

Doing Business Guide

India

1st Edition



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About This Booklet

This booklet has been produced by S. C. Vasudeva & Co., Chartered Accountants for the benefit of its clients and associate offices worldwide who are interested in doing business in India.

Its main purpose is to provide a broad overview of the various things that should be considered by organisations considering setting-up business in India.

The information provided cannot be exhaustive and – as underlying legislation and regulations are subject to frequent changes – we recommend anyone considering doing business in India or looking to the area as an opportunity for expansion should seek professional advice before making any business or investment decision.

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While every effort has been made to ensure the accuracy of the information contained in this booklet, no responsibility is accepted for its accuracy or completeness.

Contents

Introduction and Background	4
Banking and Finance	6
Institutions Providing Assistance to Enterprises	10
Legal Structures of Business Organisations	13
Foreign Direct Investment	16
Labour and Personnel	18
Taxation System	20

Introduction and Background

History

India is one of the oldest civilisations in the world, with a kaleidoscopic variety of sights and a rich cultural heritage. As the land of vast empires and historic trade routes, the Indian subcontinent has been associated with cultural and commercial wealth for much of its long history. Gradually annexed by the British East India Company from the early eighteenth century and colonised by the UK from the mid-nineteenth century, India became a Sovereign Nation in 1947 after a struggle for independence that was marked by widespread use of non-violent resistance as a means of social protest. It has achieved all-round socio-economic progress during the period since Independence. As well as being self-sufficient in agricultural production, India is now one of the top industrialised countries in the world and one of the few nations to have ventured into outer space.

The country's official name, 'India', is derived from *Sindhu*, the Old Persian name for the river Indus. Another name in common usage, and officially recognised by the Constitution of India, is 'Bharat' – derived from the Sanskrit name of an ancient Hindu king whose story is to be found in the *Mahabharata*. A third name, 'Hindustan' (Persian for 'Land of the Hindus'), has been used since the Mughal Empire (sixteenth century).

Geography

India covers an area of 3,287,263 km², extending from the snow-covered Himalayan heights to the tropical rain forests of the south. As the seventh largest country in the world, India stands apart from the rest of Asia, marked off as it is by mountains and the sea, which give the country a distinct geographical entity. Bounded by the Great Himalayas in the north, it stretches southwards to the Tropic of Cancer, where it tapers off into the Indian Ocean between the Bay of Bengal and the Arabian Sea. India is subdivided into 29 states and six union territories.

Lying entirely in the northern hemisphere, the mainland extends between latitudes 8° 4' and 37° 6' north and longitudes 68° 7' and 97° 25' east; it measures about 3214 km from north to south between the extreme latitudes, and about 2933 km from east to west between the extreme longitudes. It has a land frontier of about 15,200 km. The total length of the coastline of the mainland, Lakshadweep Islands and Andaman and Nicobar Islands is 7517 km.

Population and Language

The 2011 preliminary census showed India's population to be 1.21 billion (623.7 million males and 586.5 million females). India accounts for only 2.4% of the world surface area of 135.79 million km², yet supports and sustains 17.5% of the world population.

A number of languages are spoken in India; 22 are officially recognised and accepted nationally, while another 33 languages and around 2000 regional dialects have also been identified. Hindi, written in the Devanagari script, is the official language of the Union Government of India, while English is the secondary official language.

Constitution and Law

India is a union of states and is a sovereign, socialist, secular democratic republic with a parliamentary system of government. The President of India is the official head of the state, elected indirectly by an electoral college. The Prime Minister is, however, the *de facto* head of the government and exercises most executive powers.

India is the largest democracy in the world, with a federal form of government comprising three branches:

- *Executive.* The President; Vice President; and the Council of Ministers, headed by the Prime Minister
- *Legislature.* The bicameral parliament consists of the Upper House (*Rajya Sabha*, Council of States) and the Lower House (*Lok Sabha*, House of the People)
- *Judiciary.* The three-tiered system is led by the Supreme Court in New Delhi, with High Courts standing at the head of each state judicial system, followed by District and Sessions Courts in the judicial districts into which the states are divided. The third tier comprises local Courts of Civil and Criminal Jurisdiction.

Every state has a Legislative Assembly. Certain states also have an Upper House, called the State Legislative Council. Executive power is vested in each Head of State, a governor appointed by the president. The Council of Ministers, headed by the chief minister, advises the governor in the discharge of executive functions. The Council of the Ministers of a State is collectively responsible to the Legislative Assembly of the State.

The Economy

The Indian economy is one of the fastest-growing economies, currently ranking 11th largest in terms of nominal GDP (US\$ 1.73 trillion) and fourth largest in terms of purchasing power parity. It is one of the most attractive destinations for business and investment opportunities due to a vast manpower base, diverse natural resources and strong macro-economic fundamentals. The economic reforms that have been taking place since 1991 have also helped to create an investor-friendly environment through a liberalised policy framework spanning the whole economy.

