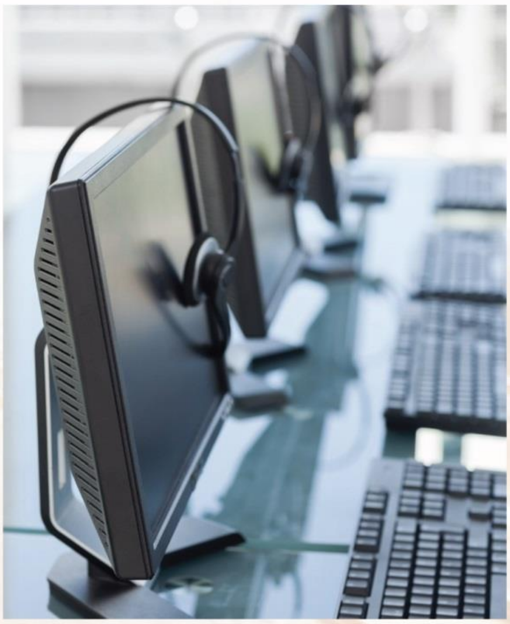
SKP

Invest India
GUIDING YOUR INVESTMENTS



Doing business in India

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Empanelled Partner Consultant

Disclaimer

This Doing Business in India guide contains general information existing at the time of its preparation only (up to October 2014). It is intended as a point of reference and is not intended to be comprehensive nor to provide specific accounting, business, financial, investment, legal, tax or other professional advice or opinion or services. This publication is not a substitute for such professional advice or services, and it should not be acted on or relied upon or used as a basis for any decision or action that may affect you or your business. Before making any decision or taking any action that may affect you or your business, you should consult a qualified professional adviser and also refer to the source pronouncement/documents on which this publication is based.

Professional advisers, such as accountants, lawyers and advisers, will find that the guide provides them with the broad information that they need to discuss their clients' overseas requirements before directing them to the relevant specialist.

Whilst every effort has been made to ensure the accuracy of the information contained in this guide, this cannot be guaranteed, and neither SKP Business Consulting LLP nor any related entity shall have any liability to any person or entity that relies on the information contained in this publication. Any such reliance is solely at the user's risk.

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About Invest India

Invest India is a not-for-profit joint venture between the Department of Industrial Policy & Promotion of the Ministry of Commerce & Industry, Government of India, state governments and the Federation of Indian Chambers of Commerce and Industry (FICCI).

Operationalised in early 2010, it is a dedicated investment promotion agency (IPA) to attract investments into the country in a structured and comprehensive manner. It is the first point of reference for both domestic and foreign investors, while investment promotion and facilitation constitute the core mandate of the company.

Invest India regularly partners with similar agencies across the world in an endeavour to enhance bilateral investment and economic engagement. It has signed MoUs with IPAs of Italy, France, USA, UK, Japan, South Korea, Czech Republic and Mauritius. In addition, Invest India actively contributes to the Government of India's investment-related engagement with Africa.

An Investor Facilitation Cell has been set up at Invest India as a part of the Make in India initiative launched by the Prime Minister of India on 25 September 2014. The Cell acts as primary support for all investment queries and for providing handholding and liaising services to investors. Invest India is also a part of the Japan Plus initiative, launched to facilitate and speed up investment proposals and augment economic ties between India and Japan. Invest India has also set up investment-promotion and facilitation help desks for select economic ministries and countries.

About SKP

SKP is a long established and rapidly growing professional services group located in six major cities across India. We specialise in providing sound business and tax guidance and accounting services to international companies that are currently conducting or initiating business in India as well as those expanding overseas. We serve over 1000 clients including multinationals, companies listed on exchanges, privately held and family-owned businesses from more than 45 countries.

From consulting on entry strategies to implementing business set-ups and M&A transactional support, the SKP team assists clients with assurance, domestic and international tax, transfer pricing, corporate services, and finance and accounting outsourcing matters, all under one roof. Our team is dedicated to ensuring clients receive continuity of support, across the business lifecycle.

The SKP Value Chain

Pre-Investment

Advisory

- Entry Strategy
- Assessment of Strategic Alternatives
- Market Assessment/ Attractiveness
- Competition Analysis
- Regulatory Consulting
- Product Pricing Studies

Business Set-up

Hand-holding

- Company Incorporation
- Registrations and Approvals
- Business Plan Creation
- Funding Advisory and Compliance Support
- Holding Company Jurisdictions
- Location Evaluation Studies
- Land Scouting and Acquisition
- Incentives Evaluation and Availment
- Vendor/Supplier Search
- Project Management
- Project Accounting

Start-up Operations

Single Window Service

- Compliance
  - Advance Tax
  - Withholding Tax
  - Indirect Tax
  - Transfer Pricing
  - Corporate Tax Returns
- Company Secretarial
- Recurring
  - Accounts Payable
  - Expense Reports
  - Bookkeeping
  - Cash Management
  - Payroll
- Reporting
- Research and Opinions

Stable Operations/Growth

Business Function Support

- Managed Solutions
  - Vendor Management
  - Dealer Management
  - Sales Force Management
  - Fixed Asset Management
  - Accounting and Reporting
  - Analytics

OBJECTIVE

Enabling businesses to become successful in India

Business Advisory

Outsourcing

Our clients value our collaborative approach. Right from inception, SKP's founders have emphasised the importance of professional standards and personalised service; and to this day, we continue to reflect this progressive mindset by serving our clients with integrity, delivering high quality, innovative results. Our ability to easily identify, confront and resolve a variety of issues and concerns for our clients comes from our years of experience across a wide range of industries and geographies, combined with a versatile group of professionals and a multi-disciplinary team.

To know more, visit **www.skpgroup.com**.

Chapter 1

Introducing India

At a glance

Location: North of the Equator
(Latitude: 8° 4′ to 37° 6′ North; Longitude: 68° 7′ to 97° 25′ East)
Capital: New Delhi
Population: 1.21 billion (2011 census estimate)
Area: 3.3 million sq km
Indian Standard Time: GMT + 5:30
Telephone country code: +91
Official language: Hindi is an official languages in India (English is also used for official communication)

Geography and climate[1]

Covering an area of 3.3 million square kilometres, India is the seventh largest country in the world, occupying a major portion of the south Asian subcontinent. Extending from the Himalayas in the north, it stretches southwards to the Tropic of Cancer, and tapers off into the Indian Ocean between the Bay of Bengal on the east and the Arabian Sea on the west.

India's climate varies significantly from the permanently snow-capped Himalayas in the north to the tropical south. In spite of much of the north of India lying beyond the tropical zone, the entire country has a tropical climate marked by relatively high temperatures and dry winters. There are four seasons in India: winter (December–February), summer (March–June), south-west monsoons (June–September) and the post-monsoon season (October–November).

Political system[2]

India is a sovereign socialist secular democratic republic with a parliamentary system of government. It is governed by the Constitution of India, which came into force on 26 January 1950. It has a federal government with 29 states and seven union territories and is the largest democracy in the world. The central/union government is further divided at the state and local levels.

The government is divided into three structural segments: the executive, the legislature and the judiciary.

Executive: The executive branch comprises the President as the head of state, the Vice President and the Council of Ministers. The Council, headed by the Prime Minister, aids and advises the President, who exercises his/her functions accordingly. Thus, the real executive power is vested in the Council of Ministers and the Prime Minister (head of the government). Mr Pranab Mukherjee is the current President of India and Mr Narendra Modi is the Prime Minister.

Legislature: India has a bicameral parliament with the Council of States (Rajya Sabha) and the House of the People (Lok Sabha). Elections to the Lok Sabha are held at an interval of five years, after which the Prime Minister is appointed by the President.

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[1] National Portal of India, http://india.gov.in/india-glance/profile, accessed 7 August 2014
[2] Ibid.

Judiciary: The Supreme Court is the apex body of the Indian legal system, followed by the High Courts and subordinate courts. The judiciary is independent of the executive and legislative branches of the government.

The 16th Lok Sabha elections were held in April–May 2014. The National Democratic Alliance (NDA), which is an alliance of several parties led by the Bharatiya Janata Party (BJP), secured over 300 of the 543 seats. The leading party BJP won over 272 seats, the minimum requirement for a party or alliance to form a government. The former ruling alliance, United Progressive Alliance, led by the Indian National Congress, secured 58 seats, of which 44 were won by the Congress.

Other major political parties in India include the Nationalist Congress Party, Bahujan Samaj Party, Communist Party of India, and the Communist Party of India (Marxist).

Legal system[3]

India has one of the oldest legal systems in the world. The Constitution of India is the supreme law of the country, which, in turn, gives due recognition to statutes, case laws and customary laws consistent with its dispensations. There is also a vast body of laws known as subordinate legislations in the form of rules, regulations and bylaws made by the central and state governments and local authorities.

The Constitution has generally provided for a single integrated system of courts to administer both union and state laws. As mentioned above, the judiciary is divided into various levels, with the courts forming a strict hierarchy of importance: the Supreme Court of India, High Courts (of respective states/groups of states), District Courts and other subordinate courts.

Population

India is currently the second most populous country in the world. According to the 2011 census, India's population is estimated to be around 1.21 billion (624 million males and 587 million females), having grown @ 1.76% per annum between 2001 and 2011.[4]

According to the 2001 census, Hinduism, Islam, Christianity and Sikhism are the four main religions in India. Others include Buddhism, Jainism, Judaism and Zoroastrianism.

Language

While English is used for all official communication across the country, the Constitution of India recognises 22 different languages, of which Hindi is an official language. Other Indian languages, recognised by the constitution are Assamese, Bengali, Gujarati, Kannada, Kashmiri, Konkani, Malayalam, Manipuri, Marathi, Nepali, Oriya, Punjabi, Sanskrit, Sindhi, Tamil, Telugu, and Urdu. However, according to the 2001 census, about 30 languages are spoken by more than a million native speakers, and 122 are spoken by more than 10,000 speakers.

According to the 2011 census, the literacy rate in India stands at 74.04% (82.14% for males and 65.46% for females).

[3] Supreme Court of India, http://supremecourtofindia.nic.in/constitution.htm, accessed 7 August 2014
[4] National Portal of India, http://india.gov.in/india-glance/profile, accessed 7 August 2014

Currency

The Indian currency is the Rupee (ISO code: INR; symbol: ₹). One rupee consists of 100 paise. The Reserve Bank of India, which is the central bank of the country, has the sole authority to issue banknotes and coins.

Business hours

Typically, a work day is 8 hours long from 9am to 5pm IST (GMT + 05:30) and working days vary between 5 to 6 days a week. Business hours could vary from 8 to 10 hours a day depending on the type of the organisation i.e. government, private company, multinational corporation, etc.

Public holidays

India has three national holidays:

- Republic Day – 26 January
- Independence Day – 15 August
- Mahatma Gandhi's Birthday – 2 October

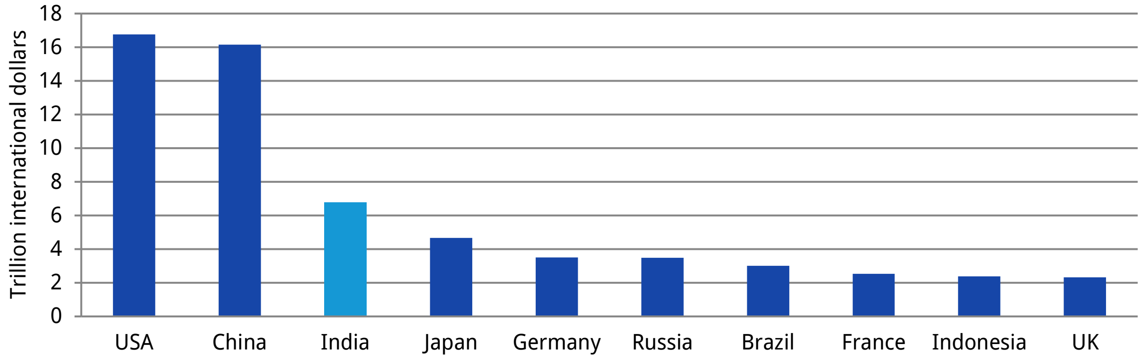
In addition, there are about 15 gazetted holidays and 28 restricted holidays on the official calendar.[5] These public holidays are set by every state government each year under the Negotiable Instruments Act, 1881.

Economy

India is among the fastest growing economies in the world. It is the third largest economy in terms of gross domestic product (GDP) based on purchasing power parity (PPP) and the tenth largest by nominal GDP.

The world's largest economies by GDP (PPP): 2013

Trillion international dollars



Source: International Monetary Fund, World Economic Outlook Database, October 2014

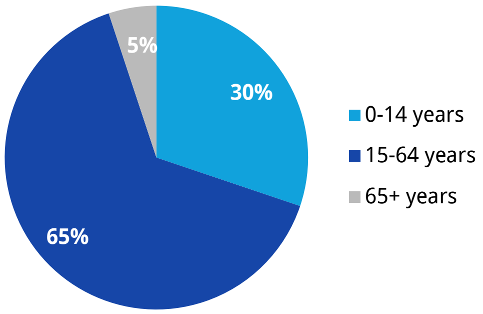
[5] Holiday calendar, National Portal of India, http://india.gov.in/calendar, accessed 7 August 2014

The services sector has been driving economic growth in India, accounting for 67.4% of GDP in 2013-14, followed by industry with an 18.7% share and agriculture accounting for 13.9%.[6] However, agriculture still has the largest share in employment (48.9% of the total workforce in 2011-12), followed by services (26.9%).[7]

India will soon have the largest and youngest workforce the world.[8] With 65% of the population being in the age range of 15–64 years and a median age of 25.5 years, India has a favourable demographic dividend.

Population distribution by age group: 2010

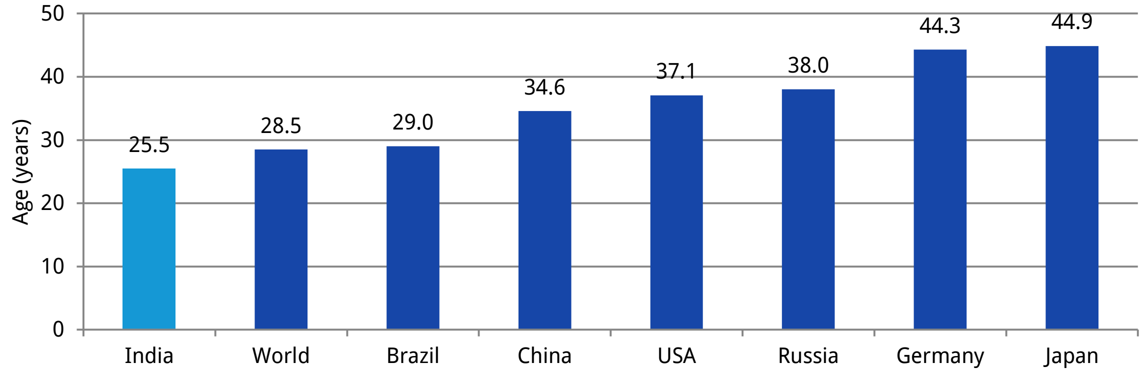
% share



Source: United Nations, Department of Economic and Social Affairs, Population Division, World Population Prospects: The 2012 Revision

Median age of the total population: 2010

Years



Source: United Nations, Department of Economic and Social Affairs, Population Division, World Population Prospects: The 2012 Revision

Well-regulated and stable financial markets, coupled with rising per capita income, a growing middle class, rapid urbanisation, and a strong domestic market (private consumption accounts for about 60% of GDP), offer significant promise and potential for investors. India offers opportunities to

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6 Reserve Bank of India Bulletin, October 2014, http://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/BUL10102014_FL.pdf, accessed 13 October 2014

7 Economic Survey 2013-14, http://indiabudget.nic.in/es2013-14/echap-01.pdf, accessed 13 October 2014

8 World Bank, India, http://www.worldbank.org/en/country/india/overview, accessed 13 October 2014

investors across sectors, including automobiles, chemicals, defence manufacturing, infrastructure, information technology, pharmaceuticals, steel and space technologies among others.

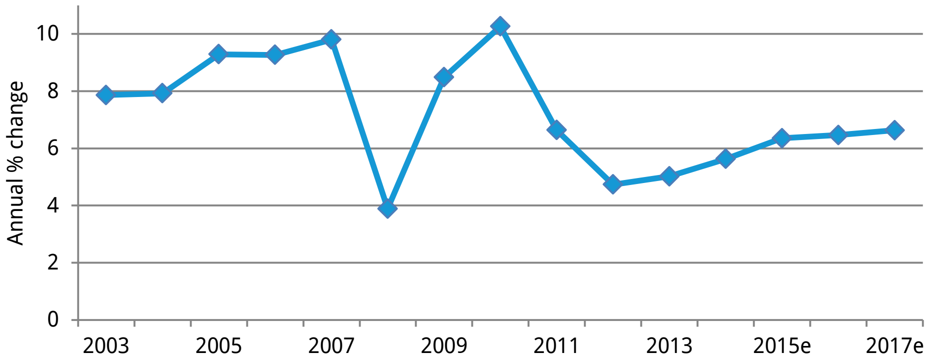
The new business-friendly government's policies will help boost foreign investments further. The government aims to:

- focus on reviving growth by fuelling investments in infrastructure and manufacturing;
- promote foreign direct investment (FDI) selectively in sectors;
- introduce administrative reforms to expedite project implementation;
- have a stable, predictable and investor-friendly taxation regime;
- increase transparency and establish systems to eliminate corruption; and
- strengthen and expand India's trade network with regional, bilateral and multilateral trade agreements.

As a result of effective policies and a post-election renewal of confidence, India's GDP growth is expected to accelerate to 6.4% by 2015 compared to the sub-5% growth in recent years.[9]

Real GDP growth in India: 2003–2017

Annual % change



Source: International Monetary Fund, World Economic Outlook Database, October 2014

Foreign trade: In 2013, India ranked 19th among the world's leading merchandise exporters (compared to 31st in 2000) and 12th among importers (from 26th in 2000) according to the World Trade Organization (WTO). There has also been a marked improvement in India's total merchandise trade to GDP ratio from 21.8% in 2000-01 to 44.1% in 2013-14. India's top trading partners are China, USA, UAE, Saudi Arabia, Switzerland, Germany, Hong Kong and Indonesia.[10]

India's top export commodities include petroleum products, engineering goods, gems and jewellery, textiles, pharmaceuticals, chemicals and automobiles. Under non-oil imports, major commodities include electronic goods, machinery, gold, chemicals, iron and steel, coal and precious and semi-precious stones.

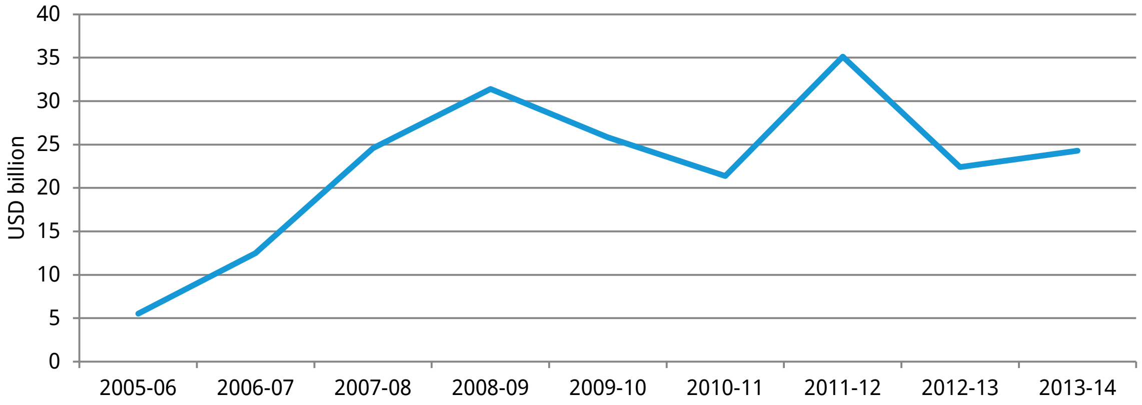
[9] International Monetary Fund, World Economic Outlook, October 2014, http://www.imf.org/external/pubs/ft/weo/2014/02/, accessed 13 October 2014

[10] Economic Survey 2013-14, Chapter 7: International Trade, http://indiabudget.nic.in/es2013-14/echap-07.pdf, accessed 13 October 2014

Foreign direct investment: According to UNCTAD's World Investment Prospects Survey 2013–2015, India is one of the top three destinations for FDI[11]. Cumulative FDI equity inflows into India stood at USD 228 billion during April 2000 to July 2014.[12]

Annual FDI equity inflows into India: financial years 2005-06 to 2013-14

USD billion

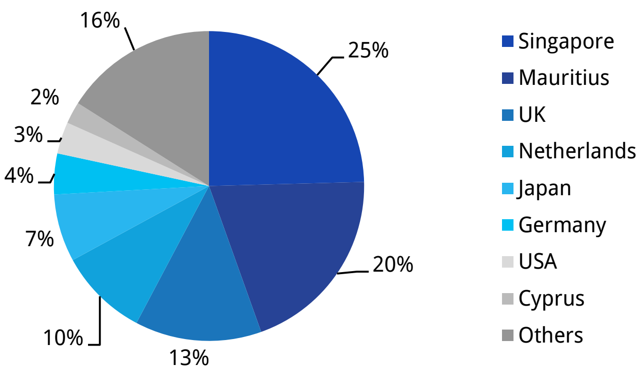


Source: Department of Industrial Policy and Promotion, FDI Statistics, July 2014

From April 2000 to July 2014, cumulative FDI equity inflows from Mauritius stood at USD 81.9 billion, making it the largest source of FDI. In 2013-14, Singapore was the top investor into India with USD 5.98 billion, followed by Mauritius, UK, Netherlands, Japan, Germany, USA, Cyprus, Switzerland and France.

