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TAX AND REGULATORY

Investing in India

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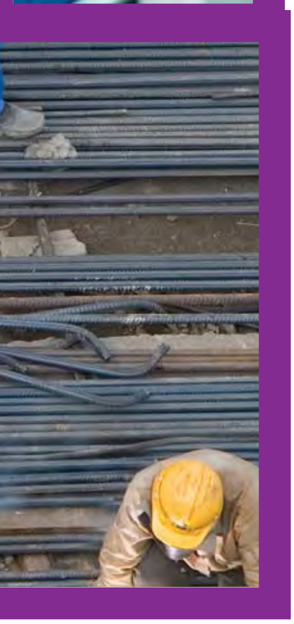


INDIA OVERVIEW

India is the world's largest democracy and the second fastest-growing economy. The past decade has seen fundamental and positive changes in the Indian economy, government policies and outlook of business and industry.

Total Area	3.29 million square kilometers
Capital	New Delhi
Population	Over 1 billion
Political System and Government	The Indian Constitution provides for a parliamentary democracy with a bicameral parliament and three
Head of State	President
Head of Government	Prime Minister
Territories	There are 28 states and 7 Union territories
Languages Spoken	Multilingual society with Hindi as its national language. English is the preferred business language
Literacy rate	65.4 percent
Time zone	GMT + 5 1/2 hours
Currency Unit	Indian Rupee (INR/Rs.)
Principal Markets for Exports	US, UAE, Hong Kong, UK, China, Singapore, Belgium, Japan, Italy, Bangladesh, Sri Lanka, France, Netherlands, Indonesia, Saudi Arabia, Germany, Spain, Malaysia
Principal Markets for Imports	US, China, Belgium, Switzerland, UK, Germany, Spain, Austrailia, Korea, Indonesia, UAE, Malaysia, Singapore, South Africa, Hong Kong, Italy, France, Russia, Saudi Arabia, Sweden

Country fact file

Political framework

- India is the world’s largest democracy
- Primacy of rule of law
- Free and vocal media.

Judicial framework

- Independent judiciary
- Supreme Court, the apex judicial authority, is vested with powers to enforce fundamental rights and act as a guardian of the Constitution.
- High Courts in every state and lower courts at the town level
- Alternative dispute resolution mechanisms to assist in the resolution of pending cases through either arbitration or conciliation.

BRIEF ECONOMIC OVERVIEW

The Indian economy has witnessed phenomenal growth during the last decade. The country posted decent growth during the recent slowdown and is among one of the countries to lead the recovery path. The growth in real Gross Domestic Product (GDP) stood at 6.9 percent in 2009-2010[1]. The GDP growth projection for 2010-2011 is 7.1 percent[1]. The key drivers of India's growth include a booming domestic marked by increasing consumption and a surge in investment, supported by certain inherent fundamental strengths such as favorable demographics.

However, burgeoning inflationary pressures are posing as an area of concern for the government. Rising inflation has led to stringent controls in the domestic financial environment. The Reserve Bank of India (RBI), India's central bank, has given high precedence to uphold price stability, contain inflation expectations and sustain the growth momentum

Transforming the domestic market[2]

- Favorable Demographics: India, where about 50 percent of the population is below 25 years of age, has one of the youngest populations in the world compared to the aging populations of the US, China, Japan, and the UK
- Increased Urbanization: By 2025, due to migration and population growth, the urban population is estimated to account for 37 percent of the total population. By the same time, the Indian consumer market is likely to largely be an urban affair with 62 percent of consumption in urban areas versus 38 percent in rural India.
- Rise of the Middle Class: The middle class (including aspirers), which, in 2005, accounted for 45 percent of total households is expected to rise to 68 percent by 2025.
- Increased Consumption: Aggregate consumption in India is expected to grow four-fold in real terms from USD 420.7 billion in 2006 to USD 1.73 trillion by 2025.

Foreign trade[3]

In the last five years, India's exports witnessed robust growth to reach a level of around USD 185 billion in 2008–09 from USD 63 billion in 2003–04. India's share of global merchandise trade was 0.83 percent in 2003 which rose to 1.45 percent in 2008 as per WTO estimates. India's share of global commercial services export was 1.4 percent in 2003 which also rose to 2.8% in 2008, and at the same time, its share in goods and services increased to 1.64% in 2008 from 0.92 percent in 2003.

Foreign reserves[4]

India's foreign exchange reserves stood at USD 283.5 billion at the end of December 2009 as against USD 252 billion in 2008, making it the third largest stock of reserves among the emerging market economies.

Mergers & Acquisitions (M&A) and Private Equity deals (From EMIS – Emerging Market Information Service)

The total number of M&A Deals announced during the 12 months of 2009 stands at 330 with a total announced value of USD 11.96 billion as against 454 deals with a total announced value of USD 30.95 billion in 2008 and 676 deals amounting to USD 51.11 billion in 2007. There were 174 domestic deals in 2009-2010 (both acquirer and target being Indian) with an announced value of USD 6.70 billion and 156 cross-border deals with an announced value of USD 5.26 billion.

1 Central Statistical Organization (CSO)
2 NCAER
3 Directorate General of Foreign Trade
4 Directorate General of Foreign Trade

Foreign direct investments inflows

- India's favorable regulatory regime continues to attract foreign investment. According to the global survey of corporate investment plans carried out by KPMG International, released in June 2008, India is likely to see the largest growth in its share of foreign investment and become the world leader for investment in manufacturing in the next 5 years. Corporate investment strategists from over 300 of the largest multinational companies in 15 major economies participated in the survey. The results showed a move away from investment in the US, Japan, Singapore and the UAE, and a big increase in flows to Brazil, Russia, India and China (BRIC).
- Foreign direct investments (FDI) into India went up from USD 4,029 million in 2000-2001 to USD 33,053 million in 2009-2010 (upto Feb '10), one of the highest among emerging economies. Cumulative amount of FDI inflows from April 2000 to March 2009 amount to USD 89, 840 million[5].

Portfolio investments in India

- India has been a preferred emerging capital market for foreign capital inflows in the last decade. Net investment by Foreign Institutional Investors (FIIs) into India touched USD 65,636 million from April 2000 to February 2010[6].

Capital market

- The Indian capital market has witnessed transformation over the last decade and India is now placed among the most mature of the world.
- The BSE Index has a market capitalization (as of December 31, 2009) of USD 13.14 trillion, the highest among major Asian economies including Japan, China, Malaysia, and Hong Kong[7].

5 Economic Survey of India 2009-2010

6 Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, April 30, 2010

7 Bloomberg

SECTOR PRESENTATIONS

Introduction

- India's conventional image has made a paradigm shift from being a mere source of inexpensive labour to a pool of high caliber human capital. Moving beyond the perception of a service-led economy, India's manufacturing sector is scaling new heights. The country has been successful on a number of fronts and leading multinationals today are setting up their R&D centers in India, thereby acknowledging India's true potential

- While the prospects of sectors such as IT, Telecommunications, Healthcare and Biotechnology have been well recognized, the Indian Media and Entertainment Industry, Financial Services, Real Estate, Renewable Energy, Travel and Tourism, Retail, Education, and Auto Components among others, are also attracting global attention

- This report identifies and highlights the investment attractiveness and business potential of various industries. These sectors have been analyzed, from the perspective of the existing scenario as well as future opportunities and growth potential.

AUTO AND AUTO PARTS

The market

- In last 25 years the Indian automobile industry has witnessed a huge change – from being a closed market to automatic approval of foreign equity of up to 100 percent
- With the de-licensing of this sector in 1993, global major Original Equipment Manufacturers (OEMs) including General Motors, Ford, Honda and Hyundai setup their shops in India
- Today India is one of the major two wheeler and commercial vehicle markets in the world
- Total number of vehicles sold including passenger vehicles, commercial vehicles, two-wheelers and three-wheelers in 2009-10 was 12.29 million as compared to 9.72 million in 2008-09
- As per the Automotive Mission Plan 2006-16, the size of the Indian Automotive industry is expected to be over USD 120 billion by 2016
- India also has well developed, globally competitive Auto Ancillary Industry
- The Indian auto component sector has about 600 organized and over 6300 unorganized players.
- Auto component manufacturers are gradually moving up the value chain with the share of supply to OEMs in total exports increasing. OEMs and Tier 1 companies accounted for 80 percent of export demand in 2008 as compared to a 35 percent in 1990
- India has an established automobile testing and R&D centers. Designing expertise in India has improved over the time. Global OEMs are now looking at outsourcing critical operation like auto design from India
- The Indian auto component industry is expected to grow to USD 33 billion to USD 40 billion by 2016
- The Investment Commission has set a target of attracting foreign investment worth USD 5 billion for the next few years to increase India's share in the global auto components market from the existing 0.9 percent to 2.5 percent by 2015.

Opportunities

- Growth in income levels and easy availability of financing options are driving the passenger car market
- Shrinking replacement cycle to boost passenger car market in India
- There is a rising demand for small and mid-size cars in India
- Though Compact and Mid-size segments driving the growth in the domestic market, Premium and Luxury segment are evolving at a faster pace
- Infrastructure spending is likely to boost the commercial vehicles market in India
- Competitive advantage arising out of low-cost advantage mainly on account of the availability of low-wage, proximity to Asian markets and lower shipments costs, makes India a sourcing hub and a manufacturing base for major OEMs.

Industry - snapshot

	Automotive industry	Auto components
Size (2016 estimated)	USD 120 - 159 bn	USD 40 – 45 bn
Compounded Annual Growth Rate CAGR (2006-2016)	13 percent	14.2 percent
Regulatory	• 100 percent FDI under the automatic route • Additional benefits if set up in a Special Economic Zone (SEZ)	• 100 percent FDI under the automatic route
Select foreign players in India	General Motors, Toyota, Ford, Hyundai, Honda, Maruti Suzuki, Mercedes, Volkswagen, BMW, Renault, Nissan	Delphi, Viseton, Bosch, Denso and Thyssen Krupp

Source: Automotive Mission Plan, 2016, IBEF, Investment Commission

BANKING AND FINANCIAL SERVICES

The market

- Savings to GDP ratio in India has been increasing since independence and has crossed 39.1 in FY09
- Credit extended by the Indian banking sector grew by 16.7 percent at the end of March 2010
- India's market cap as a percentage of world market cap was 2.8 percent as on December 31, 2009
- India is the fifth largest life insurance market in the emerging insurance economies globally and the segment is growing at a healthy 32-34 percent annually.

Opportunities

Banking and financing

Banking

- Total banking assets expected to grow to USD 2764.6 billion by FY14
- In Union Budget FY11, RBI has proposed to accord more banking licenses
- Other Opportunities - SME Finance, Agri and Rural Finance, Institutional.

Insurance

- Non-Life Insurance - Projected market size of USD 12 billion by 2010
- Life Insurance - Life insurance market is expected to grow at a CAGR of 15 percent over next 5 years to USD 98 billion 15
- Opportunities in areas of health insurance, motor insurance, unit-linked insurance etc.

Asset management companies

- Asset Management - Mutual funds AUM expected to grow at a CAGR of 17 percent in to become a USD 297.5 billion industry by FY14 [16]
- Other opportunities include wealth management, pensions, investment banking, etc.

Emerging opportunities

- Private equity and venture capital, structured finance, distressed assets, real estate finance, leveraged finance, ancillary services (IT, Consultancy, Training)

Industry - snapshot

	Banking	Insurance	Asset management companies
Size	Total assets of USD 1105.35 bn in FY10	Life insurance - USD 56.1 bn in FY10	USD 157.6 bn in FY10
Size (Projected)	13 percent	14.2 percent	
Regulatory	Total assets of USD 2764.6 bn in FY14	Life insurance - USD 98.2 bn by FY14	USD 297.5 bn for FY14
Projected CAGR	16 percent during FY10-FY14	15 percent (Life insurance) during FY10-FY14	17 percent during FY10-FY14
Regulatory	Foreign ownership in private banks allowed upto 74 per-cent (including FII ownership) , with a 5% cap on ownership by any one entity	• FDI upto 26 percent • Allowed under automatic • Route subject obtaining • License from IRDA	Up to 100 percent investment in Indian Asser management companies is allowed, subject to regulatory approvals
Volume Vise	Bank credit expected to grow at a CAGR of 18 percent between FY10-FY14 to reach USD 1823.8 bn	Penetration levels expected to touch 4.4 percent from the current level of 4 percent by FY10	AUM as a percentage of GDP is expected to rise from 13 percent in FY09 to 20% by FY20

Note: AUM & Total Premium has been used as a metric for Asset Management Companies & Insurance Companies, respectively

Source: BMI, Edelweiss Research

Opportunities:

- Across the value chain for ancillary businesses such as cold chain infrastructure, packaging, warehousing, containerization, agri inputs and irrigation etc.
- Contract farming initiatives leading to greater private sector involvement e.g. Reliance Industries, has signed a deal with the Punjab government to source about 700,000 liters of milk everyday from farmers in the state
- Key investment opportunities, both for catering to the domestic market as well as for exports; exist in many areas of food processing in India. Milk and milk products, meat and poultry, fruits and vegetables are some of the areas with huge potential.

FOOD PROCESSING

The market

- The food processing industry ranks fifth in size, contributing 6.3 percent to GDP and 13 percent to exports
- India is one of the world's largest producers of wheat, milk, spices, fruits, vegetables, tea, rice and sugarcane
- As of 2008-09 agriculture contributed to 17.5 percent of GDP
- Processed food market is growing at over 14.7 percent p.a.

Industry - snapshot

Size (2009)	USD 200 bn[2]
Size (2015 estimated)	USD 260 bn[2]
Share of Organized sector (2007)	27%[1]
Volume-wise	World's second largest producer of food next only to china
Exports (2007-08)	USD 62.5 bn
Total projected investment (2011)	USD 23.5 bn
Select foreign players in India	Hershey, Lotte Confectionary, New Vernon PE Ltd., Indo Nissin Foods

1 The Indian Food Industry, Technopak
2 DNA India, "India's food processing industry seen at USD 260 billion in 6-years", October 15, 2009

IT- ITES

The market

- IT/ ITeS sector is expected to contribute over 6.1 percent of India's GDP for FY2010, an increase from 5.2 percent in 2008-09
- The IT-BPO is expected to reach USD 73.1 billion in FY2010, an aggregate growth rate of 5.4 percent. Export revenues including hardware is estimated to reach USD 50.1 billion in FY2010 and domestic revenues of about USD 23 billion
- Direct employment in expected to reach nearly 2.3 million, an addition of 90,000 employees, while indirect job creation is estimated to touch 8.2 million
- The Export revenues are estimated to USD 50.1 billion in FY2010, accounting for 69 percent of the total IT-BPO industry revenues. Software and services exports are expected to account for over 99 percent of total exports

Opportunities:

- **Low cost delivery location**
  - India offers the low cost delivery location as compared to other offshore locations; savings of 70 percent over source locations
- **New verticals and segments**
  - Significant opportunities exist in terms of new verticals such as healthcare, retail, public sector, travel and tourism and new segments such as Small Medium Business (SMBs) segments
- **R&D product innovation**
  - Emergence of platform solutions and innovations in technology such as cloud computing, virtualization, open source software and service oriented architecture
- **KPO market**
  - The BPO sector has been moving up the value chain in the global outsourcing industry from the low-end processes to high-end tasks such as business analytics and other knowledge services
  - The worldwide KPO market is expected to be around USD 16.7 billion in revenues by 2010 of which USD 12 billion (70 percent) would be outsourced to India
- **Small Medium Business (SMBs) segment**
  - SMBs accounts for nearly 30 percent of the total IT spend (USD 6.5 billion) and provides a relatively untapped growth opportunity for India's IT-BPO sector
- **e-Governance**
  - E-Governance presents a significant opportunity to actively collaborate with government for the projects such as The Unique Identification (UID) project, e-District, e-Court, e-Office and central excise.

Source: NASSCOM Strategic Review 2010 and Press Articles

Industry - snapshot

Size (2010E)	USD 73.1 bn
Size (2011E)	USD 77.3 bn
CAGR 2007-2010	15 percent
Exports (2010E)	USD 50.1 bn
Exports Growth Rate	5.4 percent p.a.
Select foreign players in India	Genpact, Aegis, Microsoft, IBM, HP, Dell, EDS, Cap Gemini, Accenture, Oracle, SAP, etc.

INFRASTRUCTURE

The market[1]

- Investments in infrastructure have been expanding at a rapid pace. According to the planning commission, USD 507 billion of investment is proposed for the XIth plan period (2007-12)
- An estimated 25 percent of the overall expenditure is to be made by private sector as compared to 18 percent in the Xth plan
- In some areas like the ports and airports the amount financed through the Public Private Partnership (PPP) model exceeds 60 percent of the required funds
- The total requirement of debt by the public and private sector is likely to be USD 240 billion.

Opportunities[2]:

Public private partnership

- Over past three to four years, the government has been promoting PPP projects, whereby it plays the role of a regulator and the private participator invests in the build out of infrastructure. The constraints in budgetary allocation towards infrastructure projects have enhanced the need for private participation

Electricity

- Large generation opportunities exist; Close to 15000 – 20000 MW required to be added every year, a large step up from the current pace of capacity addition[3]
- The target announced by the Government for 2012 includes inter-regional capacity of 37,000 MW and target installed capacity over 200,000 MW. By the end of the Xth Plan 17000 MW of inter regional capacity was achieved and the installed capacity as on March 31, 2010 is 159,398 MW[4]

Oil and gas

- India remains a vastly unexplored territory by far, with only a small percentage of its sedimentary basins under exploration and development. The Government accordingly introduced the New Exploration Licensing Policy (NELP), with an aim of encouraging private sector participation in the oil and gas sector. The recent rounds of NELP have proved attractive in gaining the interest of Indian private sector and foreign players
- India offers significant potential for investment in the refining sector. The country is poised to emerge as a major refining hub, with considerable capacity additions being planned over the next few years. Its favourable location, close to the oil-producing regions of the Middle East renders it an advantage

Roads – Target for XIth plan[5]

- The Government plans to spend USD 10 billion per annum on road development in the next few years
- Investment opportunities exist in a range of projects being tendered by National Highway Authority of India (NHAI) for implementing the remaining phases of the National Highway Development Project (NHDP)

The target for XIth Plan which is currently underway is as follows

- The ambitious 7-phase NHDP is India's largest road project ever. Phase II, III, and IV are under implementation. Key sub projects under this include; the Golden Quadrilateral and the North-South & East-West Corridors
- A program for 6-laning of about 6,500 km of National Highways is also underway

Ports

- Opportunities in setting up terminals, greenfield and brownfield
- Capacity addition and modernization of major and minor ports in India; new capacity planned in the XIth plan; 485 Million Metric Tonnes (MMT) in major ports and 345 MMT in minor ports[6]
- Rapid growth in traffic at minor ports is signaling investment requirements

Defence

- India's defence spending has grown manifold since the country announced its first defence budget in 1950, to approx. USD 30.5 billion (INR 1,420 billion) in 2009-10. Of this, approximately 40 percent relates to capital expenditure which is currently driven by equipment modernisation programmes in each of the three services. India currently procures approximately 70 percent of it equipment needs from abroad, but Government's aim is to reverse this balance and manufacture 70 percent or more of its defence equipment needs in India thereby creates a huge opportunity[7]

1 Government of India, Committee on Infrastructure
2 BNP Paribas, SSKI, Government of India, Committee on Infrastructure
3 IBEF, Power, September 2009
4 IBEF, Power, September 2009, CEA
5 Investment Commission of India
6 Planning Commission – XIth Plan
7 Finance Budget 2009-10

Education[8]

- Indian Education Sector (IES) is by far the largest capitalized space in India with USD 30 billion of government spend (3.7% of GDP; at global average), and a large network of ~1 million schools and 18,000 higher education institutes
- Valued at USD 50 billion in 2008, it is expected to grow at a 12% CAGR to USD 80 billion by 2012
- K12,(Kindergarten to 12th Grade) is the largest segment (USD 20 billion) within IES, and is expected to grow to USD 33 billion by 2012 (14% CAGR) on the back of world's largest school-aged population
- Higher Education (HE) –The HE segment consists of graduation (targeting population between 18-21 years) and post graduation (>22 years) courses, offered after completion of K12 studies
  - The Indian Government aims to increase tertiary gross enrolment ratio to 15 percent by 2012 and then to 30% from the current levels of 12 percent
  - It is estimated that India would need at least 800 more universities and another 35,000 colleges in the next 10 years to boost HE and achieve Gross Enrollment Ratio (GER) targets[9]
  - Foreign Education Bill if passed would open doors for foreign players in Higher education thereby creating an opportunity for establishing campuses in India

Airports

- Airports need to develop alternative revenue streams. Indian airport operators have huge scope to develop airport enabled activities and increase their non-aeronautical revenues like their global counterparts[10]
- Significant opportunity exists in the area of airport development modernization; 35 non-metro airports to be modernized / developed and several greenfield projects to be constructed
- Upgrading of air traffic management facilities

Railways

- Construction of dedicated freight corridors between Mumbai-Delhi and Ludhiana- Kolkata have been planned
- New rail - 8132 kms and gauge conversion of 7148 by end of XIth Plan[11]

Shipping

- According to International Maritime Organization (IMO), single-hull oil tankers over 25 years old will not be permitted to operate from 2010 onwards, while those less than 25 years old will be prohibited from operation unless the country of ownership registration, the country of loading and the country of unloading have all granted permission. Thus, this offers huge opportunity for the ship building industry. Besides, the phasing out of the old ships would provide an opportunity for the ship breaking industry[12]
- Liquefied Natural Gas (LNG) is to be imported to harness India's power and fertiliser projects. This plan involves huge volume of business for the shipping industry amounting to several billion dollars[13]
- According to the Planning Commission, USD 19.6 billion will be invested in the ports sector during the Eleventh Plan (2007-2012). Furthermore, the government has announced that it will award 21 port expansion projects worth USD 3.13 billion under the PPP mode in 2010-11.Thus, there is a huge opportunity for private sector to invest through the PPP route[14]
- Inland Waterways today accounts for a meager 0.15 percent of the total domestic transport today, compared to 14 percent in the US and 46 percnet in the Netherlands. Due to the gradual increase in cargo movement through inland waterways, India is developing inland waterways which provides good opportunity to inland water transport and coastal shipping[15]

Others

- Irrigation projects in rural India, safe drinking water, warehousing and gas grids

Industry - Snapshot

Investments Xth Plan (2002-2007)	USD 220 bn
Investments XIth Plan (2007-2012)	USD 507 bn
Growth Rate	125 percent
Select foreign players in India	Widmann AG, Dyckerhoff, Mitsubishi Corporation, Siemens, Alstom, Itochu, Toshiba, Kawasaki, Terry Farrell and Partners, Von Gerkan, Marg und Partner, Aedas Ltd., Hellmuth, etc.

