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Destination India

Critical Tax Considerations when Investing into India
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Accredited Tax Advisor (Income Tax) Rohan Solapurkar provided clarity on a complex India tax regime with various illustrations.

It seems that India is, once again, an exciting destination for foreign investment. After all, Christine Lagarde, Managing Director, International Monetary Fund (IMF), did say that in this "cloudy global horizon, India is a bright spot" during her March visit to the world's second most populous nation.

At an engaging *Tax Excellence Decoded* session organised by the Singapore Institute of Accredited Tax Professionals (SIATP), Accredited Tax Advisor (Income Tax) Rohan Solapurkar, Director of Taxes, Deloitte Singapore, shared his insights on the reforms and progress in India. He also provided a synopsis of the taxes that are critical for foreign companies investing into India.

Snapshot of India

India is a federal republic, with 29 states and seven federally administered union territories. India is a trillion dollar economy with a largely self-sufficient agricultural sector, a diversified industrial base and a stable financial and services sector, and is characterised by a liberalised foreign investment and trade policy.

India's central bank is the Reserve Bank of India (RBI). RBI acts as the supervisory authority for all banking operations in India and controls the inflow and outflow of funds both into and out of India through exchange control regulations. To facilitate the remittance of funds both into and out of India, exchange control regulations have been liberalised over the years. Foreign companies may now send money into India as loans for working capital purposes, subject to meeting certain conditions.

Investments into India

Foreign investment in almost every sector is permitted in India on an automatic basis. However, there are some sectors such as agriculture, multi-brand retail, lotteries, etc, in which foreign investment is restricted. There are also certain sectors such as telecommunications, defence, insurance, etc, in which sector-specific caps on foreign investment are set.

Foreign direct investments for proposals outside sectorial caps or other specific scenarios (such as swap of shares) will require prior approval from the Foreign Investment Promotion Board (FIPB). On the other hand, foreign direct investments for proposals within sectorial caps or in industries with no sectorial caps

do not require any prior approvals, and are also allowed the use of normal banking channels.

Forms of Businesses

The common forms of business presence in India include liaison office, branch office, project office, subsidiary, joint venture and limited liability partnership. A liaison office, branch office and project office are extensions of their respective parent entities and are not considered legal entities by themselves.

A liaison office (also known as representative office) may act as a channel of communication between its Head Office abroad and parties in India, but is not allowed to undertake any business activities or earn any income in India. This is unlike a project office which may execute a specific project in India after its foreign parent has secured a contract from an Indian company. The income generated by the project office will be taxed in India, and the project office will be closed upon the completion of the project. A branch office, on the other hand, may engage in any activity (except manufacturing) in which its parent company is engaged, and the income generated in relation to the branch office will be taxed in India.

Unlike a liaison office, branch office or project office, a subsidiary company is a legal entity. Such a set-up may be preferred as it limits the liabilities of the foreign parent. A subsidiary provides the maximum flexibility in conducting business in India. It may be funded through a mix of equity, debt (both foreign and local) and internal accruals. The exit strategy for a subsidiary is, however, generally more cumbersome than for other forms of businesses.

Overview of Indian Taxes

India levies taxes at both the national and state levels. Here are some of the essential tax issues businesses should note when investing in India.

- **Corporate Income Tax**

The tax year in India (known as the “previous year” or “fiscal year”) is mandated to be the year beginning April 1 and ending March 31. Income of a fiscal year is taxed in the next fiscal year.

The corporate income tax rate for an Indian company (assuming it earns an income of at least INR100 million) is 34.61%. This rate is made up of a basic tax rate of 30%, surcharge of 12% and education cess of 3%. It was announced in the Budget for 2015-2016 that the basic tax rate of 30% be reduced to 25% over the next four years.

Unlike an Indian company, a foreign company with a taxable presence in India through a branch office, project office or permanent establishment will be subject to a corporate income tax rate of 43.26% (assuming it earns an income of at least INR100 million). This is made up of a basic tax rate of 40%, surcharge of 5% and education cess of 3%.

A company that is a tax resident in India where its control and management is situated in India, is liable for income tax on its worldwide income. A non-resident company, on the other hand, is liable for income tax on its income arising in or received in India, or deemed to arise or accrue in India.

It is mandatory for every company (subject to certain conditions) in India to spend at least 2% of their net profits on activities that are eligible towards Corporate Social Responsibility (CSR) spend. Such mandatory CSR spend is, however, not tax deductible as it is not incurred wholly and exclusively for business purposes.

A developer of the Special Economic Zone (SEZ), which is a designated area where businesses set up operations, may enjoy a tax holiday of 100% of profits for any 10 consecutive years out of the first 15 years of operations. The export profits from a new industrial established in a SEZ is eligible for a tax holiday of 100% for the first five years from the year of commencement of manufacturing, and a further tax exemption of 50% for the next 10 years, subject to certain conditions.

- **Minimum Alternate Tax**

A company with a tax liability of less than 18.5% of its book profit will have to deem its book profit to be the total income chargeable to minimum alternate tax (MAT) at a tax rate of approximately 21%. For

example, a company with a tax loss but makes a book profit will be liable to pay MAT on its book profit, which is computed as per specific provisions of the Income Tax Act, 1961. MAT is akin to an advance tax payment and may be carried forward to be set off against the income tax payable in the next 10 years, subject to certain conditions.