Between 2006 and 2010 the GDP grew at an impressive rate, averaging 8–9%, with the 2010–11 growth rate pegged at 8.2%. The economy is expected to continue to grow at a similar rate over the next 5–10 years.

India's diverse economy encompasses traditional village farming, modern agriculture, handicrafts, a wide range of modern industries, and a multitude of services. Services are the major source of economic growth, accounting for more than half of India's output with less than one-third of its labour force.

The services sector, backed by the IT revolution, had the biggest impact on the national GDP – making a contribution of 58.4%, compared with industry (24.1%) and agriculture (17.5%).

Banking and Finance

Banking

India has an extensive banking system in place that is conducive to international business. The Reserve Bank of India (RBI) is the supreme monetary authority controlling the banking system, following the legal framework provided by the Banking Regulation Act, 1949.

Indian banks can be broadly classified into public sector banks (those in which the Government of India holds a majority stake), private sector banks (the government has no stake in these; they may be publicly listed and traded on stock exchanges), and foreign banks. Public sector banks (PSBs) are the pillars of the banking sector in India, accounting for more than 78% of the total banking industry assets.

The commercial banking structure in India consists of scheduled commercial banks and co-operative banks (state and urban). Scheduled commercial banks are those which have been included in Schedule 2 of the Reserve Bank of India (RBI) Act, 1934, and are categorised into five different groups according to their ownership and/or nature of operation:

- Nationalised banks
- The State Bank of India and its associates
- Regional rural banks (RRBs)
- Foreign banks
- Other Indian private sector banks.

This wide network of banks and financial institutions offers a variety of financial products and services such as retail banking, debt syndication, financial advisory services, portfolio management, and asset management.

Specialised Financial Institutions in India

The specialised financial institutions in India are government undertakings that were set up to provide assistance to the different sectors, encouraging overall development of the Indian economy. At central level, the significant institutions include:

- Board for Industrial and Financial Reconstruction (BIFR)
- Export–Import Bank Of India (EXIM)
- Small Industries Development Bank of India (SIDBI)
- National Housing Bank (NHB).

Non-Banking Finance Companies (NBFCs)

NBFCs play a key role in the growth of the economy. An NBFC is a company incorporated under the Indian Companies Act, 1956 and is a specialised financial institution that supplies

credit for the purchase of consumer goods and services or by granting small loans directly to consumers. There are various finance companies in India supporting the financial needs of business organisations.

NBFCs perform functions similar to those of banks; however NBFCs cannot accept demand deposits, and an NBFC is not a part of the payment and settlement system as it is not authorised to issue cheques.

Microcredit Institutions

Microcredit institutions extend very small loans (microloans) to those individuals who lack collateral, steady employment and a verifiable credit history and therefore fail to meet the minimal criteria for accessing traditional credit. Microcredit institutions are becoming an important vehicle in the government's drive for financial inclusion.

Obtaining Credit Facilities from Banks

In order to secure finance in India, business organisations must convince banks and financial institutions as to both the security of the loan and the borrower's ability to meet loan repayment commitments, including any interest. The size of the loan and security offered will determine how much information the financiers require; however, the information and documents listed below are generally expected to be provided by the borrower:

- Borrower's financial background
- Memorandum of Association, Articles of Association and Certificate of Incorporation
- Proof of identity of authorised signatory/director
- List of directors, shareholding pattern, and any related documents of authentication
- Statements for all bank accounts
- Description of purpose of loan
- Draw-down requirements, repayment provisions, etc.
- Details of any available security
- Demonstrated ability to service both the interest and debt repayment
- Copies of financial accounts for past few years
- Certified extract of directors' resolution for acceptance of bank facilities.

Opening a Bank Account

To open an account with a bank in India, the following documents are usually required:

- A duly certified Board resolution for opening a bank account
- Certified true copy of the Memorandum of Association and Articles of Association
- List of present directors, indicating their percentage holding and their residential address
- Copy of permanent account number (PAN) card
- Proof of company's address, evidenced by
 - The document registered with Registrar of the Company
 - Acknowledged copy of income tax return
 - Bank statement
 - Leave and License Agreement/Agreement of Sale.

Insurance

In India, insurance is mainly of two types: life insurance and general insurance. Until 1999, the insurance sector was regulated and was under the direct control of the government. The life insurance business was handled by the Life Insurance Corporation of India (LIC), while non-life insurance business was conducted by four nationalised insurance companies – the United India Insurance Co. Ltd, the New India Assurance Co. Ltd, the Oriental Insurance Co. Ltd and the National Insurance Co. Ltd.

In order to protect the the interests of holders of insurance policies, and to regulate, promote and ensure orderly growth of the insurance industry, the Government of India has set up the Insurance Regulatory and Development Authority (IRDA). The Insurance Regulatory and Development Authority (IRDA) Act of 1999 deregulated the insurance sector in India, allowing private companies to enter; foreign direct investment (FDI) is allowed, up to 26% of the total capital held by the Indian insurance companies. To date, the IRDA has agreed the registration of 12 private life insurance companies and nine general insurance companies.