Source: Government of India, Committee on Infrastructure

8 IDFC –SSKI , Indian Education – Long way from Graduation, 16 January 2009, Netscribes,K12 market in India 2010, March 2010, KPMG, Special Education Zones, 2009
9 Times of India, '800 varsities, 35,000 colleges needed in next 10 years: Sibal' March 24 2010
10 Ministry of Civil Aviation, Airports Infrastructure: The Business Opportunities
11 Planning Commission – XIth Plan
12 Above Sea Level, Dolat Capital, 19th April, 2010
13 Challenges and opportunities for India's shipping industry, shippingbiz360, 21st October, 2009
14 IBEF
15 Shipping report by Anagram, Press, Inland Waterways Authority

MEDIA AND ENTERTAINMENT:

The market

- India is one of the largest media markets globally:
  - Large print market – 62000 newspapers
  - Highest number of films produced – over 1000 films produced and approximately 3.2 billion tickets sold annually
  - Cable household network – 95 million cable and satellite households
- In the past few years, regional media has been a key growth driver of the industry. Established national players are increasing their regional footprints. For e.g.: growth in regional channels, city specific channels, regional language newspapers, etc.
- The Indian media industry has also witnessed growth of digital TV distribution platforms: digital cable, Direct-to-Home (DTH) and IPTV, digitization of Film, Prints and digitization of music libraries and sales of online and mobile music
- The industry has also witnessed emergence of niche content genres across sector: reality TV shows, niche TV channels, cross over content in music and films, niche genre magazine, etc
- elevision and Print are the largest sectors of the industry contributing ~74 percent of the total revenues while Gaming and Internet are fastest growing segments
  - Gaming and Internet are expected to grow at a CAGR of 32 percent and 30 percent to reach USD 0.7 billion and USD 0.6 billion respectively over 2009-14

Opportunities

Growth in Indian media and entertainment industry

- Indian media and entertainment industry is expected to grow from USD 12 billion in 2009 to USD 22 billion in 2014 at a CAGR of 13 percent
- Television and print with a market size of USD 5.3 billion and USD 3.6 billion in 2009 are projected to grow to USD 10.7 billion and USD 5.5 billion at a CAGR of 15 percent and 9 percent over 2009-14 respectively
- Films industry is valued at USD 1.8 billion in 2009 is projected to grow to USD 2.8 billion at a CAGR of 9 percent over 2009-14
- Radio and Music with a market size of USD 0.16 billion each in 2009 are projected to grow to USD 0.33 billion and USD 0.35 billion at a CAGR of 16 percent each over 2009-14 respectively
- Animation and VFX is valued at USD 0.41 billion in 2009 is projected to grow to USD 0.96 billion at a CAGR of 19 percent over 2009-14
- Advertising industry is expected to grow from USD 4.5 billion in 2009 to USD 8.7 billion in 2014 at a CAGR of 14.1 percent
- The ad spend as a percentage of GDP is 0.41 percent in India compared to 1.08 percent in the US and world average of 0.8 percent, leaving immense potential for growth

Favorable demographics

- Vast majority of young population backed by increasing spending power, higher disposable incomes and rising consumerism
  - Share of the population in the deprived class is expected to reduce to 35 percent by 2015 from 54 percent in 2005
  - India's per capita income has grown from USD 446 in FY2003 to USD 807 in FY2009
  - Increasing spends towards discretionary items
    - (i) Discretionary spending is expected to increase to 61 percent by 2015 from 52 percent in 2005

Liberal foreign investment regime

- Foreign investment norms across media segments:
  - Television channels – 100 percent FDI permitted with exception to news and current affairs channel where 26 percent is permitted
  - Films – 100 percent FDI permitted
  - DTH and cable network - 49 percent (FDI + FII)
  - FM Radio broadcasting - 20 percent (FDI + FII)
  - News print media - 26 percent (FDI + FII); 100 percent FDI permitted for facsimile edition of newspapers

Under-penetrated market

- Low media penetration in rural areas and small towns
- Overall media reach in rural areas is 56 percent
- Only 38 percent of the literate population read any daily or magazine, reach in urban areas is 58 percent while 30 percent is in rural areas
- The need to capitalize this untapped market has been a key driver for the growth in regional markets

Industry - snapshot

Industry size – 2009	USD 12 billion
y-o-y growth	1 percent
Industry Size – 2014	USD 22 billion
CAGR (2009-14)	13 percent
TV Household penetration	58 percent (129 million TV Households)
Pay TV subscribers	89 million
Television channels (2009)	~460
Number of multiplex screens (2009)	800+
Number of newspaper	62000 newspapers in 22 languages
Number of FM Radio stations (2009)	248 (as on Dec, 2009)

Source: FICCI-KPMG, Indian Media and Entertainment Industry Report, March 2010; TRAI

POWER

The market

- Fifth largest electricity generation capacity in the world[1]
- Large transmission and distribution network
- Per capita electricity consumption - 704 kWh during 2007-08[1]
- Electricity is the backbone of the nation and falls under the concurrent list where both the Union and State Government can regulate the sector[1]
- Estimated renewable energy potential in India – 84,776 MW[2]

Opportunities

Generation

Ultra Mega Power Projects (UMPP):

- Introduction of UMPP's is likely to help achieve the Government plan of 'Power for all'. The government targets to add 100000 MW of additional capacity in the XIIth Plan and UMPPs are likely to contribute over 36,000 MW power generation capacity in this Plan.[3] The UMPP's are being viewed as savior for the government's power capacity addition programme. This is primarily due to its sheer size (4000 MW) since these projects have the capability to deliver power equivalent to several conventional sized power projects.

Transmission

- Development of the National Grid is expected to meet energy demands of deficit regions. The program envisages addition of over 60,000 km of transmission network in a phased manner by 2012[4].

Distribution

- Privatization of distribution circles is likely to unbundle the State Electricity Boards (SEBs). To the extent state utilities are privatized, the funds requirement will shift to private sector.

Rural electrification

- The Government has plans to provide 100 percent rural electrification by the end of the XIth Plan. This provides great opportunity to investors and developers in creating a sound rural electricity infrastructure in the country.

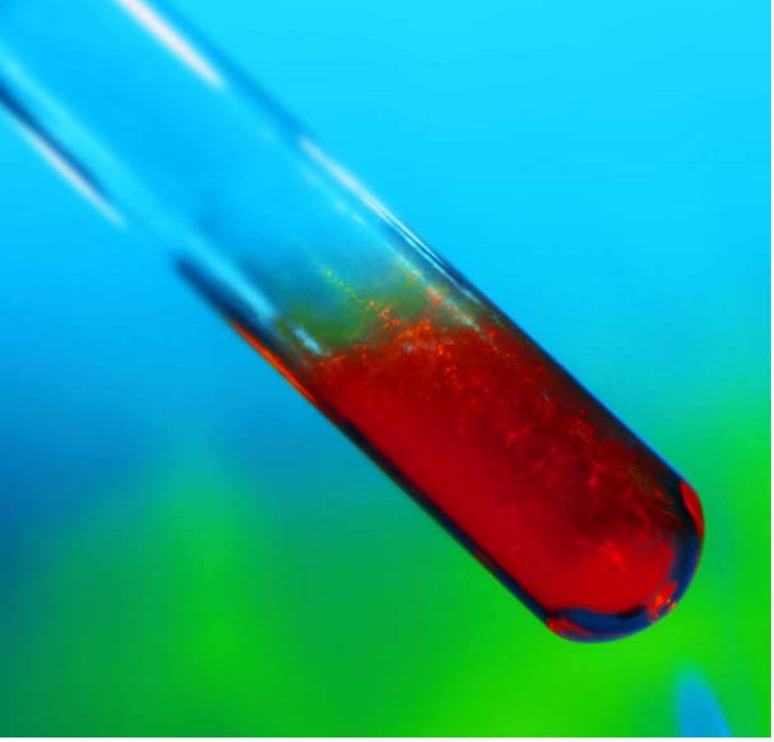
Renewables

- The inability to meet constant rise in power demand coupled with environment sustainability has pushed renewables to the forefront. The country has a much higher potential of approximately 45,000 MW of wind power, 18,000 MW from biomass-based sources and close to 15,000 MW of small hydro resources.[5] The Ministry of New and Renewable Energy (MNRE) has envisaged an increase in total renewable energy capacity to around 25,000 MW by 2012 and further to about 54,000 MW by the end of 13th Plan period (2022).[6] Of this, pollution free generation methods such as wind-based generation is expected to retain its prominent position as the single largest contributor in the renewable portfolio mix. Solar energy is also expected to develop to a significant extent, particularly as the costs of solar power reduce from their current levels. Accordingly, a "National Mission on Solar Energy" has been launched, with a goal to generate 20,000 MW by 2022.[7]

1 Netscribes, "Power Sector – India", March 2009
2 Planning Commission
3 Economic Times, Two UMPP bids in April as govt plugs power gaps, March 15, 2010
4 Public Private Partnerships in India (www.pppindia.com)
5 4th South Asia Renewable Energy Conference 2009 – Renewable Energy: An overview and a look at the potential, July 29, 2009
6 MNRE, Report on the Working Group on New and Renewable Energy for XIth Five Year Plan, XIth Plan Proposals for New and Renewable Energy, December 2006
7 Economic Times, National solar mission cleared; to generate 20,000 MW by 2012, November 19, 2009

Industry - snapshot

Investments (Xth plan)	USD 73 billion
Investments (XIth plan) Estimates	USD 167 billion
Installed generating capacity (March, 2010)	159,398 MW
Inter-regional transmission capacity (September, 2009)	20,750 MW
Transmission network capacity (XIth plan) Estimates	37,150 MW
Peak demand deficit (March, 2010)	13.3 percent
Regulatory	Hundred percent FDI is allowed in all segments of power sector including trading
Prominent players	NTPC, Powergrid, ABB, Alstom, Siemens, Areva T & D, GMR, Adani group, CESC
Foreign players	Marubeni Corporation, China Light & Power (CLP)



PHARMACEUTICALS

The market

- The double-digit growth of the Indian pharmaceutical market outpaces the growth of the global industry[1]
- India is regarded as a high-quality and low-cost producer of pharmaceuticals
- The introduction of the product patent regime has enabled rapid integration of the Indian industry into the global pharma industry
- Cumulative FDI inflow for Drugs and Pharma for the period from April 2000 to February 2010 is USD 1.7 billion[2]
- Highly fragmented industry with about 300 – 400 units in the organized sector and around 15,000 units in the unorganized sector
- Generics remain the mainstay of the Indian pharmaceutical industry

Opportunities:

Domestic market

- Domestic market to witness significant growth on the back of sustainable growth drivers—growing population, improving healthcare awareness and increasing per capita income
- The domestic formulation market was USD 7.6 billion in FY09 and is expected to grow at a CAGR of 14.4 percent till FY14[3]
- Long-term demand is likely to be driven by chronic and life-style diseases segments
- Healthy growth of the rural pharma market is driven by a variety of factors such as rising disposable incomes, improving awareness levels among the rural population and doctors, increased focus of Indian pharma companies and the strategies adopted by them

Generic exports

- Drugs worth an estimated USD 137 billion are expected to go off-patent in the US and Europe over the next five years.[4]
- Focus shifting from EU / US markets to semi-regulated markets

Contract Research and Manufacturing Services (CRAMS)

- Segment gaining traction on the back of increasing CRAMS deals between Indian companies and MNCs
- Although India currently accounts for approximately 3 percent of the global CRAMS market and 2 percent of the clinical trials market, this is expected to increase in the future[5]
- India is gradually emerging as the preferred outsourcing destination for activities spanning the pharma value chain

Discovery research

- Increasing number of in-licensing and out-licensing deals and collaborative research
- Over 60 New Chemical Entities (NCEs) are under various stages of development in the pipelines of the leading Indian companies

Industry - snapshot

Size (FY09E)	USD 19.4 bn
CAGR (FY04-FY09 and thereafter till FY14)	20.6 percent and 17.8 percent
Size (2014 Projected)	USD 43.8 bn
Volume-wise	10 percent of global market (3rd largest in the world)
Value-wise	14th among drug producing countries, (1.9 percent of the global market)
Exports (FY09E)	USD 11.7 bn
Select foreign players in India	GlaxoSmithKline, Novartis, Pfizer, Wyeth, Abbott, Astrazeneca, Aventis

Source: CRISIL Research 2010, First Global Report January 2010

1 IMS Data
2 Fact Sheet on Foreign Direct Investment, February 2010
3 Crisil Research
4 India-Pharma IIFL Report 1Q2009
5 Reliance Money 'Indian Pharma CRAMS' July 15, 2008, RNCOS ''Booming Clinical Trials Market in India', January 2009

RETAIL

The market

- India is ranked first on the Global retail development index –2009, conducted by AT Kearney across 30 emerging economies. India is also ranked fourth in the 2009 Retail Apparel Index[1]
- India has also been ranked first on the Global consumer confidence index —January 2009, conducted by the Nielsen Company[1]
- Indian retail industry size (organized and unorganized) is estimated at around USD 511 billion (FY08)[4]
- Share of organized retail market has increased from 0.5 percent in 1999 to 5 percent[2] in 2008 but continues to remain lower than other countries like Malaysia, Thailand, Brazil and China. However, penetration levels are likely to rise to 9.6 percent by FY12.
- The industry currently accounts for 12 percent of India's GDP and in 2008; the retail industry employed over 38 million people in India accounting for 8.5 percent of the total employed population in the country[3]

Opportunities:

- Retail franchising has been growing at the rate of 60 percent in the last 3 years and is set to grow two-fold in the next 5 years
- Food and Grocery remains one of the biggest categories of consumer spending (75 percent) but account for only 10 percent of organized retailing, representing a big opportunity for retailers. Wet groceries (fruits, vegetables and meat products) are the most promising category with great untapped potential
- There are opportunities in consumer durables segment which currently has 9 percent share of the modern retail is expected to grow to 11 percent by 2013. Home furnishing is another segment which is expected to show a steep rise jumping from 2 percent in 2008 to 9 percent in 2013
- Number of shopping malls is expected to increase at a CAGR of more than 18.9 percent from 2007 to 2015.
- The retail boom which has so far been concentrated in the metros is beginning to percolate down to smaller cities and towns. Rural market is projected to dominate the retail industry landscape in India by 2012 with total market share of above 50 percent.
- Development of India as a sourcing hub shall further make India an attractive retail opportunity for global retailers. Retailers, such as Tesco, J.C. Penney, etc are stepping up their sourcing
- Requirements from India, and moving from third-party buying offices to establishing their own wholly owned/wholly managed sourcing and buying offices.

Industry - snapshot

Size (FY08)	USD 511 bn (organized + unorganized)[4]
Size (FY13 estimated)	USD 833 bn
Projected CAGR (FY18)	10 percent
Organized retail (FY13 estimated)	USD 107 bn
Value-wise	India is fifth largest retail destination globally
Regulatory	Current FDI policies allow 100 percent foreign investment only in wholesale cash-n-carry and 51 percent in single-brand retailing
Foreign players sourcing from India	Levis-Strauss, Wal-Mart, Nike, Marks & Spencer, Metro AG, etc

1 IBEF, September 2009
2 Welspun Retail Limited, "Indian Home Retail"
3 Retailing in India, Euromonitor
4 AT Kearney report (http://business.mapsofindia.com/india-market/retail.html)

TELECOM

The market

- India is first among the fastest expanding telecom markets in the world, adding more than 15-20[1] million new mobile subscribers per month with an average 16[1] million customers added every month.
- India has the third largest telecommunication network in the world and is the second largest in terms of number of wireless connections.[2]
- Approximately 20.59[3] million telephone connections, including wire line and wireless, were added during March 2010, taking the total number of telecom subscriber base at the end of March 2010 to 621.28[3] million.
- The industry is expected to create gainful employment opportunities for about 10 million people during the same period.[4]
- Seventy four percent FDI permitted in the sector.

Opportunities[7]:

- The target of the 11th Plan period (2007-12) to have 600 million phone connections has already been accomplished as the current subscriber base stands at 621 million. The plan on the other hand anticipates an investment of about USD 54 billion in the telecom infrastructure sector by 2012, backed by opportunities in rural areas, roll out of 3G technology and adequate government support.[8]
- According to industry analysis fixed line revenues are expected to touch USD 12.2 billion and mobile revenues are expected to be close to USD 39.8 billion by 2012
- Mobile Value Added Services (VAS) in India accounts for 10 percent of the operator's revenue, which is expected to reach 18 percent by 2010.
- In order to enhance revenues, India's top two mobile firms, Bharti Airtel Limited and Reliance Communications have launched their online mobile applications stores as well. Other operators are expected to follow suit.
- With the roll out of the 3G spectrum, close to 275 million Indian subscribers will subscribe to 3G-enabled services, and the number of 3G-enabled handsets are expected to reach close to 395 million by end of 2013
- India's telecom equipment manufacturing sector is set to become one of the largest globally. Mobile phone production is estimated to grow at a CAGR of 28.3 percent from 2006 to 2011, touching 107 million handsets by 2010. On the other hand revenues are estimated to grow at a CAGR of 26.6 percent from 2006 to 2011, touching USD 13.6 billion.

Industry - snapshot

Size	USD 30 billion[5] (Projected for 2013)
Projected CAGR (2009 - 2013)	12.5 percent[5]
Tele-density	52.74 percent (March, 2010)
Volume-wise	Second Largest cellular market with 584 million subscribers at the end of March 2010
Value-wise	Lowest telecom tariffs in the world at about USD 0.02 per minute
Total projected investment (2007-2012)	USD 73 billion[6]
Regulatory	74 percent FDI permitted in the sector 100 percent FDI permitted through automatic route in telecom equipment manufacturing
Foreign players in India	Vodafone, Flextronics, Nokia, Motorola, Samsung, Alcatel-Lucent, Virgin Mobile, Maxis, Telenor, Etisalat, Batelco, NTT Docomo

1 TRAI Report, KPMG Analysis, March 31, 2010
2 Government of India: Economic Survey Energy, Infrastructure and Communications, 2008 - 09
3 TRAI Subscription data, March 31, 2010
4 Indian telecom market to be at Rs 344,921 Crore by 2012, November 22, 2007
5 Gartner, June 18, 2009
6 Press Release, May 2009
7 IBEF – Telecom Sector Update, February, 2010
8 Infrastructure in India – Ports, Roads and Telecom, January 2010

- The recent inbound tourist figures show that FTAs grew by 12.8 percentage during Jan-March 2010 as against 13.5 percent drop during Jan-March 2009, staging a full recovery after the 2009 slowdown. Hotels in key business and tourists destinations depend a lot on FTAs.
- The market size of Indian hospitality sector has crossed USD 3.9 billion in 2008-09, registering an impressive CAGR of 15 percent from 2004-09. The domestic hospitality sector is expected to see investments of over USD 11 billion in the next two years within 40 international hotel brands making their presence in the country in the next few years.

TRAVEL AND TOURISM

The market

- In 2010, industry is expected to contribute 8.6 percent of GDP (USD 117.9 billion) rising to USD 330.1 billion by 2020.
- Despite short- and medium-term setbacks, tourism economy is expected to grow at an average rate of 8.5 percent per annum from 2010 to 2020.
- India is expected to become an increasingly important player in the global tourism economy, climbing to fourth place in the contribution of its Travel & Tourism Economy to total GDP growth over the next ten years
- India is expected to remain at the forth place in terms of annual growth in Travel & Tourism demand between 2010 and 2020, averaging 8.5 percentage per annum – ahead of Vietnam, Thailand, Indonesia, Sri Lanka and Malaysia.
- The medical tourism sector is also expected to generate revenue of USD 2.4 Billion by 2012, growing at a CAGR of over 27percentage during 2009–2012.
- Growing popularity and marketability of India as a business destination as well a tourist destination, aided by campaigns like Incredible India, there has been an upswing in inbound tourism in the past few years. During 2002-2008, Foreign Tourist Arrivals (FTAs) in the country grew at a CAGR of 14.5 percentage.

Opportunities:

- Increased budgetary allocation for tourism
- Up-gradation of national highways to expressways connecting major cities and towns in India has created integrated tourist circuits
- Medical tourism - Medical care, packaged with traditional therapies like yoga, meditation, ayurveda, allopathy, and other traditional systems of medicines, attract high-end tourists especially from European countries and the Middle East.
- The Union Budget 2009 spells out a sound framework for restoring the economic growth on a nine percent trajectory during 2009 -10. This will usher in opportunities for growth sectors like hospitality and tourism to make a larger contribution to both GDP and employment in the country.
- Service tax exemption has been provided for transportation of passengers in vehicles bearing contract carriage permits which is expected to bring down the cost of travel within the country and increase popularity of tourist circuits like the Golden Triangle
- Abolition of Fringe Benefit Tax will also benefit the industry of hospitality.

Sources: WTTC, Travel & Tourism Economic Impact – India, 2010

Ministry of Tourism, Statistics, FTAs and FEE from tourism during 2010 and Analyst Reports

Industry - snapshot

Size of the hotel Industry (2009)	USD 3.9 billion
Share of premium hotels segment (2009)	USD 2.3 billion
Growth rate 2004 to 2009	15 percent
International visitor average spend	USD 2000 in 2010 and Expected to grow more than USD 3,000 in 2020
Select foreign players in India	Marriott, Intercontinental, Hyatt, Shangri-La, Starwood Hotels, Hilton, Accor Etc.

