annexure 1

Tax rates under tax treaties India has entered with various jurisdictions

Recipient	Withholding Tax (%)			
	Dividend (1)	Interest	Royalty (12)	Fee for technical services (12)
Albania	10	10	10	10
Armenia	10	10	10	10
Australia	15	15	10 (refer to Note 2)/15 in other cases	10 (refer to Note 2)/15 in other cases
Austria	10	10	10	10
Bangladesh	10 (refer to Note 3)/15 in other cases	10	10	No specific provision (refer to Note 5)
Belarus	10 (refer to Note 9)/15	10	15	15
Belgium	15	10 (refer Note 11)/15	10	10
Bhutan	10	10	10	10
Botswana	7.5 (refer to Note 9)/10	10	10	10
Brazil	15	15	25 (refer to Note 15)/15	No specific provision (refer to Note 5)
Bulgaria	15	15	15 (refer to Note 7)/20	20
Canada	15 (refer to Note 3)/25	15	10 (refer to Note 2)/15	10 (refer to Note 2)/15
China (People's Republic of China)	10	10	10	10
Chinese Taipei (Taiwan)	Treaty yet to be notified			
Colombia	5	10	10	10
Croatia	5 (refer to Note 3)/15	10	10	10
Cyprus	10	10	10	10
Czech Republic	10	10	10	10
Denmark	15 (refer to Note 9)/25	10 (refer to Note 11)/15	20	20
Estonia	10	10	10	10
Ethiopia	7.5	10	10	10
Fiji	5	10	10	10
Finland	10	10	10	10
France	10 (refer to Note 6)	10 (refer to Note 6)	10 (refer to Note 6)	10 (refer to Note 6)
Georgia	10	10	10	10
Germany	10	10	10	10
Greece	(refer to Note 14)	(refer to Note 14)	(refer to Note 14)	No specific provision (refer to Note 5)
Hungary	10 (refer to Note 6)	10 (refer to Note 6)	10 (refer to Note 6)	10 (refer to Note 6)
Iceland	10	10	10	10
Indonesia	10 /15	10	15	No specific provision (refer to Note 5)
Ireland	10	10	10	10
Israel	10	10	10	10
Italy	15 (refer to Note 3)/25	15	20	20
Japan	10	10	10	10
Jordan	10	10	20	20
Kazakhstan	10	10	10	10
Kenya	15	15	20	17.5

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

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

Notes

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

International assignments

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

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

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

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

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

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

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

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

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

Scope of taxation

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

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

Taxation of employment-generated income

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

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

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

The value of any specified security, or sweat equity shares allotted or transferred directly or indirectly by employers or former employers, free of cost or at a concessional rate, and the contribution of employers to an approved superannuation fund, if this exceeds INR 150, 000, are taxable as perquisites in the hands of employees. Car and driver facilities provided by employers are also taxable as perquisites, although at a concessional value.

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

Withholding Tax

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

DTAA

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

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

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

Tax rates

Taxes are levied at progressive rates in India. Rates applicable for tax year 2017-18 are as follows:

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

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

A surcharge of 10% is to be levied where the total income of individuals exceeds INR 5 million, but does not exceed INR 10 million. Where the total income of individuals exceeds INR 10 million, the rate of surcharge will be 15%. In addition to this, an education cess at the rate of 3% of the tax and surcharge (if applicable) will be levied to compute the final tax liability of individuals.

The maximum marginal tax rate for individuals with an income of up to INR 0.5 million is 30.9%. It is 33.99% for those with a total income of above 0.5 million, but not more than 10 million, and 35.54% for those with a total income of more than 10 million.