Country-wise FDI equity inflows: 2013-14

% share



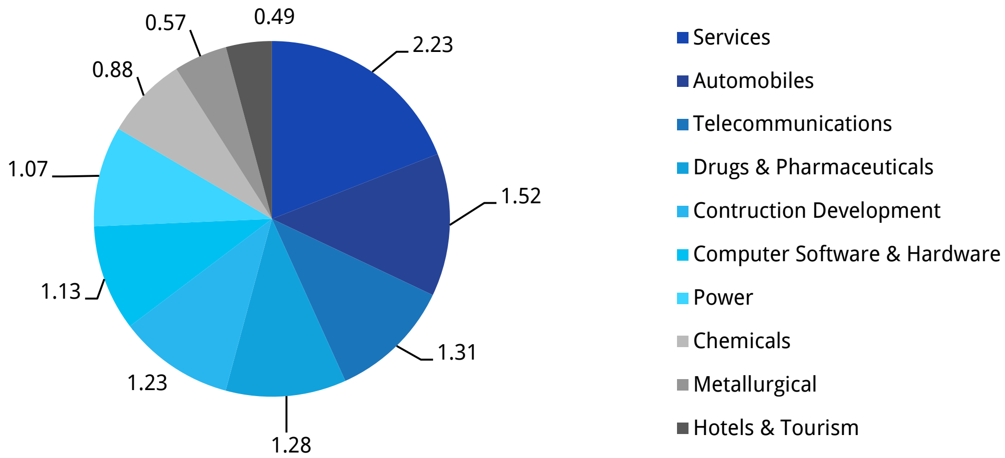
Source: Department of Industrial Policy and Promotion, FDI Statistics, July 2014

[11] UNCTAD World Investment Prospects Survey 2013–2015, http://unctad.org/en/PublicationsLibrary/webdiaeia2013d9_en.pdf, accessed 13 October 2014.
[12] Department of Industrial Policy and Promotion, Fact Sheet on Foreign Direct Investment, July 2014 http://dipp.nic.in/English/Publications/FDI_Statistics/2014/india_FDI_July2014.pdf, accessed 13 October 2014

Considering sector-wise inflows, services attract the highest amount of FDI in India and accounted for 18% of total inflows during April 2000–July 2014. In 2013-14, besides services, the other top sectors for FDI were automobiles, telecommunications, drugs and pharmaceuticals, construction development, computer software and hardware, and power.

Sector-wise FDI equity inflows: 2013-14

USD billion



Source: Department of Industrial Policy and Promotion, FDI Statistics, July 2014

As on 3 October 2014, India's foreign exchange reserves stood at USD 311 billion.

For FDI regulations in India, please see the FDI section in Chapter 2.

Chapter 2

Government policies and business regulatory environment

Business regulations

Companies Act

The Ministry of Corporate Affairs (MCA) regulates corporate affairs in India through the Companies Act, 1956, 2013 and other allied Acts, Bills and Rules. Companies incorporated in India or foreign companies having a place of business in India are regulated by the Companies Act, 1956 and 2013 (to the extent notified). The new Act consolidates and amends the law relating to companies. Some of the provisions of the new Act have been implemented while some provisions of the Companies Act, 1956 are still in force.

The Registrar of Companies (ROC), Company Law Board (CLB) and National Company Law Tribunal (NCLT) are responsible to administer the Act and to ensure compliance. Following the constitution of NCLT, the CLB will cease to exist and all the powers of CLB will be vested in the NCLT. Companies are broadly classified into public and private companies. A public company may further be listed or unlisted. Listed public companies have to additionally comply with the regulations issued by the Securities and Exchange Board of India (SEBI).

Foreign exchange laws

The Foreign Exchange Management Act, 1999 (FEMA) aims at facilitating external trade and payments and promoting the orderly development and maintenance of the foreign exchange market in India[13].

Foreign direct investment[14]

A foreign company planning to set up business operations in India can incorporate a company under the Companies Act as a joint venture or a wholly owned subsidiary. A foreign company could also set up a liaison office/representative office, project office or branch office of the foreign company, which can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or Other Place of Business) Regulations, 2000. A foreign company may also invest in a Limited Liability Partnership (LLP) under the Limited Liability Partnership Act, 2008, a relatively new but popular concept in India. Please also see Chapter 4 Business entities.

An Indian company may receive foreign direct investment (FDI) under the automatic route or the government (approval) route. FDI is allowed under the automatic route without prior approval either of the government or of the Reserve Bank of India (RBI) in all activities/sectors as specified in the consolidated FDI Policy, issued by the Indian government from time to time. FDI in activities under the government route is considered by the Foreign Investment Promotion Board (FIPB) under the Ministry of Finance. An Indian company receiving FDI is required to comply with other provisions of the FDI policy such as reporting requirements, allotment of securities and pricing guidelines.

FDI is prohibited in atomic energy, lottery business, gambling and betting, business of chit fund, Nidhi company, agriculture (excluding floriculture, horticulture, development of seeds, animal husbandry, pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and plantation activities (other than tea plantations), housing and real estate business (except development of townships, construction of

[13] Preamble to the Foreign Exchange Management Act, 1999

[14] RBI: Foreign Investments in India, http://www.rbi.org.in/scripts/FAQView.aspx?Id=26, accessed 7 August 2014

residential/commercial premises, roads or bridges), trading in Transferable Development Rights (TDRs), manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

Depending on the nature of business to be carried out by the Indian entity, specific registrations, approvals and licenses such as Permanent Account Number (PAN), Tax Account Number (TAN), Shops and Establishments registration/Factories license, Central Sales Tax and Value Added Tax (VAT) registrations, Excise registration, Import Export Code (IEC) are required to be obtained.

The Industrial Policy, 1991 looks at industrial licensing, foreign investment, foreign technology agreements, public sector policy, and the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969.[15] States have their own industrial policies that may have different focus areas.

Government incentives and assistance

Industry-specific incentives: These are available to promote specific industries in India, which include agriculture, food processing, textile, power and infrastructure. These incentives can be governed by both central and state government legislation and mainly provide capital and interest subsidies for investments in specified industries.

State-level incentives: These are governed by state industrial policies and depend on the amount of investment and location of the industrial project. The incentives are mainly in the form of a VAT/Central Sales Tax refund, interest subsidies, power tariff/electricity duty exemptions, stamp duty exemptions, etc.

Export incentives: Special Economic Zones (SEZs) and Export Oriented Units (EOUs)**:** The SEZ Act, 2005 aims at attracting larger foreign investments into India by providing quality infrastructure complemented by an attractive fiscal package at the centre and the state level, with minimal regulations.[16] Incentives provided in an SEZ differ from state to state.

Units undertaking to export their entire production of goods and services may be set up under the EOU Scheme, Electronics Hardware Technology Park (EHTP) Scheme, Software Technology Park (STP) Scheme or Bio-Technology Park (BTP) Scheme for manufacture of goods, including repair, re-making, reconditioning, reengineering and rendering of services.[17]

The Export Promotion Council for EOUs and SEZs (EPCES) has been set up to service the export promotional needs of 100% EOUs, SEZ units and Agri Economic Zones in the country. The EPCES is a multi-product- and scheme-specific export promotion council. The EOUs/SEZ units cover major industrial sectors, like textiles, garments & yarn, food & agro products, electronics & software, chemical, engineering, minerals, granite, etc.[18]

[15] Industrial Policy Highlights, Office of the Economic Adviser, http://eaindustry.nic.in/Industrial_Handbook_0809_Main.html, accessed 7 August 2014
[16] Special Economic Zones in India http://sezindia.nic.in/about-introduction.asp, accessed 7 August 2014
[17] Foreign Trade Policy 2009-2014, http://dgft.gov.in/exim/2000/policy/hbppol1/2009-2010/chap06.htm, accessed 7 August 2014
[18] Export Promotion Council for EOUs and SEZs, http://www.eouindia.gov.in/epc_about.htm, accessed 7 August 2014

Government agencies supporting business growth

The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry, is the main government agency that facilitates investment and technology flows by formulating and implementing policies and monitors industrial development in India. Other agencies include state industrial corporations, investor facilitation centres and bilateral chambers of commerce.

Invest India is the country's official agency dedicated to investment promotion and facilitation. Set up as a joint venture between the Federation of Indian Chambers of Commerce and Industry (FICCI) (51% equity), DIPP (35% equity) and state governments of India (0.5% each), its mandate is to become the first reference point for the global investment community. It provides sector- and state-specific information to a foreign investor, assists in expediting regulatory approvals, and offers hand-holding services.[19]

On 25 September 2014, Prime Minister Modi launched the 'Make in India' campaign, focusing on initiatives to facilitate investment into India and build best-in-class manufacturing infrastructure. The scheme aims to make doing business in India easier: reducing red tape with new de-licensing and deregulation measures, improved infrastructure, more sectors being opened up to FDI and most importantly, a change in mindset from the government being a 'permit-issuing authority' to a true business partner. Invest India will act as the first reference point for guiding foreign investors on all aspects of regulatory and policy issues and assist them in obtaining regulatory clearances. Its dedicated Investor Facilitation Cell will answer queries of business entities within 72 hours. The government has identified 25 sectors in which India can excel, details for which are available on www.makeinindia.com.

eBiz is India's government-to-business (G2B) online portal aimed at creating an investor-friendly business environment in India by making all regulatory information – starting from the establishment of a business, through its ongoing operations, and even its possible closure – easily available to various stakeholders. It aims to develop a transparent, efficient and convenient interface through which the government and businesses can interact in a timely and cost-effective manner, reducing unnecessary delays in various regulatory processes.[20]

Bank accounts

India has a well developed banking system regulated by the Reserve Bank of India (RBI). Established in 1935, the RBI is the central bank of India. The RBI regulates the issue of bank notes and keeping of reserves, controls the credit system, regulates and supervises the financial system, regulates foreign exchange, acts as banker to governments and to other commercial banks and plays a developmental and promotional role in the banking system. Public and private sector banks coexist in India and are subject to the control and supervision of the RBI. The Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 are the core legislations pertaining to the banking sector in India.[21]

A foreign company setting up business in India typically opens a current (checking) account with an Authorised Dealer (AD) bank. An AD bank functions under the direction and supervision of the RBI and handles both current and capital account transactions. Current account transactions such as

[19] Invest India, http://www.investindia.gov.in, accessed 7 August 2014
[20] eBiz, India's G2B portal, https://www.ebiz.gov.in/aboutus, accessed 7 August 2014
[21] RBI: About Us, http://www.rbi.org.in/scripts/AboutusDisplay.aspx, accessed 7 August 2014

payments in the course of foreign trade and banking and credit facilities in the ordinary course of business are usually freely permitted. Capital account transactions such as transfer or issue of any foreign security by an Indian resident, transfer or issue of security by a non-resident, any borrowing or lending, acquisition of immovable property by a non-resident and giving of a guarantee in respect of a debt or liability are regulated by the RBI.[22] The ease with which banking account transactions can be carried out is also dependent on whether an entity is operating under the automatic route or government route as mentioned earlier.

Intellectual property (IP)

Acts covering intellectual property in India include the Trade Marks Act, 1999; Patents Act, 1970; Designs Act, 2000; and Geographical Indications of Goods (Registration & Protection) Act, 1999. The intellectual property needs to be registered with the Controller General of Patents, Designs and Trademarks.[23]

Patents

The patent law in India is governed by the Patents Act, 1970 as amended by the Patents (Amendment) Act, 2005 and the Patents Rules, 2003 as amended by the Patents (Amendment) Rules, 2006.

Under the Patent Act, 1970, any invention that has the following three essential ingredients may be patented:
a. Novelty
b. Utility / Usefulness
c. Non-obviousness / inventive step

[24]Normally a patent obtained in India is not enforceable in another country as patent rights are territorial in nature. However, India is a signatory to the Patent Cooperation Treaty (PCT) which allows a person to file a single application to seek protection in all of the contracting parties to the PCT. India is a signatory to the Paris Convention for the protection of Industrial Property. The Indian patent system also allows applicants to claim priority of an earlier filed application in another Paris Convention country. Apart from the above India is signatory to the Budapest Treaty and Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

[25]Only the true and first inventor or his/her assignee or the legal representatives of deceased inventor or assignee are authorized to file a patent application in India. The patent system in India is on a 'first-to-file' basis. The grant of patent in India normally takes four to five years. In India a patent application can be filed with the Office of the Controller General of Patents, Designs and Trade Marks. There are four patent offices in India, which are located in Mumbai, Kolkata, Delhi and Chennai. Patent application can be filed in any one of these patent offices, depending on the territorial jurisdiction. The Patent office also accepts patent applications online thorough the website at http://ipindia.nic.in/ipr/patent/patents.htm.

[22] Ministry of Finance, http://finmin.nic.in/the_ministry/dept_eco_affairs/capital_market_div/FEMA_act_1999.pdf, accessed 7 August 2014
[23] Controller General of Patents, Designs and Trademarks, http://www.ipindia.nic.in/, accessed 7 August 2014
[24] http://newdelhi.usembassy.gov/iprpatents.html
[25] http://newdelhi.usembassy.gov/iprpatents.html

An applicant can file a patent application if they have a place of residence or business or a domicile in India. The Applicant must be an Indian national or a national of a Convention country. Foreign Applicants who do not have a place of business in India can file their patent applications through an Indian patent agent.

[26]The term of a patent is twenty years from the date of application. A renewal fee has to be paid every year to keep the patent valid for the term of 20 years.

[27]The Patent Act, 1970 provides for the enforcement of patents by way of suits on infringement. The patentee may file an action for patent infringement in either a District Court or a High Court. The relief which a court may grant in any suit for infringement includes, an injunction and, at the option of the patentee, either damages or an account of profits. The court may also order that the infringing goods be seized, forfeited or destroyed without payment of any compensation.

Copyright

The Copyright Act, 1957 protects original literary, dramatic, musical and artistic works and cinematograph films and sound recordings from unauthorised use. Unlike patents, copyright protects the expression and not ideas. There is no copyright protection for ideas, procedures, methods of operation or mathematical concepts as such. It is not necessary to register a work to claim copyright in India. Acquisition of copyright is automatic – it comes into existence as soon as a work is created and requires no formalities. However, a certificate of registration of copyright and the entries made therein serve as prima facie evidence in a court of law with reference to disputes on ownership of copyright. The Copyright Office has been set up to provide registration facilities to all types of works and is headed by a Registrar of Copyrights. The Copyright (Amendment) Act, 2012 extends copyright protection in the digital environment, ensuring the right to receive royalties for authors, and music composers, exclusive economic and moral rights to performers, equal membership rights in copyright societies for authors and other right owners, and exception of copyrights for the physically disabled to access any works.[28]

Trademarks

Under the Trade Marks Act, 1999, a person who is the proprietor of the trademark can apply to the Registrar of Trade Marks for the registration of its mark for goods and services. A trademark is a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of another. The 'Mark' includes a device, brand, heading, label, ticket, name, signature, word, letter, numeral, shape of goods, packaging or combination of colours or any combination thereof.[29]

Design

[30]The essential purpose of design law is to promote and protect the design element of industrial production. It is also intended to promote innovative activity in the field of industries. The existing legislation on industrial designs in India is contained in the New Designs Act, 2000.

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[26] http://ipindia.nic.in/ipr/patent/patents.htm

[27] Patent Act ,1970

[28] Copyright Office, http://copyright.gov.in, accessed 7 August 2014

[29] Controller General of Patents, Designs and Trademarks, http://ipindia.nic.in/tmr_new/tmr_act_rules/TMRAct_New.pdf, accessed 7 August 2014

[30]http://www.ipindia.nic.in/

Following are the essential requirements for the registration of 'design' under the Designs Act, 2000:

- The design should be new or original, not previously published or used in any country before the date of application for registration.
- The design should relate to features of shape, configuration, pattern or ornamentation applied or applicable to an article.
- The design should be applied to any article by any industrial process.
- The features of the design in the finished article should appeal to and judged solely by the eye.
- Any mode or principle of construction or operation or any thing which is in substance a mere mechanical device would not be a registrable design.
- The design should not include any Trade Mark or property mark or artistic works as defined under the Copyright Act, 1957.

The registration of a design confers upon the registered proprietor 'Copyright' in the design for the period of registration. [31]It gives the proprietor an exclusive right to sell, import and apply it to any article. Registration of a Design in India will provide protection only in India as rights are granted on a country-by-country basis. India has not yet acceded to the Hague System for the International Registration of Industrial Designs, which gives the owner of an industrial design the possibility to have its design protected in several countries by filing just one application with the International Bureau of WIPO.

Any person (including a partnership firm or a body corporate) claiming to be the proprietor of the design can apply for its registration. The application for registration of design can be filed by the applicant himself or through a professional person (i.e. patent agent, legal practitioner). However, for the applicants who are not Indian residents, an agent residing in India must be employed. In India, a design application can be filed with the Office of the Controller General of Patents, Designs and Trademarks.

The duration of the registration of a design is initially ten years from the date of registration. This initial period of registration may be extended by 5 years.

The registered proprietor may bring a suit for recovery of damages for any infringement of design and for injunction against repetition of the same. Total sum recoverable can not exceed Rs. 50,000/-. The suit for infringement and/or passing off or recovery of damages can be initiated either in the District Court or in the High Court depending on the valuation of the suit.

Privacy

The Indian Constitution does not expressly guarantee the right to privacy, but the Supreme Court of India has time and again protected the right to privacy by reading it into the fundamental right to life and personal liberty available to all persons. Privacy rules in India are contained in the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011 (Privacy Rules) notified under the Information Technology Act, 2000. The Privacy Rules are applicable to bodies corporate across industries and sectors.

Under the Privacy Rules, a body corporate handling or collecting personal information from any person is required to**:**

- provide a privacy policy and make it accessible to the providers of information;
- have in place reasonable security practices and procedures;

[31] http://newdelhi.usembassy.gov/iprdesign.html

- obtain consent from the providers of information regarding use of such personal information;
- use the personal information only for the purposes for which it has been collected;
- retain information only for such time period as may be required;
- keep the information secure and not publish it;
- obtain permission of the provider of information prior to disclosure of such information unless required to be disclosed by law or to certain government agencies.
- take reasonable steps while collecting information directly from the person concerned to ensure that the person concerned is having the knowledge of —
  - (a) the fact that the information is being collected;
  - (b) the purpose for which the information is being collected;
  - (c) the intended recipients of the information; and
  - (d) the name and address of —
    - i. the agency that is collecting the information; and
    - ii. the agency that will retain the information
- permit the providers of information, as and when requested by them, to review the information they had provided and ensure that any personal information or sensitive personal data or information found to be inaccurate or deficient is corrected or amended as feasible
- provide an option to the provider of information to not to provide the data or information sought to be collected or to withdraw the consent given earlier. In such cases the body corporate shall have the option not to provide goods or services for which the said information was sought.
- address any discrepancies and grievances of their provider of information with respect to processing of information in a time bound manner. For this purpose, the body corporate has to designate a Grievance officer and publish his name and contact details on its website. The Grievance Officer will have to redress the grievances of provider of information expeditiously but within one month from the date of receipt of grievance. [32]

Certain industries where technology and data transfer are critical are closely monitored by the government. E.g. licensed defence industries in the private sector.