REGULATORY FRAMEWORK FOR INVESTMENT IN INDIA

Governing law

The objective of FDI policy issued by the Government is to invite and encourage foreign investments in India. Since 1991, the guidelines and the regulatory process have been substantially liberalized to facilitate foreign investments in India.

The Government issued a consolidated FDI Policy vide Circular 2 of 2010 dated 30 September 2010 effective from 1 October 2010. This Circular consolidates and subsumes all Press Notes, Press Releases, Clarifications issued on FDI policy as on 30 September 2010. The Government has also announced that it will issue a consolidated circular every six months to update the FDI policy.

The administrative and compliance aspects of FDI including the modes/instruments of Foreign Investments in an Indian Company (e.g. Equity, Compulsorily Convertible Preference Shares, Compulsorily Convertible Debentures, American Depository Receipt (ADR)/Global Depository Receipt (GDR), etc) are embedded in the Foreign Exchange Regulations prescribed and monitored by the RBI. The Foreign Exchange Regulation also contains beneficial schemes/provisions for investments by Non-Resident Indians (NRI)/ Person of Indian Origin (PIOs) within the overall framework/policy.

Apart from fresh investments in an Indian company, the FDI and Foreign Exchange Policy is also relevant for transfer of shares in an Indian Company between residents and non-residents. These are subject to detailed guidelines, valuation norms, compliances and approval requirements as stipulated.

For the purpose of FDI in an Indian company, the following categories assume relevance:

- Sectors in which FDI is prohibited
- Sectors in which FDI is permitted
  - Investment under Automatic Route; and
  - Investment under Prior Approval Route i.e. with prior approval of the Government through the Foreign Investment Promotion Board (FIPB).

Automatic Route

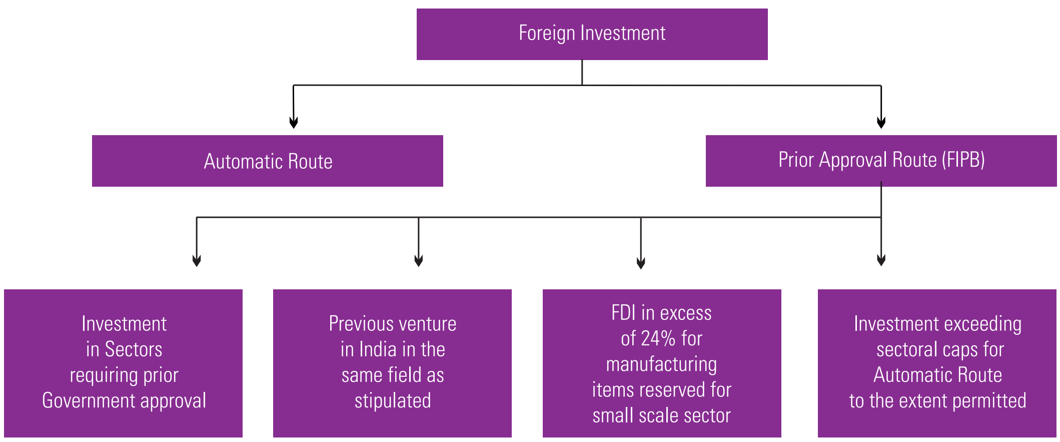
Under Automatic Route there is no requirement of any prior regulatory approval but only post facto filing by the Indian Company to the RBI through Authorized dealer (Bankers) are required as under:

- Filing an intimation, in the prescribed format, within 30 days of receipt of FDI in India including KYC norms; and
- Filing prescribed form and documents within 30 days of issue of equity shares/equity convertible instruments to foreign investors. The equity shares/equity convertible instruments are required to be issued within 180 days from the receipt of application money.

FDI by a non-resident entity in an Indian Company in most of the business or commercial sectors now falls under the Automatic Route and very few cases require prior Government approval.

FDI Routes

A diagrammatic representation of the FDI routes is given below:



Prior Approval Route

FDI in the following activities or sectors generally requires prior approval of the Government/FIPB:

- Proposals where the foreign collaborator has an existing financial or technical collaboration in India in the 'same field' prior to or as on 12 January 2005.
- Proposals falling outside notified sectoral caps for Automatic Route but within the ceilings permitted under the Approval Route
- Proposals for FDI in sectors / activities in which FDI is permitted only under the Prior Approval Route.

Approval is granted by the FIPB on a case to case basis after examining the proposal for investment. Post FIPB approval, prescribed filings as applicable under the Automatic Route are also required to be carried out by the Indian Company under the Prior Approval Route.

Sectoral guidelines

The **Annexure I** provides an illustrative sectoral list for FDI falling under the Automatic Route, Prior Approval Route and prohibited list. These are revised on a regular basis by the Government depending upon the industry need.

The FDI is also subject to other relevant sectoral laws or regulations (e.g. banking industry which is governed by separate banking regulations, insurance industry which is governed by Insurance Regulatory and Development Authority, etc.).

Apart from above, for stipulated manufacturing/industrial activities by an Indian Company, the applicability and need for availing an industrial license under the Industrial Licensing Policy needs to be examined and complied with.

Discussion paper on FDI in Multi- Brand Retail Trading

The Government of India released a discussion paper on FDI in Multi-Brand Retail Trading for public comments. Currently, FDI in Multi-Brand retailing is prohibited in India while FDI in Single Brand Retailing permitted, to the extent of 51 percent under Prior Approval route and FDI in cash and carry wholesale trading is permitted, to the extent of 100 percent under the Automatic route.

The discussion paper outlines some key Issues for Resolution i.e. should FDI in multi-brand retail be permitted and if so, should a cap on investment be imposed and if so, what should this cap be, etc. The discussion paper has invited public comments in order to resolve these issues.

Discussion paper on FDI in the defence sector

The Government has released a discussion paper on FDI in the defence sector for public comments. The paper suggests for liberalisation of FDI cap in the Sector from 26 percent to 74 percent with the Approval Route i.e. with prior approval of the Government. The paper also outlines current policy, rationale and benefits arising out of the liberalisation proposed.

Discussion paper on FDI in Limited Liability Partnership (LLP)

The Government has released a discussion paper on FDI in LLP for public comments. The LLP form of business has not yet been recognized under FDI policy. The LLP structure lies between that of a company where FDI is permitted and that of a partnership, where it is generally not permitted. The discussion paper highlights the differences between a LLP and companies and partnerships. In the context of prescribing a regime for FDI in LLPs, the discussion paper highlights the issues in relation to induction of FDI in LLPs.

Issue and transfer of instruments and pricing guidelines

The Indian companies can issue the following equity shares/equity convertible instruments subject to sectoral caps, timelines and pricing norms as prescribed as under:

- Equity shares;
- Fully compulsorily and mandatorily convertible debentures;
- Fully, compulsorily and mandatorily convertible preference shares
- Foreign Currency Convertible Bonds (FCCB)
- Depository Receipts (ADR and GDR)

Foreign investor can also invest in Indian companies by purchasing or acquiring existing shares/convertible instruments from Indian shareholders or from other non-resident shareholders.

Pricing guidelines

Any issue or transfer of equity shares/equity convertible instruments is subject to pricing or valuation norms. The pricing of the convertible capital instruments is required to be determined upfront at the time of issue/ transfer of the instruments. In general, for listed companies, the pricing guidelines stipulate recourse to the Securities and Exchange Board of India (SEBI) Guidelines and for unlisted companies, as per the discounted free cash flow method except for rights issue and preferential allotment

Previous venture conditions/criteria for FDI

These provisions apply only to a foreign investor with an existing venture or collaboration (technical and / or financial) with an Indian partner prior to or as on 12 January 2005 in a particular field and who is proposing to invest in another Indian company / joint venture in the 'same field' (as per relevant 4 digit 1987 NIC code) in India. In such cases of foreign investment, prior FIPB approval is required. Further, both parties are obliged to submit or demonstrate to the FIPB that the new venture does not prejudice the earlier venture. The prior FIPB approval is not required under the following circumstances:

- Investment to be made by a venture capital fund registered with the SEBI.
- Investments by Multinational financial institutions like Asian Development Bank, International Finance Corporation, Commonwealth Finance Corporation, etc.
- Where, in the existing joint venture, investment by either of the parties is less than 3 percent.
- Where the existing joint venture or collaboration is defunct or sick.
- For issue of shares of an Indian company engaged in IT sector or mining sector, if the existing joint venture or technology transfer or trade mark agreement of the person to whom the shares are to be issued are also in the IT sector or in the mining sector for same area or mineral.

January 2005. In such cases, the joint venture agreements are expected to include a conflict of interest clause. This clause determines or safeguards the interests of both the joint venture partners in the event of one of the partner desires to set up another joint venture or a wholly owned subsidiary in the same field of economic activity.

Discussion paper on Approval of Foreign/Technical collaborations in case of existing ventures/tie ups in India

The Government has released a discussion paper on approval of Foreign/Technical collaborations in case of existing ventures/tie ups in India. The discussion paper suggests relaxation of the existing requirements to obtain a prior approval where the foreign investor has an existing joint venture or technology transfer/trademark agreement in the 'Same' field which has been in existence as on or prior to 12 January 2005.

Manufacturing items reserved for micro and small enterprises

Any industrial undertaking which is not a micro or small enterprise, but manufactures items reserved for the MSE sector would require prior FIPB approval where foreign investment is more than 24% in the equity capital. Such an undertaking would also require an Industrial License for such manufacture.

The issue of Industrial License is subject to a few general conditions and the specific condition that the Industrial Undertaking shall undertake to export a minimum of 50 percent of the new or additional annual production of the MSE reserved items to be achieved within a maximum period of three years. The export obligation would be applicable from the date of commencement of commercial production.

External commercial borrowing/foreign currency convertible bonds/foreign currency exchangeable bonds

Overseas loans in foreign currency by Indian companies/entities from Foreign lenders are governed by the guidelines on External Commercial Borrowings (ECB) issued by the RBI under Foreign Exchange Regulations. The ECB Policy stipulates detailed guidelines for Eligible borrowers, recognized lenders, amount and maturity period, all-in-cost interest ceilings, end-use stipulations, compliances, etc.

Issue of any non-convertible, optionally convertible or partially convertible preference shares or debentures is considered as ECB from a foreign exchange regulation perspective and needs to comply with ECB guidelines.

An Indian company can also raise funds by issuing FCCBs. FCCB means a bond issued by an Indian company to non-residents in foreign currency, the principal and interest of which is payable in foreign currency. The FCCB are convertible into ordinary shares of the issuing company in any manner, either in whole, or in part.

Similarly, an Indian company can also raise funds through Foreign Currency Exchangeable Bonds (FCEBs). FCEB are similar to FCCBs except that in this case equity shares of another Indian Company (Offered Company – being a listed company, which is engaged in a sector eligible to receive FDI and eligible to issue or avail of FCCB or ECB) are issued on conversion. The issuer company should be part of the promoter group of the Offered company.

The policy for ECB is also applicable to FCCBs and FCEBs and accordingly all norms applicable for ECBs also apply to them as well.

American depositary receipts or global depositary receipts

A company can issue ADRs or GDRs if it is eligible to issue shares to person resident outside India under the FDI Policy subject to compliance with framework stipulated in this regard.

In general, Unlisted companies, which have not yet accessed the ADR or GDR route for raising capital, would require prior or simultaneous listing in the domestic market. Unlisted companies which have already issued ADR/GDR in the international market, have to list in the domestic market on making profit or within three years of such issue whichever is earlier.

Portfolio investment in India

FII who are eligible and apply / get registered with SEBI are eligible to invest in India under the Portfolio Investment Scheme (PIS) within prescribed guidelines, ceilings and parameters.

Eligible Institutional Investors that can register with SEBI as FIIs include, Pension Funds, Mutual Funds, Investment Trusts ,Banks, Charitable Societies, Foreign Central Bank, Sovereign Wealth funds,, University Funds, Endowments, Foundations, Charitable Trusts Insurance Companies, Re-insurance Companies, Foreign Government Agencies, International or Multilateral Organisations/ Agency, Broad based Funds, Asset Management Companies Investment Managers / Advisors Institutional Portfolio Managers and Trustee of a Trust.

Conceptually, an application for registration as an FII can be made in two capacities, namely as an investor or for investing on behalf of its sub-accounts.

Sub-account means any person resident outside India, on whose behalf investments are proposed to be made in India by a FII and who is registered as a sub-account under these regulations. Entities eligible to register as sub-account are Broad Based Funds, Broad Based Portfolios, Proprietary Funds of the FII, University Funds, Foreign Corporates, Endowments, Foundations, Charitable Trusts, Charitable Societies, Sovereign Wealth Funds and Foreign Individuals satisfying the prescribed conditions.

SEBI grants registration as FII based on certain criteria, namely constitution and incorporation of FII, track record, professional competence, financial soundness, experience, general reputation of fairness and integrity, being regulated in home country by appropriate foreign regulatory authority,, legal permissibility to invest in securities as per the norms of the country of its incorporation, fit and proper person, etc. SEBI grants registration to the FII and sub-account which is permanent unless suspended or cancelled by SEBI, subject to payment of fees and filing information every three years. The approval of the sub-account is co-terminus with that of the FII.

FIIs/sub-accounts can invest in Indian equities, debentures, warrants of companies (listed on recognized stock exchange or to be listed on a recognised stock exchange in India), units of a scheme floated by domestic mutual funds including Unit Trust of India, dated government securities, derivatives traded on a recognised stock exchange, commercial papers, security receipts and debt instruments within the ceiling/framework prescribed.

The FIIs can also access FDI route for investments in an Indian company.

Investment as foreign venture capital funds

A Foreign Venture Capital Investor (FVCI) which is eligible and registered with SEBI can invest in an Indian Venture Capital Fund / Indian Venture Capital Undertaking. It can also set up a domestic asset management company to manage the fund. All such investments are allowed under the Automatic Route subject to SEBI and RBI regulations and FDI Policy.

If the Indian/Domestic VCF is a registered Trust, then it seems prior Government approval may be required for foreign investment therein. FVCIs are also allowed to invest as non-resident entities in other companies subject to FDI Policy.

Investment by non-resident Indians

NRIs/PIOs can invest in the shares or convertible debentures of Indian company on repatriation basis on Indian stock exchange under PIS subject to limits and conditions.

NRIs/PIOs can also invest in the shares or convertible debenture of an Indian company (not engaged in sectors of in agricultural or plantation activities or real estate business or construction of farm houses or dealing in Transfer of Development Rights) on non-repatriation basis subject to conditions.

NRIs/PIOs are also eligible to invest in dated government securities, mutual funds, bonds, etc on repatriation and non-repatriation basis as per scheme/framework stipulated.

Calculation of total foreign investment

The FDI Policy also provides the methodology for calculation of Total Foreign Investment in an Indian Company for the purpose of sectoral cap and approval requirements. For this purpose all types of foreign investments i.e. FDI; FII holding as on 31 March; NRIs; ADRs; GDRs; FCCB; FCEB; fully, compulsorily and mandatorily convertible preferences shares; and fully, compulsorily and mandatorily convertible preferences shares are to be considered.

Total foreign investment is equal to Direct foreign investment plus indirect foreign investments in an Indian company.

- Direct investment are all specified types of foreign investment directly by a non-resident entity into the Indian company
- Indirect foreign investment are investments in an Indian company through investing Indian companies which are 'owned or controlled' by non-resident entities to be calculated as per the prescribed methodology.

These provisions are far-reaching in terms of scope, coverage, computation and go beyond the pro-rata methodology which was hitherto being applied in most cases.

There are detailed guidelines with respect to investment in 'operating cum investing companies' and 'investment companies'.

The entry level guidelines or conditions for FDI in an Indian Company have been expressly clarified to extend to indirect foreign investment as well i.e. downstream investments by Indian entities owned and controlled by non-resident entities.

For the purpose of indirect investments, the Indian companies are categorised into

- Only operating companies;
- Operating-cum-investing companies;
- Investing companies; and
- Companies which do not have any operations in India and do not have any downstream investments.

For foreign investments in an Indian Investment company or which does not have any operation prior Government approval is required followed by notification has been stipulated.

For all cases of transfer of ownership or control of Indian companies in specified or controlled sectors from resident Indian citizens or entities to non-resident entities prior Government approval will be required.

For downstream investment by an operating-cum-holding company with foreign investment as stipulated, a notification to the Government is stipulated within the prescribed timeframe and parameters.

The investing companies cannot leverage funds from the domestic market for the purpose of downstream investment.

INVESTMENT VEHICLES FOR FOREIGN INVESTORS

Choice of vehicle

Depending upon its business needs, a foreign company can choose between setting-up a Liaison Office (LO), a Branch Office (BO) or a Project Office (PO) instead of incorporating/investing in an Indian company under FDI Guidelines.

Eligibility criteria for foreign companies wanting to set-up Liaison Office/Branch Office in India

A Foreign Company can establish a LO or a BO in India with prior approval from the RBI if it is engaged in a sector where 100 precent FDI is permitted under the Automatic Route as per the FDI policy. In other cases and that of Non Governmental Organisations (NGO), Not for Profit Organization (NPO), Government Bodies, Departments are considered and approved by the RBI with prior permission of the Government. The application needs to be filed with the RBI through an Authorized Dealer (Banker).

The LO/BO approval of RBI is location specific and subject to guidelines issued in this regard. The RBI also monitors its activities through authorized dealers (Bankers) on an ongoing basis primarily by seeking an Annual Activity certificate for the LO's operation from its Auditors in India. Such Certificate now is also required to be co-filed with the Income Tax Authorities.

There exist eligibility criteria and procedural guidelines for establishment of LOs by foreign entities in India. The foreign entity needs to have a successful profit making track record during immediately preceding 3 years in the home country. Further, a net worth of not less than USD 50,000 is also required.

The foreign company proposing to set-up a BO in India needs to have a successful profit making track record during immediately preceding 5 years in the home country. Further, a net worth of not less than USD 100,000 is also required.

Foreign companies that do not satisfy the eligibility criteria and are subsidiaries of other companies may submit a Letter of Comfort from their parent company in the prescribed format subject to the parent company satisfying the eligibility criteria.

Post set-up in India, various registrations and compliance obligations entail on the LO/BO including obtaining a Unique Identification Number from the RBI. In view of sizeable paperwork and time frame obligations, the entire process needs to be carefully planned and implemented.

Liaison Office

A LO is permitted to act as a channel of communication or carry out a liaison role between the head office or group companies and the parties in India and is not permitted to undertake any commercial or trading or industrial activity, directly or indirectly.

The LO is obliged to maintain itself and meet its expenditure through inward remittances from the Head Office. An LO is generally approved only for specified period which is subject to renewal and in certain sectors, the LO is obliged to upgrade into a Company (wholly owned subsidiary or joint venture) post the initial approval period.

The Bankers/Authorized Dealers are now authorised to extend the validity period of liaison offices of foreign entities and also deal with closure application of such liaison offices in India.

The LO of Foreign banks obtaining prior approval from RBI under the Banking Regulation do not need separate RBI approval under the foreign exchange regulations. Similarly foreign insurance companies are permitted to set-up LO without RBI approval subject to necessary approval from the Insurance Regulatory and Development Authority of India.

Branch Office

A foreign company is permitted to establish a BO in India to undertake prescribed commercial activities and is generally suitable for manufacturing and trading companies wanting to market/sell their products in India or IT Enabled/Consultancy Firms wanting to render services in India.

The activities permitted for a BO does not include manufacturing (unless set up in SEZ for which set up and operation is governed under that separate regulations) and domestic/retail trading.

No prior approval is required to set up a BO in SEZ to undertake manufacturing or service activity provided 100 percent FDI under Automatic Route is allowed in this sector and subject to other conditions.

The BO of Foreign banks obtaining prior approval from RBI under the Banking Regulation do not need separate RBI approval under the foreign exchange regulations.

The Bankers/Authorized dealers are now authorized to deal with the closure application of such Branch office of foreign company in India.

Project office

Foreign companies undertaking projects in India and satisfying prescribed requirements can set up PO for the purpose of executing the project.

The requirement of obtaining prior RBI approval for PO that meets specified conditions has been dispensed with and only post facto filings are obligated. Similarly it can be wind up without any specific approval by relevant filings through Bankers.

A PO can only undertake activities relating to and incidental to the execution of specific projects in India and has to wind up post the completion of the Project.

A PO can is permitted to open, hold and maintain one or more foreign currency accounts subject to prescribed conditions / parameters. A PO is allowed to remit intermittent surplus to its Head office.

Local Indian subsidiary or joint venture company

Subject to FDI Guidelines and Foreign Exchange Regulations discussed in the above chapters, a foreign company can set up its own wholly owned Indian Subsidiary or Joint Venture Company with an Indian or Foreign Partner.

Subsidiary or a Joint venture company can be formed either as a Private limited company or a Public limited company. A private limited company is obliged to restrict the right of its members to transfer the shares, can have only 50 shareholders and is not allowed to have access to deposits from public directly. It is also subject to less corporate compliances requirements as compared to a public company which is eligible for listing on stock exchanges.

A company is regulated inter alia by the Ministry of Company Affairs /Registrar of Companies (ROC) under the Companies Act, 1956. The table bellow highlights certain key differences between a private and public company

A private company can commence business immediately on obtaining a certificate of incorporation from the ROC. A public company is required to obtain a "Certificate of Commencement of Business" by filing additional documents with the ROC.