Capital Market

The Indian capital market is among the most vibrant in the world, with 20 stock exchanges as of 31 July 2011 – all of them tightly regulated and technologically advanced. Foremost among these are the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE), one of the oldest in Asia. Since it began formal trading in 1875, the BSE has facilitated the growth of the Indian corporate sector by providing it with an efficient capital raising platform. Today the BSE is the world's premier exchange in terms of the number of listed companies (over 4,900); the fifth most active, in terms of number of transactions handled

through its electronic trading system; and among the top 10 global exchanges in terms of market capitalisation of its listed companies.

Debt Market

The Indian debt market is one of the largest in Asia. As elsewhere, the debt market in India is considered a useful alternative to banking channels for obtaining finance. Importantly, the debt instruments used in India mean that the return is fixed, so the risks are considerably reduced. The Indian debt market can be classified into two categories:

- Government securities (G-Sec) market – the most dominant category in the Indian debt market, consisting of central and state government securities
- Bond market – bonds and debentures issued by financial institutions, corporates and public sector undertakings. These bonds are issued to meet financial requirements at a fixed cost.

Financial regulators, the Securities Exchange Board of India (SEBI), the RBI, the Department of Corporate Affairs and various stock exchanges all oversee the capital markets in their designated jurisdictions, to ensure that investors are well-informed and protected against fraudulent practice.



Institutions Providing Assistance to Enterprises

Department of Commerce

The Department of Commerce has been set up under the Ministry of Commerce and Industry to regulate, develop and promote India's international trade and commerce. Its basic role is to facilitate an environment and infrastructure that will encourage accelerated growth of international trade. The department formulates, implements and monitors the appropriate international and commercial policies – including the Foreign Trade Policy, which provides a basic framework for strategies to be followed in promoting exports and trade.

Ministry of Finance

The Ministry of Finance is concerned with taxation, financial legislation, financial institutions, capital markets, central and state finances, and the union budget.

The Union Finance Ministry of India comprises five departments:

- Department of Economic Affairs
- Department of Expenditure
- Department of Revenue
- Department of Disinvestments
- Department of Financial Services.

Foreign Investment Promotion Board (FIPB)

Among the most important agencies in the country dealing with FDI, the FIPB handles foreign investment proposals that fall outside the automatic route and require government approval. The FIPB's main objective is to increase the flow of FDI into India by taking up activities that will promote investment.

Directorate General of Foreign Trade (DGFT)

Known before 1991 as the Chief Controller of Imports and Exports (CCI&E), the DGFT is a government organisation responsible for the formulation of national export and import (EXIM) guidelines and principles. The DGFT is responsible for implementing the Foreign Trade Policy or EXIM Policy, with the main objective of promoting Indian exports.

Securities and Exchange Board of India (SEBI)

SEBI was established on 12 April 1992; its basic function is to regulate the securities market, promoting its development while protecting the interests of investors.

Ministry of Corporate Affairs

The Ministry is primarily concerned with administration of the Companies Act, 1956 and associated Acts, rules and regulations that regulate the functioning of the corporate sector – including the Competition Act, 2002; the Partnership Act, 1932; the Companies (Donations to National Funds) Act, 1951, and the Societies Registration Act, 1980. The Ministry also exercises supervision over three professional bodies that are constituted under three separate Acts of the Parliament for proper and orderly growth of their respective professions: the Institute of Chartered Accountants of India (ICAI), the Institute of Company Secretaries of India (ICSI), and the Institute of Cost and Works Accountants of India (ICWAI).

The following offices are affiliated to the Ministry of Corporate Affairs:

- Official Liquidator
- Company Law Board
- Directorate General of Investigation and Registration
- Serious Fraud Investigation Office
- Competition Commission of India
- Cost Audit Branch
- Indian Institute of Corporate Affairs.

Registrars of Companies (ROC)

Registrars of Companies (ROC) – appointed under Section 609 of the Companies Act, 1956 – are vested with the primary duty of registering companies floated in the respective states and union territories, ensuring that they comply with statutory requirements. These offices keep a registry of company records that are available for inspection by members of the public on payment of the prescribed fee. The central government exercises administrative control over these offices through the respective regional directors.

Legal Structures of Business Organisations

Forms of business organisation that are commonly used in India are illustrated in Figure 1.

