

# Doing Business with India

## tax & regulatory

### Cologne/ Bonn India Business Club

*January 26, 2010*

**Rajiv Arya** II Partner II

**Sunil Arora** II Partner II



**ASA & Associates** chartered accountants

*A member firm of NIS Global*

**&**

**Corporate Catalyst India**

## PRESENTATION OUTLINE

### **Session 1-** Rajiv Arya

- India - Policy & regulatory issues

\*\*\*\*\*

### **Session 2 –** Sunil Arora

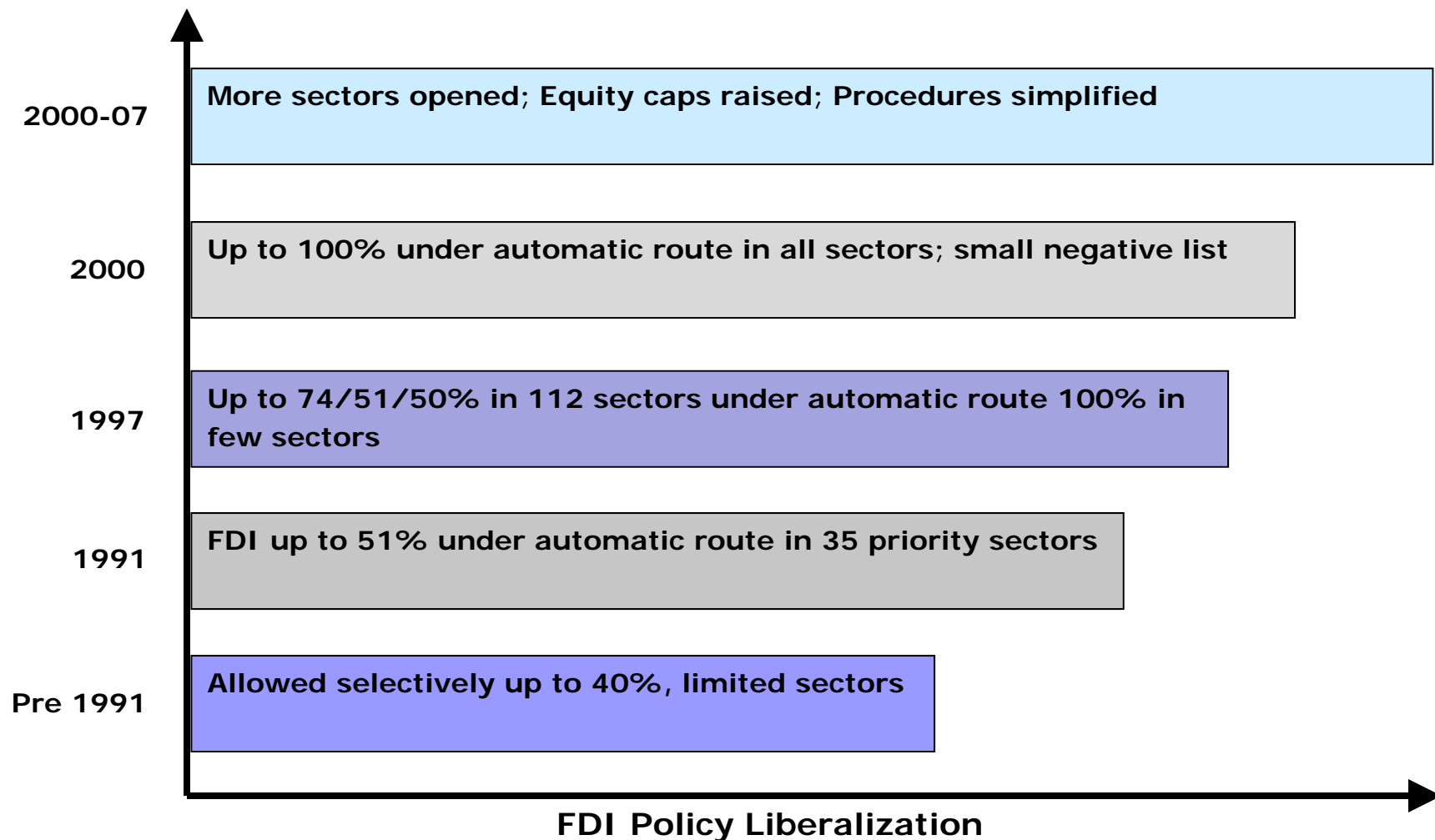
- Tax matters

# The Economy and the Tell Tale Signs

## INDIA TOUR

- ❑ The 2<sup>nd</sup> **most attractive investment destination**  
*(source UNCTAD World Investment Report 2008)*
- ❑ Advantage - **low cost of production, large size domestic market**
- ❑ Besides service industry, evolving into a **manufacturing hub**
- ❑ India figures in the **Research and Development** strategy of global corporate