Sr. No.	Particulars	Private Company	Public Company
1.	Minimum number of shareholders	Two	Seven
2.	Maximum number of shareholders	Fifty	Unlimited
3.	Minimum number of directors	Two	Three
4.	Maximum number of directors	Seven	Twelve (can be increased with Government approval)
5.	Minimum paid –up capital requirement in general	INR 1,00,000 (Approx. USD 2200)	INR 5,00,000 (Approx. USD 11000)

Comparative summary

A comparative summary of previously discussed business entities is as under:

Particulars	Liaison office	Branch office	Project office	Subsidiary/Joint Venture
1. Setting up requirements (General)	Prior approval of RBI required.	Prior approval of RBI required.	Prior RBI approval not required if certain conditions are fulfilled.	If activities/sectors fall under Automatic Route, no prior approval but only post facto filings with the RBI is obligated. Otherwise obtain Government/ FIPB approval and then comply with post facto filings
2. Permitted activities	Only liaison, representation, communication role is permitted. No commercial or business activities or otherwise giving rise to any business income can be undertaken.	Activities listed / permitted by RBI can only be undertaken. Local manufacturing and domestic / retail trading are not permitted.	Permitted if the foreign company has a secured contract from an Indian company to execute a project in India.	Any activity specified in the Memorandum of Association (MOA) of the company. Wide range of activities permissible subject to FDI guidelines / framework.
3. Funding for local Operations	Local expenses can be met only out of inward remittances received from abroad from Head Office through normal banking channels.	Local expenses can be met through inward remittances from Head Office or from earnings from permitted operations	Local expenses can be met through inward remittances from Head Office or from earnings from permitted operations.	Funding may be through equity or other forms of permitted capital infusion or borrowings (local as well as overseas per prescribed norms) or internal accruals
4. Limitation of liability	Unlimited liability (limited to the extent of capital of Foreign Company)	Unlimited liability (limited to the extent of capital of Foreign Company)	Unlimited liability (limited to the extent of capital of Foreign Company)	Liability limited to the extent of capital of Indian Company.
5. Compliance requirements under Companies Act	Requires registration and periodical filing of accounts / other documents.	Requires registration and periodical filing of accounts/ other documents.	Requires registration and periodical filing of accounts/ other documents.	Required to comply with substantial higher statutory compliance and filings requirements as compared to LO / BO
6. Compliance Requirements under Foreign Exchange Management Regulations	Required to obtain and file an Annual Activity Certificate from the Auditors in India with the Authorized Dealer / Bankers with a copy to the Income Tax Authorities.	Required to obtain and file an Annual Activity Certificate from the Auditors in India with the Authorized Dealer/ Bankers with a copy to the Income Tax Authorities.	Compliance certificates stipulated for various purposes	Required to file Periodic and Annual filings relating to receipt of capital and issue of shares to foreign investors
7. Permanent Establishment (PE)/taxable presence	LO generally do not constitute PE / taxable presence under Double Taxation Avoidance Agreements (DTAA) due to limited scope of activities in India	Generally constitute a PE and are a taxable presence under DTAA as well domestic income-tax provisions	Generally constitute a PE and are a taxable presence under DTAA as well domestic income-tax provisions	It is an independent taxable entity and does not constitute a PE of the Foreign Company per se unless deeming provisions of the DTAA are attracted
8. Compliance Requirements under Income Tax Act	No tax liability as generally it cannot/does not carry out any commercial or income earning activities.	Obliged to pay tax on income earned and required to file return of income in India. No further tax on repatriation of profits.	Obliged to pay tax on income earned and required to file return of income in India. No further tax on repatriation of profits.	Liable to tax on global income on net basis. Dividend declared is freely remittable but subject to Dividend Distribution Tax (DDT) of 16.609 percent on Dividends declared/distributed/paid by the Indian Company. Pursuant to DDT, dividend is tax free for all shareholders. Limited inter-corporate dividend set-off apply.

REPATRIATION OF FOREIGN EXCHANGE

The Foreign Exchange Management Act, 1999 (FEMA), forms the statutory basis of foreign exchange management in India. The RBI which is the apex banking authority administers the foreign exchange management regulations jointly with the Government of India.

India does not have full capital account convertibility as yet. However, there have been significant relaxations in the recent past for drawal of foreign exchange for both current account as well as capital account transactions.

The payments due in connection with foreign trade, other current business, services, etc. are regarded as Current Account transactions. As per the Current Account Transaction Rules, the withdrawal of foreign exchange for current account transactions is regulated as under:

Prescribed schedule of Current account rules	Drawal of foreign exchange for	Approving authority
Schedule I	Transactions which are prohibited	N.A.
Schedule II	Transactions which require prior approval of the Central Government:	Concerned Ministry or Department of Government
Schedule III	Transactions which require prior approval of the RBI:	RBI

In case of certain transactions listed in Schedule II and III, prior approval is not required if the payment is made out of foreign exchange funds held in Exchange Earner's Foreign Currency EEFC account of the Remitter.

Remittances for all other current Account transactions can generally be made directly through the Authorized Dealers (Bankers) without any specific prior approval. Some of the relevant Current Account payments are discussed hereunder.

Dividends

Dividends declared by an Indian Company can be freely remitted overseas to foreign shareholders without any specific prior approval. There is currently no dividend balancing currently in vogue.

Foreign technology collaboration

The Government has liberalised the policy on Foreign Technology Collaboration (FTC) and it now permits all payments for royalty, lump-sum fee for transfer of technology and payments for use of trademark/brand name under the Automatic Route without any restrictions. An independent reporting mechanism is proposed to be put in place to monitor remittances / compliance.

Consultancy services

Remittance upto USD 1 million per project (USD 10 million for specified infrastructure projects) can be made without any prior approval of the RBI. However, no such prior approval is necessary if the remittance exceeding this ceiling is made out of an EEFC account of the Remitter.

Import of goods

Payments in connection with import of goods and services in the ordinary course of business are generally permissible and can be undertaken freely through direct filing of required documents with the Authorized Dealer / Banker. The Foreign Exchange Management regulations regulate the period of settlement, rate of interest that can be charged, advance that can be made, etc.

Netting-off overseas receivable and payables

Generally, netting-off of foreign exchange receivables against foreign exchange payables is not permitted. The exporter is obliged to realize the entire export proceeds and the importer is obliged to pay for the import of goods and services separately. Specific relaxation exists in the regulations for some cases like units in SEZs. The RBI can also give case specific approvals for netting off based on industry requirement/practice and internal norms.

Portfolio investment in India

FII registered with SEBI and NRIs are eligible to invest in India under the PIS within prescribed guidelines and parameters.
Investment by FIIs are primarily governed by the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995, ('SEBI Regulations'). Eligible Institutional Investors that can register as FIIs include, Pension Funds, Mutual Funds, Investment Trusts ,Banks, Charitable Societies, Foreign Central Bank, Sovereign Wealth funds,, University Funds, Endowments, Foundations, Charitable Trusts Insurance Companies, Re-insurance Companies, Foreign Government Agencies, International or Multilateral Organisations/ Agency, Broad based Funds, Asset Management Companies Investment Managers/Advisors Institutional Portfolio Managers and Trustee of a Trust.
Sub-account means any person resident outside India, on whose behalf investments are proposed to be made in India by a FII and who is registered as a sub-account under these regulations. Entities eligible to register as sub-account are Broad Based Funds, Broad Based Portfolios, Proprietary Funds of the FII, University Funds, Foreign Corporates, Endowments, Foundations, Charitable Trusts, Charitable Societies, Sovereign Wealth Funds and Foreign Individuals satisfying the prescribed conditions.
Conceptually, an application for registration as an FII can be made in two capacities, namely as an investor or for investing on behalf of its sub-accounts.

SEBI grants registration as FII based on certain criteria, namely constitution and incorporation of FII, track record, professional competence, financial soundness, experience, general reputation of fairness and integrity, being regulated in home country by appropriate foreign regulatory authority,, legal permissibility to invest in securities as per the norms of the country of its incorporation, fit and proper person, etc. SEBI grants registration to the FII and sub-account which is permanent unless suspended or cancelled by SEBI, subject to payment of fees and filing information every three years. The approval of the sub-account is co-terminus with that of the FII.
FIIs / sub-accounts can invest in Indian equities, units, exchange traded derivatives, commercial papers and debt. FIIs can also invest in security receipts of Asset Reconstruction Companies on its own behalf.

A FII can invest any portion of its portfolio in debt instruments as the requirement to maintain 70:30 (equity: debt) investment limit by pure equity FIIs has been removed by SEBI subject to limits being sanctioned by SEBI..

Foreign investment policy on FII investment

FII investments in India are subject to the following policy/limits:

- As per RBI, no single FII/sub-account can acquire more than 10 percent of the paid-up equity capital or 10 percent of the paid-up value of each series of convertible debentures issued by the Indian company. In case of foreign corporate or individuals, each such sub-account shall not invest more than 5 percent of the total issued capital of that company.
- All FIIs and their sub-accounts taken together cannot acquire more than 24 percent of the paid-up capital or paid up value of each series of convertible debentures of an Indian Company. The investment can be increased upto the sectoral cap/statutory ceiling, as applicable to the concerned Indian company. This can be done by passing a resolution by its Board of Directors followed by passing of a special resolution to that effect by its General Body. Also, in certain cases, the permissible FDI ceiling subsumes or includes a separate sub-ceiling for the FII Investment as per stipulation which needs to be complied with.

  As per the new Consolidated FDI Policy Framework (effective from 1st April 2010) 10 percent individual limit and 24 percent aggregate limit for FII investment shall be applicable even when FIIs invest under the FDI scheme/policy.
- FIIs/sub-accounts can transact in dematerialized form through a recognized stock broker and on a recognized stock exchange and are required to give or take delivery of securities. Further, short selling is permitted within prescribed parameters/norms. FIIs /sub-accounts can also lend or borrow securities in the Indian market under a scheme framed by SEBI.
- FIIs can buy/sell securities on Stock Exchanges in most sectors except those prohibited. They can also invest in listed and unlisted securities outside Stock Exchanges subject to prescribed guidelines/compliances/approvals.

Annexure I – Illustrative sector-wise regulation for FDI

Sectors prohibited for FDI (Illustrative)

- Real estate business and construction of farm houses
- Nidhi company and business of chit fund
- Atomic energy
- Trading in transferable development rights
- Lottery, gambling and betting including casino
- Agriculture (excluding permissible under automatic route) and plantations (other than tea plantations under Approval Route)
- Retail trading (except 51 percent in Single Brand Product Retailing under Approval Route)
- Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

Sectors falling under the Automatic Route for FDI (Illustrative) (100 percent unless specified)

Agriculture	• Floriculture, horticulture, development of seeds, animal husbandry, pisciculture, aqua-culture, cultivation of vegetables & mushrooms (specified) and services related to agro and allied sectors
Manufacturing	• Alcohol distillation and brewing • Coffee, rubber processing and warehousing • Drugs and pharmaceuticals including those involving use of recombinant technology • Hazardous Chemicals (specified) • Industrial explosives
Mining	• Coal and lignite mining for captive consumption by power projects; iron & steel and cement units and other specified activities • Setting up coal processing plants like washeries subject to conditions • Mining and exploration of metal, non-metal ores including diamonds, precious stones, gold, silver and minerals
Power	• Power including generation (except atomic energy), transmission, distribution and Power Trading
Service Sector	• Advertising and Films • Business services (e.g. data processing, software development, consulting, market research, technical testing, etc.) • Construction and maintenance of roads, bridges, etc.; Ports and harbours related activities; Mass Rapid Transport Systems in metropolitan cities; etc. • Development of Township, Housing, Built-up Infrastructure and construction development projects • Development of Special Economic Zones • Health and medical services • Hotel and Tourism related industry • Industrial parks • Insurance (26 percent) • Non banking finance companies (as specified - e.g. Stock broking, finance, etc.) • Research and development services • Storage and warehouse services • Transport and transport support services

Sector falling under either Automatic Route and / or Approval Route (also refer Notes below)

Sector heading	Sector sub-heading	Automatic Route (%)	Approval Route (%)
Airports	• Greenfield • Existing	100 74	--- up to 100
Air transport services	• Scheduled • Non-scheduled / chartered and cargo airlines • Helicopter services / seaplane services (specified)	49 (NRIs – 100%) 49 100	--- up to 74 ---
Asset reconstruction companies		---	49
Banking (subject to RBI approval/conditions)	• Private sector • Public sector	74 / 100 ---	--- 20
Broadcasting	• Headend-In-The-Sky • FM Radio • Cable network and direct-To-home • Hardware facilities such as uplinking of HUB / Teleports • Hardware facilities such as uplinking a news and current affairs TV channel • Hardware facilities such as uplinking a non-news and current affairs TV channel	49 --- --- --- --- ---	up to 74 20 49 49 26 100
Civil aviation services	• Ground Handling services • Maintenance and repair organisations, flying training institutes, and technical training institutions	49 100	up to 74 ---
Commodity exchanges		---	49
Courier services other than those covered by Indian Post Office Act, 1898		---	100
Credit information companies		---	49
Defense manufacturing		---	26
Infrastructure companies in securities markets, namely, Stock Exchanges, Depositories and Clearing Corporations		---	49
Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities		---	100
Petroleum and natural gas	• Private sector (Exploration / Refining) • Public Sector Undertakings (Refining)	100 ---	--- 49
Print media	• Publishing newspapers & periodicals dealing with news and current affairs • Publishing Indian edition of foreign magazines • Publishing of scientific magazines, specialty journals / periodicals • Publishing facsimile edition of foreign newspaper	--- --- --- ---	26 26 100 100

Sector heading	Sector sub-heading	Automatic Route (%)	Approval Route (%)
Satellite establishment and operation		---	74
Security agencies in private sector		---	49
Tea sector including tea plantation		---	100
Telecommunication	• Basic, cellular services unified access services, value added and other specified services • ISP with or without gateways, radio paging, end to end bandwidth • Infrastructure provider (specified), electronic mail and voice mail	49 49 49	up to 74 up to 74 up to 100
Trading	• Wholesale Trading and Cash & Carry wholesale Trading including E-commerce activities (subject to detailed guidelines) • For exports • For items sourced from small scale sector • Test marketing of items for which company has approval for manufacture • Single Brand Product Retailing	100 100 --- --- ---	--- --- 100 100 51

Note:

1 Certain sectoral cap include investments by NRI, FII, FVCI investments having underlying cap on FDI investments and NRI, FII, FVCI investments.

2 Sectoral caps are subject to detailed guidelines, other conditions, sectoral laws, licensing and other requirements (e.g. divestment) hence readers are requested to refer to detailed policy guidelines before acting upon.

Source: Circular 1 of 2010 issued by the Department of Industrial Policy and Promotion, Ministry of Finance, Government of India on 31 March 2010

COMPANY LAW

Indian company law is predominantly modeled around the English law. Companies Act, 1956 governs the incorporation, operation, governance and closure of companies in India. The administration of Company Law is under the Ministry of Company affairs through the Company Law Board (CLB) and ROC. A National Company Law Tribunal (NCLT) has been proposed to be set up which is to take over the functions of the CLB.

Types of companies

The Companies Act provides for incorporation of different types of companies, the most popular ones engaged in the commercial activities being the private limited and public limited companies (liability of members being limited to the extent of their shareholding).

Private company

A private company is required to be incorporated with a minimum paid-up capital of INR 100,000 and two subscribers.
Broadly, it:

- Restricts the right to transfer its shares
- Limits the number of its members (shareholders) to 50
- Prohibits any invitation to the public to subscribe for any of its shares or debentures
- Prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

The balance sheet and profit and loss account of the company has to be filed with the ROC.

Public company

A public company means a company which is not a private company. A public company is required to be incorporated with a minimum paid-up capital of INR 500,000 and 7 subscribers.
A private company which is a subsidiary of another company which is not a private company shall be a public company.
The profit and loss accounts, balance sheet, along with the reports of the directors and auditors, of a public company are required to be filed with the ROC and are available for inspection to the public at large.

Listed public companies are additionally regulated by the SEBI and have listing agreements with the respective stock exchange on which they are listed.
A private company is a more popular form as it is less cumbersome to incorporate and also has comparatively less stringent reporting requirements. Usually, foreign corporations set up their subsidiary companies as a private company.

Share capital

The issue of shares symbolizes the payment of share capital in a company. The share capital is required to be stated in the company's MOA.

Authorized share capital

The nominal or authorized share capital is the amount of capital stated in the MOA that the company is authorized to issue. The issued capital is that part of the nominal or authorized capital that the company offers for subscription. Enhancement of authorized capital necessitates passing of appropriate resolutions by the board and shareholders of the company and payment of additional fees to the ROC.

Paid-up share capital

The paid-up share capital is the amount of capital which is subscribed by the shareholders i.e. the shareholders have agreed to give consideration in cash or kind for the shares, unless those shares are fully paid up bonus shares issued by a company (generally out of the accumulated profits which are available for appropriation).

Management

The Act lays down specific provisions with respect to managing the affairs of a company so as to protect the interest of its shareholders and investing public.

Directors

A public company is required to have a minimum of three directors and a private company a minimum of two directors.

Directors are under a statutory duty to ensure that company's funds are used for legitimate business purposes.

They have an obligation to:

- Maintain a register and index of members/ debenture holder
- Call general meetings including the AGM each year
- Ensure proper maintenance of books of accounts
- Prepare balance sheets, profit and loss accounts and to get them audited and place before Annual General Meeting (AGM)
- Disclose shareholdings, etc.

Wholetime/Managing directors

Every public company or a private company which is a subsidiary of a public company having a paid up share capital of INR 50 Million must have a managing or whole time director or a manager. An approval from the Central Government (Department of Company Affairs) is required if the remuneration proposed to be paid to such wholetime/ managing director is more than what is prescribed in Schedule XIII of the Act.

Board meetings

Board meetings are required to be held every three months. The Board may delegate its powers to borrow, invest funds and make loans up to certain specified limits, to the committee of directors or managing directors.

Audit of accounts

Auditors of a company are appointed/ re-appointed in the AGM of a company. Their tenure lasts till the conclusion of the next AGM. The company in a general meeting may remove auditors before the expiry of their term in office. Auditors are required to make a report to the members of the company in respect of the accounts (balance sheet, profit and loss account) examined by them at the end of each financial year.

The Act also provides for formation of an audit committee, consisting of qualified and independent directors, inter alia to have discussions with the auditors about the internal control systems and review half yearly and annual financial statements before submission to the CLB.

Director Identification Number (DIN)

DIN is a unique identification number allotted to an individual who is proposed as a director and is now a mandatory requirement for appointment as a director.

Companies Bill 2009:

Companies Bill 2009 is introduced in Lok Sabha on 15 September 2009. The main objectives of the Companies Bill, 2009 are as follows -

- To revise and modify the Companies Act in consonance with the changes in the national and international economy;
- To bring about compactness by deleting the provisions that had become redundant over time and by regrouping the scattered provisions relating to specific subjects;
- To re-write various provisions of the Act to enable easy interpretation; and
- To delink the procedural aspects from the substantive law and provide greater flexibility in rule making to enable adaptation to the changing economic and technical environment.

The Companies Bill, 2009 provides, inter alia, for:

- The basic principles for all aspects of internal governance of corporate entities and a framework for their regulation, irrespective of their area of operation, from incorporation to liquidation and winding up, in a single, comprehensive, legal framework administered by the Central Government. In doing so, the Bill also harmonizes the Company law framework with the imperative of specialized sectoral regulation.
- Articulation of shareholders democracy with protection of the rights of minority stakeholders, responsible self-regulation with disclosures and accountability, substitution of government control over internal corporate processes and decisions by shareholder control. It also provides for shares with differential voting rights to be done away with and valuation of non-cash considerations for allotment of shares through independent valuers.
- Easy transition of companies operating under the Companies Act, 1956, to the new framework as also from one type of company to another.
- A new entity in the form of One-Person Company (OPC) while empowering Government to provide a simpler compliance regime for small companies. Retains the concept of Producer Companies, while providing a more stringent regime for not-for–profit companies to check misuse. No restriction proposed on the number of subsidiary companies that a company may have, subject to disclosure in respect of their relationship and transactions/ dealings between them.
- Application of the successful e-Governance initiative of the Ministry of Corporate Affairs (MCA-21) to all the processes involved in meeting compliance obligations. Company processes, also to be enabled to be carried out through electronic mode. The proposed e-Governance regime is intended to provide for ease of operation for filing and access to corporate data over the internet to all stakeholders, on round the clock basis.
- Speedy incorporation process, with detailed declarations/ disclosures about the promoters, directors etc. at the time of incorporation itself. Every company director would be required to acquire a unique Directors identification number.
- Facilitates joint ventures and relaxes restrictions limiting the number of partners in entities such as partnership firms, banking companies etc. to a maximum 100 with no ceiling as to professions regulated by Special Acts.

- Duties and liabilities of the directors and for every company to have at least one director resident in India. The Bill also provides for independent directors to be appointed on the Boards of such companies as may be prescribed, along with attributes determining independence. The requirement to appoint independent directors, where applicable, is a minimum of 33% of the total number of directors.
- Statutory recognition to audit, remuneration and stakeholders grievances committees of the Board and recognizes the Chief Executive Officer (CEO), the Chief Financial Officer (CFO) and the Company Secretary as Key Managerial Personnel (KMP).
- Companies not to be allowed to raise deposits from the public except on the basis of permission available to them through other Special Acts. The Bill recognizes insider trading by company directors/KMPs as an offence with criminal liability.
- Recognition of both accounting and auditing standards. The role, rights and duties of the auditors defined as to maintain integrity and independence of the audit process. Consolidation of financial statements of subsidiaries with those of holding companies is proposed to be made mandatory.
- A single forum for approval of mergers and acquisitions, along with concept of deemed approval in certain situations.
- A separate framework for enabling fair valuations in companies for various purposes. Appointment of valuers is proposed to be made by audit committees.
- Claim of an investor over a dividend or a security not claimed for more than a period of seven years not being extinguished, and Investor Education and Protection Fund (IEPF) to be administered by a statutory Authority.
- Shareholders Associations/ Group of Shareholders to be enabled to take legal action in case of any fraudulent action on the part of company and to take part in investor protection activities and 'Class Action Suits'.
- A revised framework for regulation of insolvency, including rehabilitation, winding up and liquidation of companies with the process to be completed in a time bound manner. Incorporates international best practices based on the models suggested by the United Nations Commission on International Trade Law (UNCITRAL).
- Consolidation of fora for dealing with rehabilitation of companies, their liquidation and winding up in the single forum of National Company Law Tribunal with appeal to National Company Law Appellate Tribunal. The nature of the Rehabilitation and Revival Fund proposed in the Companies (Second Amendment) Act, 2002 to be replaced by Insolvency Fund with voluntary contributions linked to entitlements to draw money in a situation of insolvency.
- A more effective regime for inspections and investigations of companies while laying down the maximum as well as minimum quantum of penalty for each offence with suitable deterrence for repeat offences. Company is identified as a separate entity for imposition of monetary penalties from the officers in default. In case of fraudulent activities/actions, provisions for recovery and disgorgement have been included.
- Levy of additional fee in a non-discretionary manner for procedural offences, such as late filing of statutory documents, to be enabled through rules. Defaults of procedural nature to be penalized by levy of monetary penalties by the Registrars of Companies. The appeals against such orders of Registrars of Companies to lie with suitably designated higher authorities.
- Special Courts to deal with offences under the Bill. Company matters such as mergers and amalgamations, reduction of capital, insolvency including rehabilitation, liquidations and winding up are proposed to be addressed by the National Company Law Tribunal/ National Company Law Appellate Tribunal.