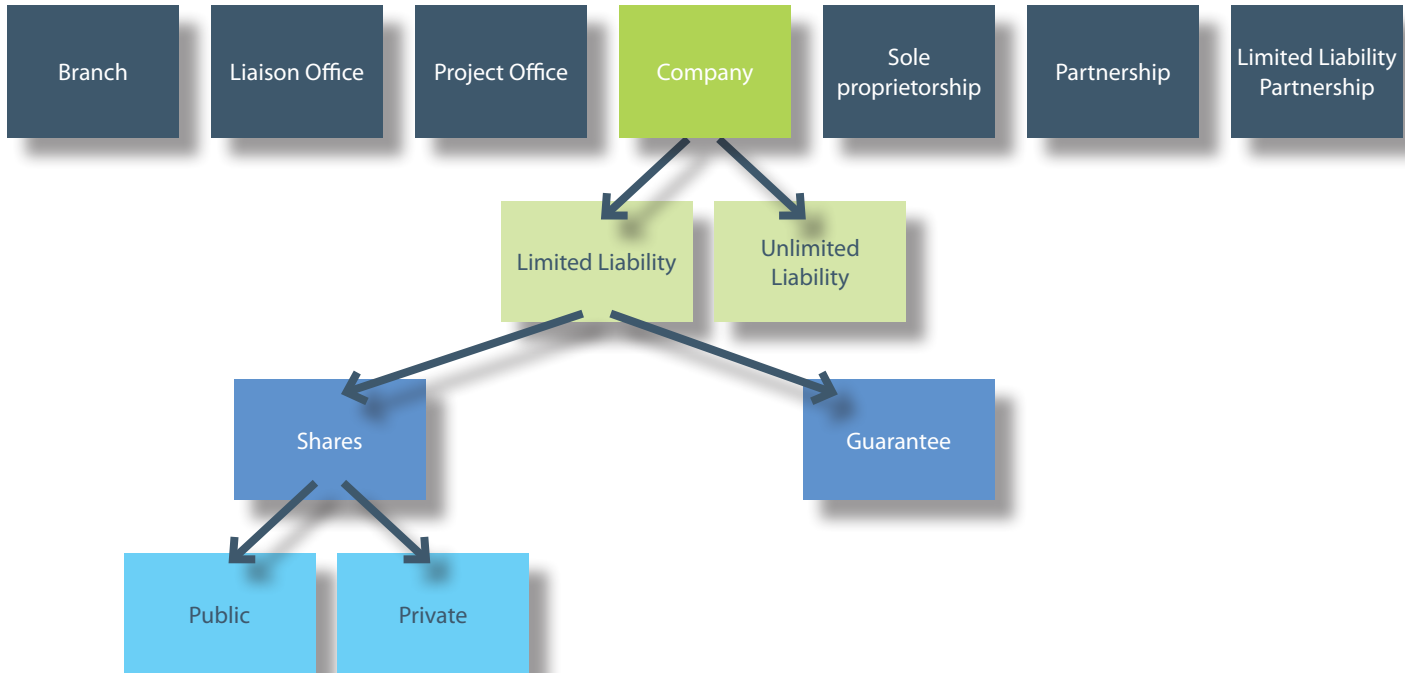


Figure 1. Typical forms of business organisation in India.

Legal Structure of Business Organisations

Company

A company is an incorporated entity under the Companies Act, 1956, and has a separate legal entity. It may be incorporated as a private or public limited company. No permission is required for foreign nationals to be appointed directors of the proposed company.

Limited Company

A limited company is one in which the liability of its members or subscribers is limited by the extent of their investment in either shares or guarantees:

- 'Limited by shares' means that the company (which can be either public or private) has shareholders, whose liability to company creditors is limited to the capital originally invested (the nominal value of the shares, plus any premium paid)
- 'Limited by guarantee' means that the company has no share capital, but is guaranteed by its members who agree to pay a fixed amount in the event of the company's liquidation.

Unlimited Company

An unlimited company is incorporated either with or without share capital, but its members' liability is unlimited – that is, members or shareholders have a joint, several and unlimited obligation to meet any insufficiency in the assets of the company in the event of the company's formal liquidation.

Private Limited Company

A private limited company has a minimum paid-up capital of INR 100,000 or such higher paid-up capital as may be prescribed, and by its articles:

- Restricts the right to transfer its shares; or
- Limits the number of its members to 50, not including
 - persons who are in the employment of the company
 - persons who, having formerly been in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased; and
- Prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company; and
- Prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives:
 - provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this definition, be treated as a single member.

A private limited company is required to have a minimum of two directors and two members.

Public Limited Company

A public limited company:

- is not a private company
- has a minimum paid-up capital of INR 500,000, or such other higher paid-up capital as may be prescribed
- is a private company which is a subsidiary of a company which is not a private company.

A public limited company is required to have a minimum of three directors and seven members.

Partnership

A partnership is an arrangement where entities and/or individuals agree to cooperate to advance their interests. A partnership is formed between one or more businesses in which partners (owners) work together to achieve profits and share losses. The partnership is the simplest and least expensive co-owned business structure to create and maintain.

A partnership is considered to have a separate tax entity from its owners. However, the liability of partners is unlimited: if the firm's assets are insufficient to meet its business liabilities, these can be covered by the liquidation of the partners' personal property (if any).

Limited Liability Partnership (LLP)

Regulated by the Limited Liability Partnership Act, 2008, an LLP is an alternative corporate business form that combines the limited liability of a company with the flexibility of a partnership arrangement: although it is a separate legal entity and liable to the full extent of its assets, the liability of an LLP's partners is limited to their agreed contribution.

Representative Office/Liaison Office

Foreign companies can establish offices to carry on liaison activities in India on behalf of the parent company. A person resident outside India permitted by the RBI to establish a liaison office in India may undertake the following activities:

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

All other activities are prohibited, unless otherwise specifically permitted by the RBI.