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

Tax registration

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

Filing of tax returns

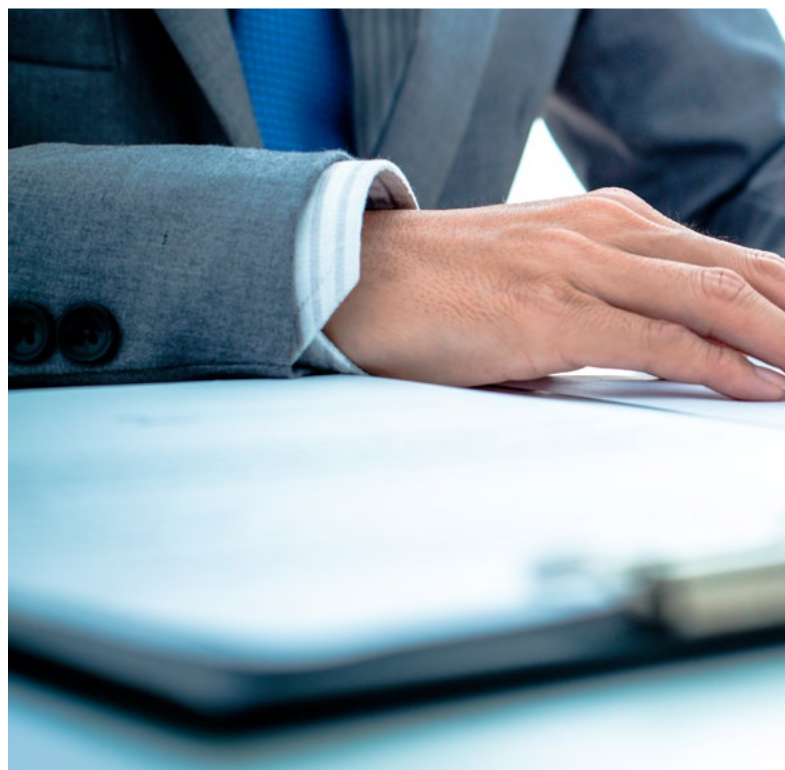
At the end of every tax year, a tax return needs to be filed with the Income Tax authorities in the prescribed format. The due date for filing returns is 31 July of the year immediately following the relevant tax year. However, a fee of INR 5,000 is levied where the tax return is filed after the due date, but by 31 December of the relevant assessment year, and a fee of INR 10,000 if filed after 31 December. This fee is capped at INR 1,000 for taxpayers earning a total income of up to INR 0.5 million. It is mandatory for individuals to file returns electronically if their total income exceeds INR 5,00,000, if they qualify as RORs and own foreign assets or they have signing authority for any of their accounts located outside India. Wealth Tax, which was earlier levied on individuals' taxable wealth, has not been applicable from the tax year 2015–16.

There are detailed disclosure-related requirements in the return form for RORs in relation to their foreign accounts and assets. Non-disclosure or inaccurate disclosure can result in severe penalties, including prosecution under the Black Money Act (introduced on 1 July 2015). Furthermore, the Income-tax Return Form requires individuals with total income exceeding INR 5 million to report details of their assets and their corresponding liability at the end of their year in India. This includes assets such as immovable and movable property; cash in hand; other tax assets; jewellery; bullion; archaeological collections; drawings, paintings, sculptures or any works of art; vehicles, yachts, boats and aircraft; financial assets such as bank, shares and securities; insurance policies; loans and advances given or interest held in the assets of a firm or association of persons or members.

Other matters

Visa

Foreign nationals wanting to come to India need to have valid passports and visas. Visas are issued by Indian Consulates or High Commissions in their home countries, depending on the purpose and duration of their visit. Foreign nationals are not permitted to take up employment in India unless they hold valid employment visas, which are issued to



highly skilled individuals or professionals, provided they earn a salary exceeding the prescribed limit. Such a visa is generally issued for a period of one to two years and can be subsequently extended in India. Foreign nationals coming to India to attend business meetings or set up Joint Ventures (JVs) require business visas, which cannot be converted into employment visas in the country.

Registration with Foreigners' Regional Registration Officers

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

Payment of salaries outside India

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

Social security in India

Foreign nationals holding the passports of foreign countries are mandatorily required to contribute to Indian social security schemes, provided they are working for

is deposited in the Provident Fund account and no allocation is made to the Pension Fund. However, for existing IWs (who joined before 1 September 2014) and those who are still working in India, an amount equal to 8.33% of their salaries is allocated to the Pension Fund and the balance is deposited in the Provident Fund account.

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

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

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

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

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

Singapore is the only country with which India had signed a CECA before October 1, 2008. It has signed SSAs with 18 countries. However, so far, its SSA with Brazil is not operational.

All international employees are required to contribute 12% of their salaries to India's social security system. Employers need to deduct this amount from their employees' monthly salaries, and after making a matching contribution of 12%, deposit the amount with the country's social security authorities. Currently, for any IW coming to work in India for a covered establishment, and drawing a salary of more than INR 15,000 per month, the employer's contribution of 12%

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

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

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

- Exchange control regulations
- Corporate Tax-related implications (exposure to permanent establishment)
- Withholding Tax
- Transfer Pricing regulations

- Service Tax-related implications
- The Companies Act
- Indian social security regulations

'Black Money' Act

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

Aadhaar registration in India

The Aadhaar number is a 12-digit individual identification number issued by the Government of India. It is based on an individual's biometric and demographic data. It is not a proof of Indian citizenship and only serves as proof of identity.