The Companies Bill is yet to become an Act

Winding up of companies

Under the Companies Act, winding up can be done in two ways i.e. winding up by Tribunal and Voluntary winding-up.

- **Winding up by Tribunal**

The company may be wound up by the Tribunal on -

- Passing a special resolution
- Failure to hold statutory meeting or delivering the statutory report to the registrar
- Failure to commence business within a year from its incorporation
- Reduction in number of members below required number
- Inability to pay its debts
- Winding up on just and equitable grounds
- Default in filing with the Registrar the financial statements or annual return for five consecutive years.
- Acting against the interest of the country
- If the company is a sick industrial company and is not likely to become viable in future

- **Voluntary winding-up**
  - A company may voluntary wind up its affairs if it is unable to carry on its business or to meet its financial obligation, etc. A company may voluntary wind up itself under any of the two modes i.e. members voluntary winding-up and creditors voluntary winding-up.

DIRECT TAXES

In India, under the constitution taxes can be levied by Central and the State Governments, and by the local government bodies. Principal taxes, including Income-tax, Custom Duties, Central Excise Duty and Service Tax are levied by the Central Government. On the other hand, States levy taxes like State Excise Duties, Value-Added Tax, Sales Tax and Stamp Duties. Local government bodies levy Octroi Duties and other taxes of local nature like Water Tax, Property Tax, etc. Income is taxed in India in accordance with the provisions of the Income-tax Act, 1961 (the Act). The Ministry of Finance (Department of Revenue) through the Central Board of Direct Taxes (CBDT), an apex tax authority, implements and administers direct tax laws.

India has embarked on a series of tax reforms since the early 1990s. The focus of reforms has been on rationalisation of tax rates and simplification of procedures.

India follows a 'residence' based taxation system. Broadly, taxpayers may be classified as 'residents' or 'non-residents'. Individual taxpayers may also be classified as 'residents but not ordinary residents'.

The 'tax year' (known as the financial year) in India, runs from 1 April to 31 March, of the following calendar year for all taxpayers. The 'previous year' basis of assessment is used i.e. any income pertaining to the 'tax year' is offered to tax in the following year (known as the assessment year).

Taxable income has to be ascertained separately for different classes of income (called as heads of income) and is then aggregated to determine the total taxable income. Income tax is levied on 'taxable income', comprising of income under the following categories, referred to as heads of income:

- Salaries
- Income from house property
- Profits and gains of business or profession
- Capital gains
- Income from other sources.

Generally, the global income of domestic companies, partnerships and local authorities are subject to tax at flat rates, whereas individuals and other specified taxpayers are subject to progressive tax rates. Foreign companies and non resident individuals are also subject to tax at varying rates on specified incomes which are received/accrued or deemed to be received/accrued in India.

Agricultural income is exempt from Income-tax at the central level but is taken into account for rate purposes. Income earned by specified organisations, for e.g. trusts, hospitals, universities, mutual funds, etc., is exempt from Income-tax, subject to the fulfillment of certain conditions.

India adopts the self-assessment tax system. Taxpayers are required to file their tax returns by specified dates. The Tax Officer may choose to make a scrutiny assessment to assess the correct amount of tax by calling for further details.

Generally, taxpayers are liable to make Income-tax payments as advance tax, in three or four installments, depending on the category they belong to, during the year in which the income is earned. Balance tax payable, if any, can be paid by way of self-assessment tax at the time of filing the return of income. Employed individuals are subject to tax withholding by the employer on a 'pay-as-you-earn' basis. Certain other specified incomes are also subject to tax withholding at specified rates.

Residential status

Individual

Depending upon the period of physical stay in India during a given tax year (and preceding 10 tax years), an individual may be classified as a resident or a non-resident or a 'not ordinarily resident' in India.

Company

A resident company (also referred to as an Indian Company) is a company formed and registered under the Companies Act, 1956 or one whose control and management is situated wholly in India. An Indian company by definition is always a resident.

A non-resident company is one, whose control and management are situated wholly outside India. Consequently, an Indian company that is wholly owned by a foreign entity but managed from India by foreign individuals/companies is also considered a resident Indian company.

Kinds of taxes

Corporate Income tax

Income-tax @ 30 % is levied on income earned during a tax year as per the rates declared by the annual Finance Act. Surcharge @ 7.5 % is chargeable, in case of companies other than a foreign company, if the total income exceeds INR 10 million. Education cess is applicable at 3 percent on income-tax (inclusive of surcharge, if any).

Minimum Alternate Tax (MAT)

With a view to bring zero tax paying companies having book profits, under the tax net, the domestic tax law requires companies to pay MAT in lieu of the regular corporate tax, in a case where the regular corporate tax is lower than the MAT.

However, MAT is not applicable in respect of:

- Income exempt from tax (excluding exempt long-term capital gains)
- Income from units in specified zones including SEZs or specified backward districts
- Income of certain sick industrial companies.

The Finance Act 2010 increased the rate of MAT from 15 percent to 18 percent (plus applicable surcharge and education cess) of the adjusted book profits of companies where the income tax payable is less than 18 percent of their book profits. Education cess is applicable at 3 percent on income-tax (inclusive of surcharge, if any).

A tax credit is available being the difference of the tax liability under MAT provisions and regular provisions, to be carried forward for set off in the year in which tax is payable under the regular provisions. However, no carry forward shall be allowed beyond the tenth assessment year succeeding the assessment year in which the tax credit became allowable.

Dividend Distribution Tax

Dividends paid by an Indian company are currently exempt from Income-tax in the hands of the recipient shareholders. However, the company paying the dividends is required to pay DDT on the amount of dividends declared. The rate of tax is 16.609 % (inclusive of surcharge and educational cess). DDT is a tax payable on the dividend declared, distributed or paid. An exemption from this tax has been granted in case of dividends distributed out of profits of SEZ developers.

Domestic companies will not have to pay DDT on dividend distributed to its shareholders to the extent of dividend received from its subsidiary if:

- The subsidiary has paid DDT on such dividend received; and
- Such a domestic company is not a subsidiary of any other company.

A company would be subsidiary of another company if such a company holds more than half in nominal value of equity share capital of the company.

Tonnage tax scheme for Indian shipping companies

Tax is levied on the notional income of the shipping company arising from the operation of ships at normal corporate tax rates. The notional income is determined in a prescribed manner on the basis of the tonnage of the ship. Tax is payable even in the case of loss. The scheme is applicable to shipping companies that are incorporated under the Indian Companies Act (with its effective place of management in India) with at least 1 ship with minimum tonnage of 15 tonnes and holding a valid certificate under the Merchant Shipping Act, 1959. Shipping companies have an option to opt for the scheme or taxation under normal provisions. Once the scheme has been opted for, it would apply for a mandatory period of 10 years and other tax provisions would not apply.

Securities Transaction Tax (STT)

STT is levied on the value of taxable securities transactions at specified rates.

The taxable securities transactions are –

- Purchase/Sale of equity shares in a company or a derivative or a unit of an equity-oriented fund entered into in a recognised stock exchange
- Sale of unit of an equity-oriented fund to the mutual fund

- The rates of STT are:

Transaction	Purchase/Sale of equity shares, units of equity oriented mutual fund (delivery based)	Sale of equity shares, units of equity oriented mutual fund (non - delivery based)	Sale of Derivatives (on the premium amount)	Sale of an option in securities	Sale of derivatives (where the option is exercised)	Sale of unit of an equity oriented fund to the mutual fund
Rates	0.125%	0.025%	0.017%	0.017%	0.125%	0.25%
Paid by	Purchaser/ seller	Seller	Seller	Seller	Purchaser	Seller

Source: Income-Tax Act, 1961

Wealth Tax

Wealth tax is leviable on specified assets at 1 percent on the value of the net assets as held by the assessee (net of debts incurred in respect of such assets) in excess of the basic exemption of INR 3 million.

Tax rates

Personal taxes

Individuals (excluding women and senior citizen) are liable to tax in India at progressive rates of tax as under:

Individual

Income Slab	Effective Tax rate (including educational cess of 3 percent) (in percent)
Upto INR 160,000	NIL
INR 160,001 to 500,000	10.3
INR 500,000 to 800,000	20.6
800,001 and above	30.9

Source: Income-Tax Act, 1961

Women

Income Slab	Effective Tax rate (including educational cess of 3 percent) (in percent)
Upto INR 190,000	NIL
INR 190,001 to 500,000	10.3
INR 500,000 to 800,000	20.6
800,001 and above	30.9

Source: Income-Tax Act, 1961

Senior Citizens (individuals of the age of 65 years or more)

Income Slab	Effective Tax rate (including educational cess of 3 percent) (in percent)
Upto INR 240,000	NIL
INR 240,001 to 500,000	10.3
INR 500,000 to 800,000	20.6
800,001 and above	30.9

Source: Income-Tax Act, 1961

Capital gains tax

The profits arising from the transfer of capital assets are liable to be taxed as capital gains. Capital assets include all kinds of property except stock-in-trade, raw materials and consumables used in businesses or professions, personal effects (except jewellery), agricultural land and notified gold bonds.

The length of time of holding of an asset determines whether the gain is short term or long term.

Long term capital gains arise from assets held for 36 months or more (12 months for shares, units, etc).

Gains arising from transfer of long-term capital assets are taxed at special rates / eligible for certain exemptions (including exemption from tax where the sale transaction is chargeable to STT). Short-term capital gains arising on transfer of assets other than certain specified assets are taxable at normal rates.

The following figure shows the rates of capital gains tax (excluding the effect of cess and surcharge that may apply):

Type of gain	Tax rate in case of transfer of assets subject to payment of STT	Tax rate in case of transfer of other assets
Long-term capital gains	NIL	20 percent
Short-term capital gains	15 percent	Normal Tax Rates applicable to corporates/ individuals

Source: Income-Tax Act, 1961

Taxability of Non Resident Indians

NRIs are also be liable to tax in India on a gross basis depending upon the type of income received.

Foreign nationals

Indian tax law provides for exemption of income earned by foreign nationals for services rendered in India, subject to prescribed conditions. For example:

- Remuneration from a foreign enterprise not conducting any business in India provided the individual's stay in India does not exceed 90 days and the payment made is not deducted in computing the income of the employer
- Remuneration received by a person employed on a foreign ship provided his stay in India does not exceed 90 days.

Companies

A resident company is taxed on its global income. A non-resident company is taxed on income which is received / accrued or deemed to accrue / arise in India. The scope of Indian income is defined under the Act. The tax rates for the tax year 2010-11 are given in the table below:

Type of Company	Effective tax rate (including surcharge and educational cess)
Domestic company	33.28 percent*
Foreign company	42.23 percent**

* Income-tax 30 percent plus surcharge of 7.5 percent (if the total income exceeds INR 10 million) thereon plus education cess of 3 percent on Income-tax including surcharge

** Income-tax 40 percent plus surcharge of 2.5 percent thereon plus education cess of 3 percent on Income-tax including surcharge

A company may be required to pay the other taxes eg. MAT, Wealth tax, DDT, etc.

Modes of taxation

Gross basis of taxation

Certain specific income streams earned by non-residents are liable to tax on gross basis in certain cases, i.e. a specified rate of tax is applied on the gross basis and no deduction of expenses is allowed. The details of nature of income and applicable rate of tax are as under:

Income stream	Rate of tax
Interest	21.11 percent
Royalties	10.55 percent
Fees for technical services	10.55 percent

The rates are in the case of a foreign company and are inclusive of surcharge of 2.5 percent and education cess of 3 percent on tax and surcharge in respect of agreements made on or after 1 June 2005 respectively.

Presumptive basis of taxation

Foreign companies engaged in certain specified business activities are subject to tax on a presumptive basis i.e. income is recognized at a specific percentage of gross revenue and thereafter tax liability is determined by applying the normal tax on deemed income. Certain activities taxed on a presumptive basis along with the basis of taxation are set out below:

Activity	Basis of taxation	Effective tax rate (including surcharge of 2.5% and education cess of 3%) (in percent)
Oil and gas services	Deemed profit of 10 percent of revenues	4.223
Execution of certain turnkey contracts	Deemed profit of 10 percent of revenues	4.223
Air transport	Deemed profit of 5 percent of revenues	2.115
Shipping operations	Deemed profit of 7.5 percent of freight revenues	3.167

Deductions allowable from business income

Generally, all revenue expenses incurred for business purposes are deductible from the taxable income. The requirement for deductibility of expenses is that the expenses must be wholly and exclusively incurred for business purposes; that the expenses must be incurred or paid during the previous year and supported by relevant papers and records. Expenses of a personal or a capital nature are not deductible. Income tax paid is not allowable as a deduction. Depreciation on specified capital assets at prescribed rates is also deductible.

Expenditure incurred on taxes (excluding Income-tax) and duties, bonus or commission to employees, fees under any law, interest on loans or borrowings from public financial institutions and interest on loans and advances from scheduled banks is deductible only if it is paid during the previous year, or on or before the due date for furnishing the return of income. However, interest on capital borrowed for acquisition of assets acquired for extension of existing business is not allowed as a deduction until the time such assets are actually put to use.

Employee's contributions to specified staff welfare funds – that is, provident funds, gratuity funds, etc. are allowed only if actually paid on or before the specified/ applicable due date. Salaries, interest, royalties fees for technical service, commission or any other amount payable outside India or in India to non-residents or a resident on which the tax has not been withheld or after deduction has not been paid within the prescribed time are not deductible. Such amounts are deductible in the year in which the withholding tax is paid.

Similarly, any payment made to residents for interest, commission or brokerage, rent, royalty, fees for professional or technical services, contract/sub-contract payments, where taxes have not been withheld or after withholding have not been paid within the prescribed time limit, will be disallowed in the hands of the payer. The deduction for such a sum will be allowed in the year in which the withholding taxes are paid.

Various allowable expenditures from business income are given below

- **Head-office expenditure**

  Foreign companies operating in India through a branch are allowed to deduct executive and general administrative expenditure incurred by the head office outside India. However, such expenditure is restricted to the lower of:

  - Five percent of adjusted total income (as defined) or
  - Expenditure attributable to the Indian business.

In cases where the adjusted total income for a year is a loss, the expenditure is restricted to 5 percent of the average adjusted total income (as defined).

- **Bad debts**

  Bad debts written off are tax deductible. Provision for doubtful debts is not tax deductible. Banking companies are allowed a deduction for provisions for bad and doubtful debts upto 7.5 percent of total income or 10 percent of its assets classified as doubtful assets restricted to the provision for doubtful debts made in the books. Banks incorporated in a country outside India and public financial institutions are allowed a deduction for provisions for doubtful debts up to 5 percent of income, as specifically defined for this purpose. Bad debts actually written off by banks and public financial institutions, in excess of the accumulated provision for doubtful debts, are deductible.

- **Depreciation**

  Depreciation allowance on various assets is available at specified rates on the written down value of the asset based on a block asset concept. Further, in case of manufacturing or production activities, additional depreciation is allowable at the rate of 20 percent of the cost of new plant and machinery (other than ships or aircraft) acquired and installed during the year. Assets used for less than 180 days in the year of acquisition are entitled to half of the normal depreciation allowance. Depreciation not set off against current year's income can be carried forward as unabsorbed depreciation, for set off against any future income.

- **Amortisation Expenses**

  Indian companies are allowed to claim certain preliminary expenses such as expenses in connection with preparation of feasibility report, project report, legal charges for drafting Memorandum and Articles of Association of the company etc. as specified, and incurred before commencement of his business, or after commencement of his business, in connection with the extension of his industrial undertaking or in connection with his setting up a new industrial unit.

  A deduction shall be allowed of an amount equal to $1/5^{th}$ of such expenditure for each of the five successive previous years beginning with the previous year in which the business commences or, the previous year in which the extension of industrial undertaking is completed or the new industrial unit commences production or operation.

Grouping/consolidation

No provisions currently exist for the grouping / consolidation of losses of entities within the same group.

Taxation on transfer of shares of a closely held company without any consideration

With effect from 1 June 2010, the transfer of shares of closely held company without or for inadequate consideration to a firm or to a closely held company is to be taxable in the hands of recipient of shares. The taxable income for the recipient will be the fair market value of the shares if the transfer is without consideration or difference between the fair market value and inadequate consideration exceeds the stipulated threshold of INR 50,000. The fair market value of the shares transferred is to be computed as under:

If the transferred shares and securities are quoted and	If the transferred shares and securities are not quoted and
a. The transaction is carried out through stock exchange then the FMV of such shares and securities will be transaction value as recorded in such stock exchange.	a) The shares transferred are equity shares then the FMV of such shares on the valuation date[1] shall be determined in following manner: $FMV = \frac{(A-L)}{(PE)} * (PV)$
b. The transaction is not carried out through recognised stock exchange then the FMV will be i. The lowest price of such shares and securities on any recognized stock exchange on the valuation date ii. If shares and not traded on the valuation date then the lowest price of such shares and securities on any recognised stock exchange on a date immediately preceding the valuation date when such shares and securities were traded on such stock exchange	Where A = (Book value of all the assets shown in Balance Sheet) – (Advance tax paid under the Act) – (any amount which does not represent the value of any asset like Profit and Loss Account or the profit and loss appropriation account) L = (Book value of all liabilities shown in the Balance Sheet) – (paid up equity share capital) – (provision for dividend on preference and equity shares where such dividends is not declared before the date of transfer at a general body meeting of the company) – (Reserves except those set apart towards depreciation) – (amount of Profit and Loss Account) – (tax provision in excess of the tax payable with reference to the book profits as per the Act) – (provision for unascertained liabilities) – (amount of contingent liabilities except outstanding dividend on cumulative preference shares) PE = Total amount of paid up equity share capital as shown in Balance Sheet. PV = Paid up value of such equity shares.
	b) The shares and securities transferred are other than equity shares, then the FMV of such shares shall be estimated selling price which such shares would fetch if sold in the open market on the valuation date. The taxpayer may obtain a report from a merchant banker[2] or an accountant in respect of such valuation.

1 Valuation date shall be the date on which the respective property is received by the assessee
2 Merchant Banker means category 1 merchant banker registered with Security and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992)

Withholding of taxes

Generally, incomes payable to residents or non-residents are liable to withholding tax by the payer (in most cases individuals are not obliged to withhold tax on payments made by them). The rates in case of residents would vary depending on the income and the payee involved for e.g. in case of rent the rate is 2 percent for the use of any machinery or plant or equipment, 10 percent for other kind of rental payments.

Except where preferential tax rates are provided for under DTAA, payments to foreign companies/non-residents are subject to the following withholding tax rates:

Type of income	Foreign companies*	Other non-residents**
Interest on foreign currency loan	21.115 percent	20.60 percent
Winnings from horse races	31.67 percents	30.90 percent
Royalties and technical services fee approved by the Government or in accordance with the industrial policy	10.55 percent	10.30 percent
Winnings from lotteries and crossword puzzles	31.67 percent	30.90 percent
Long term capital gains	21.115 percent	20.60 percent
Any other income	42.23 percent	30.60 percent

*Effective tax rate including surcharge of 2.5 percent and education cess of 3 percent

**Effective tax rate including education cess of 3 percent.

Carry forward of losses and unabsorbed depreciation

Subject to the fulfillment of prescribed conditions:-

- Business loss can be carried forward for eight consecutive financial years and can be set off against the profits of subsequent years. Losses from a speculation business can be set off only against gains from speculation business for a maximum of four years
- Unabsorbed depreciation may be carried forward for set-off indefinitely
- Capital losses may also be carried forward for set-off for eight subsequent financial years subject to fulfillment of certain conditions. Long-term capital losses can be set off only against long-term capital gains, whereas short- term capital losses can be set off against short-term as well as long-term capital gains. These losses cannot be set off against income under any other head
- Carry back of losses or depreciation is not permitted

Corporate reorganizations

Corporate re-organisations, such as mergers, demergers and slump sales are either tax neutral or taxed at concessional rates subject to the fulfilment of prescribed conditions.

- **Merger**

Mergers are tax neutral, subject to the fulfilment of following conditions:

  - All assets and liabilities are transferred to transferee company
  - Transferee company should issue shares to the shareholders of the transferor company as consideration for merger
  - Transferee company continues to hold at least 3/4th of the book value of assets of the transferor company for a minimum period of 5 years
  - Business of the transferor company is continued for at least 5 years
  - Transferee company shall achieve minimum production level of 50 percent of the installed capacity within 4 years of the merger and maintain the minimum level of production until the end of fifth year.

Upon fulfilment of the above conditions, the losses and the depreciation of the transferor company are available for carry forward and set off to the transferee company.

- **Demerger**

  Demergers are also tax neutral, subject to certain conditions. The conditions in relation to the method of demerger are relatively more restricted than in the case of mergers. For e.g., it is provided that the entire assets and liabilities of the relevant undertaking must be demerged, shares must be issued to the shareholders of the transferor company in the transferee company and the assets and liabilities must be transferred at book value in order for mergers to be tax neutral. Further, losses related and attributable to the undertakings transferred are also allowed to be carried forward in the hands of transferee company

- **Slump Sale**

  Slump Sale refers to the transfer of one or more undertaking/s by way of sale for a lump sum consideration without values being assigned to the individual assets and liabilities comprised in the undertaking/s. The term 'undertaking' for this purpose has been defined under the Act in an inclusive manner and means:

  - Any part of an undertaking or
  - A unit or division of an undertaking or
  - A business activity taken as a whole but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

  To qualify as a Slump Sale, it is necessary to ensure that:

  - All the assets and liabilities relating to the business activity are transferred
  - The transfer is on a going concern basis
  - The transfer is for a lump sum consideration i.e. no part of the consideration should be attributed to any particular asset or liability.