Mergers and monopolies

Mergers: Mergers are a popular form of corporate restructuring in India. The Companies Act, 2013, the Company Court Rules, the Income Tax Act, 1961, the Indian Stamp Act, 1899 and the Competition Act, 2002 are the key regulations concerning mergers. Public companies have to additionally comply with the regulations issued by SEBI. Companies that have foreign capital will have to meet the requirements under FEMA.

A merger in India typically needs to be sanctioned by the court (tribunal under the new Companies Act, 2013) and requires, in most cases, reports from the offices of the Registrar of Companies, Official Liquidator and Regional Director under the Ministry of Corporate Affairs. The RBI would administer the provisions relating to mergers under FEMA. Valuation, accounting treatment and stamp duty are other critical aspects of a merger.

[32] Department Of Electronics & Information Technology, http://deity.gov.in/sites/upload_files/dit/files/GSR313E_10511(1).pdf, accessed 7 August 2014

Monopolies: The erstwhile Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act) controlled monopolies and prohibited monopolistic and restrictive trade practices in India. The MRTP Act was completely replaced by the Competition Act, 2002 with effect from 1 September 2009.

The Competition Act moved away from the earlier emphasis of curbing monopolies towards promoting and sustaining competition and thereby increasing efficiency, innovation and competitiveness.[33] The Competition Act aims at preventing practices having an adverse effect on competition, protecting interests of consumers and ensuring freedom of trade.[34]

It prohibits anti-competitive agreements and abuse of a dominant position and regulates combinations.

Import and export controls

In India, exports and imports are regulated by the Foreign Trade (Development and Regulation) Act, 1992 and the Foreign Trade Policy (FTP). The Department of Commerce, Ministry of Commerce & Industry, facilitates the creation of an enabling environment and infrastructure for accelerated growth of international trade. The Department formulates, implements and monitors the FTP, which provides the basic framework of policy and strategy to be followed for promoting exports and trade.[35] The new Foreign Trade Policy 2014–2019 is expected to be announced shortly.

Free Trade Agreements (FTAs) are an important element of India's trade strategy – a comprehensive list of India's FTAs can be viewed on the Department of Commerce's website.[36]

Duty Exemption Schemes enable duty-free import of inputs required for export production. These include the Advance Authorisation Scheme and Duty-Free Import Authorisation (DFIA) scheme. A Duty Remission Scheme enables post-export replenishment/remission of duty on inputs used in export products. Duty Remission Schemes consist of the Duty Entitlement Passbook (DEPB) Scheme and the Duty Drawback (DBK) Scheme. Other schemes include the Zero-duty Export Promotion of Capital Goods Scheme, 100% Export Oriented Unit Scheme, Deemed Exports, etc.[37]

The Customs Act, 1962 provides for levy and collection of customs duty on imports and exports, import/export procedures, prohibitions on import and export of certain goods, penalties, offences, etc. The central government levies customs duty on import and export of goods at the rates and on the basis of classification under the Customs Tariff Act, 1975. The Central Board of Excise and Customs (CBEC) is the apex body that deals with the formulation of policy concerning the levy and collection of customs and central excise duties, prevention of smuggling and administration of matters relating to customs, central excise, service tax and narcotics to the extent under CBEC's purview.[38] The Customs/Import tariff for various goods can be viewed on the CBEC website. According to the Union Budget 2014-15, an 'Indian Customs Single Window Project' to facilitate trade will be implemented.[39]

[33] Annual Report of the Competition Commission of India for 2011-12, http://www.cci.gov.in/, accessed 7 August 2014
[34] Preamble to the Competition Act, 2002
[35] Department of Commerce, http://commerce.nic.in/aboutus/aboutus_organisational.asp?id=1, accessed 8 August 2014
[36] Trade Agreements, Department of Commerce, http://commerce.nic.in/trade/international_ta.asp, accessed 8 August 2014
[37] Foreign Trade Policy 2009-2014, http://dgft.gov.in/exim/2000/policy/ftpplcontentE1213.pdf, accessed 8 August 2014
[38] Central Board of Excise and Customs, http://www.cbec.gov.in/whoweare/whoweare.htm, accessed 8 August 2014
[39] Key features of Budget 2014-15, http://indiabudget.nic.in/ub2014-15/bh/bh1.pdf, accessed 8 August 2014

Consumer protection

The Department of Consumer Affairs, Ministry of Consumer Affairs, Food and Public Distribution, is responsible for the formulation of policies for consumer cooperatives, monitoring prices, consumer movement in the country and controlling of statutory bodies like the Bureau of Indian Standards (BIS) and Weights and Measures.[40]

The Consumer Protection Act, 1986 is a social legislation that lays down the rights of consumers and provides for promotion and protection of consumer rights in India. The provisions of this Act cover 'goods' as well as 'services'. Goods covered under this Act are those that are manufactured or produced and sold to consumers through wholesalers and retailers. Services are in the nature of transport, telephone, electricity, housing, banking, insurance, medical treatment, etc. The remedy under the Consumer Protection Act is an alternative in addition to that already available to an aggrieved consumer by way of civil suit.

To provide inexpensive and speedy redressal of consumer disputes, quasi-judicial bodies have been set up in each district, state and at the national level, called District Forums, State Consumer Disputes Redressal Commissions and the National Consumer Disputes Redressal Commission, respectively. Also, aggrieved consumers can file their complaints with Consumer Forums that can award compensation and provide other relief to the consumer.[41] They could also call the toll-free National Consumer Helpline on 1800-11-4000.

Building regulations

The National Building Code of India, 2005 (NBC) is a comprehensive building code providing guidelines for regulating building construction activities across the country. It serves as a model code for adoption by all agencies involved in building construction, such as Public Works Departments, construction departments, local bodies or private construction agencies. The NBC mainly contains administrative regulations, development control rules and general building requirements; fire safety requirements; stipulations regarding building materials, structural design and construction (including safety); and building and plumbing services.[42] Local bylaws are also formulated and adopted by state governments, urban local bodies and development authorities to regulate construction activities in the area that they are framed for.

Environment, pollution and waste management

There are various laws governing environmental and pollution control matters, including the Water (Prevention and Control of Pollution) Act, 1974; the Air (Prevention and Control of Pollution) Act, 1981; Environment (Protection) Act, 1986; the Biomedical Waste Management & Handling) Rules, 1998; the Manufacture, Storage and Import of Hazardous Chemicals Rules, 1989; and the Hazardous Waste (Management, Handling and Transboundary Movement) Rules, 2008. Contravention of the above acts attracts a fine and imprisonment. The Ministry of Environment & Forests (MoEF) is the nodal agency of the central government for planning, promoting, coordinating and overseeing the implementation of India's environmental and forestry policies and programmes.[43]

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[40] Department of Consumer Affairs, http://consumeraffairs.nic.in/consumer/index.php, accessed 8 August 2014
[41] National Consumer Disputes Redressal Commission, http://ncdrc.nic.in, accessed 8 August 2014
[42] National Building Code of India, 2005, http://www.bis.org.in/sf/nbc.htm, accessed 11 August 2014
[43] Ministry of Environment & Forests, http://envfor.nic.in/about-ministry/about-ministry, accessed 11 August 2014

In India, the Public Liability Insurance Act, 1991 applies to all owners associated with the production or handling of any hazardous chemicals. It provides for damages to victims of an accident which occurs as a result of handling any hazardous substance.[44]

The Central Pollution Control Board (CPCB) is a statutory organisation under the MoEF that advises the central government on any matter concerning the prevention and control of water and air pollution and coordinates the activities of the State Pollution Control Boards (SPCB) among other things.[45] Each SPCB provides detailed guidelines for necessary approvals and conditions required for setting up operations in the state.

[44] Public Liability Insurance, Ministry of Environment & Forests, http://envfor.nic.in/rules-regulations/public-liability-insurance, accessed 11 August 2014
[45] Central Pollution Control Board, http://cpcb.nic.in/Functions.php, accessed 11 August 2014

Chapter 3

Banking and finance

The banking system

The banking and financial sector in India functions under the superintendence and control of the central bank of the country, the Reserve Bank of India (RBI). It was established in 1935 with the main aim of maintaining monetary and financial stability.

The RBI performs the following functions[46]:
Monetary authority
- Formulates, implements and monitors the monetary policy.
- Objective: maintaining price stability and ensuring adequate flow of credit to productive sectors.

Regulator and supervisor of the financial system
- Prescribes a broad operational framework for the country's banking and financial system.
- Objective: to maintain public confidence in the system, protect depositors' interests and provide cost-effective banking services.

Manager of foreign exchange
- Implements the Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment, and promote orderly development and maintenance of the foreign exchange market in India.

Issuer of currency
- Issues and exchanges/destroys currency and coins not fit for circulation.

Other functions
- Banker and debt manager to the government: performs merchant banking function for the central and state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.

Existing banking structure[47]

Different departments of the RBI oversee the various entities that comprise India's financial infrastructure, such as commercial banks, financial institutions, cooperative banks, and non-banking financial companies (NBFCs).

Types of banks		Number of banks (as on 31 March 2013)
Commercial banks	Public sector banks	26
	Private sector banks	20
	Foreign banks	43
	Regional rural banks	64
	Local area banks	4
Cooperative banks	Urban cooperative banks	1,606
	Rural cooperatives	93,551

Legal framework[48]

The primary acts governing this sector are the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949 (also the Banking Laws (Amendment) Act, 2012). Several other Acts govern

[46] About Us, RBI, http://www.rbi.org.in/scripts/aboutusdisplay.aspx#MF, accessed 9 September 2014
[47] Discussion Paper on Banking Structure in India - The Way Forward, http://rbi.org.in/Scripts/PublicationReportDetails.aspx?ID=713, accessed 22 September 2014
[48] About Us, RBI, http://www.rbi.org.in/scripts/aboutusdisplay.aspx#MF, accessed 22 September 2014

specific functions (e.g. the Foreign Exchange Management Act, 1999), banking operations and individual institutions.

Setting up a bank in India[49]

The Banking Regulation Act, 1949 provides that a company intending to carry on banking business must obtain a license from the RBI except for those banks (public sector banks and regional rural banks) that are established under specific enactments.

The RBI issues licences only after 'tests of entry' are fulfilled. These tests include minimum capital requirements, ownership structure, operating plans and controls, ability of the bank to pay its present and future depositors in full, quality of management and whether the licensing of the bank would be in public interest.[50] Currently, the minimum paid-up capital requirement for setting up a bank is INR 5 billion.

Foreign banks in India[51]

Foreign banks account for less than 1% of the total branches of commercial banks in India. The share of foreign banks in the total assets of India's banking sector is just 7%. Moreover, the operations of foreign banks are mainly concentrated in urban and metropolitan areas. As on 31 May 2013, there were 43 foreign banks in India operating through a network of 333 branches, of which 331 were in urban and metropolitan areas. Also, 47 foreign banks have a presence in India in the form of representative offices.

With increasing globalisation, the presence of foreign banks must expand, particularly because they specialise in providing sophisticated financial products and also facilitate the flow of foreign capital. Their increased presence would meet the requirements of the growing Indian economy.

Currently, foreign banks can establish their operations in India either through a branch or by setting up a wholly owned subsidiary (WOS) with near national treatment.

The RBI issues a single class of banking licence for conducting all types of banking business, ranging from retail, wholesale, foreign exchange, derivative products, credit cards, etc. There is no restriction as to the type of business to be conducted through branches unlike in some countries where restrictions are placed on acceptance of retail deposits, conducting business in local currency, types of clientele, region, availability of deposit insurance, access to clearing and settlement systems, etc. Once established, the regulation is non-discriminatory in India, and foreign banks enjoy near national treatment [52]

It is important to note that foreign banks that have commenced banking business in India after August 2010 or those who are not carrying on banking business in India at present but wish to do so

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[49] Discussion Paper on Banking Structure in India - The Way Forward, http://rbi.org.in/Scripts/PublicationReportDetails.aspx?ID=713, accessed 22 September 2014
[50] Core Principles of Effective Banking Supervision, http://www.rbi.org.in/upload/publications/pdfs/10115.pdf, accessed 22 September 2014
[51] Discussion Paper on Banking Structure in India - The Way Forward, http://rbi.org.in/Scripts/PublicationReportDetails.aspx?ID=713, accessed 22 September 2014
[52] Discussion Paper on Banking Structure in India - The Way Forward, http://rbi.org.in/Scripts/PublicationReportDetails.aspx?ID=713#C2, accessed 22 September 2014

in the future must set up through a wholly owned subsidiary if they fall under certain categories e.g. if they have complex structures, are not widely held, etc.[53]

Foreign shareholding in banks

According to the RBI, the aggregate non-resident shareholding from FDI, non-resident Indians (NRIs) and foreign institutional investors (FIIs) in new private sector banks shall not exceed 49% for the first five years from the date of licensing of the bank. No non-resident shareholder will be permitted to hold 5% or more of the paid-up capital of the bank. After five years from the date of licensing, foreign shareholding would be as per the extant policy. Currently, foreign shareholding in private sector banks is allowed up to a ceiling of 74% of the paid-up capital (up to 49% under the automatic route).[54]

In case of FIIs/foreign portfolio investors (FPIs), qualified foreign investors (QFIs) individual holding is restricted to less than 10% of the total paid-up capital. The aggregate limit for all FIIS/FPIs/QFIs cannot exceed 24% of the total paid-up capital, which can be raised to 49% by the bank through a resolution by its Board of Directors followed by a special resolution by its General Body. FDI/portfolio investment in public sector banks is limited to 20%.[55]

Capital requirements

The RBI has instructed banks to maintain adequate capital on a continuous basis for credit risk, market risk, operational risk and other risks. Capital adequacy is measured in terms of the Capital to Risk-Weighted Assets Ratio (CRAR). Basel III capital regulations specifying minimum capital requirements have been implemented in India as on 1 April 2013 in phases and will be fully implemented by 31 March 2018. The Basel III liquidity standards, viz Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR), will be binding on banks from 1 January 2015 and 1 January 2018, respectively.[56]

Currency exchange control[57]

The RBI supervises and regulates the foreign exchange market in India through the Foreign Exchange Management Act, 1999 (FEMA). It issues licences to banks and other institutions to act as Authorised Dealers in the foreign exchange market. The RBI has undertaken substantial elimination of licensing, quantitative restrictions, and other regulatory and discretionary controls.

The foreign exchange market in India comprises Authorised Persons (banks, money changers and other entities) in the foreign exchange business, foreign exchange brokers who act as intermediaries, and customers – individuals as well as companies – who need foreign exchange for their transactions. The customer segment is dominated by major public sector entities, the Indian government and large private sector companies. FIIs have emerged as an important constituent in the equity market and thus contribute significantly to foreign exchange market activity. The Indian

[53] Scheme for Setting up of Wholly Owned Subsidiaries (WOS) by foreign banks in India, http://rbidocs.rbi.org.in/rdocs/content/pdfs/SBSC061113F.pdf, accessed 22 September 2014

[54] Draft Guidelines for Licensing of New Banks in the Private Sector, http://www.rbi.org.in/Scripts/bs_viewcontent.aspx?Id=2414, accessed 9 September 2014

[55] Consolidated FDI Policy, DIPP, Ministry of Commerce, http://dipp.nic.in/English/Policies/FDI_Circular_2014.pdf, accessed 22 September 2014

[56] Financial Sector Regulation and Infrastructure, RBI, http://rbi.org.in/scripts/PublicationReportDetails.aspx?UrlPage=&ID=709, accessed 22 September 2014

[57] Reserve Bank of India: Functions and Working, http://rbidocs.rbi.org.in/rdocs/Content/PDFs/FUNCWWE080910.pdf, accessed 9 September 2014

foreign exchange market primarily comprises two segments – the spot market (the dominant segment) and the derivatives market.

A unified, single, market-determined exchange rate system based on the demand and supply of foreign exchange has been effective from 1 March 1993. The RBI's exchange rate policy focuses on ensuring orderly conditions in the foreign exchange market; therefore, it closely monitors developments in financial markets in India and abroad. When necessary, it intervenes in the market by buying or selling foreign currencies. Market operations are undertaken either directly or through public sector banks.

Non-banking financial institutions/companies

Non-banking financial institutions cater to a wide range of financial requirements and can broadly be divided into financial institutions (FIs) and non-banking financial companies (NBFCs).

There are four FIs under the regulation and supervision of the RBI: Export-Import Bank of India (EXIM), National Bank for Agriculture and Rural Development (NABARD), National Housing Board (NHB), and Small Industries Development Bank of India (SIDBI).

With the growing importance of financial inclusion, NBFCs have been regarded as important financial intermediaries, particularly for the small-scale and retail sectors.[58] The RBI regulates and supervises NBFCs. An NBFC is a company registered under the Companies Act, whose principal business is lending, investments in various types of shares/stocks/bonds/debentures/securities, leasing, hire-purchase, insurance business, chit business, and whose principal business is receiving deposits under any scheme or arrangement in one lump sum or in instalments. However, an NBFC does not include any institution whose principal business is agricultural activity, industrial activity, trading activity or sale/purchase/construction of immovable property. 100% FDI is permitted under the automatic route for NBFCs involved in specific activities.[59] The RBI has recently introduced changes in the regulatory framework for NBFCs, covering prudential regulations on core capital, asset classification and provisioning norms, corporate governance which will strengthen the NBFC sector, making it more resilient to economic downturns, lower systemic risks and enhance stakeholder confidence.[60]

Some NBFCs are not regulated by the RBI. For example, housing finance companies are regulated by the National Housing Bank, merchant bankers/venture capital funds/stock exchanges/stock brokers/sub-brokers are regulated by the Securities and Exchange Board of India (SEBI), insurance companies are regulated by Insurance Regulatory and Development Authority, chit fund companies are regulated by the respective state governments and Nidhi companies are regulated by the Ministry of Corporate Affairs.[61]

[58] Financial Intermediation, Economic Survey 2013-14, http://indiabudget.nic.in/es2013-14/echap-05.pdf, accessed 22 September 2014
[59] Consolidated FDI Policy, DIPP, Ministry of Commerce, http://dipp.nic.in/English/Policies/FDI_Circular_2014.pdf, accessed 22 September 2014
[60] RBI Notification, October 2014, http://rbidocs.rbi.org.in/rdocs/notification/PDFs/RRFNC101114F.pdf, accessed 11 November 2014
[61] Non-Banking Financial Companies, RBI, http://www.rbi.org.in/scripts/FAQView.aspx?Id=71 accessed 9 September 2014

Recent developments

Financial inclusion

Even with 157 domestic banks operating in the country, just about 40% of adults have formal bank accounts.[62] Financial inclusion is an important priority of the new Modi government in order to have increased savings, security and empowerment of the weaker sections and low-income groups. In August 2014, the Prime Minister launched the Pradhan Mantri Jan-Dhan Yojana – a national mission for financial inclusion. The objective of the scheme is to ensure access to various financial services, including availability of a basic savings bank account, access to need-based credit, remittance facility, insurance and pension to the excluded sections of society.[63]

Besides a bank account, other benefits include a RuPay debit card, INR 100,000 accident insurance cover, and an additional INR 30,000 life insurance cover for those opening accounts before 26 January 2015. Based on account performance, an overdraft facility would also be given. On the first day itself, 15 million bank accounts were opened across 77,000 locations. The scheme's initial target is to open 75 million bank accounts by 26 January 2015.

Migration from cash to e-payment

The Payment Systems Vision Document 2012-15 of the RBI portrays a renewed commitment towards provision of safe, efficient, accessible, inclusive, interoperable, and authorised payment and settlement systems in the country. The vision document also recognises existing challenges such as the predominance of cash payments, lack of penetration of modern electronic payment systems in rural and semi-urban areas, challenges to financial inclusion and migration of government payments to electronic modes as well as other infrastructural issues.

New thrust on mobile banking[64]

Despite over 900 million mobile users in India, only 40 million are mobile banking customers (September 2014), underscoring the need for active collaboration between banks and telecom companies. In 2013-14, the number of mobile banking users went up 57.9% to 35.5 million with a 275% increase in value to INR 224 million, showing the growth potential.