## The changing face of the FDI Policy



## FDI Inflow - Top Investing Countries

US\$ Million

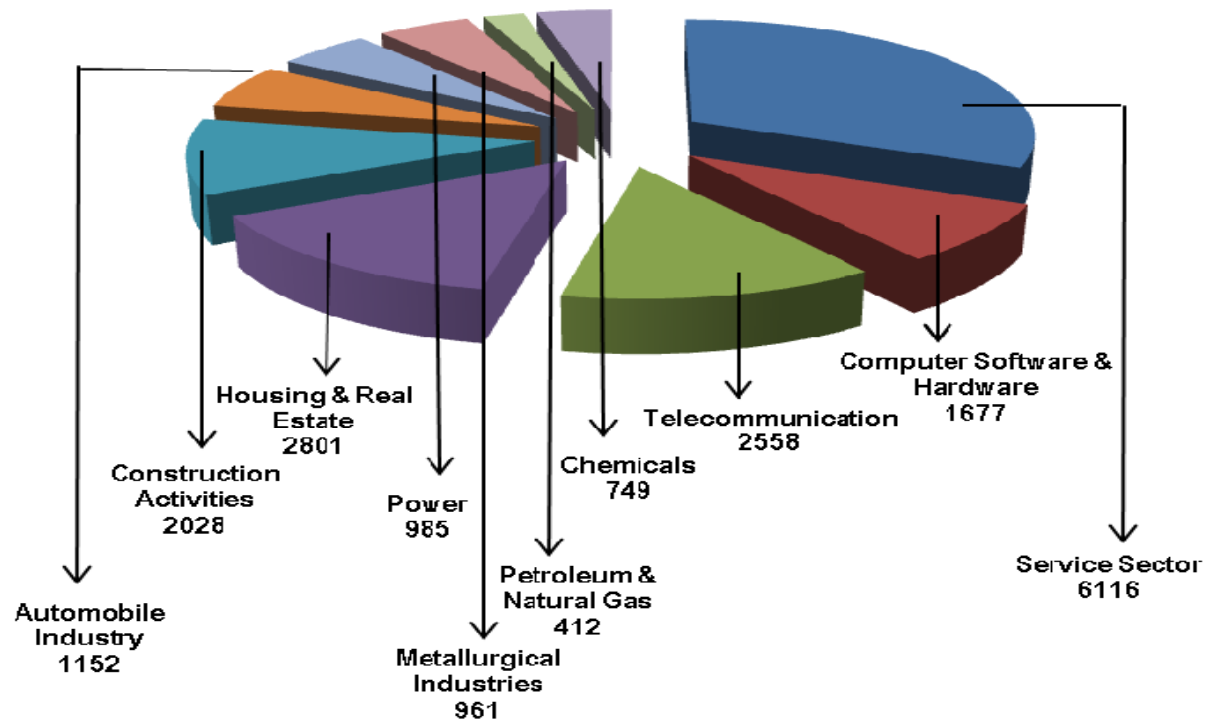
Ranks	Country	2006-07	2007-08	2008-09	2009-10 (May 2009)	Cumulative
1	MAURITIUS	6,363	11,096	11,208	2,515	39,379
2	SINGAPORE	578	3,073	3,454	260	8,071
3	USA	856	1,089	1,802	173	6,508
4	UK	1,878	1,176	864	62	5,289
5	NETHERLANDS	644	695	883	110	3,701
6	JAPAN	85	815	405	303	2,834
7	GERMANY	120	514	629	205	2,378
8	CYPRUS	58	834	1,287	307	2,579
9	FRANCE	117	145	467	6	1,233
10	U.A.E.	260	258	257	75	995
	<b>Total</b>	<b>15,726</b>	<b>24,579</b>	<b>27,309</b>	<b>4,434</b>	<b>94,274</b>

Source – Department of Industrial Policy & Promotion

[www.asa.in](http://www.asa.in)

## FDI - Sectoral Composition

Sectoral Composition of FDI 2008-09 (USD million)