The Finance Act, 2017, has introduced a new section 139AA, which provides mandatory quoting of the Aadhaar number or the Enrolment ID of the Aadhaar application form for filing Income-tax returns, applying for a PAN or keeping an existing PAN active. This will be effective from July 1, 2017, and will be applicable for all individuals with Aadhaar numbers. According to the Aadhaar Act, every individual who has resided in India for an aggregate of 182 days or more in any preceding 12-month period is eligible for an Aadhaar number. However, it has been recently clarified by the Government of India that this requirement will not apply to individuals who do not have Aadhaar numbers or Enrolment IDs and are:

- Residing in Assam, Jammu and Kashmir, and Meghalaya
- Non-residents according to the Act
- 80 years or more at any time during the tax year
- Not citizens of India

Indirect taxes

Tax structure prior to 1 July 2017

India follows a federal structure under which the authority to impose taxes has been distributed between the Central and state governments. Till 30 June 2017, the following types of indirect taxes were applicable in India:

Tax/Duty	Levied by	Levied on
Value Added Tax (VAT)	State government	Sale of goods within the state
Central Sales Tax (CST)	Central Government Administered by state from which the goods were supplied	Inter-state sale of goods
Service Tax	Central Government	Provision of all services (except those specified in the Negative List or notified as exempt)
Customs Duty	Central Government	Import or export of goods into India
Excise Duty	Central Government	Manufacture of excisable goods
Entry Tax/ Octroi/ Local Body Tax	State government/ local bodies	Entry of goods in a particular area in a state

However, the indirect tax structure given above had several shortcomings, some of which are listed below:

- Tax cascading
- The requirement for multiple compliances
- The need for interaction with multiple tax authorities at the Central and state levels
- No cross-utilisation of credits inter se goods and services
- Input Tax Credit (ITC) of certain taxes or duties such as CST not always available

The Government has implemented the Goods and Services Tax (GST) with effect from 1 July 2017 to address and eliminate these shortcomings.

Tax structure with effect from 1 July: Introduction of the GST regime

GST is a consumption-based tax, which aims to transform India's indirect tax landscape.

Hailed as the most important tax reform since Independence, GST subsumes applicable additional Customs Duty levied in lieu of Central Excise Duty, Special Additional Duty of Customs, Central Excise Duty, Service Tax, cesses applicable for goods and services, CST, VAT and other state levies.

India has opted for a dual GST model under which the Central Government and state governments have the power to levy GST on supply of goods and services. Taxes applicable under GST include the following:

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

GST being a consumption-based tax, revenue accrues for a transaction based on the consumption/destination state, unlike under the past indirect tax regime, wherein revenue accrued to the supplying state.

GST rates: The Government has set the following slabs for GST rates:

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

The tax rates mentioned above denote the cumulative rates for CGST and SGST/UTGST or IGST (depending on whether a transaction is local/intrastate or interstate). For local transactions, the rates given above are to be bifurcated equally into CGST and SGST/UTGST.

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

Identified luxury goods and services are also liable to Compensation Cess. The rate of Compensation Cess varies from 1% to 15%. It is higher for tobacco and tobacco products.

Exemption of threshold: A supplier with an annual turnover of up to INR 20 lakh in a financial year is exempt from GST and is not required to obtain GST registration. In the case of some northeastern states (that have been identified), this threshold has been fixed at INR 10 lakhs.

Registration: A supplier of goods and/or services is required to obtain GST registration in every state from which it supplies goods and/or services. GST registration is not required if the turnover of a supplier is less than the threshold limit mentioned above or the person is exclusively engaged in supplying GST-exempt goods and/or services.

However, specified categories of persons (such as those making inter-state supplies or those liable to pay tax as recipients) are mandatorily required to obtain GST registration even if their annual turnover is less than the prescribed threshold.

Composition Scheme: To ease the compliance burden, small taxpayers with an aggregate turnover of up to INR 75 lakhs have been given the option to opt for a Composition Scheme.

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

A supplier making interstate supplies is not eligible for the Composition Scheme and cannot opt for it.