A liaison office is restricted from undertaking any trading, commercial or industrial activities or entering into contractual agreements or transactions. It is not permitted to generate

income from any activities in India. All the expenses of the liaison office must be met from funds received through inward remittances from the foreign/parent company.

Branch Office

Foreign companies can establish branch offices in India to undertake the following activities:

- Export/import of goods
- Render professional or consultancy services
- Carry out research work that involves the parent company
- Promote technical or financial collaborations between Indian companies and parent company or overseas group
- Represent the parent company in India and act as a buying/selling agent in India
- Render IT services and software development in India
- Offer technical support to the products supplied by the parent/group companies
- Airline/shipping activities.

Where the branch is proposed to be set up in Special Economic Zones to undertake manufacturing and service activities, no RBI approval is required (subject to certain conditions).

Unlike a liaison office, a branch office is permitted to earn and generate income in India through its activities there, and may repatriate its entire profits to its parent company – subject to Indian income tax.

Project Office

A foreign company can open a temporary project office for the execution of a specific project or contract. Where a person resident outside India has secured from an Indian company a contract to execute a project in India, and the project:

- is funded directly by inward remittance from abroad; or
- is funded by a bilateral or multilateral international financing agency; or
- has been cleared by an appropriate authority; or
- has been granted a term loan by a public financial institution or a bank in India to the company or entity in India awarding the contract.

A branch office/project office is deemed to be a permanent establishment within the meaning of the Double Taxation Avoidance Agreement (DTAA), and is therefore subject to Indian income tax.

Foreign Direct Investment

In recent years, India has emerged as an attractive FDI destination. The cumulative amount of FDI equity inflows from April 2000 to January 2011 stood at US\$ 189.84 billion; during the period April 2010 to January 2011, India received US\$ 22.05 billion FDI inflow.

Over the last few years, Mauritius has emerged as the leading investor into India, followed by Singapore, the US, the UK and the Netherlands. The inordinately high investment from Mauritius is due to routing of international funds through the country given its significant tax advantages; double taxation is avoided due to a tax treaty between India and Mauritius.

FDI via the business forms described earlier is subject to regulations prescribed by the Government of India. There are two routes of entry:

- Automatic route. Under current Government of India policy, FDI into India is possible under the automatic route – that is, without any RBI or government approval – in most sectors (except certain specific industries; see below), subject to certain specific terms and conditions
- Approval route. Investment proposals that are not covered by the automatic approval route must be filed with the Foreign Investment Promotion Board (FIPB), and the FIPB considers each proposal on a case-by-case basis. There is no standard form – applications are typically in the form of a letter setting out an executive summary of the applicant's details as well as outlining the proposed investment/project, with a specific request for the proposed foreign investment. Wherever an industrial licence is required, the application for approval should be filed with the Secretariat of Industrial Assistance (SIA).

The Foreign Exchange Management Act, 1999 (FEMA), and the various Press Notes issued by the government's Department of Industrial Policy and Promotion, together form the basis of legislation regulating FDI into India. The RBI and/or FIPB share the monitoring/regulating of agencies in this regard.

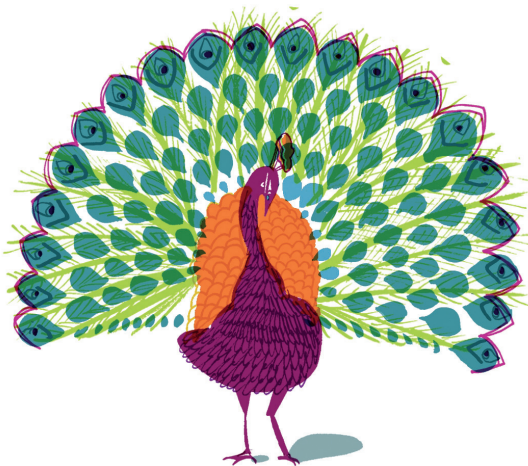
FDI is prohibited under the approval route, as well as the automatic route, in the following sectors:

- Retail trading (except single-brand product retailing)
- Atomic energy
- Lottery business (including government/private lottery, online lotteries etc.)
- Gambling and betting (including casinos, etc.)
- Chit fund business
- Nidhi company
- Agricultural (excluding floriculture, horticulture, seed development, animal husbandry, pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro/allied sectors) and plantation activities (other than tea plantations)

- Activities/sectors not open to private sector investment
- Real estate business or construction of farm houses. 'Real estate business' does not include development of townships, construction of residential/commercial premises, roads or bridges, educational institutions, recreational facilities, city/regional-level infrastructure or townships
- Trading in transferable development rights (TDRs)
- Manufacture of cigars, cheroots, cigarillos and cigarettes, or tobacco or tobacco-substitute products.

Besides foreign investment in any form, foreign technology collaboration in any form – including licensing for franchise, trademark, brand name, or management contract – is also completely prohibited for lottery business and gambling and betting activities.