Bharat Bill Payment System (BBPS)

The BBPS is proposed to be a pan-India system for running the bills payment system in the country, operating on a single brand image so as to win the confidence and trust of the customers. The BBPS is aimed to provide the convenience of 'anytime anywhere' bill payments, an interoperable bill payment system for millions of customers and to replace the segmented bill payments taking place at present.

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[62] Discussion Paper on Banking Structure in India - The Way Forward, http://rbi.org.in/Scripts/PublicationReportDetails.aspx?ID=713, accessed 22 September 2014

[63] Pradhan Mantri Jan-Dhan Yojana, http://financialservices.gov.in/Banking/PMJDY%20BROCHURE%20Eng.pdf, accessed 22 September 2014

[64] Digital India: Emerging Challenges & Opportunities for the Banking Sector, RBI, http://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/DIECOBS160914.pdf, accessed 22 September 2014

Chapter 4

Business entities

Sole proprietorship

A sole proprietorship is an organisation where a single individual owns, manages and controls the business. There is no requirement for registration of the firm. The firm has no legal existence separate from its owner. However, the sole proprietor may be required to obtain a license for carrying out business from the local administration. The required capital is supplied wholly by the owner himself, who alone enjoys the profits of the business and he alone bears the losses. The liability of the proprietor is unlimited i.e. it extends beyond the capital invested in the firm. This form of organisation is suitable for businesses that involve moderate risk.[65]

A non-resident Indian (NRI) or Person of Indian Origin (PIO) may invest in a sole proprietorship concern with repatriation benefits only with the prior approval of the Secretariat for Industrial Assistance (SIA), Indian government or Reserve Bank of India (RBI). No person resident outside India other than NRIs/PIOs can make any investment by way of contribution to the capital of a proprietorship concern. However, the RBI may, on an application made to it, permit a person resident outside India subject to terms and conditions as may be considered necessary.[66]

Partnership

A partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons who have entered into partnership with one another are called individually, 'partners' and collectively 'a firm', and the name under which their business is carried on is the 'firm name'. It is governed by the Indian Partnership Act, 1932.[67]

A partnership can be formed by an agreement, which may be either written or oral. If the written agreement is duly stamped and registered, it is known as a 'Partnership Deed'. If the firm is not registered, it will be deprived of certain legal benefits, such as when there are disputes between partners. The Registrar of Firms is responsible for registering partnership firms. There must be a minimum of two partners, while the maximum number can be 10 in case of a banking business and 20 in all other types of businesses. The firm has no separate legal existence i.e. the firm and the partners are the same in the eyes of law. The liability of the partners is unlimited – they are jointly and severally liable for the liabilities of the firm. There are restrictions on the transfer of interest i.e. none of the partners can transfer their interest in the firm to any person (except to the existing partners) without the unanimous consent of all other partners. The firm must be dissolved on the retirement, lunacy, bankruptcy, or death of any partner.[68]

NRIs/PIOs may invest in partnership firms with repatriation benefits only with the prior approval of Secretariat for Industrial Assistance (SIA), Indian government or RBI. No person resident outside India other than NRIs/PIOs can make any investment by way of contribution to the capital of a firm. However, the RBI may, on an application made to it, permit a person resident outside India subject to such terms and conditions as may be considered necessary.[69]

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[65] Sole Proprietorship, http://business.gov.in/starting_business/sole_proprietorship.php, accessed 9 September 2014

[66] Foreign Investments in India – Investment in Proprietorship Concern/ Partnership Firm A.P. (DIR Series) Circular No.39 (December 3, 2003), http://rbidocs.rbi.org.in/rdocs/notification/PDFs/40493.pdf, accessed 9 September 2014

[67] Partnership Act, 1932, http://www.mca.gov.in/Ministry/actsbills/pdf/Partnership_Act_1932.pdf, accessed 9 September 2014

[68] Procedure for Registration of a Partnership Firm, http://business.gov.in/starting_business/org_partnership.php, accessed 9 September 2014

[69] Foreign Investments in India – Investment in Proprietorship Concern/ Partnership Firm A.P. (DIR Series) Circular No.39 (December 3, 2003), http://rbidocs.rbi.org.in/rdocs/notification/PDFs/40493.pdf, accessed 9 September 2014

Limited companies

The Companies Act, 2013 (to the extent applicable) broadly recognises four types of companies:

- Public Limited Company
- Private Limited Company
- Dormant Company
- One Person Company

Private Limited Company

A private company[70] is one that restricts (by its Articles of Association):

- the rights of its shareholders to transfer shares;
- the number of shareholders (excluding present- and past-employee shareholders) to 200;
- the company from making invitation to the public to subscribe to any shares or debentures of the company;
- a minimum of two shareholders are required to form a private limited company and the paid-up capital should be a minimum of INR 100,000.

The name of a private company carries the suffix 'Private Limited' (Pvt Ltd).

Public Limited Company

A public company is a company, which is not a private company[71]. The abovementioned restrictions applicable to a private company are not applicable to a public company. A minimum of seven shareholders and share capital of INR 500,000 are required to form a public company.

Also, a private company that is a subsidiary of a public company is defined as a public company. The name of a public company carries the suffix 'Limited' (Ltd).

Under the Companies Act, a private limited company enjoys certain privileges and exemptions from various provisions of the Act unlike a public company, which is subject to greater scrutiny, transparency and compliance regulations. Furthermore, a public company (which is listed on a stock exchange in India) is also regulated by the Securities and Exchange Board of India (SEBI).

Dormant Company (notified under the new Companies Act, 2013)

A company formed and registered under this Act for a future project or to hold an asset or intellectual property and having no significant accounting transactions, may make an application to the Registrar of Companies (ROC) for obtaining the status of a dormant company if it satisfies the terms and conditions as mentioned in the relevant provisions of Companies Act, 2013, and the rules made there under. The ROC, on consideration of the application, would allow the status of a dormant company to the applicant and issue a certificate.

One Person Company (notified under the new Companies Act, 2013)

'One person company' is a new concept introduced by the Companies Act, 2013. As the name suggests, it is formed with only one person as its member. Since such companies have only one member, these companies enjoy certain privileges or exemptions as compared to other companies. It can be formed by a person who is a resident and citizen of India; a foreign national is not eligible to incorporate a one person company under existing regulations.

[70] Section 2(68) of the Companies Act, 2013
[71] Section 2(71) of the Companies Act, 2013

Object/activity: A company incorporated under the provisions of the Companies Act, 2013 can undertake only those business activities as specified in its 'Main Objects' under its Memorandum and Articles of Association. The proposed business activities to be carried out by an Indian entity owned by non-residents shall be subject to the FDI policy of the Indian government as amended from time to time.

You may also wish to see Chapter 5 Company formation and administration and Chapter 7 Company taxation.

Trusts[72]

Trusts can be public or private. Public trusts are generally formed for charitable or religious purposes and not for commercial activities. A public charitable trust is one which benefits the public at large while income from a private trust is available only to specified beneficiaries.

Public and private trusts differ in the process of their creation. In creating a charitable or religious trust, a formal deed or any writing is not necessary, while private trusts are created and governed by the Indian Trusts Act, 1882. In case of a private trust declared by a will, registration is not necessary, whether it involves movable or immovable property. In all other cases, registration of a private trust is necessary under the Indian Trusts Act, 1882. For public trusts, registration is optional but desirable.

Trusts (public and private) are subject to taxation under the Income Tax Act, 1961. However, charitable and religious trusts enjoy several tax exemptions and benefits.

Entity options for foreign companies

A foreign company planning to set up business operations in India can[73]:

- set up a liaison office/representative office, project office or branch office of the foreign company to undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or Other Place of Business) Regulations, 2000;
- incorporate a company under the Companies Act as a joint venture or a wholly owned subsidiary; or
- invest in a Limited Liability Partnership (LLP) under the Limited Liability Partnership Act, 2008.

Liaison office/Representative office[74]

A liaison office (LO) can undertake only liaison activities, i.e. it can act as a channel of communication between the Head Office abroad and parties in India. It is not allowed to undertake any business activity in India and cannot earn any income in India. Expenses of such offices are to be met entirely through inward remittances of foreign exchange from the Head Office outside India.

The RBI allows LOs to undertake the following activities in India:

- represent in India the parent company/group companies;
- promote export/import from/to India;

[72] Taxation of Trusts: Public or Private, http://business.gov.in/taxation/public_pvt_trust.php, accessed 11 September 2014
[73] RBI: Foreign Investments in India, http://www.rbi.org.in/scripts/FAQView.aspx?Id=26, accessed 7 August 2014
[74] Liaison/Branch/Project Offices of foreign entities in India, http://www.rbi.org.in/scripts/FAQView.aspx?Id=100, accessed 12 September 2014

- promote technical/financial collaborations between parent/group companies and companies in India;
- act as a communication channel between the parent company and Indian companies.

Also, upon expiry of the validity period of an LO, it must either close down or be converted into a joint venture/wholly owned subsidiary, in conformity with the current FDI policy.[75]

Branch office[76]

Companies incorporated outside India and engaged in manufacturing or trading activities are allowed to set up branch offices (BO) in India with specific approval of the RBI. Such BOs are permitted to represent the parent/group companies and undertake the following activities in India:

- export/import of goods;
- render professional or consultancy services;
- carry out research work, in areas in which the parent company is engaged;
- promote technical or financial collaborations between Indian companies and the parent or overseas group company;
- represent the parent company and act as a buying/selling agent in India;
- render services in information technology and development of software;
- render technical support to the products supplied by the parent/group companies;
- foreign airline/shipping company.

A BO is not allowed to carry out manufacturing or processing activities in India, directly or indirectly, or any retail trading activities.
Profits earned by BOs can be freely remitted from India, subject to payment of applicable taxes.

Foreign companies wanting to set up an LO/BO in India are required to submit their application to the Foreign Investment Division of the RBI through an Authorised Dealer bank.

Project office[77]

The RBI has granted general permission to foreign companies to establish project offices in India if they have secured a contract from an Indian company to execute a project in India, and

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

Wholly owned subsidiary/Joint venture[78]

A foreign company may set up a wholly owned subsidiary in sectors where 100% foreign direct investment is permitted under the FDI policy (available on the website of the Department of

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[75] Master Circular on Establishment of Liaison/Branch/Project Offices in India by Foreign Entities, http://www.rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=7312, accessed 13 September 2014
[76] Liaison/Branch/Project Offices of foreign entities in India, http://www.rbi.org.in/scripts/FAQView.aspx?Id=100, accessed 12 September 2014
[77] Ibid.
[78] Entry Strategies for Foreign Investors, DIPP, http://dipp.nic.in/English/policy/entry.htm, accessed 12 September 2014

Industrial Policy & Promotion (DIPP). Alternatively, it could enter into a joint venture with an Indian partner, which may entail the following advantages for a foreign investor:

- established distribution/marketing set-up of the Indian partner
- available financial resources of the Indian partner
- established contacts of the Indian partner, which help smoothen the process of setting up operations

A foreign company incorporated as either of the two entities under the Companies Act is treated at par with any domestic Indian company within the scope of approval and subject to all Indian laws.

Limited Liability Partnership

A Limited Liability Partnership (LLP) is an alternative corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership. It is governed by the provisions of the Limited Liability Partnership Act, 2008, and not the Indian Partnership Act, 1932.

An LLP can continue its existence irrespective of changes in partners. It is capable of entering into contracts and holding property in its own name. It is a separate legal entity, is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP. Further, no partner is liable on account of the independent or unauthorised actions of other partners, thus individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct. Mutual rights and duties of the partners within an LLP are governed by an agreement between the partners or between the partners and the LLP as the case may be. The LLP, however, is not relieved of the liability for its other obligations as a separate entity. Also, an LLP will have more flexibility and lesser compliance requirements compared to a company.[79]

The LLP Act, 2008 allows foreign nationals and foreign LLPs to become partners in LLPs. An LLP, existing or new, operating in sectors/activities where 100% FDI is allowed under the automatic route would be eligible to receive FDI.[80]

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[79] FAQs on LLPs, Ministry of Corporate Affairs, http://www.mca.gov.in/LLP/faq_llp_basic_concept.html, accessed 12 September 2014

[80] Foreign Direct Investment in LLPs, http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=8844&Mode=0, accessed 9 September 2014

Chapter 5

Company formation and administration

Forming a company

The process of incorporating a company in India incorporation can be broadly divided into the following four steps:

1. Director Identification Number (DIN) and Digital Signature Certificate (DSC)
   Obtaining a DIN and DSC for all directors of the company is a pre-requisite for checking the availability of the company name and making an application to register the company. All relevant forms and documents have to be filed electronically.

2. Application for name availability
   Select a few suitable names indicative of the main objectives of the company. The proposed name should not resemble the name of any other company already registered and should not violate the provisions of the Name Availability Guidelines issued by the Ministry of Corporate Affairs (MCA). The Name Application must be submitted online with the concerned Registrar of Companies (ROC) for their approval.

3. Drafting of Memorandum and Articles of Association
   The Memorandum and Articles of Association (the governing charter) of the proposed company need to be drafted in accordance with the applicable provisions of the Companies Act, 2013 and are subject to the FDI policy of the Indian government as amended from time to time.

4. Application for company incorporation
   The fourth step is to apply for the registration of the company. After the name is approved, prescribed forms along with the prescribed filing fees and stamp duty are to be submitted through the MCA portal along with the Memorandum and Articles of Association and other supporting documents duly signed and certified. The ROC, after scrutiny of documents submitted online, approves the company incorporation application and issues the digitally signed Certificate of Incorporation.

Timeline: The entire process of incorporation can be completed in 4–6 weeks.

Formation cost: The cost of formation depends upon the authorised capital of the company. Also, the total statutory fees payable to the regulatory authority vary depending on the state in which the registered office will be situated.

Additional step to commence business under the Companies Act, 2013: According to the provisions of the Companies Act, 2013, a company formed on and after 1 April 2014 cannot commence business or exercise any borrowing power unless it has obtained the Certificate of Commencement (COC) from the concerned ROC.

In order to obtain a COC, a declaration in the prescribed format is required to be filed with the ROC to the effect that:

- every subscriber has paid-in the value of shares subscribed to MOA;
- paid-up share capital of the company is not less than the minimum prescribed; and
- its registered office has been verified.

Shares and capital structures

The minimum capital required to incorporate a private company is INR 100,000 and a public company is INR 500,000.

Classification of share capital

The share capital of a company limited by shares can be classified into equity and preference. Preference share capital is that part of the issued share capital of a company limited by shares which gives the concerned shareholder preference rights in respect of payment of dividend and repayment in case of winding up. Equity share capital means all share capital that is not preference share capital. Preference share capital can be:

- Redeemable or irredeemable
  Redeemable preference shares can be redeemed on or after a period fixed for redemption under the terms of issue or after giving a proper notice of redemption to preference shareholders. The Companies Act, however, imposes certain restrictions for the redemption of preference shares. Irredeemable preference shares are those shares which cannot be redeemed during the lifetime of a company.

  As per the provisions of the Companies Act, 2013, a company limited by shares cannot issue irredeemable preference shares. Further, except in case of infrastructure projects, only preference shares that are liable to be redeemed within a period not exceeding 20 years from the date of issue can be issued.

- Convertible or non-convertible
  Preference shares that are convertible into equity shares are convertible preference shares, and the ones that are not convertible into equity shares are non-convertible preference shares.

The shares or debentures or other interest of any member in a company shall be movable property transferable in the manner provided by the Articles of the company. A company may, if so authorised by its Articles, pay dividends in proportion to the amount paid-up on each share.

Directors

Every company must have a Board of Directors which is responsible for the conduct of its business. According to the Companies Act, the minimum number of directors required in case of private companies is 2 and in case of public companies is 3; and the maximum directors a company can have is 15. Every company belonging to prescribed classes shall have the following full-time key managerial personnel:

- managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;
- company secretary; and
- Chief Financial Officer.

Role of directors

The Companies Act empowers the Board to do all such activities, in accordance with the company's Memorandum and Articles of Association (MOA), as the company is authorised to do, unless any law or the MOA of the company requires any act to be done by the company by way of resolution of the shareholders in their general meeting.

Since directors act as agents of a company, all acts done and contracts entered into by them are binding on the company, unless such acts are outside the scope of authority of such directors. Since directors of a company occupy a fiduciary position, and are persons responsible for the management of the affairs of the company, they are subject to duties and liabilities, including penal liabilities in case of default or misconduct on their part, in circumstances mentioned under the Companies Act.

Appointment of directors

- Unless the Articles provide, individuals who are subscribers to the Memorandum of Association shall be deemed to be the first directors of the company until the directors are duly appointed.
- Otherwise expressly provided in the Act, every director shall be appointed by the company in the general meeting
- Every proposed director shall have DIN

Disqualification for appointment of directors

A person shall not be eligible for appointment as a director of a company if he/she:

- is of unsound mind and stands so declared by competent court
- is undercharged insolvent
- has applied to be adjudicated as an insolvent and his application is pending
- has been convicted by court and sentenced to imprisonment for at least six months and five years have not lapsed from the expiry of the sentence
- has been convicted and sentenced to imprisonment for seven years or more
- has been disqualified as a director by an order passed by a court or tribunal
- has not paid any calls of any shares held by him and six months have lapsed from the last day fixed for the payment
- has been convicted of related-party transactions during the preceding five years
- has not obtained a DIN

Removal of directors

- A company may remove a director before the expiry of the period of his office through an ordinary resolution.
- On receipt of notice of the resolution, the company shall send a copy of the notice to the concerned director, who shall be entitled to be heard on the resolution at the meeting.
- A vacancy shall be filled by the company in the meeting in which he was removed by the appointment of another director in his place but special notice is required. The director so appointed shall hold office till the date up to which his predecessor would have held office if he had not been removed.
- A director who is removed from office shall not be re-appointed as a director by the Board.

Resignation of directors

- A director may resign from office by giving a notice to the company, who shall intimate the ROC within 30 days of receiving the notice
- The resignation shall be mentioned in the Board's report in the next general meeting of the company.
- The director shall also forward his resignation along with detailed reasons for the resignation to the ROC within 30 days of resignation.

- Resignation shall take effect from the date on which the notice is received by the company or the date specified by the director in the notice, whichever is later.
- A director who has resigned shall be responsible for offences that have occurred during his tenure even after his resignation.

Types of directors

First directors: The number of directors and the names of the first directors shall be determined in writing by the subscribers of the Memorandum or a majority of them. However, where no provision is made in the Articles of a company for the appointment of first directors, the subscribers of the Memorandum, who are individuals, shall be deemed to be the first directors of the company until the directors are duly appointed in accordance with provisions of the Companies Act.

Executive and non-executive directors: Directors who are in whole-time employment or are entrusted with the day-to-day operations of the company are termed as executive directors. Non-executive directors are from outside the company. They do not take part in the day-to-day activities of the company and do not have knowledge about the company's routine operations.

Resident director: As per the Companies Act, 2013, at least one of the directors of a company must be a person who has stayed in India for a total period of not less than 182 days in the previous calendar year.

Independent directors in case of public companies: As per the Companies Act, 2013, the appointment of an independent director is mandatory to certain classes of companies. Every listed public company shall have at least one-third of the total number of directors as independent directors. However, private limited companies need not appoint an independent director.

Woman director: A new provision of the Companies Act, 2013, requires certain classes of companies to appoint at least one woman director on the Board of the company. This is not mandatory for private limited companies.

Director elected by small shareholders: Under the Companies Act, 2013, only listed companies may appoint a small shareholders' director. Shareholders holding shares of nominal value of not more than INR 20,000 or such other prescribed sum may appoint one director from amongst them.

Additional director: The Board may appoint an additional director at any time, if the Articles confer such powers.

- A person who fails to get appointed in a general meeting cannot be appointed as an additional director.
- An additional director shall hold office until the next Annual General Meeting (AGM) or the last date on which the AGM should have been held, whichever is earlier.

Alternate director: The Board may appoint an alternate director at any time, if the Articles confer such powers.

- The person to be appointed as an alternate director shall not hold another alternate directorship for any other director in the company.
- An alternate director can only be appointed in case a director leaves India for a period of at least three months.