The tax rate prescribed under the Composition Scheme:

The highest tax rate prescribed under the Composition Scheme:

- 5% of their turnover for persons engaged in supply of food or beverages for human consumption
- 2% of their turnover for manufacturers
- 1% of their turnover for other suppliers in states or Union Territories

The Government may prescribe a lower tax rate for the categories mentioned above.

ITC: One of the key features of GST is that it has brought in a liberal ITC regime. Taxpayers are permitted to avail ITC of GST they have paid on procurement during the course of or in furtherance to business to make taxable supplies. ITC can also be utilised to make payment for output GST liability.

ITC is not allowed for procurement, including rent-a-cab, outdoor catering and expenses for personal consumption.

Under the earlier indirect tax regime, cross utilisation of VAT paid on goods against output Service Tax liability, and vice-versa, was not permitted. Under GST, cross utilisation of taxes paid on goods and services is allowed.

Under GST, a supplier's eligibility to claim ITC is subject to a vendor's compliance.

Transaction between related persons: Generally, only supplies made for a consideration are liable to GST. However, in the case of transactions between related parties and the locations of the same entity in different states, even supplies made without consideration will attract GST.

Exports and supplies to SEZs: Export of goods or services and supplies to SEZs have been categorised as zero-rated supplies. A supplier making zero-rated supplies is eligible to either:

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

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

BCD and Customs Cess paid at the time of import is non-creditable and is therefore a cost. However, ITC of IGST will be available for adjustment against output GST liability. ITC of Compensation Cess is only available for utilisation against an output Compensation Cess liability.

Liability to pay GST: Generally, the supplier of goods or services bears the liability to pay GST. However, the recipient is liable to pay tax for certain types of transactions (such as procurement from unregistered suppliers or import of services). This is usually referred to as reverse charge mechanism. In addition to the payment of tax under reverse charge mechanism, the recipient may be required to raise a 'self-invoice' and 'payment voucher' for tax reporting and compliance purposes.

Compliance requirements: The GST law prescribes stringent compliance-related requirements. A supplier of goods and services is required to file multiple returns within a month on a state-wise basis for each registration.

All mandatory compliances under GST are to be undertaken on a common portal managed by the Goods and Service Tax Network (GSTN).

It is clear that businesses will need to be supported by robust IT/ERP systems in order to comply with the complex compliance-related requirements under GST.

Stamp Duty

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

Mergers and Acquisitions (M&A)

India's M&A framework

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

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

Transactions through share transfer

Implications for sellers

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

Nature of capital gain	Unlisted shares/ shares of private company	Listed shares
Long Term Capital Gains (LTCG)[9] (gains from shares held for more than: 12 months in the case of listed 24 months in the case of unlisted shares)	For residents – 20% (with indexation) For non-residents – 10% (without indexation)	• If sold through stock exchange – exempt • If sold outside stock exchange: - Resident – 10% (without indexation)/20% (with indexation), whichever is beneficial - Non-resident – 10% (without indexation)/20%
Short Term Capital Gains (STCG)[9] (gains that do not qualify as long term)	For resident companies – 30% For non-resident companies – 40%	• If sold through stock exchange – 15% • If sold outside stock exchange– tax implications similar to treatment of sale of unlisted shares

Taxability of indirect transfer

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

However, no indirect transfer taxation applies on transfer of minority stakes (of 5% or less) in the foreign company. Additionally, in the event of a merger or demerger of the foreign company, exemption from Capital Gains Tax is available in India on fulfillment of prescribed conditions.

Implications for buyers

- According to SEBI's Takeover Code, acquisition of 25% shares (or more) or control of a listed company obligates the acquirer to make an offer to the remaining shareholders of the company.
- Stamp duty at 0.25% of the value of the shares is levied if shares are physically transferred.
- Funding costs, i.e., interest charged on a loan for acquisition of shares may not be tax-deductible, since the corresponding dividend income is tax-exempt in the hands of shareholders.
- In the case of non-resident sellers, a buyer (including a non-resident) is required to withhold Indian tax arising to the sellers, and therefore, needs to obtain a tax registration number in India. Parties can seek clarity on the aspects of Withholding Tax by obtaining prior clearance from the Tax authorities.
- If a buyer receives any property, without consideration, or at a consideration that is less than the FMV (determined on the basis of prescribed rules), the difference between the FMV and sale consideration is taxable in the hands of the buyer.