    The profits or gains arising from a Slump Sale in excess of its net worth are deemed to be income chargeable to tax as capital gain/loss arising from transfer of a long term capital asset provided the undertaking is held for at least three years. If undertaking is held for less than three years, the gain/loss shall be treated as short term capital gain/loss.

- **Tax neutrality in restructuring**

  If the transferee company is an Indian company, then, subject to the fulfilment of prescribed conditions, transactions pursuant to merger/demerger are entitled to various other tax concessions, including the following:

  - No capital gains to the shareholders in transferor company
  - No capital gains to the transferor company
  - Merger/demerger expenses shall be allowed to be amortised 1/5th every year for a period of five years
  - Pursuant to restructuring, various tax incentives hitherto available to the transferor company will ordinarily be available to the transferee company

The Limited Liability Partnerships

The Finance Act 2009 introduced the tax treatment for the Limited Liability Partnerships which are recently introduced by the Limited Liability Partnership Act, 2008 in India. The terms 'Firm', 'Partner' and 'Partnership' has amended and an LLP defined under the LLP Act has been put on par with a partnership firm under the Indian Partnership Act, 1932 (General Partnership) for the purpose of income-tax. Consequently, provisions relating to interest and remuneration to partners would apply to a LLP, while provisions applicable to companies such as MAT, DDT, etc. will not apply to an LLP.

Tax treatment on conversion of a company into a LLP:

The conversion of a private company or unlisted public company (Company) into LLP to be exempt from tax subject to the following:

- The total sales or turnover or gross receipts of the Company not to exceed INR 6 million in any of the immediate three preceding previous years;
- All the assets and liabilities of the Company before conversion become those of the LLP;
- All the Shareholders of the Company become partners of LLP with their capital contribution and profit sharing ratio remaining same as their shareholding in the company;
- Apart from the above, the shareholders of the company do not receive any other consideration or benefit, directly or indirectly;
- The aggregate profit sharing ratio of the shareholders of the company in LLP to be minimum 50 per cent in subsequent five years;
- The Partners do not draw any amount out of accumulated profit on the date of conversion in subsequent three years.

The tax neutrality specified for a private company or an unlisted public company (both referred hereafter as the company) on transfer of capital/intangible assets to LLP on conversion into LLP is available to their shareholders transferring shares in the company.

The above-referred exemption will be withdrawn if the specified conditions are not complied with.

The cost of acquisition of capital asset for the LLP will be the cost to the Company plus the cost of improvement, if any, by the LLP or the Company. Further, where the asset being rights of the LLP partner on tax neutral conversion of company into a LLP are subsequently transferred, the cost of acquisition thereof will be cost of the share(s) in the company immediately before its conversion.

The actual cost of block of assets for the LLP will be the written down value for the Company on the date of conversion. The depreciation on capital assets to be apportioned between the Company and LLP as per number of days of use.

The accumulated loss and unabsorbed depreciation of the Company to be that of the LLP as stipulated.

The profits or gains on conversion and benefit of losses claimed by LLP to be taxable for LLP if conditions stipulated are not met.

The credit in respect of MAT paid by the Company not available to the LLP.

The five year amortization for expenditure on voluntary retirement scheme eligible to the Company to be claimed by the LLP for unamortized installments.

Foreign Institutional Investors

To promote the development of Indian capital markets, qualified FIIs /sub accounts registered with the SEBI and investing in listed Indian shares and units, are subject to tax as per beneficial regime as under:

Interest	20 percent
Long-term capital gains *	NIL
Short- term capital gains *	15 percent

*Subject to payment of STT

In addition, there is a surcharge of 2.5 percent in case of companies and 10 percent in case of non-corporate where the income exceeds INR 1 million and education cess of 3 percent. The rate of tax on other short-term capital gains is 30 percent plus surcharge and education cess; and on long-term capital gains (if not exempt) is 10 percent plus surcharge and education cess.

Relief from Double Taxation

For countries that have DTAAs with India, bilateral relief is available to a resident in respect of foreign taxes paid. Generally, provisions of DTAAs prevail over the domestic tax provisions. However, the domestic tax provisions may apply to the extent that they are more beneficial to the taxpayer. The DTAAs would also prescribe rates of tax in the case of dividend income, interest, royalties and fees for technical services which should be applied if the rates prescribed in the Act are higher. Business income of a non-resident may not be taxable in India if the non-resident does not have a PE in India.

For countries with no DTAA with India, a foreign tax credit is available under Indian domestic tax law to a resident taxpayer in respect of foreign taxes paid. The amount of credit allowable should be the lower of the tax suffered in the foreign country or the Indian tax attributable to the foreign income. Currently, there is no carry forward/carry back of excess tax credits. Also, there are no detailed rules for availment of foreign tax credit but is governed by the DTAA's clauses. With effect from 1 June 2006, a statutory recognition has also been given to agreements entered into between specified Indian association and a non-resident specified association for grant of double taxation relief, for avoidance of double taxation, for exchange of information for the prevention of evasion or avoidance of income tax or for recovery of income tax. It is also clarified that a higher charge of tax on the foreign entity will not be considered as discrimination against such an entity.

The Central Government may enter into agreement with the Government of any specified territory outside India for the purpose of double tax relief and specified purposes in the same manner as with the Government of any country outside India.

Authority for Advance Ruling (AAR)

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

- The advance rulings are binding on the tax authorities as well as the applicant. Further, an appeal can be filed before the High Court against the AAR order

Dispute resolution mechanism

In order to facilitate expeditious resolution of transfer pricing disputes and disputes relating to taxation of foreign companies, an alternate dispute resolution mechanism has been provided in the form of Dispute Resolution Panel (DRP) effective from 1 October 2009 [a collegium comprising of three Commissioners of Income - tax (CIT)]. Under the proposed mechanism, the Assessing Officer (AO) is required to forward the draft of the proposed assessment order to the taxpayer, which the taxpayer may accept; or instead file an application against the same with the DRP within 30 days. The DRP upon hearing both sides shall issue necessary directions to the AO for completing the assessment, within a period of 9 months from the end of the month in which the draft order is forwarded to the taxpayer. Such directions of the DRP would be binding on the AO. Any appeal against the order passed by the AO in pursuance of the directions issued by the DRP shall be filed by the taxpayer only with the Income - tax Appellate Tribunal. It has also been clarified that the DRP is an alternate remedy for taxpayers; the traditional route of appeal through normal appellate proceedings, i.e. the Commissioner of Income Tax (Appeals) is still available.

Chart of witholding tax rates under various tax treaties (in percent)

Sr. No.	Country	Dividend	Interest	Royalty	Fees for Technical Service (FTS)	Remarks
1	Armenia	10	10 (Note 1)	10	10	
2	Australia	15	15	10/15/20 (Note 2)	10/15/20 (Note 2)	
3	Austria	10	10 (Note 1)	10	10	
4	Bangladesh	10/15	10(Note 1)	10	No separate provision	10 tax on dividends if at least 10 of capital is owned by a company; in other cases 15
5	Belarus	10/15	10 (Note 1)	15	15	10 tax on dividends if at least 25 of the capital is owned by a company; in other cases 15
6	Belgium	15	10/15	10 (Note 3)	10 (Note 3)	Interest taxable at 10 if the recipient is a bank; in other cases 15
7	Botswana	7.5/10	10 (Note 1)	10	10	7.5 tax on dividends if at least 25 of the capital is owned by a company; in other cases 10
8	Brazil	15	15 (Note 1)	15 (25 for trademark)	No separate provision	15 tax on dividends if paid to a company; otherwise as per local tax laws
9	Bulgaria	15	15 (Note 1)	15/20	20	15 tax on royalties if relating to copyright of literary, artistic or scientific works, other than cinematograph films or films or tapes used for radio or television broadcasting; in any other cases 20
10	Canada	15/25	15 (Note 1)	10/15/20 (Note 2)	10/15/20 (Note 2)	15 tax on dividends if at least 10 of capital is owned by a company; in other cases 25

Sr. No.	Country	Dividend	Interest	Royalty	Fees for Technical Service (FTS)	Remarks
11	China (People's Republic)	10	10 (Note 1)	10	10	
12	Cyprus	10/15	10 (Note1)	15	15	10 tax on dividends if at least 10 of capital is owned by a company; in other cases 15
13	Czech Republic	10	10 (Note 1)	10	10	
14	Denmark	15/25	10/15 (Note 1)	20	20	1)15 tax on dividends if at least 25 of the capital is owned by company; in other cases 25 2) Interest taxable at 10 if the recipient is a bank; in other cases 15
15	Egypt	As per domestic law	As per domestic law	As per domestic law	No separate provision	
16	Finland	15	10 (Note 1)	10/15/20 (Note 2)	10/15/20 (Note 2)	
17	France	10 (Note 3)	10 (Note 1) (Note 3)	10 (Note 3)	10 (Note 3)	
18	Germany	10	10 (Note 1)	10	10	
19	Greece	As per domestic law	As per domestic law	As per domestic law	No separate provision	
20	Hungary	10	10 (Note 1)	10	10	
21	Iceland	10	10 (Note 1)	10	10	
22	Indonesia	10/15	10 (Note 1)	15	No separate provision	10 tax on dividends if at least 25 of the capital is owned by a company; in other cases 15
23	Ireland	10	10 (Note 1)	10	10	
24	Israel	10	10 (Note 1)	10	10	
25	Italy	15/25	15 (Note 1)	20	20	15 tax on dividends if at least 10 of the capital is owned by company; in other cases 25
26	Japan	10	10 (Note 1)	10	10	
27	Jordan	10	10 (Note 1)	20	20	

Sr. No.	Country	Dividend	Interest	Royalty	Fees for Technical Service (FTS)	Remarks
28	Kazakhstan	10	10 (Note 1)	10	10	
29	Kenya	15	15 (Note 1)	20	No separate provision	17.5 tax in case of management and professional fees
30	Korea (Rep)	15/20	10/15 (Note 1)	15	15	1) 15 tax on dividends if at least 20 of the capital is owned by a company; in other cases 20 2) Interest taxable at 10 if the recipient is a bank; in other cases 15
31	Kuwait	10	10 (Note 1)	10	10	
32	Kyrgyz Republic	10	10 (Note 1)	15	No separate provision	
33	Libya	As per domestic law	As per domestic law	As per domestic law	No separate provision	
34	Luxembourg	10	10 (Note 1)	10	10	
35	Malaysia	10	10 (Note 1)	10	10	
36	Malta	10/15	10 (Note 1)	15	10	10 tax on dividends if at least 25 of the capital is owned by a company; in other cases 15
37	Mauritius	5/15	As per domestic laws	15	No separate provision	5 tax on dividends if at least 10 of the capital is owned by a company; in other cases 15
38	Mongolia	15	15 (Note 1)	15	15	
39	Montenegro	5/15	10 (Note 1)	10	10	5 tax on dividends if at least 25 of the capital is owned by a company; in other cases 15
40	Morocco	10	10 (Note 1)	10	10	
41	Myanmar	5	10 (Note 1)	10	No separate provision	
42	Namibia	10	10 (Note 1)	10	10	

Sr. No.	Country	Dividend	Interest	Royalty	Fees for Technical Service (FTS)	Remarks
43	Nepal	10/15	10/15 (Note 1)	15	No separate provision	1) 10 tax on dividends if at least 10 of the capital is owned by company; in other cases 15 2) Interest taxable at 10 if the recipient is a bank; in other cases 15
44	Netherlands	10 (Note 3)	10 (Note 1) (Note 3)	10 (Note 3)	10 (Note 3)	
45	New Zealand	15	10 (Note 1)	10	10	
46	Norway	15/25	15 (Note 1)	(Note 4)	10	15 tax on dividends if at least 25 of the capital is owned by a company; in other cases 25
47	Oman	10/12.5	10 (Note 1)	15	15	10 tax on dividends if at least 10 of the capital is owned by a company; in other cases 12.5
48	Philippines	15/20	10/15	15	No separate provision	1) 15 tax on dividends if at least 10 of the capital is owned by a company; in other cases 20 2) Interest taxable at 10 if recipient is insurance company or similar financial institutions and also in case of public issue of bonds, debentures etc; in other cases 15 3) Royalty taxable @15 if it is payable in pursuance of any collaboration agreement approved by the government of India. No rates prescribed in other cases.
49	Poland	15	15 (Note 1)	22.5	22.5	
50	Portugal	10/15	10 (Note 1)	10	10	10 tax on dividends if at least 25 of the capital is owned by a company; in other cases 15

Sr. No.	Country	Dividend	Interest	Royalty	Fees for Technical Service (FTS)	Remarks
51	Qatar	5/10	10 (Note 1)	10	10	5 tax on dividends if at least 10 of the capital is owned by company; in other cases 10
52	Romania	15/20	15 (Note 1)	22.5	22.5	15 tax on dividends if at least 25 of the capital is owned by company; in other cases 20
53	Russian federation	10	10 (Note 1)	10	10	
54	Singapore	10/15	10/15 (Note 1)	10	10	1) 10 tax on dividends if at least 25 of the capital is owned by company; in other cases 15 2) Interest taxable at 10 if recipient is bank, insurance company or similar financial institutions ; in other cases 15
55	Serbia	5/15	10 (Note 1)	10	10	5 tax on dividends if at least 25 of the capital is owned by company; in other cases 15
56	Slovenia	5/15	10 (Note 1)	10	10	5 tax on dividends if at least 10 of the capital is owned by company; in other cases 15
57	South Africa	10	10 (Note 1)	10	10	
58	Spain	15	15 (Note 1)	10	10 (Note 3)	10 tax on royalty if paid for industrial, commercial or scientific equipment; in other cases 20
59	Sri Lanka	15	10 (Note 1)	10	No separate provision	
60	Sudan	10	10 (Note 1)	10	10	
61	Sweden	10	10 (Note 1)	10	10	

Sr. No.	Country	Dividend	Interest	Royalty	Fees for Technical Service (FTS)	Remarks
62	Switzerland	10	10 (Note 1)	10	10	
63	Syria	5/10	10 (Note 1)	10	No separate provision	5 tax on dividends if at least 10 of the capital is owned by company; in other cases 10
64	Tajikistan	5/10	10 (Note 1)	10	No separate provision	5 tax on dividends if at least 25 of the capital is owned by company; in other cases 10
65	Tanzania	10/15	12.5 (Note 1)	20	No separate provision	10 tax on dividends if at least 10 of the capital is owned by company; in other cases 15
66	Thailand	15/20	10/25	15	No separate provision	1) 15 tax on dividends if at least 10 of the capital is owned by company; 20 if company paying dividend is engaged in industrial undertaking or company owns 25 of the company paying dividend 2)) Interest taxable at 10 if recipient is insurance company or similar financial institutions ; in other cases 25
67	Trinidad & Tobago	10	10 (Note 1)	10	10	
68	Turkey	15	10/15 (Note 1)	15	15	Interest taxable at 10 if recipient is bank, insurance company or similar financial institutions ; in other cases 15
69	Turkmenistan	10	10 (Note 1)	10	10	
70	Uganda	10	10 (Note 1)	10	10	
71	Ukraine	10/15	10 (Note 1)	10	10	10 tax on dividends if at least 25 of the capital is owned by company; in other cases 15

Sr. No.	Country	Dividend	Interest	Royalty	Fees for Technical Service (FTS)	Remarks
72	United Arab Emirates	10	5/12.5	10	No separate provision	Interest taxable at 5 if recipient is bank or similar financial institutions; in other cases 12.5
73	United Kingdom	15	10/15	10/15/20 (Note 2)	10/15 /20 (Note 2)	15 tax on dividends if at least 25 of the capital is owned by company; in other cases 20
74	United States of America	15/25	10/15	10/15/20 (Note 2)	10/15/20 (Note 2)	1) 15 tax on dividends if at least 10 of the capital is owned by company; in any other cases 25 2) Interest taxable at 10 if recipient is bona fide bank or similar financial institutions ; in other cases 15 3) Fees for technical services have been referred as 'Fees for included services'
75	Uzbekistan	15	15 (Note 1)	15	15	
76	Vietnam	10	10 (Note 1)	10	10	
77	Zambia	5/15	10 (Note 1)	10	No separate provision	5 tax on dividends if at least 25 of the capital is owned by company; in any other cases 15
78	Saudi Arabia	5	10 (Note 1)	10	No separate provision	

Notes:

1) Interest earned by the Government and certain institutions like the RBI or Central Bank of the other State is exempt from taxation in the country of source.

2) In case of Royalties, rate of tax is 15 (for first 5 years of the agreement- 20 in case of payer other than government or specified institution and 15 in case of government or specified institution); 10 for equipment rental and for services ancillary or subsidiary thereto.

3) 'Most favoured Nation' clause applicable.

4) Rate not mentioned hence rate as per domestic law apply

TAX INCENTIVES

Special Economic Zones

Units set up in SEZs

A unit which sets up its operations in SEZ is entitled to claim Income-tax holiday for a period of 15 years commencing from the year in which such unit begins to manufacture or produce articles or things or provide services. The benefits are available against export profits, as under:

- Deduction of 100 percent for the first five years
- Deduction of 50 percent for the next five years
- Deduction of 50 percent for the next five years (subject to conditions for creation of specified reserves).

SEZ developer

A 100 percent tax holiday (on profits and gains derived from any business of developing an SEZ) for any 10 consecutive years out of 15 years has been extended to undertakings involved in developing SEZ's notified on or after 1 April 2005 under the SEZ Act, 2005.

Offshore Banking Units (OBU) and International Financial Services

Center units (IFSC) set up in SEZs

OBUs and IFSCs located in SEZs are entitled to a tax holiday of 100 percent of income for the first five years and 50 percent for next five consecutive years.

Export oriented Units (EOU)

Undertakings set-up in Export Processing Zones (EPZ)/Free Trade Zones (FTZ) or Electronic Hardware Technology Park (EHTP) or Software Technology Park (STP) or 100 percent EOUs, are eligible for a deduction of 100 percent on the profits derived from exports for 10 consecutive years beginning from the year in which such undertaking begins manufacturing or commences its business activities. Such a deduction would be available only up to financial year 2010-11.

Food processing

A 100 percent tax holiday to undertakings from the business of processing, preservation, and packaging of fruits or vegetables or meat and meat products or poultry or marine or dairy products or from the integrated business of handling, storage, and the transportation of food grains for the first five consecutive years and thereafter, 30 percent (25 percent for non-corporate entities) for the next five consecutive years.

Business of collecting and processing biodegradable waste

A 100 percent tax holiday to undertakings from the business of collecting and processing or treating of bio-degradable waste for generating power or producing bio-fertilisers, bio pesticides or other biological agents or for producing bio-gas or making pellets or briquettes for fuel or organic manure, for the first five consecutive years.

Commercial production or refining of mineral oil

A 100 percent tax holiday for the first seven consecutive years to undertakings (excluding undertakings located in the North eastern region) engaged in refining of mineral oil or engaged in commercial production of natural gas in blocks licensed under the VIII Round of bidding for award of exploration contracts under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February 1999 or engaged in commercial production of natural gas in blocks licensed under the IV Round of bidding for award of exploration contracts for Coal Bed Methane blocks.

In-house research and development

A weighted deduction at the rate of 200 percent of the scientific research expenditure incurred (excluding expenditure on cost of land or building) on an in-house research and development facility engaged in the business of manufacture or production of any article or thing other than the prohibited articles or things listed in the Eleventh Schedule. The weighted deduction is to be available from 1 April 2010.

Capital expenditure incurred in specified industries

A deduction in respect of entire capital expenditure (excluding expenditure on cost of land or goodwill or financial instrument) is allowed to the taxpayer engaged in following business on or after 1 April 2010:

- Setting up and operating cold chain facilities for specified products
- Warehousing facilities for storage of agricultural produce
- Laying and operating cross-country natural gas or crude or petroleum oil pipeline network for distribution including storage facilities
- Building and operating a new hospital with at least 100 patient beds
- Developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government which is notified by the CBDT
- Building and operating a new hotel of two star or above category anywhere in India.

Deduction to the expenditure incurred prior to commencement of operation of the above specified business will be allowed, if the expenditure was capitalised in the books of the taxpayer on the date of commencement of operation. The deduction will be allowed to the taxpayer in the year of commencement of operation.

Industrial parks, model towns and growth centers

For developers of industrial parks

A 100 percent tax holiday is available to developers of industrial parks for any 10 consecutive assessment years out of 15 years beginning from the year in which the undertaking or the enterprise develops, develops and operates or maintains and operates an industrial park, provided the date of commencement (i.e. the date of obtaining the completion certificate or occupation certificate) of the industrial park is not later than 31 March 2011.

Tax holiday in respect of infrastructure projects

Undertakings engaged in a prescribed infrastructure projects are eligible for a consecutive 10 year tax holiday as set out below:

- A 10 year tax holiday in a block of 20 years has been extended to undertakings engaged in developing/operating and maintaining/developing, operating and maintaining any infrastructure facility such as roads, bridges, rail systems, highway projects including housing or other activities being an integral part of the project, water supply projects, water treatment systems, irrigation projects, sanitation and sewerage systems or solid waste management system
- A 10 year tax holiday in a block of 15 years has also been extended to undertakings involved in the developing/operating and maintaining/developing, operating and maintaining, ports, airports, inland waterways, inland ports or navigational channels in the sea.

Tax holiday in respect of power projects

Undertakings engaged in prescribed power projects are eligible for a consecutive 10 year tax holiday as set out below:

- A tax holiday of 10 years in a block of 15 years has also been extended to the undertakings set up before 31 March 2011 with respect to the following:
  - generation/generation and distribution of power, laying the network of new lines for transmission or distribution, undertaking a substantial renovation (more than 50 percent) and modernisation of the existing network of transmission or distribution lines.