- An alternate director to an independent director should also satisfy the criteria for an independent director.
- The office of the alternate director shall be vacated if and when the director in whose place he has been appointed returns to India.
- Provisions of automatic re-appointment of the retiring director shall apply to the original director and not to the alternate director.

Nominee directors: Subject to the Articles, the Board may appoint any person as a director nominated by an institution as a nominee director in pursuance of any law or agreement or by the central or state government by virtue of its shareholding in a government company.

Permanent directors: The Articles may also provide for the appointment of permanent directors. Such directors continue to be lifetime directors subject to other provisions of the Companies Act.

Duties of directors[81]

Fiduciary duties

For the first time, the Companies Act, 2013 enlists the specific fiduciary duties of a director. A director of a company:

- shall act in accordance with the Articles of the company;
- shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment;
- shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment;
- shall not get involved in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company;
- shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company;
- shall not assign his office and any assignment so made shall be void.

A director who contravenes the provisions of this section shall be punishable with a fine not less than INR 100,000, which may extend to INR 500,000.

Compliances by directors under the Companies Act, 2013

- Obtain a Director Identification Number (DIN)
- Give a declaration that he is not disqualified to become a director under the Act
- Disclose his interest in any company or body corporate, firms, or other association of individuals at the first Board meeting, at the first Board meeting in every financial year, or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change
- Mention his DIN while furnishing any return, information or particulars, as required to be furnished under the Act

[81] Duties of directors, Companies Act, 2013, p.98, http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf, accessed 13 September 2014

- Restructure his directorships as per the maximum number allowed, within one year from commencement of the Act
- The total number of companies in which a person can hold office as a director shall not exceed:
  - 10 in public companies
  - 20 in private companies
  - 20 in both public and private companies

Company secretary
The functions of the company secretary include:
- to report to the Board about compliance with the provisions of the Companies Act, 2013, the rules made there under and other applicable laws;
- to ensure that the company complies with the applicable secretarial standards;
- to discharge such other duties as may be prescribed.

Other statutory requirements

The Board of Directors of every listed company shall constitute an Audit Committee. The committee shall consist of a minimum of three directors with independent directors forming a majority, provided that a majority of members should be able to read and understand financial statements.

The Board of every listed company shall constitute the Nomination and Remuneration Committee consisting of three or more non-executive directors, of which not less than half shall be independent directors. This committee shall formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy relating to the remuneration for the directors, key managerial personnel and other employees.

The Board of a company that has more than 1,000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders' Relationship Committee consisting of a chairperson who shall be a non-executive director and such other members as may be decided by the Board. This committee shall consider and resolve the grievances of security holders of the company.

Meetings

One of the statutory requirements under the Companies Act is to conduct meetings.

Meetings of Directors
Board meetings: According to the Companies Act, 2013, there must be at least one meeting of the Board of Directors every three months. Directors are allowed to participate in person, through video conferencing or other audiovisual means capable of recording and recognising the participation of the directors, and recording and storing the proceedings along with the date and time.

Committee meetings: The Board of Directors may delegate any of its powers to committees if so authorised and in accordance with its Articles of Association, and such committees must conform to any regulations that may be imposed upon it by the Board.

Shareholders'/Members' Meetings
Annual General Meeting (AGM): The Companies Act, 2013 states that every company must hold one AGM in each calendar year. It must be held within 18 months of incorporation or 9 months of the

closing of accounts, whichever is earlier, or in other cases within 15 months from the date of the last AGM or 6 months from the closing of accounts, whichever is earlier. Furthermore, a One Person Company is not required to hold an AGM.

Extraordinary General Meeting: Any general meeting held between two annual general meetings is called an Extraordinary General Meeting. Business arising between two annual general meetings that is urgent and cannot be deferred until the next Annual General Meeting is transacted at an Extraordinary General Meeting.

Class Meetings: These are meetings of shareholders holding a particular class of shares. Resolutions passed at such meetings bind only the members of the concerned class.

Liquidations[82]

Winding up of a company is the process by which the operations of a company are closed down and its property is administered for the benefit of its shareholders and creditors. The winding up of a company may be either (a) a compulsory winding up by the Tribunal (b) or a voluntary winding up by its members or creditors. A liquidator is appointed to take control of the company, collect its assets, pay its debts and to distribute any surplus among the members in accordance with their rights. On completion of the winding up process, the company would not have any assets or liabilities. After the affairs of a company are completely wound up, the company is dissolved and its name is struck off the Register of Companies, pursuant to which the legal personality of the company comes to an end.

Corporate social responsibility

According to the Companies Act, 2013, every company having net worth of INR 5 billion or more, or turnover of INR 10 billion or more or a net profit of INR 50 million or more during any financial year shall constitute a Corporate Social Responsibility (CSR) Committee of the Board consisting of three or more directors, of which at least one must be an independent director.

The CSR Committee must:
- formulate and recommend to the Board, a CSR Policy which shall indicate the activities to be undertaken by the company;
- recommend the amount of expenditure to be incurred on these activities; and
- monitor the CSR Policy from time to time.

The Board must approve the CSR Policy and disclose its contents in its report and also place it on the company's website. It must also ensure that the activities included in the CSR Policy are undertaken by the company. The Board must ensure that in every financial year, the company spends at least 2% of the average net profits made during the three immediately preceding financial years, towards CSR. The company must give preference to the area around where it operates. Also, if the company fails to spend such amount, the Board must specify the reasons for not spending the amount.

Chapter source: Companies Act, 2013, http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf, accessed 11 September 2014

[82] Ministry of Corporate Affairs, http://www.mca.gov.in/MCA21/CloseCompany.html and http://business.gov.in/closing_business/windingup_company.php, accessed 13 September 2014

Chapter 6

Financial reporting and audit requirements

Financial reporting requirements and deadlines

Type of entity	Preparation of financial statements mandatory	Relevant statutes*	Reporting standards of accounting records	Remarks	Reporting deadline
Proprietorship	Yes	Income Tax Act, 1961	Accounting Standards as issued by the Institute of Chartered Accountants of India (ICAI)	Applicable only if the turnover exceeds the limits specified in the relevant statute[83]	30 September**
Partnership Firm	Yes	Income Tax Act, 1961	Accounting Standards as issued by ICAI	Applicable only if the turnover exceeds the limits specified[84]	30 September**
Limited Liability Partnership	Yes	Limited Liability Partnership Act, 2008	Accounting Standards as issued by ICAI	Applicable only if the turnover exceeds the limits specified[85]	30 September**
Listed Public Limited Company	Yes	Companies Act, 1956 and 2013 (to the extent notified), SEBI Guidelines and any other relevant statute[86]	Accounting Standards as notified under the Companies Act or another specified statute along with Indian GAAP	In case the company falls under special statute then the requirements of such special statute shall prevail[87]	Two months from the end of the financial year
Unlisted Public and Private Limited Company	Yes	Companies Act, 1956 and 2013 (to the extent notified)	Accounting Standards as notified under the Companies Act	In case the company falls under special statute, the requirements of such special statute shall prevail[88]	Six months from the end of the financial year
Trusts	Yes	Trust Act[89], and Income Tax Act, 1961	Accounting Standards as issued by ICAI		30 September

[83] INR 10 million in case of business and INR 0.25 million in case of profession
[84] Ibid.
[85] Ibid.
[86] Banking, Financial Services, Insurance and Electricity companies where the form and contents of the financial statements are governed by their respective statutes
[87] Ibid.
[88] Ibid.
[89] Depending upon the territory of registration and the purpose of the Trust

Societies	Yes	Respective Societies Act[90], and Income Tax Act, 1961			30 September
Liaison Office/ Branch Office/ Project Office	Yes	FEMA and Companies Act, 2013	Accounting Standards as notified under the Companies Act		Nine months from the end of the financial year[91]

* The Preface to the Statements of Accounting Standards issued by the ICAI states that "Efforts will be made to issue Accounting Standards which are in conformity with the provisions of the applicable laws, customs, usages and business environment of our country. However, if due to subsequent amendments in the law, a particular Accounting Standard is found to be not in conformity with such law, the provisions of the said law will prevail and the financial statements should be prepared in conformity with such law." E.g. Banks need to prepare financial statements as per the Banking Regulation Act, 1949

** This deadline shall be extended to 30 November where transfer pricing regulations become applicable

The complete set of financial statements comprises the following:

- Directors' Report (applicable in case of specific types of entities only)
- Balance Sheet as at the end of the reporting period
- Statement of Profit and Loss/Income and Expenditure Account for the reporting period
- Statement of Cash Flows (applicable in case of specific types of entities only, exemptions available for certain entities)
- Notes forming part of the financial statements consisting of schedules to the balance sheets and Statement of Profit and Loss/Income and Expenditure Account, summary of Significant Accounting Policies, other explanatory information that may be required under relevant statutes.

The following key records are to be maintained by most entities:

- All sums of money received and expended and the matters in respect of which the receipt and expenditure take place
- All sales and purchases of goods/services
- Assets and liabilities
- If the entity is engaged in manufacturing, processing, mining, etc., particulars related to the utilisation of material/labour or other items of cost
- In addition, there may be a need to maintain additional records under relevant statues.

[90] Depending upon the territory of registration and the purpose of the Society

[91] In case where Form No. 49C or an annual activity certificate is required to be filed/furnished then the date of furnishing such form/certificate

Audit requirements

Types of mandatory audits to be conducted by an independent practicing Chartered Accountant:

Type of audit[92]	Timeline	Applicability
Statutory audit	Within six months from the end of the financial year	All companies
Limited reviews	Within 45 days from the end of the quarter	Listed companies
Audit of financial statements for tax purpose	30 September if transfer pricing regulations are not applicable, else 30 November	Companies: where statutory year-end is different from the tax year-end and where tax audit is applicable[93] Entities other than companies: where tax audit is applicable[94]
Tax audit certification	30 September if transfer pricing regulations are not applicable, else 30 November	(see previous footnote)
Cost audit	180 days from the end of the financial year	Depends on the type of goods as well as turnover or net worth
VAT audit	Differs from state to state	Differs from state to state. E.g. In some states, there is no provision of VAT audit (filing of Annual Return may be applicable instead). In some other states, applicability depends on the turnover.[95]

Application of IFRS to financial reports

India is finally going to fulfil its longstanding commitment to converge its accounting standards with International Financial Reporting Standards (IFRS). While presenting the Union Budget 2014-15 on 10 July 2014, India's Finance Minister, Arun Jaitley, proposed that from financial year (FY) 2016-17, it would be mandatory for Indian Companies having a turnover of over INR 10 billion to adopt Ind AS (Indian Accounting Standards converged with IFRS). They could also adopt these standards from FY 2015-16. Timelines for the financial sector, including banking and insurance companies, are also expected to be finalised soon.

[92] This does not include any other audit that is specifically needed under special statutes

[93] In India, Companies are allowed to follow a different statutory year-end than the fiscal year-end (31 March). However the new Companies Amendment Bill mandates the same year-end which is yet to be notified. The old Companies Act, 1956 is currently in the process of being replaced by the new Companies Act, 2013. Since the new Companies Act, 2013 has not been fully notified, the above document does not take into consideration any implication that the new Companies Act, 2013 may have on any of the contents of the said document.

[94] Applicable when turnover is over INR 10 million in case of business and INR 0.25 million in case of profession

[95] Based on the Maharashtra Value Added Tax Act, 2002 as applicable for FY 2013-14, if the aggregate **sales** turnover and the value of goods transferred to any other place of his business, or his agent, or principal situated outside the state, not by reason of sale, or turnover of **purchases** exceeds INR 10 million in any year, a VAT audit is required. The Audit report should be submitted by 15 January.

Chapter 7

Company taxation

Company taxation

All domestic companies are liable to tax in India on their global income, while foreign companies are liable to tax in India in respect of income received or deemed to be received in India, or income accruing or deemed to be accruing in India. The effective corporate tax rate [base rate + surcharge + education cess] depends on the type of the company i.e. domestic or foreign and the quantum of its taxable income in the previous year. Previous year means the financial year (FY) beginning on 1 April and ending on 31 March. The rate of tax and surcharge and cess could be changed by the Finance Act passed every year by the Indian government.

The corporate tax structure for FY 2014-15 is as follows:

Particulars	Taxable income > INR 100 million	INR 10 million < taxable income < INR 100 million	Other cases
Domestic company	33.99% (30% base rate + 10% surcharge + 3% education cess)	32.445% (30% base rate + 5% surcharge + 3% education cess)	30.90% (30% base rate + 3% education cess)
Foreign company	43.26% (40% base rate + 5% surcharge + 3% education cess)	42.02% (40% base rate + 2% surcharge + 3% education cess)	41.20% (40% base rate + 3% education cess)

The Income Tax Act, 1961 (ITA) also provides for tax on 'book profits' in case the tax on the company's book profit (post certain adjustments) is greater than the tax on income computed as per the normal provisions of the ITA. This is commonly known as MAT (Minimum Alternate Tax) which is charged @ 18.5% on book profits plus applicable surcharge and 3% education cess on the tax and surcharge. The limits for applicability of the surcharge are the same as mentioned in the table above. Credit for MAT paid can be carried forward and claimed against normal corporate tax payments arising in the future subject to a limitation period of 10 years.

Apart from the above, foreign companies engaged in the business of shipping, exploration of mineral oils, operation of air craft and civil construction in relation to turnkey power projects can opt for presumptive taxation where income is taxed at a certain fixed percentage of the gross receipts and then the above referred corporate tax, surcharge and cess would be applied.

In addition to corporate tax, Dividend Distribution tax (DDT) is levied on all companies on the payment or distribution of dividend. The effective rate of DDT is 19.994% (17.65% base rate + 10% surcharge + 3% education cess).

Resident companies

A company incorporated in India under the Companies Act, 1956/2013 would always be a 'resident' in India. A foreign company is regarded as a 'resident' in India only if, during the previous year, the control and management of its affairs is situated wholly in India. This would imply that a foreign company would be treated as a non-resident if, during the previous year, the control and management of its affairs is either wholly or partly situated out of India. The control and management of the company means the 'head and brain' of the company that directs the affairs of policy, finance, utilisation of profits and other vital matters affecting the operations of the company.

Tax incidence on companies depends on their residential status:

<table>
<tr><th>Particulars</th><th>Resident</th><th>Non-resident</th></tr>
<tr><td>Income received or deemed to be received in India</td><td>Taxable</td><td>Taxable</td></tr>
<tr><td>Income accruing or arising or deemed to accrue or arise in India</td><td>Taxable</td><td>Taxable</td></tr>
<tr><td rowspan="2">Income accruing or arising outside India from:
• Business controlled in India or profession set up in India
• Any other source</td><td>Taxable</td><td>Not taxable</td></tr>
<tr><td>Taxable</td><td>Not taxable</td></tr>
</table>

Thus, if a foreign company can prove that its control and management is outside India, even partly, it can avoid taxation of global income and only its income accruing or arising in India or deemed to accrue or arise in India or received in India would be taxable.

Wealth tax

For resident companies, wealth tax is levied only on specified assets held in India, subject to specific exclusions. Specified assets include buildings other than those occupied for business, motor cars, jewellery, urban land, unaccounted cash exceeding INR 0.05 million

Wealth tax is levied @ 1% when the net wealth of resident company exceeds the prescribed limit (INR 3 million) as on the valuation date (i.e. 31 March of every financial year).

Foreign companies

Income tax

Under the ITA, a foreign company is liable to income tax in India on income received in India or income accruing or arising in India or deemed to accrue or arise in India.
Income deemed to accrue or arise in India would include:

- Income arising from a business connection in India or a property or asset or source of income in India;
- Capital gains from the transfer of capital assets situated in India; and
- Interest, royalties and fees for technical services paid to a non-resident.[96.]

Taxability of business income

In case non-residents have a business connection/permanent establishment (PE) in India, income attributable to such business connection/PE would be taxable in India @ 40% (plus applicable surcharge and education cess). However, while calculating the taxable income, deduction for the expenses incurred for earning such income and some part of general administrative expenses are allowed as an expense.

Business connection includes any business activity carried out by a non-resident through a person or a person acting mainly or wholly on its behalf.

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[96] The said income would be taxable in India whether or not the non-resident has a residence or place of business in India or has rendered services in India.

PE means some presence in India in the form of fixed place, employee presence, etc. through which business activities are carried in India by the non-resident.

Where a non-resident constitutes a business connection/PE in India, it is required to carry out compliances as required of a domestic company (i.e. maintaining books of accounts, getting accounts audited, various regulatory filings, etc).

Presumptive taxation

Furthermore, as stated above, the ITA also provides for a mechanism wherein income in case of specified businesses such as shipping, aircraft, civil construction, etc. is computed on a presumptive basis, which results in a lower effective tax rate.

Taxability of income (other than business income) under the Income Tax Act

- Royalty/Fees for Technical Services: Income earned by a foreign company in the nature of royalty/fees for technical services is taxable in India on a gross basis @ 25% (plus applicable surcharge and education cess).

- Interest: Interest income earned by non residents for loans provided in a foreign currency is taxable in India @ 20% (plus applicable surcharge and education cess).

  However, the interest from foreign currency loans and any long-term bonds would be taxable at a concessional rate of 5% (plus applicable surcharge and education cess) provided the loan or bonds are acquired during a specified period and subject to specified conditions. Further, the said concessional rate of 5% would apply even if the non-resident does not have a Permanent Account Number (PAN) in India.

- Dividend: Dividend income received from an Indian company on which Dividend Distribution Tax is paid is exempt from tax in the hands of foreign companies.

- Other Income: Other income earned by foreign companies would be liable to be taxed at the maximum rate (i.e. 40% plus applicable surcharge and education cess).

However, with respect to the above, where a beneficial rate/provision is prescribed under any treaty entered into by India with a foreign country, a non-resident can claim such beneficial rate/provision subject to conditions mentioned under the treaty with the respective country.

Wealth tax

For foreign companies, wealth tax is levied only on specified assets held in India, subject to specific exclusions. Specified assets include buildings other than those occupied for business, motor cars, jewellery, urban land, unaccounted cash exceeding INR 0.05 million.

Wealth tax is levied @ 1% when the net wealth of non-resident companies exceeds the prescribed limit (INR 3 million) as on the valuation date (i.e. 31 March).

Tax returns and assessment

The Indian fiscal year as well as corporation tax year runs from 1 April to 31 March. All companies (irrespective of having made a profit or loss) are required to file their tax returns electronically by 30

September each year. However, for those that have entered into international transactions with associated enterprises or into Specified Domestic Transactions (SDT) (see section Transfer Pricing), the due date to file tax returns electronically is 30 November.

Even foreign companies are required to file tax returns with respect to income earned in India except in certain specified circumstances where income consists of dividend, specified interest, royalty and fees for technical services and due taxes have been withheld on the same. Tax returns must be digitally signed by the Managing Director of the company and in case the company does not have one, then by any director. However, in case of a foreign company, the tax return can be digitally signed by an individual holding a valid power of attorney.

It is mandatory for the company and the signatory to get a PAN in India.

The company is also required to obtain and furnish electronically the report of a Chartered Accountant in respect of its transaction with the Associated Enterprise. Similarly, it must obtain and furnish electronically the report of a Chartered Accountant if its annual turnover exceeds INR 10 million.

In case of any error or omission in the tax returns, the same can be revised within two years from the end of the relevant fiscal year or before the completion of the tax assessment, whichever is earlier. Similarly, a belated tax return can be filed within a period of two years from the end of the relevant fiscal year or the completion of the tax assessment, whichever is earlier. In case of a belated tax return, the company cannot carry forward its tax losses and it also loses the right to revise its tax return.

Revenue audits

Tax returns filed by companies can be subjected to a revenue audit, popularly known as a scrutiny assessment in India. The tax authorities lay down certain parameters every year and if a company fits those parameters, it would mandatorily be selected for assessment. For other companies, the same is based on random selection through the computer-aided selection systems (CASS). In the assessment proceedings, the tax authorities could either accept the income as in the return if they are satisfied with the correctness of the income and expenditure, or make adjustments to the income either by increasing revenues or disallowing the expenditure. A company can file an appeal against the adjustments made. There is an exhaustive and robust appeal mechanism and tax judiciary system in India.