Foreign investment in trusts, other than investment by SEBI-registered (foreign venture capital investors [FVCIs]) in domestic venture capital fund (VCF), is not permitted. FDI is also prohibited in companies, sole-proprietorship and partnership firms etc., subject to sectoral caps as outlined in the current RBI regulations.



Labour and Personnel

Statutory Requirements for Immigration

The entry of foreigners into India is regulated by the Acts passed by the Indian Parliament and related rules that are framed periodically by the central government.

Foreign nationals wishing to take up employment in India should apply for an employment visa or a work permit, issued by Indian embassies and missions in their country. Initially granted for a period of 1 year, the visa or permit can be extended in India to cover the period of the contract.

Usually, the employer offering an employment opportunity initiates the visa application process in India. Alternatively, the applicant may apply to the Indian Embassy/High Commission in their country of residence. Both approaches require recent photographs of the applicant, together with proof of employment (the appointment/contract letter, terms and conditions of employment etc.).

Any foreign national (including those of Indian origin) coming to India with a visa that covers a period longer than 180 days is required to register with the local or regional Foreigners Registration Officer (FRO) within 14 days of their first arrival in India. This only needs to be done once for the duration of the visa, regardless of how many times the visitor leaves and re-enters India; only if they return on a new visa are they required to register again.

Some categories are exempt from this requirement:

- Those visiting India on tourist visas for up to 180 days, who can move freely about the country (apart from restricted/protected areas and prohibited places)
- US nationals holding 10-year tourist/business visas, provided their continuous stay during each visit does not exceed 180 days
- Foreign nationals of Indian origin holding a 5-year multiple-entry visa with an endorsement that their stay should not exceed 180 days during each visit. Should they wish to stay in India continuously for more than 180 days, then registration is required within 14 days of arrival
- Person of Indian Origin (PIO) card holders, provided their continuous stay does not exceed 180 days. If it does, they should approach the local or regional FRO to register; this must be done within 30 days of the 180-day limit.

Major Labour Laws in India

There are many labour laws enacted by both central and state governments. Some of the most relevant are outlined below.

The Industrial Disputes Act, 1947

Provides the framework for regulating the rights of employers and employees, and facilitates the investigation and harmonious settlement of industrial disputes.

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

A social security legislation enacted to provide for provident fund, family pension and insurance to the employee (in factories and other establishments), who is required to pay a contribution that is matched equally by the employer. The employee gets a lump sum amount on retirement. The Act covers three schemes: Provident Fund (PF), Family Pension Fund (FPF), and Employees Deposit Linked Insurance (EDLI).

The Payment of Wages Act, 1936

Regulates payment of wages to a certain class of employed persons – mainly to ensure regular and timely payment of wages, as well as preventing unauthorised deductions and arbitrary fines.

The Payment of Gratuity Act, 1972

A gratuity is a lump sum payment to an employee when they retire or finish service. However, under this Act, a gratuity is payable to an employee who leaves after completing at least 5 years of service with the employer.

The Employees' State Insurance Act, 1948

An 'insurance' scheme that makes appropriate provision, including benefits, to the employee in case of sickness, maternity, disability or employment injury.

The Factories Act, 1948

Regulates all industrial establishments employing 10 or more persons and carrying manufacturing activities with the aid of power (defined as a 'factory'). The Act makes provision for the health, safety, welfare, working hours and leave of workers in factories; it is enforced by the state government through their Factory Inspectorates. The Act strengthens the provisions relating to safety and health at work; in larger factories it provides for statutory health surveys, appointment of safety officers, and establishment of canteen, crèches, welfare committees, etc. It includes specific safety guidelines for the use and handling of hazardous substances, and for dealing with emergencies.

The Payment of Bonus Act, 1965

Within specified categories of work, provides for payment of a fixed-sum bonus after a certain time period. Employees can share the prosperity of the establishment as reflected by the profits earned from the contributions made by capital, management and labour.

Taxation System

The Indian tax system can broadly be classified into two categories:

- Direct taxes – income tax and wealth tax
- Indirect taxes – excise duty, custom duty, state-level VAT, service tax, central sales tax.

Income Tax

Section 4 of the Income Tax Act, 1961 (referred to as 'the Act' from here on), income tax is charged for every assessment year at the rate(s) prescribed in the Finance Act on each person's total income from the previous year. Everyone required to pay tax is known as an 'assessee'.

'Previous year' means the financial year immediately preceding the assessment year; 'assessment year' means the period of 12 months running from 1 April to 31 March (the Indian fiscal year).

Meaning of 'Foreign Company'

A foreign company is any company that is not a domestic company. A domestic company is defined as 'an Indian company, or any other company, which, in respect of its income is liable to tax under this Act, has made the prescribed arrangements for the declaration and payment, within India, of the dividends payable out of such income'. In other words, any company incorporated in India will be a domestic company.

Concept of 'Residence'

A company is said to be resident in India in any previous year either if it is an Indian company or if, during the year concerned, the control and management of its affairs was situated wholly in India. The term 'control and management' refers to the 'head and brain' that direct the affairs of policy, finance, disposal of profits, and other crucial aspects of company management. Usually, the control and management of a company's affairs are located where its Board meetings are held.