# 2010 - focus & reforms

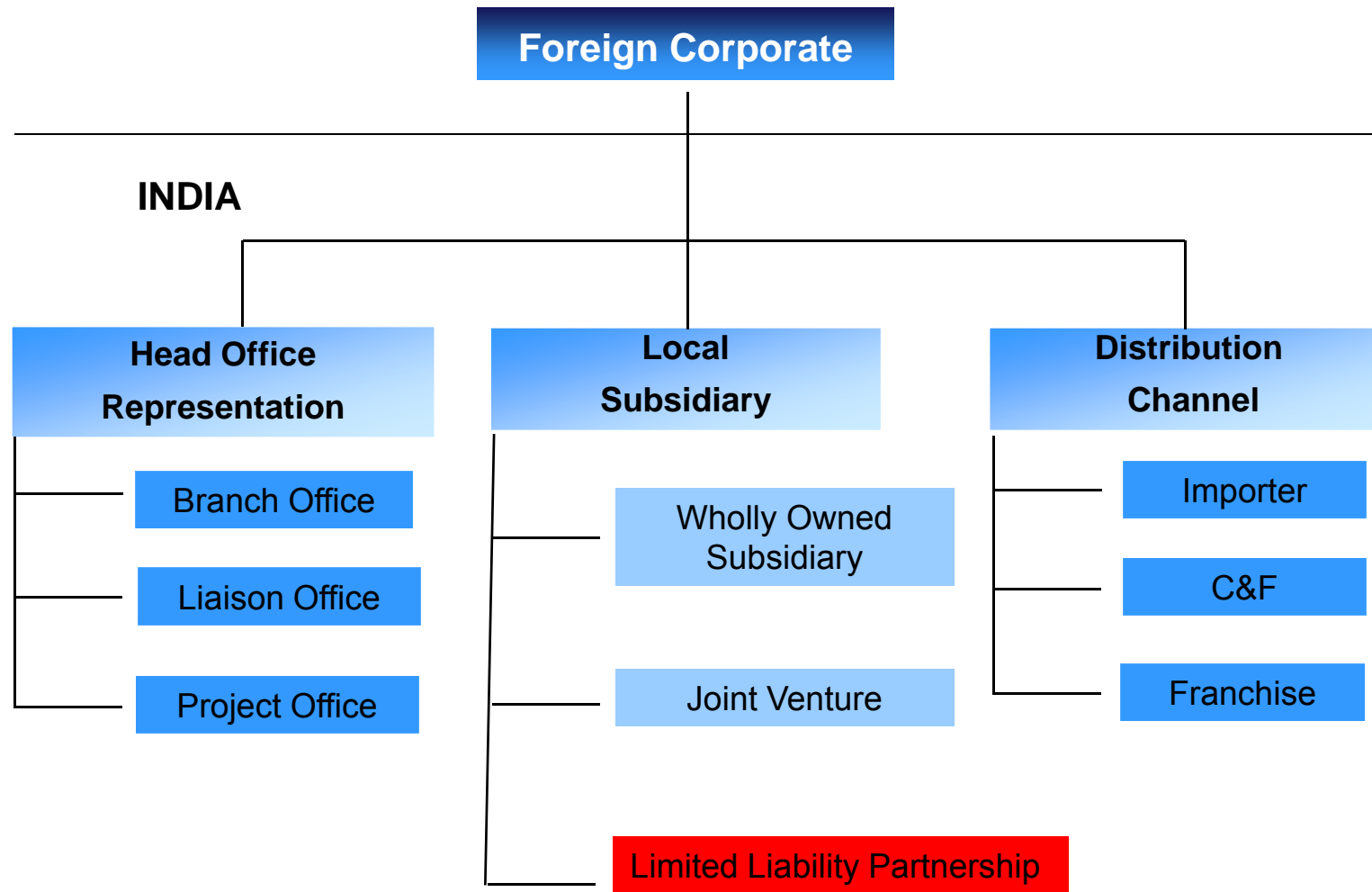
## Objectives

- ❑ Recovery – focus on infrastructure
- ❑ Control fiscal deficit
- ❑ Spreading opportunities across the rural belt
- ❑ Encourage foreign direct investment
- ❑ Ease-out defunct laws, rationalise taxes

## Promising Sectors

- ❑ Retail
- ❑ Healthcare
- ❑ Logistics
- ❑ Power
- ❑ Transport
- ❑ Telecom
- ❑ Education

# INDIA ENTRY - Mode of Investment



## INDIA ENTRY - Alternate Entity Comparison

	<b>Corporate [CO]</b>	<b>Liaison Office [LO]</b>	<b>Project Office [PO]</b>	<b>Branch Office [BO]</b>
<b>Characteristics</b>	Share capital owned by parent company	No commercial activities allowed	Temporary site office, specific projects	Commercial activities allowed
<b>Status</b>	Shareholders	Foreign Company	Foreign Company	Foreign Company
<b>Tax Rate</b>	30% +	Non Taxable	40% +	40% +
<b>Control</b>	Board of Directors	Parent Company	Parent Company	Parent Company
<b>Set-up</b>	FIPB Approval / Automatic Route (4-6 weeks)	RBI approval (4 weeks)	RBI approval (4 weeks)	RBI approval (4 weeks)
<b>Closure</b>	ROC (6-9 months)	RBI (3 months)	RBI (3 months)	RBI (3 months)

RBI – Reserve Bank of India  
FIPB – Foreign Investment Promotion Board  
ROC – Registrar of Companies

## INVESTMENT STRATEGY - Policy matters

- ❑ Analysis of **Sectoral Caps** - Investment Allowed Under Automatic or Approval Route
- ❑ **Negative List** - Gambling & Betting, Lottery business, Atomic Energy, Retail trading (except 'Single Brand' product retailing)
- ❑ **Press Note 1 of 2005** - Special Approval on Investment in Existing Industries



Examine the Negative List, Sectoral caps and SSI reservations while conceptualizing investment into India