Profits subject to tax

The taxable income for a business is computed in accordance with the common business or accounting principles to which necessary tax adjustments in accordance with the ITA are required to be made. Profits from the business are chargeable to tax on a receipt or accrual basis as per the accounting method adopted by the assessee. However, companies have to offer the profits to tax on an accrual basis as the Indian Companies Act does not allow them to follow the cash system of accounting. Principally, deductions are allowed for all business-related revenue expenses incurred during the fiscal year. Capital expenses (other than those specifically allowed) and personal expenses are not deductible. The onus of proving that the expenditure has been incurred wholly and exclusively for the purpose of the business is squarely on the company. Furthermore, any expenditure that is considered against public policy is not allowable as a deduction. In case of fixed assets, depreciation is available at prescribed rates and in accordance with the provisions of the ITA. Certain revenue expenditures that are necessary to bring the fixed asset into its existing condition have to be added to the cost of the fixed asset. Certain specified expenses are allowable only on the basis of actual payment irrespective of the accrual system of accounting followed by the company. The following sections of this Chapter cover some specific allowable and disallowable deductions in calculating taxable business profits.

Employee taxes

An employee is liable to pay taxes on the salary earned by him/her. For an income to be regarded as 'salary', it is imperative to have an employer-employee relationship. The income under the head 'salary' is liable to tax either on a receipt basis or accrual basis, whichever event is earlier. It would also include arrears of salary.

Components of salaries mainly include basic salary, fees, commission, bonus, retirement benefits, contribution for social security in excess of the specified limits, allowances, perquisites, etc. Perquisites are benefits provided in kind and would, *inter alia*, include rent-free accommodation, interest-free loans or subsidised loans, provision of movable assets for use or transfer of such assets to the employees at subsidised cost, free or concessional education, provision of motor cars, provision of domestic help, club membership, etc.

The ITA also provides for several exemptions and deductions while computing income under the head 'salaries'. These, *inter alia*, include medical reimbursement, conveyance allowance, professional taxes paid, house rent allowance subject to specified limit and conditions, etc. The mechanism of calculating the exempt allowances is based on Rules. However, the quantum of deduction and/or exemption is not very significant and most of the limits specified in the ITA/Rules have outlived their utility.

Employers are required to compulsorily withhold tax on taxable salary if income exceeds the minimum exemption limit. Tax is to be withheld at an average rate based on the estimated income of the employee for the whole year at the time of actual payment of salary every month. While calculating the estimated income of the employee, the applicable deductions and exemptions are also considered.

Calculating trading profits

Trading profits represent profits as per the Profit and Loss Account drawn in accordance with the provisions of the Indian Companies Act, which is further adjusted considering the admissible/inadmissible expenses as per the provisions of the ITA (see section Profits subject to tax).

As per the ITA, for the purpose of calculating profits, all incomes accrued/earned during the fiscal year should be considered. Capital receipts are not considered while calculating trading profits. However, what constitutes a capital receipt is a matter of considerable litigation.

As explained earlier, capital expenses are not deductible. However, the ITA has prescribed certain capital expenses that can be allowed as deductions, but over a period of time. For example:

- Preliminary expenses incurred prior to the set up of or in connection with the extension of the business are allowed over a period of five years subject to certain conditions

- Expenditure incurred on amalgamation is allowed over a period of five years
- Expenditure on the prospecting of certain minerals is allowed over a period of 10 years
- Expenditure on obtaining a telecommunication license over the license period.

Furthermore, according to the ITA, certain capital expenditures are allowed in the year that they're incurred in. For example:

- Capital expenditure on scientific research related to the business carried on by the company
- The entire capital expenditure in case of specified businesses that have commenced in the specified time period
- Weighted deduction of 200% in case of expenditure on an in-house scientific research and development facility as approved by the prescribed authority, which *inter alia* includes capital expenditure except that on land and building.

Similarly, a company is eligible to claim depreciation on fixed assets according to the rate prescribed in the Income Tax Rules. A corporate is also eligible to claim bad debts, provided the sales in respect thereof have been offered to tax either in the same previous year or in the earlier previous year.

Besides allowing the claim for expenditure, the ITA also allows claims for business losses provided they are in the revenue field and discovered in the year under consideration. Examples of business losses are loss on account of obsolete stock, loss on account of fire/theft/burglary/fraud, etc.

The ITA also restricts the allowance of certain revenue expenses, if certain requirements are not met:

- If tax is not withheld and deposited in the government treasury within the prescribed time, 30% of the expense claimed by the company shall be disallowed.
- Certain statutory expenses in the nature of tax, duty, cess or fees, are not allowed as deduction unless they are actually paid either during the year or up to the time allowed to file tax returns.

Certain expenses are expressly not allowed while computing taxable income. For example:

- Tax on profits, tax on capital (wealth tax)
- Tax paid by an employer on behalf of an employee on non-monetary perquisites
- Expenditure incurred with respect to exempt income – a controversial provision.

The computation of trading/business profits for tax purposes would be as follows:

S. No.	Particulars	Amount (INR)	Amount (INR)
A.	**Net Profit as per Profit and Loss Account**		XXX
B.	**Inadmissible Expenses debited to Profit and Loss Account**		
	Disallowable Expenses/Claims	XXX	
	Depreciation as per the Companies Act	XXX	
	Deemed Income not credited to Profit and Loss Account	XXX	XXX
C.	**Total = (A + B)**		**XXX**
D.	**Admissible Deduction**		
	Allowable claims/deduction	XXX	

	Depreciation as per the Income Tax Act	XXX	
	Incomes chargeable under other heads credited to Profit and Loss Account	XXX	XXX
E.	**Profits and Gains of Business or Profession (C – D)**		**XXX**

Interest deduction

Interest on capital borrowed for the purpose of business or profession is allowed as a deduction. However, interest payable on capital borrowed for acquiring a capital asset for extension of business, until the date such asset is first put to use, is not allowable as a revenue deduction. Such interest shall be loaded on the cost of the capital asset and would be eligible for depreciation. Utilisation of loans is an important factor in deciding the allowability of interest on the same. Interest on borrowings utilised for the purpose of granting interest-free advances to related parties or sister concerns may not be allowed, if the business expediency of such advance is not proved. Furthermore, interest on borrowings utilised for the purpose of earning tax-free income (e.g. dividend income) would be disallowed due to special provisions of the ITA.

Thin capitalisation rules

A number of jurisdictions across the globe have specific thin capitalisation rules to deter erosion of the tax base through excessive debt and thereby excessive interest payments. There is no specific thin capitalisation provision under the ITA. As there are no enabling provisions to question whether a business should have raised funds through equity instead of a loan, interest deduction is allowed solely on the basis of principles laid down in the paragraph above. Interest payments to overseas related parties and in some specific instances to domestic related parties would, however, be subject to transfer pricing provisions. Further, with effect from 1 April 2015, if the transaction of debt is construed by the tax authorities as solely for the purpose of tax benefit then the said arrangement could be examined and disregarded under the General Anti-Avoidance Rules (GAAR).

Capital assets

According to the ITA, capital assets have been defined to mean property of any kind including, business assets but excluding stock-in-trade and moveable personal effects such as wearing apparel, personal furniture, personal car, etc. Thus, broadly 'capital assets' can be classified as business-related assets and personal capital assets excluding the ones specified above. Business-related capital assets can be further classified as 'depreciable capital assets' and 'non-depreciable capital assets'.

The tax treatment of personal capital assets and non-depreciable assets has been dealt with separately in the section Capital Gains Tax. The tax treatment of 'depreciable capital assets' is explained here:

According to the ITA, depreciation for tax purposes has to be calculated on the Written Down Value (WDV) of the 'block of assets' at the prescribed rates (except for undertakings engaged in the generation or generation and distribution of power, that have the option of claiming depreciation on a straight line basis). A 'block of assets' has been defined as a group of assets falling within a class of assets comprising of 'tangible' and 'intangible' assets in respect of which same percentage of depreciation is prescribed. The rates of depreciation are given in the following table:

Asset class	Rate of depreciation (%)
General plant and machinery	15
Cars other than those used in the business of running them on hire	15
Computers (including software)	60
Purely temporary erections	100
Residential buildings	5
Buildings other than above	10
Furniture and fittings including electrical fittings	10
Ships	20
Intangible assets: knowhow, patents, copyrights, trademarks, licences, franchises or any other business or commercial right of similar nature	25

The WDV of a block of assets is calculated as under:

First year:		
Cost of the asset at the time of acquisition of assets		XXX
Less: Depreciation as calculated based on the above rates	XXX	
Closing WDV of the block of assets		**XXX**

Subsequent year:		
Opening WDV of the block at the beginning of the next year		XXX
Add: Actual cost of assets acquired during the year		XXX
Less: Sales proceeds from the disposal of any asset during the year	XXX	
WDV for the purpose of calculating depreciation		**XXX**

The actual cost of a depreciable asset comprises its purchase price (including import duties and other non-refundable taxes or levies) and any directly attributable cost of bringing the asset to its working condition for its intended use.

The sale of an individual depreciable asset does not result in any capital gains as long as the sales proceeds of those individual assets are less than the WDV of that particular 'block of assets'. If the sales proceeds are more than the WDV of the 'block of assets' then the resultant gain is regarded as a 'deemed short-term capital gain' irrespective of the holding period of the individual assets and would be chargeable to tax at the normal corporate tax rate.

The concepts of short-term and long-term capital gains are explained in the section on Capital Gains Tax. This concept of taxation differentiates capital gains on depreciable assets as compared to capital gains on non-depreciable assets and personal assets.

Furthermore, additional or accelerated depreciation @ 20% is allowed to taxpayers engaged in the manufacture or production of any article or product in the year in which new plant and machinery acquired is first put to use.

Double taxation relief

India allows relief from double taxation of income in the following ways:

Unilateral relief: A resident of India deriving income from a country with which India does not have a tax treaty is eligible to claim credit for taxes paid in the foreign country. However, such credit would be restricted to Indian taxes on such foreign income or actual foreign taxes paid, whichever is less.

Bilateral relief: India has a comprehensive tax treaty network with more than 80 countries to avoid double taxation of income. Under the Indian tax laws, a taxpayer can avail the provisions of the tax treaty or domestic tax laws, whichever is beneficial to the taxpayer. Typically, bilateral relief is provided through the 'Credit method' or 'Exemption method'. To avail beneficial provisions of a tax treaty, non-resident companies and entities are required to obtain a valid Tax Residency Certificate (TRC) from the government of the country of residence along with other prescribed documents and information.

Withholding tax

Withholding tax, known as tax deducted at source (TDS) in India, aims to collect revenue at the very source of income. Its significance to the government lies in the fact that this tax is collected in advance, it ensures a regular source of revenue, provides for a greater reach and widens the tax base. The ITA requires the payer to withhold tax at source at:

- the appropriate rate considering the nature of payment and status of the recipient i.e. corporate or non-corporate assessee
- the time of payment or credit of the amount, whichever is earlier, except salary payments where tax is required to be deducted only on actual payment of salary.

Please see Appendix 1 for TDS rates on some common payments to residents and Appendix 2 for TDS rates on payments made to non-residents and foreign companies.

If the rates prescribed in a tax treaty are lower than the rates in the table in Appendix 2, the lower rates can be adopted. It is pertinent to note that a person availing the treaty benefit is required to furnish the Tax Residency Certificate (TRC) as stated earlier and is also required to give a declaration in the specified form.

If the recipient does not have a Permanent Account Number (PAN) in India, the TDS would be the maximum of the following:

- tax rate prescribed in the ITA, or
- rates in force (i.e. tax rate specified in the Finance Act or the rate specified in the treaty, whichever is lower), or
- 20%.

The person deducting the tax has a tedious compliance burden post deduction of tax as follows:

- In case of expenses other than salary, deposit the tax within seven days from the end of the month in which tax has been deducted except in case of tax deduction for the month of March. In respect of tax deducted in March, the due date of payment is 30 April.
- In respect of TDS on salary, the same timeline as specified above applies except that even for the month of March, tax needs to be deposited by 7 April.

- Apart from the deposit of taxes, a corporate is required to file the statement of TDS within 15 days from the end of each quarter, specifying the details of taxes paid and the deductees on whose behalf the taxes were paid. However, for the quarter ending March, the due date is 15 May and not 15 April. This statement is required to be filed separately in three different forms for salary payments, payments to non-residents and all other payments.
- A corporate is also required to issue a TDS certificate to the persons from whose payments the tax has been deducted within the specified time.

There are stringent penal provisions, including prosecution, for not complying with these TDS provisions.

Capital Gains Tax (CGT)

According to the ITA, an assessee is chargeable to pay capital gain tax on transfer of 'capital assets'. See the section on Capital assets for the definition of the term. The rate of capital gain tax depends on whether the capital asset is a short-term or long-term capital asset.

Any capital asset held for less than 36 months is regarded as a short-term capital asset; otherwise it is considered to be a long-term capital asset. However, securities listed on a recognised stock exchange in India, units of an equity-oriented mutual fund and zero-coupon bonds held for more than 12 months are considered as long-term assets.

The sale of capital assets is taxable based on the following rate structure:

S. No.	Particulars	Tax rates*
		Resident and non-residents
1	Sale of short-term capital assets: listed equity shares and units of equity-oriented mutual funds, which have been charged to Securities Transaction Tax (STT) in India	15%
2	Sale of short-term capital assets: other than the above	Based on corporate tax rate/individual tax rate
3	Sale of long-term capital assets: listed equity shares and units of equity-oriented mutual funds, which have been charged to STT in India	Exempt
4	Sale of long-term capital assets: listed securities or zero-coupon bonds, which have not been charged to STT	If costs are not adjusted for inflation – 10%
		If costs are adjusted for inflation – 20%
5	Sale of long-term capital assets: other than those mentioned in points 3 and 4 above	20% with adjustment for inflation

*applicable surcharge and education cess @ 3% shall also be levied.

However, exceptions in case of taxability of capital gains in the hands of a non-resident are:

- Capital gains arising from the transfer of a capital asset, being shares and debentures of an Indian company that have been initially purchased and sold in foreign currency, are required to be computed in the foreign currency and the net gain in foreign currency would be converted to Indian Rupees considering the prevailing exchange rate on the last day of the month immediately preceding the month in which the capital asset is transferred. Further, the cost of such capital assets cannot be adjusted for inflation in spite of the same being a long-term gain.

- Long-term capital gains arising from the transfer of unlisted securities would be chargeable to tax @ 10%. However, the cost of the said asset cannot be adjusted for inflation.

Transfer of capital assets as a consequence of amalgamation, demerger or business reorganisation, in compliance with conditions of the Indian income tax law is not taxable in India.

The capital gains arising on account of long-term capital assets are also exempt up to INR 5 million, if the gain is invested in specified bonds within six months of the transfer of the long-term capital asset. Also, there are a few other avenues available to save tax on capital gains in case of an individual.

Tax losses

The ITA deals with the losses arising under the following heads of income:

- Losses under the head 'income from house property'
- Losses under the head 'business income', further split into 'business loss' and 'unabsorbed depreciation'
- Losses under the head 'speculation income'
- Losses under the head 'capital gains', further classified into 'long-term capital loss' and 'short-term capital loss'
- Losses under the head 'income from other sources'

These losses are computed under the different provisions of the ITA and there are various provisions governing the set off and carry forward of such losses. The losses under the head 'income from house property' and 'business income' can be set off against income from any other head computed for the same year. However, losses under the head 'speculation loss' and 'capital loss' can be set off only against the speculation gain and capital gain respectively computed for the year. This is shown in the following table:

Loss under the head	Can be set off against						
	Salaries	**Income from house property**	**Business income**	**Speculation business income**	**Short-term capital gains**	**Long-term capital gains**	**Income from other sources**
Loss from house property	✓	✓	✓	✓	✓	✓	✓
Business loss	X	✓	✓	✓	✓	✓	✓
Speculation business loss	X	X	X	✓	X	X	X
Unabsorbed depreciation	✓	✓	✓	✓	✓	✓	✓
Short-term capital loss	X	X	X	X	✓	✓	X
Long-term capital loss	X	X	X	X	X	✓	X
Loss from income from other sources	✓	✓	✓	✓	✓	✓	✓

Also, there are restrictions on the utilisation of tax losses under each head when they are carried forward to subsequent years, as shown in the following table:

Loss under the head	Can be set off against						
	Salaries	**Income from house property**	**Business income**	**Speculation business income**	**Short-term gains**	**Long-term gains**	**Income from other sources**
Loss from house property	X	✓	X	X	X	X	X
Business loss	X	X	✓	✓	X	X	X
Speculation business loss	X	X	X	✓	X	X	X
Unabsorbed depreciation	✓	✓	✓	✓	✓	✓	✓
Short-term capital loss	X	X	X	X	✓	✓	X
Long-term capital loss	X	X	X	X	X	✓	X
Loss from income from other sources	X	X	X	X	X	X	X

There are specific provisions for carrying forward losses with respect to the head of income against which they can be set off and the time limit for each:

Nature of loss	Can be set off against	Number of years that it can be carried forward for
Business loss	Business income	8 years
Speculation business loss	Speculation profits	4 years
Unabsorbed depreciation	Against any head of income	Indefinite
Capital loss – short-term	Capital gain (short-term or long-term)	8 years
Capital loss – long-term	Long-term capital gain	8 years
Loss from house property income	Income from house property	8 years
Loss from income from other sources	Not applicable	Cannot be carried forward

It may be pertinent to note that closely held companies are required to satisfy a 51% continuity of ownership criteria for carrying forward business losses.

General anti-avoidance provisions

In an effort to curb tax avoidance and evasion, the Indian government introduced the General Anti-Avoidance Rules (GAAR) in the Income Tax Act. GAAR will be implemented from financial year 2015-16 i.e. 1 April 2015. Once GAAR comes into effect as proposed, it will empower the tax authorities to declare an arrangement as an impermissible avoidance arrangement (IAA) if it was entered into with the main purpose of obtaining a tax benefit. Once an agreement is declared to be an IAA, the tax authorities will be entitled to, *inter alia*, re-characterise the transaction, ignore the transaction, disregard accommodating parties, reallocate income/expenses, etc. However, a recent update from the Finance Ministry, which is preparing the budget for 2014-15 indicates that the Ministry is considering deferring implementation of GAAR by one year with a view to improve business sentiment and promote investments and growth. The discussion of deferment is still at a nascent stage and one will have to wait for Budget 2015 to have a better picture.

Planning points for foreign investors

According to Indian exchange control regulations, a foreign business can have a presence in India in the form of a liaison office, branch office, project office, company and Limited Liability Partnership (LLP).