Scope of total Income

In case of a foreign company, only income that is received or deemed to be received in India, or accrues or arises or is deemed to accrue or arise in India, is taxable in India. In the case of an Indian company, the income earned anywhere in the world is taxable in India.

Sources of Income

When calculating total income for tax purposes, all income earned by a company is classified under the following headings:

- Income from house property
- Profits and gains from business or profession

- Capital gains
- Income from other sources.

Ascertainment of Taxable Income and Tax Payable

Figure 2 illustrates how taxable income is determined.

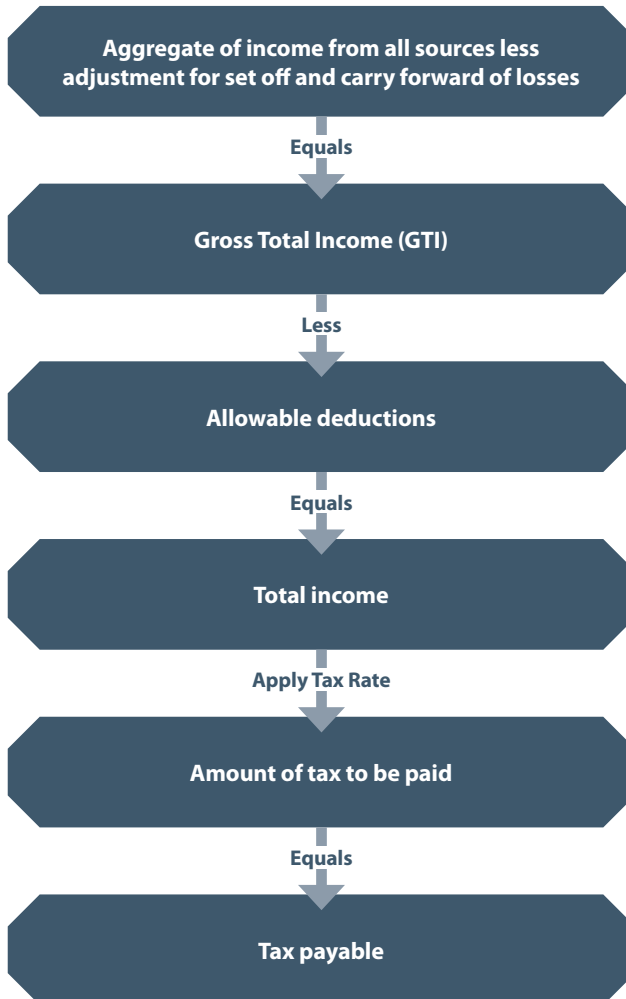


Figure 2. Process for calculating taxable income.

Advance Tax

The tax for the current assessment year must be estimated by the company and paid in advance in four instalments:

- By 15 June: 15% of the total tax payable for that assessment year
- By 15 September: 45% of the total tax payable for that assessment year
- By 15 December: 75% of the total tax payable for that assessment year
- By 15 March: 100% of the total tax payable for that assessment year

Minimum Alternate Tax (MAT)

The provisions for paying MAT apply to a foreign company, just as they do to an Indian company. Even if there is no tax payable for any assessment year according to the computations of the Act (normal provisions), the company would be liable to pay tax at 18.5% of its book profits (as increased by a surcharge of 5% in case of a domestic company and 2% in case of a foreign company), provided the book profits exceeded INR 10 million and also increased by an education cess at 3%. In other words, this is the minimum amount of tax that the company would have to pay if its accounts show profits.

With effect from 1 April 2008, the undertakings availing exemption under Section 10A or 10B are also liable to pay MAT as per the provisions of Section 115JB of the Act.

Wealth Tax

Companies are also liable to pay a wealth tax on their net wealth, of 1% in excess of INR 3 million on certain specified assets.

Audit of Accounts

In addition to the requirements of audit as per the provisions of the Companies Act, 1956, a company is subject to a further audit (commonly referred to as the tax audit).

Income Tax Returns

Every company is required to file its income tax returns, using Form ITR-6, by the due date specified in the Act (currently 30 September of the assessment year). For companies which need to submit a transfer pricing report along with their income tax return, the deadline is 30 November in that assessment year.

Interest

In case of default on the payment of advance tax, a company is liable to pay interest under Sections 234B and 234C of the Act. Interest under Section 234B is levied if the advance tax paid is less than 90% of the assessed tax (total tax less tax deducted at source). Interest under

Section 234C is levied if there is a default in the payment of instalments of advance tax. If there is any delay in filing its income return, the company is subject to interest under Section 234A. The rate of interest under all these sections is 1% per month or part of the month. With effect from assessment year 2004–05, where a refund is granted to an assessee based on their income return and the assessment proceedings concluded that no refund was due or that the refund was excessive, then under Section 234D the assessee is liable to pay simple interest at 0.5% per month or part of the month on the whole or excess refund amount.