Tax holiday in respect of hospitals/hotels/convention centres'

- A 100 percent tax holiday for the first five consecutive years to an undertaking deriving profits from the business of operating and maintaining a hospital located anywhere in India (subject to exclusions), provided the hospital is constructed and has started or starts functioning at anytime before 31 March 2013.
- A 100 percent tax holiday for the first five consecutive years to an undertaking deriving profits from the business of a hotel or from the business of a building, owning and operating a convention centre, in specified areas, if such a hotel/convention centre is constructed and has started or starts functioning before 31 July 2010.
- A 100 percent tax holiday for the first five consecutive years to an undertaking deriving profit from the business of a hotel located in the specified district having a World Heritage Site, if such a hotel is constructed and has started or starts functioning before 31 March, 2013.

TRANSFER PRICING IN INDIA

Background

- Taking into account the increased participation of Multinational groups involved in economic activities in India, Transfer Pricing regulations were introduced in 2001 to ensure that fair and equitable proportion of profits and tax arising from cross border transactions between related entities are duly received in India. India today is experiencing an evolving transfer pricing regulation with issues relating to interpretation and effective implementation mechanism that have surfaced in the course of sustained transfer pricing audits. India now ranks among the top 50 countries that have enacted comprehensive Transfer Pricing regulations to protect the erosion of its tax base. Since its introduction in April 2001, the Indian transfer pricing regulations have come of age– both in terms of quality of audits as well as the revenue generated for the Indian Government. It is estimated[1] that till date, the Directorate of Transfer Pricing has made adjustments of approximately INR 230 billion, which is a considerable achievement in a relatively small period of time - this being due to the focused efforts of the Indian Revenue Authorities on transfer pricing matters.
- The Indian transfer pricing regulations are broadly based on the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
- Issued by Organization for Economic Co - Operation and Development (OECD Guidelines), albeit with some differences. The regulations prescribe detailed mandatory documentation requirements along with disclosure of international transactions and impose steep penalties for non - compliance.

Scope and Applicability

- Section 92 of the Act provides that the price of any transaction between "associated enterprises", either or both of whom are non resident for Indian income tax purposes, shall be computed having regard to the arm's length price.
- Two enterprises are considered to be "associated" if there is direct/indirect participation in the management or control or capital of an enterprise by another enterprise or by same persons in both the enterprises. Further, the Transfer Pricing regulations prescribe certain other conditions that could trigger an "associated enterprise" relationship. Significant conditions among these include:
  - Direct/indirect shareholding giving rise to 26 percent or more of voting power
  - Substantial purchase of raw materials/sale of manufactured goods by an enterprise from/to the other enterprise at prices and conditions influenced by latter
  - Authority to appoint more than 50 percent of the board of directors or one or more of the executive directors
  - Dependency in relation to intellectual property rights (know - how, patents, trademarks, copyrights, trademarks, licenses, franchises etc) owned by either party; and
  - Dependency relating to borrowings i.e. advancing of loans amounting to not less than 51 percent of total assets or provision of guarantee amounting to not less than 10 percent of the total borrowings.

Determination of arm's length price

The Indian transfer pricing regulations require the arm's length price in relation to an international transaction to be determined any one of the following methods, being the most appropriate method.

- Comparable uncontrolled price (CUP) method
- Resale price method (RPM)
- Cost plus method (CPLM)
- Profit split method (PSM)
- Transactional Net Margin Method (TNMM).

The regulations also permit the CBDT to prescribe any other method - however, no other method has been prescribed to date. Further, there is no hierarchy of methods prescribed.

The most appropriate method shall be the method which is best suited to the facts and circumstances of each particular international transaction, and which provides the most reliable measure of an arm's length price in relation to an international transaction. In a case where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices. Further the Transfer Pricing regulations also incorporate the option of a 5 percent variation in the arithmetic mean, in determining the arm's length price. However, the recent amendment now restricts the adjustment only to those cases which fall within the +/- 5% variance range. Those cases falling outside the range shall no longer be eligible for the benefit as the option clause has now been omitted.

Compliance Requirements

The Transfer Pricing regulations have prescribed an illustrative list of information and supporting documents required to maintain by taxpayers entering into an international transaction. Currently, the mandatory documentation requirements are applicable only in cases where the aggregate value of the international transactions entered into by the taxpayer as recorded in the books of account exceed INR 10 million.

The information and documents specified, should, as far as possible, be contemporaneous and should exist latest by the specified date and should be maintained for a period of nine years from the end of the relevant financial year. The prescribed documentation include details of ownership structure, description of functions performed, risks undertaken and assets used by respective parties, discussion on the selection of most appropriate method and economic analysis resulting into determination of arm's length price, etc.

In addition to maintaining the prescribed documentation, taxpayers are also required to obtain a certificate / report (detailing the particulars of international transactions) from an accountant and file the same with the Revenue Authorities on or before the specified date (currently the due date of filing the corporate tax return) in the prescribed from and manner.

The Act has prescribed penal provisions for default in compliance with the aforesaid transfer pricing regulations, which are summarized below.

Nature of Default	Penalty prescribed
Failure to maintain prescribed information/ documents	2 percent of value of international transaction
Failure to furnish information/ documents during audit	2 percent of value of international transaction
Adjustment to taxpayer's income	100 percent to 300 percent of tax on adjustment amount
Failure to furnish accountant's report	INR 100,000

Transfer Pricing Audits

Transfer pricing matters are dealt with by specialized Transfer Pricing Officers duly guided by Directors of International Taxation, being part of the Indian tax administration. In accordance with the internal administrative guidelines issued to the Revenue Authorities, all taxpayers reporting international transactions with associated enterprises exceeding INR 150 million are subject to a mandatory transfer pricing audit. In the course of a Transfer Pricing audit, in case any adjustments are made by the Revenue authorities to the taxable income reported, taxpayers cannot avail of any tax exemption to which they may be otherwise entitled to. Further, the penalties as stated above may also be levied.

Recent Developments

Safe Harbor Rules

The CBDT has been empowered to introduce Safe Harbor provisions aimed at minimizing disputes relating to transfer pricing matters. 'Safe Harbor' has been defined to mean 'circumstances' in which the Revenue authorities shall accept the transfer prices declared by the taxpayers - i.e. such taxpayers would not be subject to transfer pricing scrutiny. The primary objective seems to be reduction of judgmental errors in determination of transfer price relating to international transactions. Safe harbor provisions are expected to offer three main benefits to taxpayers and tax administrators: i) compliance relief ii) administrative simplicity and iii) certainty.

Detailed rules to operationalize the safe harbor provisions are awaited and with the establishment of Committee constituted by CBDT, it is anticipated that the same shall be introduced soon.

Advance Pricing Agreements

Currently, the Indian transfer pricing provisions do not provide any facility for Advance Pricing Agreements (APAs), however this is proposed to be introduced in the DTC. An APA is a mechanism whereby a taxpayer enters into an agreement with the Revenue authorities on its transfer prices. If the taxpayer meets the criteria agreed in the APA, the taxpayer will not be subject to a transfer pricing adjustment and such an arrangement would remain valid for a period of five years. This would help in minimizing risk of a transfer pricing adjustment; providing certainty through a negotiation process and avoiding tax risk by preventing double taxation.

Mutual Agreement Procedure

The taxpayers can choose Mutual Agreement Procedure (MAP) to resolve bilateral transfer pricing issues with certain foreign jurisdictions depending on the provisions in the relevant DTAAs. The Revenue Authorities have issued notifications whereby subject to the satisfaction of certain conditions and depending on the relevant foreign jurisdiction, the taxpayers choosing the MAP process may not need to pay the tax demand until the closure of the MAP proceedings.

Judicial Guidance

Since the introduction of Transfer Pricing regulations in India, litigation on Transfer Pricing matters has consistently been on the increase. Five rounds of transfer pricing audits have been completed. Each year has seen a steep increase in the quantum of adjustments with the latest assessment year (AY 2006-07) resulting in an estimated INR100 billion adjustment for about estimated 800 cases[2].

The numerous judicial precedents available on Transfer Pricing matters to date provide guidance on the interpretation and application of Indian transfer pricing laws. Though some of them may have varied interpretations on contentious issues, many of them acknowledge certain fundamental Transfer Pricing principles and in a way, have supported that the following are an integral part of an objective Transfer Pricing analysis.

- Detailed FAR analysis for tested party and comparable companies is crucial - taxpayers must have robust documentation with sound FAR analysis and well developed economic analysis to justify their transfer prices.
- International transactions should not be aggregated unless they are inextricably linked.
- Greater need to build adequate "cost-benefit" documentation to substantiate management and technical fee payouts
- Least complex entity to be selected as the tested party.
- Adjustments may be made to improve comparability between the results of taxpayer and the comparables
- Transfer Pricing provisions being specific in nature; override other general provisions as contained in the Act.
- The business case and the economic environment of the taxpayer must be taken into account while testing the arm's length criterion.

Transfer Pricing and Customs Valuation

There is a lack of consistency between customs valuation procedure and transfer pricing regulations under tax laws. Both departments work at divergent purposes in relation to the same transactions. Suitable methods for valuation of imported goods should be established which are acceptable to both customs law and the Indian transfer pricing regulations. Towards this end, the Indian Revenue Authorities set up a Joint Working Group, comprising of transfer pricing and customs officers. This initiative was undertaken by the Revenue Authorities in order to bring greater harmonization, coordination and communication between the two departments as regards valuation of imported goods.

2 VThe Economic Times in an article "800 Cos. slapped with Rs. 10k cr. Transfer pricing demand" dated 11th December 2009.

While the transfer pricing compliance requirement and audits are stringent, there is good hope for the taxpayers that the objectivity witnessed through recent developments and in particular on the dispute resolution mechanism, is expected to overhaul for better the Indian transfer pricing administration.

DIRECT TAXES CODE, 2010

The Direct Taxes Code,2010 ('the Bill'), has been laid before the Parliament for discussion. The Bill would now need to be approved by both the Houses of the Parliament of India and the President of India before it becomes law. Some of the salient features of the Bill have been discussed below.

Preface

The DTC aims to replace the Act and the Wealth-tax Act, 1957. Several proposals of the DTC are path-breaking and aim to bring changes to the ways we have traditionally understood tax issues in India.

General provisions

- The DTC 2010 would come into force on 1 April 2012, if enacted.
- The concept of previous year has been replaced with a new concept of financial year which inter alia means a period of 12 months commencing from the 1st day of April
- Income has been proposed to be classified into two broad groups: Income from Ordinary Sources and income from Special Sources
- Income from Ordinary Sources refers to:
  - Income from employment
  - Income from house property
  - Income from business
  - Capital Gains
  - Income from Residuary Sources
- Income from Special Sources to include specified income of non-residents, winning from lotteries, horse races, etc. However, if such income is attributable to the PE of the non-resident it would not be considered as Special Source income. Accordingly, such income would be liable to tax on net income basis

Corporate Tax

Tax rates for domestic companies

Category	Existing rate*	As per draft DTC**
Income-tax	30 percent	30 percent
MAT	Levied at 18 percent of the adjusted book profits in case of companies where income-tax payable on taxable income according to the normal provisions of the Act is lower than the tax @ 18 percent on book profits	Levied at 20 percent of the adjusted book profits in case of companies where income tax payable on taxable income according to normal provisions of the DTC is lower than the tax @ 20 percent on book profits
DDT	15 percent	15 percent
Income distributed by mutual fund to unit holders of equity-oriented funds	Not applicable	5 percent of income distributed
Income distributed by life insurance companies to policy holders of equity-oriented life insurance schemes	Not applicable	5 percent of income distributed

Notes:

* Exclusive of surcharge and education cess

** There is no surcharge and education cess under DTC

- MAT credit is allowed to be carried forward for 15 years
- In the case of a Company, its liability to pay income-tax is to be the higher of the two:
  - The amount of income-tax liability computed at normal rates of tax on its Total Income
  - The amount of income-tax liability calculated at the specified rates on 'Book profits'.

Provision pertaining to non-residents

Category	Existing rate	As per DTC
Foreign company	40 percent	• 30 percent • Additional branch profits tax of 15 percent (on post tax income)

- A foreign company is considered to be a resident in India if its 'place of effective management' is situated in India.

  Place of effective management of the company means –

  - the place where the board of directors of the company or its executive directors, as the case may be, make their decisions; or
  - In a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions.

  Any other person is considered to be a resident in India if its place of control and management at any time in the year is situated wholly or partly in India 1 April 2000.

  The provisions of the DTC or the relevant tax treaty, whichever are more beneficial shall apply except where provisions relating to (a) General Anti-Avoidance Rules (GAAR), (b) levy of Branch Profits Tax, or (c) Controlled Foreign Companies (CFC) shall apply in preference to the beneficial provisions of the relevant tax treaty.

- Income shall be deemed to accrue in India, if it accrues, whether directly or indirectly, through or from the transfer, of a capital asset situated in India
- Income from transfer of share or interest in a foreign company by a non resident outside India will not be deemed to accrue in India if the fair market value of the assets in India owned (directly or indirectly) by that company is greater than or equal to 50 percent of the fair market value of the total assets owned by that company

  Further, it is provided that proportionate gains would be taxable in India where any income is deemed to accrue to a non-resident by way of transfer of share or interest in a foreign company

- PE defined in the same way as in treaties and includes the concept of one day Service PE, (substantial) equipment PE and insurance agent PE
- In relation to availability of Foreign Tax Credit, it has been clarified that:
  - Foreign Tax Credit to be available to a person resident in India; and
  - Foreign Tax Credit to be restricted to the amount of Indian income tax payable on (a) income taxed outside India and (b) total income of the assessee.

The Central Government may prescribe methods for computing the foreign tax credit, the manner of claiming credit and such other particulars as are necessary for providing the relief or avoidance of double taxation

- Income of FIIs from transfer of any security will be taxable as capital gains
- For non-residents, head office expenditure shall be restricted to one-half percent of the total sales, turnover or gross receipts

Controlled foreign companies

- The total income of a Resident taxpayer to include income attributable to a CFC which means a foreign company:
  - that is a resident of a territory with lower rate of taxation (i.e. where taxes paid are less than 50 percent of taxes payable on such profits as computed under the DTC)
  - whose shares are not listed on any stock exchange recognised by such Territory
  - individually or collectively controlled by persons resident in India (through capital, voting power, income, assets, dominant influence, decisive influence, etc.)
  - that is not engaged in active trade or business (i.e. it is not engaged in commercial, industrial, financial undertakings through employees/personnel or less than 50 percent or more of its income is of the nature of dividend, interest, income from house property, capital gains, royalty, sale of goods/services to related parties, income from management, holding or investment in securities/shareholdings, any other income under the head income from residuary sources, etc.)
  - has specified income exceeding INR 2.5 million
- The income attributable will be computed based on the net profit as per the profit and loss account of CFC for the accounting period
- The accounting period will be the period ending on 31 March or the period it regularly follows for complying with the tax laws of the Territory for reporting to its shareholders
- The resident taxpayer will have to furnish details of investments and interest in entities outside India in the prescribed form and manner
- The amount received from a CFC as dividend in a subsequent year will be reduced from the total income to the extent it has been taxed as CFC income in any preceding previous year
- CFC provisions applicable to taxpayers notwithstanding the provisions of the DTAA that may be more beneficial

General anti-avoidance rules

- The DTC contains GAAR provisions which provide sweeping powers to the tax authorities. The same are applicable to domestic as well as international arrangements
- GAAR provisions empower the CIT to declare any arrangement as "impermissible avoidance arrangement" provided the same has been entered into with the objective of obtaining tax benefit and satisfies any one of the following conditions:
  - It is not at arm's length
  - It represents misuse or abuse of the provisions of the DTC
  - It lacks commercial substance
  - It is carried out in a manner not normally employed for bona fide business purposes
- An arrangement would be presumed to be for obtaining tax benefit unless the tax payer demonstrates that obtaining tax benefit was not the main objective of the arrangement
- IT to determine the tax consequences on invoking GAAR by reallocating the income etc or is regarding/recharacterising the whole or part of the arrangement
- GAAR provisions to be applicable as per the guidelines to be framed by the Central Government
- GAAR to override Tax Treaty provisions.

Capital gains

- Definition of capital assets have been modified and replaced with the term investment asset. Investment asset does not include business assets like self generated assets, right to manufacture and other capital asset connected with the business. Further, Investment Asset is defined to include any securities held by FII and any undertaking or division of a business.

Personal taxation

- New beneficial tax slabs are proposed to be introduced which will reduce the tax burden for individuals. Peak rate of 30 percent applicable on income exceeding INR 1 million.
- The category of 'Not Ordinarily Resident' abolished and only two categories of taxpayers proposed viz. residents and non-residents. The additional condition of stay in India of 729 days during the 7 preceding financial years is retained only to ascertain taxability of overseas income earned during a financial year.
- A citizen of India or person of Indian origin living outside India and visiting India will trigger residency by staying in India for more than 59 days in a financial year proposed earlier.

Wealth tax

- Every person, other than a NPO, would be liable to pay wealth-tax at the rate of 1 percent on net wealth exceeding INR 10 million
- The specified assets for computing 'net wealth' have been retained in line with existing taxable assets, with additional items as under:
  - Archaeological collections, drawings, paintings, sculptures or any other work of art
  - Watches with a value in excess of INR 50,000
  - Bank deposits outside India, in case of individuals and HUFs, and in the case of other persons, any such deposit not recorded in the books of account
  - Any interest in a foreign trust or any other body located outside India (whether incorporated or not) other than a foreign company
  - Any equity or preference shares held by a resident in a CFC
  - Cash in hand in excess of INR 200,000 in the case of an individual and HUF.

INDIRECT TAXES

India has a combination of a federal as well as a decentralized system of levying taxes. The Central Government of India, the Governments of each individual state and the local authorities are empowered to impose various indirect taxes. The key indirect taxes include:

A. The Central taxes, which are levied by the Central Government, such as:
- Customs Duty
- CENVAT (or excise duty)
- Service Tax
- Central Sales Tax[1]
- Research and Development Cess.

B. The State taxes, which are levied by the respective State Governments, such as:
- Value Added Tax (VAT)
- Entry Tax
- Octroi[2]
- Other Local Taxes.

C. The Government of India is planning to introduce a single uniform Goods and Services Tax (GST) in the financial year 2011-12 which would subsume many of the above taxes.

1. Customs duty

Customs duty is applicable on import of goods into India. It is payable by the importer of goods into India.

Customs duty comprises of the following elements:
- Basic Customs Duty (BCD);
- Additional customs duty (ACD) (this is in lieu of CENVAT, i.e. excise duty, levied on goods manufactured in India);
- Education Cess(E-cess);
- Secondary and Higher Education cess (SHEC); and
- Special Additional duty (SAD)

The applicable customs duty rate on the import of any goods into India is based on the universally accepted Harmonized System of Nomenclature (HSN) code assigned to the said goods. In India, the Customs Tariff Act, 1975 outlines the HSN codes assigned to various goods determining the duty rate on the import of such goods.

The generic BCD rate is 10 percent at present and the effective customs duty rate (i.e. the aggregate of the abovementioned components, i.e. BCD, ACD, SAD and cesses) with BCD at 10 percent is 26.85 percent (with ACD at 10 percent, SAD at 4 percent and cesses at 3 percent).

The ACD paid as part of customs duty would be available as credit (set-off) to the manufacturers / service providers using the imported goods as inputs in their manufacturing / service provision activity. The SAD paid as part of customs duty would be available as credit to the manufacturer, whereas for a trader, the same would be available as refund (subject to the prescribed procedure). This refund of SAD is available to a trader subject to VAT being paid on the subsequent sale of the imported goods. Further, an exemption from SAD has been provided to importers trading in pre-packaged and other specified goods.

2. Foreign Trade Policy (FTP)

The FTP provides a broad policy framework for the import and export of goods and services outlined by the Ministry of Commerce. The objective of the FTP is to promote the exports and to regulate the imports of the country.

The FTP outlines export promotion schemes for enterprises in designated areas such as Software Technology Parks, Export Oriented Units and Units in SEZs. Such enterprises are inter alia granted exemptions from customs duty and CENVAT on the procurement.

1 CST levy is governed by the law legislated by the Central government but administered and collected by the State VAT authorities.
2 Octroi is levied and collected by Municipal Authorities and is presently imposed only in the state of Maharashtra.

- **Export Promotion Capital Goods (EPCG)**

Under the EPCG Scheme, capital goods (including second hand capital goods) can be imported at a concessional customs duty rate of 0 percent and 3 percent (depending on the goods imported). This concession is available subject to fulfilment of the export obligation of 8 times the duty saved (owing to the concessional duty rate) over a period of 8 years.

- **Served From India Scheme (SFIS)**

Under the SFIS, service providers exporting their services are allowed to import goods without payment of duty upto 10 percent of the realisations from such service exports in the current/previous financial year. Services exported means services rendered to any other country or to a consumer of any other country or through presence in any other country. The consideration received for such export services can be received in foreign exchange or in Indian rupees which are otherwise considered by the RBI to be paid in foreign exchange.

- **Duty Free Import Authorization ('DFIA')**

Under the DFIA Scheme, the raw materials for manufacture of goods meant for export are allowed to be imported without payment of duty. This exemption from duty is available subject to prescribed Standard Input Output Norms depending on the quantity and value of imported and exported goods. Further, there is an additional requirement of achieving a minimum value addition of 20 percent.

3. Research and development Cess (R&D Cess)

R&D Cess is leviable at the rate of 5 percent on import of technology under a foreign collaboration. The term 'foreign collaboration' has been defined to include Joint ventures, partnerships, etc.
Import of any designs/ specifications from outside India or deputation of foreign technical personnel, under a foreign collaboration, would also be liable to R&D Cess.

R&D Cess paid is available as deduction with respect to service tax payable for Consulting Engineer's services and Intellectual Property Right related services.

4. CENVAT

CENVAT, also known as Excise duty, applies on goods manufactured in India. It is payable by the person undertaking manufacturing activity and the point of payment is when manufactured goods are removed out of the factory of manufacture. Further, certain prescribed processes undertaken would also qualify as manufacture, commonly known as 'deemed manufacture' and would be chargeable to CENVAT. It can be recovered from the buyer of the goods.

The applicable CENVAT rate on the manufacture of any goods into India is based on the universally accepted HSN code assigned to the said goods. In India, the Central Excise Tariff Act, 1985 outlines the HSN codes assigned to various goods determining the rate on the manufacture of such goods.