The various factors to be looked at are:

Particulars	Liaison Office	Branch Office and Project Office	Subsidiary Company	Limited Liability Partnership (LLP)
Regulatory approval	Reserve Bank of India (RBI)[97], Registrar of Companies (ROC) and local registrations	RBI, ROC and local registrations	ROC and local registrations	Prior approval of the Indian government and Foreign Investment Promotion Board
Rate of tax[98]	Nil (since it is not permitted to carry out any revenue-generating activity)	Normal tax rate – 40% of net taxable income. Minimum Alternate Tax (MAT)[99] – 18.5% of adjusted book profits.	Normal tax rate – 30% of net taxable income. MAT – 18.5% of adjusted book profits.	Normal tax rate – 30% of net taxable income. Alternate Minimum Tax (AMT)[100] – 18.5% of adjusted book profits.
Long-term capital gain tax rate[36]	Not applicable (since it is not permitted to carry out revenue-generating activity)	Nil[101] 10%[102] 20%[103]	Nil[39] 10%[104] 20%[41]	Nil[39] 10%[42] 20%[41]
Advance tax payment	Not applicable (since it is not permitted to carry out revenue-generating activity)	To be paid in four instalments	To be paid in four instalments	To be paid in three instalments
Minimum capital norm	Not applicable (funded by Head Office)	Not applicable (funded by Head Office/internal accruals)	Public Limited Company – INR 500,000 Private Limited	No minimum capital

[97] Could be under automatic or approval route involving post-facto intimation or prior approval, respectively
[98] Excluding surcharge and education cess
[99] MAT is designed to ensure that no company with substantial accounting income can avoid tax liability by using exclusions, deductions and incentives available under the Income Tax Act
[100] AMT is similar to MAT and is applicable to non-corporate bodies only if they are claiming incentive linked or profit linked deduction
[101] Transfer of equity shares/unit of an equity-oriented fund which attracts Securities Transaction Tax (STT)
[102] Transfer of unlisted securities (without benefit of indexation and foreign currency fluctuation)
[103] Other cases
[104] Transfer of listed securities (other than units) or zero-coupon bonds without indexation benefit

			Company – INR 100,000	
Repatriation of profits	Not applicable	No further tax on repatriation of profits	Subject to Dividend Distribution Tax of 19.994%. Exempt in the hands of shareholders.	No further tax on repatriation
Transfer pricing regulations	Not applicable	Applicable	Applicable	Applicable
Permanent establishment (PE)	Generally, do not constitute PE, but litigation exists	Constitutes PE and a taxable presence under a tax treaty or Income Tax provisions	An independent taxable entity and not a PE of foreign company. However, where working as a shell/conduit entity, it may constitute a PE.	Should not constitute PE. However, whether interest in LLP results in PE is still ambiguous.
Applicable surcharge and education cess	Not liable to tax	Surcharge: Total income of: Up to INR 10 million – Nil Up to INR 100 million – 2% Above INR 100 million – 5% Education cess @ 3%	Surcharge: Total income of: Up to INR 10 million – Nil Up to INR 100 million – 5% Above INR 100 million – 10% Education cess @ 3%	Surcharge: Total income of: Up to INR 10 million – Nil Above INR 10 million – 10% Education cess @ 3%

<u>Investment via shares or loans</u>

A foreign corporation can fund its Indian subsidiary by infusing share capital (foreign direct investment (FDI)) or by extending a loan (external commercial borrowing (ECB)). Both FDI and ECBs can be availed by the Indian subsidiary subject to fulfilment of prescribed exchange control regulations. Key tax implications of FDI/ECBs are:

- Repatriation of capital – Foreign capital invested in India is generally allowed to be repatriated along with capital appreciation, if any, after payment of taxes due on them, provided the investment was made on a repatriable basis. The repatriation is however, subject to lock-in conditions in certain sectors.
- Repatriation of dividend – A company is liable to pay Dividend Distribution Tax @ 19.994% (including surcharge and education cess) on the amounts declared or distributed as dividend. Such dividends are not taxed in the hands of the recipient.
- Payment of interest on ECBs – Subject to certain conditions, withholding tax on ECBs (wherever allowed) has been reduced from 20% to 5% (with applicable surcharge and cess) for ECBs availed between 1 July 2012 and 1 July 2017. Furthermore, the said concessional rate of 5% would apply even in case the non-resident does not have a PAN in India.

<u>Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs)</u>
The Finance (No. 2) Act, 2014 introduced a taxation regime for business trusts – REITs and InvITs. These business trusts give small investors access to large-income-producing real estate and infrastructure assets, much like how mutual funds provide access to stocks. The Securities and Exchange Board of India (SEBI) issued guidelines for regulating such business trusts and an investor can enter the property market with as little as INR 200,000. Both these models have the following distinctive elements:

- The trust would raise capital by issuing units, which would be listed on recognised stock exchanges in India;
- The trust can raise debt from residents as well as non-residents;
- Income-bearing assets would be held by the trust by acquiring controlling or other specific interest in an Indian company (special purpose vehicle (SPV)) from the sponsor (promoters of the SPV).

Further, the proposed taxation regime of such business trusts would, *inter alia,* include the following:

- No capital gains tax on the sponsor at the time of exchange of shares of the SPV with the units of the trust.
- The current beneficial regime of capital gains tax available on listed shares would also apply to such units for their holders. However, this benefit would not be available to the sponsor at the time of disposal of such units.
- Capital gains on the disposal of other assets by the trust shall be taxable in the hands of the trust. However, the same would not be taxable in the hands of the unit holders at the time of distribution.
- Dividend received by the trust from the SPV (which is subjected to DDT) would be exempt from tax at the time of receipt as well as distribution to unit holders by the trust.
- Interest income received by the trust from the SPV is accorded pass-through status. Accordingly, the said interest income would not be chargeable to tax in the hands of the trust. However, at the time of distribution of this interest to investors of the business trust, taxes would be required to be withheld as per the ITA.
- Other income of the trust shall be taxable at the maximum marginal rate (i.e. 30%).

In addition, certain other reporting compliances like filing of tax returns, etc. would be required to be undertaken by business trusts.

<u>Tax incentives</u>
The Indian government, in order to accelerate economic growth, extends various direct and indirect incentives to the business community. Some incentives available under the ITA are as follows:

- India has robust tax treaties with many countries. Taxpayers have the option of availing benefits under a tax treaty to the extent it is more beneficial vis-à-vis the provisions of the ITA (subject to certain documentation requirements).
- The rate of withholding tax on interest on ECBs reduced from 20% to 5% subject to certain conditions.
- Profit and Investment linked incentives:
  i. For units located in Special Economic Zones (SEZs), 100% income tax exemption on export income for the first five years, 50% for the next five years, and 50% on the re-invested export profit for the next five years.

ii. For SEZ developers – income tax exemption on income for a block of 10 years in 15 years.
iii. Investment linked incentive for specified activities/sectors such as:
   - Infrastructure
   - Oil and gas
   - Research and development activities
   - Activities in specified geographical areas
   - Cold storage, warehousing facilities for agriculture produce and sugar
   - Hotel, hospital and slump redevelopment or rehabilitation with certain restriction

   However, the company will be liable to pay tax under the provisions of MAT wherever profit linked and investment linked incentive is available.

- Accelerated depreciation @ 20% available on new plant or machinery acquired and installed by an undertaking engaged in the manufacture of any article.
- In addition, an investment allowance of 15% on the cost of machinery is allowed to a manufacturing company by investing a minimum of INR 250 million within a specified time frame and subject to fulfilment of other conditions.

Transfer pricing

Transfer pricing refers to inter-company pricing arrangements between related business entities and commonly applies to inter-company transfers of services and tangible/intangible properties. In India, detailed provisions relating to transfer pricing were introduced by the Finance Act, 2001 in order to facilitate the computation of reasonable, fair and equitable profits and tax in India in the case of businesses carried on by multinational companies. Simply put, transfer pricing is the process of adjusting the prices of cross-border transactions between related/associated parties.

Section 92 of the ITA provides that the price of any transaction between associated enterprises (AE), either or both of whom are non-residents for tax purposes (international transaction), shall be computed having regard to the arm's length principle. The recent amendment of the Finance Act, 2012 brought 'specified domestic transactions' where transactions are carried out between two related Indian entities also under the purview of transfer pricing.

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 the same persons in both the enterprises.

In determining whether there is participation in management or control, various factors are taken into consideration including:

- Direct/indirect shareholding having 26% or more voting power
- Advancing of loans of 51% or more of total assets
- Appointment of more than 50% of the board of directors
- Goods manufactured sold under influenced prices
- Dependence on intellectual property rights owned by either party, etc.

Recently, an additional clarification was issued highlighting the concept of a 'deemed international transaction', thereby widening the scope of transfer pricing in India. This provision considers a transaction between two residents in India as an international transaction subject to certain conditions.

<u>Determination of 'arm's length price'</u>

A crucial aspect of transfer pricing is the process of determining the arm's length price. The Central Board of Direct Taxes (CBDT) has prescribed five methods for determining the arm's length price:

- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost Plus method
- Profit Split Method
- Transactional Net Margin Method

Recently, the CBDT prescribed another method regarded as the 'other method' to potentially cover transactions involving intangibles and business restructurings for which the above methods may not be the most appropriate.

The choice of the appropriate method is determined with respect to the nature and class of transaction, the classes of associated persons, the functions performed by them and other relevant factors.

Also, it is proposed to introduce the range concept for determination of arm's length price and use of multiple-year data for comparable analysis of transactions. Appropriate rules for the same would be prescribed.

International transactions

Apart from routine transactions relating to the purchase and sale of goods and services, the Finance Act, 2012 enhances the definition to include transactions involving business restructuring, intangibles, goodwill, corporate guarantees, overdue debtors, etc. There is no threshold exemption limit for this compliance.

Also, it is mandatory to obtain an accountant's certificate in the prescribed format for all international transactions between associated enterprises. This report would have to contain prescribed particulars of the transaction, and would have to be filed with the tax authorities by 30 November of the relevant assessment year, along with the tax return.

Stringent penal provisions have been prescribed for non-compliance with the prescribed requirements under the new transfer pricing regime.

Advance Pricing Agreements

- The Finance Act, 2012 introduced Advance Pricing Agreements (APAs). An APA is an agreement between a taxpayer and the tax authorities for specifying the manner in which the arm's length price is to be determined with respect to an international transaction.
- The arm's length price shall be determined on the basis of the prescribed methods or any other method.
- An APA would be valid for a maximum of five consecutive years unless there is a change in the provisions or the facts having a bearing on the international transaction.
- Recently, roll-back provisions were introduced, according to which, an APA would also be applicable to international transactions undertaken in the previous four financial years subject to certain conditions.
- On 19 December 2014, India signed the first bilateral APA with Japan which would be valid for 5 years. The APA has been finalised within a time span of 1.5 years, which is shorter than the time normally taken to finalise APAs internationally.

Chapter 8

Personal taxation

While companies contribute a considerable amount to the tax collected each year by the Indian government, contributions from individuals also form a vital element of the revenue.

Taxes as per the Indian Income Tax Act (ITA) are levied on *persons*, which includes individuals. The rates of taxation differ in each fiscal year (from April to March), and are usually lower than the corporate rate of taxation.

Residential status

It is crucial for an individual to determine his/her correct residential status since, in India, taxation for a particular year is dependent on his/her residential status in India for that year. The Indian tax law categorises the residential status of an individual as 'resident' or 'non-resident'. An individual can be regarded as 'resident' or 'non-resident' in India depending on the number of days of stay in India.

An individual is considered to be a resident if he/she satisfies any of the following conditions:

a) Been in India for a period of 182 days or more during that financial year (1 April - 31 March); or
b) Been in India for a period of 60 days or more during that financial year **and** at least 365 days during the preceding four years.

Further, in condition (b) above, the period of 60 days would be extended to 182 days in the following cases:

- An Indian citizen who leaves India in any year for the purpose of employment; or
- An Indian citizen who leaves India as a member of the crew on an Indian ship; or
- An Indian citizen or a Person of Indian Origin, who has settled abroad, visits India.

An individual is classified as a non-resident if he/she does not satisfy either of the above conditions.

The law has further categorised the residential status of a 'resident in India' into 'resident and ordinarily resident' and 'resident and not ordinarily resident'. A person is said to be 'resident and not ordinarily resident' in India in any year if the person has:

- been a non-resident in India in 9 out of the preceding 10 years; **or**
- been in India for a period of, or periods amounting in all to, 729 days or less during the preceding 7 years.

Thus, if an individual fulfils any **one** of the above conditions he would be regarded as 'resident and not ordinarily resident' in India for that particular year (April–March).

The actual number of days an individual is present in India is generally determined on the basis of entries in the passport, taking into account the day of entry as well as exit.

An individual considered to be a resident of India as well as another country can determine his residential status as per the criteria specified under the tax treaty, if any, entered into by the Indian government with the government of that other county.

Scope of taxation

Once the residential status has been determined based on the above conditions, taxation of income would be determined as follows:

Particulars of income	Resident and ordinarily resident	Resident and not ordinarily resident	Non-resident
Income received or deemed to be received in India	Taxable	Taxable	Taxable
Income accrues or arises in or deemed to accrue or arise in India	Taxable	Taxable	Taxable
Income earned outside India	Taxable	Taxable (only if earned from a business/ profession controlled from India)	Not Taxable

*As per the table, once it is determined that the income of the individual is taxable in India, the computation mechanism would be more or less similar for all individuals irrespective of the residential status. However, there could be few exceptions which have to be looked at on a case-to-case basis.

How to compute tax – a broad structure

For tax purposes, income is broadly divided into different heads of income and different computation mechanisms have been prescribed for each head. The heads are:

- Income from employment/salary
- Income from house property (rental income)
- Income from business and profession
- Income from capital gains
- Income from other sources (viz. dividend, winnings from lotteries, gifts, family pensions, etc.)

After aggregating income under the various heads, the taxpayer can then reduce taxable income with certain allowable deductions. For example, an individual could claim deduction in respect of investments made in public provident fund or payment of life insurance premium, medical health policy premium, certain mutual funds, etc. After the said deductions, the resultant taxable income is required to be offered to tax at the rates prescribed in the law.

Income tax rates

The tax rate applicable to an individual would depend on the income bracket in which he falls. Various income slabs along with different tax rates are provided every year in the Union Budget, generally presented to the Parliament of India on the last day of February. The slab rates mentioned in the Budget are applicable for the following year (April–March). For instance, the Union Budget 2014-15 has prescribed the following rates for individual taxpayers (other than senior citizens):

Income	Tax rate
Up to INR 250,000	Exempt
INR 250,001 to 500,000	10%

INR 500,001 to 1 million	20%
Above INR 1 million	30%

Further, the law also provides special exemptions to 'resident senior citizens' (individual who are more than 60 years of age) and 'resident very senior citizens' (individuals who are more than 80 years of age) where the basic exemption limit is INR 300,000 and INR 500,000, respectively.
In addition to the above, individuals with a total income of INR 10 million or more in the year are liable to pay a surcharge @ 10%.

All taxes in India are further increased by an education cess, which is 3% of the total tax payable (tax plus surcharge).

To know more about individual tax liabilities, visit www.incometaxindia.gov.in.

Ways to discharge income tax liability

An individual can discharge his income tax liability in either or all of the options mentioned below:

- Advance Tax
- Tax Deducted at Source (TDS)
- Self Assessment Tax

Advance Tax

Advance tax means the payment of tax before the end of the year. An individual has to estimate his/her total income for that year and discharge tax liability in three instalments during the year itself i.e. 30%, 60% and 100% of the tax liability, which is due by 15 September, 15 December and 15 March of that year. However, an individual is liable to pay advance tax only under the following conditions:

- The tax liability is more than INR 10,000; and
- The above liability of INR 10,000 is arrived at after considering TDS if any deducted by payers who have paid income to such person.

For individuals with salary as the sole source of income, advance tax would not be applicable as the entire tax liability would be taken care of by the employer by way of TDS. Further, no advance tax is payable by a senior citizen if his/her total income does not include income from business or profession.

Tax Deducted at Source (TDS)

TDS refers to the portion of a payment that is deducted by the payer before making payment of the net amount to the payee. The TDS rate would depend on the nature of the income earned by the individual. For example, TDS from professional fees would be 10% while that from contractual payments would be 2%. The TDS collected by the payer is required to be deposited with the tax authorities within prescribed time limits.

It is crucial to keep in mind that TDS is only a part payment of tax. The final tax liability would be arrived at based on the slab rates applicable to the individual.

For non-residents, TDS is applicable on any sum paid to them. For example, if a foreign individual receives a certain sum from an Indian company and such amount is taxable in India, then the Indian company is liable to deduct tax at the applicable rates and deposit the same with the authorities within the prescribed time limits.

Self Assessment Tax

In case the advance tax paid by the individual and the TDS are not adequate to cover the entire gross tax liability for the year then the same can be discharged by the individual himself before the tax return is filed. Such tax paid would be regarded as Self Assessment Tax.

Tax treatment of Employee Stock Option Plans (ESOP)

An increasing number of multinational companies prefer granting Employee Stock Option Plans (ESOPs) to their employees nowadays wherein they are granted an option to buy the shares of the employer company at a discounted rate, lower than the market value.

The taxation of ESOPs as per Indian laws happens in two stages. In the first stage, it is taxable in the hands of the employee as salary (perquisite given by the employer), which is represented by the difference between the fair market value (FMV) of the shares and the actual price at which they are purchased by the employees. The law lays down the procedure for determining the FMV of the shares. The point of taxability is the date on which the option is exercised by the employee to subscribe to the shares. Employers are liable to deduct tax at source on this part of the income.

The second stage of taxability arises when the said shares are sold or transferred. The difference between the sale price and the FMV (calculated in the earlier phase of taxation) is taxable as capital gains. The tax treatment of such capital gains would be as prescribed in the section Capital Gains Tax in Chapter 7.

Wealth tax

Apart from income tax, Indian laws prescribe for the payment of wealth tax in case of specific assets. It is payable @ 1% of the taxable net wealth. Wealth tax is applicable to an individual only if his/her total wealth exceeds INR 3 million for a particular year.

Electronic filing of tax returns

The past few years have seen a sea-change in the process of filing tax returns in India. Now, most taxpayers are expected to file their tax returns electronically instead of manually. This has been a paradigm shift in tax administration in India.

The Indian tax department has set up a state of the art facility in Bengaluru called the Central Processing Centre (CPC), which processes all tax returns that have been filed electronically. The CPC has been responsible for drastically reducing the time taken to process tax returns and issue refunds. As a result, a large number of taxpayers, particularly individuals, have started receiving their refunds within a few months of filing their returns.

For more information on e-filing of income-tax returns, visit www.incometaxindiaefiling.gov.in.

Personal taxation in India is dynamic and complicated with several interpretational and other issues. However, the scheme of law provides for many relaxations with a view to avoid unnecessary hassles for individual taxpayers and has simplified the process to encourage timely and correct tax return filing and payment.

Chapter 9

Labour regulations, welfare and social security

In this Chapter, we have provided an overview of Acts that are applicable across India. In addition, states also specify certain compliances/Acts or extend the scope of certain central government Acts. These have not been included.

Employment and industrial relations[105]

Under the Constitution of India, labour is a subject in the concurrent list[106] where both the Central and state governments are competent to enact legislations. As a result, India has a plethora of laws (over 50 Central Labour Acts alone) addressing various aspects such as industrial relations, safety and health, child and woman labour, social security, labour welfare, employment and training, wages, etc. India is a founder member of the International Labour Organisation (ILO) and has ratified 43 conventions, of which 42 are in force.[107]

The Industrial Disputes Act, 1947, was enacted to make provisions for the prevention and settlement of industrial disputes and for providing certain safeguards to the workers. It contains the following:

- the procedure, power and duties of the authorities constituted under the Act
- provisions to prohibit strikes and lockouts, declaration of strikes and lockouts as illegal
- provisions relating to lay-off, retrenchment and closure
- provisions covering unfair labour practices
- provisions of various penalties

It applies to every industrial establishment carrying on any business, trade, manufacture or distribution of goods and services irrespective of the number of workmen employed. Every person employed in an establishment for hire or reward including contract labour, apprentices and part-time employees to do any manual, clerical, skilled, unskilled, technical, operational or supervisory work, is covered by the Act. It does not apply to persons mainly in managerial or administrative capacity, persons engaged in a supervisory capacity, etc.

The Industrial Employment (Standing Orders) Act, 1946, requires employers to clearly define and publish standing orders (service rules) and to make them known to the workmen employed by them. It applies to every industrial establishment where 100 or more workmen are/were employed on any day of the preceding 12 months.

The Industrial Employment (Standing Orders) Central Rules, 1946, cover the classification of workmen, working hours, holidays, pay days, wage rates and payment, shifts, attendance, leave, termination of employment, disciplinary action for misconduct, complaints, etc.

The Plantations Labour Act, 1951, provides for the welfare of plantation labour and conditions of work in plantations. It applies to all tea, coffee, rubber and cinchona plantations but state governments may also extend it to other plantations. The Act is administered by the state governments and is applied to any land used as plantations, which measures five hectares or more in which 15 or more persons are working. The state governments are, however, free to declare any plantation land less than five hectares or less than 15 persons to be covered by the Act.

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[105] Labour laws in India, http://www.nacib.in/pdf/Labour%20Act.pdf, accessed 15 September 2014

[106] Ministry of Labour & Employment, http://labour.gov.in/content/innerpage/constitutional-provision.php, accessed 2 September 2014

[107] Ratifications for India, International Labour Organization, http://www.ilo.org/dyn/normlex/en/f?p=1000:11200:0::NO:11200:P11200_COUNTRY_ID:102691, accessed 15 September 2014

The Factories Act, 1948, provides for the health, safety, welfare, service conditions and other aspects of workers in factories. It applies to all factories employing more than 10 people and working with the aid of power or employing 20 people and working without the aid of power. The Act aims at protecting workers employed in factories from unfair exploitation by the employer. The Act also covers the following:

- industries involving hazardous processes
- permissible levels of certain chemical substances in the work environment
- facilities and conveniences
- working hours
- overtime wages
- employment of women, night shifts
- leave
- notice of accidents, diseases, etc.
- obligation regarding hazardous processes/substances

There are no mandatory provisions in terms of leave and termination of employment. Every establishment can lay down its own policy after taking into account the mandatory requirements under the legislation.