Double Taxation Avoidance Agreements (DTAA)

India has entered into DTAA with many countries and specified territories. As per Section 90 of the Act, the provisions of the DTAA or the Act (whichever are more favourable to the company) are applicable. The business profits of a foreign company are taxable in India only if the foreign company has a permanent establishment (PE) in India.

Withholding Tax/Tax Deduction at Source (TDS)

Payments made to foreign companies are subject to withholding tax as per the rates applicable for the relevant assessment year. Section 206AA provides that if the PAN number of the deductee is not available, tax is deducted at the rates prescribed in the Act, or the rates in force, or 20% (whichever is highest). Thus, if a foreign company/non-resident has no PAN number, any payment to them is subject to the higher rate of taxes. In certain cases, a foreign company is also required to deduct withholding tax on payments made by it to a person resident in or outside India.

If any person, principal officer or company does not deduct whole or any part of the tax, or after deducting fails to pay such tax as required by the provisions of the Income Tax Act, 1961, then Section 201(1A) specifies that they are liable to pay simple interest:

- At 1% for every month or part of a month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is deducted; and
- At 1.5% for every month or part of the month on the amount of such tax from the date on which such tax was deducted to the date on which such tax is actually paid.

Advance Ruling

A foreign company can seek an advance ruling from the Authority for Advance Rulings on any question of law in relation to a transaction that is proposed to be undertaken by the company. Such a ruling is binding upon the applicant and the income tax authorities.

Transfer Pricing

All international transactions between associate concerns that take place after 1 April 2001 would have to comply with the Transfer Pricing Guidelines. As a result, any income arising from an international transaction in the hands of an entity in India shall be computed having

regard to the arm's-length price. Non-disclosure or non-computation of such arm's length price is subject to penalty provisions. A company has to obtain a transfer pricing report from a chartered accountant using Form 3CEB, which has to be submitted to the tax authorities within the prescribed time. In addition, in accordance with the Finance Act 2012, the provisions of transfer pricing have been made applicable to specified domestic transactions.

Rate of Tax

Foreign companies are currently charged to tax at 40% (plus 2% surcharge if income exceeds INR 10 million and education cess at 3%) on their business profits and income arising on account of short-term capital gains. Long-term capital gains are charged to tax at 20% under Section 112 of the Income Tax Act. Short-term capital gains other than those already outlined are charged to tax at 15% under Section 111A (i.e., inclusive of securities transaction tax). These rates are subject to certain exceptions, where the income is taxed on a gross basis but at a lower rate of tax.

Indian companies are charged to tax at 30% plus a surcharge of 5% (if income exceeds INR 10 million and education cess at 3%).

Excise Duty

Every company manufacturing goods in India is liable to pay excise duty at a specified rate. There are three basic rates of excise duty: 10%, 16% and 24%. There are special rates for certain products, and some goods are exempt. Since excise duty is in the nature of an indirect tax, it is normally recovered from the customer through increasing the sale price by the amount of excise duty.

CENVAT Credit

Credit in respect of duty paid inputs (i.e. on which excise duty has been paid) and duty paid services (i.e. on which service tax has been paid) can be availed as a set-off against payment of final excise duty.

Custom Duty

All imports, unless specified exempt, are subject to payment of custom duty. The general rates are 5%, 10% or 15%. There are special rates for special products.

VAT

State-level VAT has been introduced in India with effect from 1 April 2005. Each state in India has a separate VAT Act. The rates of tax are more or less uniform for all commodities across all states, but there are differences in the rates for certain commodities. Each state has four rates

of tax: 1%, 4%, 12.5% and 20%. Credit is available in respect of duty paid inputs, subject to certain conditions.

Service Tax

The Finance Act 2012 has changed the way services are taxed. Prior to the Act only specified services were taxed (119 services), however after the enactment of the Finance Act 2012 all services are taxed unless on the “negative list” or specifically exempt. The present rate of tax is 12% (plus education cess at 3%). Service tax paid on input services is eligible for CENVAT credit.

Central Sales Tax

On every sale made inter-state, a 2% tax is payable by the company making the sale. This tax is going to be phased out within a period of 2 years following introduction of the Goods and Service Tax.

Trade Policy

Under the foreign trade policy of the Government of India, special incentives are given to export-oriented units (EOUs) set up in Electronic Hardware Technology Parks (EHTPs), Software Technology Parks (STPs) and Biotechnology Parks (BTPs). These incentives include:

- Import of products on payment of duty at a concessional rate
- Duty-free import of second-hand capital goods
- 100% of export earnings can be retained in foreign currency in a special account, the Exchange Earners Foreign Currency Account (EEFC).

In addition, to augment exports and generate employment, the government has introduced the concept of the special economic zones (SEZ). A SEZ is a clearly delineated duty-free enclave – deemed to be foreign territory for the purposes of trade operations, duties and tariffs. Like EOUs, units set up in a SEZ are entitled to various benefits and incentives.

The Next Step

Contact S.C Vasudeva & Co. to discuss your needs.

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