[9] Plus surcharges

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

- There is no tax impact on change in shareholding of a listed company carrying forward tax losses
- Unlisted companies are not entitled to carry forward and set off their unabsorbed business losses (excluding depreciation), if any, due to a change in their shareholding of more than 49%.

Valuation of shares

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

Business or asset purchase model

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

Asset purchase model

Implications for the seller:

- Gains are computed for every asset individually and are taxable as STCG or LTCG, depending on the period during which they were held. Sale of depreciable assets always results in STCGs.
- Capital gains are determined by reducing the acquisition cost of assets from the sale consideration. In the case of LTCGs, the cost of an acquisition is indexed, based on the cost inflation index notified by the tax authorities every year. For self-generated intangible assets, the cost of their acquisition is taken as 'nil' for calculation of capital gains
- On transfer of movable property, the seller is liable to charge GST at rates specified by specific states.
- On transfer of immovable property, the sale consideration for computing capital gains cannot be less than the value determined by the stamp valuation authorities on the date of the agreement.
- In the case of transfer of investments in unquoted shares at a price that is less than its FMV (determined in the manner prescribed), the FMV is deemed to be the total value of the consideration, for the purpose of computing capital gains on the transfer.

Implications for the buyer:

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

Business purchase model

Implications for the seller:

- Capital gains are determined by reducing from the sales consideration the net worth of the business undertaking (determined in the manner prescribed).
- Capital gains are taxable as LTCGs if the business undertaking is held for more than three years. However, no indexation benefit is available.
- Capital gains are taxable at 20% (plus surcharges) if long term or at 30% (plus surcharges) if short term.
- Business transfers on a 'going concern' basis are typically not subject to GST.

Implications for the buyer:

- The excess of the lump sum purchase consideration over the book value of assets purchased can be allocated to the various assets acquired by the buyer. This will entitle the buyer to an increased depreciation allowance.
- Interest on loans taken for acquisition of assets or business undertakings through a slump sale is generally tax-deductible and subject to certain prescribed rules.

Amalgamations and demergers

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

Amalgamations and demergers normally attract stamp duty at varying rates prescribed in state laws. Clearance may be needed from other statutory authorities such as stock exchanges (in the case of a listed company), RBI and other regulatory bodies. An amalgamation or demerger can be conditionally tax-neutral. The relevant provisions are tabulated on the next page.

Outbound mergers

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

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

[10] Provisions not applicable on unabsorbed depreciation

Outbound mergers (i.e. the merger of an Indian company with a foreign one) requires prior approval from RBI and is only permitted if the foreign company is incorporated in the specified jurisdiction.

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

Transfer Pricing

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

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

Furthermore, scrutiny of multinationals' TP operations has intensified year on year around the world, and 2016 saw significant changes introduced in TP regulations and documentation in response to the OECD's Base Erosion and Profit Shifting (BEPS) project.

Presented below are the key TP highlights of the Financial Year (FY) 2016–17:

Budget: TP provisions

Secondary adjustment

The Indian Finance Act, 2017, has introduced a secondary adjustment mechanism vide section 92CE of the Act. The primary adjustment results in addition to income or reduction in expense and creates an additional tax liability for taxpayers. The secondary adjustment will be applicable for the following primary adjustments:

a. Suo-moto adjustment offered by taxpayers

b. Adjustment made by Tax Officer (TO) and accepted by taxpayer

c. Adjustment determined by an Advance Pricing Agreement (APA)

d. Adjustment made according to India's safe harbour rules

e. Adjustment arising due to a Mutual Agreement Procedure (MAP) resolution

A primary adjustment is the difference between the transfer price determined, based on the arm's-length principle, and the transfer price at which a transaction has taken place. This difference also represents the 'excess money' that needs to be repatriated to India. If this money is not sent to India, it is considered as an 'advance' and interest is computed on this. CBDT has notified interest computation rules for secondary adjustment. A secondary adjustment applies to a primary adjustment amounting to more than INR 10 million and relates to or is made in respect of FY 2016–17 and onwards.

Introduction to Thin Capitalisation Rules

In line with recommendations from the OECD's BEPS project, the Finance Act, 2017, has introduced the Thin Capitalisation Rules. These provisions do not allow deduction for payment of interest under certain circumstances. As a basic rule, there will be a 30%* Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) cap on claims for payment of interest to overseas related parties. Excess interest disallowed in a year will be eligible for carry forward up to eight consecutive years.