- **Dividend Distribution Tax**

Companies are required to pay dividend distribution tax (DDT) of 20.36% on any amounts declared, distributed or paid as dividends. Dividends on which DDT have been paid are not taxed again in the hands of the recipient.

- **Withholding Tax**

Indian tax law mandates the withholding of tax in respect of any payments (chargeable to tax in India in the hands of the non-resident) made by a resident to a non-resident.

It is important to note that a non-resident needs to produce a tax residency certificate and a Permanent Account Number to enjoy concessionary tax rate under the Indian tax treaty with its home country. In addition to the tax residency certificate, the non-resident may also be required to file a Form 10F to certify that it does not have any permanent establishment in India.

- **Capital Gains Tax**

Profits and gains derived from the disposition of capital assets other than those held for business purposes are taxed in India as capital gains. The tax treatment on capital gains is dependent on the type of capital assets and the holding period.

Long-term capital gains on listed shares or equity-oriented funds (where the assets were held for a period of more than 12 months) are exempt from capital gains tax but charged to securities transaction tax (STT). This is unlike short-term capital gains on listed shares or equity-oriented funds (where the assets were held for a period of less than 12 months) are taxed at 15% (plus surcharge and cess) and charged to STT.

Long-term capital gains on capital assets other than listed shares or equity-oriented funds (where the assets were held for a period of more than 36 months) are taxed at 20% (plus surcharge and cess). Separately, short-term capital gains on capital assets other than listed shares or equity-oriented funds (where the assets were held for a period of less than 36 months) are treated as normal business income and taxed at the prevailing corporate tax rate.

- **Transfer Pricing**

Any transactions (including domestic and international transactions) between two associated enterprises are subject to transfer pricing regulations in India. The definition of associated enterprise is very wide and also extends beyond shareholding and management control.

In line with recommendations by the Organisation for Economic Cooperation and Development, India has five prescribed transfer pricing methods, namely traditional transaction methods such as comparable uncontrolled price method, resale price method, cost plus method, and transactional profit methods such as profit split method, and transactional net margin method.

It is important to note that transfer pricing documentations are mandatory in India, and that companies need to file Form No. 3CEB (which is a certification by a Chartered Accountant in India to confirm that all associated party transactions have taken place at arm's length prices) along with their income tax returns.

- **Indirect Transfer of Assets**

Following the amendment of the Finance Act in 2012 which nullified the landmark judgement in the Vodafone case, India now taxes gains arising from the transfer of shares of an offshore company if the offshore company derives its value "substantially" from assets located in India. It has been clarified recently that the offshore company will be deemed to have derived its value "substantially" from assets located in India if the assets exceeds INR100 million and represents at least 50% of the value of all the assets owned by the foreign entity.

- **Indirect Taxes**

Indirect taxes in India are levied at both the central level (such as excise duty, customs duty, service tax, research and development cess and central sales tax) and the state level (such as value-added tax and entry tax). Rates for state taxes generally vary from state to state.

In the Budget, the Indian Finance Minister re-affirmed the commitment to introduce Goods and Services Tax (GST) from April 2016. The GST is proposed to be a comprehensive indirect tax levy on the manufacture, sale and consumption of goods and services at the central level, and will replace all indirect taxes levied on goods and services by the Indian central and state governments. The impending implementation of GST is set to change the indirect tax landscape in India.

- **Individual Tax**

Ordinarily residents of India are taxed on worldwide income. Non-residents, on the other hand, are liable for tax on India-sourced income, including interest, royalties and fees for technical services paid by an Indian resident, salaries paid for services rendered in India, income that arises from a business connection or property in India, and any income first received in India.

There is no doubt that doing business in India can be complex, but the trillion-dollar economy provides so much opportunity that it is difficult for foreign investors to ignore. With careful planning and the expert guidance of the right advisors, foreign investors can reap handsome rewards from the latest efforts by the Indian government to create a pro-business environment.

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About SIATP's Technical Discussions
SIATP's technical discussions have continually been very well received by accredited tax professionals. Unlike the run-of-mill Continuing Professional Educational courses which typically cover tax fundamentals, SIATP's interactive technical discussions are designed to cover tax issues that do not have clear-cut solutions or situations that may have different interpretations. Over time, these discussions contribute in boosting the overall tax standards in Singapore.

About Mr Rohan Solapurkar

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With more than 20 years of experience in international tax, Rohan has a deep understanding and knowledge of the Indian tax and regulatory framework and has been advising multinationals on various aspects such as entry strategies, cash repatriation strategies and tax minimisation strategies.

His advisory work encompasses companies in diverse sectors such as IT, hospitality, infrastructure and media. During his career with several Indian companies, he has assisted them in their outbound strategies, minimisation of the effective tax rate and etc.

Rohan is a Chartered Accountant from India and holds a Bachelor of Commerce from the Bombay University. He has worked in another Big Four firm in Hong Kong and London prior to Singapore.

This technical event commentary is written by SIATP's Tax Manager, Felix Wong. Felix has over seven years of experience in corporate and international tax. Previously from PwC Singapore, he now leads various tax initiatives in Singapore's first dedicated professional body for tax specialists to enhance Singapore's position as a centre of excellence