The generic CENVAT rate is 10.30 (including 2 percent E-Cess and 1 percent SHEC).

The CENVAT paid on inputs used in the manufacture of final goods, is available for setoff against the tax liability on such finished goods manufactured, subject to satisfaction of prescribed conditions under the CENVAT Credit Rules, 2004.

Certain duty incentives are presently available to manufacturers having units in notified areas (such as J&K & North Eastern states etc). Such incentives are in the nature of complete exemption from duty (in which case no CENVAT would be charged by the manufacturer) or in the nature of remission of CENVAT charged (in which case CENVAT would be charged, collected and deposited by the manufacturer and subsequently refunded by the Government).

5. Service tax

Service tax was introduced in India in 1994. The levy of service tax is governed by the Finance Act, 1994 ('the Finance Act') and is applicable to the whole of India, except the state of Jammu and Kashmir. Currently, it seeks to levy tax on 115 categories of services specifically defined under the Finance Act.

Service tax is generally imposed at the rate of 10 percent (plus 2 percent education cess and 1 percent SHEC on service tax) (i.e. 10.30 percent) on the gross taxable value of specified services.

Service tax is generally paid by the service provider. However, in certain cases like goods transport agency, sponsorship services or services received from outside India, the service recipient would be liable to discharge the service tax liability on the services received by him on a reverse charge basis.

Further the Export of Service Rules, 2005 have provided an option to service providers for exporting services without levy of service tax, subject to satisfaction of prescribed rules and conditions. Thus, the concept of 'export' is based on zero-rating principles adopted by several countries around the world.

The service tax paid on the services received can be used as set-off while payment of service tax on provision of services or CENVAT on removal of goods manufactured.

6. Central Sales Tax (CST)

This is a form of transaction tax applicable on sale transactions involving movement of goods from one state to another. Presently it is levied and collected by the seller's state (though levied under and governed by the Central Government's legislation) and is payable by the seller. The seller can recover it from the buyer.

Under the CST legislation, the buyer can issue declaration in Form C, subject to fulfilment of conditions, to be able to claim concessional CST rate of 2 percent (at present). Form C can be issued by the purchasing dealer provided he is registered with the VAT authorities of the relevant state and has procured the goods for any of the following purposes:

- Resale;
- Use in manufacture or processing of goods for sale;
- Use in telecommunication network;
- Use in mining;
- Use in generation or distribution of electricity or any other form of power

In the absence of issuance of Form C by the purchaser, the applicable tax rate would be the VAT rate applicable to the goods in the selling state.

CST paid to vendors while procuring inputs is not available as set-off for payment of VAT or CST liability at the time of sale of finished goods and hence increases the cost of procurement.

Interstate stock transfers

Goods can be transferred by a branch of a company in one state to another branch of the company in another state without payment of CST by collecting declaration in Form F from the recipient branch. In case of failure to issue Form F by the recipient branch, the VAT rate applicable in the dispatching state would be payable.

7. VAT

This is a form of transaction tax applicable on sale transaction involving movement of goods within the same state, i.e. buyer and seller located within the same state. The levy of VAT is state specific. Each state has prescribed the schedule of rates applicable to goods sold within the state. The generic VAT rates in the states are as follows:

Goods	Rate (in percent)
Essential commodities – fruits, vegetables, staples, etc	0
Precious goods – jewellery, bullion, etc	1
Capital goods and Industrial Inputs	4-5
Residuary category – consumer durables	12.50- 15
Liquor, tobacco, fuel, etc	Specific Rates

It is pertinent to note that the VAT is paid to vendors for procurement of goods cans leases and mortgages, transfers of property, insurance policies, hire purchase agreements, motor vehicle registrations and transfers, etc. The rates of stamp duty vary from state to state.

8. Entry tax

Entry tax is levied on the entry of specified goods into a state for use, consumption or sale therein.

The entry tax rates vary from state to state depending on the type of goods. It may be noted that, in certain states, the set-off of entry tax paid is available against the VAT payable on the sale of goods in the state, subject to state prescribed laws.

9. Octroi

Octroi is levied on the entry of specified goods into a specified municipal limit / local areas (for eg, Mumbai) for use, consumption or sale therein. Presently, octroi is levied only in certain areas of the state of Maharashtra.

The octroi rates vary from municipal limit to municipal limit depending on the type of goods. It may be noted that the set-off of octroi paid is not available against the VAT payable and hence is a cost to the business.

10. Other Local Taxes

Besides the abovementioned taxes, there are certain local taxes applicable within specific areas of certain identified cities, towns, villages, etc, for eg: Agricultural Produce Market Cess (APMC) and Mandi Tax.

Such taxes are generally levied on the removal of goods from the specified locations. No set-off of the taxes paid is available and hence such taxes would form part of the cost of procurement.

Further, another tax known as stamp duty is applicable on documents. The State Governments impose the stamp duty on a range of instruments such as leases and mortgages, transfers of property, insurance policies, hire purchase agreements, motor vehicle registrations and transfers, etc. The rates of stamp duty vary from state to state.


Change
-0.430
-0.990

GOODS AND SERVICES TAX

The Indian indirect tax system as mentioned above is complicated and multi-layered with levies both at the Central and State levels. There has been a constant evolution of the indirect tax laws over a period of time such as allowing cross credits between goods and services and introduction of VAT in all states. Despite such efforts, the existing structure and mechanism for indirect taxes in India is fraught with various inefficiencies such as multiplicity of taxes at the Central and State levels, cascading effect of taxes, non availability of VAT credit against CENVAT liability, non availability of CST credit, multiplicity of tax rates, etc.

With an attempt to integrate the multiple indirect taxes on goods and services into a single levy, the Finance Minister in the Central Budget for the year 2006-07 announced the proposed implementation of the GST for the first time from 1 April 2010. More recently, the Honorable Finance Minister had announced in the Union Budget 2010-11 that a GST would be introduced with effect from 1 April, 2011.

A model of dual GST is proposed to be introduced comprising of the Central GST (CGST) levied by the Centre and the State GST (SGST) to be levied by the States. The dual GST would replace a number of existing central and state level taxes such as excise duty, service tax, additional duty of customs, State level VAT, Entertainment tax ,Central Sales Tax, etc.

The said GST would operate as a VAT whereby credit of all taxes paid on the procurements would be available for discharging the GST liabilities on supplies. The GST will not make a distinction between goods and services and there would be free flow of credits between goods and services. This will have the effect of removing the distortions in the existing tax regime, wherein cross credits between goods and services is not available.

An Empowered Committee of State Finance Ministers has been formed to lay out the plan for the implementation of GST. The Empowered Committee had published a Discussion Paper outlining the proposed features of the dual GST in November 2009 for views of the industry and trade. In furtherance to the Discussion Paper, the Honorable Finance Minister made a speech to the Empowered Committee outlining the broad contours of the proposed GST. Some of the features of the proposed GST as outlined by the discussion paper and the Honorable Finance Minister's speech to the Empowered Committee on 21 July 2010 are as follows:

- GST is a broad based and a single unified consumption tax on supply of goods and services
- GST would be levied on the value addition at each stage of supply chain
- GST proposes to subsume the following taxes:
  - Central taxes – CENVAT, CVD, SAD, Service Tax, Surcharges, and Cesses
  - State taxes – VAT, Entertainment tax; Luxury tax; Taxes on lottery, betting and gambling; State Cesses and Surcharges, Entry Tax. No decision has been taken yet on whether purchase tax would be subsumed in GST
- Petroleum products and alcoholic beverages have been proposed to be kept out of GST.
- It has been proposed that there should be a two-tier rate structure for goods and different rates for goods and services, which would converge into a single rate for goods and services after two years of GST implementation as tabulated below:

Year	Goods		Services
	Lower Rate	Standard Rate	
Year 1	6%	10%	8%
Year 2	6%	9%	8%
Year 3	8%	8%	8%

- The CGST and SGST rates are propsed to be kept same as mentioned above.
- CGST and SGST would be applicable to all transactions of goods and services except:
  - Small list of exempted goods and services
  - Goods which are outside the purview of GST (petroleum products and alcoholic beverages)
  - Transactions which are below the prescribed threshold limits. Presently a threshold limit of INR 10 million has been prescribed under CGST and INR 1 million for SGST (no threshold limit prescribed for services)
- Integrated GST (IGST) which is combination of CGST and SGST would be applicable on all inter-state transactions of goods and services and would be levied by Central Government. Interstate stock transfers would be treated at par with interstate sales for the levy of GST
- Exports would be zero rated, whereas GST would be levied on imports
- Full input credit of the taxes paid in the supply chain would be available. However, there would be no cross credit available between CGST and SGST.

LABOUR LAWS

The entire gamut of employer- employee relationships is governed by a number of labour laws, which would vary from State to State. The legislation is broad based and ranges from the size of signage to working hours for women to grievance procedures. However, a large chunk of the labour legislation applies only if the foreign investor were to carry out manufacturing activities in India.

Specifically, the statutes requiring payment of gratuity, bonus, provident fund contributions etc., need to be complied with on an ongoing basis as noncompliance would entail penal consequences.

Some of the central labour legislations which may be of relevance to a foreign investor are mentioned below. Apart from these, a particular State may have its own laws / rules with which an establishment would need to comply.

Payment of Bonus Act, 1965

Payment of Bonus Act, 1965 applies to every factory and establishment all over India. Bonus is granted under the Act based on profit or on productivity. It will be applicable if the number of employees is greater than or equal to 20 on any day during an accounting year. It would only be applicable to an employee (other than an apprentice) whose total salary does not exceed INR 10,000/- per month. The minimum bonus payable is generally 8.33 percent of salary or wages earned by the employee in an accounting year.

Employees provident fund and Miscellaneous Provisions Act, 1952

Social security regime in India is primarily governed by Employees' Provident Fund and Miscellaneous Provisions Act 1952, (the Act) and comprises of following schemes:

- Employees Pension Scheme, 1995 (EPS)
- Employees Provident Fund Scheme,1952 (EPFS)
- Employee Deposit linked Insurance Scheme (EDLIS)

The above schemes provide for the social security of employees working in an establishment employing 20 or more people .The employer is required to contribute towards these schemes for the employees earning wages below INR 6,500 per month. However, employees earning wages more than INR 6,500 can voluntarily choose to participate in these schemes.

Recently, the government of India, issued a notification introducing a new concept of international workers (IWs) which includes expatriates (foreign citizens) working for an employer in India and the Indian employees working overseas. The IW(s) are required to join the schemes from 1 November 2008 and the employers are required to contribute towards these schemes irrespective of the salary threshold of INR 6,500 per month. A relief has been provided in case of excluded employee which primarily refers to IW coming from a country with which India has a social security agreement.

Currently, India has signed social security agreements with Belgium, Germany, France, Switzerland, Luxembourg, Netherlands, Hungary and Denmark. SSAs with Belgium and Germany have become effective from 1 September 2009 and 1 October 2009 respectively.

Benefits covered under Social Security Agreements (SSAs)

- Employees on an assignment up to specified period are exempt from making social security contributions in the host country provided they enjoy the status of detached workers, i.e. they continue to make social security contribution in their home countries and have obtained certificate of coverage (CoC) from the appropriate authority in their home country which serves as a proof of exemption from the social security contributions in the host country.
- Employees on assignment for more than a specified period and making social security contributions under the host country laws will be entitled to the export the benefits under the SSA at the time of relocation to the home country on completion of their assignment or on retirement.
- Employees are entitled to the benefit of totalisation of benefits, i.e. the period of service rendered in the host country shall be considered for eligibility of social security benefits.

Payment of Gratuity Act, 1972

The Payment of Gratuity Act, 1972 provides for gratuity inter alia to employees in factories, plantations, shops, establishments, and mines in the event of superannuation, retirement, resignation, death or total disablement due to accident or disease. The employee will get 15 days of wages based on the rate of wages last drawn for every completed year of service in excess of 6 months.

Gratuity is payable in any one of the following circumstances:

- on the employee's retirement; or
- on his becoming incapacitated prior to such retirement; or
- on termination of his employment; or
- on the employee's death (gratuity is received by the successors of the employee).

However except in the case of death or disablement, gratuity is payable only if the employee has rendered 5 years of continuous service.

Recently, the both houses of Parliament (Lok sabha and Rajya Sabha on May 3, 2010 and May 5, 2010 respectively) has approved the proposed 'Payment of Gratuity (Amendment) Bill, 2010' under the said Act in respect of enhancing the existing monetary limit upto which gratuity can be paid to an employee from INR 0.35 million to INR 1 million. Consequently, the limit upto which gratuity would be exempt under the Act, stands increased upto INR 1 million

The proposed Bill will be enacted once it becomes an Act when the Presidential assent is received for the same.

The Employees State Insurance Act, 1948

The Employees State Insurance Act, 1948 provides certain benefits to employees (of factories and specified establishments) in case of sickness, maternity, disabilities and employment injury resulting in loss of wages or earning capacity. It will be applicable if the employees are more than or equal to 10 on any day in the preceding 12 months . As per the recent amendment in the Employees State Insurance (Central) Rules, 1950, the existing wage ceiling in respect of coverage of employees under the said Act has been enhanced from INR. 10,000 per month to INR. 15,000 per month. The amendment shall come into force with effect from May 1, 2010.

The sickness cash benefit includes a cash allowance that equals half of the sick person's average daily wages during the previous six months.

In case of an employment injury, disablement and dependents' benefit may be granted. When the disablement is full, the person will receive a monthly pension as applicable. Medical care and treatment to insured workmen are provided by Provincial Governments at appropriate hospitals, dispensaries and other medical institutions. All the medical care costs may be shared by the Corporation Provincial Government.

Contract Labour (Regulation and Abolition) Act, 1970

The Act is applicable if the number of contract employees in an establishment (principal employer) is 20 or more on any day of the preceding 12 months.

Contract labour refers to a workman who is hired for the work of an establishment through a contactor. For e.g. the security services, housekeeping services being provided by an Agency (contractor) to the principal employer. It is the primary responsibility of the contractor to provide wages and other benefits to the contract labour. However where the contractor fails to discharge his liability, the onus shifts on the principal employer. In order to ensure that the contractor is complying with its various obligations, generally a compliance certificate specifying the compliance with respect to the various laws is submitted by the contractor to the principal employer at timely intervals (say once in a quarter).

Shops & Establishment Act

This law broadly regulates the employment of workers in shops and commercial establishments and is applicable depending on the specific rules of each State in India. This law sees to inter alia regulate the opening and closing hours of shops and establishments, and provision of weekly holiday with wages. Generally, every State requires registration with the Shops and Establishment authorities for obtaining a certificate which is required to be displayed in the establishment at all times.

Minimum Wages Act, 1948

The object of this Act is to ensure fixing of minimum rates of wages in certain employments as specified. The employer shall pay to every employee in a specified employment the minimum rates of wages fixed under the Act. The minimum wages are fixed state wise and employment wise. It also provides for regulation of working hours, overtime, weekly holidays and overtime wages.

Industrial Disputes Act, 1947

This Act applies to every industrial establishment and seeks to provide for the investigation and settlement of industrial disputes arising on account of employment, or non-employment or the terms of employment or with the conditions of labour of a workman. This Act inter alia does not apply to persons engaged mainly in managerial or administrative capacities and persons engaged in supervisory capacities drawing wages exceeding INR 1,600 per month (i.e. approx USD 32.89 per month).

Workman's Compensation Act, 1923

This Act provides for the payment of compensation by the employer to his employees (for their dependents in the event of fatal accidents) if personal injury is caused to them by accidents arising out of and in the course of their employment.

Maternity Benefit Act, 1961

The objective of this Act is to regulate the employment of women in certain establishments for certain periods before and after childbirth and to provide for maternity and other benefits. The Act applies inter alia to every factory, mine and shop and establishment in which such persons are employed on any day of the preceding 12 months. A woman shall be entitled to maternity benefits (subject to eligibility) at the rate of the average daily wage for the period of her actual absence and any period on and immediately following the date of delivery. In addition, every woman shall also be entitled to receive a medical bonus of INR 1,000 (i.e. approx USD 20.55), subject to conditions.

Profession tax

Profession tax is a State level tax imposed in India on professions, trades, callings and employments. The tax is state specific and would vary from state to state with respect to applicability and quantum of levy.

USD 1= INR. 48.66

NEW VISA REGULATIONS

New Visa Regulations:

Business and employment visa

The Ministry of Commerce and Industry (MCI) had issued a letter dated 20 August 2009 requiring all foreign nationals in India holding Business Visa (BV) and working on project/ contract based assignments in India to return to their home countries on expiry of their BV or by 30 September 2009, whichever is earlier. This deadline was subsequently extended to 31 October 2009 by the Ministry of Home Affairs (MHA).

The Government of India has also decided that all foreign nationals coming for execution of projects/contracts in India will have to come only on Employment Visa (EV). Such visa will be granted only to skilled and qualified professional appointed at senior level and will not be granted for jobs for which a large number of qualified Indians are available.

The MHA has issued Frequently Asked Questions 1 (FAQs) on work related visas issued by India, clarifying the purpose, duration and various scenarios under which BV/Employment Visa (EV) may be granted to foreign nationals. Key clarifications as per the FAQs issued by MHA

Employment Visa

In case of IT software/IT enabled service sector

- The number of EV that may be granted to the skilled/highly skilled foreign nationals will not be subject to any limit.

- The salary of the foreign national should be in excess of USD 25,000 per annum.

In case of other sectors

The number of EV that may be granted to the highly skilled and professional foreign nationals shall be subject to the limits prescribed by the Ministry of Labour and Employment (MLE) as follows:

- 1 percent of the total workers, subject to a maximum of 20.
- If 1 percent of the total workers are less than 5, then up to 5.
- Specific approval of the MLE would be required in case the number of EV desired exceed the above limits.

EV shall not be granted for jobs which are routine/ ordinary/ secretarial in nature or for which large number of qualified Indians are available.

The FAQs provide the following illustrative scenarios under which EV shall be granted to foreign nationals:

- For execution of a project/ contract (irrespective of the duration of the visit).
- Visiting customer location to repair any plant or machinery as part of warranty or annual maintenance contract.
- Foreign engineers/ technicians coming for installation and commissioning of equipments/ machines/ tools in terms of contract for supply of such equipment etc.
- Foreign experts imparting training to the personnel of the Indian company.
- For providing technical support/ services, transfer of know-how etc. for which the Indian company pays fees/ royalty to the foreign company deputing the foreign national.
- Foreign nationals coming to India as consultants on contract for whom the Indian company pays a fixed remuneration (whether monthly or otherwise).
- Foreign artists engaged to conduct regular performances for the duration of employment contract given by Hotels, clubs etc.
- For taking up employment as coaches.
- Foreign sportsmen who are given contract for a specified period by the Indian club/ organization.
- Self-employed foreign nationals coming to India for providing engineering, medical, accounting, legal or such other highly skilled services in their capacity as independent consultants.

Business Visa:

The FAQs provide the following illustrative scenarios under which BV shall be granted to foreign nationals:

- To establish industrial/ business venture or to explore possibilities to set up industrial/ business venture in India.
- To purchase/ sell industrial/ commercial products or consumer durables.
- For attending technical meetings, board meetings, general meetings for providing business services support.
- Foreign nationals who are partners in the business or functioning as Directors in the company.
- For consultations regarding exhibitions, participation in exhibitions, trade fairs etc. and for recruitment of manpower.
- Foreign buyers who come to transact business with suppliers/ potential suppliers, to evaluate/ monitor quality, give specifications, place orders etc. relating to goods/ services procured from India.
- Foreign experts/ specialists on a visit of a short duration in connection with an ongoing project for monitoring the progress of the work, conducting meetings with Indian customer and/ or to provide high level technical guidance.
- For pre-sales or post-sales activity not amounting to actual execution of any contract/ project.
- Foreign trainees of multinational companies coming for in-house training in regional hubs of the concerned company located in India.
- Foreign students sponsored by AIESEC for internship on project based work in India.
- Business visa with multiple entry facility can be granted up to a maximum period of 5 years and in case of US nationals up to 10 years.
- MHA, State Governments, Union Territories, Foreigners Registration Office, etc. can grant extension of business visa on year to year basis up to a total period of 5 years from the date of issue of the initial visa. However, the first extension of business visa will only be granted by MHA.

BV cannot be converted into EV in India

The business visa will not be ordinarily converted into any other visa except in certain specified situations, subject to the approval of MHA.

Foreign company not having presence in India cannot sponsor EV

Where a foreign entity does not have any project office/ subsidiary/ joint venture/ branch office in India, it cannot sponsor a foreign national for EV.

EV not necessarily to result in legal employment

An Indian company/ organization which has awarded a contract for execution of a project to a foreign company can sponsor employee of a foreign company for EV. Further, such Indian organization/ entity would not necessarily be considered the legal employer of that person.

The Ministry of Labour and Employment has issued revised guidelines for grant of EV to foreign nationals (as per the office memorandum dated 22 December, 2009 posted on the website of the Ministry of Labour and Employment). The key features of the revised guidelines are set out below:

1. The Indian missions abroad may at their level grant the EV up to 1 percent of the total workers working on the project with a minimum of 5 and maximum of 20. For Power and Steel sector the limit is 40, provided:

- The foreign nationals are skilled and qualified professionals, technical experts, senior executives or in managerial position; and
- Those kinds of skills are not available in India.

2. In case where the limit exceeds the above limits, necessary approvals have to be sought from the Ministry of Labour and Employment.

Tourist visa

The changes in the tourist visa guidelines have been a mixed bag. On the one hand, the Government has introduced 'On Arrival' visa facility for some countries; while on the other hand, a gap of at least two months has been prescribed for foreign nationals returning to visit India on a tourist visa. The key changes on the tourist visa front are set out below:

1. Tourist visa on arrival facility has been introduced for citizens of five countries namely Finland, Japan, Luxembourg, New Zealand and Singapore at four international airports in the country i.e. Delhi, Mumbai, Chennai, Kolkata.

2. A gap of at least two months has been stipulated for foreign nationals who intend to make a return visit to India.

3. Special permission is required from the Indian mission if the foreign national intends to visit India within two months of the last departure.

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