## **POLICY FRAMEWORK – In the horizon**

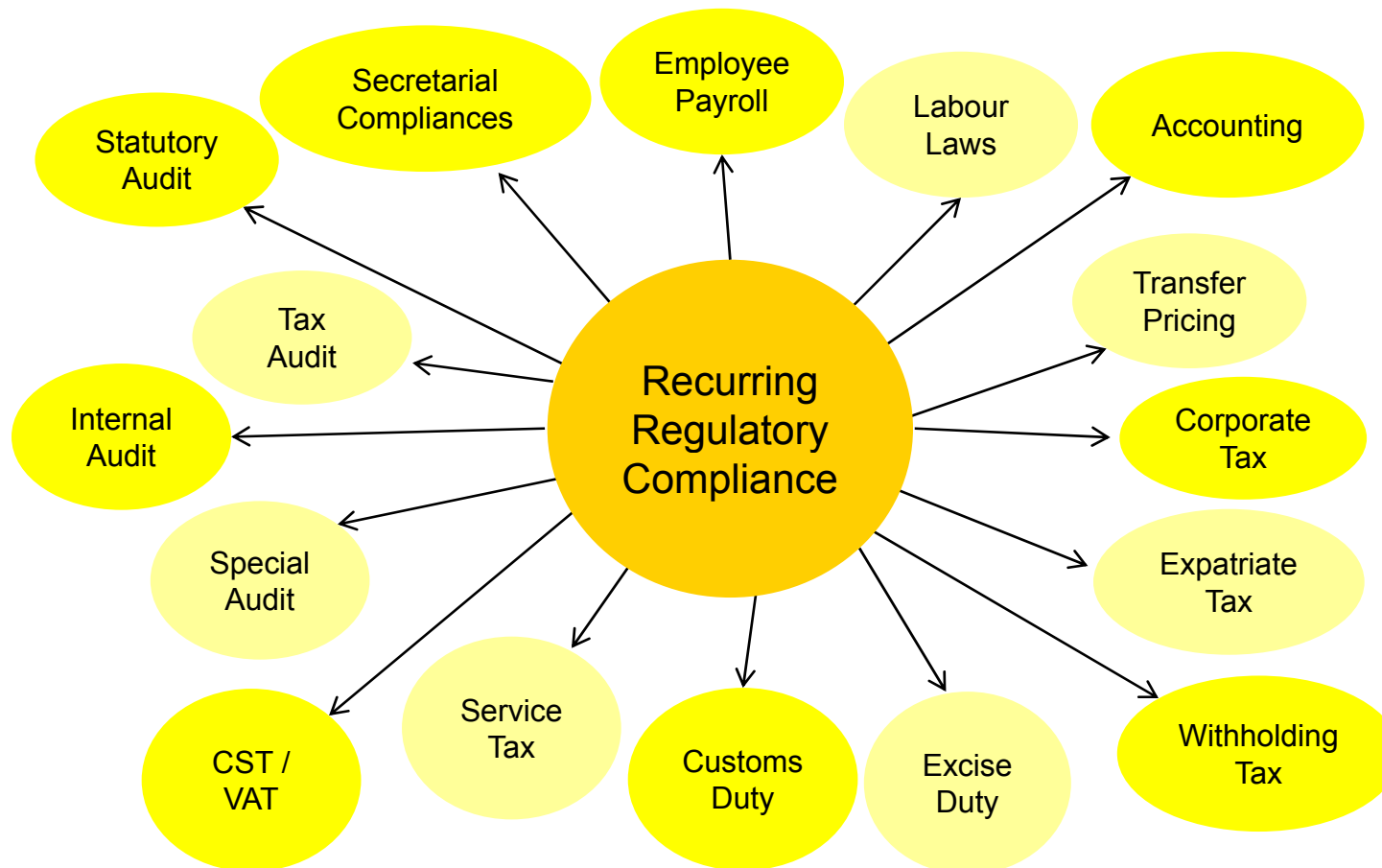
- ❑ **Companies Law Amendment Bill**
- ❑ **Goods & Services Tax**
- ❑ **Limited Liability Partnerships**
- ❑ **International Financial Reporting Standards (IFRS)**
- ❑ **New Direct Tax Code**
- ❑ Insurance Laws (Amendment) Bill
- ❑ Banking Regulations (Amendment) Bill
- ❑ Phased Increase In FDI Limits
- ❑ National ID card based on unique identification number

## **regulatory compliances - *overview***

## REGULATORY ENVIRONMENT

- ❑ Most laws originate from British Laws
- ❑ Procedure Driven
- ❑ Failures to comply usually leads to penalty and sometimes prosecution
- ❑ Stacked in favor of labour (*blue collar staff*)
- ❑ Fine reading and interpretation is the norm

## COMPLIANCES - Overview



**on the anvil**

## **NEW COMPANIES BILL 2009**

- ❑ Introduction of One Person Company (OPC)
- ❑ One Resident Director mandatory for all companies
- ❑ Director can himself file details of his resignation to ROC
- ❑ A Whole-Time Director not to hold office in more than one company unless permitted by the company
- ❑ Board Meetings to be possible through Video Conferencing

## NEW COMPANIES BILL 2009

- ❑ Financial Year closure for all companies to be made as March 31st
- ❑ Companies can be struck off if business not commenced within 180 days of incorporation
- ❑ Concept of Dormant Companies introduced for future project or to hold an asset/ IP
- ❑ Winding-up procedure simplified. No intervention of the Courts. Activity to be time bound.
- ❑ Specific provisions for M&A

## GOODS & SERVICE TAX (GST)

- ❑ Proposed to be introduced in 2010
- ❑ A two tier structure proposed
  - for the State i.e. State GST (SGST) constituting Sales tax, Entertainment tax, Luxury tax
  - for the Center i.e. Centre GST (CGST) constituting Service tax, Excise Duty and related components
- ❑ Central Sales Tax (inter state tax) to be phased out
- ❑ Exports to be “Zero” rated
- ❑ All monitoring to be done based on single tax registration mechanism

## LIMITED LIABILITY PARTNERSHIP (LLP)

- ❑ LLP - alternate corporate business entity
- ❑ Like a private limited company, is a body corporate having a distinct legal entity separate from its partners
- ❑ Benefit of limited liability, at the same time allowing members a flexible internal structure akin to partnership
- ❑ LLP introduced, appropriate changes awaited in the exchange control regulations and tax laws

## International Financial Reporting Standards (IFRS)

- India to fully converge with IFRS by April 1, 2011
  
- Will apply to all public listed companies and those with turnover exceeding USD 25 million
  
- Paradigm shift in the basis of recording transactions
  - Impresses substance over form
  - adequacy of disclosures

# India Taxation

## OUTLINE

- ❑ Overview on Corporate Taxation
- ❑ Issues Specific to Foreign Corporates
- ❑ Salient Features of the New Direct Tax Code