Each state government is empowered to make rules for the purpose of this Act. The Factories Act, 1948 should be read with the respective state rules. State legislations such as the Shops and Establishments Act do not apply to workmen in a factory or in an establishment attached to a factory to whom the benefits under the Factories Act, 1948 are applicable.

The Contract Labour (Regulation and Abolition) Act, 1970, regulates the employment of contract labourers in establishments and by contractors. The Rules for implementing the provisions of the Act vary from state to state. This Act covers the following:

- registration of the principal employer
- licensing of contractors
- payment of wages
- facilities to be provided to contract labourers (canteens, restrooms, etc.)
- submission of returns
- maintenance of records (Register of Contractors)

Wages[108]

The Payment of Wages Act, 1936, regulates the payment of wages[109] to workers employed in a factory, drawing wages up to INR 10,000 per month. This Act was enacted with a view to ensuring that wages payable to employed persons covered by the Act were disbursed by the employers within the prescribed time limit without any unauthorised deductions. It specifies the need for maintenance of registers, penalties, rights of employees, etc.

The Minimum Wages Act, 1948, provides for fixing minimum wages in certain scheduled employments and revising the rates at appropriate intervals. It covers norms for fixing minimum wages, cost of living allowance, variable dearness allowance, etc.

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[108] Laws related to wages, http://labour.gov.in/content/innerpage/wages.php, accessed 2 September 2014
[109] Excludes bonus, pension fund, provident fund, travel allowance and gratuity

The Payment of Bonus Act, 1965, provides for the payment of bonus (linked with profit or productivity) to persons employed in certain establishments. It is applicable to every factory/establishment wherein 20 or more workers are employed on any day during an accounting year. Every employee receiving salary or wages up to INR 10,000 per month and engaged in any kind of work whether skilled, unskilled, managerial, supervisory, etc. is entitled to a bonus for every accounting year if he has worked for at least 30 working days in that year. This Act covers factors such as the minimum and maximum bonus payable, time limit for payment, calculation of bonus, etc.

Employment and training

The Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959, aims to provide for compulsory notification of vacancies to employment exchanges. It applies to all establishments in the public sector and to establishments employing more than 25 employees in the private sector.

The Apprentices Act, 1961, aims to provide practical training to technically qualified persons in various trades. The objective is promotion of new skilled manpower. The scheme is also extended to engineers and diploma holders. The Act requires employers to hire apprentices in certain designated trades as notified by the government.
The Act specifies the obligations of employers and apprentices, the standard of education/physical fitness, duration of training, terms and conditions of the contract, payment, health, safety, welfare, working hours, etc.

Maternity and paternity leave

With a view to regulate the employment of women in factories or establishments, the government introduced the Maternity Benefit Act, 1961, primarily to ensure the well being of women workers specifically during the period before and after child birth and to provide for maternity benefits including maternity leave, wages, bonus, nursing breaks, etc. There is neither a wage ceiling for coverage under the Act nor is there any restriction as regards the type of work a woman is engaged in.

This act applies to women who work in factories, mines, plantations, shops and establishment with more than 10 employees. It does not apply to employees covered by the Employees’ State Insurance Act, 1948. It can be extended to other establishments by state governments.

While 15 days of paternity leave is authorised for male government employees there is no law that instructs the private sector to make it obligatory.[110]

Union representation

The Trade Unions Act, 1926, deals with the registration of trade unions (including associations of employers), their rights, their liabilities and responsibilities as well as ensures that their funds are utilised properly. It gives legal and corporate status to registered trade unions. An employer cannot prevent workers from forming a union. They are formed to promote and protect the interest and welfare of workers by enabling collective bargaining.

[110] Bangalore Mirror, 8 May 2011, http://epaper.timesofindia.com/Repository/ml.asp?Ref=QkdNSVIvMjAxMS8wNS8wOCNBcjAwNjAw&Mode=HTML, accessed 15 September 2014

Social security and pension plans

The Employees' Provident Fund (EPF) and Miscellaneous Provisions Act, 1952, was enacted to provide social security to industrial workers. It provides for retirement/old-age benefits through the compulsory institution of contributory provident funds, pension funds and deposit-linked insurance funds for employees in factories and other establishments. Furthermore, the Act provides for payment of terminal benefits in various contingencies such as retrenchment, closure, and retirement on reaching the age of superannuation, voluntary retirement and retirement due to incapacity to work.

It applies to industries specified in Schedule I employing 20 or more persons and any other class of establishments employing 20 or more persons notified by the government. It applies to all employees including contract labour and part-time labour. It was not applicable to employees drawing salaries exceeding INR 6,500 per month. However, from 1 September 2014, the statutory wage ceiling was raised to INR 15,000 per month.

The minimum contribution would be the percentage of wages as given below:

Scheme	Employer's contribution	Employee's contribution
Provident fund	3.67%	12%
Pension fund	8.33% (Up to a max. of INR 750/-)	Nil
Deposit-linked insurance fund	0.50%	Nil
Administration charges	1.16%	Nil
Total	**13.67%**	**12%**

Applicability for expatriates and international social security agreements[111]

The Indian government vide Notifications GSR 705(E) and GSR 706(E) dated 1 October 2008 extended the Employees' Provident Fund and Pension Scheme to all 'international workers'. 'International worker' includes an employee other than an Indian employee, holding other than an Indian passport, working for an establishment in India to which the Provident Fund Act applies.

EPF contribution is to be calculated on the total salary earned by the employee, whether received in or outside India. The expatriate will be required to contribute 12% (8.33% to PF and 3.67% to Pension Scheme) and a similar amount will need to be contributed by the employer. As the PF contribution is substantial, a sizeable portion of salary will get locked up if an employee has to contribute to social security schemes of two countries i.e. India and the home country.

Bilateral social security agreements are being negotiated with various countries to protect the interest of expatriate workers and the companies on a reciprocal basis. India has already entered into some agreements with Belgium, Denmark, France, Germany, Hungary, Korea, Luxembourg and Switzerland. These agreements help workers by exempting them from social security contribution in case of short-term contracts and allowing them to export pension in case of relocation. Such agreements also prove beneficial for companies as exemption from social security contribution in

[111] Business Standard, 30 May 2011, http://www.business-standard.com/article/economy-policy/pf-scheme-to-expatriates-needs-a-relook-111053000040_1.html, accessed 15 September 2014

respect of their employees substantially reduces costs.[112] However, detailed analysis would be required before structuring the salary of expatriates from these countries.

If the employer is a company and an order for winding up has been made, the amount due from the employer whether in respect of employee's or employer's contribution must be included among the debts which are to be paid in priority to all other debts. This payment will be preferential payment provided the liability therefore has accrued before the order of winding up is made.

The Payment of Gratuity Act, 1972, enforces the payment of gratuity – a reward for long service – as a statutory retirement benefit to employees engaged in factories, mines, oilfields, plantations, ports, railway companies, shops or other establishments. Every employee irrespective of his wages is entitled to receive gratuity if he has rendered continuous service of five or more years.

- Gratuity is payable on retirement or termination of service, resignation or on death of the employee.
- This Act applies to every establishment employing 10 or more persons at any time during the year.
- In case of death or permanent disablement of an employee, nominees are entitled to gratuity even if the employee has worked for less than five years.
- The rate of gratuity payable to employees is 15 days' salary for every completed year of service or a part thereof exceeding six months, subject to maximum of INR 1 million.
- Wages/salary would mean last drawn wages and include all payments earned by an employee while on duty or on leave in accordance with the terms and conditions of his employment excluding:
  - Bonus
  - Commission
  - House Rent allowance
  - Overtime Wages
  - Any other allowance

The formula to calculate gratuity is as follows:

$$\text{Gratuity} = \frac{\text{Monthly salary x 15 days x Number of years of service}}{26}$$

The Act provides only for the minimum gratuity payable. If an employee has a right to receive higher gratuity under a contract or an award, he is entitled to higher gratuity.

Injury/disability/death/survivor benefits

The Employers' Liability Act, 1938, was enacted to prohibit employers from raising certain defenses in suits for damages in respect of personal injuries sustained by workmen due to negligence by the employer.

The Employees' Compensation Act, 1923, earlier known as the Workmen's Compensation Act, was introduced to provide for payment to workmen as compensation for injury by accident. Workers and/or their dependents are provided with relief in the event of accidents arising out of or in the

[112] Ministry of Overseas Indian Affairs, http://moia.gov.in/services.aspx?ID1=81&id=m4&idp=81&mainid=73, accessed 15 September 2014

course of employment, causing death or disability. This Act is not applicable to workers covered under the Employees' State Insurance Act.

Employment insurance

The Employees' State Insurance (ESIC) Act, 1948, was enacted to provide for benefits to employees in case of sickness, maternity and employment injury. Under the Act, employees will receive medical relief, cash benefits, maternity benefits, pension to dependents of deceased workers and compensation for fatal or other injuries and diseases. It covers all employees including casual, temporary or contract employees. It is wider than the Factories Act as the benefits of this Act extend to employees whether working inside the factory or establishment or elsewhere, directly employed by the principal employee or through an intermediate agency, and whether the employment is incidental or in connection with the factory or establishment.

Profession tax

Profession tax varies from state to state so in order to get an overview, as an example we have discussed the Maharashtra State Tax on Profession, Trades, Callings, and Employment Act, 1975. An employer must get registered under the Act and obtain a Registration/Enrolment Certificate under which the payment in respect of taxes can be deducted from employees' salaries (up to a maximum of INR 2,500 per year). However, profession tax exists only in the following states, Assam, Karnataka, West Bengal, Andhra Pradesh, Maharashtra, Tamil Nadu, Gujarat, Assam, Chhattisgarh, Kerala, Meghalaya, Orissa, Tripura and Madhya Pradesh.

In Maharashtra, profession tax is applicable to both, individuals and organisations (company, firm, proprietary concern, Hindu Undivided Family (HUF), society, club, association of persons, corporation or any other corporate body in Maharashtra).

Commercial establishments

Shops and Establishments Act
States have their own acts with regards to commercial establishments. This Act provides statutory obligations and rights to employees and employers in the unorganised sector, i.e., shops and establishments. This Act is applicable to all persons employed in an establishment with or without wages, except members of the employers' family. It does not apply to workmen in a factory or in an establishment attached to a factory to whom benefits under the Factories Act, 1948, are applicable.
This Act lays down the following rules:

- registration of establishments
- working hours per day and week
- guidelines for rest, opening and closing hours, closed days, national and religious holidays, overtime work
- ban on employment of children (under 15 years)
- employment of young persons and women
- annual leave, maternity leave, sickness and casual leave, etc.
- employment and termination of service
- maintenance of registers

The rules regarding registration of shops and establishment vary from state to state. For example, the Bombay Shops and Establishments Act, 1948, is applicable to commercial establishments in Maharashtra.

Recent developments[113]

With the changing labour market scenario, the Factories (Amendment) Bill, 2014, and the Apprentices (Amendment) Bill, 2014, seek to amend the Factories Act, 1948, and Apprentices Act, 1961, respectively. Once passed, they are expected to make it easier to do business in India, with provisions to allow flexibility in hiring and working hours.

Amendments to the Factories Act include improving workers' safety, increasing the provision for overtime, increasing the penalty for violations, relaxing the norms for women to work night shifts in some industry segments, and reducing the number of days an employee needs to work before becoming eligible for benefits such as paid leave.

Amendments to the Apprentices Act propose to expand the scope of employment for apprentices and push for the induction of more non-engineers as apprentices. This would allow young job seekers and students to gain industry-relevant skills on the shop floor. The changes will also allow industries to appoint apprentices from a state different from where the employer is located. In addition, every employer will be allowed to formulate its own policy on recruiting apprentices who have completed training in the employer's establishment.

In October 2014, the Prime Minister launched the Shramev Jayate programme to focus on building skills of the youth while providing ease of doing business. A dedicated Shram Suvidha portal will allot a unique labour identification number (LIN) to around 600,000 units and simplify compliance of 16 labour laws through a single online form. A new transparent Labour Inspection Scheme will utilise technology and eliminate human discretion in the random selection of units for inspection. Also, labour inspectors will have to upload the inspection reports within 72 hours.

[113] http://www.ibef.org/news/govt-introduces-two-labour-reform-bills-in-lok-sabha, accessed 16 September 2014

Chapter 10

Indirect taxes

In India, indirect taxes levied by the central government include customs duty, excise duty, service tax, Central Sales Tax, etc. and those by the state governments include sales tax or VAT, entry tax, etc. Since the power to levy state taxes lies with the respective state governments, the tax rate and compliances of state-level taxes vary across states. In addition, there are a few local taxes, duties, cess, etc. at the Municipal level such as octroi, local body tax, cess, profession tax, etc.

Indirect tax rates

Levy	Tax rates	Remarks
Value Added Tax	Ranges from 0% to 20%	As per the schedule
Central Sales Tax	2%	Against declaration form
Service tax	12.36%	Composition scheme rates also available
Excise duty	12.36%	Peak rate
Customs duty	28.85%	

Value Added Tax (VAT)

VAT is a multi-point, destination-based system of taxation, with tax being levied on value addition at each stage of the transaction in the production/distribution chain. It applies to the sale of goods *within* a state. The transfer of a right to use goods (a lease) is included in the definition of 'sale' for this purpose. VAT is a state-specific levy and varies from state to state within India.

VAT applies to the following transactions:

- Transfer of goods during the execution of works contracts involving the supply of materials and services;
- Purchase of goods from unregistered vendors in specified situations;
- Delivery of goods on hire purchase or any system of payment by instalments;
- Supply of goods, being food, drink or any other article for human consumption.

All sellers with a turnover in excess of the registration threshold are liable to register for VAT. In most states, the threshold is sales of INR 500,000. An entity may register voluntarily for VAT (also CST and service tax).

In most states, input tax credit is allowed for VAT paid with respect to goods acquired for resale or for use in the manufacture of taxable goods. Credit is obtained by offsetting the tax paid against VAT charged on sales (output tax). Export out of India is zero-rated (i.e. denoting goods or services that are taxable for VAT, but with a tax rate of zero). There is also a negative list of goods for which credit is not admissible.

Central Sales Tax (CST)

CST applies to the movement of goods *from one state to another*, pursuant to a sale. Every person who sells goods to a buyer outside the state is required to be registered and pay CST.

VAT/CST is payable when the sale is complete (i.e. when the transfer of title to the goods takes place or, for leases, when the right to use the goods is transferred).

Service tax

Service tax applies to all services provided in India other than those in the negative list. Currently, there are 17 services in the negative list. No service tax would be applicable on those specified services and other exempted services. The rate of service tax in India is 12.36% (including education cess).

Every person who provides taxable services in excess of the turnover threshold of INR 1 million is required to pay service tax.

In specified circumstances, a service recipient is also liable to pay service tax with respect to any taxable service received under the reverse charge mechanism. For example, import of services into India.

According to the Place of Provision of Services Rules, 2012, (PPOS), the taxability of a service will be determined based on its place of provision.

The Point of Taxation Rules state that service tax liability arises on the date of raising the invoice or the date of receipt of payment, whichever is earlier. Any advance received is also liable to service tax. Invoices should be raised within 30 days of completion of services.

The service provider can take credit for duties. Credit for service tax paid on the procurement of services (input tax) is allowed against the service tax due (output tax). Credit between excise duty and service tax is fungible. Under CENVAT Credit Rules, 2004, once the eligible credit is availed, it is available as a set-off against the output service tax or excise duty liability.

Excise duty

In addition to VAT, CST and service tax, excise duty is levied in the form of a value-added tax on the manufacture of goods in India. The basic rate of excise duty is 12% and the effective rate is 12.36% (includes education cess).

Every person who undertakes manufacturing activity as per excise law is required to be registered with the central excise authority, the Central Board of Excise and Customs. However, exemption from registration is granted to a few specified persons.

The taxable event (an event that causes the tax liability to arise) for levy of excise duty is the manufacture or production of goods. However, tax is payable at the time of removal of goods from the factory or warehouse.

Customs duty

Like many countries, India levies customs duty on the import of goods into India. Customs duty in India has the following components:

- Basic Customs Duty (with a peak rate of 10%)
- Additional Customs Duty (in lieu of excise duty)
- Education cess and Higher education cess
- Special Additional Duty of Customs (in lieu of domestic sales tax)

The effective rate of customs duty works out to 28.85%.
Import duty is payable on import of goods into India at the time of clearance of goods from the customs station.

Credit for the above duties/taxes is available subject to the fulfilment of certain conditions and documentation requirements.

Invoicing

A person registered under either VAT/service tax/excise legislations must issue a tax invoice for all taxable sales made within a state. A tax invoice is generally necessary to support claims for input tax credits. Contents of the tax invoice are prescribed under the respective laws. An adjustment note (or credit or debit note) may be issued to reduce or increase the amount of tax/duty payable on a supply/service.

A small business that pays tax under the Composition Scheme (an optional and simple scheme of taxation of a small percentage of gross turnover, designed for registered dealers whose turnover does not exceed a specified amount) is generally not entitled to input tax credit and not allowed to issue tax invoices.

Payment, returns and audit

VAT, CST, excise or service tax returns must be filed monthly/quarterly/half-yearly/yearly as per the period prescribed under the respective laws.

In certain cases, it is mandatory for a registered person to get the books of accounts audited by an independent auditor (e.g. a Chartered Accountant) provided the turnover exceeds the prescribed limit (typically INR 6 million). The audit report must be submitted to the tax authorities in the specified form.

Goods and Services Tax (GST)

In his Budget 2014-15 speech, the Finance Minister, Arun Jaitley, stated that the debate on GST should come to an end and the government endeavours to approve the legislative scheme before the year ends. Replacing all existing indirect taxes by the GST will create a national market, eliminate cascading taxes, and align taxation of imports and exports correctly, which will improve the competitiveness of production and exports from India. According to the Economic Survey 2013-14, issued on 9 July 2014, the implementation of a central GST (CenGST) could be the first step towards the GST, following which it would be easier for the states to move to the GST.

Appendices

Appendix 1

TDS rates on some of the common payments made to residents:

Nature of payment	Rate of TDS in case of payment to		Threshold limit for total payment
	Individual or HUF	**Others, including corporate assessees**	
TDS on salaries paid	According to the slab rates applicable to respective employees		NA
TDS on interest on securities	10%	10%	INR 5,000
TDS on deemed dividends*	10%	10%	NA
TDS on interest other than 'Interest on Securities'			
By banks	10%	10%	INR 10,000
By others	10%	10%	INR 5,000
TDS on winnings from lottery or crossword puzzle	30%	30%	INR 10,000
TDS on winnings from horse races	30%	30%	INR 5,000
TDS on payments to contractors	1%	2%	INR 30,000 for a single transaction and INR 75,000 for the year
TDS on payment of insurance commission	10%	10%	INR 20,000
TDS on commission or brokerage	10%	10%	INR 5,000
TDS on rent			
Land, building, furniture and fittings	10%	10%	INR 180,000
Plant and machinery, equipment	2%	2%	INR 180,000
TDS on transfer of immovable property other than agricultural land	1%	1%	INR 5,000,000
TDS on fees for professional or technical services, royalty and non-compete fees	10%	10%	INR 30,000
TDS on remuneration/commission paid to Director, other than salary	10%	10%	NA
TDS on payment of compensation on compulsory acquisition of immovable property other than agricultural land	10%	10%	INR 200,000

***Regular dividend paid by the company is out of the purview of withholding taxes as the company is required to pay Dividend Distribution Tax @ 19.994%, the credit of which is not given to the recipients of the dividend.

Appendix 2

TDS rates on payments made to non-residents and foreign companies:

Nature of payment	Rate of tax*
TDS on interest on infrastructure debt fund, on foreign currency loans (under a loan agreement or by way of issue of long term bonds), on rupee denominated bonds of any Indian company or government security	5%
TDS on interest other than mentioned above in foreign currency	20%
TDS on long-term capital gains on unlisted securities	10%
TDS on long-term capital gains on other than specified assets	20%
TDS on short-term capital gains on listed shares and units of equity-oriented mutual funds	15%
TDS on short-term capital gains other than mentioned above and any other income	40%
Royalty and fees for technical services	25%
*applicable surcharge and education cess @ 3% shall also be levied	

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