Rationalisation of domestic TP provisions

The provisions relating to expenditure in respect of payments made by taxpayers to domestic-related parties have been abolished with a view to reduce TP-related compliance requirements and facilitate ease of doing business in India. Such expenditure includes payments made to specified persons, such as directors, and parent and sister companies. Going forward, domestic TP provisions will only apply to inter-company transactions if one or both the parties are engaged in activities that are eligible for tax holidays.

APA (Advanced Pricing Agreement): The CBDT has released its first ever APA Annual Report (2016-17) to mark completion of five years of the APA programme. The APA report card is impressive, with 152 APAs concluded in 4 years and a total of 815 applications filed by 31 March 2017. With FY 2016-17 witnessing the conclusion of a record 88 APAs, taxpayers should be upbeat about the continuing efforts of the CBDT to conclude APAs.

A recent development in the domain is the appointment of two new APA Commissioners in Mumbai and Bengaluru, in addition to the two existing APA Commissioners, to reinforce the teams. The USA is the top country for filing of bilateral APAs, followed by the UK, Japan and Switzerland.

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

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

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

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

Country by Country Report (CbCR): Worldwide, TP-related documentation is a top priority for MNEs. The OECD had first conceived its three-tier TP documentation standard, included in its CbCR under Action 13 of its BEPS project in September 2014. Since then, the OECD has issued additional guidance to clarify various aspects of the rules to bring about an improved understanding of and consistency in their interpretation. On 6 April 2017, the OECD released an updated version of its Guidance on the Implementation of Country-by-Country Reporting (the Guidance), which has rearranged the content of its earlier guidance into four areas, including (i) definition of the items reported in the template for CbCR, (ii) the entities to be reported in it, (iii) the filing obligations relating to it and (iv) its sharing mechanism.

Significantly, the OECD has also addressed five new issues in its Guidance:

a. Definition of the terms 'related-party revenues' and 'revenue' used in the CbCR

b. Definition of 'total consolidated group revenue'

c. The applicability of accounting principles for various items included in the CbCR

d. Treatment of major shareholdings

e. Transitional filing options for MNE groups

The Government has introduced a three-layer TP documentation process, keeping in mind India's commitment to implementing the OECD/G20's BEPS recommendations. Taxpayers will now need to prepare a master file, a local file and a CbCR. The local file will have to be maintained in the same manner as in earlier years. The new regime is effective from FY 2016-17 onwards.

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

India has signed the Multilateral Competent Authority Agreement (MCAA) to facilitate automatic exchange of CbCR. By doing so, it has agreed to bilaterally and automatically exchange CbCR with countries that are signatories of the MCAA.

Other key developments

Cyprus-India DTAA: In relation to the revised India-Cyprus DTAA, the CBDT had notified that all the provisions of the revised DTAA or protocol would be effected in India from 1 April 2017. The revised India Cyprus DTAA was signed on 18 November 2016 and came into force on 14 December 2016.

India-Singapore and India-Korea tax treaty: On 30 December 2016, the Governments of India and Singapore signed the Third Protocol (2016 Protocol), which amended the DTAA between India and Singapore (India-Singapore Tax Treaty). The introduction of the much-awaited Article 9(2) in the India-Singapore Tax Treaty is undoubtedly a significant step forward in the TP domain.

India and Korea have entered a revised agreement for a tax treaty that replaces the earlier tax treaty signed by the two countries in 1985. The amendment resulted in significant TP-related revisions and led to the inclusion of Article 9(2) in the tax treaty. This has opened an important window for resolution of TP-related disputes in which many Korean companies in India are embroiled.

Taxpayers in both the countries can now apply for Bilateral Advance Pricing Agreements for up to five years as well as for an optional roll-back for the past four years. This will give them certainty on TP-related matters for up to nine years. Such taxpayers will also have access to the MAP under the treaty, as an additional route to resolve their past TP-related disputes.

Revised Safe Harbour Rules (SHRs): The much-awaited amendments to the SHRs have been announced by the CBDT. The key changes are as follows:

a. Reduction in Safe Harbour rates for most eligible transactions, along with other changes made in the specified circumstances

b. Provision of low value-adding intragroup services now a part of eligible transactions under SHR

These amendments have brought Safe Harbour rates closer to economic reality and aligned them with the outcomes observed in APA resolutions. Clearly, the Government seems to be walking the talk on providing tax certainty to taxpayers by means of a more rationalised Safe Harbour structure.

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