## CORPORATE TAXATION - Overview

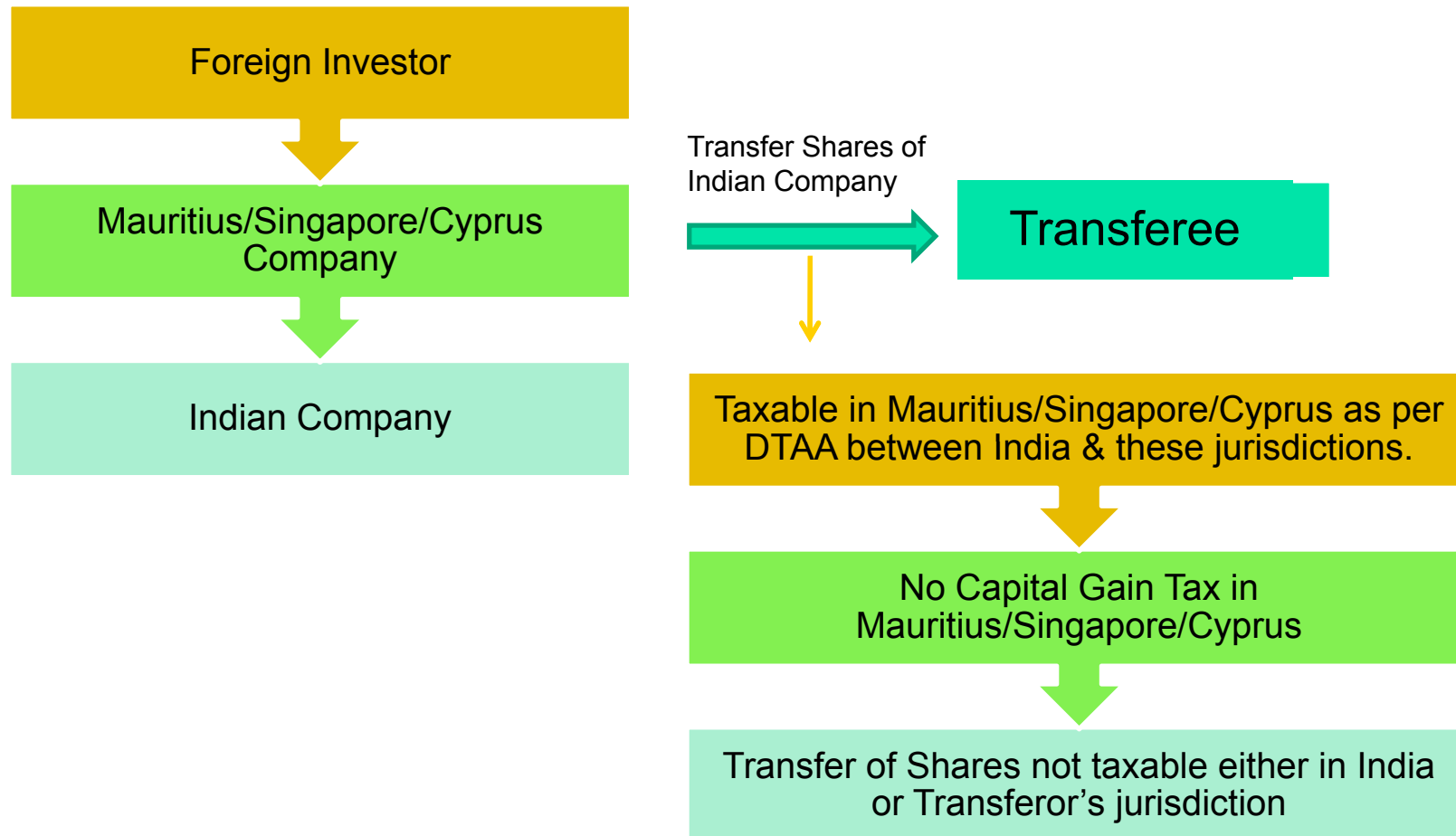
- ❑ Scope of taxability based on residential status
- ❑ Residential status determined on the basis of place of control and management
- ❑ Resident companies taxed on worldwide income in India
- ❑ Non resident companies taxed on income received, accruing or deemed to be accruing in India
- ❑ Rates of Maximum Marginal Tax (income exceeding INR 10m)

Tax Payer	Tax Rate
Indian Incorporated Companies	33.99%
Foreign Companies	42.23%

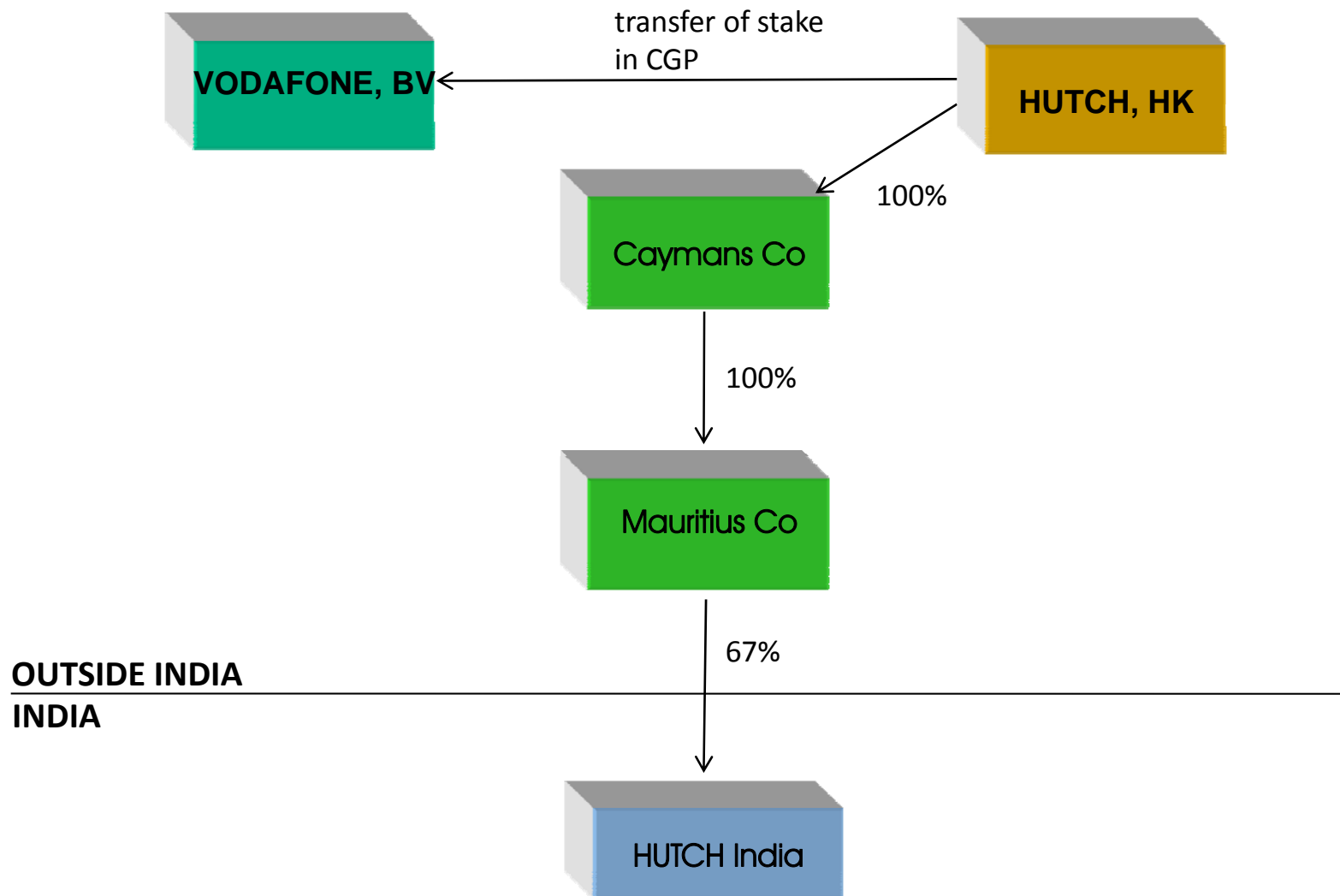
## SPECIFIC ISSUES – Investment in India

- ❑ Inbound Investment – Use of Tax Treaties
- ❑ Repatriation of Profits
- ❑ M&A related
- ❑ Exposure to Permanent Establishment (PE)
- ❑ Lower Tax Withholding
- ❑ Transfer Pricing Regulations

## INBOUND INVESTMENT – Use of Tax Treaties

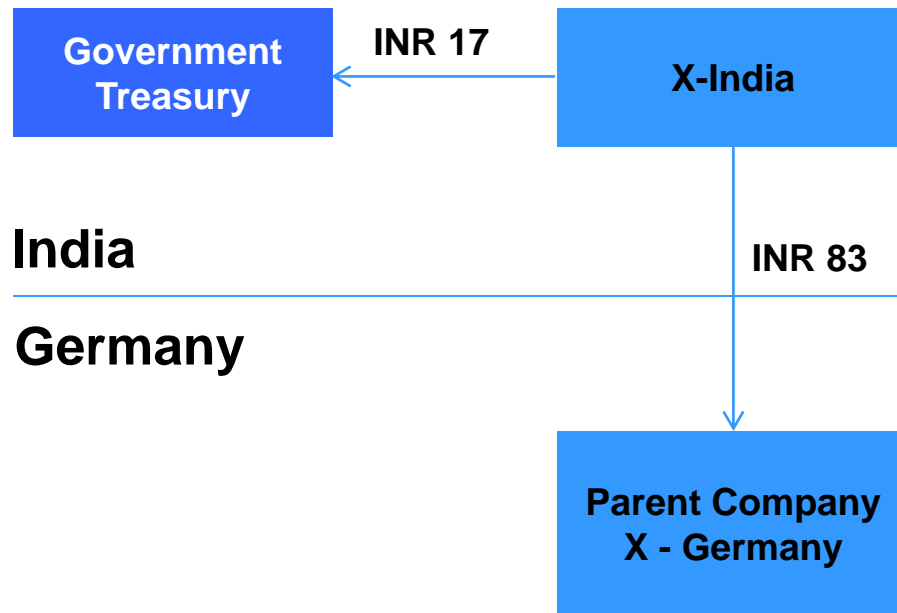


# INBOUND INVESTMENT – vodafone



# REPATRIATION OF PROFITS

## The menace of Dividend Distribution Tax



Amount in INR	
Net Profit	133
Tax on Profit	33
Distributable Profit	100

Whether the credit in respect of Dividend Distribution Tax (DDT) of INR 17 is available in the Parent Country?

## M&A – key tax issues

### Factors

- ❑ Separation tax cost (viz. capital gains, stamp duty, VAT, etc.) directly hits the seller's consideration. Therefore the need to select the **most optimum mode** of sell-out
- ❑ Future tax planning greatly impacts the financial feasibility for buyer. Therefore, the need to be aware of eligible tax holidays, unabsorbed losses, VAT credits etc to assess the real benefit.
- ❑ Procedural compliances and time-lines related to transfer of tax benefits has a bearing on the timeline to transaction closure

## M&A – Modes of Carve Out

- ❑ **Demerger** : Vertical split of business unit into a new/existing entity. Generally tax neutral and allows carry forward of all benefits/losses; No VAT/ Sales tax on transfer of assets; time consuming
- ❑ **Slump Sale** : Sale of business unit as a whole on a going concern basis; may be tax efficient; widely used to dispose loss making business units; less time consuming; No VAT/ sales tax on transfer of assets; continuation of tax holidays can also be argued
- ❑ **Itemized Sale** : Sale of identified assets & liabilities; allows flexibility to sell; less time consuming; exposed to VAT/ sales tax on transfer of assets; tax holidays cannot be continued;
- ❑ **Equity Carve-Out** : Sale of shares in wholly owned subsidiary; restriction on carry forward of unabsorbed business loss, time efficient; tax holidays can be continued

## PERMANENT ESTABLISHMENT - Risk of exposure

- Foreign company operating through an agent, branch, etc. regarded as having a PE in India
- In certain cases, an Indian subsidiary can be classified as a PE

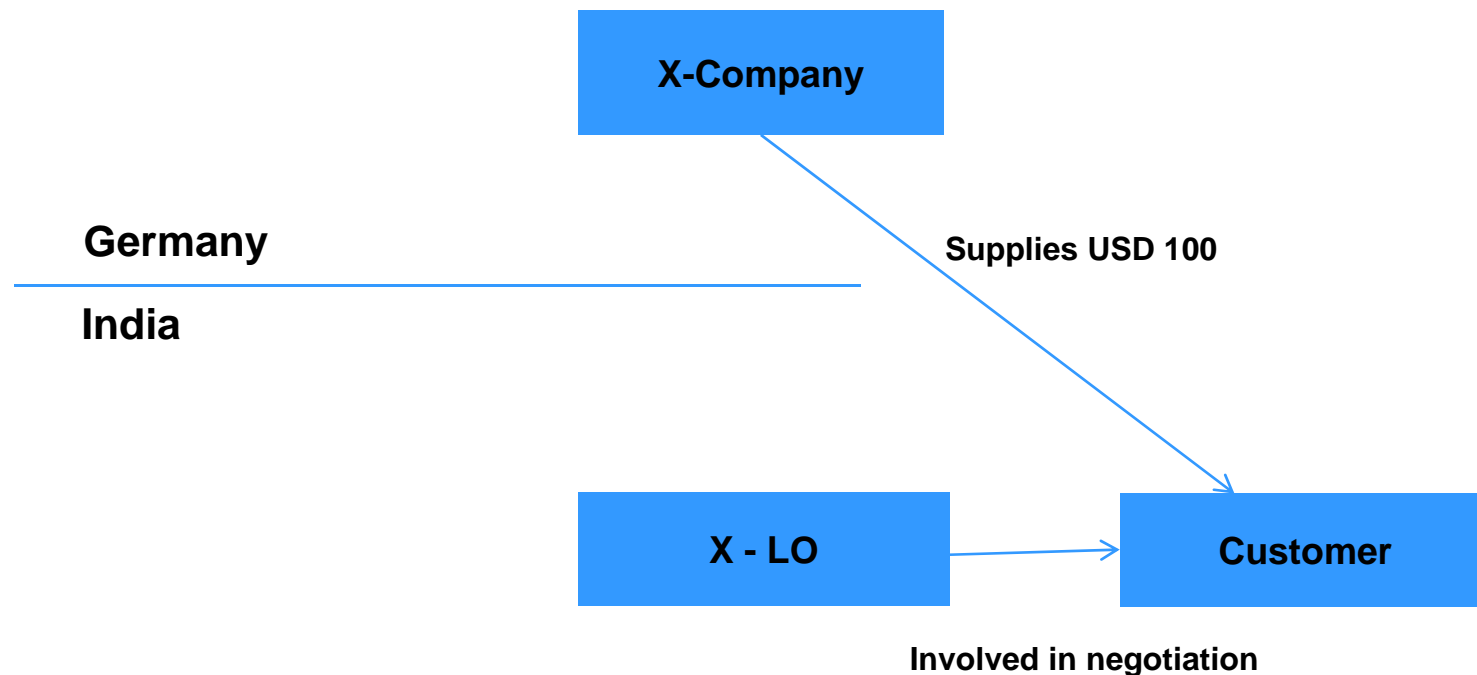
Where work linked to India,  
India tax office can prove  
existence of PE, part or entire  
portion of India linked  
transactions can be brought to  
tax in India

## LIAISON OFFICE - The PE Trap

- Does the India Liaison Office ('LO') sign direct contracts in India ?
- Is the LO deeply involved in price negotiations?
- Are the employees of the LO paid incentives on sales ?
- Does the LO raise Purchase Orders on the Head Office ?

An affirmation to any of the above – LO regarded as a Permanent Establishment of the parent company in India. This is a high risk of exposure to taxation

## LIAISON OFFICE - The PE Trap



*Effect: Part or whole of USD 100 can be taxed to India*

## LOWER TAX WITHHOLDING

- ▲ Under a PE situation, withholding tax is applied at 41.2 percent i.e. the maximum tax rate applicable to foreign companies
- ▲ In case the actual margins are lower, either the payee or payer (foreign company) can make an application to the tax authorities for determining appropriate rate of tax

Estimated Project Receipts	INR 100,000,000
Estimated Net Profit	INR 20,000,000
Net Profit/ Receipts Ratio	20%
<b>Tax @ 42.23% on Net Profit of 20%</b>	<b>8.45%</b>
<b>Withholding Tax on receipts at Normal Rates</b>	<b>42.23%</b>

- ▲ The non-resident should provide adequate basis of arriving at the estimated net profit

## TRANSFER PRICING

- **Arm's Length price ('ALP')**

Any income arising from an international transaction between associated parties to be computed having regard to ALP

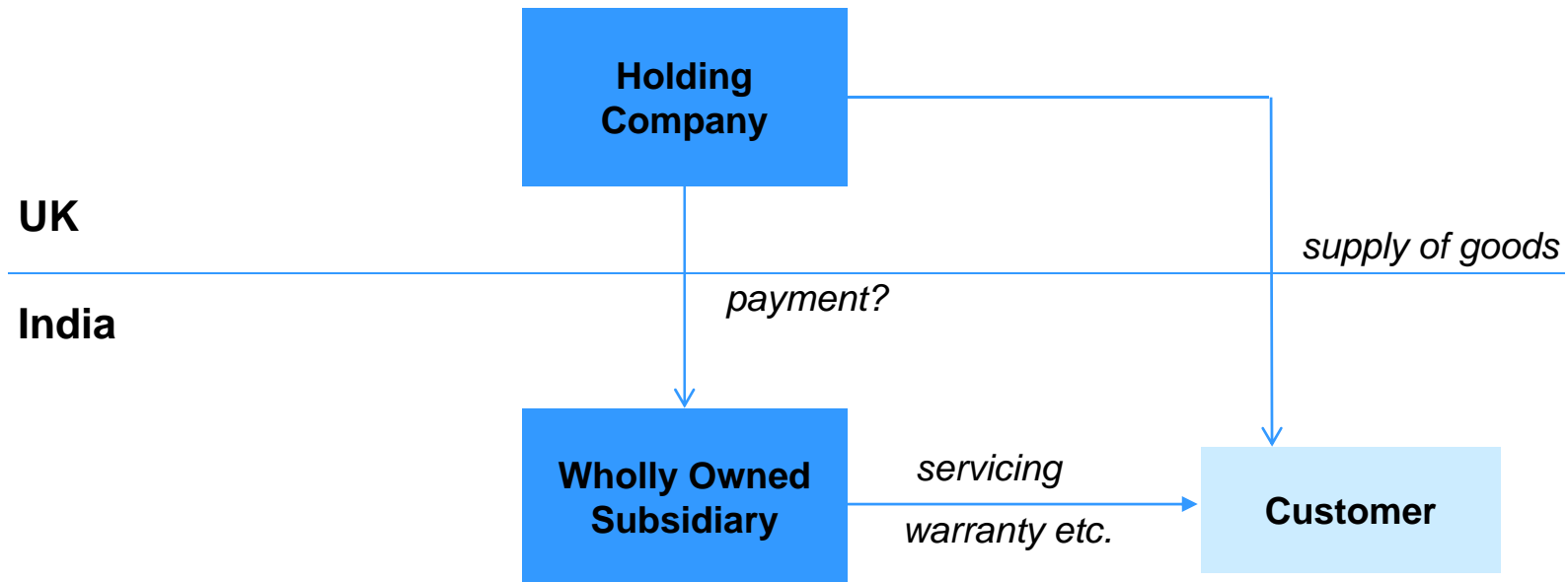
ALP means a price which is applied in a transaction between persons other than associated enterprises

- **Associated Enterprise ('AE')**

Participation in management or control or capital of other enterprise  
Directly through intermediaries

# TRANSFER PRICING

Determining the appropriate pricing for intra - group transactions



Transfer Pricing Issue –  
what should be the profit  
margin of the Wholly  
Owned Subsidiary?

# direct tax code – key provisions

## DIRECT TAX CODE (DTC)

- ❑ Tax rates rationalized for both corporate and non-corporate tax payers. All corporates to now pay a reduced tax of 25 per cent
- ❑ Domestic companies to still pay a 'dividend distribution tax' at 15 per cent
- ❑ Export based incentives (viz. STPI, EOU etc) discontinued; though the existing schemes of deductions/exemptions will be grandfathered
- ❑ Fresh tax exemptions to be 'investment linked' rather than 'profit linked'
- ❑ Foreign companies to pay an additional 'branch profits tax' at 15 per cent of post tax profits
- ❑ Payment of Minimum Alternate Tax (MAT) now based on 'value of gross assets' and not 'book profits'. Rate revised to 2 per cent from 15 per cent. No credit allowed of taxes paid under MAT

## DIRECT TAX CODE (DTC)

- ❑ Business related loss can be carried forward for an indefinite period
- ❑ Tax rate on royalties and fee for technical services payable to non-residents enhanced to 20 per cent on gross payment
- ❑ Head office expenses, earlier based on 5 per cent of net profits of non-resident Permanent Establishment (PE), will now be computed at 0.5 per cent of net sales
- ❑ Introduction of General Anti Avoidance Rule (GAAR) wherein commercial expediency of international transactions can be challenged by the authorities; primarily to check contentious issues viz. check round trip financing, lifting of corporate veil etc
- ❑ Provisions of DTC to have an overriding effect over all past tax treaties signed by India

## About Us

**ASA**

*(A MEMBER FIRM OF NIS GLOBAL)*

**&**

**CCI**

*(IN JOINT VENTURE WITH SCS GLOBAL)*

*NEW DELHI – MUMBAI – BANGALORE - CHENNAI*

## Our Strengths

- ❑ **ASA** - member of **NIS Global (H.O. UK)**, an international association of independent accounting firms
- ❑ **CCI** – joint venture with **SCS Global (H.O. Japan)**
- ❑ Approximately 80 per cent are **overseas clients**
- ❑ More than 20 years **work experience**
- ❑ Professional **staff strength** of over 150 in India & 1,500 through associate network

## Our Services



**Services**

- ❑ **Tax – Expatriates, Transfer Pricing**
- ❑ **Compliance – Bookkeeping, IFRS, SOX**
- ❑ **Audit – Statutory, Internal**
- ❑ **Market Research/ Industrial Analysis**
- ❑ **Business Advisory – Inbound investments**
- ❑ **Transaction Advisory – M&A, Restructuring**

# THANK YOU

**ASA & Associates** chartered accountants [www.asa.in](http://www.asa.in)

*A member firm of NIS Global*

**&**

**Corporate Catalyst India** [www.cci.in](http://www.cci.in)